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June 19, 2026

Via email: ferroviaire-rail@otc-cta.gc.ca.

Secretariat, Canadian Transportation Agency
60 Laval Street, Unit 1-117
Gatineau, Quebec
Canada, J8X 3G9

RE: CN's Responses to Initial Submissions - Agency's Consultation on Commercial Market Factors to Be Considered in Determining Regulated Interswitching Rates

Dear Sir/Madam,

CN hereby submits its responses to certain comments raised in the initial submissions filed by Canadian Pacific Kansas City ("**CPKC**"), the Competition Bureau (the "**Bureau**") and the FAIR Rail Coalition ("**FAIR**") in the context of the Canadian Transportation Agency's ("**Agency**") consultation on commercial market factors to be considered in determining fair and reasonable interswitching rates (the "**Consultation**").

The Agency's Consultation stems from the Federal Court of Appeal's decision in Cana*dian National Railway* v. *Canadian Transportation Agency*, 2025 FCA 184 (the "**FCA Decision**"), which directed that "the Agency must consider commercial market factors" when setting regulated interswitching rates that are "commercially fair and reasonable to all parties" under section 112 of the *Canada Transportation Act* (the "**Act**").

As outlined in CN's initial submission dated March 6, 2026, CN retained an independent economic expert, Dr. Nadia Soboleva of Charles River Associates, to develop and propose a market-based methodology. The methodology outlined in her March 5, 2026 report essentially proposes to replace the Agency's existing cost-based rate table with a rate table derived from a regression analysis of unregulated market rates in both Canada and the United States, with rates varying by distance, block size, and shipment type (including premiums for hazardous materials, automobiles, and dimensional loads) (the "**CN Proposed Methodology**"). CN submits that the CN Proposed Methodology is the most rigorous and appropriate methodology to implement, consistent with the FCA Decision. It is also the only methodology proposed in the context of this Consultation.

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A. CN'S RESPONSES TO THE INITIAL SUBMISSIONS

The initial submissions of CPKC, the Bureau and FAIR (together, the "**Initial Submissions**") reveal fundamental disagreements about the role and the weight of commercial market factors in rate setting. CN addresses the issues raised by the Initial Submissions below, organized by issue.

CN has also retained Dr. Soboleva to review and provide comments on the Initial Submissions. Her supplemental expert report is attached hereto as Appendix A (the "**Supplemental Report**"). CN makes reference to that Supplemental Report in support of its submissions.

a) No methodology proposed in the Initial Submissions

First, it is striking that none of the Initial Submissions propose a methodology that the Agency could use to calculate interswitching rates under s. 127.1 of the Act, as requested by Question 4 of the Consultation. In contrast, the CN Proposed Methodology, developed by a renowned economic expert, Dr. Soboleva, offers a rigorous, transparent, and replicable approach to incorporating commercial market factors into the rate-setting exercise.

CPKC did not propose any methodology in its submissions. It proposes that commercial market factors be disregarded except in relation to Toxic Inhalation Hazard/Poison Inhalation Hazard (TIH/PIH) hazardous goods, which should have either a separate rate or a surcharge on regular rates.[1] It suggests that this rate or surcharge could give "full weight" to commercial market factors for these goods.[2] However, CPKC does not propose a methodology to calculate that separate rate or surcharge. As explained below, while CN's primary position is that these goods should be excluded from interswitching, the CN Proposed Methodology can be used to calculate evidence-based rates for these goods that account for associated additional costs and risks as submitted by CPKC.

The Bureau does not provide a methodology to calculate rates. It proposes that the Agency should "primarily" rely on cost-based estimates and use commercial market rates "as secondary checks",[3] but does not provide a methodology for the identification of commercial market rates or how they would be used to "check" the cost-based estimates. As set out below, the CN Proposed Methodology provides a methodology to conduct such a secondary check, which establishes that cost-based rates are artificially low and not commercially fair and reasonable as required under s. 112 of the Act.

[1] CPKC Submission, paras. 4, 20.

[2] CPKC Submission, para. 41.

[3] Bureau Submission, p. 3.

