Short Lines and Regional Railways - Competitor or Feeder?

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I. Introduction

The railways in Canada have played a particularly important role in Canadian history. It was the glamour industry more than a century ago and is still the backbone of transportation services in Canada. The industry has continued to evolve in the last decade and short line railways are one of the most interesting innovations to have emerged.[1] The short line phenomenon is considered to be of great importance to the railway sector. Their operation may not only result in the marketing of new rail services by short lines but could also restore the competitiveness in markets where high cost operators have been unsuccessful.[2]

In this paper we shall examine: the short line and regional railways in Canada; the growth and rationale for the short line and regional railways; the regulations affecting short line and regional carriers; and whether the short line and regional railways will become a competitor or feeder.

II. Short line and Regional Railways in Canada

The operation of short line and regional railways usually evokes a sense of entrepreneurship and freedom. The latter have existed in Canada for quite some time and are traditionally classified as Class II railways. However, interest in short lines is of recent origin with the spotlight being on Class I railways - CN, CP and VIA Rail with occasional references to terminal railway operations (referred to as Class III railways).

a) The Short line and Regional Railway Concept

The use of the term 'shortline' developed in the United States following the passage of the *Staggers Rail Act* in 1980. The concept of short lines is of recent origin in Canada and short lines are usually considered smaller railways than regionals that emerged after 1993. They may be independent but usually operate as an affiliate of a Class

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** The views expressed here are those of the author and are not purported to be those of the Commissioner or the Competition Bureau, Industry Canada.*

I carrier. They are distinguished from the larger, regional railways that have operated for many years in Canada. Another source describes it as "...a company, under Federal or Provincial jurisdiction which owns or leases a branch line (s) connecting with one of more tracks owned or operated by one or more main line carriers and which operates trains on that branch line(s) as a feeder service to the main line carrier's track for furtherance by that main line carrier and/or as a feeder service from the main line carrier's track to points on the branch line(s), with the intent of yielding a direct or indirect economic benefit to the owner." [3]
In the U.S., they are defined as railways with less than 350 miles of track and less than $40 million in annual revenues.

The use of the term 'regional' railways has existed in Canada for quite some time. They are Class II carriers that are larger than the short lines or terminal carriers. In the U.S., they are defined as railways with 350 miles or more of track and revenues of between $40 million and $250 million annually.

b) The Structure of Short Line and Regional Railways in Canada

The short line and regional railways are basically involved in the provision of short line and regional services in their respective province. The number of short line and regionals in various provinces are shown in the table 1. The majority of these lines are in the Provinces of Quebec and Ontario and account for 16 and 13 of all lines or 31% and 25%, respectively.

Table 1 - RAILWAY OPERATORS IN CANADA

	BC	**Alta**	**Sask**	**Man**	**Ont**	**Que**	**N.B.**	**N.S.**	**Nfld.**	Canada
Regional and Local	4	4	3	4	13	16	3	3	1	51

Source: ***Transportation in Canada*** , Annual Reports and ***Canadian Transportation Agency***, Annual Reports.

In terms of trackage, regional and short lines owned 13,209 kilometres (or 27.1%) of the total 48,683 kilometres of track in Canada in 2004. In terms of output from Canadian operations, short lines and regional carrier's output was 24.0 billion revenue tonne kilometres or 7.55% of total railway output in 2003. In terms of employment, short lines and regional carrier's accounted for 4,802 or 13% of the total employment by rail carriers in 2003.

c) The Freight and Its Composition Carried by Short Lines and Regionals

The freight tonnage carried and traffic received or forwarded from

CN and CP are shown in Tables 2 and 3. Both show overall increases.

Table 2 - Tonnage Originating by Regional and Short line

	1995		1996		2000		2002		2003	
Regional (000/%)	58	19.9	57	19.4	54	15.3	43	12.8	43	12.8
Short line (000/%)	26	9.0	28	9.7	67	19.9	765	19.9	65	19.2

Source: ***Transportation in Canada 2004***, Annual Report, Addendum, p. A6-8.

Table 3 - Traffic Received and Forwarded by Class II Carriers from CN or CP

	1996	2000	2002	2003
Received only (mt)	3.00	8.68	8.08	10.4
Forwarded only (mt)	10.36	18.94	19.48	19.98

Source: ***Transportation in Canada 2004***, Annual Report, Addendum, p. A6-7. Excludes US based carriers in Canada.

The railway freight moved in each province (intraprovincial, interprovincial movements, exports and imports by water moved by rail, and movements to and from the US) is shown in the table hereafter. The diagonal (bold) shows the intraprovincial movements within provinces. If it is assumed that only short lines and regionals move intraprovincial freight, it provides an indication of freight moved by them.

