Canada Transportation Act Review

Canada

Examen de la Loi sur les transports au Canada

COMPETITIVE RAIL ACCESS

Canada Transportation Act Review Panel

Interim Report

December 29, 2000

Canada

29 December 2000

The Honourable David M. Collenette, P.C., M.P.
Minister of Transport
Tower C, Place de Ville
Ottawa, Ontario
K1A 0N5

Dear Minister:

Pursuant to the Terms of Reference of the *Canada Transportation Act* Review, we transmit to you the interim report on competitive rail access.

Yours sincerely,

Brian Flemming, C.M., Q.C.
Chair

Jean Patenaude

Robert Keith Rae, C.P., c.r.

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CHAPTER 1: COMPETITIVE RAIL ACCESS—THE CONTEXT

1.1 INTRODUCTION

This interim report of the Canada Transportation Act Review Panel (hereafter referred to as the Panel) stems directly from the terms of reference given to the Panel some six months ago. By July 2001, the Panel is to report the results of its comprehensive review of the *Canada Transportation Act* (CTA) and related legislation. However, the Panel was also charged with delivering another report halfway through its mandate, focused specifically on issues surrounding competitive rail access. It is clear that these issues embody controversies of long standing, that the parties involved believe the stakes are high and that despite best efforts, the issues have evaded satisfactory resolution.

The Panel's goal in this report is to clarify the issues and identify key questions, which when answered (through its own research or that of others) can move the discussion forward. The Panel hopes, through this report, to clear away some of the rhetorical underbrush so that stakeholders are able to focus on the practical challenges of fostering a rail transport system that is safe and efficient as well as competitive and financially viable. The Panel believes this report provides a framework for resolution of issues relating to competitive rail access.

To that end this report comes in two parts—the first sets out what the Panel regards as essential economic and policy background in three distinct areas:

- the economic and regulatory environment of Canada's rail industry (Chapter 2);
- the extent of competition in the rail sector, the role of the market and the current regulatory instruments (Chapter 3);
- the US regulatory environment in the context of North American rail integration (Chapter 4).

The second part reflects the Panel's understanding of stakeholder views (Chapter 5) and provides a review of the various proposals for competitive rail access that emerged from the Panel's consultations (Chapter 6). In Chapter 6, the Panel also proposes various criteria for evaluating access proposals and sets out the key issues requiring resolution. Finally, Chapter 7 lays out how the Panel intends to integrate this work on competitive rail access within the context of its broader mandate.

As will be evident in Chapter 6, the Panel believes one reason for the apparent stalemate in the competitive rail access discussion is that options for change proposed so far have left too many critical questions unexplored and unanswered. The regulatory, economic and legal implications of changes to competitive rail access need to be more completely understood than they are currently.

Based on the context and criteria set out in this report, the Panel intends to use the second half of its mandate to bring the parties closer to a common ground. The Panel believes the key to moving forward lies in encouraging proponents to question their own assumptions and think through the practicalities of their respective positions.

1.2 CONTEXT FOR COMPETITIVE RAIL ACCESS IN CANADA

The mandate given to the Panel specifically requests it to consider "…proposals for enhancing competition in the railway sector, including enhanced running rights, regional railways and other access concepts." The objective of such "competitive access" proposals is to enable rail customers served by only one railway to gain access to other railways. This would increase rail transportation choices available and stimulate competition.

Rail Access

Rail access generally refers to one railway (the guest railway) operating trains over the tracks of another railway (the host railway). This could be in the form of voluntary arrangements that result from commercial negotiation, but might also be required by legislation or by a regulatory authority. Access could be limited to "running rights" (i.e. operating trains over the host railway's tracks), or could include "traffic solicitation rights," whereby a guest railway would be allowed to solicit business and compete directly with the host carrier.

"Access" is also understood by some parties to include any provision that allows a rail customer to require a railway to deliver its traffic to a competitor at a regulated rate.

The object in both cases is to restrict the ability of an incumbent carrier to block competitors' "access" to customers located on its network.

Current legislation contains three competitive access provisions: interswitching, running rights and competitive line rates (CLRs). Interswitching,[1] and the power of regulators to impose running rights, date back to the early 1900s. CLRs,[2] on the other hand, have been part of the regulatory framework only since 1987.

1.2.1 Past Policy Consultations

The enhancement of rail competition has been studied before. It was a major concern leading up to the legislative reforms in the late 1980s, which re-enforced the notion of competition among and within transport modes. The *National Transportation Act, 1987* contained specific provisions to stimulate competition among railways: interswitching distance limits were extended and confidential contracts, final offer arbitration (FOA) and CLRs were introduced.

More recently, the idea of enhancing rail competition by liberalizing running rights provisions was raised by The Honourable Willard Estey in 1998.[3] The work of Mr. Estey, and subsequently that of Mr. Arthur Kroeger in 1999, were focused specifically on grain handling and transportation.

At the time, there was widespread agreement among grain shippers that railway competition needed to be improved as one of the conditions of moving to a more commercial contract-based system. The main line railways thought that competition was already effective, and in cases where it was not, the existing provisions of the CTA were an adequate remedy for shippers and producers. The Panel has been drawn into this policy impasse by virtue of its mandate.

As the Panel went about consulting with stakeholders, it became clear that impatience and skepticism had settled into the discussion. Positions have hardened and the debate is on occasion acrimonious in tone. There is widespread weariness with the lack of resolution and, among some, growing skepticism that it can be attained.

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[1] Interswitching is the requirement that a railway transfer rail traffic at a regulated rate between a shipper's siding and an interchange with a connecting carrier when the siding is located within a specified distance of the interchange.

[2] A competitive line rate is a regulated rate that may be imposed on a railway for transferring traffic between a shipper's siding and an interchange when the shipper's siding is located beyond the specified interswitching distance limit.

[3] The Honourable Willard Z. Estey, C.C.,Q.C., *Grain Handling and Transportation Review Final Report*, December 21, 1998.

1.3 A Broadened National Context

Much of the discussion of competitive rail access has focused on Western grain and the different sectors of the grain growing, grain handling and grain transportation industries. However, as clearly vital as grain is to Canada's international trade position, to the economy of the Prairies and to thousands of farm families, rail transport has broad implications for other sectors and for the entire country—implications the Panel cannot ignore by virtue of its mandate.

The Panel wishes to be consistent in reviewing access proposals across modes and market circumstances. Considering the entire national rail network, and all of its users, would seem to add enormous complexity to the already daunting challenge posed by competitive rail access. However, a broad approach, encompassing regional, national and international dimensions, is necessary to advance the discussion.

In the course of its consultations the Panel heard various perspectives on rail access (with similar questions raised about other modes):

- there are different interpretations of degrees of access and differing views about appropriate access charges;
- urban regions are interested in access for rail passenger service, now or in the future;
- intercity or tourist trains require access to freight track;
- there are debates about access and reciprocal access, as well as on switching operations as opposed to line haul operations;
- "access" issues arise in other modes such as airport access, airline reservation systems and situations where there is shared use of congested facilities, including roads;
- there is some expectation that enhanced rail access could arrest or reverse the diversion of grain transport from rail to truck and attendant road impact;
- provinces hold divergent positions on enhancing rail access.

1.4 The International Competitive Backdrop

Although not directly the subject of the Review, there persists in the background the recognition that Canadian transportation policy—including rail transport—cannot be considered in a vacuum. Globalization, market integration and international competitiveness are now commonplace notions in any discussion of all but the most parochial elements of national

policy. And while the Panel does not believe these trends are inexorable, it does believe they will continue.

It is the Panel's view that any responsible proposal to revise transport policy must recognize that Canada is a trading nation and the effectiveness and efficiency of its transportation system has a direct impact on its ability to compete internationally. At stake is the wealth of the country and well-being of its citizens.

One development the Panel cannot ignore is increased concentration in the North American railway industry. In the United States, enactment of the *Staggers Rail Act* in 1980 provided for substantial operational and commercial deregulation. One result has been the restructuring and consolidation of the US industry through mergers, not unlike the trend exhibited by other industries in recent decades.[4] Today, many observers believe that further market restructuring on a North American scale is likely. The Panel will be examining whether amendments to the regulatory structure will be required in Canada to deal with increased consolidation among railways.

[4] There are now four major US rail carriers: the Burlington Northern/Santa Fe (BNSF), the Union Pacific (UP), the CSX and the Norfolk Southern (NS).

CHAPTER 2: RAIL FREIGHT IN CANADA

2.1 THE ECONOMIC AND REGULATORY ENVIRONMENT

Since 1995, the financial situation of Canada's railways has improved significantly. This contrasts with the difficulties the railways faced in the first half of the 1990s. Favourable economic conditions and changes to rail public policy have both played a role in this turnaround. However, while the lot of the railway industry has improved, some shippers and producers contend that rail productivity gains have not been equitably shared among rail users.

Many in the grain farming sector are experiencing severe hardship. Producers of resource commodities have described to the Panel their problems in coping with adverse trends in world prices and increased international competition. It is this evident contrast between the economic condition of those in the agricultural and bulk resource sectors, and that of the railways, which in large part is driving current demands to bring about more competition in the rail transportation industry.

There is no question that there are major transformations taking place in the Prairie economy, which are resulting in difficult circumstances. It must be recognized, however, that these challenges cannot be addressed through the resolution of transportation issues alone.

This chapter outlines the major economic and policy factors that have influenced recent railway performance. However, important collateral issues need to be examined by the Panel. These include:

- whether the current financial situation of the rail industry is sustainable over an entire business cycle;
- whether railway profitability is adequate to attract capital and sustain capital investments;
- how pressures to consolidate North America’s major railways will impact Canadian railways;
- the extent to which the various sectors served by the railways have benefited from improved rail performance;
- the economic prospects facing the various sectors served by the railways.

2.2 PUBLIC POLICY AND GOVERNMENT REGULATION

The last three decades have seen changes in public policy that have had considerable impact on Canada's railway industry. Important initiatives came in several areas:

- substantive change to the national regulatory environment;
- the privatization of Canadian National Railways (CN);
- the termination of federal transport subsidy programs;
- North American free trade.

2.2.1 REGULATORY CHANGE

Regulatory change occured in three stages: the *National Transportation Act*, 1967 (NTA '67), the *National Transportation Act*, *1987* (NTA '87) and the *Canada Transportation Act*, 1996 (CTA). The NTA '67 increased commercial rate-making freedom. The NTA '87 also focused on issues of commerce—introducing confidential contracts that permitted enhanced rate and service competition in Canadian rail transport markets.

For its part, the CTA enacted in 1996 focused primarily on operational issues. Its most significant provisions dealt with the need to rationalize the physical infrastructure.[5] Barriers to the discontinuance of rail lines were lowered and the establishment of short line railways was encouraged. By 1999, CN and Canadian Pacific Railway (CPR) operated about 70 percent of the rail trackage in Canada,[6] and a sizeable short line industry had come into being. Since 1996, both CN and CPR have concentrated on becoming high-density main line carriers, much as their counterparts in the US had in the early 1980s.