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FAIR does not propose any methodology. It argues that commercial market factors should be given little or no weight unless the Agency is satisfied after "thorough analysis" that such market factors reflect conditions of effective competition.[4] The CN Proposed Methodology is supported by an expert report that explains why the commercial market factors underlying the methodology reflect competitive conditions and are appropriate benchmarks.

As Dr. Soboleva explains in her Supplemental Report, a methodology should be assessed based on identifiable criteria, including feasibility, reliability, and flexibility. The CN Proposed Methodology satisfies those criteria. No other party has proposed such a methodology that could be adopted by the Agency.

b) A cost-based approach is not legally sound nor economically justified

Second, all three Initial Submissions appear to support the status quo, in which commercial market factors are given no consideration in the setting of interswitching rates under s. 127.1 of the Act. However, this status quo was found to be unlawful in the FCA Decision and is further contrary to economic principles.

In the FCA Decision, the Federal Court of Appeal concluded that "when setting interswitching rates, the Agency <u>must</u> consider commercial market factors".[5] This is a statutory constraint on the Agency's rate-setting authority under s. 112 of the Act as a matter of law. A methodology that does not consider commercial market factors is unlawful because the Agency cannot say, as a blanket proposition, that those factors are irrelevant to setting rates that are commercially fair and reasonable.[6]

Accordingly, CPKC's submission that commercial market rates should be given "no weight" in the rate-setting methodology[7] cannot be accepted. This approach would not provide the Agency with any opportunity to assess the relevance of commercial market rates when setting interswitching rates, contrary to the FCA Decision.

FAIR's submission that commercial market rates should be given no weight unless the Agency is satisfied, after thorough analysis, that such factors reflect conditions of effective competition[8], is also inconsistent with the FCA Decision because it presumes that market

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[4] FAIR Submission, para. 17.
[5] FCA Decision, para. 39.
[6] FCA Decision, para. 32.
[7] CPKC Submission, paras. 22, 42.
[8] FAIR Submission, para. 17.

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evidence is irrelevant unless proven otherwise. To the contrary, the FCA Decision holds that the Agency must consider commercial market factors when setting interswitching rates.

The Bureau's submission that the Agency should "primarily rely on cost-based estimates, with commercial market rates potentially serving as secondary checks, if used at all",[9] similarly fails to comply with the FCA Decision because it would permit the Agency to disregard commercial market factors. It perpetuates the primacy of cost-based estimates while treating market evidence as either irrelevant or an afterthought, contrary to the FCA Decision. Moreover, the Bureau submits that "when cost-based rates are consistent with competitive benchmark rates, this may further support the costing process".[10] But CN has filed evidence in this Consultation demonstrating that the cost-based rates are not consistent with competitive benchmark rates. Based on the Bureau's submission, this provides a basis to depart from a cost-based approach.

Ultimately, none of the Initial Submissions can be accepted because they do not articulate any meaningful role that commercial market factors play in the rate-setting methodology, as required by the FCA Decision. More fundamentally, all of the Initial Submissions fail to grapple with the central finding in the FCA Decision that "commercially fair and reasonable" means something different than "fair and reasonable" and requires rates that reflect the commercial realities in which CN and other railways operate.[11]

Maintaining the cost-based methodology is also fundamentally problematic from an economic standpoint. Relying solely on historical or incurred costs disincentivizes innovation, ignores market-driven supply and demand dynamics, and often leads to price distortions. As underlined by Dr. Soboleva in the Supplemental Report, cost-based methods, however carefully implemented, are inherently incomplete proxies for 'commercially fair and reasonable' pricing because they focus on measured past costs, while omitting critical market factors such as demand conditions, expectations of future demand, and competitive constraints that influence negotiated prices and future investment incentives. For this reason, extensive academic literature explains that cost-based price regulation fails in industries with large fixed and common costs and increasing returns to scale and scope, including in the context of freight rail transportation. Relying on market benchmarks avoids these market distortions by using observed prices that already internalize these market factors.

[9] Bureau Submission, p. 3.

[10] Bureau Submission, p.3.

[11] FCA Decision, paras. 27, 37.