The freight moved by short lines and regionals can also be examined in terms of its composition. The bulk of the freight moved consists of

Table 4 - Railway commodity Freight Origin and Destination 2002 ('000 tonnes)

Destination/ Origin	Atlantic	Québec	Ontario	Manitoba	Saskatchewan	Alberta	B.C	US by Rail	Mexico	**Total**
Atlantic	**5,346**	18, 456	1, 205	39	10	136	63	2,858		28,,113
Québec	2,206	**6,384**	5,438	298	116	731	1,389	11,716	70	28,347
Ontario	1,606	5,501	**7,872**	932	377	3,560	2,307	15,613	143	37,911
Manitoba	75	691	3,351	**355**	318	578	1,473	2,883	123	9,847
Saskatchewan	287	886	7,494	1,080	**242**	790	8,431	10,991	38	30,239
Alberta	151	1,076	2,817	1,326	1,012	**3,196**	20,133	13,333	9	43,053
B.C.	148	2,003	4,406	307	109	1,153	**25,699**	7,982		41,806
US by Rail	993	4,659	6,815	525	897	4,419	922	**5,495**	21	24,747
Mexico			2			1		2		7
Total	**10,812**	**39,656**	**39,399**	**4,863**	**3,079**	**14,564**	**60,418**	**70,872**	**405**	**244,071**

Source: ***Rail in Canada 2002***, Statistics Canada, Catalogue No. 52-216, p. 95.

steel (wire rod, billets and scrap); forest products (osb, mdf, pulp, paper softwood lumber and logs); chemicals (propane, acid, chlorine, alum, methanol, hydroxide, etc.); dry bulk (dolomite, fertilizer, salt, sodash, corn, grain, silica, sand and ballast); plastic components (polymers); grain (agricultural products); and other commodities (automotives, petroleum, coke and fuels oils).[4]

In sum, the concept of shortline railways is of recent origin in Canada. These lines were basically formed after 1993 and the majority are in Ontario and Quebec. Their freight basically consists of raw material, steel and chemicals.

III. The Growth and Rationale for SL & RR in Canada

a) The growth and development of short line and regional railways

The first short line to be created in Canada was the Central Western Railway located in Alberta in December 1990. The legal challenges to its formation led to short lines operating within a province to be put under provincial jurisdiction (Supreme Court of Canada Decision of 1990). The second was Southern Rails Cooperative in Saskatchewan and the third was Goderich & Exeter Railway of Ontario in 1991.

Before 1996, eleven new short lines had formed. Between 1996-2000, thirty-seven new short line carriers were formed bringing the total number of short line carriers in Canada to 48. After 2000, only a few new short lines were formed. One noticeable aspect of this development was the concentration of the ownership of these short lines in the hands of five companies: Rail America, OmniTRAX, SCFQ, Genesee Rail-One and Iron Road. Four of these companies are owned by US corporations. A short line railway is usually established through the abandonment or conveyance of

Table 5 - Cumulative CN and CP Rationalization (1990 - 2003)

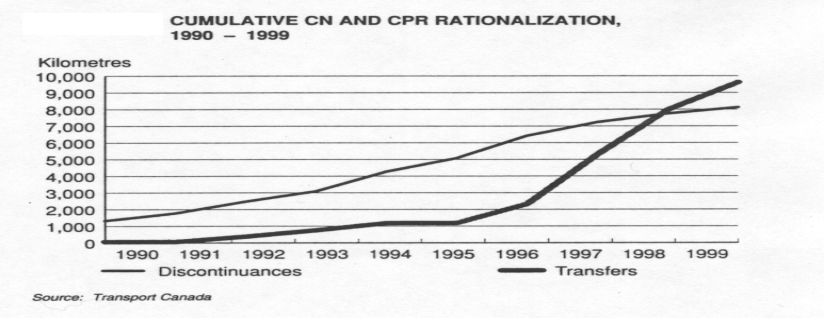
Year	1990	1991	1992	1993	1994	1995	1966	1997	1998	1999	2000	2001	2002	2003	2004
Discontinuance	1,323.8	1,778.2	2,475.3	3,095.8	4,269.3	5,076.9	6,424.1	7,239.0	7,746.8	8,124.6	8,255	8,782	9,447	9,437	9,869
Transfers	68.4	68.4	379.8	757.3	1,180.5	1,180.5	2,330.4	5,316.4	7,981.7	9,620.9	10,529	11,247	11,366	12,695	15,998

a low density line of a Class I railway. Discontinuance and transfers from 1990 to 2004 are shown in table 5 and the graph.

According to the Railway Association of Canada (RAC), over 80% of

rail lines identified by Class I for discontinuance have been leased or purchased by short line operators, since 1990.

Other indicators of the growth of short lines such as revenue, employment, revenue tonne-kilometres and fuel consumption are shown in Table 6. These statistics provide ample testimony to the dramatic growth of short lines not only in terms of number but also in terms of trackage



owned. This growth suggests the importance of the emergence of this new innovation in Canadian rail. It was predicted as early as the 1990s by the NTARC which stated "We believe that the short line phenomenon has great importance to the railway sector. ...it does offer an attractive alternative to abandonment."[5] It presents a promising alternative to our current rigid structure and while common in United States, short lines have begun to emerge and flourish in Canada, at least between the period 1995 and 2001.