2.2.2 PRIVATIZING CN AND TERMINATION OF SUBSIDIES

In the mid-1990s, two additional steps were taken to foster a rail transportation industry responsive not to government control and subsidy, but rather to the competitive forces of the market. In 1995, the federal government privatized CN. More or less simultaneously, federal transport subsidy programs were terminated, including those mandated under the *Atlantic Region Freight Assistance Act*, the *Maritime Freight Rates Act* and the *Western Grain Transportation Act*.

[5] CTA, s. 140-146.1
[6] Transport Canada, "Transportation in Canada, 1999 Annual Report," p. 83.

Henceforth, railways and rail freight users were to look to the marketplace, and not to government, for signals as to how to conduct their commercial relations and move their products.

2.2.3 North American Free Trade

The advent of more liberalized North American free trade was arguably the most significant Canadian economic development of the 1990s. Its impact has been far-reaching. Canadian trade with the US has grown by over 13 percent per year since 1992, and now accounts for some 85 percent of Canadian exports and 68 percent of imports.[7]

The influence of North American free trade is evident in the operations of both of Canada's major railways. Building on long-held US subsidiaries and more recent commercial acquisitions, CN and CPR are integrated on a continental scale in terms of their operations and the traffic they carry. Transborder traffic, and traffic moving within the continental US, now account for about half of the total revenues of CN and CPR. Management and operations are integrated across North America.

2.3 Operational and Financial Performance

In the "new economy", the quality of transportation service is becoming increasingly important. Recent growth in transport demand has tended to be captured by trucking because of its service flexibility. Railways, in response, appear to be focusing more and more of their efforts on high-growth, high-value markets. Nevertheless, railway volumes still primarily consist of bulk products.

While resource-based bulk products remain important in railway traffic, growth in these has tended to be flat (Figure 1). Shippers of other products (such as motor vehicles and parts, refined petroleum products and chemicals) account for a substantial portion of railway demand. These products, and the transport of containers on flat cars, have been the fastest growing segments of rail traffic.

[7] Transport Canada, " Transportation in Canada, 1999 Annual Report," p. 67.

FIGURE 1

Canadian Railway Freight Traffic by Major Commodity Group
(thousands of tonnes)

	1998	Percentage Growth 1988–1998
Grains	30,619	-8.7
Iron Ore	39,063	-1.5
Coal	39,522	-9.6
Forest Products	42,121	9.8
Fertilizer Materials	21,928	3.7
Chemical Products	21,798	31.5
Non-Ferrous Metals	10,847	3.8
Non-Metallic Minerals	10,132	-14.9
Petroleum Products	8,148	59.9
Iron & Steel	6,978	18.7
Motor Vehicles and Parts	5,575	35.2
Containers on Flat Cars	18,075	75.9
Trailers on Flat Cars	1,869	-57.1
Other	28,088	42.9

Sources: Statistics Canada, Transport Canada

2.3.1 RAIL FREIGHT RATES

Since the NTA '87, average freight rates have declined significantly. A standard measure of the average railway freight rate is freight revenue per revenue ton-mile.[8] According to CN's submission, the combined CN and CPR average revenue per ton-mile has declined 35 percent since 1987 in real inflation-adjusted terms.

Another indicator of freight rates is the set of indices developed by Transport Canada that standardize the mix of commodities and regions. These show a similar result.[9] In nominal terms, the overall index was 7 percent lower in 1998 than in 1991, although variations exist by commodity group. The rail freight price index for grains—the only regulated commodity—was 2 percent higher in 1998 than in 1991, whereas the indices for other bulk and non-bulk commodities were lower.[10]

[8] Revenue per ton-mile is not a perfect measure of average freight rates but it is widely accepted and used. It can be impacted by a change in the mix between high yielding and lower yielding traffic, as well as by changes in the average length of haul. Since the late 1980s, according to data from Transport Canada's internet database (T-Facts), the overall average length of haul has increased slightly and there has been little change in traffic mix in terms of broad commodity groups.

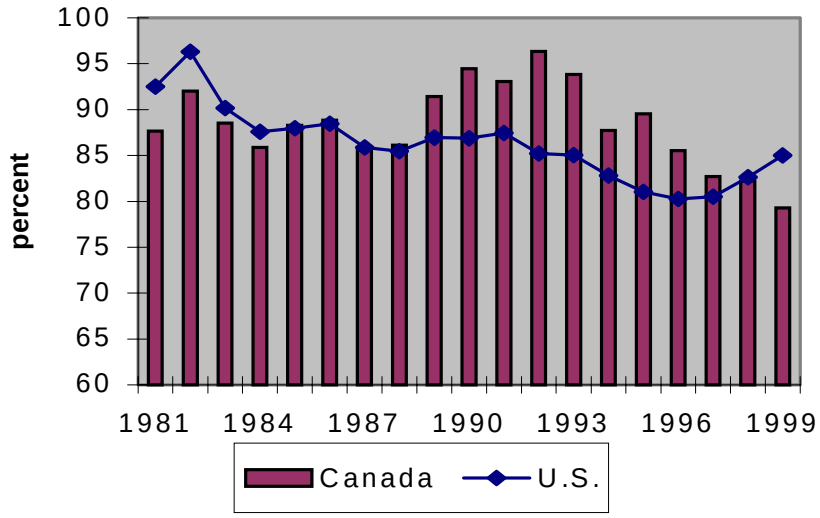
[9] Transport Canada, "Transportation in Canada, 1999 Annual Report", p. 172.

[10] Transport Canada, ibid.

2.3.2 Financial Performance and Capital Spending

The operating ratio, defined as the ratio of operating costs to operating revenues, has long been a key measure of financial performance. CN and CPR operating ratios have greatly improved over the levels recorded in the early 1990s and, since 1997, compare favourably to those of the major US railways (Chart 1).[11]

CHART 1
Canadian and U.S. Rail Operating Ratios
(excluding special charges)



Sources: Canada: railway filings with Canadian Transport Commission/National Transportation Agency/Canadian Transportation Agency and Statistics Canada.
US: Association of American Railroads and railway filings with Surface Transportation Board; as compiled by Harvey M. Romoff Consulting Inc.

In spite of their improved operating profitability, CN and CPR point out that their returns on capital remain below those earned by most other major industry groups in Canada. According to CPR's submission, its average rate of return for the period 1995–1999 was 8.6 percent. This compares, for example, with chemicals at 21.7 percent, telephone

[11] Chart 1 compares the average operating ratio (excluding special charges) of CN and CPR with that of the US Class 1 carriers. The US Surface Transportation Board (STB) defines a US Class 1 carrier as a railroad with operating revenues in 1999 of US $258.5 million or more. The Canadian ratios shown are not strictly comparable to the US ratios. The data are based on regulatory filings. They reflect differences in accounting practices for regulatory purposes and include only the Canadian operations of CN and CPR. These operating ratios will also differ from those reported on the basis of the companies' corporate accounts.

utilities at 15.9 percent, broadcast and cable at 13 percent, forest products at 12.7 percent, gas utilities at 12.2 percent, electric utilities at 9.2 percent, and metal and other mines at 9.1 percent.[12] CPR also points out that its return on capital has been and remains below the Canadian Transportation Agency's (the Agency) approved cost of capital rate.

Consistent with the railways' improved financial situation in recent years, the railway industry's capital spending has undergone an important resurgence after being depressed from the late 1980s through much of the 1990s.[13] The railways have indicated that as a percent of revenues, capital spending in the last couple of years has exceeded 20 percent.

2.4 QUESTIONS FOR CONSIDERATION

Railways are financially stronger now than in the early 1990s, but this corresponds to a very strong North American economy. Can current railway financial conditions be sustained in the event of a downturn in the economy?

Canadian railways are considered to be among the most efficient in the world, and this performance has helped Canadian industries. What is the scope for further cost reductions and efficiency improvements?

While much of the railways' productivity gains has been passed on to shippers, this may differ considerably among commodities and markets. Are there specific market sectors that have not benefited from railway productivity gains?

Railways have invested heavily and achieved significant productivity gains and service improvements. Under what conditions and to what extent can these investment trends be sustained?

[12] Globe and Mail Report on Business, Top 1000 Corporations, July 2000
[13] Statistics Canada gross fixed capital formation for railway transport and related service industries, CANSIM series D994704

CHAPTER 3: COMPETITION IN CANADA'S RAIL SECTOR

3.1 FACTORS, MEASURES AND REGULATIONS

While debate continues on whether productivity and efficiency gains have been equitably shared among carriers and users, there is little doubt about the importance of an effective rail system to the broader economy. It follows that any changes to rail regulation and legislative provisions should only be made after carefully considering the relevant evidence.

This chapter considers the factors influencing the extent of rail competition, the degree to which such competition exists, and the effectiveness of the present policy instruments in limiting rail market power.

3.2 TYPES OF COMPETITION

Railway markets are subject to varied forms of competition that fall under three broad categories:

Intermodal competition, where the shipper has an effective competitive choice in another mode such as trucking or marine.

Intramodal competition, which can be direct or indirect. Direct competition means the user has access to more than one railway at the same location or is given the functional equivalent of that access through regulatory provisions—for example, interswitching. Indirect competition is more complex and takes many different forms. The simplest example is represented by situations where a shipper can move products by truck to a reload centre of another railway. For example, a sawmill reliant on one railway may be able to truck lumber to the reload centre of another carrier.

Market or source competition refers to instances where a particular carrier's freight rates can be influenced by the amount of competition the shipper faces from producers (using other railways) elsewhere in the country, or from foreign producers. Market competition also includes "geographic" competition, wherein a shipper can, via another railway, send the same product to a different destination or get inputs from a different source. "Product" competition exists where a shipper can avoid using a rail carrier by shipping or receiving a substitute product.

3.3 THE DEGREE OF COMPETITION

In assembling available information and evidence about the extent of rail competition in Canada, a number of key points emerged:

The extent of competition is highly variable across rail transportation markets. In general, the degree of viable competition depends on the particular market being considered, the length of haul and the characteristics of the product shipped. Conclusions concerning the degree of competition are also sensitive to the data and methodology employed.

Information on indirect competition remains to be developed. The Panel's survey of shippers currently in progress should help fill this gap. A number of shippers who have discussed competition with the Panel do not consider indirect competition to be a significant factor.

As regards *market competition,* the Panel intends to examine the relationship between changes in freight rates and commodity prices received by shippers. Some shippers acknowledge their ability to partly offset reduced prices by negotiating new arrangements with railways. The Commissioner of Competition, however, asserts that where rail has a monopoly, source competition (especially for shippers with large sunk costs) is much less effective in constraining prices.

The extent of captivity remains controversial. There appears to be no commonly agreed upon definition of captivity, with data varying widely depending on the source. Some studies assume a shipper to be truly captive only where there is no effective competition of any kind or where shippers have no leverage over the railways. Such a definition was used in CN's Rail Competition Profile that suggested only 1 percent of total CN and CPR traffic is captive.

In contrast, a recent Brookings Institution study of the US rail industry[14] defines a captive shipper as one who is unable to use another mode, is served by only one railroad (with no alternative railroad within 50 miles), and has no alternative locations from which to ship using competing railroads. Using these assumptions, the researchers determined that 19.6 percent of US rail traffic involved "captive" shippers.