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CN submits that the FCA's direction requires a meaningful change to the Agency's approach, not a mere affirmation that the current cost-based methodology is sufficient.

c) Considering commercial market factors is not circular

CPKC submits that it is circular to rely on "market factors" to set regulated interswitching rates because the very purpose of regulated interswitching is to substitute for non-existent competitive market outcomes, because there is "little to no market competition". This claim is unsubstantiated. The existence of a substantial number of unregulated interswitching transactions proves that competition market outcomes do, in fact, exist and can be observed. Accordingly, there is no inherent circularity in considering those outcomes when setting regulated rates.

CN responds that any concern in this regard is appropriately addressed by relying on unregulated interswitching rates derived from transactions that fall outside the regulated interswitching regime. The use of observed market prices in unregulated contexts is not circular. These prices provide direct insight into what railways are willing to pay for comparable switching services in the absence of regulatory price-setting, thereby offering a reliable benchmark for rate determination.

d) Commercial market factors are not captured in the cost-based methodology and adding them as proposed by CN would not be "double counting"

CPKC submits that the Agency's existing cost-based methodology already captures many "market factors" and that separately incorporating those factors risks double counting.[12]

CN agrees that if the Agency were to mechanically combine a cost-based determination with a separate market-based add-on, this would raise a double-counting concern. As Dr. Soboleva explains in the Supplemental Report, market prices already embed cost drivers. However, the CN Proposed Methodology does not propose layering a market add-on onto a cost-based framework. Rather, CN proposes that the Agency should benchmark regulated rates directly against market prices observed in comparable, unregulated interswitching movements. This approach avoids double counting by relying on a single coherent source of evidence—market prices—rather than mixing two partially overlapping frameworks/methodologies.

However, the concern raised by CPKC demonstrates why the CN Proposed Methodology is a sound approach to calculating interswitching rates based on commercial market factors

[12] CPKC Submission, para. 16.

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because it ensures that cost considerations inherent in pricing are not double counted, as may occur under a methodology that is grounded in a costs assessment with commercial market factors considered after the fact. Dr. Soboleva explains that market rates are the more economically sound approach for this precise reason.

e) CPKC supports commercial market factors for TIH/PIH goods

CPKC proposes either establishing a separate interswitching rate for the transportation of TIH/PIH hazardous goods or applying a surcharge to the standard rates to account for the additional risks, operational complexities, capacity constraints, and costs incurred by railways associated with handling these shipments[13].

CN agrees with CPKC that the transport of TIH/PIH hazardous goods involves additional risks and costs that ought to be reflected in regulated interswitching rates. If these goods are not excluded from interswitching (which is CN's primary proposal and briefly discussed below), the CN Proposed Methodology identifies a statistically significant premium associated with hazardous materials and dangerous goods. As Dr. Soboleva explained in her March 5, 2026 report, movements requiring elevated handling and risk management command higher prices, and a benchmarking approach can empirically quantify that premium using observed data from unregulated switching transactions.

However, while CPKC asserts that TIH/PIH risk warrants an adjustment, it does not provide an implementable methodology to quantify such a surcharge. By contrast, Dr. Soboleva demonstrates how a benchmark approach for all rates can be used to calculate premiums for hazardous goods based on observed switching prices for comparable movements. This ensures that any premium reflects revealed market valuations of risk and operational and handling complexity, rather than an untested assumption.

CN further emphasizes that its position goes beyond CPKC's proposal. Indeed, CN submits that TIH/PIH hazardous goods should be fully excluded from the regulated interswitching regime. In the alternative, should the Agency decide to retain TIH/PIH movements within the regime, then CN's market-based methodology, which can be used to calculate premiums for these goods, provides an evidence-based mechanism to account for associated additional costs and risks.

[13] CPKC Submission, paras. 4-5, 20.

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f) Comparable movements can be relied upon to set commercially fair and reasonable interswitching rates

i) Meaningful Canadian benchmarks exist

CPKC asserts that there is no meaningful market for unregulated interswitching in Canada, relying on a limited number of observations identified in its revenue waybill data[14]. However, CN's evidence demonstrates that this conclusion is unfounded.

