SUBMISSION

TO THE

CANADA TRANSPORTATION ACT REVIEW

BY

CANADIAN NATIONAL RAILWAY COMPANY

MARCH 10, 2015

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1. INTRODUCTION AND RECOMMENDATIONS[1]

The mandate of the current comprehensive Review of the *Canada Transportation Act* (the "*Act*"), set out in Terms of Reference established by the Minister of Transport in June 2014, includes a number of considerations that are of keen interest to CN.

Foremost, the Review is mandated to examine the extent to which the Canadian transportation system has the capacity to respond effectively to changing market conditions in Canada and internationally. The Review is asked specifically to advise on *"possible steps to help ensure that the national transportation system has the capacity and nimbleness to support economic activity across all sectors over the medium- and long-term."*

Also of great importance to CN, the Review is asked to give consideration to whether adjustments to the present legislative and policy framework are required to support Canada's international competitiveness and economic growth. The Discussion Paper circulated by the Chair of the Review emphasizes that:

> ***"Canada's transportation system will have to be globally competitive: efficient, reliable, innovative, responsive to change, and resilient to disruptions".*** [2]

These are disruptions that could result from changing global trends, changes in Canadian competitiveness and production trends. As the Chair stated in the introduction to the Discussion Paper:

> ***"A status quo assumption for the long term seems improbable. We need to think and plan ahead, through shocks and perturbations, likely to characterize a changing world".***[3]

CN fully supports that view. CN's business agenda is built on the pursuit of efficiency and service excellence, through innovation, flexibility and responsiveness to customer needs. CN is a backbone of the Canadian economy and is ready to play our role fully to support a globally competitive transportation system. We have demonstrated that we have the capacity to grow in line or beyond the economy's needs for several decades, and will continue to do so if it makes economic and business sense.

From CN's perspective, **it is self-evident that the capacity of the rail system specifically cannot be viewed or assessed in isolation** of the end-to-end capacity of the many supply chains the railways serve. They are inter-related and inter-dependent, both structurally and operationally. **The network nature of railway**

[1] For a detailed list of Recommendations, see Appendix I.

[2] Discussion Paper, Canada Transportation Act Review, page 5

[3] Ibid, page 1.

operations, which involve common use of assets and resources, is another fundamental factor that must be taken into account. Short-term railway issues, such as those associated with winter operations, are inherently related to the nature of railway and network operations and are not indicative of long-term capacity requirements.

The Minister also specifically mandated the Review to consider the provisions of the *Act* that apply to the transportation of grain by rail "taking into account the broader goal of a commercially based, market-driven, multi-modal transportation system that delivers the best possible service in support of economic growth and prosperity." CN agrees that it is timely to re-think these provisions, which are unique and specific to grain and grain products moving in Western Canada. They are an anachronistic hold-over from grain-specific statutory regimes of previous times. The market circumstances and state of competition for transportation in Western Canada in the twenty-first century are different from those prevailing at the time these provisions were enacted as a transition measure shortly after the Government abolished longstanding grain transportation subsidies. These changes have brought into existence, twenty years later, new competitive and market-driven crop production, grain handling, and value-added activities in Western Canada.

Current grain-related legislation was not designed for, and is ill-suited to support, the vibrant growth expected in Western Canada's agriculture-based economy in coming years. CN describes in this submission how the **grain-specific provisions of the *Act* blunt and misalign railway incentives and are counterproductive**, by hindering the railways from making the investments and introducing the service innovations that Western Canadian producers, marketers, processors, and other grain supply chain participants will need over the next 10 to 20 years.

It should be noted that the Minister also asked that the Review address the issue of transportation safety in general, and as it relates to rail transportation of dangerous goods in particular. CN has continued to actively enhance its safety practices since the Lac-Mégantic incident and is fully supportive of the numerous initiatives taken by the Minister in that area. CN's submission on the CTA review will therefore exclude any further comments on these matters.

Guiding principles

CN's position in this submission is based on key guiding principles. First and foremost, **CN recognizes the need for a globally competitive transportation system for Canada to achieve economic growth and prosperity over the next 10 to 20 years**. CN believes that Canadian railways have demonstrated that such a system is already in place. Canadian railways have become the most efficient in North America and are objectively world-class operators with the capacity to grow in line with demand.[4]

CN's position in this submission is based on key guiding principles. First and foremost, CN recognizes the need for a competitive transportation system for Canada...

[4] For evidence of the relative performance of Canadian railways on an international basis, refer to report prepared for CN by Oliver Wyman on a comparison of rail regulations and performance. See reference in Appendix II.

This remarkable success was made possible by a supportive underlying framework, based on the railways operating within a commercial framework and in the context of competitive markets, totally funded with private capital, with the full knowledge that their own success depends on the success of their customers. CN believes these achievements must be acknowledged and the policy framework that made these achievements possible must be clearly understood.

Second, **CN's position in this submission is based on the power of a commercial framework.** This approach aligns with the National Transportation Policy, set out in section 5 of the *Act,* the first tenet of which is that:

> ***"…competition and market forces, both within and among the various modes of transportation, are the prime agents in providing viable and effective transportation services;"*** [5]

This supreme principle, rooted in the work of the MacPherson Royal Commission on Transportation in 1961, has been the foundation for National Transportation Policy since first enacted in 1967. CN believes this remains the key principle to guide the Review in its assessments and recommendations.

As the Chair acknowledged in his introduction to the Discussion Paper, at various times in Canada's history, it was government that undertook the development, financing, and operation of transportation infrastructure, including railways, whereas today "the transportation system is substantially more market-based, deregulated and competitive."[6] To support Canada's future growth and prosperity, it is essential to maintain a policy framework for transportation that can attract and harness private capital for the further development of Canada's rail transportation system.

In the half century after the MacPherson Commission, Canadian transportation legislation evolved consistently in the sound direction of being more market-based, deregulated and competitive, until six to seven years ago. Since then, mostly in response to "short-term crises", a series of legislative amendments have started to move the *Act* and rail regulation away from a healthy reliance on competition, market forces, and commercial incentives. This is a dangerous reversal in direction that is inconsistent with the statement of National Transportation Policy.

This is not to suggest that CN is opposed in principle to the continued existence of so-called "shipper protections" in the *Act*. CN understands the need for such protections. However, **CN opposes universal and indiscriminate availability of shipper protections**, since this conflicts with, and completely subordinates, the core premise that competition and market forces should be the prime agents in providing and guiding transportation services.

[5] Canada Transportation Act, subsection 5(a).

[6] Discussion Paper, Canada Transportation Act Review, page 1.

As such, a third principle that should guide the Review's thinking and recommendations is **"regulate as a last recourse, only where and when regulation is needed".** Again, this approach is consistent with National Transportation Policy, the second tenet of which states:

> *"...regulation and strategic public intervention [be] used to achieve economic, safety, security, environmental or social outcomes that cannot be achieved satisfactorily by competition and market forces..."*[7] [emphasis added]

In CN's view, **shipper regulatory safeguards must not be indiscriminately and universally available to all, and in all circumstances**. In Canada's market-based transportation system, safeguards should be subject to threshold tests and used as a last resort. In addition, safeguards must be applied in a way that recognizes and takes into account the characteristics of the railway industry, which is inherently a network business.

Finally, CN's position in this submission is based on the conviction that well documented facts are key to sound regulations and policy: facts about performance, facts about how railway networks work, and facts about how commercial markets work. That is relevant for all commodities, including Western grain.

In that regard, it is important to have a clear understanding of the facts surrounding the extraordinary grain situation during crop year 2013-14. The Chair's Discussion Paper suggested:

> *"...the situation created by last year's backlog in grain deliveries raises important questions related to the capacity and adaptability not only of the rail sector, but other links in the supply chain as well."*

It continued:

> *"...what some see as a temporary surge may be part of a permanent shift that would require increasing capacity for the shipment of bulk commodities . . . For large regions of the country, prosperity is at risk if the transportation system fails to deliver. For Canada, a reputation as a reliable source of products and trade partner is at stake".*[8]

While CN agrees that the transportation system must not fail, it is important to have an appreciation of how markets work. It is a significant fact that the 2013-14 crop was harvested only one year after legislation that ended the Canadian Wheat Board's marketing monopoly. This was a fundamental and historic change, since the CWB had for generations governed and regulated the markets for purchase and sale, delivery, handling and rail transportation of the large segment of grains under the CWB's jurisdiction. It is particularly important for the Review Panel to consider how grain markets, including futures markets and storage infrastructure, will respond to deal with variability, uncertainty and risk with respect to demand and supply, both for short-term fluctuations or long-term trends.

[7] Canada Transportation Act, subsection 5(b).

[8] Discussion Paper, Canada Transportation Act Review, pages 10 and 11.

Summary of recommendations

In light of that context and given those principles, CN has developed recommendations in the following four broad areas:

1. **A process must be established to review the conditions for regulatory recourse so that such recourse is available only where it matters and is applied wisely;**

2. **Interswitching provisions must be reviewed to restore an adequate distance limit and ensure compensation is fair and commercially driven;**

3. **The Revenue Cap must be reviewed to remove constraints to appropriate pricing so as to encourage growth and innovation for Western grain;**

4. **Ensure that network and supply chain perspective and the fundamental economics of railway operations are taken on the application of regulation and remedies.**

CN believes such recommendations, if implemented, would improve the regulatory framework and support the investment and innovation in rail transportation that will support economic growth and allow Canada to prosper for the next 10-20 years.

2. BRIEF OVERVIEW OF REGULATORY DEVELOPMENTS

A long history of focus on railways in Canadian regulatory debates and policy

Throughout the years, Canada's policy in the area of transportation has been a large part of national policy debates and legislation. From the completion of a transcontinental railway to the construction of ports and airports, and the building of the Saint-Lawrence Seaway, examples of how transportation policies have shaped the country abound. Of all the transportation modes, however, only railways have attracted as much attention over the decades. Indeed, between 1917 and 1959, no less than six royal commissions were created to address perceived rail service and rate issues. In the more recent past, successive statutory or ad hoc reviews have continued to focus on railway transportation. This section provides a brief summary of major reviews and legislative initiatives relating to railway transportation since the 1960's.

The MacPherson Royal Commission on Transportation (1959-1961) was the first to articulate the vision that competition and market forces, rather than government directives, **are to be relied upon** to produce an efficient transportation system. MacPherson recommended the dismantling of the then existing regulatory framework and underscored the need to distinguish between transportation policy and the use of transportation as an instrument of public policy. As a result, MacPherson recommended that railways be adequately compensated for any public duties that may be imposed on them by governments.

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In 1967, the *National Transportation Act* (NTA) implemented much of the MacPherson Report. This resulted in the substantial relaxation of the minutia of the previously prevailing restrictive rail regulation. For the first time, railways were given pricing freedom to compete with trucking which had emerged as a competitive mode and had eroded railway traffic. The amendments also provided compensation to railways when required to operate uneconomic branch lines in the public interest. While these amendments were successful in reducing costs, regulations continued to preclude competition among the railways.

Importantly, a national transportation policy statement establishing the role of an economically efficient transportation system was enshrined in the legislation for the first time. While the policy statement introduced as a result of the MacPherson Commission was periodically amended over the years, the fundamental principle of an efficient transportation system achieved through competition and market forces has survived all iterations and continues to be the cornerstone of the National Transportation Policy contained in section 5 of the *Act*.

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The MacPherson Commission recommendation[9] that railways be compensated for the losses incurred in moving grain at statutory rates remained unanswered until 1983 when the *Western Grain Transportation Act* (WGTA) was enacted. The WGTA shifted the burden of costs of moving grain not paid by shippers of grain from the railways to the federal government. It also provided for a gradual decrease of the subsidy and commensurate increase of the transportation cost for grain shippers.

In 1985, the government issued the policy paper ***Freedom to Move*** leading to the enactment of the *National Transportation Act, 1987*. These amendments **introduced further economic deregulation** by permitting railways to enter into confidential contracts with their customers, eliminating minimum and maximum rates and collective rate making, introducing final offer arbitration to protect shippers against potential abuse of market dominance and extending regulated interswitching from what had been four miles since 1908[10], to 30 kilometers. It also included a provision requiring the government to conduct a comprehensive review of the operation of the legislation.

In its 1993 Report, the ***National Transportation Act*** **Review Commission concluded that the 1987 regulatory reform had been a particular success** as it found that costs for shippers had declined and more competitive options had been made available through multimodal competition and carrier innovations. The Commission specifically concluded that:

> ***"The withdrawal of government from direct management of the transportation section, and from the business of balancing economic interest through regulation, is a timely and appropriate policy".*** [11]

The Commission considered the various transportation subsidies then being paid by the federal government, including the WGTA subsidies. The conclusion was clear: ***"subsidies change the behaviour and structure of markets. They act as artificial stimulants which undermine entrepreneurship and cost-efficiency by promoting otherwise inefficient decisions or activity."***

> ***The Commission reiterated that "the transportation system should handle all commodities on the same basis."***

According to the Commission, subsidies to a specific economic sector should be paid directly to that sector and not through transportation as doing so distorts the transportation market. Finally, the Commission reiterated its views that "the transportation system of Canada should handle all commodities on the same basis."[12]

In 1995, the WGTA was repealed, subsidies were eliminated. The federal government provided a $1.5 Billion transition payment to grain producers in order to compensate for the elimination of the subsidies. The

[9] Royal Commission on Transportation, March 1961.

[10] Board of Railways Commissioners, Order no 4988, 1908.

[11] Competition in Transportation, National Transportation Act Review Commission, 1993, Vol. I, page 19.

[12] Ibid page 151.

transportation of regulated grain was subject to a rate cap. For the first time, rail transportation of Western Canadian export grain was brought under the same statutory framework of economic regulation as all other commodities. Since then, the provisions of the *Act* have fully applied to Western grain, including shipper protections and competitive access available for other products shipped by rail. **The legislation implementing the changes included a provision contemplating the eventual sunsetting of the special regulatory regime for grain rates.**

The enactment of the *Canada Transportation Act* in 1996 provided greater latitude for railways to rationalize rail infrastructure and encouraged the establishment and line transfer to lower cost short line railways. While the rate provisions of the previous legislation were essentially retained, the government wisely introduced a ***"substantial commercial harm"*** provision which required the Agency, prior to granting relief, to satisfy itself that the applicant for a regulatory relief would suffer substantial harm in the absence of the requested relief. By introducing this provision, the government was indicating its preference for commercial solutions, reserving regulatory relief as a measure of last recourse.

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In 2000, the rate cap for the movement of regulated grain introduced in 1995 was changed to a maximum revenue entitlement for railways. While this allowed railways more flexibility on rates for the movement of grain, revenues could not, and still to this day cannot, exceed the maximum amount established in the legislation. The Cap immediately reduced railway revenues by 18% compared to an estimated cost basis for the year 1992. Subsequent amendments to the *Act* in 2005 and 2007 expanded Revenue Cap coverage, to comply with World Trade Organization (WTO) rulings after a U.S.-initiated dispute, to include movement of grain, crops and products grown or processed in the U.S., and reduced railway revenues from Western Canadian grain by another 8%.

The last comprehensive review of the *Act* was conducted in 2000-2001. A substantial part of the Canada Transportation Act Review Panel's work and analysis was again dedicated to railway transportation matters. The Panel reiterated MacPherson's conclusion that the best means to an efficient and effective transportation system is to rely on market forces and that regulatory intervention should only be used to solve instances of market failure. An essential element of the Panel's work was its analysis of the extent of rail competition system-wide. The Panel concluded as follows:

The Panel reiterated MacPherson's conclusion that the best means to an efficient and effective system is to rely on market forces and that regulatory intervention should only be used to solve instances of market failure.

> *"Another precondition for framing policy guidance was an assessment of the state of competition: the extent to which shippers are subject to anti-competitive prices or other forms of market abuse. The difficulties in making definitive judgements on this based on hard data are many. The Panel is nevertheless confident in the view that Canada's rail system is not inherently anti-competitive; nor is market abuse systemic or widespread. Indeed, by all available indicators, most shippers in most markets in most parts of the country are well served."* [13] [emphasis added]

In respect of grain transportation, the Panel recognized the substantial efforts that the government had devoted to reform the grain handling and transportation system (GHTS). The Panel reiterated the view of the NTA Review Commission and saw **no reason why grain transported by rail should be treated any differently than any other commodities** and recommended the GHTS be moved to a more commercial basis which could eventually lead to the repeal of the Revenue Cap.

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In 2008 began what clearly appears to be a reversal in policy orientation and a new tendency towards regulation. **The *Act* was unfortunately amended to eliminate the "substantial commercial harm" clause that had been included in 1996**. The Final Offer Arbitration (FOA) provisions, which had been introduced in 1987, were amended. While the previous recourse allowed individual shippers dissatisfied with a rate or condition of service to file an FOA, this amendment provided the ability for **a group of shippers** to join in a new group FOA recourse in respect of rates, charges, terms or conditions specified in a tariff that is common to all the shippers.

At the time the 2008 amendments were introduced, the government also committed to commence a review of railway services within 30 days. The Review was conducted in two phases, the first phase consisting of quantitative and qualitative analysis carried out by consultants for Transport Canada, in support of the work of the second phase which consisted of the appointment of a Review Panel to develop recommendations for the Minister of Transport.

Two conclusions from the consultants' analyses are worth noting. In a report comparing how service issues are addressed in other regulated industries and other countries, one consultant made the following observations:

> *"we have found none of the legislative regimes reviewed, including the regulation of LOS (Level of Service) in the U.S., to be clearly superior in an overall sense to the regime for regulating LOS in the Canadian rail freight services industry."* [14]

[13] Vision and Balance, Report of the *Canada Transportation Act* Review Panel, June 2001, page 56.

[14] *Service Issues in Regulated Industries Other that Canadian Rail Freight Industry*, prepared by CPCS Transcom

In a separate report, another consultant made the following comments after having conducted a fact-based analysis of transit times and order fulfillment.

> *"While it might be expected that shippers with competitive access would have better service, there is no advantage in terms of consistency for CN customers with access to direct rail competition, as compared to those at non-competitive origins. In fact, shippers from non-competitive origins have somewhat better transit time consistency…"* [15]

In short, it was confirmed that CN does not discriminate among its customers and does not exhibit the behaviour that would be indicative of abuse of market dominance.

In its January 2010 report, the Rail Freight Service Review (RFSR) Panel recommended a commercial approach for the resolution of railway service issues, including the negotiations of service agreements between shippers and railways. The Panel recommended that a facilitator be appointed to assist the parties in this respect and specified that legislative action should only be taken in the event of failure of the commercial approach.

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In March 2011, when it publicly released the Panel's final report, the government proceeded with the Panel's recommendation and initiated a facilitation process to develop a service agreement template. The government also indicated that it would be introducing legislation on the matter, notwithstanding the Panel's recommendation that parties should be allowed time to find commercial solutions.

Jim Dinning was appointed in October 2011 to lead the facilitation process for the development of a template service agreement. In his report issued in May 2012, the Facilitator stated that, while progress was made during the process, in the end, agreement could not be reached on a commercial package. He pointed to the link that shippers made between the facilitation process and the promised legislation noting that the shippers' *"expectations extended beyond the scope or ability of the Facilitation process intended to establish commercial tools."* [16]

The hurdles to reaching a commercial package centered on the inability for some shippers to make binding traffic commitments or to even provide a forecast of traffic. In the words of the Facilitator: "What is also

LTD for Transport Canada, August 31, 2009.

[15] *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, prepared by QGI consulting for Rail Freight Service Review, March, 2010.

[16] Facilitator's Final Report, May 31, 2012, page iii.

acknowledged is that the world of business actually works better for those who make commitments. Invariably their service is more customized; it is more reliable and predictable." [17]

The Facilitator nevertheless proposed a three-tiered template based on whether a shipper provided a traffic commitment, a forecast or no information on future traffic to use as an "agenda" for negotiating service agreements. He concluded with the following advice to industry stakeholders: "Try these tools; they just might work." His advice, unfortunately, was not followed by the Government.

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In the meantime, the *Marketing Freedom for Grain Farmers Act* in 2012 brought the most fundamental, structural change to Western grain marketing in over half a century. With this enactment, the Canadian Wheat Board's monopoly over Western Canadian wheat and barley marketing and logistics was removed, and an open, market-driven system for all grains, crops and processed products was created which would have major implications for the way farmers and grain elevator companies interacted.

Focus on railway transport continued in earnest during 2013 and 2014. Notwithstanding the RFSR Panel and the Facilitator's advice on allowing parties to develop commercial solutions, the government introduced **Bill C-52** in January 2013, the *Fair Rail Freight Service Act*, **to give freight shippers the right to enter into service agreements with railway companies** to specify how the railway intended to meet its service obligations to the shipper. In cases where negotiations failed, the amendments made by Bill C-52 established a process by which an arbitrator is appointed to impose the terms and conditions that a railway must comply with in providing service to the shipper, other than transportation rates.

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The latest legislative initiative oriented towards the railways was taken in June 2014 with the enactment of Bill C-30, the *Fair Rail for Grain Farmers Act,* in response to complaints by farmers and grain companies in respect of the railways' capacity to meet all demand for grain cars. The fact that there was a wholly unexpected surge in demand due to a huge increase in export grain after a 100-year crop, and that the railways' operational capacity was impaired as the result of the coldest winter on record in close to a century, were not considered relevant. **Bill C-30 introduced numerous regulatory measures including the ability for the government to issue orders specifying minimum volumes of grain** that the railways are required to move on a weekly basis, and the imposition of penalties in the event of a railway's failure to do so.

[17] Ibid, page iv.

Bill C-30 provided the Agency with **the authority to make regulations defining what constitutes "operational terms"** for the purposes of the arbitration of service level agreements. It also provided the Agency with the discretion to establish different interswitching distances for different commodities in different regions of Canada and set the regulated rates for such services. In introducing Bill C-30, the government made it clear that it expected the Agency to extend the interswitching distances from 30 km to 160 km and that it would apply to all commodities within the three Prairie Provinces. **This conclusion was reached without the benefit of any consultation or factual analysis.**

3. KEY ISSUES FACING POLICY-MAKERS TODAY

As this brief review of regulatory developments has highlighted, the reversal of a long-standing trend of deregulation started in 2008, and which continued unabated in 2013 and 2014, has changed the approach to regulatory intervention as well as some of the specific parameters of the level of service obligations. **This reversal has a number of implications and raises key issues of importance for policy-makers pondering the future of Canada's transportation system.**

Recent legislation has created a lack of accountability as a result of regulatory intervention

Level of service obligations have been part of the Canadian legislative landscape, in one form or another, for well over a century. But the enactment of Bill C-52 in 2013 and Bill C-30 in 2014 has reinforced the view that individual regulatory decisions can unfortunately be made with no regard to the **network nature of railroading**. This creates a disturbing lack of accountability in the regulatory process.

