

2019 Consultation by the Canadian Transportation Agency on Regulated Interswitching Rates

Response of the Freight Management Association of Canada (FMA) to those Issues where responses are due by August 21, 2019

1.0 Introduction:

Following from revisions to the *Canada Transportation Act* made by Bill C-49, and pursuant to Section 128 (5) of the *Act*, “Review of Interswitching Regulations”, the Canadian Transportation Agency (Agency) announced that it is undertaking a 60-day consultation, commencing June 20, 2019, of both the regulatory requirements and Agency practices.

The Agency has identified nine “Issues” for which it is requesting comments as part of the consultation. These nine issues are:

- Developing interswitching rates for federally regulated short-line railways
- Regional and commodity specific interswitching rates;
- Interswitching zones up to 30 km;
- Long-term investment needs of the railway companies (cost of capital methodology);
- Contribution to fixed costs;
- Productivity factors;
- Volume discount rate categories;
- Collecting interswitching service units; and
- Transparency of the regulated interswitching rates and methodology.

FMA notes that seven of the nine “Issues” raised by the Agency require a written response no later than August 21, 2019. In response to a request by FMA and other industry associations requesting a six-month extension for all nine issues, the Agency has given an extension to January 20, 2020 to only Issue 5 – “Contribution to Fixed Costs” and Issue 6 – “Productivity Factors”. Given the limited time available, the complexity of many of the issues, FMA will provide responses to those Issues where FMA has useful comments to contribute.

As a first general comment, the Interswitching regime, which has been regulated since 1904, has proven to be a useful tool for many shippers who are captive to one railway at either origin or destination. For over a century, Canadian railway law has recognized that the rail freight market is not a normally functioning competitive market and many shippers face a monopoly situation with their rail supplier. Regulated Interswitching is one of the provisions that helps rebalance the bargaining power between the buyer and the seller in the rail freight market.

Regulated Interswitching allows a shipper who is captive to one railway to obtain competitive quotes on its traffic from two railways if the first interchange is within 30 km of the point of origin. The regulated rates are published and the shipper can access the process directly with the carriers and it does not require any investigation or other intervention by the Agency.

The Introduction section of the Agency discussion paper provides the current methodology and algebraic formulae for computing the interswitching variable costs and Interswitching rates. These formulae have been well-tested over many years and FMA recommends that they should continue to be used.

With this background, a general observation and recommendation is that this review should not add complexities that will make it more difficult to use and thus discourage its use. In contrast It should be noted that the new “Long-haul Interswitching” is not automatic, but requires application to the Agency on a case-by-case basis, and as far as FMA is informed has never been used.

2.0 FMA Answers to the questions posed in the Agency Discussion Paper

2.1 Issue 1: Developing Interswitching Rates for Federally Regulated Short-line Railways

Question 1 a, b, c

A first point of consideration is the difference between federally and provincially regulated short lines, as this would only apply to federally regulated short lines.

The Agency website lists a total of 33 federally regulated railways, these include the Canadian and U.S. class 1 carriers, VIA Rail, railways not connected to the North American Network, and other federally regulated “railways” where this would not apply. Of the 33 federally regulated railways, the following railways may possibly be able to take advantage of this provision, but only if they connect to more than one Class1 railway. These railways are:

- Central Maine & Quebec
- Essex Terminal Railway
- Goderich and Exeter Railway
- St. Lawrence and Atlantic Railway

All of these railways except the Essex Terminal were spun off from either CN or CP in the 1980s or later and one would have to know the details of the sale or lease agreement that the new short line had with either CN or CP. FMA has no access to any of these agreements, but there is anecdotal evidence that the Class 1 carrier may have imposed constraints on the new short line in its lease or sale agreements. For example, if CN spun off a branch line that had a connection with CP as well as with CN, the lease or sale agreement may have contained a provision preventing the new short line operator from interchanging any originating traffic to CP.

The Essex Terminal Railway in Windsor Ontario has been an independent short line for over a century. In addition to connecting with CN and CP, it connected with the three U.S. based Class 1 carriers that operated along the north shore of Lake Erie until the second half of the 20th century. These were the New York Central, the Wabash and the Chesapeake & Ohio railways. It may be that relationship between the Essex Terminal; and CN and CP should be investigated as an exception to the general application of Regulated Interswitching

As the Agency discussion paper notes, the overwhelming majority of cars interswitched is between CN and CP and the short lines should not be burdened to provide the data required that would have only minimal increase on the accuracy of the regulated rates.

FMA recommends that the regulated rates continue to be based solely on the costs of CN and CP and that the current regime for interswitching involving federally regulated short lines should continue as is.

2.2 Issue 2: Regional and Commodity Specific Interswitching Rates

As stated in the Agency Discussion Paper, “*A national average interswitching rate is easy to administer and places the least burden on both railway companies and shippers.*” As noted in the FMA introduction, one of the advantages of Regulated Interswitching is its simplicity and ease of use. To introduce regional and commodity specific rates will add complications that will inhibit its use. Answers to the specific questions 2: a, b, and c follow.

