RECENT PUBLIC POLICY INITIATIVES IN RESPECT OF RAILWAY SERVICES

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Transportation has the capacity to arouse emotions and prejudices and to obscure the vision of most people even more completely than questions of race, religion or language.

Hon. Jack Pickersgill
Minister of Transport
Hansard, September 1, 1966, p. 7989

Introduction

Section 5 of the *Canada Transportation Act* (CTA) defines Canada's National Transportation Policy (NTP) and sets out clear objectives and the means to achieve them. Two recent legislative initiatives respecting rail transportation raise questions as to their consistency with the NTP.

Bill C-52, the *Fair Rail Freight Service Act*, gives a shipper the right to request a service level agreement (SLA) from its federal railway service provider and establishes an arbitration process in the event the shipper and the railway company cannot agree on the terms of an SLA. Bill C-52 came into force in June 2012

Bill C-30, the *Fair Rail for Grain Farmers Act*, allows the government to establish weekly minimum volumes of grain to be moved by CN and CP and provides penalties for railway companies in the event of their failure to move the minimum volumes. It also provides the Canadian Transportation Agency (the Agency) with the authority to extend the interswitching distances and to specify what matters can be subject to SLA arbitrations. Bill C-30 came into force in May 2013.

This paper reviews and discusses the factual context in which both Bills were enacted and their consistency with the principles of the NTP enunciated in the *Canada Transportation Act*.

National Transportation Policy

The first NTP statement was enacted in the *National Transportation Act* of 1967 which implemented the vision of the MacPherson Royal Commission on Transportation (1959-1961). MacPherson called for the replacement of the then-existing regulatory framework with reliance on market competition as a way to achieve an efficient transportation system.

The NTP statement of 1967 was amended on numerous occasions over the years, but the underlying objective of an economically efficient transportation system remains to this day.

The current NTP statement in section 5 of the CTA is clear: the means to achieve an economically efficient transportation system is to rely, as much as possible, on "*competition and market forces*". Regulation or other public intervention should only be used as a last resort and, according to the 2001 CTA Review, "*should only be used to solve instances of market failure*."[ii] A corollary to this goal is that where public intervention is required, it should foster and be consistent with commercial outcomes, not undermine them.

Policy statements are not jurisdiction-conferring provisions, but they do serve to describe the objectives of Parliament in enacting the legislation and to circumscribe the discretion granted to regulators and subordinate legislative bodies.[iii] So, while not binding on Parliament, transportation legislation and policy developed over the last three decades have indeed been guided by the principles set out in the NTP[iv]

It is therefore fitting to consider the extent to which the principles of the NTP have guided the development of Bills C-52 and C-30.

NTP reliance on competition – implications:
When considering the competitive constraints on railways, a review of whether the customer is served by more than one railway might be warranted. However, a serious analysis of competitive constraints needs to go well beyond such limited consideration.

All competitive constraints preventing potential exercise of market power must be considered including: indirect intramodal competition (service by two railways via interswitching or reload centres), intermodal competition, source of supply or geographic competition, product substitution and countervailing power[v]. All constitute competitive constraints on rail service providers. In addition, the development of numerous logistics and supply chains fiercely competing with each other also create competitive pressure on the various participants in the supply chain, including railway service providers. While the competitive choices available to shippers may vary from product to product or market to market, the analysis of available choices must extend beyond the narrow focus of choice between two railways.

Even in cases where a railway company may hold some market power in a given market, further analysis is required before regulatory intervention is warranted, especially when looking at low density markets that cannot support competition. In this respect, it is worth recalling the Competition Bureau's statement in its Enforcement Guidelines in respect of the Abuse of Dominance provisions (sections 78 and 79) of the *Competition Act* that "*the fact that a firm holds market power is not, in and of itself, sufficient to warrant intervention under section 79. Likewise, charging higher prices to customers, or offering lower levels of service than would otherwise be expected in a more competitive market, will not alone constitute abuse of a dominant position.*"[vi]

Bill C-52 – the *Fair Rail Freight Service Act*

The context:
In response to shippers' complaints that the legislative provisions specifying the railways "service obligations" were too vague and the process before the Agency too long and costly, the Minister initiated a review of rail freight services. The Rail Freight Service Review (RFSR) Panel was appointed in 2009. Their review included analytical work carried out by independent consultants and the appointment of a Panel to develop recommendations in respect of the rail-based logistics supply chain. The recommendations were to include commercial and, if necessary, regulatory solutions.