CN submits that CPKC's conclusion reflects the inherent limitations of revenue waybill records for capturing railway-to-railway switching settlement charges. Interswitching/reciprocal switching charges are typically settled through separate railway-to-railway data exchanges and are not systematically or reliably recorded in customers' revenue waybills as distinct price items. As Dr. Soboleva explains, the small number of observations in revenue waybills data therefore does not establish the absence of unregulated interswitching transactions. Rather, it demonstrates that revenue waybills are not the appropriate data source for identifying or benchmarking such transaction, and that alternative data sources must be relied upon for this purpose.

ii) Canadian shortlines provide a comparable benchmark

CPKC argues that unregulated interswitching involving Canadian shortline railways is not an appropriate comparison, suggesting that such railways lack foreclosure incentives and may charge lower rates than Class I railways[15].

Whether shortline interswitching rates are appropriate or not is ultimately an empirical question and should not be dismissed without further analysis. Using CN's interswitching data, the Agency can directly test whether shortline unregulated interswitching rates differ from unregulated Class I interswitching rates. Moreover, as explained in the Dr. Soboleva Report, to the extent that observed shortline unregulated interswitching rates are observed to be low relative to Class I rates, such evidence would in fact alleviate concerns about the potential influence of market power on interswitching charges, rather than justify their exclusion from the analysis.

CPKC also submits that it does not observe charges for line-haul services provided by shortline railways[16]. However, this critique is misplaced. The CN Proposed Methodology

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[14] CPKC Submission, paras. 26-27.
[15] CPKC Submission, paras. 29-31.
[16] CPKC Submission, para. 32.

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does not rely on line-haul pricing. It is confined to switching services, and CPKC necessarily observes all relevant switching fees, either those it pays to other railways for unregulated interswitching services or those it receives when it provides such services itself. Accordingly, the absence of line-haul data does not undermine the validity of CN's approach.

iii) U.S. reciprocal switching provides a comparable benchmark

CPKC argues that U.S. reciprocal switching rates are not comparable due to network structural differences and limited access to data[17].

CN submits that U.S. reciprocal switching rates are comparable, and any structural differences in the network can be addressed in the methodology. As Dr. Soboleva explains in the Supplemental Report, structural differences can be appropriately addressed through comparability analysis and the use of appropriate empirical controls, and her proposed methodology includes a separate variable in the regression analysis that shows whether the interchange was in Canada or the U.S. as a characteristic of the movement. Incorporating a broader dataset, provided that movements are rigorously screened for comparability, enhances statistical power and improves the stability and reliability of benchmark estimates. Dr. Soboleva further explains that greater network optionality in the U.S. may in fact indicate stronger competitive discipline on unregulated switching charges, making such data particularly informative when setting commercially based rates.

Dr. Soboleva also notes that the CN Proposed Methodology does not require data from every U.S. carrier. CN has already demonstrated to the Agency, in its initial submission, the feasibility of producing data on a large number of interswitching rates in both Canada and the U.S. involving CN and CPKC. As Dr. Soboleva explains, although her analysis relied only on CN data, the available sample contained a sufficient number of observations to support statistically reliable estimation.

iv) The comparable rates underlying the CN Proposed Methodology do not reflect captive markets

The Bureau contends that commercial market rates may reflect the exercise of market power rather than competitive outcomes, and that rates from captive markets should be "avoided" as benchmarks[18]. CN submits that the CN Proposed Methodology is entirely

[17] CPKC Submission, para. 33.
[18] Bureau Submission, pp. 3-4.

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consistent with the Bureau's submission because the unregulated interswitching rates underlying its methodology are produced by a competitive market between carriers.

As explained by Dr. Soboleva in her March 5 report as well as in her Supplemental Report, unregulated interswitching rates are commercially determined between railways, not between a railway and a captive shipper. These are rates that one railway charges another for performing a switching service. They are negotiated in markets where regulation does not apply, and are shaped by competitive pressures, including competition for line-haul traffic and, depending on commodity and corridor, modal alternatives. The competitive dynamics in this railway-to-railway market are fundamentally different from the shipper-to-railway relationship that gives rise to concerns about captivity and market power. Neither party to an unregulated interswitching transaction is "captive" in the sense contemplated by the Bureau; both are sophisticated commercial actors with options. A line-haul carrier that finds a terminal carrier's switching rate excessive at one location can exert pressure at other interconnecting locations, negotiate alternative arrangements, file a complaint with the regulator, or in some cases perform the switching service itself.