Table 6 - Short line revenue, employment, revenue tonne-kilometres and fuel consumption vs. all Railways

	1995		1996		2000		2002		2003	
Rev. ($m) / %	90	1.25	134	1.7	369	4.55	392	4.77	405	4.88
Emp. / %	517	1.0	694	1.5	1830	4.5	2015	5.4	2029	5.6
RTM (m / %)	1492	0.5	1834	0.7	7457	2.3	7267	2.3	7338	2.3
Fuel Con (ml / %)	23	0.1	26	0.1	89	4.5	89	4.4	85	4.1

Source: ***Transportation in Canada 2004***, Annual Report, Addendum, pp. A6-3-A6-6.

In the view of the Railway Association of Canada, in the future, new growth will have to come from increases in business by existing operators,

not from creation of new short lines.[6]

b) Theory for discontinuance, transfer and development of SL&RR

Let $(Y^i e_i ..... Y^n e_n, p)$ (1)

be a network configuration where $Y^i = y^i + z^i$ is the output of each segment $e_1 = \{A, B\}$. y^i is the output of the segment e_i on its own together with a contribution from another segment; z^i is the contribution of this segment e_i to another; and p^i is the price on this segment. e_2 is similarly defined as {B,C} and n is the number of segments. Y, y, z, p and c are all vectors.

Let N be the set of segments (N=1...n) and S a subset of N (S=k...n). The set S of segments would be viable if

$$p_k y^k - c_k y^k \geq 0 \qquad k=n-j....n. \qquad (2)$$

or if $p_k y^k - c_k y^k < 0$ but $p_i Y^i - c_i Y^i \geq 0$ i=1....n. (3)

(i.e., zero or positive profits for the entire network or set N) with $p_{n-k} Y^{n-k} - c_{n-k} Y^{n-k} = 0$, (i.e., profits are zero for the set n-s).

If (2) and (3) do not hold then for the network to be viable the network should be replaced by the network with segments n-k, since S is not profitable on a standalone basis or makes a contribution to the network i.e., where the network with segments n-k does not lose money

$$p_{n-k} y^{n-k} - c_{n-k} y^{n-k} = 0 \qquad (4)$$

If (3) holds and $c > c^*$ (c* only applies to set S when separated) (5)

so that $p_k y^k - c^*_k y^k \geq 0$ (6)

then networks $(Y^i e_i ..... Y^{n-k} e_{n-k,} p)$ and $(Y^i e_i ..... Y^k e_{k,} p)$ (7)

are more viable than the network in (1) since profits under networks in (7) exceed profits under (1) and they will eventually replace network (1), if traffic from $(Y^i e_i ..... Y^k e_k, p)$ is captive to $(Y^i e_i ..... Y^{n-k} e_{n-k,} p)$.

In other words, one network will replace another if it more profitable by abandoning lines that are not profitable on a standalone or overall basis and transfers leading to short lines will develop when it is more profitable to both the original network carrier and profitable to new entrants.

The evidence of the railways after deregulation provides ample testimony to this. As soon as the *National Transportation Act 1987* facilitated the discontinuance of segments of the railway network, the railways discontinued a large portion of their unprofitable network (which they could not easily do previously). Similarly, when the *Canada Transportation Act 1996* facilitated the transfer of rail segments after 1996

the railways transferred or sold segments of their networks which led to the rapid growth of short line railways. In addition, their growth was facilitated given the non-union labour that these transferred lines could operate under and the provincial labour laws (which require more workers or higher wages to be paid under existing contracts, etc.).

c) Other Rationales for SL & RR Development

1. Possibility of using existing infrastructure and absence of major sunk costs needed to begin operation: The starting of a new line is much more complicated than starting one that is being discontinued or abandoned. Not only must land be appropriated and the regulatory requirements be satisfied to construct a line but a large part of the cost may not be recovered. In addition, there is a time lag before the investment can pay-off. Further, they can be bought cheaply as they are often sold at 'net salvage value'. It is therefore common that most short lines have developed from the existing infrastructure or discontinued infrastructure. As noted by the NTARC "They are usually established through the abandonment or conveyance of a low density line which a Class I railway can no longer profitably run."[7]

2. Possibility of lower input costs and efficiencies: "Short lines view many of the Class I's expense related problems as opportunities. Since many do not employ union labour, it is possible for them to operate with reduced crews at lower wage rates. Unshackled by historic work rules, the short line can operate more efficiently."[8] "Both in absolute terms and as a percentage of revenues, short lines incur lower labour costs for train crews."[9] This is apparent in the statistics, where typically the labour costs /operating expenses ratio of Class I and short line carriers are 47% and 24%, respectively. Further, short lines often employ two-man crews, whereas many Class I train runs are operated by three-man crews in accordance with collective agreements. Furthermore, operating practices also employed at short lines are generally more flexible.

