October 14, 2016

Canadian Transportation Agency
15 Eddy Street
Gatineau, Quebec J8X 4B3

To Consultations:

This letter is an initial response to the:
AGENCY STAFF CONSULTATION DOCUMENT
Methodology for Determining the Capital Structure of Canadian National Railway Company (CN) and Canadian Pacific Railway Company (CP) for Determination of the Cost of Capital of the two Railway Companies.

The two issues under consideration are (1) the specific items to be included in the capital structure and (2) a methodology for determining the working capital allowance of the capital structure. The Consultation document poses five questions for consideration, the first question is related to issue one, and the next four questions are related to issue number two.

Issue 1: Items to be included in the capital structure

Question 1

Does the proposed Balance Sheet Approach list of items adequately include all appropriate elements that the Agency should take into consideration in determining the prescribed railway companies' capital structure, and if not, what components should be included or excluded, based on what elements of GAAP? Please provide clear justification for any elements or components that you think should be added or excluded.

Response:

It is not possible for us to provide specific comments with regard to inclusion of additional items or proposed exclusions absent any proposals, and their justifications, that the railways or the Agency might put forward. In general, we would object to any modifications which have the impact of increasing the cost of capital.

Issue 2: Methodology to determine the working capital allowance

The Agency is considering whether to update the working capital allowances for CN and CP from the current methodology.

Question 2:

The working capital allowances in CN and CP’s capital structure were determined in 1992 and maintained to date. Is there is a need for a working capital allowance adjustment in today’s railway operating environment?

Response:
If there is a need for adjustment, it is not possible to provide meaningful comments until the railways or the Agency have offered proposals and the justification for such proposals. In general, we would object to any modifications which have the impact of increasing the cost of capital.

Question 3:
If yes, what methodology would be appropriate for determining the amount of the required working capital allowance?

(see response to # 2 above)

Question 4:
How would the methodology proposed in 3) distinguish investor-supplied cash versus supplier-financed cash, with specific reference to the interrelationship between cash, inventory, and accounts payable?

(see response to # 2 above)

Question 5:
How often should the working capital allowances be updated?

(see response to # 2 above)

The Agency's decisions following from the answers to the five questions will have an impact on shippers. As noted in the *Consultation Document*, the Cost of Capital is used by the Agency in determining the Maximum Revenue Entitlement (MRE) for western grain, for determining interswitching rates, and for other regulatory purposes, for example Final Offer Arbitration (FOA) of rate disputes. It is understood that increases in the cost of capital may have an indirect impact on commercial railway rates offered to shippers either under tariff or in confidential contracts. Cost of capital is a significant input in cost determinations and any major modifications to the methodology that affect the cost of capital are of concern to shippers.

At this stage, FMA is not able to provide detailed expert responses to the five questions posed, but offers the general comments above. It is important that the Agency decisions on the two issues should reflect the reality of the railways' capital structure and working capital allowance and, to the extent that the Agency thinks appropriate, follow Generally Accepted Accounting Principles (GAAP).

An issue for shippers in deciding on the effort and resources to address the questions posed, is the impact these determinations will have on the Volume Related Composite Price Index and other pricing decisions for which the Agency is responsible. As we understand the *Consultation Document,* the Agency is considering a limited number of possible variations in the two issues under consideration. FMA may request an meeting with Agency staff to discuss the impact that the different variations in capital cost determination under consideration would likely have on the VRCPI and the cost of capital calculation as it is applied in other rate determinations.

FMA appreciates the opportunity to provide comments and requests the opportunity to provide more detail at a later date.

Sincerely,

R.H. Ballantyne, P. Eng.
President

Cc: FMA Board of Directors