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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 is pleased to provide its third-round submission to the Canadian Transportation Agency in the consultation on commercial market factors to be considered in determining fair and reasonable interswitching rates. We also confirm that our initial and second submissions continue to reflect our views.

In this submission, we focus our comments on select competition-related issues raised in the second-round submissions. In particular:

- regulated interswitching rates are intended to promote competition;
- considering commercial market factors does not require adopting commercial market rates;
- CN has not shown that unregulated interswitching rates are an appropriate benchmark for regulated rates; and
- the Bureau's proposal provides a practical way to consider commercial market factors while preserving the competition protections of an independent benchmark for rate-setting.

The purpose of regulated interswitching rates is to promote competition

Regulated interswitching is intended to promote competition by providing shippers with access to competing railways where direct rail competition is limited. Accordingly, regulated interswitching rates need not mirror unregulated market rates. Where commercial rates may reflect the effects of limited competition, regulated rates may appropriately differ in order to preserve the competitive-access function of the regime.

As noted in the Bureau's initial submission, regulated interswitching provides shippers served by a single railway with access to a competing railway's network and therefore promotes competition in circumstances where direct rail competition is limited. The Bureau explained that interswitching was originally intended to reduce the need for redundant rail lines but also plays an important role in providing shippers with additional transportation options and protecting against uncompetitive pricing where market power exists.[1]

The FAIR Rail Coalition similarly emphasizes that regulated interswitching is a pro-competitive access mechanism designed to protect shippers and provide access to competing railways. FAIR notes that policy makers have long recognized that regulated interswitching rates are intended to increase access to competing railway companies while compensating railway companies for the cost of providing the service.[2]

This competition-promoting purpose is important when evaluating proposals to rely on unregulated interswitching rates as benchmarks for regulated rates. Regulated interswitching rates are not meant to mirror rates in unregulated markets. Their purpose is to support competition, protect against the exercise of market power, and ensure that rates are commercially fair and reasonable to all parties. As the Bureau noted earlier, market rates can reflect market power when there is not enough competition.[3]

The Agency need not adopt commercial market rates to consider commercial market factors

The obligation to consider commercial market factors does not require the Agency to replace its existing cost-based methodology with one based on unregulated interswitching

[1] Bureau first submission, p. 2.
[2] FAIR first submission, pp 3-4; 13-17.
[3] Bureau first submission, pp 2-5.

rates. CN's position conflates considering commercial market factors with adopting commercial market rates. Commercial market rates are only one potential form of evidence. The Agency should assess their relevance and probative value alongside the rest of the evidentiary record and determine what weight, if any, they should receive. CN's proposal would instead reduce rate-setting to a formula derived from commercial rates alone.

CN has not demonstrated that unregulated interswitching rates are an appropriate benchmark

CN's proposal depends on the assumption that unregulated interswitching rates provide an appropriate benchmark for regulated rates. The record does not support that assumption. As explained below, CN has not demonstrated that unregulated rates are competitive, its remaining arguments do not overcome that deficiency, and additional concerns further undermine its proposed approach. Taken together, the record does not provide a persuasive basis for replacing the Agency's existing methodology.

CN has not demonstrated that unregulated interswitching rates are competitive

CN's position depends on the assumption that unregulated interswitching rates are appropriate as a competitive benchmark. CN submits that these rates are "commercially determined between railways," that neither party is "captive", and that both parties are "sophisticated commercial actors with options."[4] CN further submits that a line-haul carrier facing an excessive switching rate can "exert pressure at other interconnecting locations, negotiating alternative arrangements, file a complaint with the regulator, or in some cases performing the switching service itself."[5]

However, CN has not shown that commercial rates are competitive. Commercial sophistication is not a substitute for competition. A party may be commercially sophisticated and still lack practical alternatives in a particular location or transaction. Similarly, the fact that two railways came to a commercial agreement does not demonstrate that the rate was competitive.

CN does not offer any evidence that interswitching rates are kept competitive by "pressure" at other interconnecting locations, or by the other mechanisms it lists.

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[4] CN second submission, p. 9.
[5] CN second submission, p. 9.

Switching services are tied to specific locations. Where there are few alternatives at a particular location, rates may not be competitive, regardless of whether railways have options elsewhere. CN does not explain, or provide supporting evidence showing, how either filing a regulatory complaint or performing the switching service itself would result in a competitive rate.

CN's expert mischaracterizes the Bureau's submission.[6] The Bureau did not argue that any transaction involving two railways constitutes a competitive benchmark. Rather, the Bureau stated that any benchmark rates should reflect market conditions where competition is present and meaningful.[7] The academic study cited by the Bureau refers to rates observed in corridors where multiple railways compete for traffic. By contrast, the fact that an unregulated interswitching arrangement involves more than one railway does not, by itself, establish that the resulting rate was competitive. One railway relies on the other for access, which may limit competition between the railways. The report does not demonstrate that observed unregulated interswitching rates are set in the type of competitive market contemplated by the Bureau's submission. Accordingly, the report has not shown that unregulated interswitching rates are comparable to the competitive benchmarks discussed in the Bureau's submission.

CPKC argues that CN's proposed benchmark includes rates that are not from comparable markets, noting that interswitching rates are lower with shortline railways than with Class I railways and that unregulated interswitching in the United States may be more competitive than in Canada. CN's expert responds that these differences are a strength, not a weakness, because they include rates from more competitive settings and therefore reduce concerns about market power.[8] In doing so, the report appears to agree with the Bureau's view that the level of competition matters when assessing a benchmark. However, the fact that some observations may come from more competitive settings does not establish that the benchmark as a whole is based on competitive rates. The report does not demonstrate that the commercial rates used in the proposed methodology are competitive benchmarks.