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As outlined above, through Bill C-52, the *Act* was amended to give freight shippers the right to enter into service agreements with railway companies for the purpose of specifying how the railway intends to meet its service obligations to the shipper. In the event the parties are unable to reach agreement, a shipper may ask the Agency to appoint an arbitrator to fix the terms and conditions that a railway must comply with in providing service to the shipper. The legislation specifies that only matters relating to "operational terms" may be arbitrated under this process.

It is important to specify that the transportation rates associated with the service to be imposed by the arbitrator are **completely divorced** from this process. Rather, they are subject to the Final Offer Arbitration (FOA) process. No other commercially-based business has a process where the nature and extent of the service is determined in one forum and the price to be paid for that service is determined independently and in a separate forum. To illustrate practically, this is like an arbitrator setting the price of a new automobile and another arbitrator deciding independently what features, such as leather seats, etc., should be included. This is not wise policy.

Bill C-30, introduced in 2014, conferred upon the Agency the authority to make regulations defining what constitutes **"operational terms".** In August 2014, the Agency issued a regulation specifying a full three-page list of what could constitute operational terms that could be submitted to arbitration. According to the Agency, it includes the quantity of

In 2014, the Agency issued a regulation specifying a three-page list of what could constitute operational terms that could be submitted to arbitration . . . it includes the quantity of locomotives, train crews and cars to be supplied to a shipper, the schedule...

locomotives, train crews and cars to be supplied to a shipper, the schedule and place where they are to be furnished, their condition, type and specifications, the cycle time for handling the cars, the time of pick-up and schedule for pick-up, the number and schedule of switches, the transit time and route for delivery of the cars and performance standards for measuring compliance. **In other words, basically anything and everything related to railway operations.**

As each service level arbitration is specific to a single shipper, an arbitrator has the power to impose a specific train service for that specific shipper regardless of the network and supply chain consequences . . .

The legislation directs arbitrators to take into account a railway company's service obligations to its other customers. This requirement is supposed to ensure that the arbitrator takes a network and supply chain perspective in imposing operational terms. But, in practice, the nature of the recourse is such that it is exceedingly difficult to ensure that arbitrators pay heed to this direction. **Each arbitrator's decision is specific to a particular shipper; it is also confidential, final and binding.** In other words, it is impossible for an arbitrator to hear from other shippers the impact of a potential decision on them. In addition to this information gap, each matter is considered independently. Different arbitrators can reach different conclusions on similar matters and lead to divergent or conflicting results. In short, as each service level arbitration is specific to a single shipper, an arbitrator has the power to impose a specific train service for that specific shipper regardless of the network and supply chain consequences, a clear example of misplaced decision-making.

Two illustrations suffice to demonstrate that this type of "shipper by shipper" approach to service level arbitrations is inconsistent with the very nature of railway operations. Transit times and scheduling of trains are based on a "network operation". **Railway service provides a common network service to a number of customers – it is not like a dedicated taxi or truck providing service** to a single customer at a time. This distinction is especially important considering the broad and potentially intrusive power of the regulator to impose "operational terms". Railway schedules and pick-up times are established on a network basis to ensure adequate connection times and crew and power availability. They are not established in a vacuum or whimsically. An arbitrator specifying a pick-up window or transit time that is inconsistent with a connecting train schedule or crew or power availability can affect a railway's overall service design to the detriment of efficiency and all other shippers. The fact is, **the network nature of railway operations should be a fundamental consideration in any decision regarding service levels,** whether by the Agency under a service level complaint or by an arbitrator in a service level agreement arbitration.

In the same manner, rail customers are served from a common pool of resources, whether cars, locomotives, or crews on a common track infrastructure. Grain cars are a good example. In periods where demand for this type of cars exceeds the number of cars available, as is often the case for periods post harvest, cars must be allocated among the various users. The normal method of allocation of assets in such cases would be demand-based pricing which could act as a self regulator – this commercial method, however, is not available to the railways in the current regulated grain environment of the Revenue Cap, as will be explained below. As a second best approach, CN proceeds with car allocation on the basis of the percentage of each

shipper's volumes in a given period. This method has the merit of being fair and consistent, and ensures that CN does not artificially affect customers' market shares.

The issue arises when individual shippers file service level arbitrations seeking the allocation of a specific number of cars. In a period of excessive demand on a finite common pool of cars, granting a specific number of cars to specific shippers completely ignores the common service nature of railway operations. Granting by regulation a specific number of cars that is different and superior to the number resulting from a fair and consistent allocation methodology by the railway can only result in less cars being available to the remaining shippers and effectively causes a market share shift to the benefit of the shipper that first exercised the regulatory recourse.

Granting by regulation a specific number of cars that is different and superior to the number resulting from a fair and consistent allocation methodology can only result in less cars being available to the remaining shippers…

It is CN's considered view that the nature of the recourse itself, being confidential and "shipper by shipper-based", fails to take into account, not only the network nature of railway service, but also the fact it is a common service used by all shippers. This will inevitably lead to inconsistent and conflicting decision-making, with no accountability for the impact on service to the overall users of the system. The direction to arbitrators given in the legislation to take into account a railway company's service obligations to other shippers is clearly insufficient. Indeed, different decisions implementing different performance standards and providing specific numbers of cars to individual shippers (out of a finite common pool of cars) are clearly inconsistent with the common nature of the service and with the network nature of railway operations.

Similar comments apply to the process to address level of service complaints. While level of service obligations have been part of the Canadian legislative landscape for decades, there was a time when the Agency and its predecessors specifically invited and encouraged third parties whose interest could be affected to participate in the proceedings and make submissions.[18] By now, however, it is clear the "shipper by shipper" approach to rail service matters introduced by Bill C-52 in the context of service level arbitrations has permeated and spilled over into the Agency's process in its consideration of complaints on a railway's level of service obligations under the *Act*. In a recent service complaint by a major grain company alleging that CN was not providing it with a sufficient number of grain cars, two other majors asked to intervene in the proceedings given that a decision by the Agency could have service impacts on them (such as reducing the number of cars available to be

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[18] As an example, see Decision No. 475-R-1998. This case involved a level of service complaint by the Canadian Wheat Board against CN and CP. The Agency allowed numerous interested parties to make submissions including the Western Grain Elevator Association and the Western Canadian Wheat Growers Association.
Third party intervention is specifically contemplated in the Agency's General Rules, rule 21.

allocated). Notwithstanding the clear interconnectedness of the issues resulting from the allocation from a pool of assets available to all shippers and the network nature of the operation, the Agency denied the two companies the right to intervene while inviting them to file their own level of service complaints, which they ultimately did. In fact, in considering the reasonableness of the car supply to the initial complainant, the **Agency surprisingly refused to look at the overall demand for such cars by other grain shippers**.[19]

This "silo" approach in considering this complaint prevented the Agency from taking the required network and supply chain perspective in reaching its decision. It also led to contradictory decisions[20]. The Agency ordered CN to provide the grain company in the initial complaint with a larger and guaranteed number of cars than CN's allocation methodology provided for. This left fewer cars to allocate to other grain shippers. In its subsequent level of service decisions regarding the two other grain companies, the Agency found CN in breach of its service obligations again, this time for failing to apply its car allocation methodology. It was, in fact, mostly the Agency's initial decision that placed CN in the position of not being able to allocate the number of cars to the two companies that would have resulted from a fair and consistent approach.

It was mostly the Agency's initial decision that placed CN in the position of not being able to allocate the number of cars to the two companies that would have resulted from a fair and consistent approach.

The blatant contradiction between these decisions could have been avoided firstly, if the Agency had taken a network view of a railway company's service obligations, and secondly, if it had considered together the three cases dealing with the common issue of car allocation. The "silo" approach by the Agency is a recent change in process that is likely to create a slippery slope inviting more regulatory action over time.

The multiplicity of such inconsistent and intrusive decisions by the Agency or arbitrators removes the railways' ability to manage assets efficiently for the greater benefit of all its customers and shareholders. It displaces the accountability for such decisions away from those best equipped to make them and can only result in the creation of inefficiencies in the railway system. **This slippery slope of regulatory intrusion is in direct contradiction to the National Transportation Policy set out in section 5 of the *Act*.**

The contradiction between these decisions could have been avoided, had the three cases dealing with the issue of car allocation been considered together. This "silo" approach is a recent change in process.

[19] CN considers that this decision contains serious errors of law and has obtained leave to appeal to the Federal Court of Appeal.

[20] In Letter Decision No. 2014-10-03, the Agency stated "As the level of service provision are remedial on a case-by-case basis, **their purpose cannot be achieved, for example, by assessing a railway company's compliance with its level of service obligations using a benchmark expressed in relation to its overall average levels of service to all shipper across the network** or based on "historical levels" […]" In a subsequent unpublished decision issued on December 18, 2014, the Agency stated: "While the Agency deals with level of service applications on a case-by-case basis, **it cannot do so without regard to the overall service obligations that railway companies have to shippers across the rail network**". These statements, in two separate decisions issued two months of each other, are simply irreconcilable.

Aside from the "silo" approach, the recent Agency decisions are attempting to fundamentally change the extent of a railway company's service obligations under the law, at least insofar as car supply is concerned. Indeed, these decisions purport to change the nature of these obligations, from one of reasonableness based on previous jurisprudence, to one that is near absolute. [21] The Agency has stated that a railway has to provide the number of cars requested by a shipper provided that request was reasonable. According to the Agency, a shipper's request will be considered reasonable if the shipper has the capacity on its siding to receive the number of cars requested and nothing else. The assessment of the reasonableness of one shipper's demand is **made in isolation of all other shippers' demand.** Furthermore, the capacity of the railway to supply the cars, the overall increased demand for cars supply resulting from an unprecedented and unexpected 100-year crop, and the impact of an unusually harsh winter in reducing network velocity and increasing car cycle times were not even considered to determine the reasonableness of the car supply that CN did make available.

Attached as Appendix III is the public version of CN's submission made in response to a level of service complaint which sets out in more detail the resulting service issues associated with a "silo" approach to regulatory intervention as described above. It is a perfect illustration of what the railways have to deal with in the context of excessive regulations and a "silo" approach to adjudication. Each situation, leading to individual regulatory intervention, can only lead to ever more individual requests for further regulatory intervention – each such intervention being sought for the benefit of one at the expense of others. This micro regulation is inconsistent with commercial decision-making and illustrates the vicious circle created by indiscriminate regulatory involvement in complex rail-based supply chains. **This is not sound policy to ensure the long term health of Canada's transportation infrastructure.** Clearly, legislative guidance needs to be provided to the Agency to emphasize the importance of considering the network nature of railway operations in all regulatory decisions.

[21] The leading case on the question is *Patchett & Sons Ltd. v. Pacific Great Eastern Railway Co*. [1959] SCR 271 where Justice Rand stated "the statutory obligations of a rail transport carrier are not absolute – they are in fact pervaded by the test of reasonableness in all the circumstances." He added: "The qualification of reasonableness is exhibited in one aspect of the mater of the present complaint, the furnishing of facilities; a railway, for example, is not bound to furnish cars at all times sufficient to meet all demands…"
The Agency's own predecessor, the Board of Railway Commissioners, reviewing the same railway service obligation provisions stated in *Harris v. Quebec Central Railway* 27 C.R.C. 447 "In time of shortage, it is what is, on the average, reasonable that must be looked at from the standpoint of car supply."

Changes to interswitching were made in haste, with no consideration of the serious issues involved

Interswitching is a mandated service whereby a railway company picks up a shipper's traffic at either its origin or destination, and conveys it at an interchange point to a second railway company, which then completes the movement to its ultimate destination. The rate for providing the interswitching service is set by Agency regulations.

The 30 km radius is typically the distance within which a local train assignment gathers the traffic at origin or distributes it at destination. The yards are typically the interchange points between the two railway carriers.

Until recently, in order for the regulated interswitching rate to apply, the interchange point had to be within a 30 km radius from the traffic's origin or destination point. At origin, a local train assignment picks up the traffic and brings it to the local yard to be classified and assembled into the mainline trains. At the destination yard, trains are disassembled and cars placed on a local train assignment for distribution. The 30 km radius is typically the distance within which a local train assignment gathers the traffic at origin or distributes it at destination. The yards are typically the interchange points between the two railway carriers.

As required by law[22], the Agency reviews its interswitching regulations every five years, or more often if circumstances warrant. During the periodic reviews until now, several shippers have requested extensions of the interswitching distances. The Agency has consistently rejected such extensions. In 2004, the Agency concluded that extending the distance limits to 150 km, as had been suggested by some,

Several shippers have requested extensions of the interswitching distances in the past. The Agency has consistently rejected them.

> *"would have substantial repercussions in the rail transportation industry and the magnitude of these repercussions would be so significant that such an amendment cannot be contemplated by way of regulatory changes."* [23]

Similarly, in 2010, the Agency stated:

> *"…the 30 km limit was implemented as urban areas grew, so that the practical focus on reducing rail line congestion in urban areas and providing competitive opportunities for shippers would continue. The current interswitching limit is appropriate at this time."* [24]

[22] Canada Transportation Act, subsection 128(5).

[23] Canada Gazette Part II, Vol. 138, No 20, page 1417.

[24] Agency Decision - LET-R-66-2010, April 21, 2010, page 12.

Interswitching was also extensively addressed by the CTA Review Panel of 2000-2001. In its 2001 Report, the Panel concluded as follows:

> *"… expanding the interswitching limits would worsen the market-distorting aspects of the interswitching rate regime and would be a step backward. The proposal ignores market conditions and the averaging effects of a fixed rate – all shippers pay the same rate, regardless of their circumstances.*
> *[…]*
> *Government should be involved in regulating commercial relationships only when one party is abusing monopoly power."*[25] [emphasis added]

Bill C-30 amended the *Act* to provide the Agency with the discretion to establish different interswitching distances for different commodities in different regions of Canada and to set the regulated rates for such services. While Bill C-30 was intended to aid in the movement of grain in what was then considered a critical short-term situation, the government nevertheless made it clear, at the time of introduction, that it expected the Agency to extend the interswitching distances from 30 km to 160 km and that it would apply to all commodities within the three Prairie Provinces.

Bill C-30 amended the Act to provide the Agency with the discretion to establish different interswitching distances for different commodities in different regions of Canada…

Prior to proceeding with amendments to the interswitching regulations, the **Agency conducted an eight-day pretended consultation process**. The consultation was limited to the proposed rates for the new interswitching distances. During the consultation period, CN expressed its concerns on the truncated process and the limited scope of consultation, explaining that a five-fold increase in interswitching distances was not a mere tweaking of existing regulations. Extending the distances from 30 km to 160 km would necessarily have significant ramifications on the participants in the supply chain industry and on railways in particular. In fact, CN explained that a 160 km movement is no longer an "interswitching movement", but rather a linehaul freight movement requiring multiple crews, locomotives and yards to perform the work. With no analysis whatsoever of the impact of these changes or of the conditions requiring such changes, and with no additional evidence that would contradict its own conclusions of 2004 and 2010 or those of the CTA Review Panel of 2000-2001, the Agency nevertheless chose not to consult further and proceeded with the expansion of the interswitching distance to 160 km and its application to all commodities in the three Prairie Provinces.

With no analysis . . . and with no additional evidence that would contradict its conclusions of 2004 and 2010 or those of the CTA review Panel of 2000-2001, the Agency nevertheless chose not to consult further…

[25] Vision and Balance, Report of the *Canada Transportation Act* Review Panel, June 2001, page 63.

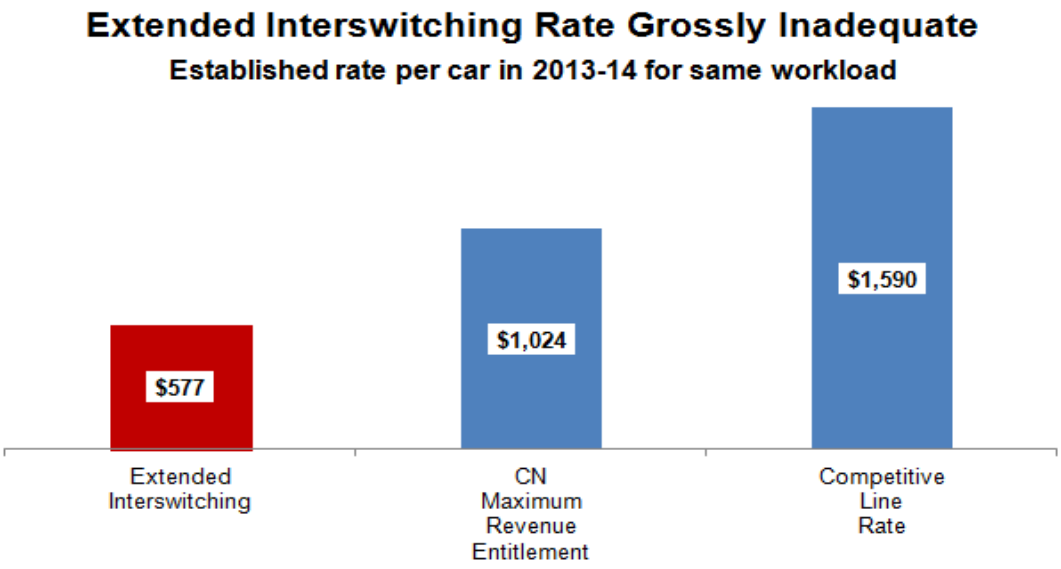
To make transportation policy in such haste, on the back of a short term "grain crisis", is not conducive to the establishment of the sound policy framework necessary to deliver the innovative, flexible and efficient rail transportation services Canada requires to support its future economic growth and prosperity. The Agency developed the 160 km interswitching rate with no actual data on which to base its cost analysis and therefore proceeded strictly on a modelling basis.

The Agency's rate determination methodology made no recognition for the fact that, operationally, at 160 km such movements differ fundamentally from a 30 km interswitching movement. In fact, the **Agency established a regulated rate for linehaul service based on average costs**, the very type of rate regulation that was at the root of earlier railway policy failures. This type of detailed rail rate regulation based on average costs is a practice that Canada had abandoned almost 30 years ago with the enactment of the NTA in 1987.

It is instructive to look at the rate that the Agency established for the new extended interswitching distances in comparison with the rate that would have resulted had the Agency determined the same rate under two other regulatory rate-making provisions of the *Act* – the Maximum Revenue Entitlement (MRE) for the movement of grain and the Competitive Line Rate (CLR) provisions.

Figure 1 below shows that, under the Revenue Cap (MRE), CN would be entitled to earn $1,024 to move a grain car for a distance of 160 km. Yet if the same movement involving the same workload is performed for interswitching purposes, CN would only be able to earn $577 per carload based on the Agency determined extended interswitching rate (and would also entirely lose the rest of the long haul revenue). In the same manner, if the Agency had been required to determine a CLR[26] under the provisions of section 133 of the *Act*, CN would have been entitled to earn $1,590 to move a grain car for a distance of 160 km.

Figure 1



[26] Section 133 provides that the Agency must calculate CLR based on the average revenue earned by the railway company for moving similar traffic over similar distances.

That CN would be entitled to earn close to three times the revenue to perform the same service in moving the same product over the same distance under the regulated CLR provisions clearly **demonstrates that the extended interswitching rate established by the Agency is grossly inadequate.**

CN made those points to the Agency during its hasty consultation process. While the Agency did not address them in the Regulatory Impact Analysis Statement accompanying the amended regulations, it did note that:

> ***"...the new interswitching rates could potentially reduce the revenues of the carriers serving captive shippers as compared to what might be achieved in the absence of interswitching".*** [27]

This is an understatement, to say the least, as CN is not only inadequately compensated for the first 160 km, but also loses all long-haul revenue associated with the interswitched traffic. This is not sound policy.

The extended interswitching rates clearly do not provide sufficient contribution to fixed costs and, as such, are not compensatory. Bill C-30 and the rates established by the Agency have further increased the market-distorting effect of the interswitching regime that had been identified by the CTA Review Panel of 2000-2001. As always, non-compensatory rates distort investment decisions. There is no incentive for railway companies to invest in facilities if traffic originating or terminating at the proposed facilities is required to be moved totally or even partially under the regulated interswitching rates, as such rates provide insufficient returns to justify the investment. Indeed, the interswitching rates could very well result in the loss of some lighter density lines or grain-dependant branch lines that will become uneconomic as a result of such rates.

The extended interswitching rates clearly do not provide sufficient contribution to fixed costs and, as such, are not compensatory.

It is also important to recall that the new interswitching regime disadvantages Canadian railways. It is available to U.S. railways operating at the Canadian border and can result in loss of traffic to U.S. carriers and ports with no reciprocity for Canadian railways, interswitching not being available to Canadian railways in respect of U.S. traffic. **Any such traffic loss can only further undermine investment in railway infrastructure in Canada to the detriment of the longer term capacity and efficiency of the railway network.** Of all CN carloads (not including intermodal) originating or terminating in Canada, 73% are within the 160 km distance, an important portion of which are within the reach of U.S. railroads.

[27] Canada Gazette Part II, Vol. 148, no 17, page 2322.

4. MYTHS ABOUT THE RAILWAYS AND ABOUT GRAIN

The impetus for change in legislation or in the application of regulations in the last two years has been largely based on the persistence of old myths and the emergence of new ones, amid allegations and advocacy on the part of the grain industry, both before and after the harvest of the record 2013-14 crop. These myths around railways and grain must be de-bunked for policy-makers to have a clear and broad perspective on what kind of future transportation policies and regulations are needed to support trade and economic growth in Canada going forward.

The Coal Association predicted exports would quadruple by 1990. Other predictions were for a 300 per cent increase in potash shipments, and 25 per cent in the case of sulphur. In addition, the Wheat Board had set a target of increasing its grain exports by 50 per cent by 1985.

Concerns about railway capacity have always been blown out of proportion

It has often been claimed that Canadian railways lack the capacity to grow and serve Canadian industry. As far back as the early 80's, and probably well before that, the railways were said to be on the verge of a capacity "crunch". In 1981-82, there was a Task Force on "Canada's Crisis in Railway Transportation", in the context of which such concerns were voiced with gravity. In his book "*Retiring the Crow Rate: a narrative of political management*" Arthur Kroeger recounts:

> *"The strong economic growth of Canadian exports to Asia, which was forecast to continue and perhaps accelerate in the 1980's, had important implications for the railway system. The Coal Association of Canada predicted that its exports through the port of Vancouver would quadruple by 1990. Other predictions were for a 300 per cent increase in potash shipments, and 25 per cent in the case of sulphur.*
>
> *In addition, the Canadian Wheat Board had set a target of increasing its grain exports by 50 per cent by 1985. Whether these very large increases would materialize could only be known in the future, but the responsibilities of the Minister of Transport dictated that he take them seriously. Traffic growth of such magnitudes would severely tax the two railways, particularly on their main lines through the mountains to the West Coast. Unless major investments were made, the railways would hit the limits of their capacity by the mid-1980's and would then have to begin rationing traffic. In such an eventuality, the losses to the Canadian economy would soon mount into hundreds of millions of dollars. Capacity limitations on the western railway system were thus not merely a problem for grain producers, or for the West, but rather for the entire country".* [28]

[28] Arthur Kroeger, The University of Alberta Press, 2009, pages 23-24.

