PRB 05-73E

Library of Parliament
Bibliothèque du Parlement

RAIL SHIPPER PROTECTION UNDER THE *CANADA TRANSPORTATION ACT*

Allison Padova
Economics Division

26 January 2006

PARLIAMENTARY INFORMATION AND RESEARCH SERVICE
SERVICE D'INFORMATION ET DE RECHERCHE PARLEMENTAIRES

The Parliamentary Information and Research Service of the Library of Parliament works exclusively for Parliament, conducting research and providing information for Committees and Members of the Senate and the House of Commons. This service is extended without partisan bias in such forms as Reports, Background Papers and Issue Reviews. Analysts in the Service are also available for personal consultation in their respective fields of expertise.

CE DOCUMENT EST AUSSI PUBLIÉ EN FRANÇAIS

TABLE OF CONTENTS

Page

INTRODUCTION 1

SHIPPER PROTECTION CURRENTLY AVAILABLE UNDER THE *CANADA TRANSPORTATION ACT* 2

A. Interswitching 2

B. Competitive Line Rates 3

C. Running Rights 4

D. Grain Revenue Cap 5

E. Final Offer Arbitration 5

F. Level of Service and Right to a Rate 6

SHOULD THERE BE OPEN ACCESS TOO? 6

A. Supporters of Open Access 7

B. Opponents of Open Access 8

CONCLUSION 9

CANADA

LIBRARY OF PARLIAMENT
BIBLIOTHÈQUE DU PARLEMENT

RAIL SHIPPER PROTECTION UNDER THE *CANADA TRANSPORTATION ACT*

INTRODUCTION

Although there are more than 30 federally regulated railways in Canada, many freight rail customers are "captive" shippers; that is, only a single railway company offers direct service to their area. For these shippers, the rail transportation environment is not naturally competitive and, in the absence of adequate legislative measures, there might be a tendency for the railway company to take advantage of its position as a monopolist in the region. A monopolist railway would have an incentive to offer lower levels of service at higher prices than it would under more competitive market conditions.

A number of provisions exist in the *Canada Transportation Act* (CTA) to protect shippers from railway companies exercising market power in this way. For example, shippers have recourse to the Canadian Transportation Agency (Agency) if they can prove that rail companies' levels of service or freight rates will cause them substantial commercial harm unless relief is granted.(1) This document describes the provisions in the CTA that have been enacted to bring to bear some competitive pressure on a monopolist railway, and some criticisms of those provisions.

There is no provision in the CTA that is enforced in such a way as to provide a rail carrier with access to another carrier's track and its customers, i.e., to award "open access"; and this situation continues to attract debate. Currently, the right of a "guest" railway to pick up traffic along the track of a "host" railway company may be granted only through a commercial agreement negotiated between the two railways. Some of the advantages and disadvantages of an "open access" regime in the Canadian rail industry are also explored in this document.

---

(1) The Agency is an independent, quasi-judicial tribunal that, among other things, serves as a dispute resolution authority over certain transportation rate and service complaints involving federally regulated modes of transportation. The Agency has the powers, rights and privileges of a superior court to exercise its authority. It is made up of 7-10 Members, along with about 270 employees who assist the Members in their decision making and provide administrative support.

SHIPPER PROTECTION CURRENTLY AVAILABLE UNDER THE *CANADA TRANSPORTATION ACT*

Provisions respecting interswitching, competitive line rates and running rights are generally regarded as the three "competitive access" provisions affecting rail markets under the CTA. Also offering some form of competitive remedy to captive rail shippers are provisions relating to:

- the cap on railway revenues from the carriage of grain;
- a railway's obligation to provide service to shippers;
- shippers' recourse to final offer arbitration; and
- shippers' right to request a freight rate.

In each case the Agency is the final authority on whether or how a remedy is to be applied.

A. Interswitching

Interswitching is a competitive access provision that has been available to rail shippers for over 100 years. Interestingly, interswitching is available to shippers that are located within 30 kilometres of an interchange with another railway regardless of the level and type of competition in their area. The Agency regularly sets rates to be applied on hauls to interswitching points or prescribes the manner in which the rate is to be calculated. A rail carrier must apply the rate when transferring freight traffic to a connecting rail carrier at the request of a shipper, a municipality or any other interested person. Interswitching for distances greater than 30 kilometres may be permitted if it is the Agency's opinion that the point of origin or destination is "reasonably close" to the interchange. Such "extended interswitching" may require the shipper to satisfy a "substantial commercial harm" test. Interswitching is covered in sections 127-128 of the CTA.

In its 2001 report, *Vision and Balance*, the *Canada Transportation Act* Review Panel (CTA Review Panel) indicated that both shippers and railways found interswitching to be an effective and practical provision. It appears that the Agency has never received a request for an extended interswitching order.