3. Ability to operate more cost-efficiently on a limited traffic base than Class I carriers while maintaining service: In the 1990s, 10% of the Canadian rail system was very low density (i.e., less than .2 million gross ton-miles per mile) and another 34% was low density (i.e., between .2 and 2 million gross ton-miles per mile). This in conjunction with the higher cost structure of Class I carriers called for rationalization of plant structure.

However, with the lower input costs mentioned above, maintenance of such trackage with its limited traffic may have been viable. As stated by the NTARC "The establishment of shortline railways is perceived by Class I railways and by the shipping community as a means of ensuring the continuation of rail freight service on certain low density lines. Short lines have a much lower cost structure ... The main line railways want to be relieved of the expenses of lower density lines, but to see rail service continue to the communities affected and hence obtain long haul traffic from interchange with the short lines."[10]

4. Ability to offer service more directly related to the needs of a shipper: Short line operators are closer to customers enabling them to offer tailored services reversing the perceived notion that Class I railways are undependable, unpredictable and unresponsive. As stated in some sources "In many cases, the short line and the shippers along the line have a more cooperative relationship, particularly if the shippers have invested in the short line."[11] "The short line railways are then able to do what they do best - provide personal, individualized services for smaller shippers."[12]

5. Possibility of local subsidies or financial assistance: In Canada, Quebec is the only Province that provides direct infrastructure support to short lines and so far eight lines have qualified. Ontario and British Columbia provincial governments, both have indicated that while they will support cost effective transportation alternatives, there are no existing programs established to assist short line railways. Short lines could also qualify under four federal programs but there are no formal programs available. As a result, Canadian short lines are not as fortunate as US short lines where twenty-two States fund projects and there are at least six well known federal programs.[13]

In sum, from 1996 shortlines increased from 11 to 51 due to discontinuance and transfers by Class I carriers. The rationale for their development has been attributed to a number of factors resulting in a more efficient overall railway network.

IV. Regulations Affecting Short Line and Regional Railways in Canada

The history of regulation in rail goes back to the mid 1850s. In 1851, the first general law on rail transportation, the *Railway Act*, was enacted.

Whether short line and regional railways fall under federal or provincial jurisdiction depends on whether they are federally or provincially incorporated. Their incorporation is usually based on their area of operation. If they operate within a province they are incorporated under provincial regulation, however, if they operate interprovincially or across international boundaries they are incorporated under federal regulation.[14]

a) Federal Regulations

Since the 1850s up until the mid 1990s, the railways were regulated by several federal acts.[15] However, the basic federal act governing the formation of short lines was initially the *Railway Act* and later the *Canada Transportation Act*.

Before 1987, section 256 of the *Railway Act* dealing with abandonment or rationalization of lines and services determined the development of short lines. After 1987, two major reforms that influenced the development of short lines and regional railways were: a) access to alternative rail service through expansion of the interswitching limits from a radius of 6.4 kilometres to 30 kilometres; and b) rail network rationalization which included a streamlined abandonment procedure for the transfer of lines to independent operators. However, the provisions were not totally conducive to the formation of short lines in the period 1988-1992 as section 159(4) of the *National Transportation Act* specified that a railway company is not allowed to abandon more than 4% of its route mileage in any one year.

On July 1, 1996, the *Canada Transportation Act* (i.e., CTA) the successor to the *National Transportation Act, 1987* was enacted. The transfer and discontinuance provisions are embodied in sections 140-146 of the *Canada Transportation Act* (formerly sections 157-181 of the *National Transportation Act*). The focus of the new provisions were on: developing a healthy short line industry, reducing cost of the major Class I carriers through rationalization and providing opportunities for retaining rail services. First, the Act eases the entry of smaller, lower cost rail carriers into operations in concert with CN and CP. The basic intent of this section is to encourage the development of shortline railways as they complement the mainline carriers as feeders of traffic. Lines must be offered for sale before they are abandoned and the legislation affords governments ample opportunity to acquire such lines when no interested party is found. Second, to provide for rail rationalization along more commercial lines and

to make it a less adversarial process and more conducive to the sale or lease to new operators, revisions were made to the old act. Third, the new Act introduces a new statutory requirement for federal railways to issue a three-year network plan. This is intended to protect the public interest by providing an opportunity to interested parties.

On July 26, 2000, the *Canada Transportation Act* was amended. The amendments affecting shortline railways include: compensating affected municipalities or districts when a grain line is closed with transitional payments of $10,000 per mile for three years, operating the remaining part of the branch line for three years, discouraging de-marketing (i.e., purposefully deferring maintenance to make operations uneconomic) of grain lines by ordering improvement of services, granting running rights and identifying lines for discontinuance in the three year plan.

