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RE: CN RESPONSE - CONSULTATION ON THE CANADIAN TRANSPORTATION AGENCY'S PROPOSED CHANGES TO INTERSWITCHING RATE SETTING AND BILLING

Thank you for the opportunity to comment on the four proposals described in the Consultation Paper "Regulated Interswitching: Proposed Changes to Rate-Setting and Billing" dated August 12, 2020. We submit our comments following the same structure established in the Consultation Document.

Proposal 1 – One Zone and Rate

This proposal consists of merging the existing four zones into a single zone of 30 kilometres, with one rate applicable to the entire zone. The Consultation Paper explains that when the Agency ceased to use linear regressions in 2010 to force a positive linear correlation of interswitching costs vs. distance, it determined that the distance of interswitching movements did not always reflect the cost of such movements. As we understand it, this explains why the current rate structure derives higher rates for zone 1 movements than for zone 4, notwithstanding the fact that the latter involves a longer distance.

CN agrees with the decision made in 2010 to stop using linear regressions. We must however note that the discrepancy in the current rate structure discloses a general inconsistency with market practice which typically involve rates increasing with distance. In our view, this discrepancy results from an unnecessary insistence in focusing exclusively on costs. The *Canada Transportation Act* (CTA) does **not** require the Agency to set interswitching on the basis of costs. In fact, the CTA directs the Agency to set rates, under Division IV of Part III of the Act, that are **commercially fair and reasonable to all parties**:

> 112. A rate or condition of service established by the Agency under this Division must be commercially fair and reasonable to all parties. (Emphasis added)

The Consultation Paper contradicts the CTA on this point by stating unequivocally that the new single rate for the entire zone "would continue to be a cost-based rate". This is a fundamental question. Since 2010, the Agency has audited CN on many occasions respecting its interswitching costs without considering whether the rates so determined reflected the

commercial environment, and without investigating the level of commercial rates[1] applied for similar movements not subject to interswitching regulations. In our submission of August 21, 2019 about the methodology to be used by the Agency when setting interswitching rates, we reiterated our position on this point. We also showed that commercial rates with Canadian shortlines and with both shortlines and Class 1's in the U.S. lead to a vibrant switching market, where CN has almost as many transactions in the U.S. (where there is no interswitching regulation and all agreements are commercial) as with the other Class 1 in Canada, even though we have twice as much traffic in Canada. Commercial rates exist both in Canada and the U.S., and CN firmly believes that the Agency should study such commercial rates to establish the interswitching rates, as this would be more consistent with section 112 of the CTA.

We recognize that section 127 directs the Agency not to establish interswitching rates which would be below variable costs:

> 127. (3) In determining an interswitching rate, the Agency shall consider the average variable costs of all movements of traffic that are subject to the rate and the rate shall not be less than the variable costs of moving the traffic, as determined by the Agency.

Importantly however, this provision does not contradict the general principle set in section 112 of the CTA that rates must be commercially fair and reasonable for both parties, and that standard remains. Instead, the reference to costs in section 127 is made only for the purpose of ensuring that regulated interswitching rates would remain compensatory. This safeguard clause simply establishes a floor for interswitching rates.

Proposal 2: New Block Car Category

The Consultation Paper is proposing to change the current 60-car block category where a different rate applies, which would create, as we understand it, three different rate levels:

- The single car rate which would apply up to 59 cars;
- A rate per car that would apply to blocks of 60 to 99 cars; and
- A rate per car that would apply to blocks of 100+ cars.

CN certainly recognizes that there are efficiency gains resulting from moving cars as a block. North American railways have introduced similar rate structures which encourage efficiencies by reducing the number of assignments necessary to move the same number of cars, which also reduces congestion and facilitates operations for railway customers. Moving blocks of cars benefits the entire supply chain. For this reason, we believe that the proposal could be improved by encouraging greater efficiencies. For example, the shipment of 60 cars or more as a block is not available to smaller shippers, but since the establishment of that block size in 1987, many railway shippers now have the capability to ship blocks of 25 cars, but do not always choose to do so. We believe that the Agency should encourage efficiencies by having a structure for

[1] We note that the Consultation Paper makes no reference to "commercially fair and reasonable" rates. It mentions "fair" rates but without discussing them from a commercial perspective. An assessment of whether the rates are commercially fair would require a discussion of the commercial environment and the rate levels in the market.

interswitching rates applicable to blocks of 25, 50, 75 and 100+[2]. With rates being reduced as the block sizes increase to reflect efficiencies, this interswitching rate structure would derive benefits to the entire supply chain.