Finally, Dr. Soboleva notes that foreclosure-level charges would not be observed in the data because if the rate is so prohibitively high as to foreclose access, there would be no movement associated with that rate. Her March 5 report also describes robustness checks she conducted (including sensitivity to high-rate observations) that test whether a small number of unusually high prices are influencing results. This confirms that the estimated rates are not inflated by market power considerations.

The Bureau also asserts that the rail sector has a "tendency toward uncompetitive pricing".[19] There is no evidence to support this bald statement. To the contrary, nearly all pricing in the Canadian rail sector is unregulated and governed by market forces.

g) Additional supply/demand data is not required

The Bureau suggests that if the Agency considers commercial rate data, it should also obtain additional information on relevant supply and demand factors to contextualize those rates and should consider whether the benefits of data collection exceed the costs.[20]

CN disagrees. A principal advantage of a market-benchmarking approach is that it uses observed prices that already reflect supply and demand conditions (including corridor density, capacity utilization, operational constraints, commodity characteristics, and

[19] Bureau Submission, p. 3.
[20] Bureau Submission, p. 4.

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demand elasticity), without requiring the Agency to assemble separate datasets for each driver.

CN's proposed benchmarking approach can be implemented using ordinary-course switching settlement records maintained by the railways for commercial purposes, reducing incremental burden while improving alignment with the FCA's direction. As noted by Dr. Soboleva in her Supplemental Report, the data required to implement her proposed methodology is already collected electronically by the railways in the ordinary course of business. Accordingly, the costs of data collection weighs in favour of the CN Proposed Methodology. By contrast, the Agency's current cost-based methodology is itself both costly and data intensive, requiring extensive studies as well as ongoing annual updates and yard visits.

h) Comparable market data should be considered based on operational characteristics, not abstract definitions of the "market"

FAIR submits that the Agency must start with "a coherent and rigorous definition of the "market""[21]. FAIR defines the product market as "freight transportation services", and says that any assessment must be done on an origin/destination pair basis (the geographic market)[22]. CN disagrees and submits that comparable market rates should be selected based on the operational characteristics of the movement, rather than the "product" or "geographic" market.

CN maintains that switching services are differentiated by observable operational characteristics (such as distance, block size, and special handling requirements). Treating all 'freight transportation services' as a single product market obscures these distinctions. In her Supplemental Report, Dr. Soboleva explains that analyzing commercial rates based on all freight transportation services is too broad, and that distinct rates are necessary for at least some product categories. Dr. Soboleva also explains that setting interswitching rates by origin-destination pair would be administratively burdensome and statistically unreliable, such that FAIR's proposed origin–destination market definition is unsuitable for the CTA's methodology. Within CN's data, there were more than 8,000 origin-destination pairs. This not only makes pair-specific rate setting impractical, but also statistically weak, because many pairs would contain too few transactions to support valid and reliable statistical analysis.

[21] FAIR Submission, paras. 9-10.
[22] FAIR Submission, paras. 11-12.

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i) Systemwide R/VC measures are misleading and irrelevant

FAIR suggests that publicly available U.S. margin measures (e.g., revenue to variable cost or R/VC ratio) indicate that regulated interswitching rates are already commercially fair and reasonable.[23]

CN submits that this comparison is misleading and not relevant. The R/VC ratio is a systemwide margin; systemwide margins do not determine whether switching charges for interswitching services are commercially fair and reasonable. U.S. R/VC ratios for line-haul movements are not comparable to Canadian interswitching rates. Line-haul traffic involves long-distance movements across an entire network, whereas interswitching involves short-distance switching at an interchange. The cost structures, operational requirements, and competitive dynamics are fundamentally different.