[14] Curtis Grimm and Clifford Winston, "Competition in the Deregulated Railroad Industry: Sources, Effects, and Policy Issues", in AEI-Brookings Joint Center for Regulatory Studies, *Deregulation of Network Industries: What's Next*, 2000.

3.4 SHIPPER–CARRIER RELATIONS AND THE PRICING MECHANISM

Over the years the relationship between shippers and the railways has often been adversarial. Judging from some representations heard by the Panel, the fractious nature of the relationship continues unabated. The Panel heard several complaints from shippers: that railways issued tariffs and raised rates without consultation, and that rail companies set conditions for the sale and transfer of portions of rail lines so as to discourage short line operators from entering the market. The Panel was told of growing resistance on the part of the main line railways to producer grain car loading, with access to rail sidings being made increasingly difficult. All these actions have been characterized as arbitrary and unreasonable.

Some disagreement between carriers and shippers is inevitable. All shippers desire the best service and lowest rates. Railways have to trade-off service quality and costs, and pay for the overhead and other fixed costs of the rail system. Financial viability requires that railways have mark-ups above identifiable costs, and it is not surprising that individual shippers want to minimize their contribution to fixed costs.

3.4.1 DIFFERENTIAL PRICING: CURRENT CONTEXT

One of the more contentious issues in the difficult user-carrier relationship is the mechanism for establishing prices. "Differential pricing" is the railways' practice of recovering their fixed costs by charging different percentage mark-ups over variable costs depending on the responsiveness of shippers' demands for rail services to changes in freight rates (elasticity of demand). The result is that some users pay more than others for a given quantity of goods shipped over a given distance.

Shippers who are especially dependent on rail—mainly bulk commodity producers—complain that differential pricing, when combined with the lack of competitive alternatives, results in their paying more than they should. The Canadian Chemical Producers' Association maintains that the railways' power to apply differential pricing is detrimental to the competitiveness of captive shippers. Some shippers state they are paying higher rates in order that others may pay less, and have suggested the existence of differential pricing is itself evidence of a lack of competition.

Bulk commodity producers also contend that the impact of such rate setting practices has been exacerbated by declining world commodity prices generally. Bulk commodity shippers are among the strongest supporters of measures to enhance competitive rail access in order to reduce freight rates.

The Commissioner of Competition[15] is of the view that while the railways may have some justification for differential pricing, it must be accompanied by some form of regulatory oversight that will prevent railways from charging excessive rates to captive shippers. Furthermore, according to the Commissioner, any concern for the viability of Canadian railways in the face of more effective competitive access provisions is mitigated by the current state of rail profitability and the fact that railways are able to discontinue service on unprofitable lines.

The railways, for their part, maintain that differential pricing is both a necessary element in recovering their total costs and a practice whose impact on shippers is misunderstood. They provide examples of situations where differential pricing not only ensures rail service to shippers of the more competitive traffic, but provides shippers of the less competitive traffic with rail service at the lowest rates compatible with network sustainability. Furthermore, they maintain that in the absence of differential pricing the rail network would not be economically sustainable. The railways believe that their position is supported by economic theory, and furthermore state that the practice is commonplace in other industries.

3.4.2 Differential Pricing: Criteria for Resolution

Differential pricing was a feature of regulated rail rates and has been permitted in a more liberalized form since the NTA '67. None of the alternatives to differential pricing will satisfy all parties. Available alternatives involve either the subsidization of the railway industry to ensure sufficient capital resources or some form of pro-rata allocation of fixed costs to users. In either case, differential pricing would have to be replaced by a regime of regulated rate making and cost determination.

Clearly, differential pricing also gives rise to issues of equity and fairness. The Panel rejects the argument made by some shippers that the existence of differential pricing is itself evidence of a lack of competition. Since differential pricing does exist in competitive industries, it is not in itself an

[15] Submission to the *Canada Transportation Act* Review Panel Regarding Rail Access and Related Issues, the Commissioner of Competition, October 6, 2000, p.6

indicator of monopoly power, although differential market power will affect the degree of differential pricing.

In the Panel's view, the essential issue to address is not the existence of differential pricing; rather, it is whether or not the existing legislation contains provisions adequate to prevent abuse in cases of market dominance. Ideally, such provisions would have two distinct elements: (1) to create sufficient safeguards for rail-dependent shippers; (2) to provide incentives to the railways to be as efficient and innovative as possible in those markets, and to pass on an appropriate portion of the efficiency gains to shippers.

3.4.3 Reconciling Competitive Rail Access with Differential Pricing

In examining various competitive rail access proposals, the Panel will have to address whether and how these approaches can be reconciled with differential pricing.

Two problems are apparent: first, in a situation where competitive access provides a guest railway with access to a host railway's infrastructure and customers, the host railway becomes susceptible to "cherry-picking" of its high margin traffic, potentially causing the host railway financial harm. The Panel will assess the potential severity of this problem, and examine whether such harm can or should be mitigated through regulatory provisions such as access fees paid by the guest railway and/or the rights and obligations of the respective railways under such enhanced access.

Second is the matter of inconsistency of pricing. Some of the competitive access proposals currently before the Panel are based on the regulation of freight rates rather than access fees. To the extent that these or similar access proposals would impose uniform average rates, particularly over substantial distances, such proposals would be inconsistent with differential pricing. Further, with each new application for regulatory relief, this type of approach would lead to recurrent reductions in the average revenue, thereby threatening the sustainability of the network.

3.5 Legislative Constraints to Market Power

The CTA provides a number of competitive access and shipper protection provisions that are intended to constrain the ability of a railway to exercise market power over shippers. There are strong and divergent positions on the effectiveness of these various provisions. A brief description of each, and an overview of what the Panel has been told about their effectiveness or shortcomings, follows.

3.5.1 INTERSWITCHING[16]

A shipper with access to only one railway at the origin or destination of a haul may choose to have the shipment transferred to another carrier—"interswitched"—at prescribed rates, if the origin or destination is within a 30-kilometre radius of an interchange point. Under certain circumstances, the CTA permits interswitching at distances greater than 30 kilometres.

Shippers have stated that interswitching is generally an effective provision for promoting competition and fostering efficiency. The Canadian Shippers' Summit (Shippers' Summit)[17] qualified its comments by noting that the definition of "interchange" and "interswitching" rests on who owns the track, not on who operates over it. The result, shippers believe, is that some users' traffic is unnecessarily prevented from taking advantage of the interswitching provision. For their part, the main line railways hold the view that current interswitching rates make an inadequate contribution to fixed costs.

3.5.2 RUNNING RIGHTS[18]

This provision permits any federally regulated railway (including US-based railroads with a certificate of fitness to operate in Canada, viz., BNSF, CSX, UP, and Norfolk and Western) to apply to the Agency for running rights over the lines of any federal railway in Canada, where a commercial agreement cannot be negotiated.

The National Transportation Agency (predecessor to the Agency) received three requests for running rights in the years 1988–1996: two were rejected on jurisdictional grounds, while the third was withdrawn before the National Transportation Agency made a determination. No requests have been filed since the enactment of the CTA in 1996. The result is that there have been no recent rulings on the substance of the provision.

A broad spectrum of rail users, including the Western Canadian Shippers' Coalition, Council of Forest Industries and Canadian Pulp and Paper Association, told the Panel that restricting the availability of running rights to

[16] CTA, s. 127-128

[17] The Canadian Shippers' Summit is a coalition of nine national and regional industry associations. It is comprised of the following: Canadian Industrial Transportation Association, Canadian Fertilizer Institute, Canadian Chemical Producers' Association, Canadian Pulp and Paper Association, Western Canadian Shippers' Coalition, Mining Association of Canada, Council of Forest Industries, Canadian Manufacturers & Exporters and Western Grain Elevator Association.

[18] CTA, s. 138

only federally regulated railways limits the utility of the provision in promoting competition. On the other hand, nearly all of the railways hold the view that a broadened running rights provision would threaten the long-term viability of the rail infrastructure and reduce efficiency. Several provinces opposed altering the existing running rights provision. Other provinces were in favour of expanded running rights.

The issue of running rights raises complex questions about access conditions and charges that are discussed in Chapter 6.

3.5.3 COMPETITIVE LINE RATES[19]

A shipper located outside the 30-kilometre interswitching limit may ask the Agency to establish a Competitive Line Rate (CLR) for moving goods over the originating railway to an interchange point for transfer to a connecting railway. A precondition is that the shipper must first reach an agreement with the connecting carrier for the balance of the movement. The Agency bases the CLR on a combination of the applicable interswitching rates and the revenue the railway generates in moving the same or substantially similar commodities over similar distances. A CLR lasts only one year unless the shipper and carrier agree otherwise.

CLRs were first introduced in the NTA '87 and subsequently amended in the CTA. In the period 1988–1992, the National Transportation Agency established five CLRs; four in consecutive years for the same shipper, and all five to permit access to US main line railways. Since the CTA came into force in 1996, the Agency has received no requests for CLRs.

On this issue as well, shippers and carriers have sharply divergent views. Shippers maintain that the requirements within the CLR provision constitute an effective barrier to the kind of relief they believe the provision was intended to give them. The Canadian Fertilizer Institute (CFI) submits that because subsections 27(2) and 27(3) ("substantial commercial harm") require a subjective determination on the part of the Agency, the contested proceedings that would result act as a significant deterrent to any prospective applicant. Similarly, the CFI and other shippers submit that Section 112 of the CTA ("commercially fair and reasonable rates") constitutes an unnecessary barrier to Agency relief.

[19] CTA, s. 129-136

In its brief to the Panel, Luscar Ltd. (a coal producer) commented on the CTA provision that requires a shipper applying for a CLR to have an agreement with the connecting carrier to move the traffic:

> Competitive Line Rates (CLRs) have worked only a few times involving American carriers from the connecting point, and it is most unlikely that they would participate today. The two national railways have declined to compete with CLRs because it is not in their economic self interest to do so.[20]

For their part, the main line railways suggest that CLRs are used principally as a negotiating lever, rather than as a means to correct justifiable rate concerns. Moreover, they contend that setting CLRs using methodologies such as the average revenue per ton-mile earned by the railway for the same commodity is fundamentally flawed, and that differential pricing, not rate averages, is the only valid means to arrive at prices that cover total rail network costs. CN has specifically requested elimination of the CLR provisions.

3.5.4 Level of Service Obligations[21]

Section 113 of the CTA requires that railway companies provide "adequate and suitable accommodation" for the carriage of traffic. A shipper believing that a rail carrier has not met this obligation with respect to service may file a complaint with the Agency. Upon review, the Agency can order the railway to fulfill those obligations in a manner, and within a time period, the Agency deems proper. Since 1996, the Agency has received 18 level of service complaints.

The Shippers' Summit submits that level of service obligations are the foundation on which competitive access provisions are built. Shippers contend that lower rate levels resulting from applying competitive access provisions are of little value without assurance that adequate service will be provided. Also, delays resulting from the Agency's inability to issue interim *ex parte* orders on level of service disputes is seen by some shippers as undermining the effectiveness of the provision.