B. Competitive Line Rates

Competitive line rates (CLRs) are a more recently available group of competitive access provisions; they were first introduced in 1987 and amended in 1996. A CLR may enhance rail competition for shippers if they:

- are located outside of the interswitching limits;
- have access to only one railway company at the origin or destination of the haul, and a continuous route is operated by two or more carriers; and
- can demonstrate that they would suffer "substantial commercial harm" if relief were not granted.

With few exceptions, under these circumstances, a shipper may ask a railway company for a CLR to move freight to the nearest interchange point with a connecting carrier. If the railway company and the shipper do not agree on the rate, the shipper may apply to the Agency to set the rate. It is important to note that, before requesting a CLR, a shipper must have an agreement in place with the connecting carrier for the balance of the movement. Exceptions to the situations in which a CLR may be established include:

- movements of containers, trailers on flatcars or less than carload traffic, unless they are being shipped to or from a marine port in Canada; and
- movements where the CLR distance is greater than 50% of the total haul, or exceeds 1,200 kilometres, unless the Agency approves the application specifically.

The details of the CLR provision are contained in sections 129-136 of the CTA.

It is interesting to note that the Agency has never received a request for a CLR. This is likely due to the fact that shippers have never been able to reach the agreement with the connecting railway that is a prerequisite to filing a CLR application. With respect to both extended interswitching and CLRs, proving substantial commercial harm in the absence of a remedy is difficult and can be costly for shippers, with the result that the requirement discourages them from making applications. The CTA Review Panel recommended in its 2001 report that the CLR provision be replaced with a more accessible one, notably one without the substantial commercial harm test and not requiring an agreement with a connecting carrier for a shipper to be eligible.(2)

---

(2) Canada Transportation Act Review Panel, *Vision and Balance*, 2001, Recommendation 5.5, p. 69.

C. Running Rights

Running rights are contained in provisions that have been in existence since 1888. If awarded, they permit one railway to make use of another federally regulated railway's assets (e.g., land, terminals, track, etc.). Specifically, the running rights contained in sections 138 and 139 of the CTA permit any federally regulated railway to apply to the Agency for the right to:

- take possession of, use or occupy any land belonging to another federal railway company;
- use the whole or any portion of the right-of-way, tracks, terminals, stations or station grounds of any other federal railway company; and
- run and operate its trains over and on any portion of the railway of any other railway company.

The request may originate from the railway company, a municipal council or any other interested party.

In order to rule in favour of running rights, the Agency must find them to be in the public interest.(3) If the Agency grants running rights to a guest railway, the railways have an opportunity to negotiate a rate. If they cannot agree on a rate, the Agency sets one.

Some stakeholders assert that the running rights provision does little to promote competition in the railway industry. They note that applications to the Agency for running rights are infrequent and generally not successful. The public interest criteria and the requirement to be a federal railway are viewed as the chief obstacles in the few recent cases. Furthermore, stakeholders consider that the right of a guest railway to compete for traffic on the host railway's line is essential if the intent of the provision is to introduce competition in the rail freight market. However, when faced with its first application for running rights with traffic solicitation rights for the guest railway in 2000, the Agency ruled against it. In its decision, the Agency stated that its interpretation of the running rights provision in the CTA was that it was intended to be limited to operating trains, rather than broadly interpreted to include traffic solicitation rights.(4) The concept of running rights with traffic solicitation rights, so-called "open access," is discussed further in a later section of this paper.

---

(3) While the term "public interest" is not defined in the federal transportation legislation, it is expected to be consistent with the National Transportation Policy, which appears in section 5 of the CTA.

(4) Canada Transportation Agency, Decision No. 213-R-2001, May 2001.

D. Grain Revenue Cap

Shippers of western grain are further protected from railways exercising market power under the CTA by a "cap" restricting railways' revenue from the transportation of grain for export (section 150). The cap was introduced in August 2000, allowing the Canadian National (CN) and Canadian Pacific (CP) railways to set rates for moving western grain as long as the annual grain revenues do not exceed a certain entitlement (the revenue cap) set by the Agency each year. In addition to setting the cap, the Agency monitors compliance with the cap and, if it finds that a railway has surpassed its revenue cap, specifies the amount of revenue that must be paid back to shippers and any penalty that may be levied.

Some shippers of western grain allege that the grain revenue cap has not protected them from railways exercising market power. Shippers say that the railways have created an array of ancillary service charges outside of the cap to increase their revenues from the carriage of grain. Moreover, under the cap, it appears that the railways are increasingly effective in pricing their services to extract their maximum allowable revenue from western grain producers. CN and CP have recently met or exceeded their allowable revenues for the crop year after falling significantly short of the cap in the first few years of its existence.