Oddly enough, **twenty years later,** during the CTA Review Process of 2000-2001, **railway capacity and railway congestion were not even subject matters for discussion.** In fact, the only reference to any matter relating to congestion involved the Port of Vancouver and a bridge that belongs to the Federal Government.

It was not surprising that, **in the deliberations leading up to Bill C-52 in 2013 and Bill C-30 in 2014, allegations regarding railway capacity were made again and again**, given the emergence of a totally unexpected and record grain crop. Starting with the Minister of Agriculture and Agri-Food himself, whose opinions have surely been shaped by his long history with grain. At the Standing Committee on Agriculture and Agri-Food, the Minister said:

> *"The first years that I farmed in the 1970s, we had piles of grain that we couldn't move. A lot of it spoiled and never did move. So this is not the first time, but we do have an opportunity here to get this right. We have an opportunity with all of the commodity groups, all of the shippers out there saying that there are concerns in capacity and so forth.* [29]

The following statement by the Director of Pulse Canada at the same Standing Committee illustrates the mindset of several stakeholders in the lead-up to Bill C-30:

> *"I will say that Bill C-30 sends a strong signal that rail capacity that does not meet the market demand of the ag industry and rail capacity that cannot recover from adverse weather conditions is simply unacceptable. It is not consistent with Canada's economic growth strategy nor is it consistent with our National Transportation Policy, which states in section 5 that "a competitive, economic and efficient national transportation system . . . is essential to serve the needs of its users, advance the well-being of Canadians and enable competitiveness and economic growth in both urban and rural areas throughout Canada." With that as a backdrop, there is one item that I want to focus on in the limited time that I have right now and flag it as an issue of great importance to our members in connection with Bill C-30. As I mentioned, the March 7 order-in-council and the extension of that order under Bill C-30 make a strong statement with respect to rail capacity expectations. Greater capacity must be added immediately and ultimately must be set at a level that responds to industry needs".* [30]

The facts are different. CN and CP have long been challenged to grow the size of their infrastructure and their rolling stock fleet, and **the railways have always risen to the challenge with enough capacity to meet**

[29] Gerry Ritz, Minister of Agriculture and Agri-Food, at the Standing Committee on Agriculture and Agri-Food, March 31, 2014.

[30] Greg Cherewyk, Executive Director Pulse Canada, at the Standing Senate Committee on Agriculture and Forestry, May 15, 2014.

the needs of the market. Indeed, from 1980, the base year for the Task Force referred to above, to 1994, the year preceding CN's privatization, overall traffic increased at an average rate of 2% a year at CN. While that took place before the impulse which came with privatization, CN remained in a position to serve the Canadian economy during those years. And reality turned out to be quite different than the assertions made in the early 80's. Canadian grain production grew by a very normal 2-2.5% a year between 1980 and 1994; Canadian potash production was up only 1.5% a year; and, as is well known, the Canadian coal mining sector started a major decline in 1998 due to difficult competitive conditions, and did not revive until ten years later. As we speak, the Canadian coal industry has again cut back, with 5 of 7 CN-served mines either completely shut down or operating well below capacity.

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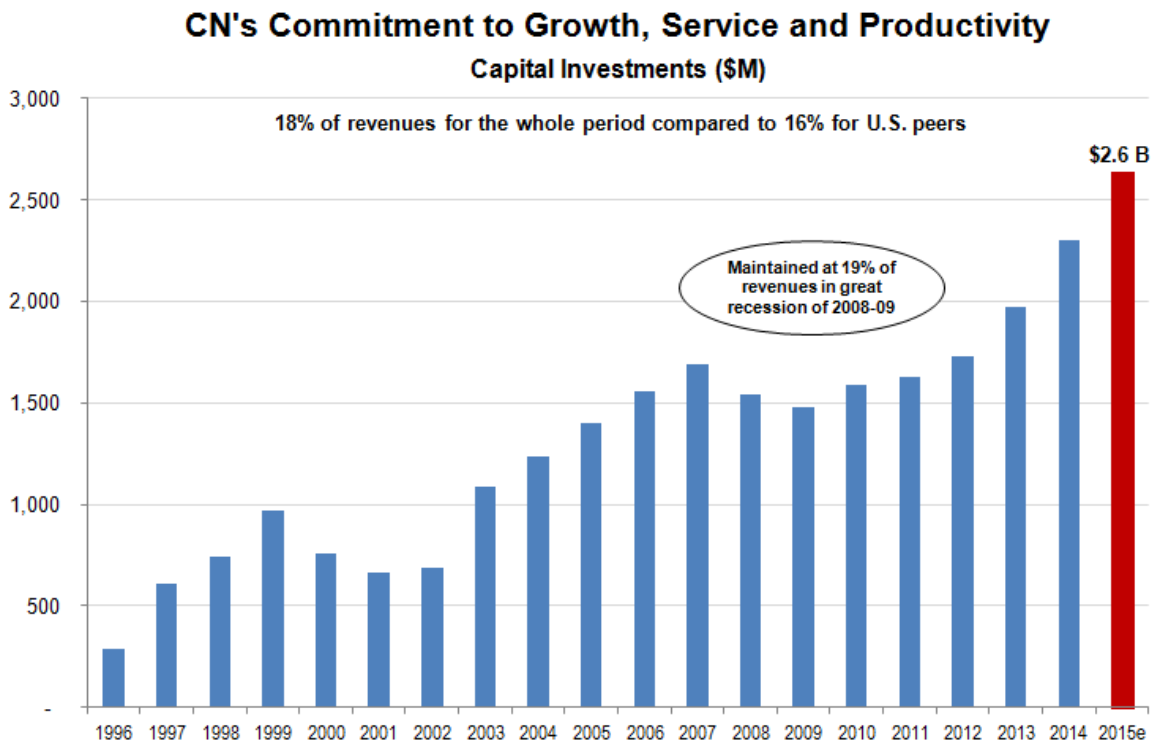
In spite of recurring fluctuations in market conditions and the inherent uncertainty associated with investments in long-lived assets, the **railways have indeed long made the necessary decisions to support Canada's international trade and the Canadian economy.** Facing market fluctuations arising from the business cycle, from changes in the competiveness of its customers, and from the unavoidable volatility of grain production, Canadian railways do what they have to do. Their investments are financed 100% internally with the railways' own cash flow and do not require any public funding. As in any other line of business, investments are made when the opportunity being seized holds reasonable economic promise and the risk that is being taken is deemed manageable.

CN capital investments over the two decades since its privatization in late 1995 have averaged $1.4 Billion a year to 2015 (including a capital budget of $2.6 Billion in 2015). This equates to over 18% of revenues during the whole period and compares to 16% for U.S. peers over a similar period. Such a ratio is evidence of CN's commitment to the business and its confidence in the ability to transform capital investments into profitable, sustainable growth, with a solid foundation and a clear strategic agenda. CN's commitment can also be seen by the steadiness of its investment spending. When the great recession of 2008-09 hit, CN maintained capital investments at a level equalling 19% of revenues, looking beyond the short-term and preparing for what it presumed to be a gradual recovery from the recession.

Figure 2



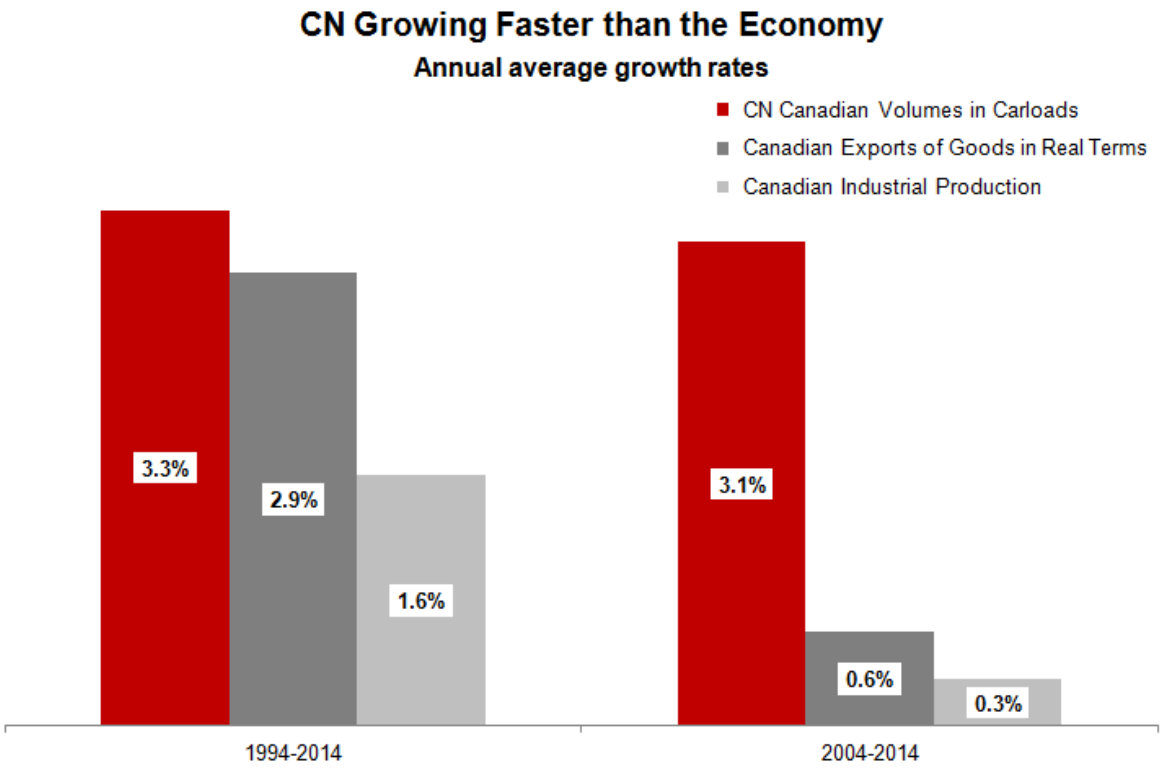
CN's commitment to growing the business has extended beyond the capital investments it has made, for it has also expanded its footprint, both in Canada and the U.S., with $8 Billion of acquisitions from 1998 to recently. Starting with the Illinois Central, which allowed CN to run though mid-America from Chicago to the Gulf coast, the Company then acquired the Wisconsin Central in 2001, the Great Lakes Transportation Company and BC Rail both in 2004, the EJ & E around Chicago in 2009, and a variety of short lines in Canada afterwards. In addition to extending its reach, these acquisitions improved CN's ability to offer seamless service and grow with its customers across a wide range of market segments and corridors.

CN's performance over the 20 years since its privatization shows how all these major investments have helped the business to grow. As **Figure 3** shows, between 1994 and 2014, total CN volumes, measured in terms of carloads moved in Canada, almost doubled, representing an average growth rate of 3.3% per year. During the same period, Canadian industrial production, a reasonable proxy of demand for overall rail transportation in the economy, increased at an average rate of 1.6%. Canadian exports of goods (expressed in constant dollars), which is another key indicator for rail traffic, grew annually by 2.9% over the same years.

CN's performance over the 20 years since its privatization shows how all these major investments have helped the business to grow.

An even stronger relative performance by CN can be seen during the latest ten years. As **Figure 3** also shows, between 2004 and 2014, CN carloads grew at an average rate of 3.1% in Canada, compared to 0.3% a year for Canadian industrial production and 0.6% a year for real exports of goods. Moreover, **CN's carload gains significantly outpaced all North American Class I railroads combined (which came in at 0.5% a year between 2004 and 2014)**. Such growth is the result of vigorous investments to meet customer demand and the deployment of a focused customer-centric agenda to meet customer needs. Growth was experienced across several business segments, from intermodal markets (both domestic and international), to industrial markets (except forest products), and bulk products (including grain).

Figure 3



CN remains committed to growing its business going forward. CN's business agenda is focused on delivering safe, efficient and high-quality services, in order to grow in a way that creates value for its customers and shareholders. That agenda calls for a dynamic mindset, using the best practices and latest technologies in deploying its investments and managing its day-to-day operations, and leveraging its innovative capabilities as a true supply chain enabler across all market segments. The $2.6 Billion capital envelope planned for 2015 will allow CN to continue down the path it has been on for several years: providing the service and the information customers need from end to end, increasing capacity and improving productivity to grow the business at low incremental cost, and maintaining a safe and fluid network across the system.

Allegations that the railways abuse market power are unfounded

It has been suggested that Canadian railways have market power and that they abuse that power with customers. **Such allegations reflect a narrow understanding of what constitutes competition for the railways** and is a presumption that goes back to the last century, before the widespread development of trucking and the significant expansion of product and source competition.

There are indeed numerous sources of competition that constrain the railways' ability to impose commercial conditions on their customers. CN asked an expert to examine several commodities, representing 80% of all its carloads originating in Canada, and assess the extent of competition, whether among railways, among CN and trucks or other modes, and where warranted, whether there were other sources of competitive pressures, including the countervailing power of large buyers. The expert concluded:

> *"InterVISTAS assessed the competitive landscape of 19 commodity groups representing 80% of CN's total traffic base originating in Canada. […] Conclusions were reached after a thorough review with extensive data and solid methodologies.*
>
> *Overall, a large majority of Canada's production of these commodities enjoys competitive conditions for their transportation. Most Canadian production is found to have a very high degree of intramodal or intermodal competition, and/or a high degree of source of supply or product substitution competition for the commodity being shipped. Analysis of the rates paid by shippers of residual traffic found in many cases that they enjoy rates no higher than comparable competitive traffic. As well, multisite shippers have potential to look across commodities and facilities and thus have some degree of countervail power vis à vis the railways. Thus for a very large share of Canadian production of the 19 commodities, there appears to be meaningful constraint on railway rates. Of course, individual shipments may have to be evaluated in rate disputes, but the finding is that there is a significant degree of competition pressure in one form or another across CN markets."*[31] [emphasis added]

In order to illustrate how the different commodities were examined, the following briefly presents the results for three totally different cases. The first case is intermodal, which is competitive by its nature and represents more that 20% of CN's volume. As essentially all intermodal traffic moves in containers, that traffic can be easily transferred from one mode to another and is particularly susceptible to competition since the transfer is so easily done. It is recognized that trucks can be cost and service competitive even over considerable distances, and not just over distances of 500 miles (800 kilometers) or less, as is often thought to be the case. Thus, in addition to extensive intramodal competition between Canadian railways for domestic intermodal

[31] *Railways Economics and Competition in Canada: Addressing the Issue of Railway Market Power*, prepared by InterVISTAS for CN. See reference in Appendix II.

traffic, there is always the threat of traffic being lost to rivals operating trucks if rates or service are not acceptable to the customers. **In the U.S., the extent of competition in the intermodal business is acknowledged to be great enough for all such traffic to be completely exempt from regulation. This is a key consideration for the Panel to take into account in its assessment of Canadian regulatory conditions going forward.**

In the international segment of intermodal, there is also considerable competition between Canadian railways. Indeed, CN and CP have been battling for the business for steamship lines since the first ocean container was imported into Canada over 50 years ago. While the railways also face competition from truckers, the existence of alternate gateways provides another key source of competition in this segment. For example, European containers moving into Halifax can always come in through New York, a very competitive port with a huge hinterland market. By the same token, shipping lines moving Asian containers into Vancouver or Prince Rupert can shift to several West Coast ports including Los Angeles/Long Beach, especially for container imports destined to Chicago or other mid-West destinations.

The second case is coal. In a sense, coal is at the other end of the spectrum in this competitive assessment. Each mine located in Western Canada is served exclusively by one railway, and few mining companies own more than one facility. In addition, coal does not lend itself to trucking due to its heavy weight, except over short distances. In coal, the competition comes from other producers in the international market. Indeed, Canadian coal producers compete heavily against producers in Indonesia and Australia in particular, which rank well ahead of Canada in terms of global coal exports to China and other major coal importing countries. A comparison of total delivered coal prices to buyers in Asia between Australia and Canada shows that Canadian coal producers pay higher rail rates, but this is explained by the five to six times longer distances coal must travel, not to mention the more costly conditions of operating in Western Canada on routes through the mountains to port. Notwithstanding the distance disadvantages, Canadian coal is still competitive in its markets. While the presence of source competition provides rail pricing constraint, coal is a good example of where shipper remedies should be maintained if abuse or commercial harm can be demonstrated. Coal mines are often located at the end of a rail line and, as a result, enjoy the benefit of rail service where there is often very little traffic. Such mines cannot be presumed to suffer commercial harm just because rail rates may be higher than on the mainline. That presumption is equivalent to saying that the airfare from Northern Quebec to London or Paris should be the same as from Montreal. **Commercial harm has to be established with the facts and in the proper context, and cannot be premised on some faulty notion of captivity or "railway market power".**

The third case is lumber. Lumber is a commodity that travels extensively on rail in Canada. Lumber producers enjoy a wide range of competitive alternatives in moving their product, from direct rail and direct trucking competition at origin to destination, to the possibility of using trucking to a reload facility for transfer to another railway[32]. Looking at total Canadian lumber production in 2013, it was concluded that a residual of

[32] To be specific, the reload option is considered to be feasible if the reload facility is within 250 miles of the plant for shipments with a total distance between 1,000 miles and 2,000 miles to destination.

only about 15% had no apparent competitive options. These are important facts. **These facts demonstrate that being served by a single railway does not imply captivity**. Nor does it mean that rail rates are necessarily out of line. A comparison of rates with competitive points shows that rates are seldom higher in residual points. In addition, when rates are higher, it is the case because the density of the line on which the lumber moves is well below average. In lumber, as in coal or any other commodity, claims or allegations made in advocacy of "railway market power" and "abuse" to justify regulatory intervention must not be accepted at face value; they must be demonstrated with facts if Canadian regulations are to support a sound and expanding railway system.

Allegations, that the railways did not plan or execute properly in 2013-14, are grossly exaggerated and simply misguided

CN's operational and business planning aims at having the assets and resources to surge above a reasonable view of a trend crop, because we understand that grain production varies up or down year to year, and rail shipment demand also varies seasonally. For Western Canadian grain, this means having the assets and resources to remain broadly in synch with waterfront grain elevator throughput capacity and the consumptive demand of domestic receivers in Canada and the US. **This includes sufficient capacity to surge in the fall and spring and some ability to respond to unexpected volatility in the size of the crop** [33].

The 2013 harvest was extraordinarily and unexpectedly large. There are many factors driving the volatility of Canadian grain production and yields: new varieties, other technological advances, better agronomics and crop inputs. But the 2013-14 crop was an outlier event, far above trend, with less than a 1-in-100 statistical probability: truly a "100-year crop". Statistics Canada's estimate of production as late as August was 60 million metric tonnes (MMT), which was revised during harvest in early October to 68 MMT. By December, the estimate had reached 76 MMT, 20 MMT or 35% above average, and 13 MMT above the previous record. The 20 MMT bump-up in Canada's exportable surplus was equivalent to 55% of Canada's best-ever annual grain export program. The final figure for 2013-14 production was 77 MMT.

The 2013-14 crop was an outlier event, far above trend, with less than a 1-in-100 statistical probability: truly a "100-year crop"

[33] This is fully developed in a CN document tabled with the Secretariat entitled "The 100-*year crop: A fact-based perspective"*. See reference in Appendix II.

The US elevator system has capacity to receive delivery of about 40% of normal production, while the Canadian elevator system can only accomodate 10%...

Entering the 2013-14 crop year, carry-in stocks were abnormally low, close to 8 MMT, or 5 MMT below average, as a result of record movements to export during the prior year. Even so, the large new crop created a demand for storage space that completely overwhelmed available on-farm and commercial storage in Western Canada. A key structural difference between Western Canada and the Northern Plains States (North and South Dakota, Montana, Idaho) is total country storage capacity. On-farm storage is similar, estimated to be in the 50 to 55 MMT range[34] [35], though there are some indications on-farm storage has been increasing recently in Western Canada into the 70 MMT range[36]. Yet the storage capacity of the Western Canadian primary elevator system has declined from an estimated 7.2 to 6.3 million tonnes since the early 1990s while the U.S. country elevator system has actually increased from 25 to nearly 40 million tonnes over the same period. The U.S. elevator system has capacity to receive delivery of about 40% of normal production, while the Canadian elevator system can only accommodate 10% of a normal year's production, i.e. has limited "surge" capacity[37]. **Limited capacity to store grain necessarily puts more pressure on the railways to compensate with disproportionate capacity in times of surging demand.**

Post-harvest, once available on-farm and commercial country storage capacity filled up, many farmers had to scramble, turning to grain in bags, sheds, or on the ground (temporary storage). This urgency of moving potentially distressed grain following an unexpectedly record harvest for which storage was not available resulted in a great push to deliver grain into elevators. When rail demand ramped up in mid- September of 2013, CN reacted quickly and deployed all available assets and resources for grain movement, with none held in reserve. During October and November, CN surged to move more grain than ever before in its history.

During October and November, CN surged to move more grain than ever before in its history . . . brutal winter conditions then hit central North America from early December until early March.

Then brutal winter conditions associated with the Polar Vortex hit central North America from early December until early March. Winnipeg had the coldest winter in a lifetime. Navigation on the Seaway shut down unexpectedly early and restarted late, and Lake Superior froze over for the first time in a generation. The sustained extreme cold weather disrupted operations of Canadian railways and other North American transportation modes and carriers. **Despite being the most northerly, CN performed better and deteriorated the least of all railroads**[38].

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[34] *Overview of Canada's Grain Industry Supply Chain,* Canada Grains Council, Mycotoxin Workshop. April 2010.

[35] *2014 Grain & Milling Annual*, World Grain Milling and Baking News.

[36] *Farm Survey – Grain and Oilseed Storage Capacity*, Statistics Canada, December 2014.

[37] For a comparison of the Canadian and U.S. grain sectors, see *Evolution of the Competitive Structure of the Western Canadian Grain Industry*, prepared for CN by CPCS, , December 2014. See reference in Appendix II.

[38] According to statistics submitted to the AAR, comparing winter 2014 with the year before, CN train speed went down 5% as opposed to 9% for its peers. The same pattern is observed for terminal dwell, another key rail performance metric, where CN saw a deterioration of its performance by 11% compared to 24% for its peers.

