



The Saskatchewan Barley Development Commission (SaskBarley)

Response to Recommendations on Grain Transportation in the CTA Review

September 2016

1.0 RESPONSE TO RECOMMENDATIONS

Saskatchewan barley producers welcome and support adjustments to the Canada Transportation Act (CTA). Given the duopolistic nature of the rail industry in Canada, a market-based solution that introduces competition to the Class 1 railways is likely not feasible. Therefore, a review of the regulatory framework is therefore required to build a world-class transportation network to deliver our products to customers. Our response to Chapter 8.2; Transport of Grain in the CTA review report released in February 2016, focuses on increasing transparency at all levels within the value chain, so that all parties can make better-informed decisions; increasing competition to ensure that excessive rent is not extracted from other parties; and ensuring that all are held accountable to commitments made to other parties within the value chain. Agricultural production is wrought with high levels of uncertainty in which all parties of the grain handling and transportation system have to accommodate and contend with during anomalous years. The goal of any changes made to the Canada Transportation Act, should be to create a grain handling and transportation system that acts, and reacts, like a value chain.

1.1 Review Recommendation #1:

The Review recommends that the Maximum Revenue Entitlement Program be modernized, in anticipation of its total elimination within a seven-year time horizon, as the Western Canadian grain-handling-and-transportation system evolves to a more commercially grounded framework. Modernization should consider, but not be limited to, all of the following:

- a. Excluding the movement of containerized grain from Maximum Revenue Entitlement calculations;*
- b. Allowing railways to set aside up to one-third of their respective railcar fleets, for which shippers may pay “freight premiums” to guarantee railcar supply and service. These “premiums” would be excluded from the railways’ respective Maximum Revenue Entitlements and charged under specific programs or conditions (e.g. winter premiums from December to March, or an auction program whereby a pool of grain hopper cars are set-aside for auction to the highest bidder, etc.); such programs should be designed to include the less than unit-train shippers;*

c. Excluding interswitching (i.e. revenues earned, costs, and tonnage moved) from the Maximum Revenue Entitlement calculations to prevent unfairness and financial harm to railways and to remove a barrier to the use of interswitching;

d. Reforming the Maximum Revenue Entitlement methodology to allow for attribution of individual railway investments in capacity, and creating incentives for overall railway investment in new equipment and railcars for the benefit of all shippers;²²

e. Expanding the list of eligible crops subject to the Maximum Revenue Entitlement and listed in Schedule II of Canada Transportation Act to include chickpeas and soybeans, in recognition of their increased production in Western Canada.

SaskBarley Response:

SaskBarley is strongly opposed to any recommendation or suggestion that the maximum revenue entitlement (MRE) be eliminated. SaskBarley requests and seeks a commitment that the MRE remain in place to protect Saskatchewan producers from the monopoly power of the railways. Without the MRE in place, the Class 1 railways are in a position to charge and receive monopoly rent for the movement of grain.¹ Producers cannot afford these extra costs with no prospect for improved service.

SaskBarley is also opposed to allowing railways to set up ‘premium’ shipments or any type of differentiated service as this will lead to a bid-car system like in the United States (U.S.). This type of system would institutionalize the Class 1 railways’ ability to extract rent from every shipment, all while having the ability to create higher demand by restricting supply.

Shippers have indicated that the railways have created an array of ancillary service charges outside of the MRE to increase their revenues from the shipment of grain. Moreover, under the MRE, it appears that the railways are increasingly effective in pricing their services to extract the maximum allowable revenue from western grain producers and shippers throughout the barley value chain. We would recommend that these additional charges and fees be included within the MRE calculations. These ancillary service charges should be identified and addressed with respect to their validity within a costing review, and allocated accordingly. Likewise,

¹ Gray, R. The Economic Impact of Elevated Basis Levels on Western Canadian Grain Producers, 2012/13, 2013/14 & 2014/15. Report to the Saskatchewan Wheat Development Commission.
<http://www.saskwheatcommission.com/wp-content/uploads/2015/09/Report-summary.pdf>

interswitching between rail companies should be done at rates that are compensatory, and included in the MRE.

We do recognize that modernizing the MRE could be considered. SaskBarley is supportive of a modified MRE that calculates the Volume Related Composite Price Index (VRCPI) separately for each railway to account for the individual company's investment in infrastructure to replace aging fleets.

1.2 Review Recommendation #2

The Review recommends that the Canada Transportation Act explicitly define “producer-car shippers” as “shippers” and therefore eligible for all shipper protection provisions enshrined in the Act, including its level of service provisions.