E. Final Offer Arbitration

Since 1987, final offer arbitration provisions (sections 159-169 of the CTA) have been available to shippers with complaints about conditions of rail services or rates. Shippers without alternative, effective, adequate and competitive means of transporting goods may submit a matter involving freight charges of over $750,000 to final offer arbitration following unsuccessful negotiations. For disputes over charges worth not more than $750,000 there is a simplified process and the shipper does not have to be without alternative, effective, adequate and competitive means of transporting goods. In both cases, the railway and the shipper provide their respective final offers to the arbitrator (or panel of arbitrators), who chooses the one that both the railway and the shipper must abide by.

Stakeholders appear to be generally happy with the final offer arbitration provisions under the CTA. Shippers have found that the threat of final offer arbitration has been proven to be enough of a deterrent that often settlements are reached without needing to go to arbitration. For example, of the 23 notices of intent to submit to final offer arbitration the

Agency has received since 1996, roughly half were withdrawn or settled before arbitration. When it is necessary to undertake the process, however, there are concerns about the complexity and expense of final offer arbitration, which can cost in the order of $500,000.

F. Level of Service and Right to a Rate

Section 113 of the CTA establishes that shippers have a right to certain levels of service from the railways. Federally regulated railways are obliged to provide "adequate and suitable" equipment for the receiving, loading, carriage, unloading and delivering of shippers' traffic and to carry it without delay. Sections 118 and 121 of the CTA further compel federally regulated railways to set a rate with respect to the movement of traffic on the railway at the request of a shipper. A shipper can make a complaint to the Agency if it believes that a railway has failed to respect these provisions, but it must meet the substantial commercial harm test for the complaint to be considered.

Some shippers complain that the level of service provisions do not ensure that their demand for rail cars will be met during peak periods. One reason for this situation is that the required level of service is not defined in the provisions, and shippers do not know what level of service they can expect for a given rate. The CTA Review Panel recommended that the level of service provisions be replaced by a requirement that a railway state the level of service it will provide in conjunction with its published rates.(5) Another reason may be that the Agency receives only a few formal complaints a year. The legal costs incurred to support a complaint (in the order of $100,000) and fear of retribution from the railways may explain the reticence on the part of shippers.

SHOULD THERE BE OPEN ACCESS TOO?

Some observers strongly believe that captive rail shippers in Canada are not adequately protected from railways that exercise their market power. They are generally proponents of all railways having open access (running rights with traffic solicitation rights for the guest railway) to the federal railway network. Transport Canada and the federally regulated track owners have been the main opponents of open access.

---

(5) Canada Transportation Act Review Panel (2001), Recommendation 5.1, p. 62.

A. Supporters of Open Access

Among the supporters of an open access rail regime, the higher-profile advocates include the CTA Review Panel, Justice Willard Estey and Senator Tommy Banks. Their positions are summarized below.

- The CTA Review Panel was given the mandate by the Minister of Transport to consider options for enhancing competition in the rail industry, as part of the comprehensive review of the Act to be completed by 1 July 2001. One option was open access to rail infrastructure. The report notes that the Panel heard support for open access from the provinces of Manitoba and Saskatchewan, the Canadian Wheat Board, the Competition Bureau and two regional railways. In its final report of 2001, the Panel concluded that while running rights did not appear to have been designed to enhance competition in the rail industry, it would be useful for them to serve as a competitive access provision when a track-owning railway acts against the public interest. The CTA Review Panel went on to describe proposed amendments to the legislation to enable selective use of running rights provisions to award competitive access to any railway and enhance competition in certain cases. It also proposed making running rights available to all railway companies, not just federally regulated railways.

- In his 1998 report to the Minister of Transport, *Grain Handling and Transportation Review*, Justice Willard Estey made a recommendation regarding the existing running rights provisions under the CTA. He recommended "the opening up of the Canadian rail system to competition by and between all competent railways operators, including short-line railways."(6) Justice Estey supported his recommendation by noting the success of what he considered parallel developments in other network industries (e.g., telecommunications and pipelines).

- Senator Tommy Banks would like to see amendments to the CTA that give the Minister of Transport power to award "enhanced" running rights (i.e., with traffic solicitation rights) at the Minister's discretion. He believes that the government should decide the matter objectively and efficiently with due regard to public interest, not delegate the decision to an arm's-length, quasi-judicial body (i.e., the Agency). Senator Banks reintroduced a private member's bill in the Senate to this effect during the 37th Parliament (Bill S-18, An Act to amend the Canada Transportation Act (running rights for carriage of grain)) that he originally introduced in the 36th Parliament. It is Senator Banks' position that the amendments are necessary because sections 138 and 139 of the CTA were misinterpreted by the Agency in a 2001 decision. Senator Banks believes that it is time for the rail industry to be subject to the same competitive pressures as found in other sectors that were once monopolies (e.g., air travel, telephone, bus, trucking). He asserts that the cost to society of having limited competition in the rail industry is significant, and he also makes the point that Canadian railways have advocated open access in the United States to increase competition and benefit the public, rendering their position on open access in Canada hypocritical.