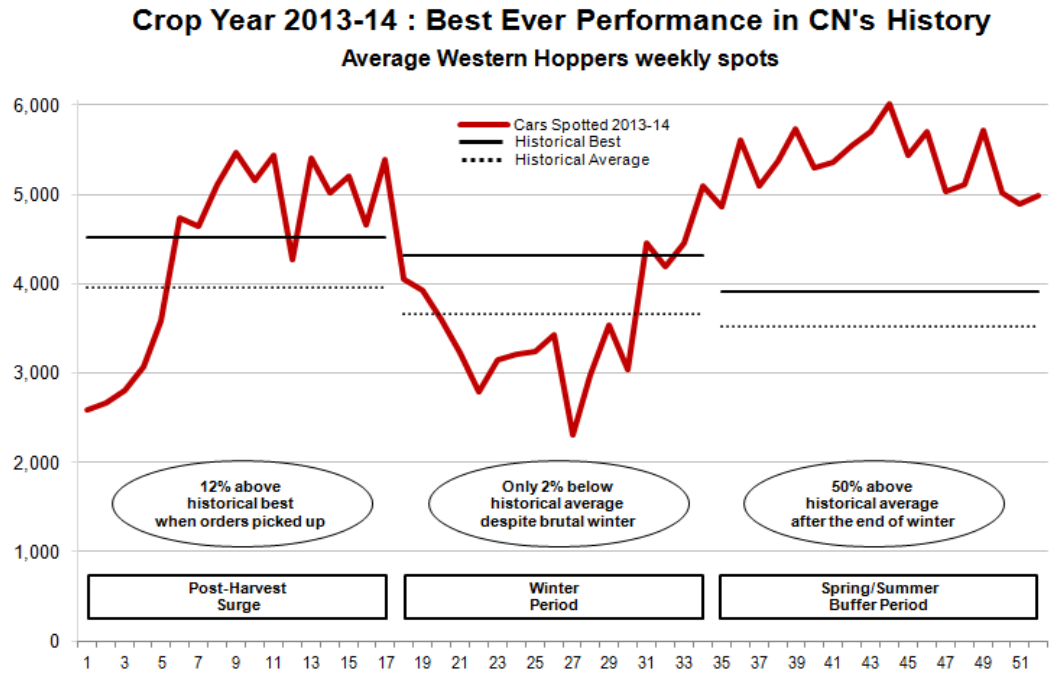
Incorrect Claim: Minimum grain mandates were necessary and consequential

Before the Canadian Government imposed grain volume requirements under Bill C-30, CN had pledged in February 2014 to Ministers Raitt and Ritz that it would recover and catch up, by moving over 4,000 cars of grain per week as soon as the extreme winter weather abated, rising to 5,500 cars per week after the port of Thunder Bay re-opened. **CN did exactly what had been pledged to the Ministers**. As soon as the weather broke in early March, CN's grain spotting program recovered strongly. This recovery helped close the December-March winter period with grain shipments only 2% below the average historic performance. From April, after the delayed re-opening of Thunder Bay, CN surged again and set records for weekly grain spotting in each month through the end of the crop year. CN's performance over this period was 50% higher than the historic average.

. . .after the delayed re-opening of Thunder Bay, CN surged again and set records in each month through the end of the crop year. CN's performance over this period was 50% higher than the historic average.

CN finished the full 2013-14 crop year setting a new record for grain hopper car movements, close to 25% above past average performance. End-to-end balance was restored to the grain supply chain. Grain car orders, which had grown beyond anything that was reasonable, were brought down significantly and, by early fall of 2014, outstanding orders were equivalent to about one week of delivery. CN's plan has always been to deliver grain as quickly as the whole supply chain would allow; **any support from other stakeholders, in the form of better supply chain collaboration or additional capacity, would undoubtedly have allowed CN to deliver even more.**

Figure 4



In the 12 months, since the volume requirements were imposed, CN has in fact delivered about 2.5 MMTmore, cumulatively, that what was mandated. For the eleven weeks when it was not possible to fully meet the required tonnages, CN has clearly exposed the facts to Transport Canada, specifically identifying the supply chain issues or the other factors that were at play. The result has been that, in all cases, but for two weeks the failure to meet the minimum volumes was completely beyond CN's control, a fact that was recognized as no penalties were imposed on CN in all other weeks.

Incorrect Claim: Railways can't or won't "surge" for grain

CN has responded to surges in grain shipping demand. Grain car orders typically decline during the May – August period, requiring railways to store grain cars over the summer prior to the fall harvest. In summer 2013, CN had over 50 miles of grain cars stored in Western Canada. The summer of 2014 was the first in the past two decades that CN did not need to store thousands of grain covered hoppers.

During 2013-14, CN augmented the Western grain fleet several times, adding 500 grain hopper cars leased in October 2013, and 500 more cars leased in December. Then an innovative new program, called the Commercial Fleet Integration Program, enabled customers to supply and integrate up to 800 cars into CN's Western grain fleet, most of which were delivered by July 2014. Cars from the U.S. were temporarily redeployed into Canada during the spring and summer as they became surplus to the seasonal needs of CN's grain business in the U.S.

In fact, both railways set absolute all-time records for Western grain movement in 2013-14. The Canadian Transportation Agency has reported CN and CP together moved 38.5 million tonnes of grain regulated by the Revenue Cap, 38% above the average since the Cap was implemented in 2000.

CN augmented the Western grain fleet several times, adding 500 hopper cars in October 2013, and 500 more cars in December. Then an innovative program enabled customers to integrate up to 800 cars into CN's Western grain fleet…

The strong contributions by CN and CP enabled the entire Canadian grain industry to set an absolute all-time disposition record of 69 million tonnes, including:

- Exports of 42 million tonnes, 20% above a year earlier;
- Domestic use of 27 million tonnes, including new production records set by the Canadian canola crushing industry, which uses the railways extensively for shipments to domestic markets.

CN has continued record-setting grain movements in the 2014-15 crop year, with volumes more than 20% higher than last year's crop to date. **CN has met, and continues to meet, the pledge made to the Canadian government** – a pledge made before any minimum grain volumes were imposed – to move as

much grain as possible, as efficiently as possible, in Western Canada. It is doing so across all the corridors it served, whether on the West coast, the East coast, or within the Canadian and North American markets per se.

A key issue regarding surge capacity is whether the whole supply chain is properly considered. Indeed, CN has tested the capacity of the chain in the last 18 months and has witnessed, first hand, when and where it can surge. During the spring and early summer of 2014, CN was able to move 5,360 carloads a week, which, as mentioned earlier, was 50% above the historic average. Though 6,000 carloads did move in week 44 (during June), it was not possible to maintain that pace as the other supply chain participants were not able to keep up. **This tends to confirm that the maximum sustainable capacity of the supply chain for CN is at most 5,500 carloads a week, or 11,000 for the industry, well below any number put forward by the Western Grain Elevator Association**[39]. It is critical that policy-makers take a reasoned and documented stand on the capacity of the whole supply chain. Sound policy must be based on facts, not on allegations made in the name of advocacy, as was the case during the winter of 2014.

Incorrect Claim: Railways would contribute to burdensome carry-over stocks at the end of 2013-14

During the harsh winter of 2013-14, **industry observers made inflated forecasts and alarmist claims regarding expected year-end stocks**, to justify interventions targeted at railways. The Canadian government, before imposing minimum grain volumes in March 2014, projected that by July 31, 2014 there would be *"26 to 30 million tonnes of carry-over into the next crop year, that at $275 per tonne, results in approximately $7.2 to $8.3 Billion in lost sales".*[40] This highly exaggerated claim was widely quoted in Parliamentary debates and subsequent press reports, some as recent as the end of 2014. [41]

CN believes it is totally misleading and blatantly unfair to equate carry-over and lost sales. This ignores the simple reality that there is a carry-over of "old crop" stocks in the Canadian system every year. In fact, the carry-over is 12.5 million tonnes on average. Moreover, carry-over turned out at 15.7 million tonnes at July 31, 2014, not 26 to 30. This projection was highly inaccurate and overstated, by 10 to 14 million tonnes, representing an error of up to 90% per month, over the 5-month forecast horizon from March to July and a clear misrepresentation of what was happening on the ground.

CN believes it is totally misleading and blatantly unfair to equate carry-over and lost sales. This ignores the simple reality that there is a carry-over every year.

[39] *Corridor Capacity, Sustainable Unloads & Correlating Breakdown of Tonnages*, Western Grain Elevator Association, communicated to the Minister of Agriculture and Agri-Food in February 2014. The Association provided absolutely no support to its claim that the grain supply chain could handle 13,767 cars per week.

[40] *Order Imposing Measures to Address the Extraordinary Disruption to the National Transportation System in Relation to the Movement of Grain*, Canada P.C. 2014-274, Regulatory Impact Analysis Statement, March 7, 2014.

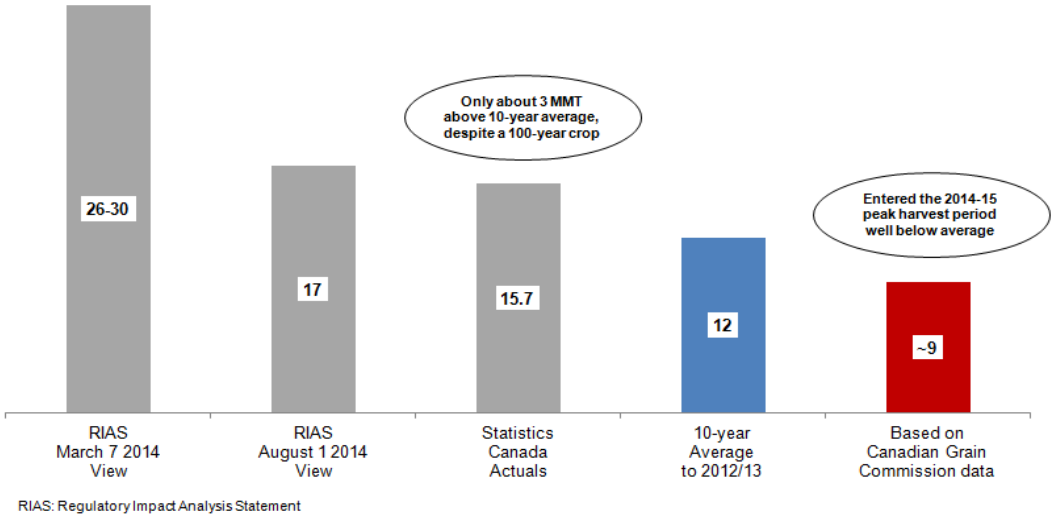
[41] "*Ritz: Canada's railways have 'overplayed their hand*, iPolitics", December 17, 2014.

After August 1, the continued strong movement of grain on rail contributed to a record-setting export pace and further domestic use, which drew down stocks by another 6 million tonnes by mid-September. **As the 2014-15 harvest came in, the "old crop" carry-over was around 9 million tonnes, well below average,** leaving ample room for the new crop.

Figure 5

CN Performance Helped Move a 100-year Crop in Just Over a Year

Year-end carry-out stock levels (MMT)



For all practical purposes, **the rail industry and grain supply chain brought Canada's grain supply back to normal within a period of a little over a year, despite having to move a 100-year crop**.

Incorrect Claim: Railways caused a "farmer crisis" in 2013-14

Some market observers incorrectly and unfairly blame railway service as being the cause of "plugged" country storage facilities, and for relatively low country bid prices (wide basis) throughout the 2013-14 crop year. The reality is that, when the size of the all-time record crop increasingly became apparent, there followed a great push by farmers to sell and deliver grain into elevators. This would not likely have happened when the Canadian Wheat Board (CWB) had the monopoly on selling Board grains, because the CWB, acting as the supply chain "governor" that took into account available system storage and throughput capacity, used its regulatory powers and non-price-based contract calls to control the actual delivery of Board grain into the elevator system.

In the post-CWB era, farmers have more marketing options available to avoid accepting low bid prices when basis is wide. Early as we are in this era, however, not all farmers are necessarily familiar enough with these options.

In the post-CWB monopoly era, as would be expected in a normal market, grain elevator companies use price bids on grain to increase or decrease the flow of product into their elevators. As the 2013 crop was harvested and off-farm deliveries ramped up in the fall bid, prices dropped, a price signal to disincent further deliveries and incent farmers to hold grain. The low bids experienced during 2013-14 were driven by the extraordinary crop size that put pressure on farms to deliver into the elevator system, compounded by the behaviour of some farmers that drove prices even lower as they continued to sell and deliver long after bid prices had begun to fall.

When basis widens and country bid prices drop lower, there is often a spread between spot prices and deferred prices for future delivery that offers a premium favouring deferred delivery. Spreads in future markets will also be wide, or at a "carry". The price spreads between different futures contracts for nearby versus forward delivery months indicate the market will pay more for grain delivered later; in other words, the market will reward the holder of grain to "carry" the grain stocks longer. **In the post-CWB era, farmers have more marketing options available to avoid accepting low bid prices when basis is wide. Early as we are in this era, however, not all farmers are necessarily familiar enough to exercise these marketing options.**

A marketing strategy for farmers to take advantage of a price premium for deferred deliveries is an effective response that has important second-order market effects. Indeed, high selling and delivery pressure drives country bid prices lower, but spreading actual deliveries of grain over time reduces the volume being marketed into the system and is eventually supportive of higher country bid prices and of narrower country to port price spreads.

This appears to be exactly what some farmers did during the 2013-14 crop year, and what Canadian government policy intended. As Canada's Minister of Agriculture and Agri-Food Gerry Ritz stated in a House of Commons debate in May 2014:

> *"The good news is less than 1% of Canada's record production in Western Canada last year was sold at that lower basis price. Those are actual numbers from the Grain Commission. This is good news in that farmers were not forced or pinched to sell at that level, but we need to see more transparency in those numbers* [...]
>
> *They now have the ability to move that grain much farther than they did under the old single desk system under the Wheat Board. They are not confined to a permit book that forced them to sell to one particular point of entry. They can actually put it on their truck and take it where they need to now. That has given us some competition to keep that price where it should be."* [42]

[42] House of Commons, Hansard, 41st Parliament, 2nd Session, May 1, 2014. Debate on Bill C-30 *Fair Rail for Grain Farmers Act*.

How many farmers actually took advantage of the premium for deferred deliveries is not known. How many were constrained by limited on-farm storage capacity from carrying a record crop – and, as a result, lost the marketing option of deferred sales and deliveries – also cannot be determined with precision. Whether the grain elevator companies actually earned extra or "windfall" profits from the widened price spread, between the country elevator and the port is also unknown, although indications are that this may have been the case for a portion of the 2013-14 export program. **One thing is sure, to blame the railways for farmers' financial hardship is simply incorrect and unfounded**.

How many farmers took advantage of the premium for deferred deliveries is not known. How many were constrained by limited on-farm storage –and, as a result, lost the option of deferred sales and deliveries – also cannot be determined…

By the same token, to measure lost sales by simply multiplying the difference between port and countryside prices by the tonnages that moved, and to blame the railways for such a theoretical loss, is a misrepresentation of reality. There is no way of knowing how many transactions on the buy-side and the sell-side actually took place at these prices in any given period. For a great deal of the winter of 2013-14 in particular, grain companies stopped buying from farms and very little new export business was being done. In fact, it has been suggested that as much grain business may have been done at more traditional spreads than at the peak.

In fact, **Statistics Canada has reported total cash receipts from crop sales by Prairie farms in the year ending September 30, 2014 were the second best ever** at $21.5 Billion, just 2% below the record of $22.0 Billion set one year earlier[43]. This was despite a deterioration in grain prices during 2013-14 – according to Agriculture and Agri-Food Canada, a 28% decline in wheat prices and 23% lower canola prices – attributable to growth in world, U.S. and Canadian supply for these and other major crops[44]. The railways' movement of grain enabled Canada's grain supply chain to dispose of a record 69 million tonnes of grain in the 2013-14 crop year, certainly alleviating any financial pain suffered by farmers and grain companies during this period.

Incorrect Claim: Removal of the Revenue Cap would hurt the grain sector

The Maximum Revenue Entitlement, or as it is commonly called, the Revenue Cap, has been in place for 15 years and was not affected by recent legislative changes. Viewed in isolation, each piece of regulation creates its own set of limitations on the functioning of a normal market. Viewed together, the existence of price controls, the wide range of shipper remedies, and the increasingly intrusive nature of regulations, all become part of an institutional framework which deepens the mindset of dependence on the part of

Viewed together, the existence of price controls, the wide range of shipper remedies, and the increasingly intrusive nature of regulations, all become part of an institutional framework which deepens the mindset of dependence . . .

[43] *Farm cash receipts, quarterly*, Statistics Canada, CANSIM Table 002-0002.

[44] *Canada: Outlook for Principal Field Crops*, Agriculture and Agri-Food Canada, December 19, 2014.

farmers and grain companies, to grow the business, gain market share and increase profits with the help of government support.

An assessment of the Revenue Cap, or prior forms of control, has been part of the statutory review of the *Canada Transportation Act* since 1985. In this context, the Revenue Cap must be seen as part of a complex system of transportation regulations which feed on each other, if not necessarily in the application of regulations, certainly in the way stakeholders perceive the role of government and the role of business.

The Revenue Cap is a form of price control that sets a volume-variable ceiling on the total revenue a railway may earn…

The Revenue Cap is simply a form of price control that sets a volume-variable ceiling on the total revenue a railway may earn in a crop year. The Cap is essentially a fixed maximum average price per tonne-mile a railway may charge in a crop year. The maximum for each of CN and CP is defined in a formula prescribed in the legislation. The formula includes a common inflation adjustment factor for annual changes in an index of railway input prices, set annually by the Agency before each crop year. After each crop year, the Agency determines the revenue earned by each railway from the movement of Western grain. Excess revenues must be paid out to the Western Grain Research Foundation together with a penalty. Revenue shortfalls in a given year may not be carried forward to the next crop year and can never be recovered.

The Revenue Cap is the latest in a series of regulatory regimes starting in the nineteenth century, all designed to limit what railways may charge to move Western grain. This began in 1897 with the Crow's Nest Pass freight rates on grain. In 1925, the rigid "Crow Rates" were made statutory under the *Railway Act* and extended to all federally regulated railways, including CN. It became apparent by the 1960s that the Crow Rate regime seriously under-compensated the railways for Western grain movement. To relieve growing grain transportation problems as grain production and export demands grew, the Government of Canada had to recapitalize the system between 1967 and 1995 by financing numerous measures, including acquisition of covered hopper rail cars, subsidizing grain branch line operation and reconstruction, and subsidizing grain export movements. In 1995, to reduce the federal deficit and comply with WTO rules, Government eliminated the Crow Rates and WGTA subsidies to grain exports, made one-time compensation payments to Western grain producers, and introduced a Maximum Rate Scale form of price control on railways.

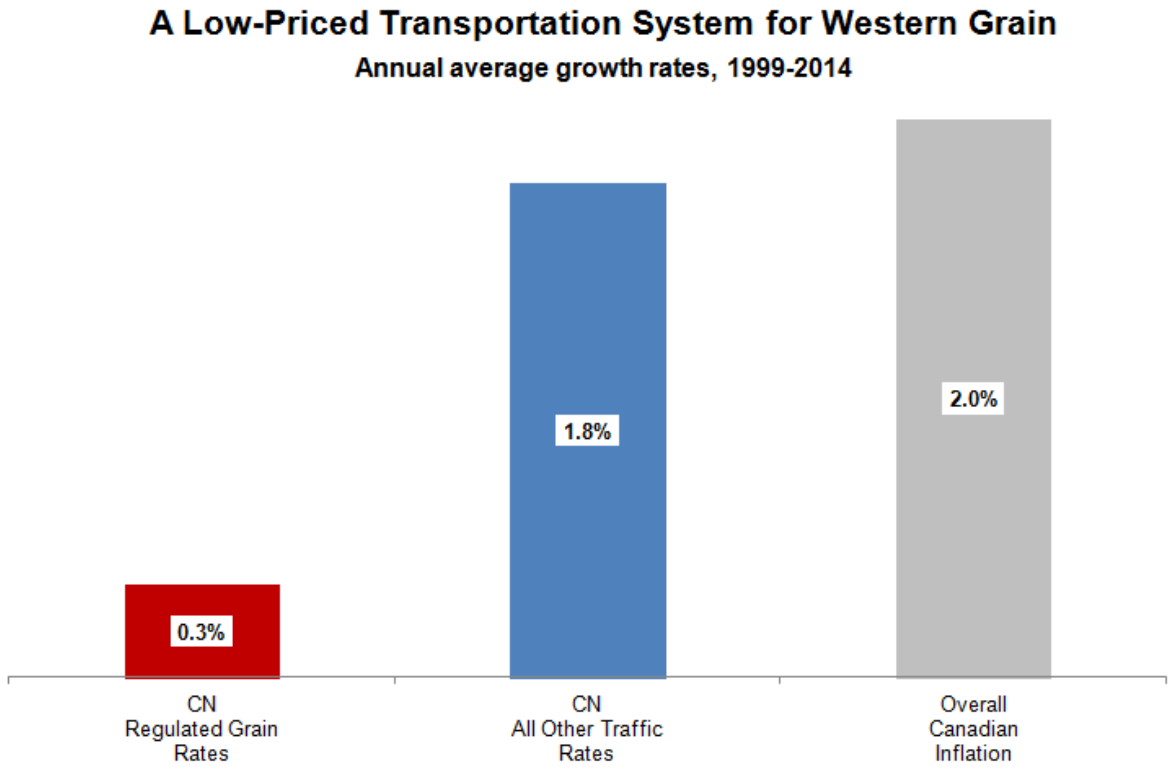
The Revenue Cap and the previous regimes of prescribed and maximum rate scales were designed to give strong incentives for railways to focus on driving productivity and cost minimization within a crop year and over time. This is how a railway can maintain or improve operating margins on capped regulated revenues. The consistent signal from policymakers has been that the railway that can reduce its costs the most will benefit the most. While efficiency is certainly an important goal for any business and any customer of that business, it is not the only one that matters in a dynamic and competitive marketplace. **Grain is**

The Revenue Cap and the previous regimes of prescribed and maximum rate scales were designed to give strong incentives for railways to focus on driving productivity and cost minimization…

indeed a very dynamic market with all kinds of changes taking place, as a result of fluctuating demand, growing crop complexity, increasing crop volatility, and solid international competition. In such a market, railways and all other partners in the supply chain need a great deal of flexibility, a strong dose of collaborative spirit, and a solid incentive to be innovative about what can be done, **exactly the things that the Revenue Cap does not encourage.**

Fifteen years into the Revenue Cap regime, and thirty years after the start of the WGTA subsidy regime, the policy focus on cost-minimization has indeed succeeded in producing a low-priced transportation system for Western grain. Grain rates at CN, as measured by revenues per revenue-ton-mile (RTM), increased by 0.3% a year on average from 1999 to 2014. By way of comparison, for all other CN business, revenues per RTM increased by 1.8% and overall Canadian inflation registered at 2% a year during the same 15-year period. And a once-large network of inefficient grain gathering branch lines has been rationalized, with the new gathering network serving new-generation high-throughput elevators and processing plants.

Figure 6



But Revenue Cap regulation is also fundamentally a structural impediment precluding the railways and the Western grain industry from responding more effectively to market and competitive forces. It is an anachronism ill-suited to the modern grain sector that has emerged in Western Canada – one that is more market-driven than in the past, characterized by more extreme seasonality and variability in production and market demand conditions.