[20] Luscar Ltd., Brief to the CTA Review Panel on Competitive Rail Access Provisions of the *Canada Transportation Act* 1996, October 2000, p.5.
[21] CTA, s. 113-116

3.5.5 THE RIGHT TO A RATE[22]

A shipper who wants to move traffic, either over a single line route or a joint route operated by two or more railway companies, can ask the railway company or companies to issue a rate for moving the traffic. If the railway company refuses (in effect declining the business), the Agency can order the railway company to publish a rate. If the rate is for a joint route, the Agency can also apportion the rate amongst the railways.

Since 1988, the Agency has received only one such request. The Agency ordered the railway to set a rate between an origin and destination determined by the shipper.

Parties have not commented on the effectiveness of the right to a rate provision to the Panel.

3.5.6 FINAL OFFER ARBITRATION[23]

Final Offer Arbitration (FOA) is available to shippers as a means of resolving disputes with carriers over rates or conditions of service. The FOA process permits an independent arbitrator to review the final offers made by the shipper and the carrier, and to decide in favour of one or the other. The parties to an FOA can, and often do, keep the details of the arbitration confidential.

Twenty-two FOAs have been initiated since 1988 when the provisions first came into force—the majority of which have been initiated since the CTA was enacted in 1996. The Panel was advised that more than half the matters submitted for arbitration have been settled by the parties before the conclusion of the arbitration hearing, suggesting that the availability of FOA is very likely an incentive to reaching a negotiated settlement.

Although FOA is recognized by some shippers as an effective dispute resolution mechanism, there are critics. In the past, shippers have cited the large expense involved and procedural delays which they attribute to the conduct of the railways in these matters. The provisions were recently amended as part of the government's effort to reform the grain handling and transportation system. Despite the lack of any reported experience with the revised procedures, shippers have expressed optimism that the revised process will address their concerns.

[22] CTA, s. 118 and s. 121-125
[23] CTA, s. 159-169

CN and CPR do not share the shippers' optimism. CN states that shippers using FOA assume virtually no risk. They suggest that a shipper may negotiate to receive the best combination of service, car supply and rates from the railway, then use FOA to try to move the rate even lower. As a result of their dissatisfaction with FOA, CN and CPR recommend it be replaced with a commercial arbitration process.

3.5.7 CONFIDENTIAL CONTRACTS[24]

Since 1988, shippers and railways who agree on rates and service conditions have been permitted to do so in a confidential contract. By far, the majority of railway traffic in Canada now moves under confidential contracts. Where a confidential contract exists, the shipper is precluded from FOA unless all parties to the contract agree. The terms of the confidential contract are binding on the Agency in the event of a level of service complaint.

The fact that confidential contracts are so widely used would seem to be evidence of their success. However, some shippers have complained that the popularity of confidential contracts makes it difficult for them to compare their rates and determine whether they are getting the best rate.

3.5.8 REVENUE CAP FOR WESTERN GRAIN[25]

As part of the package to reform the Western grain handling and transportation system (GHTS) that came into effect on August 1, 2000, railway revenues for moving Western grain are subject to a cap. Under the revenue cap, the total revenue for moving grain in any crop year (August 1 to July 31) cannot exceed a set amount. With the 2000–2001 crop year being the first applicable crop year, there is very little experience on which to draw firm conclusions. Nevertheless, the Panel heard a number of concerns about the reforms.

The Canadian Oilseed Processors Association (COPA) indicated that the amendments to the CTA allow carriers to set prices differentially (albeit within the revenue cap). COPA is concerned that the railways may look upon oilseed and oilseed products as different commodities and establish higher freight rates for the products than for the seeds, thus putting the oilseed processing industry at financial risk.

[24] CTA, s. 126
[25] CTA, s. 147-152

In its brief, the Western Grain Elevator Association, suggests that grain shippers believe railways are trying to recover the reduced revenues under the revenue cap by unilaterally imposing excessive penalties; demurrage[26] charges are cited.

Shippers also expressed concern that freight rates are not required to be adjusted downwards to reflect rail industry productivity gains, while the revenue cap can be adjusted upward for inflation. For their part, the railways have said that the significant reduction in the revenue cap on allowable earnings from grain was unwarranted.

Extensive changes are taking place in the Prairie economy. Mr. Estey recommended a move to a commercial, rather than regulated, GHTS. The recent legislative reform constitutes a step towards a commercial system. The Panel's view is that these steps have not gone far enough. The flexibility and reliance on incentives that characterize commercial systems are vitally needed to improve the GHTS. Indeed, their importance is even more urgent given the economic hardship facing grain producers. Consequently, the Panel intends that future consideration of rail access mechanisms or other interventions will take into account, among other things, the extent to which they promote a more commercial and efficient GHTS.

3.6 BARRIERS TO SHIPPERS' LEGAL RECOURSE

Shippers claim that certain provisions of the CTA restrict their ability to make use of the legislative constraints to market power found in the CTA:

Subsections 27(2) and 27(3) "Substantial Commercial Harm"

Shippers (including Agricore, the Shippers' Summit and COPA) as well as the Commissioner of Competition submit that these subsections should be repealed. Some say these provisions constitute a barrier or a burden, while the Shippers' Summit states that the test of substantial commercial harm is a subjective determination and thus open to legal contest and delay.

By contrast, CPR argued for retention of these subsections on the grounds that they provide for a test of whether the complainant shipper has a genuine need for the remedy being sought. In CPR's view, subsections 27(2) and 27(3) were introduced to preclude shippers from securing regulated remedies in situations where competition was already present.

[26] Charges assessed when a shipper does not unload a car promptly.

Section 112 “Commercially fair and reasonable rates”

This provision was also introduced with the CTA in 1996. Shippers regard the requirement that the Agency set rates according to the test that they are commercially fair and reasonable as an unacceptable barrier to relief from the Agency, and they believe this section should be repealed. COPA maintains that this regulatory test (and that for “substantial commercial harm”) cannot be justified in the absence of a demonstrated requirement for its enactment, and that its only effect is to substantially reduce a shipper’s bargaining leverage.

CHAPTER 4: THE NORTH AMERICAN CONTEXT

4.1 THE HARMONIZATION QUESTION

Canadian and US railways and their customers compete today in an increasingly integrated marketplace. This raises the question of whether, and to what degree, Canadian regulatory policies need to be harmonized with those of the United States.

Some have suggested that Canadian shippers need increased competitive access in order to offset the inevitable lessening of competition that would result from the corporate consolidation of North American railways should current trends continue. Another school of thought, advanced by the main line railways and others, contends that it is the current lack of harmonization with the US in rail regulation (and in areas such as corporate taxation) that puts Canadian railways and shippers at a competitive disadvantage.

As a first step to arriving at substantive recommendations in this area, the Panel sought out the most current understanding of the differences between regulatory approaches in Canada and the US. This section provides a brief overview of current US rail regulation as it relates to issues examined in this report.

4.2 US RAIL REGULATION AND POLICY

The legislative basis for existing rail regulatory policy in the US rests on three separate statutes: the *Railroad Revitalization and Regulatory Reform Act of 1976,* the *Staggers Rail Act of 1980* and the *Interstate Commerce Commission Termination Act of 1995*.

The primary intent of the first two statutes was to restore the railway industry to financial stability and viability in the wake of rail's early 1970s financial crisis. The third statute streamlined regulation and created the Surface Transportation Board (STB)—the federal agency charged with the economic regulation of railways and the application of federal rail policy.

4.2.1 US POLICY ON COMPETITION AND RATES: AN OVERVIEW

With respect to competition and rate setting, US rail transportation policy states it is essential "...to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to

attract capital."[27] In order to handle issues involving captive shippers and lack of competition, existing legislation gives the STB a number of regulatory instruments:

- maximum rate regulation through the application of a rate reasonableness test;
- provisions to compel competitive access;
- the mandate to review railway mergers and impose conditions on the transaction.

4.2.2 Maximum Rate Regulation and Test for Reasonableness

Maximum rate regulation applies only in limited situations; however, it is available and the use made of it is instructive. By statute every rail shipping rate must be "reasonable". If the matter is brought before it, the STB must first decide whether the railway in question has market dominance in the area and with the shipper at issue, and if so, whether the rate charged by the railway is reasonable.

Market dominance is defined as "an absence of effective competition from other rail carriers or modes of transportation to which a rate applies"[28] and has two thresholds: (1) the rate must be demonstrated to be at least 180 percent of variable cost, and (2) the shipper must demonstrate an absence of effective competition.[29]

A rate's reasonableness is determined by the "stand-alone cost test" (SAC). Costs are developed on the basis of a hypothetical model of an "efficient railway" carrying the shipper's traffic, along with the other existing traffic that contributes to fixed costs. The process is complex and time-consuming, but is intended to simulate what would be expected if competition did exist and a new railway was allowed to enter the market.

Recognizing that the expense of mounting a rate reasonableness complaint using such procedures puts it beyond the financial reach of small shippers, the STB in 1996 set out a simplified methodology for use in complaints from these shippers. In such cases, an analysis would determine whether the

[27] 49 United States Code, s. 10101
[28] 49 USC, s. 10707
[29] Two types of competition are considered: intermodal and intramodal. In 1998, the STB concluded that although it believed product and geographic competition to effectively limit pricing in certain circumstances, consideration of this type of competition in market dominance cases significantly impeded the efficient processing of complaints. As a result, the STB determined that it would no longer consider evidence of such competition in making market dominance determinations.

shipper is bearing a disproportionate share of the carrier's revenue requirements.[30]

In 1996, in the wake of complaints by several US shippers to have maximum rate provisions applied to a portion of the routing from origin to destination, the STB upheld a long-standing principle of US rail policy that reasonableness of a rate must be based on examining the entire end-to-end through rate. This ruling points to another significant difference between Canadian and US rail policy: Canadian shippers may control the routing of their traffic (essential for the Canadian competitive access instruments of interswitching and CLRs), while in the US it is the railroads that control the routing of traffic in most situations.

4.2.3 US Regulatory Instruments to Compel Competitive Access

US legislation sets out three kinds of competitive access provisions:

- reciprocal switching, by which railways can be required to switch cars to nearby competing railways in terminal areas at a reasonable charge;
- alternative through routing, by which a railway can be required to interline traffic with another railway;
- terminal trackage rights, by which a railway must permit physical access over its lines to the trains and crews of a competing carrier for a fee.

These provisions bear a superficial resemblance to those contained in the CTA: more specifically, interswitching, CLRs and running rights. In fact, the provisions are available in very limited circumstances where the STB has determined that the public interest requires the remedy, and where it has been demonstrated to the satisfaction of the STB that the railway in question has acted in an anti-competitive manner.

4.3 Review and Regulation of Mergers

The STB is the sole federal agency in the US that reviews proposed rail mergers. It is often in the context of these reviews that it must address issues of competitive access. In determining whether a merger would be in the public interest, the STB must consider, among other things, "…whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national system."[31]

[30] There is no established threshold to determine under what circumstances the STB will use the full SAC test or the simplified process. That determination is made on a case-by-case basis. Critics note that a shipper initiating a rate reasonableness complaint must prepare for both processes.