The transfer and discontinuance provisions of the *Canada Transportation Act* have in general met their stated intention, according to the Canadian Transportation Agency, however, some concerns remain. These concerns include: the *lack of requirement for notice* of impending transfer of a rail line; the *lack of guarantee of service or operation* once outside federal jurisdiction; the *short time frame* for a municipal government to decide whether to accept an offer of a railway for transfer; the *acceptance of an offer of transfer* by governments before the Agency will determine price or net salvage value; the freedom railways have to *segment lines*; and the lack of *uniform requirements* on both private operators and governments to negotiate in good faith [16]. Notwithstanding these minor concerns, the provisions designed to encourage the creation of short lines have been a success.

b) Provincial Regulations

In addition to federal regulations, the railways are also subject to their respective provincial laws, such as: The Railway Act of British Columbia of 1979; the Alberta Railway Act of 1980; the Railway Act of Saskatchewan of 1989; the Manitoba Railway Act of 1994; the Ontario Railway Act of 1950; the Québec Railway Act of 1993; the New Brunswick Act of 1927 and the New Brunswick Shortline Railways Act of 1994; and the Nova Scotia Railway Act of 1993. The major facets of economic regulation: entry (operating authority), exit (abandonment), tariff publication (filing/approval/equality), and mergers (sale or transfer) for

provinces with the above laws are indicated in the table 7.

Table 7 - Regulatory Framework of Shortline and Regional Railways

			R A T E		
Province	**Entry Control**	**Exit Control**	**Tariff Filing/Approval**	**Tariff Equality**	**Merger**
British Columbia	Yes (ss. 6-13)	Yes (s. 173)	Yes/Yes (ss. 216/225-226)	Yes (s. 217)	Yes (s. 274)
Alberta	Yes (RA ss. 5-73/82) (RAA ss.3-13)	Yes (RAA s.23)	Yes/Yes (RA s. 212)	Yes (RA s. 213)	Yes (RA ss. 197/199) (RAA s. 28)
Saskatchewan	Yes (ss. 4 & 14)	Yes (ss. 22 & 22.1)	Yes/No (s. 36 & 53)	No	Yes (s. 47)
Manitoba	Yes (ss. 29-30)	Yes (ss. 33-34)	Yes/No (s. 38)	No	Yes (s. 16(2))
Ontario	Yes				
Québec	Yes (s. 7)	Yes (s. 5)	Yes/No (s. 12/28)	No	No
New Brunswick	Yes (s. 3)	Yes (s. 8)	Yes/No (s. 8)	No	No
Nova Scotia	Yes (ss. 14-16)	Yes (ss. 41-42)	Yes/No (s. 27 & 28)	No	No

Source: Various Provincial Statutes mentioned in the preceding paragraph.

Since short line railways are expected to be under provincial jurisdiction, the NTARC indicated that it could raise a number of concerns. "First, most provincial rail legislations are antiquated and need in-depth revision to accommodate the current and future requirements of the industry. The new operator must request authority to operate from the appropriate provincial regulatory body, largely duplicating the approval process of the Agency. Secondly, shippers located on such lines are likely to lose some of the benefits now offered by the NTA, 1987, such as dispute resolution and competitive access mechanisms." [17]

In sum, the amendments to the *Canada Transportation Act* in 1987 and 1996 have largely been responsible for the conditions conducive to the creation of short lines and have been a success. Provincial regulatory developments have not kept pace with developments at the federal level.

V. SL & RR in Canada-Will they Become a Competitor or Feeder?

a) Challenges faced by Short Line and Regional Railways

The major challenges to the development of short line and regional

railways are described hereafter.

1. Lack of entrepreneurs and entrepreneurial skill - According to the NTARC "..., there appears to be a lack of Canadian entrepreneurs ready to bid for available lines ..." The lack of entrepreneurial skill was also noted with regard to US short lines. James A. Schwinkendorf states "It is extremely difficult for a short line to have individuals who are experts in all of the fields required to operate a railroad. ... It is not uncommon to find short line operators who are overwhelmed by the complexity of the requirements of operating a railroad or who take a naively simple approach to complex problems." [18]

2. Lack of capital - The NTARC also indicates that there is "... a lack of venture capital to support those who are interested."[19] One of the possible reasons is because of the long period of time required between the initiation of an acquisition and the point when the investment will become profitable. A second reason is the substantial investment needed before the venture can become profitable. A third possible reason is the limited size of the market and the possibility of obtaining voluntary running agreements on the tracks of Class I carriers is not promising. The rationale for lack of public funding of short lines provided by the RAC was: 1) short lines have no free cash flow for capital reinvestment; 2) investments of 100% by the private is virtually unavailable; and 3) partnerships by the private/public yield considerable public benefit. (The RAC also provides other reasons for lack of investments in infrastructure).

3. Lack of investment in maintenance of infrastructure - The *Canada Transportation Act Review Panel* [Panel] stated "The most challenging capital expenditures facing short lines in the coming years are those required to upgrade track structures to handle the new mainline standard of 286,000-lbs freight cars. Many short lines lack the traffic base to accommodate such investments, and it remains to be seen what will happen to railways that cannot afford to upgrade to handle heavier cars."[20] The RAC is of the opinion that short lines have an impossible challenge in upgrading infrastructure due to the lower density of most of their operations.