It is an anachronism ill-suited to the modern Western Canada's modern grain sector that has emerged – one that is more market-driven than in the past, characterized by more extreme seasonality and variability…

Demand for export grain shipping exhibits greater volatility, seasonality, and unpredictability than many other major commodities reliant on rail transportation. There are many reasons for this: crop and market diversity, variability in production and quality levels between years and regions, seasonality in production, harvest and storage, and variability of price levels and differentials over time in Canada and in international markets. Although demand to move Western Canadian grain typically surges with the increase in available supply in the post-harvest period, demand in the market for particular crops or grades may surge or peak at any time during the year. Most market participants agree grain export volumes and variability will increase in Western Canada following elimination of the CWB single desk.

In these circumstances, it is clear that Revenue Cap regulation of railways is antiquated, dysfunctional and ill-suited to the needs of participants in this dynamic marketplace. **Revenue Cap regulation distorts commercial incentives for railways in several ways**.

- ***Railways cannot retain any revenues earned from peak-load or seasonal pricing needed to encourage more efficient distribution of demand and asset use.*** The Cap is a "zero-sum" game: any additional revenues need to be offset by equivalent off-peak reductions, or else paid out as excess revenues with a penalty.

- ***Railways cannot retain any performance incentives that would be earned as a normal quid-pro-quo in commercial contracts for premium service quality.*** The Cap is asymmetric: performance incentives (higher-than-normal revenues earned from premium service commitments) are counted as revenues and cannot be offset by non-performance penalties paid out. Performance incentives earned from one shipper must be offset by equivalent reductions on other shippers: "zero-sum" once again.

- ***Railways are discouraged from increasing resources and assets to meet seasonal demand peaking.*** To meet demand during peaks takes additional railway resources and investment – in cars, crews, locomotives, and network capacity. They cost more, and in off-peak times may be unproductive, or idle and costly to store. As the Revenue Cap only varies with annual tonnage moved, the maximum revenue entitlement remains the same whether that volume moves over 6 or 12 months. Without additional revenues, railways cannot afford to incur additional costs.

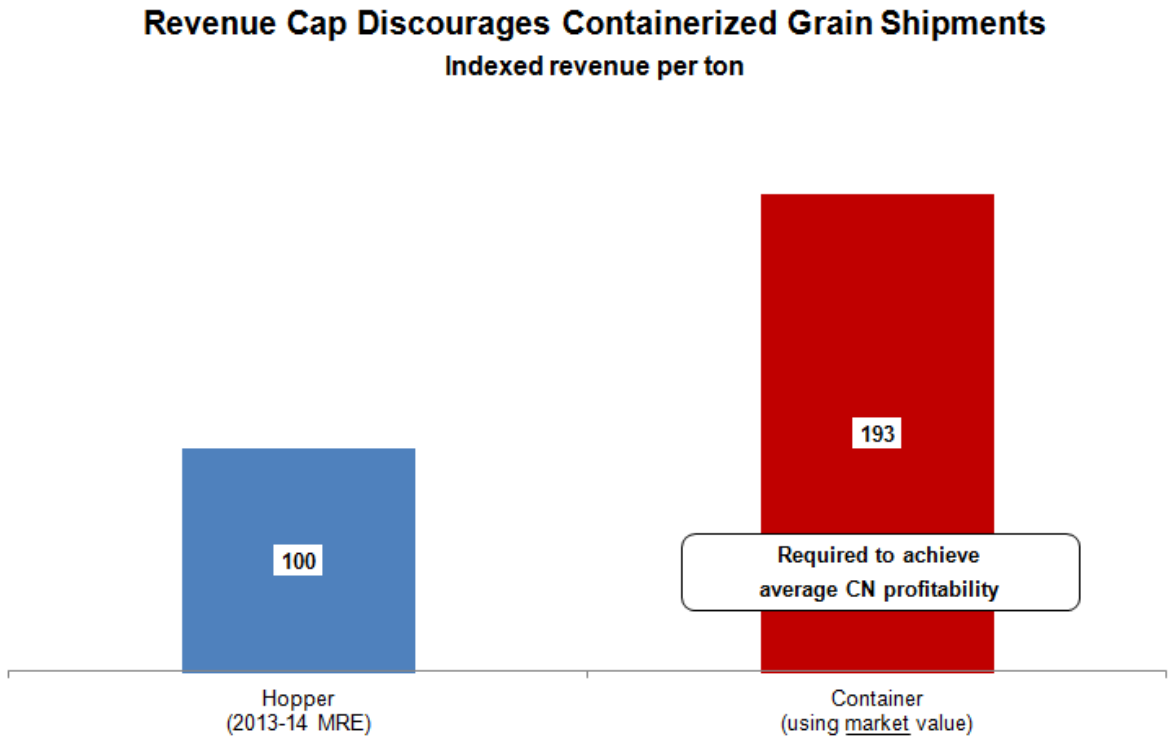
- ***Railways are discouraged from investing in surge capacity for unexpected peaks.*** To have "standby capacity" available in reserve to ramp up to meet unexpected demand peaks, such as in a record year, requires investments to be made and financed ahead of time in long-lived assets like cars and locomotives. Under the Revenue Cap, these investment costs cannot be hedged through forward commitments or be recovered, as revenue is capped in each year by actual movement (tonnes, miles).

Since excess revenues cannot be kept, shortfalls are unrecoverable. Investment may be stranded if peak volumes do not return in subsequent years. So railways have to bear all the costs and downside risks from multi-year capacity investments and from carrying more assets and resources as "surge capacity".

More aberrations and anomalies result from how the Revenue Cap was implemented in the legislation and from Agency determinations as to what would be included or excluded as regulated revenue. These give rise to further distortions and disincentives for innovation and investment.

- ***The Revenue Cap's application to containerized grain shipment disincents its growth.*** Grain movement in containers – negligible at the outset of the Revenue Cap regime – is subject to the Revenue Cap. Yet containerized movements cost much more than what moves under the Cap in covered hoppers. This is even more true given that the Revenue Cap is based on the book value of all assets being used to transport grain, while in reality cars and locomotives all need to be eventually replaced at market values which are substantially higher. Most importantly, the Cap requires any higher revenues earned on containerized grain to be offset by revenue reductions from hopper volumes, preventing railways from offering containerized alternatives, particularly in surge periods.

Figure 7



The disincentive resulting from the application of the Cap to containerized grain shipments has other adverse implications for the grain handling and transportation system. Indeed, the complexity of the grain product mix with its extensive product segregation and binning requirements would benefit from greater use of containers and make it more attractive for shippers by reducing their costs relative to bulk handling.

- ***The Revenue Cap's application to regulated switching revenues specifically discourages investments in rail infrastructure.*** The Agency counts as regulated revenues CN's net revenues from regulated switching activities – principally for moving CP-originated grain to North Shore grain elevators at Port of Metro Vancouver (PMV). The revenue entitlement for these switching activities is essentially zero. The lost compensation for these activities penalizes CN and certainly hampers CN's incentive to invest in rail infrastructure needed on the North Shore of PMV for growth in Canada's exports of grain and other products through the Pacific Gateway. Following the Agency's recent decision to extend interswitching limits in Western Canada from 30 to 160 km, it is unclear to CN whether or how the Agency will apply the Revenue Cap to revenues earned from extended interswitching of grain.

- ***Revenue Cap, and statutory provisions that disallow revenue deductions for dispatch payments, discourage regulated railways from offering port terminal operators incentives to receive and unload trains quicker.*** Over the past two decades, U.S. railroads have earned higher revenues per revenue-ton mile than regulated Canadian railways and have offered incentive programs that reward third-party grain terminal elevator operators at U.S. ports with dispatch or "destination efficiency" payments. These financial incentives have promoted more investment in efficient infrastructure capable to receive entire trains on arrival, including "loop tracks", and seven-day, round-the-clock operations to unload trains faster at ports. This has contributed to faster growth in grain export capacity at U.S. ports, including Pacific North West ports, than at Canada's West Coast ports over the past twenty years.

- ***Revenue Cap adjustments for grain car investments are limited to when government cars are scrapped and replaced.*** The only upward adjustment allowed to the Revenue Cap in respect of grain car acquisitions is to replace retired government cars. The adjustment is made post-replacement only, and with significant time lags. There are no adjustments for cars acquired to replace or add to the non-government grain car fleet.

- ***Revenue Cap adjustments when CN replaces government cars are split with CP.*** When only one railway replaces government cars, the benefit from upward adjustment to the Revenue Cap is nevertheless split with the other railway. The investing railway receives only half the benefit: a "free-rider" problem, creating disincentives to move first to replace cars, even though more Government of Canada cars have been retired for CN than CP.

- *This out-dated pricing constraint discourages investment in grain gathering branch lines.* The Revenue Cap gave railways more pricing flexibility than under the previous maximum/prescribed rate scale regimes. Yet for regulated grain movements, geographic price spreads between points on high-cost low-traffic-density branch lines and high-efficiency main lines are still limited to a minimal 3%[45]. This out-dated provision, which perpetuates pricing rigidities from past rate scale regimes, fails to account for cost differences and discourages investment in rail infrastructure in some low density grain gathering lines.

The fundamental issue is that price control in the form of the regulated Revenue Cap regime directly discourages investment and innovation by railways. By preventing the functioning of a normal market, the Cap is leading all other shippers to subsidize grain, which is unfair in addition to being inefficient. Though CN has been adding selectively to the fleet to handle more grain and improve its surge capacity, it has long been wary of investing extensively in grain-specific assets in Western Canada.

The fundamental issue is that price control in the form of the regulated Revenue Cap regime directly discourages investment and innovation by railways.

A commercial environment, where costs and benefits are better aligned than under the Revenue Cap regime, would produce a more effective and efficient system for Western Canadian export grain. As is the case in all other markets served by the railways, a commercial environment would provide the conditions for more collaboration, based on shared goals and mutual commercial requirements, and for more innovation in the way market needs are met in a dynamic and changing marketplace.

Western Canadian grain stakeholders need to turn the page and move forward. Continuation of the rigidities and distortions to railway incentives to invest and innovate cannot lead the **Western grain industry to be ready for the market opportunities of the next 10 to 20 years.** The Canadian Government made a bold decision to end the monopoly powers of the Canadian Wheat Board in 2012. **The government now needs the courage to take the next step in the evolution of Western Canadian grain policy by removing the Revenue Cap**.

Incorrect Claim: A costing review is needed for Western grain

In a commercial world, parties come together willingly to do business. Innovation is encouraged, outcomes are determined in the marketplace. Prices and price structures are not set based on cost by a regulatory authority.

In this context, it is important for the Panel to think carefully about any proposals advocating a costing review for the Maximum Revenue Entitlement for Western export grain transportation. A costing review would indeed be a radical step backward, totally inconsistent with National Transportation Policy. A costing review would move Canada in the wrong direction of the real progress that needs to be made in Western grain

[45] Canada Transportation Act, subsection 149(2).

transportation. Policymakers need to strengthen, not weaken, commercial rewards and incentives for railways to invest and innovate, as this is what will be needed to support and enable growth in exports of Western crops and value-added agricultural products in coming years.

From a policy and institutional perspective, around thirty years ago Canada moved decisively away from cost-based regulation of railway pricing for non-grain traffic categories, then did the same for Western grain about twenty years ago. In the late 1980s, the *Act* was amended to give pricing freedom to railways, by effectively eliminating the Agency's regulatory authority over railway rates and pricing structures, and by repealing all cost-based restrictions on rates (maximum and minimum). At the same time, the *Act* was amended to include commercial mechanisms such as confidential contracts to provide flexible, commercial means for a shipper and a railway to formalize agreements on freight rates, as well as dispute resolution measures such as Final Offer Arbitration as means to resolve commercial disputes over a railway's pricing.

As discussed earlier, none of these reforms initially applied to Western grain transportation, then heavily government-subsidized under the WGTA, until the mid-1990s at which point the WGTA was repealed along with the Agency's regulatory authority to conduct costing reviews. All provisions of the *Act* were applied to Western grain shippers at that point for the first time, including the confidential contracting and rate dispute resolution measures. The direction of this evolution, toward competitive and market-based pricing for railways, and away from cost-based regulated pricing, is fully consistent with the key recommendation of the MacPherson Commission and the fundamental guiding principle of National Transportation Policy that competition and market forces guide the evolution of viable and effective transportation services.

Costing reviews have no place anywhere in Canada's commercial rail transportation markets, especially in the modern circumstances of the dynamic and competitive market for transporting the crops and value-added products of Western Canada's agricultural sector. Yet the periodic appeals that are made for costing reviews, an antiquated relic of the by-gone WGTA era, are unique to Western export grain – in no other market are there similar calls to "turn back the clock". The market circumstances of Western grain are not unique; they are in fact very similar to other transportation markets.

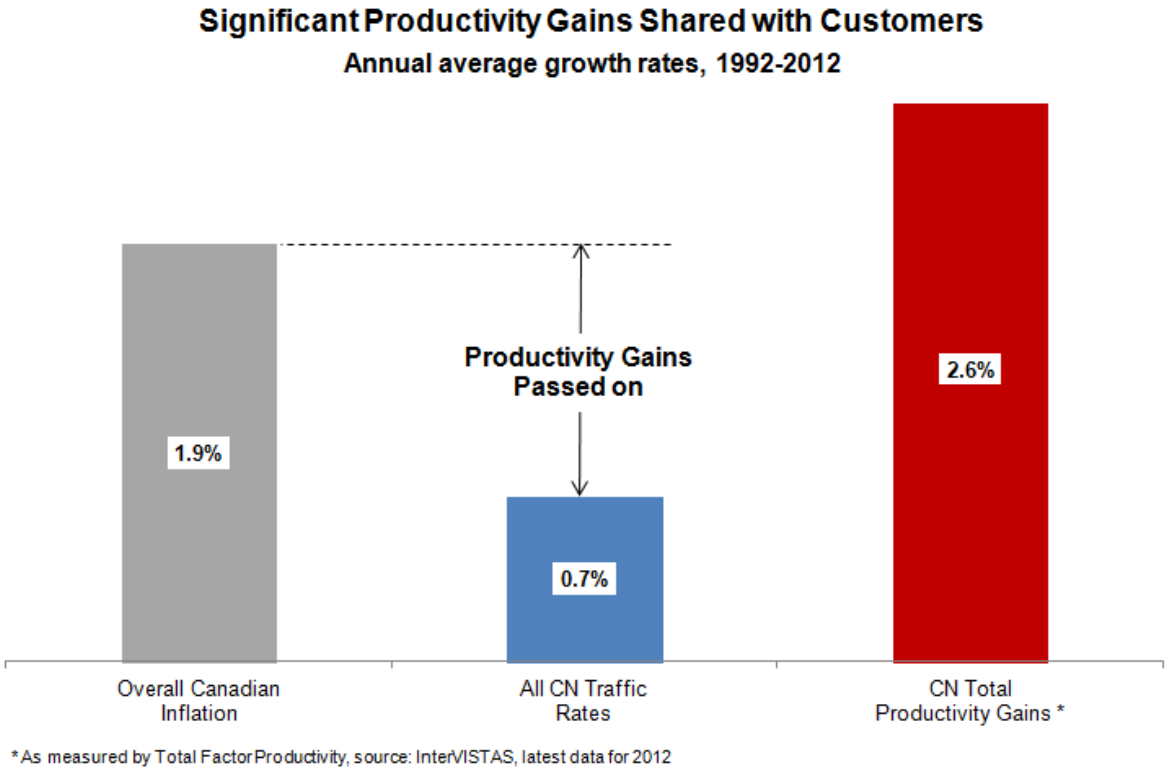
In all commercial markets, prices are based on what the market calls for: what competing sellers are prepared to offer and what buyers are willing to pay. In Western grain, as in all other rail transportation markets, railway pricing is subject to the commercial discipline of competitive pressures and market forces. There are two railroads and typically two or three grain elevator companies serving most grain growers within reach of their truck delivery. It may not be "perfect competition", but it is a competitive market that does not require today's over-regulation.

Costing reviews are not needed for customers to get a share in railway productivity gains over time. The market does this more effectively than regulatory intervention with its host of unintended consequences. **Efficiency gains in rail transportation do not come free.** Improvements in railway efficiency can only be achieved over the long term through sustained investment in expansion, renewal and improvement of infrastructure, equipment, and systems. In competitive markets, the opportunity to earn profit drives

investments. Railways invest where and when warranted by the prospective return on investment and the attendant risk.

It is an indisputable reality that market-based pricing and competitive pressures lead railways to share with customers productivity gains resulting from railway investments. In non-grain markets, evidence of this can be seen by comparing the trend in real revenue per RTM (revenue-ton-mile) versus Total Factor Productivity for Canadian railways in general and CN in particular.

Figure 8



The Panel should not accept proposals advocating a costing review for the Maximum Revenue Entitlement for Western export grain transportation. In fact, the repeal of the Revenue Cap is what should be carefully considered by the Panel.[46]

[46] For an analysis of the impact of price controls in general and on grain transportation in particular, refer to the document prepared for CN by Dr. Barry Prentice, *Peak-load Management and Surge Capacity in Western Grain Transportation*. See reference in Appendix II.

5. CN'S RECOMMENDATIONS REGARDING THE CTA REVIEW

CN believes, as stated in the Canada Transportation Act, that competition and market forces are the prime forces behind a viable and healthy rail industry. CN believes that changes need to be made to a number of regulations governing rail transportation, as well as in the way regulations are applied. The specific recommendations below are respectfully submitted in light of CN's conviction about what Canada needs for its rail system to grow and prosper over the coming decades.

A. Establish a Process to Review the Conditions for Regulatory Recourse

As discussed in the section providing an overview of regulatory developments, successive reforms gradually eased the heavy and intrusive regulatory structure that prevented railways from relying on competition and commercial considerations. The cumulative reforms allowed the railways to evolve into successful commercial enterprises. Improved returns provided railways with the necessary economic framework, incentives and capital to reinvest in their infrastructure. They also allowed the federal government to eliminate all of the railway transportation-related subsidies that had been previously required as a result of the railways' inability to fund their own investments. The success of the railways and the development of a highly effective railway system unreservedly confirmed the benefits of the deregulation measures undertaken by the various government initiatives. **Gradual deregulation of the rail industry in Canada has been a resounding success. Stakeholders should be proud of having a world-class rail system and work to protect the commercial policy framework that led to this enviable position.**

In the year 2008, however, commenced what appears to be a troubling shift towards re-regulation. A patchwork of new regulatory measures and recourses were introduced to address specific perceived railway issues born out of shipper advocacy. They were introduced on an ad hoc basis and without sufficient regard to the measures already in existence, the result being a number of overlapping and often inconsistent regulatory remedies. The Table below provides a list of these measures. As an example of multiplicity of recourses, railway service matters can be the subject of Final Offer Arbitration (FOA) proceedings, a level of service complaint or a level of service agreement arbitration.

Table 1

Regulatory Recourse	Subject Matter	Availability
Final Offer Arbitration (FOA)	• Transportation rates • Any conditions associated with the movement of the goods (including level of service)	• Available to **any** shipper of **any** commodity • **No minimum threshold** • Available regardless of shipper's competitive options
Group FOA	• Same as FOA	• Available to **any** two or more shippers of **any** commodity • **No minimum threshold** • Available regardless of shippers' competitive options • Matter must be common to all shippers part of proceeding
Complaint against railway charges	• Ancillary charges (e.g. demurrage) and associated terms or conditions.	• Available to **an**y shipper • Available **even** if shipper entered into a confidential transportation agreement with the railway • **No minimum threshold** • Available regardless of shipper's competitive options
Level of service complaint	• Any matter relating to railway service including car availability, frequency of service, transit times, etc.	• Available to **any** shipper • **No minimum threshold** • Available regardless of shipper's competitive options
Service Level Agreement	• Shipper may require arbitration for establishment of service terms on any matter relating to railway service including car supply, frequency of service, transit times, etc.	• Available to **any** shipper • **No minimum threshold** • Available regardless of shipper's competitive options
Interswitching	• Serving railway required to transfer traffic to a connecting railway within 30 Km (160 KM since C-30) of shipper location at Agency prescribed regulated rate	• Available to **any** shipper • **No minimum threshold** • Available regardless of shipper's competitive options • **Available to U.S. railroads without any reciprocity**
Competitive Line Rate (CLR)	• Shipper may ask Agency to establish a regulated rate (CLR) for the movement of traffic for the distance, beyond the IS limits, to reach the connecting railway	• Available to **any** shipper that has access to only one railway and who has an agreement with the connecting railway • **No minimum threshold**

Most of the above-described measures are **available without any threshold trigger and regardless of market conditions or competitive options**. In other words, a shipper may initiate a final offer proceeding, file a level of service complaint or seek a level of service agreement arbitration even if that shipper actually has access to a competitive option. This is not an academic issue. CN already has experienced the initiation of FOA's, level of service complaints and service level agreement arbitration proceedings by shippers who had access to a competing rail carrier, or another mode such as trucking.

The regulatory shift is also noticeable in the "revised" interpretation and application of many of these measures by the regulator. Whereas previous decisions on a railway's level of service obligation were based on a reasonableness test specified by the Supreme Court of Canada as far back as 1959, **recent Agency decisions are attempting to morph the service obligations of a railway company into near absolute requirement to meet all shippers' demand for service**, imposing an obligation of result rather than an obligation of means. In the same manner, the Agency extended a railway company's service obligations beyond shippers (the actual users of railway services) to any other third party such as unloaders and terminal operators who are not party to the transportation agreement. Finally, the Agency extended the application of the regulated interswitching provisions by reversing its long standing precedent that interswitching could not extend to a railway operating on the line of another carrier pursuant to a running rights agreement, and without taking into account the potential for regulatory poaching from U.S. roads.

The regulatory shift is also noticeable in the "revised" interpretation and application of many of these measures by the regulator.

Recommendation 1: Eliminate regulatory recourse for shipper with access to an alternate carrier or transportation mode

As discussed, the National Transportation Policy (NTP), which provides guidance on when and how government intervention should take place and on the interpretation and application of regulatory measures by regulatory authorities, calls for reliance on "competition and market forces" and for "regulation and strategic public intervention" only when competition and market forces cannot achieve the desired economic outcome. The piling up of re-regulation measures since 2008, the availability of such measures regardless of the competitive options available to users, and the highly interventionist approach by the regulatory body under the guise of "revised" interpretation and application of such measures are clearly inconsistent with the principles set out in the NTP.

The piling up of measures, the availability of such measures regardless of competitive options, and the highly interventionist approach by the regulatory body under the guise of "revised" interpretation and application of such measures, are clearly inconsistent with the NTP.

Consistent with the NTP, CN strongly recommends that **regulatory recourses not be available at all when a shipper has an adequate competitive option**. Assessing whether a shipper has a competitive option is broader that determining whether it has access to direct intramodal competition. As is the case in the U.S. assessments must extend to the consideration of other forms of competition such as indirect intramodal

competition (e.g. through interswitching or trucking to an alternate rail service provider), intermodal competition, etc. Indeed, in the presence of competitive options, a shipper who is dissatisfied with either the rate or the service of its service provider should, as in any other commercial markets, turn to alternate service providers and not seek intervention by the regulator.

