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CP's Response to the Consultation On Regulated Interswitching: Proposed Changes To Rate-Setting And Billing

Thank-you for providing CP and all stakeholders with this opportunity to submit our comments on your proposed changes to the Railway Interswitching Regulations. This regular dialogue between the Agency and industry stakeholders is critical to ensure that the Canadian regulatory environment continues to support and encourage an efficient and competitive transportation system.

An open and honest dialogue allows the regulator and stakeholders alike to understand the views of the other market participants. To that end CP provides its considered response to the Agency's proposal here.

Proposal 1: One Zone and Rate

The Agency proposes to collapse the four distance zones into one zone. There would be only one regulated rate published for all moves in a given block-size category within the 30-kilometer zone. The rate would continue to be cost-based, and the per-kilometer surcharge for moves longer than 40 kilometers by rail would be maintained.

In support of the proposal the Agency notes that a single zone rate would reduce the impact of outliers, so that the rate will be more accurate. It also notes that "distance from the interchange, within the traditional and longstanding 30-kilometre zone structure, has little impact on the cost of interswitching".

Of all of the respondents who directly addressed this proposed change in 2019 only one was in favor of collapsing the zones. All other respondents, including CP, advocated to maintain the existing zone structure. Such an overwhelming response should militate in in favor of the current four-zone structure.

In its 2019 response the Freight Management Association of Canada wrote: "the four zones have generally worked well, are understood and accepted by shippers and carriers and, with the publication of the four zonal rates, are easy to understand and apply." [FMA, 2019, Pg. 6]. This is in keeping with CP's view that the regulatory environment should favor consistency unless there is a clear and pressing need to make changes.

While distance may not be the dominant direct driver of the cost of service for interswitching activities within the confines of a 30 kilometer radius, distance does appear to provide a reliable basis to separate traffic according to other dimensions that drive the cost of service. This is evidenced by the fact that there appears to be a consistent relationship, from year to year, in the cost structure between different zones. This has become evident since the practice of forced linear-regression fitting was abandoned.

As the Agency notes, besides distance, the cost of service is driven by the efficiency of sidings and customer facilities. It may well be that there is a systematic difference in the design of facilities which may be predicted by measuring distance to the interchange.

For example it may be the case that facilities that are larger, more modern, and more efficient are likely to be located further away from the interchange. Many of these facilities were founded as a result of the scaling-up and rationalization of operations. When looking for space to expand it may be natural for businesses to move away from developed areas in order to find lower real estate costs and to escape congestion. Larger, more-efficient operations may benefit from choosing a somewhat more remote location because the increase in rail distance is more than offset by other cost savings such as lower land and building costs, and efficiencies realized by having enough space to develop optimized loading and unloading infrastructure.

In contrast, smaller operations may be more likely to co-locate with railway facilities in order to take advantage of existing infrastructure, which may be prohibitive for a smaller business to develop independently. Older, legacy industrial zones also tend to be divided into smaller parcels, which may be more suitable for a smaller business. And, because smaller operations move fewer carloads, they are not as sensitive to congestion that may be experienced in legacy industrial zones.

These factors may help to explain why we do see a consistent relationship between distance and switching costs, although the relationship is not a positive correlation.

To be clear, the above line of reasoning is presented as an hypothesis, not as fact – CP has not carried out a rigorous study on this matter. Rather, this line of thinking is presented to illustrate the real possibility that distance may be a useful predictor of interswitching costs, despite the fact that there may not be a direct correlation. If that is the case then collapsing the distance zones may eliminate a meaningful separation between operations exhibiting systematic differences in efficiency and cost, which in turn may lead to an increase in cross-subsidization among shippers.

CP recommends maintaining the existing four distance zones, unless it can be clearly shown that distance is not a reliable predictor of interswitching cost – again, regardless of whether or not the relationship represents a direct correlation. This approach also has the benefit of favoring consistency

in the regulatory environment, which is a primary concern for CP as it appears to be for the other stakeholders.

If the four distance zones are nevertheless collapsed, then CP agrees that the per-kilometer surcharge for distances beyond 40 kilometers should be maintained.

Proposal 2: New Block Car Category

The existing 60+ block size rate is dominated by traffic that is moving in blocks larger than 100 cars. Therefore CP does not expect that the 100+ block rate will be significantly different from the existing 60+ block rate. The regulatory environment should favor consistency unless and until there is a clear and pressing need for change.