Question 2

- a) the Agency should continue to determine a single rate for each zone to retain the ease of use and ease of administration.
- b) given the FMA answer to question (a), no answer is required to question (b)
- c) Again, to maintain simplicity of use, there should not be specific commodity rates. An added complication, should this be pursued, is the interswitch of a block of cars that contain a variety of commodities.

2.3 Issue 3 Interswitching Zones Up to 30 Km

Question 3:

The Agency’s current distance-based interswitching zones are sufficient. Carriers and shippers have had long experience with the zones as currently established and changing the zones would be an added complication that would increase the administrative burden and costs.

Questions 4:

The Agency should not introduce more factors such as those suggested in question 4 and should not create a broader range of rates. In addition to complicating a shipper protection provision that works well, introducing other factors, like those suggested, will likely lead to more disputes between shippers and carriers on a case-by-case basis requiring more adjudication by the Agency and leading to more delay and expense in actually accessing the regulated rate.

Question 5:

While collapsing the four zones to one zone, might be a further simplification, 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.

Further to this question, it would preferable to replace the “*Longhaul Interswitching*” provision by using regulated interswitching as was implemented on a temporary basis on the Prairie Provinces following the grain service problems of 2013.

Question 6:

The current method that the Agency uses to set rates has been working well for some time and it isn’t clear that using weighted linear regression would improve the precision of the rates. As

noted in our introductory comments, FMA supports the continued use of the algebraic equations that the Agency is currently using as outlined in the Agency Discussion Paper.

2.4 Issue 4: Long-term investment needs of railways (cost of capital methodology)

Questions 7:

FMA agrees that a realistic calculation of cost of capital and depreciation is necessary to ensure appropriate long-term investment by the carriers and FMA supports the premise of the Agency position in the Discussion Paper that states as follows:

Economic theory suggests that if the regulated rate of return deviates from the economically efficient optimum, incentives to investment may be distorted. Depending on whether rates are too high or too low, railway companies may overinvest or underinvest in their networks.

Question 8:

FMA does not currently have access to the expertise to answer Question 8.

2.5 Issue 5: Contribution to Fixed Costs

Questions 9, 10, 11:

As per the Agency letter dated, August 1, 2019, FMA will consider submitting answers to these questions by the revised deadline of January 20, 2020.

2.6 Issue 6: Productivity Factors

Questions 12, 13:

As per the Agency letter dated, August 1, 2019, FMA will consider submitting answers to these questions by the revised deadline of January 20, 2020.

2.7 Issue 7: Volume Discount Rate Categories

Question 14:

FMA believes that one of the strengths of Regulated Interswitching is its simplicity and ease of use. While the 60-car block has provided some acknowledgement of the reduction in railway costs when switching blocks of cars, some further rate differentiation for blocks both above and below the 60-car block would be useful.

Question 15:

Given the considerable switching of multiple carloads, it would be useful for the Agency to review the current 60 car block and consider developing per-car rates for several blocks both below and above the 60-car rates. The Agency is in the best position to determine the number and size of the various blocks.

2.8 Issue 8: Collecting Interswitching Service Units

Question 16:

FMA does not have access to the expertise to definitively answer this question. The process

that the Agency describes for Issue 8 in the Discussion Paper is logical. Agency field work, which includes visiting a sample of interchange points to obtain on-the-ground information on volume fluctuation and distances traveled to make switches provides a realistic overlay on the costing data that should lead to a reasonable approximation of actual costs that are at or above variable costs.

2.9 Issue 9: Transparency of the Regulated Interswitching Rates and Methodology

Question 17:

It would be useful for the Agency to offer to meet with shippers, individually, in groups, or through the various industry associations, or to hold webinars where the Agency could explain how the rates are established (in a general way) and how shippers can access the rates. FMA is of the view that it has not generally been explained that the shipper can get quotes from two carriers from origin to destination, even though the shipper's location is served only by one railway. The regulated interswitching rate then permits the second carrier to quote a through rate, because the second carrier knows that the only rate the originating carrier can charge for the interswitch is the "Regulated Interswitching Rate", which is embedded in the second carrier's long-haul rate.

Question 18:

In terms of the regulated rate being visible to the shipper, if the railways would agree to share the regulated rate on a voluntary basis that would suffice. If the railways refused to share that information, the Agency should ensure by regulation that it is provided as a separate charge on the waybill. FMA believes the current process where the rate is included in the total long-haul rate is preferable, but showing it on the waybill would be useful. FMA does not recommend that the shipper pay the regulated interswitching charge directly to the originated railway.

3.0 Concluding Remarks

With the limited time allowed by the Agency to respond to an extensive and technically complicated Discussion Paper, FMA has not had time to review this submission in detail with either the FMA Board of Directors or the full 80+ company membership. As the FMA membership spans a large range of companies from natural resource, agriculture, manufacturing, food processing, chemical, and retail industries, there will be some variation in how the FMA membership views the questions that the Discussion Paper has posed.

While it will be after the Agency deadline, any additional insights from FMA members will be passed on to the Agency.