[31] 49 USC, s.11324

In granting approval for a merger, the STB can impose conditions on the transaction including requirements for the granting of trackage rights and access to other facilities. To alleviate anti-competitive effects of the transaction, the STB can impose operating terms and amounts of compensation.[32]

Until recently, the STB's general policy with mergers "was predicated on the notion that there was a pressing need for the nation's rail carriers to reorganize their operations on a more economically efficient and sustainable basis."[33] To this end, the STB approved four restructurings in the period 1995–1999: Burlington Northern/Santa Fe (BNSF), Union Pacific/Southern Pacific, the Conrail split between NS and CSX and CN-Illinois Central.[34] As a result only four large US carriers remained.

Some of these mergers were accompanied by severe service disruptions, leading to growing concerns about the increasing concentration developing in the industry. When the CN-BNSF merger proposal was announced in December 1999, there were concerns that STB approval would cause yet another round of merger proposals, ultimately reducing the number of national carriers to two.

The result was an STB hearing held to examine whether its existing merger policies and procedures were adequate. The STB determined that they were not and embarked on a 15-month rule-making process to develop new policy and regulation. A moratorium on receipt of new merger applications for that period was announced.

In October 2000, the STB published proposed new rules for public consideration. If adopted, merger proponents would face a substantially increased burden to demonstrate that the transaction would enhance competition sufficient to offset the merger's negative impacts. In addition, applicants would be expected to propose remedies to mitigate any harms to competition. Final regulations are expected to be adopted in June 2001.

[32] In 1998, the STB made its approval of the purchase of Conrail assets by CSX and Norfolk Southern conditional on the negotiation of haulage or trackage rights between CSX and CPR to allow the latter to serve New York City. It did so to restore competition which was lost in the financial crisis that led to the formation of Conrail in the 1970s. When CSX and CPR could not reach an agreement, the STB imposed one on the two carriers.

[33] US Surface Transportation Board, Major Rail Consolidation Procedures, October 3, 2000.

[34] By a decision of November 29, 2000, the STB found that there "… have been no competitive problems in its first annual round of general oversight …" in the CN-IC merger. It also found that "… safety and employee relations have not been compromised."

4.4 OTHER JURISDICTIONS AND INDUSTRIES

In the ongoing discussion of competitive rail access, reference is often made to rail industries outside North America, and to network industries other than rail (the telecommunications and natural gas sectors are often cited).

The Panel believes it is important to examine these experiences in other jurisdictions and industries, and to weigh their relevance to the issues at hand and to the Canadian situation. Initial considerations are presented in the accompanying annex.

CHAPTER 5: STAKEHOLDER CONSULTATIONS—WHAT THE PANEL HEARD

In the course of its work the Panel has received input from a number of interested parties including shippers, grain producers and producer groups, provincial governments, passenger and urban rail authorities, chambers of commerce, community representatives, rail carriers (both main line and short line) and organized labour. The interventions took the form of briefs and papers as well as meetings.

This section summarizes the representations made by various interested parties about competitive rail access.

5.1 SHIPPERS' VIEWS

The Shippers' Summit made a submission on behalf of its members, which it claims account for the vast majority of CN and CPR rail freight revenues. The Shippers' Summit represents a broad segment of shippers, including bulk resource shippers (coal and fertilizer, for example), agricultural interests such as the Canadian Wheat Board and the Western Grain Elevator Association, and associations representing shippers of processed and manufactured goods such as the Canadian Industrial Transportation Association, the Canadian Pulp and Paper Association and the Canadian Manufacturers and Exporters Association.

For this chapter the Panel has chosen to summarize the views put forward by the Shippers' Summit as generally representative of the position of rail shippers which have provided input to the Review. As well, since a number of issues have been forcefully put before the Panel by Western agricultural and community interests—including farmers, grain companies and organizations such as the Saskatchewan Association of Rural Municipalities (SARM), the Western Rail Coalition and the Farmer Rail Car Coalition, among others—this chapter includes a discussion of issues specific to Western grain.

5.1.1 COMPETITION AND COMPETITIVE ACCESS

Many rail shippers regard themselves as captive to rail transport, for nearly all movements, simply by virtue of the nature of what they produce (i.e. its bulk) and the distances required for shipment. They maintain that this lack of modal choice results in inappropriately high freight rates. These shippers submit that they must have access to more than one railway company to obtain the benefits of competition.

Shippers note that even though competition is the clearly-stated objective of the current CTA, the competitive access provisions contained in the CTA are ineffective for many shippers and do not provide for a competitive rail system in Canada. They believe changes to the competitive access provisions are essential to give meaningful effect to the purpose of the CTA.

To that end, the Shippers' Summit presented a package of reforms, based on two fundamental principles:

- the competitive access provisions are an integrated package, allowing a shipper the flexibility to utilize the competitive provision that is best suited to its unique circumstances;
- the existing level of service provisions of the CTA must remain in place and be effective.

The package of reforms put forward by the Shippers' Summit includes:

- running rights for "any person" with reverse onus (discussed in Chapter 6);
- Competitive Access Rate to replace existing CLRs (discussed in Chapter 6);
- redefined interchange and interswitch to make interswitching available at more locations;
- repeal of CTA subsections 27(2) and 27(3), and section 112, which are seen as barriers to the use of competitive access provisions;
- revised process for sale and discontinuance of railway lines;
- restored Agency authority to deal with public interest appeals, so that it can address complaints of carrier conduct which prejudicially affects more than one shipper;
- restored Agency authority to determine whether rail acquisitions or mergers are in the public interest, and to block them if they are not;
- restored Agency authority to issue interim *ex parte* orders, thereby allowing it to act expeditiously in level of service complaints where a shipper is receiving inadequate service.

The Shippers' Summit also suggests that the recently amended FOA provisions should be given time to work.

A number of shippers presented specific suggestions for legislative changes that differ from those of the Shippers' Summit. Agricore Cooperative Ltd., for example, suggested that interswitching be made more broadly available by expanding the existing interswitching limit. NOVA Chemicals suggested

that it be able to use running rights to a competitive interchange within the interswitching zone.

5.1.2 GRAIN ISSUES

Many export grain producers have told the Panel that they regard themselves as captive to the railways, and that this results in having to pay higher shipping rates than they would in a more competitive environment. They see themselves as trapped in a cost-price squeeze: the railways seem to be able to adjust rates, whereas the prices which producers receive for their products are determined in global markets beyond their control.

Farmers see the rationalization of the grain elevator infrastructure and branch line closures as exacerbating this cost-price squeeze. Farmers are faced with increased trucking distances from farm to railway. They maintain that this is increasing direct transportation costs and having negative impacts on the road infrastructure, a significant matter for the authorities responsible.[35]

Many Western agricultural and community interests expressed a preference for market forces in the grain handling and transportation system. However, there is a strong belief that the market does not result in a competitive environment and, therefore, regulation is necessary.

Individual producers and producer coalitions expressed concerns with respect to the effectiveness and use of the branch line transfer and discontinuance procedures of the CTA. In addition, agricultural and community interests submitted that the preservation of rural branch lines, including rail sidings required for producer car loadings, was essential to genuine competition in the rail transport sector. A related concern was that in the process of disposing of excess rail lines, main line railways were engaging in practices such as de-marketing or segmentation so as to render the lines economically unattractive to potential purchasers and possible future competitors.

[35] Local elevators on branch lines close to farms are being eliminated by the grain companies, replaced by fewer “high throughput elevators” (HTEs) serving larger areas. Farmers maintain that the increased trucking distances result in higher costs, although in some cases this is moderated by incentives offered by operators of HTEs to attract customers.

5.2 RAILWAYS' VIEWS

5.2.1 SHORT LINE AND REGIONAL RAILWAYS

The Railway Association of Canada, representing nearly all the railway companies in Canada, presented a brief essentially on behalf of the smaller railway company members. While the submission echoed many of the points raised by CN and CPR, it also pointed out that its short line members "…are all deeply concerned over the potential impact of forced access on their trackage."[36] In a separate submission, BC Rail was not in favour of "…access to shippers located on other railways, or open access to new 'any person' entrants…"[37] but was in support of regional railways having limited direct access to competitive connections.

The short line operator, OmniTRAX, proposed to the Panel the notion of "managed access" to branch lines in order to raise the level of competition and to preserve the lines (discussed further in Chapter 6).

5.2.2 CANADIAN NATIONAL AND CANADIAN PACIFIC RAILWAYS

The perspectives of the main line railways on competition and competitive access were significantly at odds with those of most shippers and shipper groups.

The main line carriers argued before the Panel that the regulatory reforms enacted through the CTA in 1996 had been of benefit to both the railway industry and its users. Thus, they were skeptical about proposals to introduce additional regulation into the system. In their interventions the main line railways urged the Panel to pursue a number of initiatives:

- further deregulate the transportation system;
- refrain from tampering with the practice of differential pricing;
- increase the harmonization of the Canadian and US regulatory regime;
- implement commercial arbitration.

5.2.3 CPR'S VIEW OF COMPETITION AND COMPETITIVE ACCESS

CPR argued that main line railways already face a significant degree of competition, citing the fact that its average revenue per ton-mile has declined by 35 percent in real terms since the mid-1980s.

[36] Railway Association of Canada submission to the CTA Review Panel, November 17, 2000, p.4.
[37] B.C. Railway Company submission to the CTA Review Panel on Competitive Rail Access, October 6, 2000, p.6.

With respect to enhanced access, CPR sees such proposals as being potentially harmful to the rail industry as a whole and contends that creating lower rates is not synonymous with economic efficiency.

CPR submits that the current CLR provision, although employing a method of calculating CLRs it believes to be flawed, at least requires the shipper to demonstrate a genuine need for the remedy being sought. In CPR's opinion, the Competitive Access Rate (CAR) proposal (see Chapter 6) would give shippers an automatic right to a CAR without providing any demonstrable need. Based on its experience, CPR submits that the CAR, like CLRs, would be used principally as a negotiating tool, rather than to correct any valid and justifiable rate concerns.

CPR does not support the regional railway proposal put forward by OmniTRAX since it would place the main line railways at a commercial disadvantage. Such type of access would, in CPR's view, lead to conflicts between the major railways and the smaller operators in turn requiring additional regulatory intervention.

Finally, CPR submits that the FOA process is not working properly and that it favours shippers. Accordingly, it suggested a two-tier commercial arbitration process to replace the existing FOA provisions within the CTA. The modified system would be simplified for disputes under $750,000. This process would be managed by professional arbitrators and promote commercial relationships between shippers and carriers, while retaining differential pricing and the railway's ability to maintain and invest in rail infrastructure.

5.2.4 CN'S VIEW OF COMPETITION AND COMPETITIVE ACCESS

CN urged caution with respect to proposals for increased access and stated that, if implemented, such access could result in major structural change to Canada's rail transportation system. The railway considers that the CAR proposal would undermine the railway's ability to recover fixed costs through differential pricing.

From CN's perspective, shipper protection cannot co-exist with increased rail access and proposals to increase rail access must adhere to certain core principles:

- market-based access fees are to be subject to commercial negotiation not regulation;
- efficient competition is to be enhanced;

- access must be reciprocal;
- commercial arbitration is to be used to resolve disputes about access fees and rates;
- the Canadian rail system must be competitive in North America;
- NAFTA rules must be respected;
- vertical integration must be retained.