4. Lack of adequate facilities at interchange points - The traffic of a short line generally moves to a Class I connecting carrier. Schwinkendorf states "... the short line must interact with the Class I. He rarely has

adequate facilities on which to conduct interchange with the Class I carrier, and in order to obtain such facilities, must further erode his cash flow by renting or leasing trackage from the Class I carrier..."[21] Examples of lack of facilities are: de-thawing locomotives in winter, inspection pits, etc.

5. Lack of traffic - The lack of traffic is one of the major challenges facing the development of short line and regionals. One of the reasons why Class I carriers have discontinued or transferred short lines is because of lack of profitable traffic. This is noted briefly by CTAR in passing which stated "Many short lines lack the traffic base ..."[22] This problem also existed for short lines in the US initially, as stated by Schwinkendorf "In many cases, the short line operator finds that he has an abysmally low volume of business ..."[23] This low volume of business activity is accompanied with traffic revenue that barely covers costs.

b) Proposals by Various Groups of SL & RR - Evaluated by the CTAR Panel

The regional railway concept has been accepted with enthusiasm in parts of western Canada, with the participation of Class I railways in some cases. The Panel evaluated two visions of the regional concept which will be briefly reviewed.

The first was a proposal by the Brotherhood of Maintenance of Way Employees Approach (BMWE): "The BMWE sees the need for a regional railway as part of an overall approach to improving grain handling and transportation. It proposes an integrated regional grain system, operated for a not-for-profit service and intended to lower overall costs by making better use of existing elevator, rail and road infrastructure. The union maintains that under its approach, it can secure a supply of grain for the branch lines."[24]

The second was a proposal by OmniTRAX: OmniTRAX proposes a 'managed access' scheme. Guaranteed access to designated CN and CPR rail lines would include traffic solicitation rights, unrestricted rights to deliver traffic to designated competitive interchange locations (or to final destination if necessary), and rights to serve captive traffic on the mainline, if requested by the shipper. Under the proposal there would be no reciprocal access. OmniTRAX defines managed access as "the right for a selected railway operator to serve customers on designated lines owned by CN or CPR with the same rights and obligations as the owning carrier

while providing a return to the owner."[25] OmniTRAX proposes that the access fee be determined through commercial negotiations. If this fails the CTA would be empowered to set rates, terms and other conditions of access. Under the scheme, the number of operators would be limited to ensure the viability of services. OmniTRAX believes that its regional railway concept can be successful only if the guest operator: has adequate access to the national grain hopper car fleet and to support services (terminals, yards, maintenance areas, etc.); has the ability to set commercial rates; and has access to quick and effective dispute resolution mechanisms.

The potential impact of the OmniTRAX proposal on the degree of competition in the Panel's assessment was not at all clear i.e., if the purchased tracks were run as a monopoly and if there was no reciprocal access. On the other hand, where the selected carrier operated through running rights over CN or CPR lines, more direct competition might result. Further, the impact on system efficiency is also unclear. ... The existence of a regional railway might, however, stimulate the mainline carriers to become more efficient. However, if the objective of the OmniTRAX proposal is a more extensive use of Prairie branch lines and secondary lines, the objective may not be realized due to an attempt to move grain to high throughput elevators to take account of incentives.[26]

In conclusion, neither of the proposals are likely to realize its intended objective according to the Panel. Nevertheless, "It is encouraging to note that the concept is developing in the existing regulatory environment. The Panel believes that commercially sound regional railways could provide tangible benefits to regions where they operate. Further, the Panel's proposals to transform running rights into a competitive access tool may provide further incentives to create commercially sound regional railways."[27] The Panel did not recommend legislative changes specifically for regional railways. However the Panel, indicated that the regional railway concept has engendered much debate in the Prairie provinces due to the need to foster greater competition among the Class I railways, to retain potentially viable branch lines, to protect deteriorating Prairie roads, and to save rural communities from extension.[28] According to the Panel "The regional railway concept has been accepted with enthusiasm in parts of western Canada, with the participation of Class I railways in some cases."[29] They believed that commercially sound

regional railways could provide tangible benefits to regions where they operate.

c) Experience in the US with SL & RRs

In the US since 1980, the year when the *Staggers Act* and the *Motor Carriers Act* were introduced, 263 new short lines and regional rail roads were created. As of 2005, there were about 550 short line and regional railroads operating **70, 000** kilometres in 50 states. The peak year for short line creation was 1987, when 46 short lines were formed and 6, 674 miles (10,740 kilometres) of rail line were transferred to short line operations.[30] Three important factors that can be attributed to the success of short line and regional railroads in the US are: 1. the poor financial situation of railroads which required restructuring of the industry; 2. the legislative and policy framework; and 3. the financial assistance available through subsidies for rail rehabilitation.[31] The short line and regional railroads in the US have not only increased the traffic density of the main line carriers, but together with the other regulatory reforms have also enabled the main line carriers to increase competition within the rail industry and between railroads and motor carriers.

d) SL&RRs Will They Become a Viable Competitive Alternative?

A review of the existing literature does not indicate that SL&RR will become a viable competitive alternative to the two major Class I railways in Canada in the near to medium future for several reasons.