Also, as Dr. Soboleva's analysis demonstrates, systemwide measures aggregate values across many services and do not provide evidence about the appropriate level of switching fees. In her Supplemental Report, Dr. Soboleva explains that if regulated switching fees are decoupled from actual market conditions, then regulation can create distortions such as cross-subsidization, inefficient routing, and misaligned investment incentives. A benchmarking based on comparable switching movements provides more direct evidence for the Agency's task.

j) It is irrelevant whether existing rates are "fully compensatory" or not

FAIR relies on the Agency's statements to assert that the cost-based methodology produces interswitching rates that are "fully compensatory" to railway companies, including a normal return on capital[24]. CN submits that this is irrelevant to the Consultation because "fully compensatory" does not equate to "commercially fair and reasonable" as required by section 112 of the Act. A cost-based floor does not establish what is commercially fair and reasonable; it merely establishes a minimum below which rates cannot fall to ensure that the regulated rates do not threaten the economic viability of railways mandated to perform interswitching. The FCA Decision makes clear that the statutory standard requires consideration of commercial market evidence beyond costs alone.

In addition, there is an important economic distinction between a "compensatory rate", as characterized by FAIR, and a market-based rate. As Dr. Soboleva explains in her Supplemental Report, a compensatory rate may recover variable costs and past investments, yet still distort resource allocation and economic incentives if it fails to reflect

[23] FAIR Submission, para. 23.

[24] FAIR Submission, para. 31.

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opportunity costs and future investments, because the financial viability of a price depends on both cost and demand considerations. By contrast, a credible and economically grounded measure of the opportunity cost of providing interswitching services is the average market rate for comparable movements.

k) Commercial rates minimize cross-subsidization

FAIR argues that higher rates – as suggested by the FCA in its decision – would permit cross-subsidization, in which railways use those increased interswitching revenues to reduce their rates elsewhere, improve services or make new capital investments, so that captive shippers would be subsidizing those with more competitive options[25].

CN submits that the current interswitching regime with rates that are too low already creates cross-subsidization, in which shippers that make limited use of regulated interswitching effectively subsidize those that rely on it more heavily. Cross-subsidization arises when rates are set either too high or too low from an economic efficiency perspective. The best way to avoid it is to set market-based rates that reflect commercial reality, as CN proposes by using average commercial rates.

l) FAIR's concerns based on shipper fear of retribution

FAIR raises concerns that some shippers may be reluctant to make individual submissions on this Consultation due to a perceived risk of retribution[26].

CN takes such concerns seriously and firmly rejects any suggestion that shippers would face adverse treatment for participating in any regulatory processes. CN places significant importance on maintaining strong, constructive, and long-term commercial relationships with its customers, which depend on trust and fair dealing.

In any event, this issue does not bear on the matters before the Agency in this Consultation. The Agency's mandate here is to develop a methodology for incorporating commercial market factors into interswitching rate setting; it is not to assess or adjudicate allegations relating to commercial conduct.

B. CONCLUSIONS

The Initial Submissions of CPKC, the Bureau, and FAIR collectively urge the Agency to either maintain the status quo or relegate commercial market factors to a marginal role. CN

[25] FAIR Submission, paras. 29-30.
[26] FAIR Submission, para. 33.

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respectfully submits that such approaches are inconsistent with the FCA Decision and the statutory requirement that interswitching rates be "commercially fair and reasonable to all parties". In addition, the positions expressed in the Initial Submissions are not supported by any data or evidence, and do not propose any methodology, which was the core objective of this Consultation.

CN is the only party effectively proposing a market-based rate setting methodology, developed by a renowned economic expert, Dr. Soboleva. The CN Proposed Methodology offers a rigorous, transparent, and replicable approach to incorporating commercial market factors into the rate-setting exercise. The CN Proposed Methodology is also practical and capable of long-term implementation. Importantly, it relies on readily available data about actual unregulated interswitching transactions, controls for relevant characteristics through regression analysis, and produces rates that accurately reflect the commercial realities of the interswitching market.

CN reiterates that the FCA Decision set aside the Agency's 2024 rate determination precisely because the Agency had improperly refused to consider evidence concerning commercial market factors. If the existing methodology already adequately incorporated such factors, there would have been no basis for the FCA to find error. The FCA's direction requires a meaningful change to the Agency's approach, not a mere affirmation that the current cost-based methodology is sufficient.

As such, CN urges the Agency to adopt the CN Proposed Methodology and to give decisive weight to commercial market evidence in determining regulated interswitching rates, including for 2024, 2025, and 2026.

CN remains available to provide any additional information or clarification the Agency may require.

Best regards,

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Canadian National Railway Company