SaskBarley Response:

SaskBarley strongly supports this recommendation. Producer cars (and dealer cars) are of critical importance to producers as these represent an option for producers to circumvent the grain companies, to move down the value chain, and to collect greater rent and/or reduce costs. In many instances, producer cars represent the only option for delivering a product to market. The option of producer cars also restricts the grain companies' ability to extract excessive rent from producers. However, this is dependent on the availability of producer cars and the ability to ship them. An inability to source producer cars results in lost sales and a degradation of our shipping reputation with one of our largest customers, the processing industry within the USA.

The government of Canada assures producers' right to ship producer and dealer cars be protected no matter what changes are made to marketing or transportation functions by virtue of the CTA, subsection 87(1) and 87(2). This is being undermined by reduced service. SaskBarley has concerns that over time the railways and grain companies will reduce their access to the infrastructure and remove this competitive tool for producers. This recommendation should also include a clause to prioritize movement of producer cars, as well as ensure that policies and procedures exist so that sufficient loading facilities are available and maintained.

Shortlines and producer cars are inherently linked. Usually, shortlines are the result of the Class I railways abandoning lines because of a lack of elevators on a line, or if the grain company sells the elevator, it will be under the provision that the elevator cannot ship grain from that location. Therefore, shortlines can typically only load producer cars. Provisions should be created that allow shortlines which can put together multi-car shipments from their lines and within their

interswitching distance, be rewarded with reduced costs at a schedule representing the reduced costs to the Class I railways. Shortlines have attempted to lease cars, however, restrictions on the use of these cars deterred some from proceeding and frustrated those who did. Shortline railways have a unique position in the transportation infrastructure and this position needs to be recognized and facilitated within this process.

In addition, the Canadian Transportation Agency should be empowered to investigate and rule on a railway's genuine "operational interest" in underserved and unused rail lines in which other parties have expressed an interest. These lines should go through the de-commissioning process and be put up for commercial sale.

1.3 Review Recommendation #3

The Review recommends that the Canadian Transportation Agency review its methodology pertaining to interswitching rate setting methodology to make them compensatory. The Review further recommends that the Agency be permitted to set interswitching rates annually, to better reflect actual costs, and not only when the Railway Interswitching Regulations are reviewed and published.

SaskBarley Response:

SaskBarley strongly supports this recommendation. The simplest, most-efficient solution to grain movement would be to increase competition at the rail service level. This would include the ability of other Class I railways to use Canadian track, or allowing Class III (shortline) railways the ability to venture beyond their own track to provide service to other shippers than those directly on their lines. The competition would keep rates and service in line and provide producers and grain companies shipping alternatives for market access. Currently, producers have to go through either of the two railways for shipping to port. The duopoly nature of the export grain transportation allows the railways to exert excessive market power over producers, who cannot store large amounts of grain between crop years due to storage constraints and cash flow requirements. Thus the railways can reduce supply and increase shipping rates, thereby extracting excess rent from their captive shippers. In these instances, greater competition would allow other suppliers to enter the market and provide service to producers and grain companies.

1.4 Review Recommendation #4

The Review recommends that the Government of Canada allow the extended 160 km interswitching limits, as defined under the amended Railway Interswitching Regulations and related to the Fair Rail for Grain Producers Act (Bill C-30), to sunset.

SaskBarley Response:

SaskBarley does not support this recommendation. One variant of joint running rights is interswitching.² The recommendation allowing the extended 160 km interswitching limit to sunset is counter-intuitive to creating an environment that allows for more competition. The 160km interswitch offers access to a second railway for almost 70% (by volume) of all grain elevator locations in Western Canada, and with an estimation it would save grain shippers between \$15-\$18 million in freight charges.³

The extended interswitching distance provision was created in the Fair Rail for Grain Producers Act and this should be enshrined in the CTA. The Fair Rail for Grain Producers allows for railways the ability to solicit for traffic within the interswitching distance. Note that this, in essence, allows for “open access” by other railways within the interswitching distance. The Parliamentary intent of the Fair Rail for Grain Producers supersedes Section 138 of the Canadian Transportation Act therefore, ruling that running rights as relief for captive shippers would keep railways in check and enhance competition across Western Canada. Greater competition, at all levels of Canada's grain handling and transportation system, is in the public interest.

2.0 Further Recommendations to Modifications of the CTA

2.1 Costing Review

A formal costing review is required to ensure the MRE is relevant to current transportation costs and volumes. The Western Canadian grain handling and transport system has evolved and adapted over time. Efficiency gains in agriculture at all levels have been brought about by technological and logistical advances and more efficient equipment. In transportation, grain

² Nolan, J. and J. Skotheim (2008). “Spatial competition and regulatory change in the grain handling and transportation system in western Canada”, *Annals of Regional Science*, 42, 929-944.