CP recommends maintaining the existing 60+ car block rate structure.

If the proposal is nevertheless implemented then CP agrees with the Agency that the 100+ car block size provides a reasonable break-point.

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

The proposed definition, which equates an intermodal platform to a "car" for purposes of regulated interswitching, does not fit within the context of interswitching of intermodal traffic. Moreover, a definition for intermodal platforms is not required in this context.

As further expanded below, the proposed definition is not practical for two key reasons:

1) The market for intermodal traffic is fluid and competitive, so that rail carriers have very little market power. Protection under the interswitching regulations is not required.
2) Intermodal operations are different from carload operations to the extent that the regulated interswitching protocols are not applicable.

<u>The Market for Intermodal Traffic is Fluid and Competitive</u>

Railroads are generally intermediate carriers in the intermodal space. Containers are transported by truck or ship prior to being handed off to the railroad for the long-haul overland portion of the move. This implies that shippers have flexibility and control in their selection of routing and are able to choose which railroad(s) will carry their traffic, such that regulatory protection is not required to nearly the same extent.

Indeed, intermodal traffic is often excluded from regulatory controls for that very reason. For example, intermodal traffic is not subject to the recently introduced Long-Haul Interswitching regulation, and it falls under a broad class exclusion under the U.S. transportation regulations. It is CP's understanding that the vast majority of intermodal traffic is not subject to the interswitching regulations because it falls under an exemption Railway Interswitching Regulations [SOR/88-41, Item 2(g)].

A definition for an intermodal platform is not required. Rather, intermodal traffic should not be subject to the interswitching regulations in the first place.

Regulated Interswitching Protocols are Not Applicable

The nature of intermodal traffic in the context of regulated interswitching is different from other carload traffic in six key ways:

1) As noted, intermodal traffic is generally exempt from the regulations under SOR/88-41, Item 2(g).
2) Containers and cars are organized and "blocked" by destination more thoroughly than is generally possible with carload traffic.
3) Terminal facilities are large, efficient operations making use of automated technology in order to maximize efficiency.
4) Because the containers are blocked by destination, interswitching of intermodal traffic generally requires little or no physical switching of cars.
5) Intermodal traffic does not exhibit the normal "load-in, empty-out" pattern that characterizes carload traffic, because intermodal platforms are generally loaded with one or more containers.
6) In contrast to carloads, which are either loaded or empty, an individual intermodal platform may carry anywhere from zero to three containers, each of which may itself be full or empty.

These factors result in two key consequences as they apply to regulated interswitching. First, the operation of interswitching of intermodal traffic does not resemble interswitching carload traffic, implying that the per-car costs are significantly different. Second, the normal billing practices for regulated interswitching do not apply to intermodal traffic.

The interswitching regulations direct that:

> "No charge shall be made by a terminal carrier for the delivery of an empty car from an interchange to a siding for loading or for the return of an empty car to an interchange after unloading." [SOR/88-41, Item 6].

By implication both the empty and the loaded portion of the interswitching operation are included in the regulated rates published by the Agency, so that attaching the billing-event to the loaded car ensures that the interswitching cost is not double-billed. And indeed CP understands that this matches the Agency's practice in developing the rates.

This approach does not apply to intermodal interswitching. An intermodal platform will frequently arrive at the interchange loaded, then be moved to the terminal facility where it is unloaded and subsequently re-loaded at the terminal facility in order to maximize the utilization of the equipment. Because intermodal facilities both terminate and originate traffic, platforms are much more likely to both arrive and depart the facility carrying a load. This stands in contrast to most other lines of business where terminal facilities generally only unload the commodity, and then release an empty car.

By consequence, a regulatory rate for interswitching an intermodal car should not include the empty portion of the move (or should only include a significantly reduced pro-rated portion of an empty move). Otherwise the consequence will be that the terminal carrier will frequently bill the line-haul carrier for empty-car movements that did not occur in practice.

Billing is further complicated by the fact that intermodal traffic commonly makes use of articulated cars combining up to five platforms. Taking a hypothetical example, we could have a five-platform articulated car carrying five containers equally distributed over the platforms (i.e. one container per platform), and simultaneously have another five-platform car carrying five containers all loaded onto two platforms leaving three empty platforms. Should these cars be billed differently or the same? The terminal carrier is effectively doing the same work in each case (i.e. it is moving five platforms and five containers), but the first car would incur five interswitch charges under the regulations, while the second car would incur two charges.

