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Canadian Transportation Agency
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Submitted by email: ferroviaire-rail@otc-cta.gc.ca

RE: Fertilizer Canada's Feedback to the Canadian Transportation Agency on a New Approach to Setting Regulated Interswitching Rates

Fertilizer Canada represents the manufacturers, wholesale and retail distributors of nitrogen, phosphate, potash and Sulphur fertilizers – the backbone of Canada's agri-food economy. The fertilizer industry adds $12.7 billion annually to Canada's Gross Domestic Product and supports over 76,000 jobs. Farmers in more than 75 countries receive Canadian mined and manufactured fertilizer products each year.

Fertilizer Canada welcomes the opportunity to comment on the Canada Transportation Agency's (CTA) *Discussion Paper on the CTA Approach to Setting Regulated Interswitching Rates*. Fertilizer is one of the highest volume commodities shipped by Canada's Class I railways. Adequate and suitable levels of rail service at fair rates are essential for the success of the fertilizer industry and Canada's economy.

Overall, we believe that many aspects of the current methodology of calculating interswitching rates function as intended and that there is little reason to interfere. However, we do believe that a new method should be used to calculate the productivity factor as the necessary information is available and it would not overtly favour either shippers or carriers. In addition, we have indicated that there is a need for more information sharing amongst market participants and that transparency in rate setting is important to the fertilizer industry. Feedback to each of the nine issues outlined in the Discussion Paper are provided below.

Issue 1: Federally regulated short-line railway companies

We agree with the CTA's previous assessment that any potential increase in the accuracy of rates by including short-line railway companies is not worth the additional reporting burden and consequential increase in costs to shippers. Although short-line companies may not be able to take advantage of economies of scale they are generally able to offset these higher input costs through lower labour costs and lower maintenance costs. Overall, we expect short-line railway companies to have similar cost structures to Class 1 railway companies that average out.

As well, any change that increases a short-line railway company's profit from interswitching rates will impact fertilizer shippers as many are only able to use one carrier because of geographical considerations. This makes them captive to the carrier and unable to use competitive market forces to find better prices. This would change market price expectations, which would likely mean increased costs for consumers.

Issue 2: Regional and commodity-specific regulated interswitching rates

Fertilizer Canada and its members do not support new regional or commodity-specific interswitching rates. Canada's main railway companies, Canadian National Railway (CN) and Canadian Pacific Railway (CP) operate in a variety of locales and environments. As such, it seems unlikely that Class 1 railway companies would be unable to average out their costs across both high and low-cost terminals. In addition, interswitching rates do not generally constitute a significant portion of the cost of freight.

Creating a wide-range of rates to include regional differences and specific commodities would increase the burden on both shippers and carriers, without creating a net benefit for the industry at-large. The addition of these rates would add confusion and reduce the likelihood that shippers are receiving the most fair and transparent price for moving their goods.

Issue 3: Interswitching zones up to 30 km

Fertilizer Canada and its members support maintaining the current four zone system and their assigned distances, as they relate to the 30 km interswitching range. These ranges are sufficient for setting rates and any additional factors such as train size or grades of track characteristics will only add unnecessary logistical burden to both shippers and carriers. These suggested factors, for example, would require increased reporting by shippers and carriers and would needlessly complicate the system.

Issue 4: Long-term investment needs of the railway companies

Fertilizer Canada supports the Agency's current evidence-based market approach of addressing the railways' long-term investment needs by including factors for cost of capital and depreciation allowance, as explained in the discussion paper and Agency determination No. R-2018-254. Since railways are fully compensated for their investment needs by the current approach, no further adjustment is necessary.

When it was last reviewed, less than a decade ago, the CTA found that the Capital Asset Pricing Model (CAPM) was 'fair, reliable, and pragmatic'. Fertilizer Canada believes that there has not been enough change in the interim to justify a new model, which could have a large impact on prices across a variety of key Canadian industries.

Both CN and CP have recently announced significant investment in long-term assets. CN has indicated that it will be investing approximately $3.9 billion across Canada and the US in 2019. CP has also stated they plan on buying 5,400 train cars over the next four years. This would suggest that CAPM provides adequate levels of compensation for railways, allowing the companies to expand their operations appropriately and assuaging fears of underinvestment.

The fertilizer industry, in particular, would be drastically impacted by changes to CAPM as a primary method of shipping fertilizer is through rail, including over 11 million tonnes of fertilizer and potash between January and May 2019. If the cost of shipping increases, creating additional profits for already profitable companies, the fertilizer industry would be forced to cost recover by passing the additional costs onto consumers and end-users, including farmers.