Recommendation 2: Review rail traffic segments that could be exempted from Agency jurisdiction

Certain traffic which by definition can move by other means of transportation should be considered for exemption from Agency jurisdiction. In the U.S. for example, the Surface Transportation Board exempts intermodal services and the rail transportation of traffic in single-line boxcar (typical of forest products, industrial products, etc) from any regulatory recourse[47]. CN recommends that a review be undertaken of traffic and services that could be exempted from the Agency's jurisdiction such as, for example, intermodal, box car, and automotive traffic and ancillary services. This would implement more effectively the primary NTP principle of reliance on competition and market forces, and minimize the serious risks of unintended consequences associated with regulatory intervention in market circumstances where such intervention is not warranted, as a matter of principle.

Recommendation 3: Include a threshold or commercial harm test to the exercise or granting of regulatory relief

Even in cases where a shipper has no transportation alternative, regulatory recourse should be available only in the case of the carrier's actual and demonstrated abuse of its dominant position. Automatic access to the regulatory recourse assumes, *ex ante*, that the carrier is behaving abusively. Indeed, as the Competition Bureau states in its Enforcement Guidelines on the abuse of dominance provisions of the *Competition Act*:

Automatic access to the regulatory recourse assumes, ex ante, that the carrier is behaving abusively.

> ***"...the fact that a firm holds market power is not, in and of itself, sufficient to warrant intervention under section 79 [abuse of dominance provision of the Competition Act]. Likewise, charging higher prices to customers, or offering lower levels of service than would otherwise be expected in a more competitive market, will not alone constitute abuse of a dominant position."*** [48]

[47] For a full comparison of regulations in Canada and the U.S., see *Comparison of Canadian and United States Rail Economic Regulations,* prepared by CPCS for the Railway Association of Canada, January 2015, see reference in Appendix II.

[48] Competition Bureau, *Enforcement Guidelines, The Abuse of Dominance Provisions*, page 1.

CN submits that there should therefore be some form of threshold analysis as part of a customer's application to the Agency and a threshold test prior to the granting of a regulatory remedy.

Recommendation 4: At a minimum, Agency jurisdiction in respect of traffic subject to a transportation agreement between shipper and carrier should be eliminated.

As a result of the 1987 amendments which encouraged commercial relationships, shippers and railways regularly enter into transportation agreements rather than rely on tariff arrangements. The current legislation states that, in the event the shipper files a level of service complaint, the Agency is bound by any service provision contained in the agreement. This in effect means that even if there is an agreement, the shipper may still file a level of service agreement with the regulator. This approach creates a relationship between the parties that is part commercial and part regulatory. It is, in fact, completely at odds with the overall purpose of the legislation which is to encourage commercial dealings between the parties.

This in effect means that even if there is an agreement, the shipper may still file for a level of service agreement with the regulator.

In the U.S., where a shipper and a rail carrier have entered into a transportation agreement, the rail carrier ceases to be a common carrier with respect to the services provided under that agreement and the authority to interpret and enforce such agreements rests with courts as in the case of any other commercial contracts.

B. Review Interswitching Provisions to Ensure Proper Limits and Adequate Compensation

Recommendation 5: Rescind or allow the interswitching provisions of Bill C-30 to sunset

As also discussed in the section providing an overview of regulatory developments, no logical reasoning was provided to extend the interswitching distances in the three Prairie Provinces. Any proposal to retain these extended interswitching provisions beyond the sunset date set out in Bill C-30 could only result in calls to also extend the interswitching distances in other provinces. This would mean an across the board re-regulation of approximately 80% of all railway traffic in Canada, a strict rate regulation situation that has not existed in Canada in over a half a century. Clearly, the interswitching provisions of Bill C-30 should be rescinded as soon as possible or, at a minimum be allowed to sunset in 2016.

Recommendation 6: **Review the interswitching provisions to ensure that they take into account market conditions and the shipper's competitive options and do not create market distortions**

Aside from the extended distances discussed above, the very notion that regulated interswitching should be available as a matter of course and without regard to market conditions should be reviewed. It is important to clarify at the outset that the regulation of interswitching rates under the *Canada Transportation Act* is purely discretionary. In this context, it is also important to note that the 2000–2001 CTA Review Panel was of the view that average interswitching rates constitute in itself an anomaly as they are average rates and do not take into account market conditions. That such rates could become permanently available to all shippers, regardless of the shipper's competitive situation, would exacerbate the anomaly.

. . . average interswitching rates constitute an anomaly as they are average rates and do not take into account market conditions. That such rates are available to all shippers regardless of the competitive situation exacerbates the anomaly.

The National Transportation Policy states that a competitive, economic and efficient national transportation system that makes the best use of all modes of transportation at the lowest total cost is essential to serve the needs of its users and enable competitiveness and economic growth in Canada. The policy statement goes on to state that, to achieve this objective, regulation should only be used to achieve outcomes that cannot be achieved by competition and market forces. **In other words, the policy statement makes clear that regulation and other government intervention is a last resort** and should arise only when competition and market forces fail or are otherwise inadequate.

There are numerous examples in Canada where railway companies perform exchange switching for their customers without any regulatory direction in situations beyond those set out in the regulatory context. In the U.S. all exchange switching is performed on a commercial basis. This situation demonstrates that regulation is not required to achieve the policy objectives set out in the *Act*. To the extent that individual situations may warrant, the Agency could, upon application by the affected shipper and upon determination that a railway is abusing its position, impose a regulatory remedy. **In other words, commercial relationships should only be regulated when one party is abusing monopoly power.** To impose interswitching regulations and remedies in advance of such determination simply presumes that railways are behaving in an abusive manner.

In other words, commercial relationships should only be regulated when one party is abusing monopoly power.

The lack of consideration of market conditions and competitive options can only lead to market distortions; it also clearly offends the principles of the NTP to the effect that competition and market forces be the prime agents in providing viable and effective transportation services. It is CN's position that the interswitching provisions need to be reviewed to address both these concerns.

Recommendation 7: **Amend the interswitching provisions to clarify that other regulatory recourses are not available where a shipper has access to interswitching**

In the Regulatory Impact Analysis Statement accompanying the 2013 revision to the interswitching rates the Agency stated as follows:

> *"The interswitching provisions of the CTA are considered to be competitive access provisions, allowing the shipper to choose their "line haul" carrier while having direct access to only one carrier.*
>
> […]
>
> *Interswitching allows shippers to negotiate through normal commercial processes, suitable terms and conditions of carriage with competing carriers from the interchange point onward, for the line haul portion of the overall movement."* [49]

In other words, a shipper with access to interswitching is served by more than one carrier and therefore has the benefit of direct competition. **By definition, this should make other existing protections or forms of recourse redundant**. CN therefore recommends that the interswitching provisions be amended to clarify that when a shipper has access to interswitching, other regulatory recourses are no longer available.

Recommendations 8: **Amend the interswitching provisions to ensure that U.S. railways can have access to Canadian traffic via interswitching only if similar and reciprocal access is provided to Canadian railways**

Regulated interswitching is not available in the U.S. As a result, a railway company must enter into a commercial switching agreement with another railway in order to access a shipper located on that other railway. By contrast, U.S. railways operating in Canada have the benefit of regulated interswitching and can access shippers located on Canadian railways without the need to enter into a reciprocal commercial switching agreement. This places Canadian railways at a significant disadvantage vis-à-vis their U.S. competitors. This lack of reciprocity can result in loss of traffic and revenues to U.S. carriers and ports with no similar access for Canadian railways to respond and benefit through traffic and revenue gains from shippers located on U.S. railways. Any such traffic loss can only undermine investment in Canadian railway infrastructure to the detriment of the longer term capacity and efficiency of the Canadian railway network. For this reason, CN recommends that U.S. railways not have access to Canadian traffic through interswitching unless similar reciprocal access is provided to Canadian railways in respect of U.S. traffic.

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[49] Canada Gazette Part II, Vol. 147, No 6, SOR/2013-28, pages 584 – 586.

Recommendation 9: **At a minimum, review existing interswitching rates to ensure that they reflect market and commercial considerations consistent with section 112 of the *Act* and the principles enunciated in the National Transportation Policy**

The current legislative provisions require that the interswitching rates established by the Agency, at a minimum cover the railway's variable costs of performing the service; they do not require that such rates be set at variable costs. In fact, the ***Act*** **requires that such rates be set at a level so that they are "commercially fair and reasonable to all parties"** [50]. Rates set in a formulaic manner through averaging and at variable cost plus a contribution to constant costs cannot be said to be consistent with commercial considerations and the need for a sufficient return to justify investment. At a minimum, the interswitching rates must be reviewed to reflect market and commercial considerations.

C. Review the Maximum Revenue Entitlement (Revenue Cap) for the Movement of Western Grain

Recommendation 10: **The Revenue Cap regime should be reviewed in order to remove existing rigidities and distortions to commercial incentives and eliminate disincentives to innovation and investment**

A discussed in section 4, the Revenue Cap is essentially a fixed maximum average price per tonne-mile that a railway may charge in a crop year. It is a form of price control on railways designed to incent railways to focus on productivity and cost minimization; at the same time it constitutes a structural impediment preventing railways from responding more effectively to market and competitive forces in an otherwise modern and dynamic grain sector.

The inability for railways to retain performance incentives and earnings from demand-based (peak-load) pricing are just examples of the numerous distortions to commercial incentives caused by the Revenue Cap. In addition to distortions, the Revenue Cap regime actually creates disincentives for railway innovation and investment. For example, including intermodal grain shipments in the Revenue Cap discourages the use of this more expensive, but potentially valuable form of transportation for export grain movements. This is particularly problematic in periods when surge capacity is required. Finally, the Agency's extension of the Revenue Cap regime to interswitching revenues results in CN receiving no compensation for the performance of interswitching services which, in turn, eliminates any incentive to invest in relevant rail infrastructure.

[50] Canada Transportation Act, section 112.

The Canadian Government must build on the bold decision it took to end the monopoly powers of the Canadian Wheat Board in 2012. It is CN's recommendation that the government should proceed with a review of the Revenue Cap regime to address the rigidities and distortions to railway incentives to invest and innovate identified earlier, in order for the Western grain industry to be ready for the market opportunities of the next 10 to 20 years.

Recommendation 11: **At a minimum, the Revenue Cap regime should be immediately amended to exclude from its purview any intermodal Western grain movements and any revenues associated with the interswitching of Western grain**

Pending such review and for the reasons more fully set out in Section 4, the Revenue Cap regime should be amended to remove from its scope the movement of grain in containers and revenues earned from interswitching of Western grain.

D - Formally require a Network and Supply Chain Perspective in the Application of Regulations and Remedies

The enactment of Bill C-52 and Bill C-30 has engendered the view that individual regulatory decisions relating to railway service can be made in isolation, without regard to the network nature of railway operations and without consideration of the fact that the railway service provided to one customer is part of a common service provided to other customers. Such an approach not only reflects a misunderstanding of railway operations but can also lead to contradictory or incompatible decisions. This is not a purely theoretical concern as CN has already experienced several such situations.

Recommendation 12: **Service level arbitration should be performed by the Agency, not by arbitrators**

Being confidential and shipper-specific, the service level agreement arbitration process fosters a silo approach. The legislation does require the arbitrator to take into account a railway's service obligations to other shippers, a directive that was intended to address the fact that railways offer a common service to all shippers. Experience to date with the application of this provision, however, clearly shows that this directive is insufficient to ensure that railway efficiency and service to other shippers are not adversely affected by individual decisions. The fact that other shippers are not and cannot be part of the confidential proceedings underlines that the process leads to an information gap rendering it is essentially impossible for the arbitrator to have a good understanding of other shippers' needs. As a result, it is difficult for an arbitrator to understand the impact that his/her decision may have on other users of the common railway service. For this reason, it is CN's recommendation that service level arbitration proceedings be performed by the Agency, the body charged with the economic regulation of railways, and not by individual arbitrators who are inherently ill-equipped as a result of the process to adjudicate such complex transportation matters.

Recommendation 13: **The *Act* should be amended to include clear guidance to the Agency ensuring that the network nature of railways operations and a railway company's service to all users be taken into consideration in addressing specific level of service complaints and requests for service level agreements**

Whether the Agency is called upon to address a level of service complaint or, as recommended, to perform service level arbitration, it is imperative that the Agency take into account the network nature of railway operations including the fact that rail service to one customer is part of a common service to other users. The approach recently adopted by the Agency in considering level of service complaints has placed CN in an impossible situation. In one decision, CN is required to provide one customer with more cars than what it would have received through CN's car allocation guidelines. In order to comply with this decision, CN needed to allocate a lesser number of cars to other customers than what its own fair and transparent car allocation guidelines would have provided. When these other customers complained to the Agency, CN was held in breach of its level of service obligations for having failed to adhere rigorously to its car allocation policy. These decisions are contradictory and CN cannot at once comply with both.

While level of service complaints are received by the Agency on a case-by-case basis, the assessment of a railway's service to a particular shipper cannot be undertaken in isolation. Had the Agency taken a broader supply chain and network view in its assessment of the original complaint with due regard to the overall service obligations that CN has to other shippers across the rail network, this contradiction would have surfaced and the matter could have been addressed in a more holistic manner.

Recommendation 14: **The *Act* should be amended to ensure all Service Level Complaints and Service Level Arbitrations are assessed with sufficient time to give stakeholders an opportunity to develop a sound and suitable position.**

The *Act* was amended in 1996 to require the Agency to issue its decisions within 120 days from the date of the complaint or application. This amendment attempted to provide a balance between the need to resolve disputes as quickly as possible for shippers while still ensuring sufficient time for railways to adequately prepare and properly address the matters raised. The need to have sufficient time to develop and present the right information is fundamental given that the Agency can only rule on the basis of the information before it.

Recent amendments to the *Act* (especially in respect of the service level arbitration) and to Agency General Rules have dramatically altered this balance by inordinately reducing the time for regulatory proceedings. The result adversely affects railway companies' rights to a full and fair hearing by leaving insufficient time to properly develop the necessary information to address the matters being raised; this, in turn, can only affect the quality of the decision-making.

Indeed, it is important to note that it is the shipper who triggers the application or complaint; as is to be expected, the shipper will only do so when it is satisfied that it has fully developed the necessary information

to support its purpose. The railway, on the other hand, does not have such luxury as it is required respond within periods varying between as little as 10 days to 15 days depending on the recourse. Such period leaves insufficient time to assess the application or complaint, identify the facts and develop the information to be submitted to the regulator. Not only is the railway provided with insufficient time to prepare but in the case of service arbitrations, the arbitrator is often left with only 24 hours to assess the evidence presented before having to issue a decision. Inadequate time for the railway to develop and present its information combined with inadequate time for the regulator to consider such evidence can only lead to inadequate regulatory decisions. This cannot support good transportation policy.

Recommendation 15: **Information required to be reported by railways under the regulations should be limited and circumscribed in scope and level of detail, consistent with National Transportation Policy, with safeguards in place to prevent disclosure of confidential and commercially sensitive information**

The need to take a network perspective on rail operations and an end-to-end supply chain perspective on service is a core consideration in assessing repeated requests for the production of more public data on the railways, whether specifically for grain or in general for other traffic categories. Such requests have indeed been made by various industry associations, producer groups, and some governments.

The whole approach to "big data" is misguided for several reasons.

First and foremost, railways already supply extensive amounts of information today to supply chain partners on a mutually beneficial basis, as a normal part of commercial and supply chain relationships. Such data is geared towards, and relied upon for, logistical and operational planning and management. It enables both real-time and longer-term resolution of problems in the field. Information sharing up and down the supply chain is crucial to facilitate better shipment planning, scheduling, and inventory management. The purpose is not for "second-guessing" by third parties uninvolved in the supply chain in question or to provide grounds for regulatory intervention.

The data shared in such a commercial context is inherently real-time or forward-looking in orientation. This timeliness is necessary to give early warning signs to deal with emerging problems in ever-changing circumstances that arise – possibly for CN's customer, or in links of the supply chain including the railway, or from some other source. "Big data", produced and disclosed with time lags of a month or even a week, is inherently backward-looking, cannot be used to address and resolve issues on a real-time or forward-looking basis, and ultimately serves no useful purpose.

Finally, data exchanged in a commercially oriented context necessarily has to include information at a level of detail that is commercially sensitive and mostly confidential. Railways, as any other business, are willing to exchange confidential data with commercial partners and among other supply chain participants involved because it serves a purpose, in a spirit of mutual trust and confidence. Yet the information being shared is limited to those participants that interface or interact commercially or operationally. It is neither transparent nor open to view by third parties. This sharing of commercially sensitive or confidential information is intended to identify or anticipate logistical problems and resolve them. It is not intended to be used for finger-

pointing or placing blame, much less for use by third parties not participating in the supply chain, including rivals competing in other supply chains or markets. In sectors outside transportation, where parties are compelled to produce data to entities such as Statistics Canada, disclosure policy guidelines prevent any disclosure of confidential and commercially sensitive information. The same must apply to transportation data.

Requiring railways to report "big data" under the *Act*'s Transportation Information Regulations serves no useful purpose, and is fundamentally inconsistent with the principle that competition and market forces are the prime agents in providing and guiding transportation services.

Recommendation 16: At a minimum, the *Act* should be amended to require that parties proceed by way of mediation prior to exercising any other regulatory recourse

The review of legislation should also make clear that the exercise of the regulatory recourse is a last resort. To do so, the legislation should encourage parties to come together to attempt to first resolve their differences in a commercial manner. Mediation is a tool frequently used in the commercial world. Many courts now make mediation mandatory prior to proceeding with other legal recourses. Any case resolved by the parties, on their own or through mediation, is better that an imposed solution by a third party. For this reason, mediation should be required prior to proceeding with regulatory measures.

Recommendation 17: The *Fair Rail for Grain Farmers Act* (Bill C-30) should be allowed to sunset in total on August 1, 2016

Because it was legislated on the basis of a "short term" crisis and affects several areas of interest and involves so many new regulations, it is CN's recommendation that all of the provisions of Bill C-30 be allowed to sunset in accordance with the Bill's own terms. To not do so would put at risk the viability of Canadian railways and undermine the sound policy framework that supported the industry's revival over the last 30 years.

Appendix I

List of Detailed CN Recommendations

Recommendation 1: **Eliminate regulatory recourse for shipper with access to an alternate carrier or transportation mode**

Recommendation 2: **Review rail traffic segments that could be exempted from Agency jurisdiction**

Recommendation 3: **Include a threshold or commercial harm test to the exercise or granting of regulatory relief**

Recommendation 4: **At a minimum, Agency jurisdiction in respect of traffic subject to a transportation agreement between shipper and carrier should be eliminated**

Recommendation 5: **Rescind or allow the interswitching provisions of Bill C-30 to sunset**

Recommendation 6: **Review the interswitching provisions to ensure that they take into account market conditions and the shipper's competitive options and do not create market distortions**

Recommendation 7: **Amend the interswitching provisions to clarify that other regulatory recourses are not available where a shipper has access to interswitching**

Recommendations 8: **Amend the interswitching provisions to ensure that U.S. railways can have access to Canadian traffic via interswitching only if similar and reciprocal access is provided to Canadian railways**

Recommendation 9: **At a minimum, review existing interswitching rates to ensure that they reflect market and commercial considerations consistent with section 112 of the *Act* and the principles enunciated in the National Transportation Policy**

Recommendation 10: **The Revenue Cap regime should be reviewed in order to remove existing rigidities and distortions to commercial incentives and eliminate disincentives to innovation and investment**

Recommendation 11: **At a minimum, the Revenue Cap regime should be immediately amended to exclude from its purview any intermodal Western grain movements and any revenues associated with the interswitching of Western grain**

Recommendation 12: **Service level arbitration should be performed by the Agency, not by arbitrators**

Recommendation 13: **The *Act* should be amended to include clear guidance to the Agency ensuring that the network nature of railways operations and a railway company's service to all users be taken into consideration in addressing specific level of service complaints and requests for service level agreements**

Recommendation 14: **The *Act* should be amended to ensure all Service Level Complaints and Service Level Arbitrations are assessed with sufficient time to give stakeholders an opportunity to develop a sound and suitable position.**

Recommendation 15: **Information required to be reported by railways under the regulations should be limited and circumscribed in scope and level of detail, consistent with National Transportation Policy, with safeguards in place to prevent disclosure of confidential and commercially sensitive information**

Recommendation 16: **At a minimum, the *Act* should be amended to require that parties proceed by way of mediation prior to exercising any other regulatory recourse**

Recommendation 17: **The *Fair Rail for Grain Farmers Act* (Bill C-30) should be allowed to sunset in total on August 1, 2016**

Appendix II

List of documents tabled

In the last few months, CN shared several documents with the Panel, in order to provide relevant information on the Canadian rail environment and on CN operations, and to demonstrate CN's point of view on key issues raised by the Review. The Railway Association of Canada has also tabled documents of interest, some of which are also reflected here in.

Document	Content	Date provided
2013-14: The 100-Year Crop	**A fact based perspective to shape proper expectations** • How CN plans its service for the grain business • How CN executed during the 2013-14 crop year • How collaboration and supply chain calibration are critical to succeed	Nov 14, 2014
International Rail Regulation in Developed Markets: Where Does Canada Stand? *(Oliver Wyman)*	**Canadian railways stand on a world-scale basis** The North American model of price and service deregulation, within the context of vertically integrated railroads, has generated superior performance along several economic and policy dimensions	Nov 28, 2014
Evolution of the Competitive Structure of the Western Canadian Grain Industry *(CPCS)*	**Additional investment in elevator storage capacity and in greater throughput, particularly on the West Coast, will be needed** Due to the market adjusting to the post-CWB monopoly environment and to industry adjusting to higher crop production and growing demand from Asian markets	Dec 18, 2014
Peak-load Management and Surge Capacity in Western Canadian Grain Transportation *(Dr. Barry E. Prentice)*	**Need to reconsider the current regulatory system** Current regulations are only guaranteed • To perpetuate inefficiency in the grain supply chain and • To propagate shipper complaints, doing nothing to buffer the impact of unanticipated surges in demand	Dec 18, 2014
Railway Economics and Competition in Canada: *Addressing the Issue of Railway Market Power* (*InterVISTAS*)	**There is a significant degree of competition pressure in one form or another across CN markets** Conclusions were reached after a thorough review with extensive data (19 commodities representing 80% of CN's total Canadian traffic base)	March 3, 2015
Comparison of Canadian and United States Rail Economic Regulations (*CPCS*)	**Opportunities for change in the Canadian regulatory regime:** • Re-examine access to regulatory remedies in markets where sufficient competition exists • Allow to expire new interswitching provisions on Aug 1, 2016 • Consider whether grain should continue to have special treatment – no well-established economic reason for continuing	To be provided as part of RAC's submission

Appendix III

LDC-2 Redacted

CONTAINS CONFIDENTIAL INFORMATION
REDACTED PUBLIC VERSION

(Agency File No. 14-05341)

CANADIAN TRANSPORTATION AGENCY

IN THE MATTER OF:

The Application of Louis Dreyfus Commodities Canada Ltd. pursuant to sections 26, 28(2), 37 and113-116 of the *Canada Transportation Act*, S.C. 1996, c.10

BETWEEN:

LOUIS DREYFUS COMMODITIES CANADA LTD.