In its report, the Panel's main recommendations focused on the need for railways to enter into good faith negotiations to establish service agreements upon request by customers. Failure to reach a service agreement would be eligible for dispute resolution. The Panel also called on railways and customers to engage in negotiations, with the assistance of a facilitator, to establish a commercial dispute resolution process.

Finally, the Panel expressed a clear preference for commercial resolution of issues and recommended that the Minister not proceed with legislative action unless it is demonstrated that the commercial approach failed.

Upon receipt of the Panel's report, the government indicated its agreement with the recommendations and proceeded with the establishment of a facilitation process to develop a service agreement template and a commercial dispute resolution process. At the same time, the government indicated that it would be introducing legislation on service matters despite the Panel's recommendation to allow time for parties to develop commercial solutions.

A facilitation process with shippers and railways was set up with the objective to develop elements of a service agreement template for use by parties when negotiating their specific service agreements.

In his report, the Facilitator concluded that while progress was made, agreement could not be reached on a commercial package. The Facilitator went on to propose a commercially oriented three-tiered template and encouraged shippers and railways to use it as an "agenda" in their service agreement negotiations.

The Facilitator's proposed commercial approach established a direct link between performance standards, financial consequences and volume commitments – in other words, reciprocal commitments.

The Facilitator attributed the lack of agreement on a commercial package to the fact that *"shippers … linked the Facilitation process to the promised legislation and their expectations extended beyond the scope or ability of the Facilitation process intended to establish commercial tools."* Shipper participants[vii] who had been asking for legislation and further regulation to deal with service matters had little interest in the success of the facilitation process as success would have undermined their objective of further legislative action and regulatory remedies. They saw their participation in the facilitation process only as a necessary step on the way to legislation.

The legislation:
The *Fair Rail Freight Service Act* was enacted in June 2013. It provides shippers the right to request an SLA from federal railway companies and establishes an arbitration process in the event the shipper and the railway cannot agree on the terms of an SLA. A shipper may submit for arbitration the operational terms that a railway company must comply in respect of the transportation of the traffic including performance standards.

Competitive constraints considerations underlying Bill C-52:
At the time the government proceeded with Bill C-52, it had the benefit of the results of the three separate consultations/analyses referred to above, namely, the analytical work conducted by independent consultants, the report of the RFSR Panel and the Facilitator's report.

While the reports identified a number of service issues[viii], they also confirmed the existence of remedies to address them. The RFSR noted that shippers dissatisfied with the service provided by a railway could file a service complaint with the Agency or could choose to seek the establishment of service parameters by way of Final Offer Arbitration (FOA). On the matter of recourses available to shippers, the consultant retained to compare how service issues are addressed in other regulated industries and other countries, observed:

> *"We have found none of the legislative regimes reviewed, including the regulation of LOS (Level of Service) in the U.S., to be clearly superior in an overall sense to the regime for regulating LOS in the Canadian rail freight services industry."*[ix]

Also worth noting for the purpose of this analysis is the conclusion of the consultant that conducted the analysis of transit times and order fulfillment, used as proxies for railway service:

> *"While it might be expected that shippers with competitive access would have better service, there is no advantage in terms of consistency for CN customers with access to direct rail competition, as compared to those at non-competitive origins."* [x]

In other words, a behaviour that does not indicate, *prima facie*, an abuse of market power.

Finally, as already discussed, the RFSR Panel called for a commercial approach to the resolution of service issues and to only proceed with legislation if it is demonstrated that the commercial approach has failed.

In summary, the government had the following information:

- there is no difference in service to locations served by more than one railway versus those served by a single railway;
- a number of remedies are available to shippers to address rail service issues (service complaints to the Agency, FOA, group FOA, and recourse to Agency on ancillary charges);
- the Canadian regulatory regime in respect of level of service appears as good as those available in other countries including the U.S.; and
- panels appointed to look at service issues recommended that parties first be allowed to develop commercial approaches to service issue and government should only proceed with legislation if it is demonstrated that the commercial approach has failed.

This information is less than indicative of a system in need of urgent regulatory measures[xi]. The government nevertheless chose to proceed with Bill C-52.

Resulting situation – increased disconnect from commercial reality:
The successive enactment of additional regulatory measures has resulted in a piling up of remedies, many to address the same issue. For example, concerns by shippers about rail service can be addressed through four different remedies in four different fora:

- level of service complaints before the Agency;
- FOA before an independent arbitrator;
- group FOA before an independent arbitrator; and
- service level arbitration before an arbitrator.