The line-haul rail carrier bills the shipper for transporting <u>containers</u>, while the terminal carrier bills the line-haul carrier for switching <u>platforms</u>. Due to how intermodal traffic moves, these related activities do not align in the way that they do for carload traffic. A regulatory construct that forces the two activities to be treated as if they do align will lead to unrealistic billing, unintentionally discriminating against some shippers and carriers. This is another reason that the billing of intermodal interswitching should be left to be negotiated among carriers rather than being stipulated in regulation.

CP recommends that the proposed definition of "car" <u>not</u> be adopted, as it is likely to cause confusion while it does not appear to address any immediate problem.

Further, CP urges the Agency to issue a specific exclusion for intermodal traffic under the regulated interswitching regulations. Intermodal traffic does not require the same regulatory protection afforded other carload traffic, and it does not fit within the existing regulatory interswitching costing and billing protocols.

4: More Transparent Billing

To a certain extent this proposal may be a solution to the wrong problem.

Interswitching fees are settled between railroads, and, at least in the case of CP, they generally are not passed directly on to shippers. Interswitching fees are relatively small compared to the total freight rate for most line-haul traffic, so that freight rates are generally insensitive to normal changes in the interswitching rate. For example, if the Agency were to hypothetically issue a $10 increase to the Zone 1 rate, traffic that is subject to Zone 1 interswitching would generally not experience a commensurate increase in freight rates.

At the same time, the regulated interswitching rate structure is quite simple and easy to understand. This was reflected in the responses of some shippers in 2019. McMillan, on behalf of Teck, wrote "In our view, the publication of RIS rates in the Agency's decisions under section 127.1 of the Act (most recently in Agency Determination No. R-2018-254) is sufficient notice to allow shippers to ascertain the RIS rates that are available for a given movement." [McMillan, 2019, para. 89.]

Once a shipper knows which zone applies to its traffic, that information is unlikely to change. Simply cross-referencing the zone to the most recent Agency decision on interswitching rates will quickly reveal the applicable rate.

It may be that the fundamental problem that this proposal seeks to address is that shippers are not always sure which zone applies to its traffic. While CP is always ready to answer any questions that a shipper may have regarding its interswitching rate, we do understand that some shippers may prefer to see this information on their invoice.

However, the present proposal may generate confusion and increase the regulatory burden on shippers and carriers alike. One concern is around what will happen if the railroad shows an interswitching rate on the invoice that the shipper disagrees with.

For example, a shipper may release traffic as a block to the railroad, likely receiving a block discount on the freight rate. For whatever operational reason, the traffic may not qualify for an interswitching block rate at the interchange. In that case the invoice will show the single-car interswitching rate. The shipper may quite understandably dispute the interswitching rate and request an adjustment against the freight rate. Note, however, that the freight rate charged to the shipper would not have been affected. Had the interswitching movement qualified for the regulated block-rate, the shipper would still have paid the same freight rate. What is the carrier's obligation in this case?

Showing the interswitching rate on the invoice may also lead to confusion while the regulation is new, and when new players enter the market. For example, from time-to-time a shipper may be uncertain as to whether the interswitching fee is included in the rate or if it is a surcharge on top of the freight rate. This may lead to unnecessary disputes, delays in the billing cycle and over-payments, all of which represent increased regulatory burden.

CP understands that the intent of the regulation is to ensure that shippers receive the protection of the regulated interswitching rate to ensure that they have access to all of their shipping destinations at a reasonable price. It is understandable that a shipper would wish to verify that it is receiving this protection.

To that end, this proposal should be modified such that the invoice be required to indicate whether or not the traffic was subject to the interswitching provisions, and if so, which zone is applicable. The invoice would not be required to show the block size or the actual rate applied.

We believe that this proposal is a good compromise, addressing the underlying concern while avoiding the confusion and increased regulatory burden that the proposal is likely to generate if implemented as written. This proposal would also be simpler for the railroads to build and maintain because the applicable interswitching zone rarely changes, while the regulatory rates will change annually.

Thank-you again for this opportunity to provide our feedback on the proposed regulatory changes.

Yours truly,

[signed]

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