Applicant

- and -

CANADIAN NATIONAL RAILWAY COMPANY

Respondent

ANSWER
FILED ON BEHALF OF CANADIAN NATIONAL RAILWAY COMPANY

MacPherson Leslie & Tyerman LLP
1500 – 410 22nd Street
Saskatoon, SK
S7K 5T6

Lawyer in charge of file: Doug Hodson, Q.C.
Phone: (306) 975-7101
Fax: (306) 975-7145

CONTAINS CONFIDENTIAL INFORMATION
REDACTED PUBLIC VERSION

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CONTAINS CONFIDENTIAL INFORMATION
REDACTED PUBLIC VERSION

I. INTRODUCTION

1. On October 17, 2014, Louis Dreyfus Commodities Canada Ltd. ("**LDC**") filed a level of service complaint with the Canadian Transportation Agency (the "**Agency**") alleging that Canadian National Railway Company ("**CN**") breached its level of service obligations under the *Canada Transportation Act* (the "***CTA***")[1] with respect to LDC's elevator facilities at Rycroft, Alberta ("**Rycroft**") and Dawson Creek, British Columbia ("**Dawson Creek**").

2. In its complaint, LDC requests both final and interim relief pursuant to sections 116(4) and 28(2) of the *CTA*, respectively. LDC also claims to have suffered damages as a result of CN's alleged breach and states that it intends to file with the Agency a separate application requesting an order for compensation pursuant to section 116(4)(c.1) of the *CTA*.

3. On November 3, 2014, CN filed its response to LDC's request for interim relief together with a notice of motion requesting that the complaint be dismissed in its entirety on the grounds that that there is no jurisdiction for the Agency to review CN's obligations beyond what is set out in the agreements between the parties (being the Rycroft Service Agreement and the Consent Agreement, as defined therein).

4. On December 23, 2014, the Agency denied LDC's application for interim relief, stating that LDC's allegations of irreparable harm were "unsubstantiated". Then, on January 20, 2015, the Agency granted, in part, CN's motion to dismiss LDC's complaint. The Agency concluded that it is bound by the terms of the Rycroft Service Agreement, including the mandatory arbitration clause agreed to by the parties. As such, the complaint regarding the service provided to the Rycroft facility was not properly before the Agency and was therefore dismissed. As to the complaint regarding the Dawson Creek facility, the Agency determined that the Consent Agreement does not preclude the Agency from hearing the matter. The Agency therefore directed CN to file its Answer in response to the complaint only as it relates to the Dawson Creek facility by February 10, 2015.

[1] *Canada Transportation Act*, S.C. 1996, c. 10.

II. BACKGROUND: A SERIES OF OVERLAPPING COMPLAINTS

5. On April 14, 2014, LDC filed a level of service complaint alleging that CN breached its service obligations under the *CTA* with respect to four of LDC's elevator facilities in Saskatchewan and Alberta during the 2013-2014 crop year. On May 2, 2014, the Agency granted an interim order which required CN to allocate an additional 300 railcars per week to LDC (the "**Interim Order**"). The Interim Order was premised on an inaccurate contractual interpretation, as ultimately recognized by the Agency in its final decision, released five months later.

6. In light of the Interim Order, on May 15, 2014, both Richardson International Limited ("**RIL**") and Viterra Inc. ("**VIT**") requested intervener status in the proceeding. The purpose of that intervention was for each of those shippers to ensure that any interim or final order made by the Agency did not operate to benefit LDC ***at the expense of*** other grain shippers. The Agency rejected both RIL's and VIT's request for intervener status and suggested that they each file a separate level of service complaint. Following that decision, RIL filed a level of service complaint on June 12, 2014, and VIT filed a level of service complaint on June 20, 2014.

7. On October 3, 2014, the Agency released its decision on the merits of LDC's complaint and concluded that CN breached its level of service obligation by failing to deliver to LDC all of the cars that it had requested (the "***LDC #1***" decision). In reaching that conclusion, the Agency created and applied a new three-step "Evaluation Approach" which effectively places an absolute obligation on railway companies to service all requests of all shippers at all times, unless the railway company can establish that it was not reasonably possible to do so for reasons clearly beyond its control. The Evaluation Approach was unilaterally developed by the Agency without input from the parties to the dispute proceeding.

8. The Agency's decision in *LDC #1* marks a significant departure from existing commercial practices and legal precedents regarding the statutory level of service obligation imposed on railway companies under the *CTA*. Fifty years ago, it was recognized by the Supreme Court of Canada that the statutory duty imposed on railway companies to furnish

"adequate and suitable accommodation" was not an absolute duty, but was instead qualified by reasonableness and dependent upon all relevant circumstances.[2] This guidance recognized the dynamic nature of rail operations and the corresponding need to review a railway company's performance in its total context.

9. The Agency's decision in *LDC #1* purports to change the legal landscape, both from a substantive and evidentiary standpoint. In addition to imposing an absolute (as opposed to reasonable) service obligation on railway companies, the Agency also reversed the onus of proof by requiring the railway company to justify or prove why it should not be found in breach of its level of service obligation. For these and other reasons, CN applied to the Federal Court of Appeal for leave to appeal from the Agency's decision in *LDC #1*.

10. Meanwhile, on October 17, 2014 (just two weeks after the Agency released its decision in *LDC #1*), LDC filed the current level of service complaint with respect to its two remaining facilities at Rycroft and Dawson Creek. The complaint is premised entirely on the Evaluation Approach established by the Agency in *LDC #1*. The complaint also relates primarily to the same 2013-2014 crop year at issue in *LDC #1*. Thus far in the proceedings, the Agency has denied LDC's request for interim relief and has dismissed LDC's complaint as it relates to the Rycroft facility.

11. On December 18, 2014, the Agency released its decisions in response to the level of service complaints filed by RIL (the "**RIL Decision**") and VIT. Although the pleadings closed long before the Agency released its decision in *LDC #1*, the Agency applied its newly created Evaluation Approach to those complaints. In each of the decisions, the Agency found that CN breached its statutory level of service obligation by failing to adhere to its car allocation policy with sufficient rigour to provide RIL and VIT with exactly [redacted]% and [redacted]%, respectively, of CN's total available car supply during certain weeks of the 2013-2014 crop year. As the facts in those cases demonstrate, to the extent that shippers such as RIL and VIT received less than their entitlement under CN's rationing program, other shippers (most notably, LDC) received more than their entitlement. The Agency ordered CN to restore to RIL and VIT the number of rail cars equal to the cumulative market share shortfall and to

[2] *Patchett & Sons Ltd. v. Pacific Great Eastern Railway Co.*, [1959] SCR 271.

provide the Agency with a proposed method for doing so that would, insofar as possible, mitigate the impact on other shippers. CN provided the Agency with the requested information on January 30, 2015.

12. The Agency's decisions in *LDC #1*, RIL and VIT present inconsistencies that are essentially impossible for CN to reconcile. By way of example, in *LDC #1* the Agency rejected CN's car allocation policy and concluded that CN ought to have met essentially all demand for cars, while in the RIL and VIT decisions the Agency concluded that CN ought to have adhered rigorously to that same car allocation policy, this during the same crop year.

13. On January 20, 2015, while CN was responding to the Agency's request to provide a methodology for making up the shortfall to RIL and VIT, the Agency also directed CN to file its Answer to this complaint as it relates to the Dawson Creek facility. At the same time, the Federal Court of Appeal granted CN's application for leave to appeal from the Agency's decision in *LDC #1*.

14. The issues to be determined by the Federal Court of Appeal in that appeal are identical to the matters at issue in this dispute proceeding.[3] Furthermore, the Agency will be bound by the Federal Court of Appeal's determination of these issues. In light of this, CN filed a notice of motion requesting that the Agency adjourn or stay this dispute proceeding pending a final determination of the appeal from the Agency's decision in *LDC #1*. In addition, CN requested that certain paragraphs of LDC's application be struck, and that CN be granted a reasonable extension of time for filing its answer on the merits of LDC's

[3] In particular, the Federal Court of Appeal will be called upon to determine the following:

a) the proper interpretation of a railway company's statutory level of service obligation and, specifically, whether the obligation is an absolute or reasonable one;
b) the proper legal test the Agency must apply to assess compliance with the statutory level of service obligation and, specifically, whether the Evaluation Approach and the reverse onus it imposes on railway companies is proper or permissible;
c) what consideration and weight must be given to the total demand for service at an industry level in assessing the service provided by a railway company to a particular shipper;
d) what consideration and weight must be given to a shipper's historical ordering patterns and volumes in assessing the service provided by a railway company to that shipper;
e) what consideration and weight must be given to the record 2013 crop size in assessing the service provided by a railway company during the 2013-2014 crop year; and
f) what consideration and weight must be given to the harsh 2013-2014 winter weather in assessing the service provided by a railway company during the 2013-2014 crop year.

application until a reasonable time after the motion is determined.

15. By email dated February 6, 2015, the Agency denied CN's request for a reasonable extension of time to file its answer until after the motion was determined and directed that the answer by filed by February 10, 2015. Although the Agency indicated that it would consider CN's notice of motion "in due time", the practical effect of forcing CN to file its answer at this time is to deny the relief requested by CN in the notice of motion.

16. The Agency has put CN in an impossible position. Given the current state of affairs, it is not possible for CN to provide an informed response to the complaint without referring to the pending appeal on *LDC #1*, and filings in other proceedings before the Agency. The foundation of the level of service provisions of the *CTA* continues to shift and CN is being asked once again to try to hit a moving target. This is the very reason why CN filed a notice of motion requesting an adjournment or a stay of proceedings.

17. The request for an adjournment or a stay of proceedings was not simply to ensure that ***the Agency*** has the benefit of guidance from the Federal Court of Appeal prior to making a final determination in this matter. It was also to ensure that ***CN*** has that same benefit. CN is entitled to know what the law is prior to having to finalize its pleadings. Simply put, CN does not know the case it has to meet, as this very issue will ultimately be determined by the Federal Court of Appeal. Forcing CN to provide an answer on the merits of the complaint at this time is therefore a clear violation of CN's right to procedural fairness.

18. Furthermore, in addition to the appeal pending before the Federal Court of Appeal, the Agency has yet to release a decision identifying the method by which the market share shortfall experienced by both RIL and VIT in 2013-2014 will be cured. As such, the method for making up the shortfall and the cure period remain undetermined. This outstanding "cure situation" represents a vast majority of the entire grain market and will directly impact car allocation to all grain shippers, including LDC.

19. In short, CN is being placed in an impossible position as these overlapping proceedings, all relating to 2013-2014, are traversed by factual and legal contradictions and are entirely devoid of procedural fairness. In the interest of orderly adjudication, natural

justice and procedural fairness, CN once again respectfully submits that the Agency should have stayed this dispute proceeding until clearer guidance could be provided by the Federal Court of Appeal to inform the Agency, CN and the grain industry as a whole.

20. Given all of the foregoing, CN will provide the facts necessary to respond to the merits of LDC's complaint to the best of its ability in the time provided. However, CN reserves its right to appeal should any subsequent decision by the Agency cause it further prejudice.

III. ISSUE

21. The only issue to be determined is whether CN complied with its statutory level of service obligation to LDC with respect to its facility at Dawson Creek during the complaint period, being from Week 1 of the 2013-2014 crop year to Week 11 of the 2014-2015 crop year.

IV. LAW AND ANALYSIS

A. Level Of Service Obligation – General Principles

22. The components of the level of service regime are well-known. In this respect, the *CTA* states as follows:

> 113. (1) A railway company shall, according to its powers, in respect of a railway owned or operated by it,
>
> > (a) furnish, at the point of origin, at the point of junction of the railway with another railway, and at all points of stopping established for that purpose, adequate and suitable accommodation for the receiving and loading of all traffic offered for carriage on the railway;
> >
> > (b) furnish adequate and suitable accommodation for the carriage, unloading and delivering of the traffic;
> >
> > (c) without delay, and with due care and diligence, receive, carry and deliver the traffic;
> >
> > (d) furnish and use all proper appliances, accommodation and means necessary for receiving,

> loading, carrying, unloading and delivering the traffic; and
>
> (e) furnish any other service incidental to transportation that is customary or usual in connection with the business of a railway company.
>
> …
>
> 116. (1) On receipt of a complaint made by any person that a railway company is not fulfilling any of its service obligations, the Agency shall
>
> (a) conduct, as expeditiously as possible, an investigation of the complaint that, in its opinion, is warranted; and
>
> (b) within one hundred and twenty days after receipt of the complaint, determine whether the company is fulfilling that obligation.

23. The purpose of the level of service regime is not to ensure the economic prosperity or security of certain shippers at the direct detriment of the railways, or other shippers. Despite recent pronunciations to the contrary by the Agency, the regime is not a reflection of the fact that shippers and railways are universally and fundamentally adverse in interest. Indeed, in most instances, the goals of shippers and railway companies are aligned. Both share an interest in moving the greatest amount of freight in the most efficient manner.

24. Put simply, the Agency must recognize that its role is triggered only in limited circumstances where service review is necessitated. The corollary of this is that the railways must be sensible and practical in their service offerings. They do not, however, have to be perfect.

25. In this respect, it is well established that the standard imposed upon the railways by ss. 113-116 of the *CTA* is reasonableness. The leading decision is *A.L. Patchett & Sons Ltd. v. Pacific Great Eastern Railway*, wherein the Supreme Court of Canada stated as follows:

> Apart from statute, undertaking a public carrier service as an economic enterprise by a private agency is done on the assumption that, with no fault on the agency's part, normal means will be available to the performance of its duty. ***That***

> ***duty is permeated with reasonableness in all aspects of what is undertaken*** except the special responsibility, of historical origin, as an insurer of goods; and it is that duty which furnishes the background for the general language of the statute. ***The qualification of reasonableness is exhibited in one aspect of the matter of the present complaint, the furnishing of facilities: a railway, for example, is not bound to furnish cars at all times sufficient to meet all demands; its financial necessities are of the first order of concern and play an essential part in its operation***, bound up, as they are, with its obligation to give transportation for reasonable charges. Individuals have placed their capital at the risk of the operations; they cannot be compelled to bankrupt themselves by doing more than what they have embraced within their public profession, a reasonable service. Saving any express or special statutory obligation, that characteristic extends to the carrier's entire activity. Under that scope of a duty a carrier subject to the Act is placed.[4]

26. As described above, the burden placed upon a railway in respect of carrying traffic is "permeated with reasonableness". Moreover, "…the determination of a service complaint requires the Agency to balance the interests of the railway company with those of the complainant in the context of the particular facts of the case."[5] These propositions were, at one time, applied by the Agency in a manner consistent with *Patchett*.[6] However, a clear inflexibility has recently taken root in the interpretation of the level of service regime.

27. In this respect, the *CTA* cannot be viewed as having been breached if the railway cannot immediately, on a peak load movement, supply every single car ordered unless it is impossible to do so. With respect, ***it is absurd to conflate the legal standard of "reasonableness" with the concept of "possibility"***. It is possible for a common carrier to render itself operationally inefficient and uncompetitive in an attempt to meet all service demands at all times. However, that is not required by the law.[7] Nor has it ever been,

---

[4] *Patchett* at para. 5 [emphasis added].
[5] *Canadian National Railway v. Northgate Terminals Ltd.*, 2010 FCA 147 at para. 35.
[6] See e.g. *Northgate Terminals Ltd. v. CN*, Decision No. 166-R-2009 [*Northgate (Agency)*] at para. 42; *Naber Seed & Grain Co. Ltd. v. CN*, Decision No. 323-R-2002; *Canadian Wheat Board et al. v. CN*, Decision No. 488-R-2008.
[7] For example, in times of shortage it is what is, on average, reasonable that must be looked at from the standpoint of car supply. See e.g. *Harris v. Quebec Central Railway* (1921), 27 C.R.C. 447 at p. 450. See also *Shippers Committee*, *OT-5 (SCOT-5) v. The Ann Arbour Railway Company* (1989) 5 I.C.C. (2d) 856 at p. 857

despite LDC's arguments and recent decisions suggesting otherwise.[8]

28. If, after applying the proper threshold, the Agency determines that a carrier has committed a breach of the level of service regime, its powers to remediate that breach are contained in s. 116 of the *CTA*, which states as follows:

> Orders of Agency
>
> (4) If the Agency determines that a company is not fulfilling any of its service obligations, the Agency may
>
> (a) order that
>
> (i) specific works be constructed or carried out,
>
> (ii) property be acquired,
>
> (iii) cars, motive power or other equipment be allotted, distributed, used or moved as specified by the Agency, or
>
> (iv) any specified steps, systems or methods be taken or followed by the company;
>
> (b) specify in the order the maximum charges that may be made by the company in respect of the matter so ordered;
>
> (c) order the company to fulfil that obligation in any manner and within any time or during any period that the Agency deems expedient, having regard to all proper interests, and specify the particulars of the obligation to be fulfilled;
>
> (c.1) order the company to compensate any person adversely affected for any expenses that they incurred as a result of the company's failure to fulfill its service obligations or, if the company is a party to a confidential contract with a shipper that requires the company to pay

("It is well established that a railroad need not equip itself with sufficient cars to provide cars immediately in all circumstances whenever a shipper requests them; that would be financially impossible…This would be especially difficult in the context of the highly cyclical and seasonal grain industry.").

[8] See *Prairie Malt Limited v. Canadian National Railway Company*, Decision No. 411-R-1989 ("What is required to be provided by a railway company in the discharge of a statutory common carrier obligation as set out in the NTA, 1987, in respect of statutory grain traffic, is a basic level of service.").

> an amount of compensation for expenses incurred by the shipper as a result of the company's failure to fulfill its service obligations, order the company to pay that amount to the shipper;
>
> …

29. The Agency's powers are broad. However, there are two important constraints. First, section 112 of the *CTA* mandates that "A rate or condition of service established by the Agency under this Division must be commercially fair and reasonable ***to all parties***." The Agency has previously recognized that this section must be taken into account when crafting a remedy.[9]

30. Second, there must be a nexus between the complaint, the breach, and the remedy. A breach relates to a specific complaint. A remedy or order relates to a specific breach.[10]

31. As a result, it would be an inappropriate use of the Agency's remedial discretion to order system-wide relief to address a discrete breach at a single shipping facility. Such an order would not be commercially fair or reasonable. Nor would it bear a rational connection to the complaint or alleged breach.

32. It is in this context that the Agency must assess LDC's complaint. As will be discussed below, the Agency should not engage in review on a case-by-case basis, but rather assess the Application in the context of the overall demand for grain transportation services.

B. Overview of Answer

33. LDC asserts that CN has breached its level of service obligations in relation to its Dawson Creek facility. Its allegations reduce to three general propositions, namely that CN breached its obligations by: (i) not delivering every car ordered by LDC;[11] (ii) breaching the Consent Agreement;[12] and (iii) implementing a new car allocation policy in 2014-2015.[13]

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[9] *Wabush Mines v. Quebec North Shore and Labrador Railway Company*, Decision No. LET-R-248-2004 at paras. 47-49.
[10] See e.g. *Goff v. Canadian National Railway Company*, Decision No. 331-R-2010 at para. 29 ("If a railway company is found not to have fulfilled its level of service obligations, the Agency may order remedies ***that are relevant to the nature of the breach that has been identified***…").
[11] See e.g. Application at para 34.
[12] See e.g. Application at para. 51.

34. CN specifically denies each and every allegation in the Application. CN submits that it has not breached its level of service obligations.

35. First, as set out above, a railway's service obligations are not absolute. CN does not have an obligation to furnish cars at all times sufficient to meet all demands. Any argument or decision to the contrary is a departure from binding precedent and an error of law. Moreover, as will be detailed below, LDC's requests for service to Dawson Creek are unsubstantiated and unreasonable. In addition, CN's service offering to the facility was more than reasonable, given all of the relevant circumstances.

36. Second, the Agency's role is not to interpret, apply, or enforce the terms of the Consent Agreement. CN's performance in respect of the Consent Agreement is not relevant to assessing the level of service provided to LDC at its Dawson Creek facility. In any event, CN has not breached the terms of the Consent Agreement.

37. Third, CN's 2014-2015 allocation policy is neither relevant nor at issue. This is a red herring. It has been raised by LDC in this manner repeatedly in other level of service proceedings before the Agency.

38. Each will be discussed in various detail below.

C. CN Provided A Reasonable Level Of Service

i. The Service Requested by LDC

39. As set out above, a railway's service obligation is "permeated with reasonableness". The corollary is that, if a shipper has demanded service in a manner or to an extent that is unreasonable, there can be no corresponding obligation upon the railway to accommodate that request. In this respect, it has been previously recognized that shippers may owe "correlative obligations" to act reasonably when requesting rail services.[14]

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[13] See e.g. Application at para. 58.

[14] See e.g. *Patchett* at para. 12 ("To the duty of the railway to furnish services there is a correlative obligation on the customer to furnish reasonable means of access to his premises"). There is no basis to restrict the Supreme Court's comments to access issues. A demand for service rendered unreasonable by the actions of the customer cannot fall within the protection of the level of service regime, regardless of context. See also *Northgate (Agency)* at paras. 62-63.

40. In the present context, a brief review of the nature of LDC's application, as well as its conduct in relation to car ordering both on a systemic and facility-specific basis, reveal that this complaint is ill-founded.

41. LDC's primary contention is that CN failed to deliver all of the cars ordered to the Dawson Creek facility. LDC argues that these car orders were reasonable and, as such, that each ought to have been fulfilled by CN. However, the only evidence in support of this position is its counsel's argument that LDC's ordering pattern was more-or-less consonant with previous crop years. On that basis alone, LDC suggests that the Agency should simply assume that its car orders were authentic requests.

42. CN offers three observations in response.

43. First, LDC's position is fundamentally defective. In order to constitute a valid request for rail service LDC must ***prove*** that these were legitimate demands with evidence detailing, *inter alia*, actual delivery commitments and arrangements. Evidence of past ordering practices does not speak to this issue in any respect. As a result, neither CN nor the Agency can assess whether these car orders were *bona fide*. That information is known to LDC alone, and LDC has failed to lead any application-specific evidence on the point.