Prior to Bill C-52, shippers had (and still have) the ability to raise service issues before the Agency through level of service complaints. Shippers argued that this approach was insufficient as it only addressed service issues after the fact. They wanted to have better clarity on the level of service they were to expect, in advance, through the establishment of SLAs.

In fact, shippers already had a remedy to get this clarity through the FOA provisions[xii]. The FOA process whatever its shortcomings, At least recognizes the market reality linking rates and service considerations by allowing a shipper to raise either or both elements within the same process. Most shippers only use this recourse for the establishment of the transportation rate. The reason advanced for not using it for service issues is the fear that it might complicate the establishment of the rate. This statement appears to have been accepted at face value with no supporting information provided.[xiii]

In the event of disagreement between the parties, the resulting process is that one arbitrator will set the terms and conditions of service and a different arbitrator will set the rate in a separate and independent proceeding. Such disconnect between services and rates is inconsistent with the objectives of the NTP of having a commercially-based efficient transportation system.

In addition to level of services complaints and FOA recourses, Bill C-52 has created an additional recourse respecting service matters. This SLA arbitration recourse is available to all shippers without conditions or minimum

thresholds. In fact, they are available even if the shipper has access to transportation alternatives. There are no requirements for the shipper to demonstrate abuse of market power by the serving railway or even to submit to mediation prior to triggering the remedies.[xiv]

Bill C-52 includes a provision requiring the arbitrator to have regard to whether the shipper has an alternative and effective means of transporting their goods, implying that where such alternative means exist, the markets should be left to work and regulatory intervention should not be allowed. Practice has demonstrated, however, that this has not been the case.[xv]

As already discussed, the information available to government did not suggest a system in need of repair. More importantly, however, universal availability of remedies and regulatory interventions permitted without the need or opportunity to consider whether competitive constraints exist in respect of the market or product at issue, are clearly inconsistent with the market-based objectives and principles of the NTP. The piling up of those regulatory options respecting rail service are at odds with the NTP that primarily relies on market forces to achieve desired outcomes. The NTP makes clear that "regulation and strategic public intervention" are used only when market forces do not achieve those outcomes.

Resulting situation – silo approach to service level agreements:
Aside from the inconsistency with the principles of the NTP, a further consequence of the SLA provisions of Bill C-52 is the silo approach to the establishment of the level of service that a railway is to provide to a shipper. Each arbitration is in respect of an individual customer. While arbitrators are required to take into account the service obligations to other customers, other customers are not present during the arbitration proceedings and cannot advise the arbitrator as to how the service requested by the particular shipper could adversely affect others. In other words, the process does not allow for a network view of the situation.

As a result, SLA arbitrations have resulted in arbitrators setting terms and conditions of service tailored to the particular shipper's situation rather than for the provision of an efficient service to serve the needs of all users of that service. This is a regulatory remedy that is inconsistent with a network industry; it is also inconsistent with the objective of an economically efficient transportation industry.

Bill C-30 – the *Fair Rail for Grain Farmers Act*

The context:
The crop year following the coming into force of Bill C-52 (crop year 2013-2014) brought multiple challenges to the western Canada's grain handling and transportation system: a huge increase in export grain as a result of a record crop combined with the coldest winter in decades that impacted railway operations.

- *an un-forecasted bumper crop:*

In planning their resource requirements and service offerings for an upcoming crop year, railways rely on a number of forecasts and more specifically the forecast from Agriculture and Agri-Food Canada (AAFC). AAFC's forecasts are based on Statistic Canada's Seeding Intentions Survey. None of the forecasts on which railway companies rely had contemplated such a record crop, grain producers included.

AAFC's initial March 2013 forecast called for a production of 60 Million Metric Tonnes (MMT) for crop year 2013-2014, a number consistent with the prevailing trend line and historical production. The extent to which actual production varies substantially from such initial forecast can have a significant impact on service delivery as adding additional resources can take between six to twelve (or more) months depending on the type of resource, e.g. cars, crews or power.

In September 2013, AAFC revised its forecast production to 63 MMT. In December 2013, it was revised again to 76 MMT. It is only in October 2014, three months after the end of the crop year, that AAFC confirmed the actual production at 77 MMT, an increase of more than 28% over the March forecast.

Most, if not all, of the additional production was destined for export. For the 2013-2014 crop year, this meant an increase of approximately 50% of grain to be transported by the railways for export compared to the previous average.