CN's robustness check tests whether the results are driven by a small number of observations with unusually high rates rather than by the broader dataset. CN argues that because the results remain largely unchanged when the top 10 percent of unregulated rates are excluded, the estimated rates are not inflated by market power considerations.[9]

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[6] CN second expert report, para. 30.
[7] Bureau first submission, pp. 4-5.
[8] CN second expert report, paras. 39 & 44.
[9] CN second submission, p. 9; CN first expert report, para. 5.

The Bureau disagrees. Testing whether a few high observations influence the results is not the same as testing whether the remaining rates were established under competitive conditions. Even if the results remain similar after excluding the highest observations, the remaining rates may still reflect market power and therefore may not be appropriate benchmarks for regulated interswitching rates.

CN's remaining arguments do not overcome this deficiency

CN's reliance on general critiques of cost-based regulation is insufficient to support its proposal.[10] The Bureau acknowledges that cost-based regulation has limitations. However, identifying limitations in the existing methodology does not establish that CN's proposed benchmark is superior. CN has not shown that unregulated interswitching rates are competitive, nor has its expert identified academic support for the specific methodology proposed. Using observed prices as a benchmark means that any lack of competition reflected in those prices will also be carried through to regulated rates. CN also says that its methodology has the advantage of relying on ordinary-course switching settlement records and does not require the Agency to assemble separate supply and demand datasets because observed prices reflect supply and demand conditions.[11] But the absence of additional information requirements is not a strength. Observed prices also reflect market power, the very factor that regulated interswitching rates are supposed to protect against. CN's proposal does not address the fundamental purpose of regulated interswitching.

Additional concerns weigh against CN's proposed approach

CPKC's expert provides additional reasons for caution regarding CN's proposal. CPKC's expert identifies a number of methodological and statistical concerns with CN's expert analysis, including questions about the comparability and representativeness of the data used to derive the proposed benchmark. CPKC's expert shows that adjustments to CN's assumptions can materially affect the resulting rates. While the Bureau has set out fundamental conceptual issues and methodological shortcomings with CN's proposed approach in its second submission[12], CPKC's statistical criticisms add to the reasons why CN's proposed approach should not be used in place of the Agency's existing framework.

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[10] CN second submission, p. 4; and CN second expert report, paras. 20-28.
[11] CN second submission, pp. 9-10.
[12] Bureau second submission, pp. 1-2.

CN has not justified replacing the Agency's existing methodology

CN proposes a significant departure from the Agency's existing methodology. It should provide a persuasive basis for concluding that its proposed approach both satisfies the statutory framework and improves upon the existing methodology. For the reasons set out above, it has not done so.

The Agency should retain its cost-based methodology while considering additional commercial market factors

As the Bureau noted in its initial submission, the Agency need not choose between maintaining its existing cost-based methodology and giving meaningful consideration to commercial market factors. The Bureau proposed retaining the Agency's cost-based approach, which, in our view, already incorporates consideration of commercial market factors by considering economic costs.[13] It further proposed allowing parties to introduce evidence on commercial market rates and other relevant commercial market factors through the submissions process.

This approach would preserve an independent benchmark for rate-setting, while providing a practical mechanism for the Agency to consider additional market evidence where relevant. While the Bureau recognizes that interpreting commercial market rates may require additional context and information, commercial market rates and related evidence may still assist the Agency as a reasonableness check on costing studies and other elements of its analysis. If not, the Agency is free to assign such evidence no weight.[14] This approach allows the Agency to consider additional evidence on commercial market factors where appropriate while maintaining a methodology that remains consistent with the competition-promoting purpose of regulated interswitching and the objective of producing rates that are commercially fair and reasonable to all parties.

Conclusion

The Bureau appreciates the opportunity to provide these further comments in response to the second-round submissions.

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[13] See Canadian Transportation Agency, *Appendix A to Determination No. R-2020-194*: *The Canadian Transportation Agency's Methodology for Calculating Regulated Interswitching Rates*.

[14] Canadian National Railway Company v. Canada (Transportation Agency), 2025 FCA 184, para. 40.

As explained above, regulated interswitching serves an important role to increase competition. In the Bureau's view, the requirement to consider commercial market factors does not require the Agency to replace its existing cost-based methodology with an approach based on unregulated interswitching rates. Rather, any methodology adopted by the Agency should be assessed against the objectives of the statutory framework and its ability to produce rates that are commercially fair and reasonable to all parties, including by safeguarding against the negative effects of market power.

CN's submissions advocating total reliance on unregulated interswitching rates have not demonstrated that such rates are competitive or provide a more reliable benchmark than the Agency's existing approach. The Bureau therefore continues to support the Agency's cost-based methodology as the foundation for determining regulated interswitching rates. The Agency can nevertheless give additional consideration to commercial market factors by permitting parties to introduce evidence on commercial market rates and other relevant commercial market factors through the submissions process. This approach would preserve an independent benchmark for rate-setting while enabling the Agency to consider additional market evidence where relevant. The Bureau submits that the record in this proceeding does not establish a persuasive basis for replacing the Agency's existing methodology with one derived from unregulated interswitching rates and continues to support its proposal as a practical means of producing rates that are commercially fair and reasonable to all parties.