CN had numerous objections to the OmniTRAX regional railway proposal, including that the proposed access was not reciprocal and fees were not defined. Furthermore, both generally accepted commercial principles and long-term agreements would be violated. CN views the OmniTRAX proposal as "…a regional rail monopoly with the power to 'expropriate' those parts of the CN and CP franchises that would increase OmniTRAX revenues without regard to the effects … on the overall financial health of the two mainline carriers."[38]

5.3 VIEWS OF RAIL UNIONS

Three railway unions expressed concern about the possible effects of greater open access to CN and CPR's lines. Areas of concern included the potential for reduced productivity and economic efficiency and for reduced railway labour standards, working conditions and pay.

5.4 PROVINCIAL GOVERNMENT VIEWS OF COMPETITIVE ACCESS

To date, the Panel has received briefs from, and met with, several provincial and territorial governments. While there was consensus on the need to maintain and encourage an efficient and competitive railway system in Canada, policy positions on competitive rail access varied considerably. They ranged from no change at all to the adoption of open rail access through various intermediary and transitional approaches.

5.5 PASSENGER RAIL OPERATORS' VIEWS

Rail access issues also arise for passenger rail services in both an urban and intercity context. The issue is whether increasing road congestion can be eased by reliance on rail access. The concern to be addressed is how to assure reasonable access to rail corridors so that they can be used to move commuters and intercity passengers.

[38] CN submission to CTA Review Panel, November, 2000, p. 32.

5.5.1 URBAN RAIL

A number of intervenors support federal government investment in transportation infrastructure required for local needs. Commuter authorities called for a clear legislative framework obliging railways to provide or permit commuter rail operations. The issue of having to pay the price dictated by the sole supplier of railway capacity was raised. There was also a request for a one-time review of existing commuter rail agreements to ensure their consistency with a new access framework, if one were to be put in place. Furthermore, there was a desire to put into place a mechanism to obtain a fair price where a railway decides to dispose of an urban rail corridor.

CN believes the CTA protects rail corridors by prohibiting railways from abandoning track without first giving government the opportunity to purchase the line. However, they do have concerns about the process being susceptible to political and public pressure, and about the means used to determine the value of transportation corridors in high-density urban areas. CN argues that it is entitled to compensation, based at a minimum on the value of adjacent property, as well as a premium to recognize the value of the land as a corridor. CN points out that existing commuter rail agreements were reached on a commercial basis and took into account market values for both property and assets.

5.5.2 INTERCITY PASSENGER RAIL

Access is also an issue for intercity rail services provided by VIA Rail. VIA typically relies on access to the tracks of CN and CPR as well as a number of short lines. For VIA, access to the right of way is essential in order to maintain the integrity of the national passenger rail network. VIA is also concerned about the uncertainty that arises when the host railway sells or disposes of infrastructure, including the sale of federally regulated railway lines to provincially regulated short line operators.

CN maintains that in circumstances where a line over which passenger rail services are provided is discontinued, the cost of ownership and maintenance should be borne by either the federal government or the crown corporation charged with the provision of passenger services.

CHAPTER 6: PROPOSALS FOR ENHANCING COMPETITIVE ACCESS

6.1 AN INTERIM REVIEW

This chapter reports on the proposals to address the perceived ineffectiveness of the access provisions of the CTA and provide for a more competitive rail system. The chapter also identifies the key issues arising from these proposals and sets out the criteria with which the Panel will evaluate proposed reforms.

It is clear that some of the proposals are more complete than others. However, most leave important questions unanswered and all require additional study.

6.2 THE PROPOSALS

Rail access proposals currently before the Panel fall into two groups. The first normally involves one railway gaining physical access to the lines of another for a fee. The second is less intrusive, with none of its variants involving one carrier operating over the lines of another. Within the second group the proposals include: (1) the replacement of the existing Competitive Line Rate (CLR) provision with a newly formulated Competitive Access Rate (CAR); and (2) a broadening of existing interswitching provisions.

6.2.1 VERTICAL SEPARATION

The separation of train operations from the ownership and management of track—"vertical separation"—is a model adopted in various forms in a number of countries, notably parts of Australia, Sweden and the UK. The concept usually involves a single company operating the track and selling track access to competing carriers (whether competing as train operators or competing for contracts to provide monopoly services). The structure arose in jurisdictions where the policy objective was to introduce elements of competition in railway systems previously owned and operated by government as monopolies.

Vertical separation could involve government ownership and operation of the track, as remains the case in Sweden, though in Canada such an approach would necessitate nationalization of the rail networks. Alternatively, the structure could involve creating a private-sector track corporation—such as Railtrack Group PLC in the UK—which in Canada

would require some form of compulsory divestiture by the railways. Other forms of partial or complete separation can be envisaged, either at government direction or, conceivably, as commercial strategies of the railways.

In seeking advice on the experience with various forms of vertical separation abroad, the Panel learned that its impact cannot yet be determined with any clarity. Moreover, any form of government purchase or compulsory change in the ownership of Canadian private railway assets would be a major reversal of transportation policy in Canada, not to mention problematic in an integrated North American rail industry. In the Panel's opinion, such a step is not worth considering unless the evidence of its benefits were incontrovertible. Therefore, the Panel has decided that it will not consider further any government-imposed form of vertical separation in the rail industry. This in no way precludes the railways themselves from finding a commercial solution if considered appropriate.

6.2.2 Expanded Running Rights Eligibility

This proposal and its variants have been among the most often mentioned for the enhancement of competitive rail access. The particular variant offered depended on the specific situation of the proponent. Nova Chemicals, for example, suggested that running rights be made available to shippers to allow them to perform their own interswitching within the current distance limits.

Other users suggested that running rights be made available to the next interchange point (no limit) with a second carrier. The Shippers' Summit, for its part, proposed that access to the lines of a federally regulated railway be made available to "any person" with the approval of the Agency. Under such a regime the onus would be on the host railway to demonstrate that granting access would be harmful to the public interest.

These and similar proposals follow the lead taken by Mr. Estey in 1998. With specific reference to running rights, he stated:

> The CTA currently allows only a federal railway to apply to the Agency for authority to run over the lines of another federal railway. In order to broaden the application of the running rights provision, it is recommended that the words "any person" be substituted for the words "railway company" in the current statutory provision. The bramblebush created by the courts as to what is and what is not federal need not be resolved in order to achieve the remedy sought by the grain shipper.

> This new provision would offer open access to the existing CN and CP lines provided that fair compensation is paid and that certain conditions are met. Fair compensation should, at a minimum, cover the costs of the owner of the railway lines but concomitantly ensure that the owner cannot block access by charging unreasonably high fees. Conditions imposed may include a requirement that would-be operators must carry adequate insurance and meet license, safety and other statutory requirements.
>
> The Agency would in all such applications consider the public interest in granting or refusing a running rights order. As well, since granting running rights on main lines might significantly reduce the capacity of those lines, the Agency would be required to assess whether granting the access would affect the capacity of the rail line in question.[39]

Another variation of the running rights group of proposals—supported by, among others, the Government of Saskatchewan and the Canadian Wheat Board—would see the transition over time to a completely open regime for rail access. "Full open access" as presented to the Panel would eliminate any regulatory consideration of the public interest in running rights. The right to provide service on a network would be available to all operators wishing to do so. The Agency's role would be restricted to determining fee levels where necessary and the settlement of service disputes.

6.2.3 OMNITRAX/CANRAIL WEST INC. "MANAGED" ACCESS

OmniTRAX has proposed the creation of a new Prairie regional railway with "managed" access (running rights) to serve customers located on "designated" CN and CPR lines. Operating over all CN and CPR secondary main lines and branch lines in the Prairie region, the selected carrier would also have traffic solicitation rights over the designated lines. In addition, it would have running rights over the main lines of CN and CPR to access an interchange providing a competitive choice, or alternatively, if none were available, to the final rail destination of the traffic within Canada. At the request of a captive shipper, OmniTRAX proposes that a regional railway should be granted the right to serve that shipper's facilities on the main lines of Class 1 carriers.[40] OmniTRAX claims that it is well-positioned to initiate such a service.

The notion of a regional railway with access to the lines of CN and CPR, and access to some customers on these lines, is also to be found in several

[39] The Honourable Willard Z. Estey, *Grain Handling and Transportation Review Final Report*, December 21, 1998, p. 37.

[40] Submission by OmniTRAX, Inc. to the CTA Review Panel: A Proposal to Enhance Competition in the Canadian Railway Marketplace, October 3, 2000, p.19.

other submissions including those of the SARM, Keystone Agricultural Producers Incorporated and the Canadian Pulp and Paper Association.

6.2.4 COMPETITIVE ACCESS RATE (CAR)

Conceived originally by the Canadian Fertilizer Institute as an alternative to the current CLR mechanism, the Shippers' Summit put forward the CAR. The CAR would modify CLR provisions as follows:

- the shipper would not be obliged to have concluded an agreement with a connecting carrier before applying for a rate;
- a CAR could be applied at both the origin and destination of the movement;
- the Agency would have 30 days, rather than 45, to set the rate;
- a formula would apply to all CAR calculations, based on a railway's overall average revenue per tonne-kilometre for the commodity in question.

CAR proponents believe it would encourage originating and connecting carriers to compete for the traffic—something several shippers contend does not occur now because of the CLR requirement for a shipper to reach prior agreement with a connecting carrier. In addition, CAR proponents maintain that it would promote the movement of the traffic via the most efficient routing.

6.2.5 EXPANDED INTERSWITCHING LIMITS

Another proposal advanced has been to raise the current 30 kilometre interswitching limit significantly (distances of 100, 160 and 200 kilometres have been separately suggested) or to the first interchange with another railway. This would create an expanded zone within which shippers could have traffic transferred to the lines of a second carrier at a fee based on system average costs or another prescribed rate.

6.3 KEY CRITERIA FOR EVALUATING COMPETITIVE ACCESS PROPOSALS

The Panel has identified criteria for assessing the proposals. The key criteria are described below under three headings: competition and efficiency; compensation; regulatory burden and related costs.

6.3.1 COMPETITION AND EFFICIENCY

An underlying premise common to the proposals set out above is that there is a need to stimulate more competition in establishing freight rates. However, policy makers must also be concerned with possible implications for the efficiency of the rail transport system overall. As expressed in section 5 of the CTA, the goals of Canada's national transportation policy are multi-faceted: the maintenance of a safe, economic, efficient and adequate network of viable and effective transportation services, achieved whenever possible through the means of competition and the use of market forces.

The Panel recognizes that competition can encourage the innovation, entrepreneurship and cost control essential for increased efficiency. In general, though, it has not been demonstrated how the proposals would affect overall system efficiency. The Panel is determined to avoid access proposals that could lead to system inefficiencies, thus increasing costs that must be passed on to other shippers or which threaten railway viability. The Panel would find it most helpful to have more information on the impact of the various competitive access proposals on overall system efficiency.