- *the coldest winter on record:*

Severe winter conditions compounded the challenge of moving this un-forecasted increase in export grain. Under extreme cold conditions, railway operating procedures must be adapted to ensure the safe handling and operation of trains. For example, train lengths must be reduced in order to maintain the required brake line pressure that will ensure safe operations[xvi]. This leads to a requirement for more resources – more train starts, more crews and more locomotives – to handle the same amount of traffic potentially leading to further congestion.

So while there were record volumes of grain to be transported, the severe conditions of winter 2014 caused a reduction in the number of carloads that the railways were able to handle compared to an average winter.[xvii]

Despite these challenges, the railway companies transported the record crop in just over a year and brought the carry-in stocks in line with previous years' average, leaving ample space for delivery of the new crop.

While the railway companies continued to struggle with the winter conditions, customer demand for rail cars and rail service continued unabated. The railway companies' inability to meet all such demand in a timely manner led to complaints by farmers and grain companies and requests for government intervention. Notwithstanding the unique circumstances of an un-forecasted bumper crop and the extreme winter conditions, the government obliged.[xviii]

The legislation:

Bill C-30, the *Fair Rail for Grain Farmers Act* was introduced in March and enacted in May 2014. The Bill allows the government to establish weekly minimum volumes of grain to be moved by CN and CP and provides penalties for railway companies for failure to move the minimum volumes.

It also provides the Agency with the authority to extend the interswitching distances and to specify what matters could be subject to SLA arbitrations. Within two months, the Agency amended the interswitching distances from 30 km to 160 km in the Prairie Provinces, and developed a three-page list of operational matters that could be subject to SLA arbitrations.

These provisions are set to expire on August 1, 2016, unless postponed by a resolution of Parliament.

Competitive constraints considerations underlying Bill C-30:

The stated objective of the Bill was to get product to market quickly and more efficiently following the record crop year. However, no studies or analysis of the conditions in support of the legislative changes or of the anticipated impact of such changes were made or presented.

In respect of the interswitching limits, the government provided no information on how the new interswitching limits were established, what impact such limits would have on railway operations, why the extended limit should apply to all commodities, why it would apply to the Prairie Provinces and no analysis on how the extended limits would assist in moving product to market quickly and more efficiently.

The government, however, did have the benefit of the views of the 2001 CTAR which had compiled information and analyzed the issue and had concluded that:

> *"expanding the interswitching limits would worsen the market-distorting aspects of the interswitching rate regime and would be a step backward. The proposal ignores market conditions and the averaging effects of a fixed rate – all shippers pay the same rate, regardless of their circumstances.*
> *[…] Proposals to extend the interswitching limits assume that railways are behaving in this manner* [abusing monopoly power]. *No evidence before the Panel suggests this kind of market power exists in every circumstance where expanded interswitching would be available."*[xix]

The government also had available the Agency's previous determination of a request by some shippers to extend the interswitching limits to 150 km. At the time, the Agency concluded that:

> "*extending the interswitching distance limits from 30 to 150 km would constitute a policy amendment that would have substantial repercussions in the rail transportation industry and the magnitude of these repercussions would be so significant that such an amendment cannot be contemplated by way of a regulatory change."*[xx]

It was never explained how extended interswitching could assist in moving more grain to market when western grain supply chains were already stressed as a result of the bumper crop and extreme winter conditions.

No analysis or explanation was provided for applying the extended interswitching to all commodities although the stated objective of Bill C-30 was to facilitate movement of grain.

Finally, no analysis was carried out on the potential impact of mandated weekly grain volumes on non-regulated grain or other commodities.

Acting under the provisions of Bill C-30, the Agency issued a regulation specifying a list of operational matters that an arbitrator may establish in a service level arbitration proceeding. These vary from the number of cars to be supplied to the shipper, the locomotive and crews to be provided to the switching and scheduling of the train service for the shipper in question. By assigning the determination of such detailed railway operational issues to an arbitrator for a specific shipper, the process, in effect, removes from railway management the ability to design the most economically efficient service for the benefit of all customers, while creating preferential treatment for a customer at the expense of others

It also perpetuates the inappropriate focus on the rail segment rather than on the overall supply chain. Indeed, the lack of sufficient empty cars for loading in the prairies may be the result of delayed car unloading at waterfront terminals and a missed train connection may be the result of congestion at ports or third party facilities. In such cases, an arbitrator's decision to increase the number of cars to be provided to one shipper, or to establish specific switching or train service schedules, may in fact create service issues for other shippers or elsewhere in the supply chain.