³ Nolan, J. and S. Peterson (2015). “Grain Handling and Transportation Policy in Canada: Implications for the United States,” *Choices; the magazine of food, farm and resource issues* 30(3), 1-7.
http://www.choicesmagazine.org/UserFiles/file/cmsarticle_442.pdf

companies have consolidated and producers are typically hauling further to unit-train loading facilities thereby making railways logistically more efficient. Other cost efficiencies and cost increases had undoubtedly taken place since the last comprehensive costing review occurred. To have fair and effective regulatory framework in place, a comprehensive costing review is required and it is our recommendation that this be completed. Understanding the costs of placing grain in export position is the first step in making sure the MRE is appropriate, and in determining if excess rent is being extracted from producers.

Costing reviews should also be scheduled at regular intervals so that government and industry can be assured that the policy framework is functioning as intended and achieving the desired effect.

2.2 Dispute Resolution and Reciprocal Accountability

Today there is a discrepancy in the power between the railways, grain companies, and producers. The final offer arbitration provisions in the Canadian Transportation Act can work for large shippers, like a grain company (a shipper has to incur freight charges of over \$750,000 following unsuccessful negotiations) and while there is a simplified process for charges under \$750,000; the complexity and expense of final offer arbitration is daunting for small shippers and processors, which can cost in the order of \$500,000 or more. In most cases, the grain company would have to file the complaint to final offer arbitration to meet the \$750,000 requirement, however the grain company is open to reprisals from the railway and the producer is ultimately paying the transportation costs. Thus, it is doubtful that any grain company would bring forward any complaints to final offer arbitration.

Producers do not have the resources, either financial or human, required to take rail companies to court over service complaints and in most instances they are not the official shipper of the product. We recommend the creation of a quick and meaningful dispute resolution mechanism that can resolve issues quickly and efficiently so that the parties can go back to their respective businesses with minimal disruption. The process must be transparent, penalize or reward damages for harm done on either side, and be resolved in a timely manner. Reciprocal penalties and a streamlined process to bring forward complaints between both parties is a tenet of contract enforcement and market efficiency. The cost and timing of the process should be proportioned to the relative exigency of the harmed party.

2.3 Transparency and Information Requirements

Asymmetrical information can lead to one party taking advantage of another in a transaction. Within the Canadian grain handling and transportation system, some parties have much greater information than others. There needs to be additional reporting of grain handling, marketing and transportation information, so producers can make informed decisions in marketing their grain. Quorum Corporation's independent, third party monitoring of the overall efficiency of the prairie grain handling and transportation system is an important and necessary service for the agriculture industry. However, further information and monitoring is needed to provided information such as:

- Weekly car allocation by corridor
- Weekly port unloads
- Vessel line ups by port
- Producer car allocations and outstanding orders
- Ocean freight rates with demurrage/despatch levels
- Weekly rail car movement by corridor
- Forward sales by commodity
- Lake freight values and availability
- Performance measures for all industry participants

(this list should not be viewed as complete)

We also recommend the establishment of a planning mechanism to assist in preparing the proper capacity within the grain transportation system. The grain handling and transportation system in Canada is complex and without some planning, misallocations can happen (the number of ocean vessels waiting to load in Vancouver harbour last year broke all previous records by significant amounts). This mechanism would use stakeholder information in order to put plans in place to accommodate sales and facilitate movement. Producers ultimately pay the demurrage through the basis. The objective of planning should be the minimization of demurrage and meeting sales commitments on all corridors. The efficient and timely shipment of grain would be a step towards restoring Canada's reputation as a reliable shipper. Quorum Corporation (the grain transportation monitor) may be a natural fit for collecting and sharing this information.

3.0 CONCLUSION

The response to the recommendations contained in *Chapter 8.2: Transportation of Grain* in the CTA report are primarily focused on creating market structures that enhance efficiency and reduce transaction costs. Competitive, market-based solutions designed to enhance efficiency

and service to all parties create transparency and increase certainty for market access. In the absence of finding a market solution, we then recommend guidance on what is required for a regulated framework. The key component is that increased competition is preferred over regulation. However, in the absence of increasing competition in a meaningful way, regulation is absolutely necessary. Producers understand that rail companies are relied upon by other industries and other resource sectors, and that solutions for one industry may affect other sectors. Producers also understand that many of these other sectors and industries are also captive shippers and that the solutions must keep railways from extracting excessive rents from all captive shippers.

We appreciate the opportunity to provide a response to the CTA review report from a purely grain-producer perspective. The issues that arose between 2013-2015 illustrate the massive transfers of revenue that can occur if producer interests are not represented in ongoing operational decisions in grain transportation, and if publicly available information does not sufficiently allow for effective decision making by all participants in the industry. It is clearly demonstrable that these costs predominantly fell to primary producers. Our responses and recommendations are designed to assist in providing a more balanced framework for us to operate with in future years. We look forward to further discussion of this submission.

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