1. Economic considerations: Economic factors such as traffic volume, upgrade issues, single commodity dependence, erosion of labour cost advantages, cost disadvantage in operations (excluding labour costs and signalling and communications cost) and lack of capital for infrastructure capital and entrepreneurial skill indicate that SL & RR (especially SL) are unlikely to become viable competitors to the two major Class I carriers. As indicated earlier, one of the major reasons why the latter carriers transferred rail lines is because they were unprofitable. If the primary reason (the possibility of avoiding labour successor rights) for the development of short lines under provincial jurisdiction is removed (because provinces have closed this legal loophole), the major advantage is lost together with its possibility of being effective competitors.

2. SL&RRs viewed as complements: It is generally held that “The relationship between a short line and the Class I carrier is truly a

partnership where both sides cooperate to receive some benefit from the "feeder road" relationship. Short lines depend on Class I's to originate their inbound traffic and deliver outbound commodities, so a good working relationship is critical to a short line's success. Uncooperative Class I's can deny market access through switching charges, or joint rates, and fail to supply equipment."[32] Even the Class I railways view short lines as feeders rather than competitors. "Publicly, then, the two major Canadian railways appear to be enthusiastic about the prospects of short line railways in Canada, believing that short line railways will complement their desired main-line service by acting as feeder lines; in effect the Class 1 and the short line would become partners in the transportation of goods from origin to destination."[33]

3. SL rely on Class I carriers: Leases of equipment by short lines from Class 1 carriers are quite common since they have a difficult time raising capital. Shortlines are also constrained by the term of their agreements with Class 1 carriers. Under these conditions it is difficult visualizing short lines as competitors to Class I carriers since they could always refuse to lease or lease at rates that will discourage short lines from being competitive.[34]

4. Government policy and regulations: There is no specific federal government policy on railway or short line and regional railways. The enactment of the legislative amendments in 1996 which enabled CN and CP to transfer rail lines without regulatory intervention indicates the encouragement of railway service by new operators. It however, does not suggest promotion of viable competitive alternatives. As noted by one writer "...the CTA lacks any provision which would enable provincial short line railways to obtain a running rights order to access another rail carrier and thereby avoid captivity to the Class I rail carrier which conveyed the line to them. Accordingly, provincial short line railways created under Division V are totally reliant upon the Class I railway to which they are connected for their profitability and continued existence. They have no other options."[35] Another writer states "There is no harmony between federal and provincial rail legislation in many provinces. In some provinces, the laws governing short lines are non-existent or outdated. This uncertainty surrounding short line sales unnerves shippers on the line..."[36] In addition, it has been indicated that government policy does

not provide a level playing field for short lines as they pay twice the level in fuel taxes and property taxes.[37] All this coupled with lack of clear assistance programs for short line development does not indicate that the governments see them as a viable competitive alternative.

5. Railway views on competition: Railway views on access through CLRs and RR on competition in the rail sector do not indicate that we are at a stage where competition through access is accepted. "To date, major Canadian carriers have not attempted to capture each other's traffic by offering attractive line haul rates to be used in conjunction with CLRs. This condition is seen as discouraging the usage of CLRs and is, arguably, one reason why there have only been six CLR applications - four by one shipper - to the Agency in ten years, five of which involved an American railway as the line haul carrier."[38] Similarly, from 1987 to date only seven applications for RR were made to the Agency. All were withdrawn or denied.[39] Thus, the effect that these provisions have had in enhancing competition between the two main line carriers has been rather limited. The two major main line carriers view the North American railway system as one of the few successful railway systems in the world, therefore if there is nothing wrong there is no need to fix it. They have indicated that revenue erosion could affect their viability and is a major concern.

In sum, despite the rapid growth of the shortlines since 1996 its future is uncertain. It has also grown rapidly in the US since 1980. The Panel indicated that sound regional benefits could provide tangible benefits to regions where they operate. It is unlikely that SL & RR will become competitive alternatives to Class I carriers in the near or medium future. However, if a SL or RR is near to port they could provide an alternative service to the two Class I carriers.

VI. Concluding Remarks

The rapid growth of the short lines since 1996 has been one of the most interesting developments in the rail industry. Thirty-seven new short lines have been created bringing the total to forty-eight. Transfers of lines from the Class I carriers, CN and CP, have increased steadily from 2,330 in 1996 to 15,998 kilometres in 2004.

This development can be attributed to a number of factors: the existence of an infrastructure and the absence of the need for major sunk

costs; the possibility of lower input costs and efficiencies; the ability to operate efficiently on a limited traffic base; the ability to better serve the needs of shippers and the community; and the possibility of financial assistance.

Short lines and regional railroads continue to face a number of challenges to their growth and development: lack of entrepreneurs and entrepreneurial skill; lack of capital; lack of investment in maintenance of infrastructure and upgrades; lack of adequate facilities at interchange points; and lack of traffic and traffic diversity. A review of the literature does not suggest that short lines will become a viable competitive alternative in the near to medium future for several reasons: economic considerations; general views that SL&RR are complements: government policy and regulations; and railway views on competition.