In the same manner, the arbitrator's jurisdiction is only in respect of railway operational matters. The arbitrator cannot impose obligations on the shipper, the other party to the SLA, such as forecasting, volume commitments, etc. The process and its outcome are devoid of commercial balance considerations, the fundamental reciprocity principle that formed the basis of the Facilitator's recommendations.

The arbitration process for SLAs undermines rather than encourages commercial outcomes. It also inappropriately focuses exclusively on the rail segment of the supply chain. By focusing on the needs of a single shipper rather than those of all users of the network service, it leads to the introduction of inefficiencies in the rail transportation system.

Bills C-52 and C-30 may have served legitimate political purposes; their underlying results and policy can hardly be reconciled with the NTP's principal objective of an economically efficient transportation system.

Indeed, the Bills underscore the excerpt of Mr. Pickersgill's statement quoted at the beginning of this paper!

[i] Jean Patenaude is a former vice chairman of the Canadian Transportation Agency and former lawyer for CN. Opinions expressed in this paper are my own.
[ii] *Vision and Balance*, Canada Transportation Act Review, 2001, p. 17.
[iii] Reference re Broadcasting Regulatory Policy CRTC 2010-167 and Broadcasting Order CRTC 2010-168 (2012) 3 SCC 489 at par. (22).
[iv]
[v] See John Kenneth Galbraith *American Capitalism: the Concept of Countervailing Power*; increasing size of buyers (e.g. Walmart) or buyers working co-operatively (e.g. association of shippers) can offset market power of firms. Applies equally to shippers with multiple production points of same product or with multiple production points of different products where some points are served by only one railway and other points served by more than one railway.
[vi] Competition Bureau, Enforcement Guidelines, *Abuse of Dominance Provisions*, http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03497.html#s1_0
[vii] Of the fifteen-member Stakeholder Facilitation Committee established by the Facilitator, eleven were from shipper members directly involved in shipper-carrier negotiations.
[viii] Many of the service issues identified had already been addressed by the time the reports were filed. For example, railways had already addressed the complaint of inadequate notice prior to implementing service changes. In the same manner, complaints dealing with Demurrage and Ancillary charges had already been addressed in an earlier legislative amendment in 2008 creating two separate recourses for shippers dissatisfied with such charges: group FOA and recourse to the Agency.
[ix] Report by CPCS Transcom Ltd – *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 2019.
[x] Report by QGI Consultants - *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March, 2010, p. 100.
[xi] This was also the conclusion reached by 2010 CTA Review. Cf. *Vision and Balance*, Canada Transportation Act Review, pp 56, 57.
[xii] Similarly, they can use the group FOA provisions for the same purpose and the expedited FOA provisions where the value of the freight charges does not exceed $750,000.
[xiii] The fact is, however, that some shippers have used it for the establishment of terms and conditions of service in addition to rates.
[xiv] In the U.S., a shipper who chooses to enter into a confidential contract with one or more rail carriers loses his various statutory protections, including those relating to level of services. Moreover, the Surface Transportation Board has the authority to exempt traffic from regulation if it determines that the market for the traffic is sufficiently competitive.
[xv] The author is aware of an SLA arbitration matter where the shipper sought an imposed SLA in respect of three origins, two of which were served by two railways, one directly dual served and the other dual served via interswitching (within 30 km).

Notwithstanding this evidence, the arbitrator nevertheless issued an award granting the shipper's request at all three sites. It is difficult to think of a regulatory intervention that could be more inconsistent with the market-based principles of the NTP.

[xvi] Reduced train length is only one example of the impact of cold weather on train operations. Other examples include reduced equipment reliability, increased switch and signal failure and increased wheel and rail breaks due steel becoming brittle in extreme cold weather. To minimize such occurrences, train speeds are reduced; all these elements impact operating schedules and connections at terminals and reduce network fluidity.

[xvii] All traffic was affected by the 2014 winter conditions, not only grain. In fact, despite the harsh condition of the winter of 2014, the railways carried as much grain as during the winter of 2013 but this was insufficient to handle the increased demand due to the bumper crop.

[xviii] The president of Quorom Corp., the government appointed Grain Monitor is reported in the Dec. 11, 2015 of the Western Producer as saying that 20113-2014 was an aberration and that the railways and grain companies have actually improved the efficiency and performance of the system in the last 15 years. He is quoted as saying "Canada, probably, has the best grain handling and transportation system in the world."

[xix] *Vision and Balance*, Canada Transportation Act Review, 2001, pp. 63, 64.

[xx] SOR/DORS/2004-201, *Canada Gazette Part II, Vol. 138, No. 20*, p.1417.