As we understand that the Agency collects costing data respecting the movements of all car block sizes and yard operations, we do not see any impediments in an approach more aligned with the market, and more consistent with encouraging supply chain efficiency.

Proposal 3 – A Clear, Accurate Definition of "Car"

This proposal would clarify that for intermodal traffic (containers), one ***platform*** would count as one car for interswitching rates, and that each platform in a set would be counted individually, whether carrying containers or empty, since the latter is still occupying valuable space on the train. We have the following comments respecting this proposal dealing exclusively with intermodal traffic.

At the outset, we submit that interswitching rates should **not** be available to intermodal traffic. This market is subject to a very high level of competition which explains why the CTA treats it differently:

- Intermodal traffic does not have access to long-haul interswitching as per paragraph 129(3)(h) of the CTA;
- Amounts earned by CN and CP for the movement of grain in containers are excluded from their revenue for the purpose of calculating their Maximum Revenue Entitlement as per paragraph 153(3)(e) of the CTA;
- Final offer arbitration is not available for intermodal domestic traffic or intermodal international traffic where competition exists as per 159(1)(b) of the CTA; and
- Trucking is available at all locations where intermodal traffic is interchanged, thereby providing an additional competitive option to local customers.

In the event the Agency maintains interswitching for intermodal traffic, we have several comments. Consistent with our earlier submission respecting how rates should be set on the basis of commercial rates, we believe that consideration should be given by the Agency to trucking rates charged by local companies moving containers in the vicinity of the railway interchange. As this is the market that the interswitching carrier is competing in, to be commercially fair and reasonable, interswitching rates applicable to intermodal traffic should reflect this commercial reality.

Moreover, container trucking is often already subject to existing regulations. For example, access to the Port of Vancouver is already regulated by the Office of the British Columbia Container Trucking Commissioner (www.obcctc.ca), and the Port of Vancouver (www.portvancouver.com). Allowing container access to the port by interswitching regulation at rates different from the ones set by the commissioner and the port would undermine their authority in regulating rate undercutting practices, and would therefore distort these markets by unfairly providing some customers access to the port at rates not available to their competitors.

[2] In our August 21, 2019 CN had proposed 5 different car-block sizes (1-10, 11-30, 31-60, 61-100, 101 cars or more), but we also see the merit of simplification in using existing commercial block sizes in multiples of 25 cars.

We also believe that the rate structure should clarify, that in the event that two containers are moved on a single platform (double stacked containers), the interswitching rate should be applied to each container, in order to take into account the commercial benefit derived from the movement of two containers, for each of which customers pay a separate rate to the connecting carrier.

Proposal 4 – More Transparent Billing

For transparency, the Consultation Paper is proposing that railway companies should disclose in their invoicing the amounts paid to the interswitching carrier. We note that section 128 of the CTA does not provide the Agency with any authority to prescribe items to be included in their billing.

- Paragraph 128(1)(a) refers to the "terms and conditions governing the interswitching of traffic" which refers to how the traffic is physically interchanged between the railway companies. This positions is confirmed by the exclusion of terms and conditions relating to safety. This provision does not have a wording that would enable the Agency to set out the specific billing details to be included by the invoicing company;
- Paragraph 128(1)(b) refers to the determination of the rate, the manner of determining the rate, adjustments to the rates and the establishment of distance zones. If Parliament intended the Agency to prescribe whether the rate should be detailed in invoices, this provisions would have likely said so considering the high level of specificity found here;
- Paragraph 128(1)(c) refers to the prescription of a greater interswitching distance than 30 km and cannot be the basis for this proposal;
- Likewise, subsections 128(1.1), (2), (3), (4) and (5) do not provide the Agency with the authority to govern the content of invoices.

We note that the Consultation Paper also refers to the fact that a railway company provides the details on a voluntary basis. While we do not dispute that this may be the case, such a voluntary offer cannot provide the basis to support a regulation provision to the same effect if no legal authority to adopt it is otherwise available in the CTA.

Conclusion

We thank the Agency for this consultation and its officials for their availability during the consultation process. We remain available should more information be required from CN.

Yours truly,

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