---

(6) Hon. Willard Z. Estey, *Grain Handling and Transportation Review*, December 1998, p. 36.

B. Opponents of Open Access

Opponents of open access in Canada's rail industry generally claim that characteristics specific to the Canadian rail industry do not justify a move to an open access regime, which would be a radical transformation. The main opponents of open access are Transport Canada and federally regulated, track-owning railways.

- Transport Canada considered expanding the running rights provision to include traffic solicitation rights and non-federally regulated carriers, in response to the report of the *Canada Transportation Act* Review Panel. Given that the CTA Review Panel had also reported that the Canadian rail freight industry worked very well for most shippers, most of the time, and that the industry overall behaved competitively, Transport Canada decided that the regulatory change was unwarranted. Introducing open access provisions into the generally well-functioning Canadian rail freight industry would be at the risk of:

  - introducing considerable inefficiencies in the industry and a disincentive for track owners to invest in infrastructure; and
  - imposing significant new regulatory administration and oversight costs on industry and government.

  Following the CTA Review Panel's report, Transport Canada introduced Bill C-26, An Act to amend the Canada Transportation Act, in the 36th Parliament. With respect to rail, Transport Canada proposed to repeal the substantial harm clause, making the existing remedies more accessible to shippers, and to substitute the CLR provisions with Competitive Connection Rate (CCR) provisions as recommended by the CTA Review Panel. The CCR provisions would not require that shippers have an agreement signed with a connecting carrier in order to apply, which was considered the main barrier to accessing the CLRs. Bill C-26 died on the *Order Paper* at the end of the 36th Parliament in May 2004. Bill C-44, An Act to amend the Canada Transportation Act, which was introduced in the 37th Parliament, proposed by and large the same amendments as Bill C-26 but died on the *Order Paper* at the end of the 37th Parliament in November 2005.

- As one of the two major, federally regulated, track-owning railways, CN made the case that traffic solicitation rights were inconsistent with the regulatory framework of the CTA. The railway argued that open access would necessarily reduce efficiency because it would result in more trains hauling essentially the same amount of freight traffic.

It is interesting to note that the CTA Review Panel acknowledged that other network industries (e.g., telecommunications, natural gas pipelines and electricity) that have open access regimes in Canada are not comparable to rail. It concluded that other network industries are not as complicated as rail in terms of physical planning, coordination, safety, switching and administration. It is also worth noting that international jurisdictions that have

implemented open access regimes in rail (e.g., Australia, Sweden and the United Kingdom) did so for reasons other than lack of competition and/or found that open access did not lead to the attainment of their policy goals.(7)

CONCLUSION

With respect to many of the competitive remedies that are available to shippers under the CTA (e.g., interswitching, CLRs, the grain revenue cap and provisions on level of service and right to a rate), critics argue that they do not provide adequate relief for shippers because they are not accessible and/or effective. None of the CTA provisions to protect rail shippers from railway companies exercising market power go so far as to permit railway companies to solicit traffic on the network of another railway company.

Although the 120-year-old running rights provisions under the CTA could be interpreted as a means to open up the proprietary railway network to other carriers and allow them to compete for traffic, whether or not the running rights provisions in the CTA were intended to enhance competition in the rail industry is actively debated still. The prevailing view is that they were not, and the Agency has ruled that traffic rights are beyond the scope of the provisions. It is clear, however, that if running rights were intended to be a competitive remedy, then allowing a guest railway to solicit traffic on the host railway's network would make them more effective in that regard.

In spite of a recommendation from the CTA Review Panel to the contrary, Transport Canada did not amend the CTA to clarify that traffic rights may be awarded under the running rights provisions. Transport Canada did not think such a dramatic regulatory change was justified in the Canadian rail industry when the behaviour of railways indicated that rail markets were substantially competitive overall. Instead, in its amending legislation first introduced in the 36th Parliament, the department proposed to remove the substantial harm clause from the CTA and to amend the other existing provisions for competitive access and dispute resolution in the rail freight industry to make them more accessible to shippers. Both that bill and its successor, however, died on the *Order Paper*. It remains to be seen whether similar legislation will be proposed in the 39th Parliament.

---

(7) Andrew Shea, *Assessment of Open Access Policies in Other Industries and Jurisdictions: A Literature Review*, Conference Board of Canada, 2001.