6.3.2 COMPENSATION

Compensation is the most critical factor to the long-term success of any scheme for regulated enhancement of rail access. An access fee that is higher than warranted would defeat the purpose and effectively bar competitors from gaining access to the lines of other companies. A fee that is too low would not provide the host rail company with resources sufficient to attract capital and invest in infrastructure, inducing it to recover lost revenue by increasing rates for other traffic or cutting back on infrastructure maintenance and investment. A fee that is too low also runs the risk of subsidizing a less efficient competitor.

Proponents of greater access suggest they are willing to pay "fair" or "reasonable" fees. Several have stated that the access price should be set by commercial negotiation with recourse to the Agency if no agreement can be reached.

CN maintains that should enhanced access be pursued, access fees must be market-based and negotiated rather than regulated. In the event a negotiated agreement cannot be reached, CN proposes commercial arbitration to set fees. Arbitrators would be instructed to consider certain principles of cost recovery:

- increased track operating costs attributable to a new entrant;
- return on embedded capital;
- payment for new capital;
- lost contribution to fixed costs, including opportunity cost.

VIABILITY OF NEGOTIATED ACCESS FEES

While negotiated access prices are plausible in theory, where access is not consensual it is hardly likely that the parties would be of the same mind as to what constitutes a fair or reasonable fee. Experience in the US has been that commercial negotiation in an imposed access situation has proven to be impractical. It is probable, therefore, that the Agency or an arbitrator would be faced with setting the access fee, or at least the ground rules for arriving at one.

The Shippers' Summit submission acknowledged this problem and suggested that the Agency be given direction to recognize that access through running rights is a “pro-competitive” measure, and thus access fees could not be used to create an insurmountable barrier to their use.

The Canadian Wheat Board was more explicit:

> In establishing the fee, the Agency must be able to consider a reasonable return on railway investment in infrastructure and facilities, but must be prevented from including any opportunity costs for the host railway. That is, access fees must not include any opportunity costs claimed by the host railway for lost revenue attributable to their ability to price discriminate.[41]

For its part, OmniTRAX suggests in its proposal that the FOA mechanism be used to set fees if no agreement was reached between the parties.

[41] Canadian Wheat Board submission to the CTA Review Panel, October 20, 2000. p.6.

Further Inquiry into the Matter of Access Fees

None of the proposals treats the issue of compensation with the thoroughness it requires. Therefore, in the coming months the Panel will engage proponents on how a compensation mechanism would:

- impact the efficiency of the rail transportation system, in both congested and low traffic corridors;
- ensure the ability of the host railway (main line, short line or regional railway) to continue to raise sufficient capital in the market to undertake additional investment in the future;
- ensure the host railway's ability to continue to undertake the capital investments essential to providing the level and quality of services needed for shippers to remain competitive.

In this respect, the Panel believes that the access fee must:

- compensate for the costs of using the facilities (including physical wear and tear of the host railway's infrastructure and an appropriate portion of the host railway's overall costs of traffic control);
- provide an appropriate return to the host railway on its investment in the rail right-of-way, plant and equipment;
- provide for the new investment required to accommodate the guest railway's presence and/or compensate for interference with other traffic;
- compensate the host railway for expenses it incurs ensuring that a guest railway will operate safely on its lines, including any additional risks that the presence of the guest railway imposes on the host railway.

Among the questions for further discussion are whether the fees should also include compensation by the guest railway for:

- increased cost of the host railway's operations due to the loss of traffic, e.g. smaller train sizes;
- any net revenue loss arising from the traffic diverting to the guest railway.

Market Rates vs Uniform Regulated Rates

Some of the competitive access proposals before the Panel employ regulated freight rates.

The CAR proposal, for example, could set rates at both origin and destination; this raises the potential that Agency-regulated rates would replace commercial rates for a substantial portion of the total movement in some situations. Similarly, expanded interswitching limits imply a greater proportion of movements being subject to a regulated rate that does not reflect the railway's differential pricing system or the specific variable costs of the movement in question, thus inducing the host railway to attempt to recover costs from other traffic.

The Panel will consider the full financial and economic implications of replacing market-determined rates with uniform, regulated rates for what could be a substantial portion of the total rail transport traffic.

6.3.3 Regulatory Burden and Related Costs

Legislated enhancements of rail access can be expected to increase regulatory oversight and costs to government. Additionally, compliance and dispute resolution will raise costs to industry.

Regulatory costs arise from several sources. With any measure that requires a railway to take action it does not believe to be in its own commercial interests, it is likely that there will be disputes as to how or indeed whether the railway will comply. As a result, it can be expected that the Agency will be called upon to interpret the provision, especially in the early years. As the Agency's interpretation of the provisions becomes clearer over time, the number of disputes should decline.

A common thread running through some of the proposals is the use of rule-based or administrative decision making in the place of case-by-case adjudicative procedures, the aim being to minimize disputes and their associated costs. Critics of adjudicative regulatory procedures point to the time and expense of arguing a case, and the uncertainty of outcome, as significant barriers to their being used at all.

However, rule-based regulation also has the potential to create significant costs. While the regulator sets the general terms and conditions for access, including compensation, the regulator is obliged to monitor the outcomes of rulings, and will from time to time be required to intervene if there are indications that a party is not adhering to earlier rulings.

It should also be recognized that regulatory costs are ongoing, particularly with respect to running rights. Experience in the US has shown that in situations where access was not consensual, fee negotiations often involved protracted and expensive dispute resolution and arbitration.

Finally, the imposed sharing of infrastructure could present entirely new regulatory challenges and associated costs. A host railway could use its ownership of infrastructure as a competitive leverage gained through its traffic control and dispatch operations. The need to ensure that this does not happen has been an issue in cases of other network industries in Canada that have opened up to competition.

It is the Panel's intention to address these issues in the upcoming months and invite interested parties to make their views known.

6.4 KEY ISSUES REQUIRING FURTHER STUDY, REVIEW AND RESOLUTION

There are a number of other issues requiring further study before the Panel draws conclusions or makes recommendations. The key issues are:

- access reciprocity
- test for the public interest
- relevance of revenue adequacy for access regimes
- cumulative effect of existing shipper protections
- implications for existing shipper protections
- safety and liability
- constitutional implications
- subsidies and the international trade regime

6.4.1 ACCESS RECIPROCITY

Compelling a railway to provide access to its lines might include a condition that obliges the guest railway to provide similar access to its lines (i.e. access reciprocity). The main line railways regard access reciprocity as essential to any competitive access liberalization. In their view, it provides a disincentive for a guest carrier to gain access in order to “cherry-pick” the most lucrative traffic.

Both CN and CPR have stated that the lack of reciprocity would be an especially significant concern if US carriers were able to access Canadian traffic without having to expose their own traffic to Canadian competition in return. (Current running rights provisions do not require that reciprocal access be made a condition of granting running rights to any railway, Canadian or American, holding a certificate of fitness.)

Some advocates of increased access rights, while acknowledging the apparent fairness of a reciprocal access rule, fear that the major railways

could use it to intimidate short line railways seeking access or to cherry-pick the short line's profitable traffic.

A solution suggested by the Shippers' Summit and the Western Canadian Shippers' Coalition is that the degree of reciprocity be based on the type of access sought. Thus, if a carrier seeks simply to run over another railway's line without the right to solicit traffic, it would be required to grant similar running rights on its own lines to the other railway. If traffic solicitation rights were given, then the applicant carrier would be obliged to grant similar access to the other railway. This proposal, however, is predicated on the fact that only short line railways could trigger an application to run over another railway's line.

The Panel notes that the OmniTRAX regional railway proposal as currently structured does not appear to contemplate providing reciprocal access to the main line carriers.

6.4.2 Test for the Public Interest

Under existing legislation the Agency is required to weigh the public interest in running rights cases. A recurring question during the course of the Review was whether the public interest test is warranted, and if so, how it should be applied.

The debate over the public interest test considers three possibilities. First, there is the existing process as applied to running rights, where the onus is on the railway seeking running rights to demonstrate that granting the rights would be in the public interest. Second, there is the concept of "reverse onus", where it would be up to the host railway to show why granting running rights is not in the public interest. Third, there is the notion that under "full open access" no public interest test would be needed.

Current legislation does not attempt to define the public interest, a policy gap the Panel finds problematic. To the extent that a public interest test is retained, whether under a reverse onus approach or as currently provided, it is the Panel's view that the regulatory body should not be left without policy guidance on the criteria for and factors to be included in determining the "public interest". The Panel believes that, in the absence of such guidance, the process for considering access requests could be lengthy, open to legal challenge and expensive. This could hamper the effectiveness of the running rights provision.

6.4.3 Relevance of Revenue Adequacy for Access Regimes

The financial viability of the Canadian rail system is of great importance not only to the railways but to the shippers and the nation as a whole. The US regulatory structure explicitly recognizes and limits regulatory intervention if railways are not revenue adequate. The current national transportation policy recognizes that the financial viability of carriers is a relevant concern, along with those of enhancing competition. Several shippers have pointed out that they have no “right” to revenue adequacy and are subject to the marketplace, and they question why railways might get different consideration. “Revenue adequacy” is a concept more closely associated with a public utility than with a competitive private firm.

The Panel welcomes comment on how to balance the need for a viable rail system, while fostering a competitive environment to ensure that the system is efficient and shippers do not pay excessive charges to move their products. What emphasis should be placed on the financial viability of the rail system in considering access or other shipper protection regulations?

6.4.4 Cumulative Effect of Existing Shipper Protections

The CTA currently provides shippers with a number of means of limiting the market power of railways under federal jurisdiction. Many rail shippers have the option of using FOA to contest rates they consider unreasonable. Any shipper can request Agency intervention to address complaints of inadequate rail service. Shippers within 30 kilometres of an interchange may use interswitching to gain access to a second railway. CLRs are available to shippers located further from an interchange. (Chapter 3 provides detailed discussion of these regulatory instruments.)

The Panel is aware of the stance adopted by a number of shipper interests that the circumstances facing shippers differ and therefore a “basket" of competitive access/shipper protections may be required to provide all shippers with at least one alternative. However, in arriving at final conclusions, the Panel will be mindful of the complexity and regulatory burden an accumulation of competitive access provisions could have on the rail industry as a whole. It may also be the case that not every category of shipper needs to have such a regulatory instrument available to it. It may be the case that there is overlap and duplication among existing provisions, a possibility made more likely if new provisions are added to the CTA.

6.4.5 IMPLICATIONS FOR EXISTING SHIPPER PROTECTIONS

Given the possibility of expanded running rights provisions, the Panel needs to have a better understanding of the extent to which the existing shipper provisions apply, or ought to apply, to a carrier operating over the line of another railway:

- Under existing law, a host railway has a level of service obligation to shippers along a line, irrespective of whether the service is in fact being provided by another railway with guest rights. Should the second railway also have a level of service obligation to shippers? If not, then a guest carrier could skim lucrative traffic while leaving the host railway with the obligation to serve other traffic. If the second railway is to have a level of service obligation to shippers, how will it be determined which railway is liable should a complaint be made? Would it be appropriate to relieve both carriers of their level of service obligation on the grounds that competition between carriers exists? What happens in such a circumstance if neither railway chooses to provide service to the shipper?

