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Re: Consultation on Determining Fair and Reasonable Interswitching Rates — Competition Bureau Submission to the Canadian Transportation Agency

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The Competition Bureau appreciates the effort of the Canadian Transportation Agency (Agency) to be transparent by publishing the comments submitted to this consultation. We welcome the opportunity to reflect on the competition-related issues raised under the submissions of the other intervenors. In brief, we wanted to confirm our position as detailed under our original submission and offer a few comments on the other parties' submissions, where relevant.

As set out in the following sections, the Bureau has identified several issues with the other submissions. In particular:

- the use of unregulated interswitching rates as a benchmark has not been shown to reflect competitive market outcomes,
- the proposed exclusion or differential treatment of certain goods falls outside the scope of this consultation, and
- the sharing of confidential commercial information may raise competition concerns.

Unregulated interswitching rates are not an appropriate benchmark for competitive market outcomes

Dr. Soboleva's report (the CN Expert Report, prepared for the Canadian National Railway Company) does not – and its methodology cannot – answer the question of whether unregulated interswitching rates reflect competitive market outcomes.

The CN Expert Report uses unregulated interswitching rates as a benchmark for commercially reasonable rates, implicitly assuming those rates were set under competitive conditions. However, the analysis cannot distinguish between competitive and uncompetitive pricing. The CN Expert Report notes that the data does not include prices so high as to result in foreclosure.[1] This is referring to *complete* foreclosure where line-haul carriers do not serve rival carriers at all.

In addition, while the CN Expert Report does not use the term, it appears to contemplate situations where the data may include *partial* foreclosure, that is, rates that are set higher than otherwise because of the additional profit the line-haul carrier obtains from weaker competition as a result of disadvantaging a rival carrier.[2] Yet, it does not demonstrate that unregulated rates reflect competitive market pricing. Importantly, line-haul carriers can still exercise market power over short-line carriers that have limited alternatives, even absent foreclosure incentives. The CN Expert Report analyzes rates at which transactions occurred, not the distribution of rates that would prevail in a competitive market where all potential interswitching traffic could participate. The only way to resolve this problem is with an independent competitive benchmark such as: (1) rates from a market with demonstrated effective competition, (2) a structural model of competitive pricing, or (3) a cost-based study like the Agency currently uses. The CN Expert Report does not use any of these approaches and we would caution the Agency against using this methodology.

In addition, the methodology proposed in the CN Expert Report raises a number of other issues.

- It may create an incentive to charge unregulated rates in a manner designed to influence regulated rates. The CN Expert Report notes that there are a relatively small number of unregulated interswitching movements in Canada compared to the much larger volume of regulated interswitching traffic.[3] This increases the susceptibility of the regulated rates being influenced through unregulated rates.
- The methodology cannot generate specific rates in years where there are no (or only a few) interswitching movements.
- Pooling Canadian and US observations in a single regression implicitly assumes that the slope coefficients (e.g., the effect of distance on price) are the same in both countries. The "U.S. Interswitch" factor only controls for country-specific differences in rate levels. US data will strongly influence the regression results simply due to volume, meaning that the estimated coefficients primarily reflect US market conditions. The CN Expert Report states: "As described in Appendix B, my sensitivity analysis shows that using combined data for unregulated

[1] Paragraph 38 of the CN Expert Report.
[2] See paragraphs 39 and 40 of the CN Expert Report.
[3] Paragraph 59 of the CN Expert Report.

switches in Canada and in the U.S. results in qualitatively similar rates as using Canadian data only."[4] But Appendix B does not actually include this comparison.

Excluding or surcharging certain goods is out of scope and should not be considered in this proceeding

In its submission, CN proposes that Toxic Inhalation Hazard/Poison Inhalation Hazard (TIH/PIH) hazardous goods be excluded from the regulated interswitching regime. Canadian Pacific Kansas City Limited (CPKC) proposes that these goods instead be subject to a different rate or surcharge. CN also recommends that automotive and dimensional (oversized) loads be charged a premium.

The goal of this public consultation process is to obtain feedback about how commercial market factors should be considered in the determination of regulated interswitching rates. For this purpose, the Agency included a set of questions which relate to what commercial market factors should be considered by the Agency, what additional data should be provided by railways, what weight, if any, should be given to commercial market factors, and what methodology should be used to apply these weights to calculate interswitching rates.

Accordingly, we would caution against including matters that are out of scope of this consultation such as regulated interswitching exclusions, premiums, or surcharges.

Furthermore, excluding goods from regulated interswitching would remove a protection to the exercise of market power. The competitive implications of this proposal could be significant and have not been assessed. Before implementing any exclusion, we would encourage the Agency to consider alternative regulated access mechanisms for affected shippers; although we still believe this to be out of the original scope of this consultation.

As set out above, we identify a number of issues with CN's proposed approach to rate setting. These concerns also apply to the proposed surcharges. Instead, if the Agency found it was appropriate to do so, it could modify its cost-based rate setting methodology to allow for surcharges for certain goods. This would preserve competitive access while compensating for additional costs and risks.

Sharing confidential information can raise competition concerns

In its submission, the FAIR Rail Coalition proposes that the Agency require CN and CPKC to publicly disclose any commercial rates they advance in this Consultation as

[4] Paragraph 59 of the CN Expert Report.

support for their positions. Being open and sharing information helps ensure decisions are based on strong evidence. When information is not available equally to all participants, it may make it harder for the Agency to check if the proposed benchmarks reflect real market conditions and prevents affected shippers from taking part effectively in setting rates.

However, publishing or sharing confidential information can raise competition concerns, as it may facilitate coordination between competitors or otherwise reduce a business' incentive to compete. The Bureau has provided draft guidance on this matter in its Anti-competitive Conduct and Agreements Enforcement Guidelines (Draft ACCA Guidelines).[5] The Draft ACCA Guidelines offer examples of what may constitute competitively sensitive information shared between competitors, including pricing information, costs, trading terms, strategic plans, marketing strategies and investment or capacity decisions. Even where businesses do not object to sharing information directly with a competitor, or indirectly via public disclosure, the Agency should still be careful to avoid these risks.

Maintain a workable regulatory system

Regulated interswitching rates serve an important role in addressing rail freight competition concerns and are why, in our view, specific criteria were established to guide their implementation and oversight. Proposals that would effectively substitute unregulated commercial rates for the Agency's regulated rates risk undermining the protections that they were intended to provide. Should there be a determination that regulated rates are no longer required, we believe the appropriate course would be to revisit the statutory framework through a legislative process.

Conclusion

The Bureau appreciates the opportunity to provide a response to the initial submissions.

The Bureau continues to support the Agency's cost-based methodology as the most appropriate approach to determining interswitching rates that are commercially fair and reasonable to all parties. This methodology provides an independent benchmark that is not susceptible to the strategic pricing incentives inherent in approaches based on unregulated rates. The Bureau encourages the Agency to ensure that any modifications to its methodology remain consistent with the statutory framework and the competitive safeguards it is designed to uphold.

[5] The Draft ACCA Guidelines have been published for consultation but not yet been finalized.