Issue 5: Contribution to fixed costs

Fertilizer Canada notes that the Agency has granted an extension to provide more fulsome comments on this issue until January 20, 2020. Nevertheless, by way of preliminary comments, Fertilizer Canada and its members believe that the current model continues to meet Section 112 of the Act and is both commercially fair and reasonable for all parties. As stated, many fertilizer suppliers use rail as their main method of shipping for its ability to cost-effectively move large volumes of product, while meeting regulatory requirements. As such, it is extremely unlikely that a shipper could find another form of transportation to meet their needs without dramatically increasing their costs; their demand for rail transport is inelastic. In addition, shippers are often beholden to one local carrier because of the locations and regulatory requirements of fertilizer suppliers. As a result these shippers have highly inelastic demand for interswitching services.

A new model of full Ramsey Pricing would allow for heightened price discrimination and interference with a market that is functioning as intended. Full Ramsey Pricing would privilege certain goods or shippers as inherently more profitable to move based on their elasticity, and therefore their contribution to fixed costs. This would displace certain categories of goods while making others vastly more expensive. This would be neither commercially fair nor reasonable.

The policy underpinning the *Railway Interswitching Regulations* for decades has been to prevent railway from charging unregulated market rates on short interswitching movements so as to achieve the benefits of real rail-to-rail competition. As such, fertilizer shippers would be forced to pay higher costs in a less-competitive market, counterintuitive to the purpose of a market access tool like interswitching.

Issue 6: Productivity Factors

Fertilizer Canada notes that the Agency has granted an extension to provide more fulsome comments on this issue until January 20, 2020. Nevertheless, by way of preliminary comments, Fertilizer Canada and its members would support an update to the method the CTA uses to calculate the productivity factor for interswitching rates. The old Ideal Fisher Model and its assumptions do not reflect the current state of the railway market. The Canadian railways demonstrate largely imperfect competition with economies of scale. This negates both concepts that the current productivity factors are derived from: perfect competition and constant returns to scale.

Additionally, the old Ideal Fisher Model, as a result of being created in 1992, relied on assumptions because it was not practical or possible to source the required information from carriers without significant burden. However, because of the significant technological advancements that have occurred since, these barriers no longer exist. Now, carriers can easily provide up-to-date and accurate data on variables they likely already collect. This will allow the CTA to calculate more precise and reflective rates.

Fertilizer shippers are looking to help foster an open, fair, but competitive marketplace. As shown in the Discussion Paper, the new method would not always advantage either the shipper or the carrier, rather it would allow for prices grounded in evidence rather than assumptions.

Issue 7: Volume discount rate categories

Fertilizer Canada and its members believe that the current minimum block size of 60 units is adequate and that any additional specification of rates or shipment sizes will only increase the logistical burden shippers already face. This size represents an amount that is fair to multiple industries and maximizes the utility of both shippers and railways.

Issue 8: Collecting interswitching service units

Fertilizer Canada and its members believe that any estimates collected should be more transparent and actively communicated to shippers. Regardless of the method employed, the information, where possible, should be provided publicly to improve shipper and short-line railways access to data. This would allow companies to make more informed choices and also to recognize discrepancies for future consultations.

Issue 9: Transparency of the regulated interswitching rates and methodology

Fertilizer Canada and its members support a new invoice requirement that would provide additional transparency in interswitching rates between shippers and carriers. Specifically, it would be beneficial if interswitching rates shown separately from the long-haul rate. This would represent an incremental step forward in correcting a power asymmetry between shippers and carriers, which the CTA has already demonstrated is a priority with the publication of the interswitching rate methodology. The current presentation of rates means that shippers have little opportunity to know the interswitching rate being used and if any calculation errors have occurred.

This invoice requirement would present minimal increased burden to railways, as they must already perform the calculation when providing an overall cost, while providing shippers with enough information to correct erroneous charges. However, Fertilizer Canada believes that the interswitching rate reimbursement should remain between the long-haul carrier and local carrier. If a change were made wherein the shipper directly reimbursed the local carrier it may mean that the long-haul carrier has less of an incentive to intervene in disputes between the shipper and local carrier.

Additionally, any digital tools or platforms that helps shippers estimate their costs in advance will give industry more certainty and the ability to operate effectively. For example, a tool that could estimate interswitching rates based on relevant geographic locations would ensure shippers are able to forecast their costs accurately and with less resources.

Fertilizer Canada and its members appreciate the opportunity to provide feedback and recommendations to this important matter. We welcome the opportunity to meet with you and your colleagues to discuss our industry and our recommendations for the approach to setting interswitching rates by the CTA.

Sincerely,

Nadine Frost
Director, Policy & Industry Standards