The future of short lines and regional railroads is uncertain notwithstanding the rapid growth of short lines since 1996. Perhaps, the best strategy for SL & RR in the near future is to consolidate and improve upon the gains of the last few years. The Shortline and Regional Railroad Bill of Rights in the U.S. requiring: the right to compensation for service failures; a right to interchanging and routing freedom, a right to competitive and nondiscriminatory pricing; and a right to fair and nondiscriminatory car supply, suggest possible avenues for policy to pursue. This will not only recognize the advantages that SL & RR have brought such as cutting pollution, reducing congestion and highway repair costs but will also recognize their overall contribution to Canada's economy and global competitiveness.

Endnotes

1. *Competition in Transportation Policy and Legislation in Review*, Volume I, NTARC, 1993, p. 96.
2. Id. pp. 97-98.
3. *Transportation in Canada 2001*, Annual Report, Transport Canada, p. 69 and *Report of the Inquiry into Railway Branch Lines*, p. 47.
4. *Strategic Infrastructure Investment Opportunities: Short Lines in Canada, Railway Association of Canada*, May 2003, p. 6.
5. *Competition in Transportation Policy and Legislation in Review*, Volume I, *NTARC*, 1993, p. 97.
6. *Strategic Infrastructure Investment Opportunities*, Railway Association of Canada, p. 5.
7. *NTARC*, p. 96.
8. Schwinkendorf, James, "Short Line Operations From a Class I Railroad Perspective", *TRF*, Volume XXIV, No. 1, 1985, p. 233.
9. Friend, R. And Moore M., "Economic and Financial Aspects of Buying and Operating Short line Railways in Canada", *CTRF* 1995, p. 294.
10. *NTARC*, pp. 92-94. In addition to the above, two reasons provided by RAC in support of short lines

are: a shift from short lines to truck is not in the public interest as costs are much higher for intercity truck; and a shift would result in a considerable detrimental impact on GHG emissions.
11. See Schwinkendorf, James, p. 233.
12. See Misetich, Ann, p. 300.
13. The NTARC recommended that to the extent that the *Western Grain Transportation Act*, the *Maritime Freight Rates Act* and the *Atlantic Region Freight Assistance Act* are maintained that they be clarified to make intra provincial short lines eligible for subsidies. See p. 100 *NTARC* V. I.
14. The genesis for this is section 92(10) of the Constitution Act of 1867 as most provincial short lines are subjects of exclusive provincial legislation because they are not ".. railways ... connecting the Province with any other or others of the Provinces, or Extending beyond the limits of the Province." See Misetich, Ann, "Re-examining Government Policies with Respect to Short Line Railways", *CTRF* 1995, p. 302.
15. The *Railway Act*, the *Transport Act*, the *National Transportation Act 1967*, the *Railway Relocation and Crossing Act*, the *Canadian National Railway Act*, the *Western Grain Transportation Act*, the *Government Railways Act*, the *Maritime Freight Rates Act*, and the *National Energy Board Act*.
16. See *Canadian Transportation Agency*, Annual Reports.
17. *NTARC*, p. 94.
18. *NTARC*, V. I., p. 98 and Schwinkendorf, James, p. 234.
19. *NTARC*, V. I., p. 98.
20. *Vision and Balance*, CTAR Panel, p. 50.
21. See Schwinkendorf, James, p. 234.
22. *Vision and Balance*, CTAR Panel, p. 50
23. See Schwinkendorf, James, p. 233.
24. *Vision and Balance*, CTAR Panel, p. 91.
25. *Vision and Balance*, CTAR Panel, p. 92.
26. *Vision and Balance*, CTAR Panel, p. 93.
27. *Vision and Balance*, CTAR Panel, p. 93
28. *Vision and Balance*, CTAR, 2001, pp. 91-96.
29. Id. p. 93.
30. See Misetich, Ann, p. 305.
31. *3R Act, 1973, 4R Act, 1976*, and the *Local Rail Service Assistance Act, 1978* - all include provisions for operating subsidies and rehabilitation for light density branch lines.
32. See Misetich, Ann, p. 303.
33. Loughman, Michael, "Shortline Railway Industry In Canada," *TRF* 1991, p. 382.
34. Nolan, James, "Short Line Panel Session," Forumation, June, 2005, p. 6.
35. Foran, James, "Competition in the Rail Sector - Are We There Yet?," *Competition and Access in the Rail Industry*, September 15-16, 2000, Saskatoon, Saskatchewan, p. 7.
36. See Misetich, Ann, p. 304.
37. See footnote 35.
38. *Canadian Transportation Agency*, Annual Report 1998, p. 66.
39. Two were denied by the Agency on grounds that the applicants were not federal companies, two were withdrawn as they were subsequently obtained by negotiations, one was denied as it was beyond what could be legally granted, one was denied as no public interest would be served and one was denied due to lack of information.