- Currently, regulation can force a carrier to provide a tariff at the request of a shipper. Should that obligation apply only to the host railway, to both the host and guest railways, or to neither, since it can be argued that the existence of competition should relieve both carriers of this obligation? Application of the obligation only to the host carrier would put it at a competitive disadvantage compared to the guest.

- Should the guest railway be subject to the same rules with respect to tariffs, confidential contracts and the obligation to issue a joint rate, as apply to the host railway? How would the exemption of guest carriers from these requirements be justified?

- Should the current obligation to interswitch traffic at regulated rates apply to a guest railway? Should the guest carrier be obliged to establish a CLR at the request of a shipper in the same circumstances where the host would be obliged to do so?

- How is the overall revenue cap for the transportation of grain affected by a new entrant?

- Ought restrictions on the limitation of liability applicable to federal railways also apply to the guest carrier?

- Do shipper protections make sense if a shipper has competitive rail options using a guest carrier?

- Finally, what would happen if the host railway chose to discontinue its service and dispose of the track? Should it be restricted from doing so? Should it be obliged to offer the line to the guest carrier?

6.4.6 Safety and Liability

The coordination of two (or more) railway operations on a single line raises safety concerns that do not exist under a regime with a single line and single operator. While the rail industry seems to have successfully managed these issues where running rights are consensual, situations where the running rights have been compelled by regulation could pose different kinds of challenges to safe rail operation.

Under consensual running rights arrangements, liability in the event of unforeseen incidents is a matter negotiated between the parties as part of the commercial negotiation. Absent such agreement, general principles for apportionment of liability and payment of compensation would have to be developed for application to running rights carriers and their hosts. None exist at present.

6.4.7 Constitutional Implications

In Canada, inter-provincial and international railway transportation is the responsibility of the federal government, while responsibility for railway transportation within a provincial boundary rests with the province. There are three ways that a railway operation might come under the exclusive legislative authority of the federal government:

- the line being operated crosses a provincial boundary;
- the line being operated is integrated with the operations of a federal railway to the degree necessary to attract federal responsibility;
- the line is declared to be a work for the general advantage of Canada.

Enhanced running rights, as originally proposed by Mr. Estey in his *Grain Handling and Transportation Review Final Report*, would broaden the application of the running rights provision of the CTA by substituting the words "railway company" with the words "any person". The CTA currently allows only a federal railway to apply for authority to run over the lines of another federal railway. (Most proponents of enhanced running rights agree, as was recommended by Mr. Estey, that persons exercising running

rights would have to meet federal safety, insurance and licensing requirements before they would be permitted to operate over a federal line.)

The Panel has identified a possible unintended consequence flowing from such a change. Constitutional law provides that works or undertakings of a provincial character whose operations are sufficiently integrated with those of a federal work or undertaking may lose their provincial character. There is a possibility, therefore, that a provincial short line railway that operates to a significant degree on the lines of a federal railway might find that its operations are integrated with those of the federal line to the extent that, from a constitutional point of view, the railway will lose its provincial status and be deemed a federally regulated carrier under the law. The possibility of such an outcome could well dampen enthusiasm for provincially regulated railways to avail themselves of expanded running right provisions.

6.4.8 SUBSIDIES AND THE INTERNATIONAL TRADE REGIME

It has been suggested that provisions that permit enhanced access without full cost recovery could be regarded as a disguised subsidy to shippers and as an expropriation, thus making the measure vulnerable to challenge under international trade treaties to which Canada is a party. The Panel is examining the matter.

CHAPTER 7: NEXT STEPS

The Panel's mandate calls for a comprehensive review of federal transportation legislation and policy in order to determine whether or not it continues to provide for an efficient, effective, flexible and affordable transportation system. Such a mandate necessarily involves the consideration of all modes of transport, in all regions, and the relationship of each mode to the needs of the shippers and travellers it serves. As activities of users continue to grow and are reshaped by continental and global forces, the transportation services required must change too.

Carriers in all modes are adapting their operations by investing in new equipment and facilities, most notably in new technologies to manage their processes. Through reorganization, alliance building and merger, corporate structures are changing and traditional barriers between and among industry sectors and markets are falling. In all of this change, carriers are striving to keep investments viable by finding new cost efficiencies.

The Panel intends to look broadly at all characteristics of transportation and examine the adequacy of current federal legislation, institutions and policies to meet the public policy challenges inherent in this ongoing change. In so doing, the Panel will articulate principles that are applicable across all transportation modes, and in its final report, suggest how they should be applied in specific transport sectors that come under the CTA.

The Panel's assessment of competitive rail access proposals will be made within this broader examination, taking account of continental developments in the rail industry, and of wider developments in freight transportation in non-rail modes.

The Panel's inquiries and consultations reported in this interim report have made one thing abundantly clear: that notwithstanding the diligent efforts at seeking resolution by Mr. Estey and Mr. Kroeger, the gap between advocates and critics of enhanced rail access remains as wide as ever. The Panel is convinced that a central reason for the continued disagreement is that the options advanced so far have left too many critical questions unexplored and unanswered.

In the remaining months of its mandate, the Panel will involve the parties in greater critical scrutiny of the available options using the criteria and factors outlined previously. The Panel has heard repeated arguments from competitive access advocates that the railways have too much market power and that additional measures to increase rail competition are needed in order to reduce freight rates. Even if one accepts the premise, the right means to address the situation remain to be determined. At this stage of its deliberations, the Panel cannot rule out the possibility that abuse of market dominance can be remedied by means other than

the competitive access provisions which have been proposed (for example, by measures directed specifically to contested rates).

The Panel intends to devote considerable effort to addressing what it has come to regard as a fundamental issue in this debate: what instrument or mix of instruments is best suited for dealing with abuse of market dominance wherever it may exist?

ANNEX: ACCESS IN OTHER JURISDICTIONS AND INDUSTRIES

In debates on whether Canada should undertake measures to enhance competitive rail access, reference is often made to the steps taken by a number of countries outside North America to restructure their rail industries. Reference is also made to the steps taken by many countries, including Canada, to open network industries such as telecommunications and natural gas to greater competition.

It will be important for the Panel to examine this experience and consider its relevance to the issue of rail access in Canada. Some preliminary observations are presented below.

RAILWAYS OUTSIDE NORTH AMERICA

There is a perception among some parties that rail access policies introduced during the 1990s in a number of countries have brought about vigorous competition among railways. Some observers have suggested that this may not be the case. Nevertheless, these rail regimes are still very much in transition and the current state of affairs should be regarded as the initial commercial response.

Observers have also questioned the relevance to Canada of experience with rail access outside North America. In part, this stems from the fact that the Canadian context is vastly different from most foreign rail systems. The factors driving reforms abroad have been primarily intended to introduce market discipline to government-owned railways suffering from low productivity, mismanagement and high subsidy requirements.

Rail reforms in Europe would appear to have limited relevance to Canada. Europe's rail systems are passenger-oriented and are subsidized by governments to levels unseen in Canada or the United States.

The dominant model for reform in Europe has been one of vertical separation of "above-track" operators from "below-track" operations, coupled with horizontal separation by function (freight or passenger) or geographic market. In countries adopting this approach, the UK being the prime example, competition between train operators is absent. Instead, a monopoly track supplier provides rail slots to a collection of segregated monopoly operators. There are provisions to allow on-line competition between operators within a specific franchise, but this has yet to occur.

In European countries that approached rail reform other than by creating above-track monopoly franchises, including Sweden, Germany and Holland, there have been few entrants and almost none appear to be in meaningful competition with the dominant carrier.

In Australia, the system has added complexity, primarily because each level of government (federal and state) developed its own rail network but failed to employ a common gauge. Intrastate carriers in New South Wales and Queensland have considerable market power in the movement of coal to export that they can use as leverage, partly because ocean distances to final markets are shorter than for competing suppliers such as Canada. Both states now allow rail access with differential fees based on demand elasticity. Because rail rates were previously set by the state-owned monopolies that used their positions to extract monopoly rents, rates were set partly in lieu of royalties and thus were excessive. Under the new policy, rates are capped by a stand-alone cost test and are being realigned.

On the Australian interstate lines, traffic volume is low and train operators appear to generally have limited market power except on east/west long haul movements. Revenues appear to be insufficient to maintain the system. Under the new open access policy, entry has taken the form of "cherry-picking" with two new entrants competing with the former monopoly carrier for the potentially lucrative long haul container market. As a result, rates for this traffic were driven down by close to 40 percent.

OTHER NETWORK INDUSTRIES

Rail transport, local and long distance telecommunications, and natural gas transport are all network industries. They use a network to connect different locations. This network aggregates traffic between different origin-destination pairs, and concentrates it on interoffice or intercity links. This allows traffic to use high-capacity links, even though the traffic between any origin and destination may in fact be low volume. In turn, use of shared high-capacity links leads to much lower unit costs for the traffic going over them.

Individual customers need to access the core network. In telecommunications, competition has developed in the core network but access by individual customers to the core network has generally been provided on a monopoly basis. Competition has been encouraged by allowing customers to reach their preferred supplier over the access facilities already in place. In natural gas, while there are numerous producers of gas, the transport function has been a monopoly.[42] Competition has been encouraged by unbundling transport from the ownership and marketing of the gas.

[42] This is starting to change with the construction of the new Alliance pipeline project.

IMPLICATIONS FOR RAIL TRANSPORT

In telecommunications, open access has taken two forms: (1) interconnection, and (2) resale of facilities and functionalities. Both have analogies in rail transport. Interconnection consists of one carrier handing off traffic to another carrier, to enable it to reach locations it does not serve directly. In long distance telecommunications, it involves using other carriers' local networks. In local telecommunications, it involves call termination on another local carrier's network. In rail transport, it involves interswitching and Competitive Line Rates to access locations on another railway's network.[43]

Resale of facilities and services has a more limited role in telecommunications access. It is composed mainly of dedicated transport links: private lines between cities, local arrangements within a city, and unbundled loops to reach customers. The analogy in rail transport is with running rights over another carrier's track.

In the case of essential facilities, which cannot be duplicated, regulated access is considered necessary. For other facilities and services, regulated resale is expected to be a transitional measure in telecommunications, until facilities-based competition is established. Resale of facilities is expected to continue on a commercial basis, where it is to the advantage of both parties. However, there are not the same network externalities to justify ongoing government intervention as there are for interconnection.

With respect to natural gas, the main emphasis to date has been the unbundling of ownership of the gas from its carriage. Previously, pipelines purchased the gas from producers, transported it, and sold it to local distribution systems. Now, end users can purchase the long haul transport services separately, and make their own arrangements directly with competing gas producers and with local distributors. By contrast, railways have traditionally provided the transport function alone, unbundled from ownership of the commodities being shipped.

The transport of gas is only now becoming competitive, with the construction of an alternative pipeline system. Pipelines interconnect with each other. However, there has been no discussion, to date, of allowing competitors to directly use capacity or operate any aspect of another company's pipeline.[44] Thus, pipelines do not have the equivalent of railway running rights.

[43] Trucking may also be used to access a railway's network.
[44] There would be many difficult technical issues, e.g. the operation of compressors.