44. ***This is LDC's application***. LDC bears the legal burden of proving that its application is well-founded in all necessary respects. The Agency has discussed this requirement on a number of occasions. For example, in *Russel Metals Inc v Canadian Pacific Railway Company*, the Agency stated as follows:

> Section 120.1 of the CTA has been designed to allow one or more shippers to challenge a charge and associated term or condition imposed by a railway company, which they believe is unreasonable. The CTA does not stipulate who bears the burden of proof. As the CTA is silent, the common law principle prevails and the ultimate burden of proof rests, on a balance of probabilities, with the applicant. In this case, the legal burden of proof rests with Russel.
>
> …

> The distinction between an evidentiary burden (duty of going forward with evidence) and a burden of proof (burden of persuasion) is important. An evidentiary burden will be discharged by adducing or pointing to evidence which, if accepted, is sufficient to support one's position. The burden of proof is the duty that lies with a party – in this case on Russel – to establish the facts asserted in the complaint. It determines the ultimate outcome and, in civil cases, needs to be discharged on a balance of probabilities….
>
> As noted, the burden of proof lies with Russel at the outset to prove its case. This means that Russel also bears the evidentiary burden to present enough evidence to justify consideration of the issues, in other words, to show that it has made out a case for CP to answer.[15]

45. The same observation can be made in relation to the present circumstances. This is particularly so given the fact that LDC suggests that CN must be held to a standard that requires evidence of absolute justification for every single instance of an alleged failure to supply cars. As set out herein, CN disagrees. However, it is beyond aberrant to hold CN to this exceedingly strict standard of proof, when, in contrast, the applicant is simply taken at its word.

46. Dismissal of the complaint is the only recourse. CN refers to the decision of *Canadian National Railway v. Paterson Grain*, wherein the Federal Court of Appeal stated as follows:

> Having found that the evidence before it was insufficient for it to make a determination with respect to the question of whether the appellant had breached its level of service obligations for crop year 2007-2008, ***the Agency had no option but to dismiss the complaints***.
>
> …The plain fact is that the evidence before the Agency was not sufficient for it to provide the respondents with the remedy

[15] Decision No 273-R-2012 at paras. 9-12. The Agency ultimately dismissed Russel Metals complaint as it had failed to adduce sufficient evidence to support its allegations. See paras.16-17 and 26 ("The Agency is also of the opinion that there is no link between Russel's allegations that CP has contravened section 120.1 of the CTA, the facts presented and the orders sought. It is not sufficient for a party to simply state its conviction that there has been a violation of section 120.1 of the CTA.").

> which they sought. Hence, in those circumstances, the only possible conclusion was the dismissal of the complaints.[16]

47. If LDC actually intended for this application to be determined by the Agency, it ought to have led evidence of the nature and extent of its contracts to acquire grain, sales contracts for grain, capacity at the terminal and terminal authorizations, as well as any other delivery commitments and arrangements. Without this evidence, there is no basis upon which to assume that CN was even required to attempt to service LDC's car orders in the first instance.[17]

48. This concern is particularly acute in the present context. It is patently obvious that LDC has engaged in tactical ordering to bolster its car orders in an attempt to fortify its position in subsequent level of service complaints. For example, in weeks 10 and 11 of 2014-2015 crop year LDC ordered [redacted] and [redacted] cars respectively at the Dawson Creek facility. These numbers are far in excess of the [redacted]-car capacity of the siding, and are concurrent with a time period when LDC was preparing this Application.

49. These orders represent [redacted] cars out of a cumulative alleged shortfall of [redacted]. This is over 44% of the claimed shortfall. As above, neither CN nor the Agency can determine whether any portion of these orders represent legitimate demands for service. There is a paucity of evidence, with LDC providing only a glimpse into allegedly unfulfilled producer contracts, bereft of any supporting detail, explanation or context. LDC is silent on this point.

50. In this respect, LDC has not met its evidentiary or persuasive burden in relation to its car orders. There is insufficient evidence to justify consideration of the level of service issue.

51. Second, even if the Agency merely assumes that LDC's car orders represent legitimate demands for service at face value (and the Agency cannot), LDC's demands for service to Dawson Creek were not reasonable.

52. The service at Dawson Creek has been designed for a weekly spot of 48 cars. It is

[16] 2010 FCA 225 at paras. 31-32 [emphasis added].
[17] Additionally, CN objects in advance to any subsequent attempt by LDC to lead evidence on reply. This will not be the first instance where LDC has attempted to preclude CN from responding on the merits in such a manner. CN reserves its right of sur-reply, in this respect.

atypical to provide more than [redacted] cars in one crop week. Conversely, however, LDC claims that "…CN routinely spotted [redacted] to [redacted] cars to Dawson Creek" in previous crop years.[18] The argument is misleading.

53. From the 2009-2010 crop year to the beginning of the 2012-2013 crop year, CN spotted [redacted] cars or more twice out of [redacted] crop weeks (1.0%). Moreover, spots between 48-96 cars were infrequent,[19] with a significant amount of instances exceeding [redacted] cars only by a marginal amount.[20]

54. As such, it is hardly "routine" for LDC to expect more than a weekly service of [redacted] cars.[21]

55. Moreover, viewed from an overall perspective for this facility alone, LDC's orders to Dawson Creek during the 2013-2014 crop year as a whole represented an increase of over 48% in relation to its 2012-2013 orders. It is unreasonable for LDC to expect such an increase to be met instantaneously in this context particularly given that rationing was in place, as well as other systemic issues. This leads to the third point.

56. LDC's car orders at Dawson Creek also need to be understood holistically. They were only one component of an overall pattern of systemic, misleading and abusive ordering patterns by LDC.

57. During the complaint period, LDC ordered cars at a level representing 184% of the number of cars ordered during the reference period. As the table below confirms, no other shipper increased its order at the pace LDC did.

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[18] Application at paras. 36-39, Appendix "J".
[19] CN spotted between [redacted] cars to the Dawson Creek facility [redacted] times out of 208 crop weeks (17.8%).
[20] For example, the instances of CN providing [redacted] cars or more – 1.5 times a typical service offering – amounted to [redacted] times in the 208 weeks or 6.7%.
[21] Moreover, many of the weeks where more than 48 cars were spotted by CN coincided with periods where LDC had ordered few, or no cars, for multiple preceding weeks. This appears to be a product of unreasonable demand fluctuation or poor capacity planning at the Dawson Creek facility. CN does not agree that its attempts to accommodate LDC by surging cars over a one-week period in such circumstances informs a typical, routine, or reasonable ordering pattern for this facility.

Analysis of Ordering Patterns
Weekly Data, Week 1 of 2013/14 to Week 11 of 2014/15

Shipper	2012/13 Base Reference Period[1]			Ordering Pattern			
	Cars Ordered	Shipment Distribution	Allocation Guideline	Cars Ordered	Growth vs. Base	Order Distribution	Allocation Guideline
[redacted]							
Totals	4850	4456	100%	5126	106%	100%	100%

1 Distribution of Shipments in Weeks 8-22 of Crop Year 2012/13

58. When faced with this manner of customer behaviour, a railway cannot adjust its offering in proportion to the customer's inflated pattern of ordering. If it does, questions arise as to how a railway must treat other customers – particularly where they order less than their allocation guideline unlike the inflated ordering patterns of shippers such as LDC.

59. If the Agency required CN to accommodate LDC's inflated ordering pattern, it is a near certainty that all customers would quickly adjust their ordering behaviour upward in an effort to protect their own market share. To further illustrate the practical implications of deeming LDC's car ordering behaviour as "reasonable", the tables below show the impact of all customers adjusting their ordering patterns to match LDC's during the entirety of the period at issue.

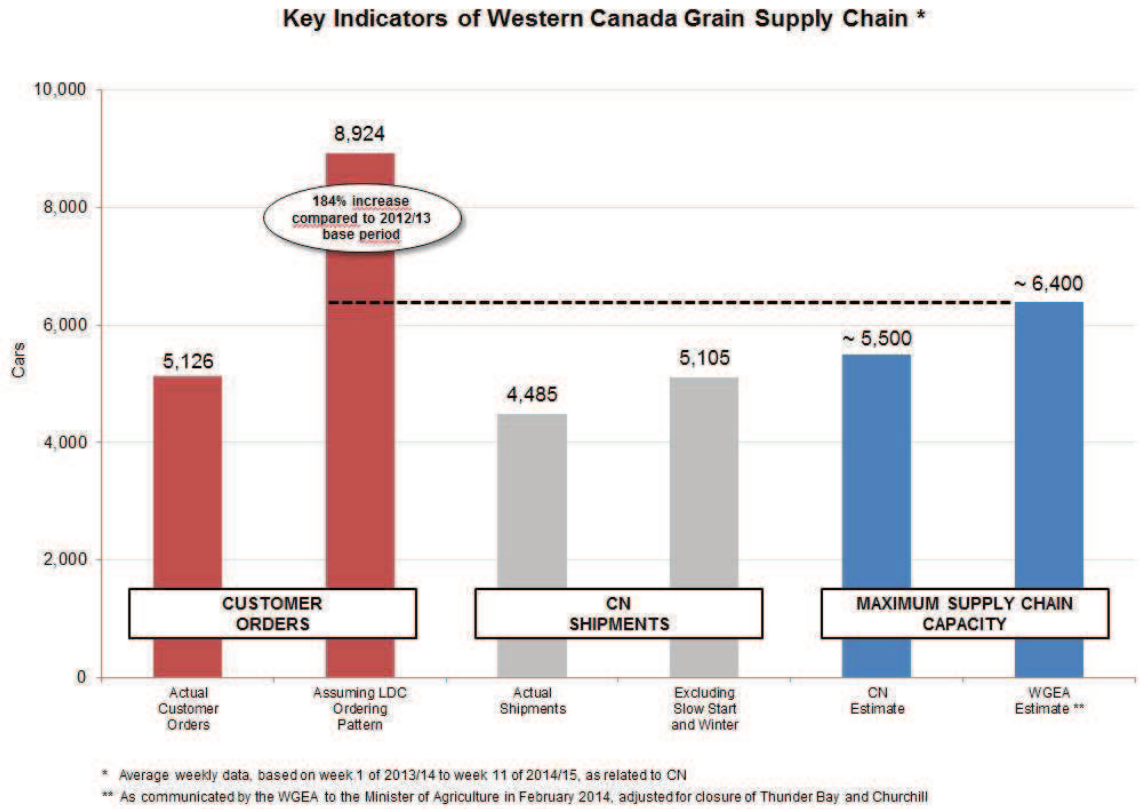
Measuring the Impact of Excessive Ordering vs. CN Allocation Guideline

Shippers	Base Period Cars Ordered[1]	Based on LDC Ordering Pattern[2]	Resulting Orders	Allocation Guideline
[redacted]				
Total	4850	184%	8924	100%

1 Weeks 8-22 of Crop Year 2012/13
2 Week 1 of 2013/14 to Week 11 of 2014/15 vs. Base Period

60. Clearly, such a pattern of over-ordering in the range of 9,000 cars, or more, would far exceed both rail and end-to-end supply chain capacity. This is true whether measured against a temporarily constrained environment or even if one assumes that capacity could somehow be sized-up to meet unconstrained and necessarily uncoordinated order levels. Faced with such pattern, and with no option but to ration, CN's car allocation approach based on past market share trends, rather than customer order distribution, is the most reasonable, if not the only viable option to allocate capacity fairly and consistently.

61. The graph below further underscores the importance of industry context. In addition to supporting the need for a sound planning framework based on crop production trends, end-to-end supply chain capacity and a clear methodology to allocate capacity based on historical market share, this graph shows that LDC's ordering patterns exceed cars at maximum capacity for the western Canadian supply chain. It also shows that CN's shipments during the complaint period could have reached 5,100 cars per week, had it not been for the slow start in terms of industry orders and the brutal winter.



62. LDC is a sophisticated entity, and it is aware of the consequences of inflating its orders. As will be discussed in further detail, the impact of the Agency's recent decisions have shifted market share in a manner that favoured LDC to the detriment of other grain shippers. This Application is simply another attempt by LDC to bolster its market share further, under the guise of regulatory "relief" against alleged breaches by CN of its level of service obligations.

63. The Agency should neither condone nor encourage this behaviour.

64. As a result of the foregoing, CN submits that any further inquiry into whether CN complied with its level of service obligations is unnecessary. LDC's car orders for Dawson Creek are entirely unsubstantiated. They are also unreasonable when viewed on a facility-specific basis and in the context of LDC's operations as a whole.

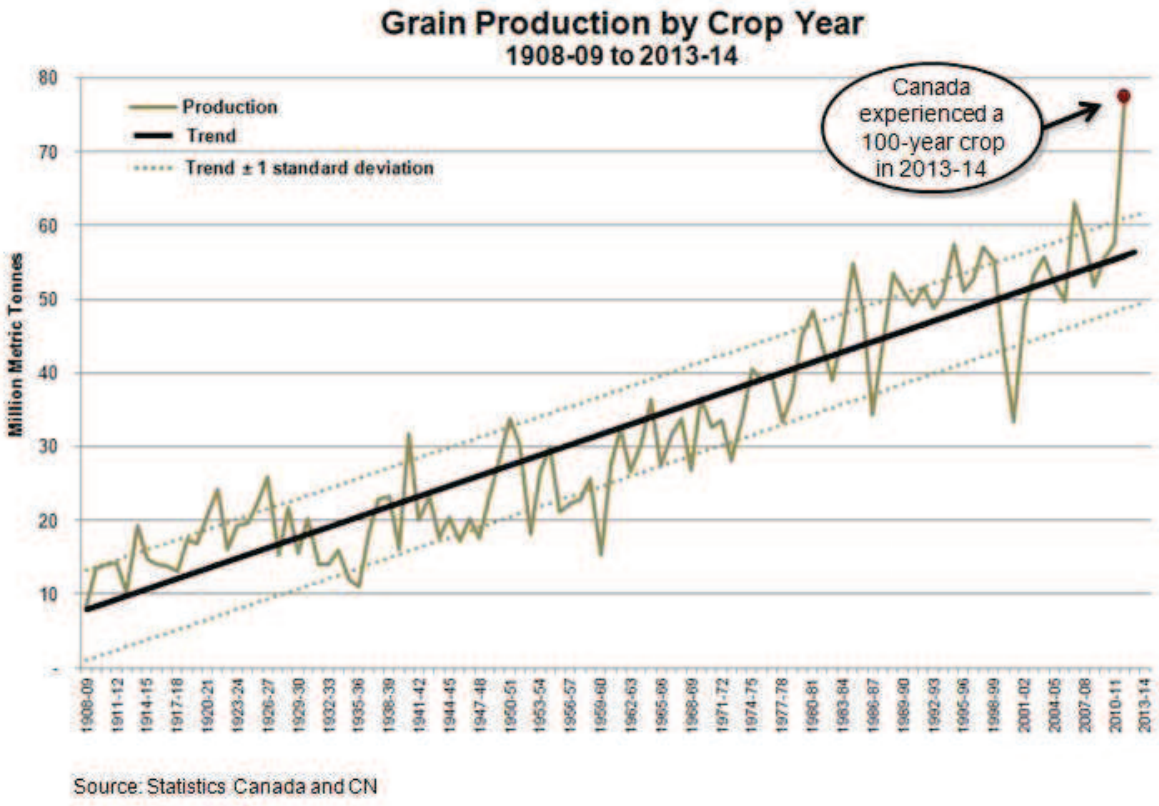
ii. The Service Provided by CN

65. Railway companies manage complex network operations and do not have the luxury of making decisions *ex post facto*. The environment they operate in is extremely dynamic and the time available to make decisions is short. This environment may lead to less than perfect decisions at times. The standard, however, is not perfection but rather reasonableness.

66. CN submits that the service provided to LDC at its Dawson Creek facility was more than reasonable in all of the circumstances.

67. As the Agency is well aware, the 2013-2014 crop was the largest crop in Canadian history. Attached as Appendix "A" is a document "2013-2014: The 100-Year Crop" which describes the magnitude of this unprecedented and unforeseeable crop, as well as CN's sound planning framework and its reasonable performance for the 2013-2014 crop year. Some of that information is summarized below.

68. The record size of the 2013-2014 crop was approximately 20 MMT higher than the historical production trend line. The graph below illustrates the significant departure from trend that the 2013-2014 crop represented.



69. The statistical probability of such a crop was, and still is, less than 1%. This explains why neither Agriculture and Agri-Food Canada nor the grain industry had forecasted such an outlier crop. It would not be reasonable to expect CN to have fared any better.

70. Planning resources for a given crop year takes at least 6 months in advance of the summer harvest, when the information available on the actual size of the next crop is minimal. When actual crop size and demand for rail services exceeds planned resources, railway companies have a very limited ability to add resources. Simply put, adding cars, locomotives and crews to handle additional traffic takes time and requires a planning lead time of 7 to 12 months. Indeed, the Agency has previously recognized that the rail cars, motive power and work force required in the movement of grain cannot be instantaneously acquired and that the planning horizon for increasing rail capacity is longer than a matter of weeks.[22]

[22] RIL Decision at para. 158.

71. In September of 2013, when it became evident that the crop would be considerably larger than forecasted, CN made major efforts to supplement its resources. CN was able to lease an additional 500 covered hopper cars which were brought into service in December. An additional 500 covered hopper cars were leased and brought into service between April and June. Further, CN temporarily introduced in its Canadian hopper car fleet an additional 800 cars to increase its capacity.

72. Simply put, the exceptional size of the 2013-2014 crop was not, and could not have been, anticipated by CN. Over the course of the crop year, CN took every step it could to acquire additional cars in order to respond to these exceptional circumstances. These efforts have been acknowledged by the Agency.[23] However, the fact remained that the unprecedented demand for service greatly exceeded car supply, meaning that cars would have to be rationed and not every unconstrained car order could possibly be filled.

73. CN implemented a rationing system and criteria designed to provide objective guideline allocation targets that CN would aim to achieve on an ongoing basis. A neutral basis was required to determine allocation targets, as all shippers were lobbying CN to allocate more cars to each of them. Since arbitrating between those subjective arguments would have proven an impossible task, an approach based on historical market shares was adopted as it provided a neutral and objective approach that was directly connected to the market.

74. The car allocation methodology implemented by CN for the 2013-2014 crop year was therefore based on each shipper's historical use of CN's grain service during the post-harvest peak period (Weeks 8 to 22) of the 2012-2013 crop year, which was the first crop year following the end of the Canadian Wheat Board monopoly on grain marketing.

75. CN selected this reference period because:

a) it was in the recent past, thereby reflecting the current customer base and infrastructure;

[23] RIL Decision at para. 148.

b) it covered a period when grain was available in all regions to all customers;

c) it covered a period when all destination port corridors (including Churchill and Thunder Bay) were operating; and

d) the pace of car order requests broadly matched CN's pace in car spotting.

76. This car allocation policy was implemented from Week 8 of the 2013-2014 crop year when it became clear that demand would exceed CN's capacity for a significant period. It should be noted that, prior to Week 8, all orders at Dawson Creek had been filled.

77. The need for rationing in periods when demand exceeds capacity has been acknowledged through the years and is incontrovertible.[24] In fact, the Agency has already determined that rationing during the extraordinary circumstances of the 2013-2014 crop year was justified.[25]

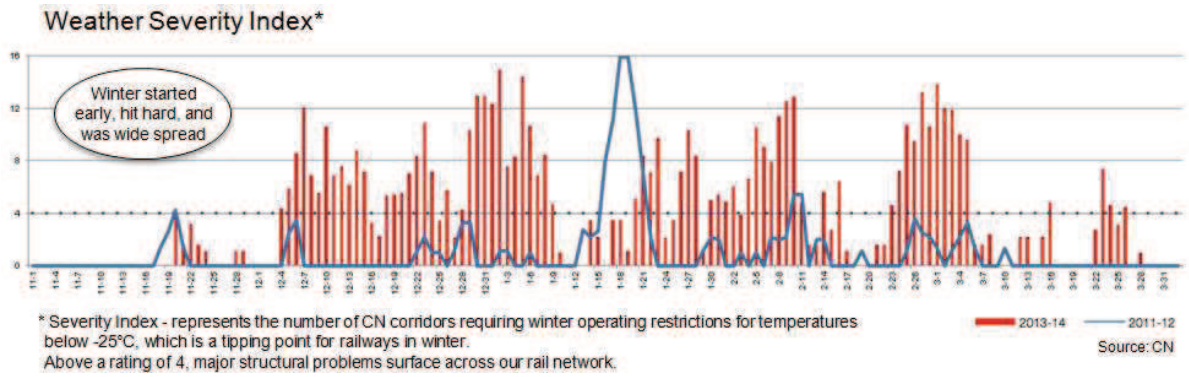
78. In addition to an unforeseeable bumper crop, the Prairies experienced by far the worst winter in decades, with almost 30 days below -30 in Winnipeg and Saskatoon. Not surprisingly, Environment Canada ranks first Canada's Long Cold Winter in "Canada's Top Ten Weather Stories for 2014"[26], stating that "Canada's reputation as the second coldest country next to Russia was reaffirmed in winter 2013-14." Environment Canada comments the cold temperature that afflicted the prairies as follows:

> Nobody had it worse than Winnipeg, arguably the coldest big city in Canada. No one alive can say they've lived it colder there as residents survived the coldest December to March, inclusive, since 1898 – long before urban heat islands, automobiles, heavy industry and long before global warming.

[24] Appendix "B", Western Transportation Advisory Council report dated May 1998, "Grain Handling and Transportation Profile"; Appendix "C", CN Grain Marketing publication dated July 20, 2000 "General Allocation – Canadian Ports and North American Destinations"; Appendix "D", Final Report of Mr. Justice Estey submitted to the Minister of Transport on December 21, 1998 (excerpts).
[25] RIL Decision at para. 55.
[26] http://www.ec.gc.ca/meteo-weather/default.asp?lang=En&n=C8D88613-1&offset=2&toc=show.

> Temperatures averaged -20°C when the normal average is -14.3°C, and there were 30 raw days when the temperature dropped below -30°C versus a typical average of 12. Adding to the misery, the city received an abnormally large amount of snow. The 155 cm that fell was well above the average of 100 cm and the most the city had received since the winter of 1996-97 – enough to bust the myth that it's ever too cold to snow! The only good news was that the cold and snow were so dry it helped minimize the spring flood risk.

79. The structural impact of winter on railroads is more fully explained in the document "The Unique Impact of Winter on Railroad Operations", which is attached as Appendix "E". The graph below illustrates the number of corridors requiring operating restrictions for temperatures below -25 for both the 2012-2013 and 2013-2014 crop years. When more than four corridors (green dotted line) have restrictions, serious repercussions are felt throughout the ***entire*** CN network and its fluidity is greatly impacted.



80. The impact of winter on rail operations cannot be altogether avoided with better planning or by simply adding more resources. It is not a matter of "sweating the assets", it is a structural issue, one that results from the specific features and technology used by the rail industry. It follows from the very difficult 2014 winter conditions that the number of carloads handled by CN during the winter period decreased compared to an average winter. CN experienced four or more corridor restrictions in the majority of weeks extending from the beginning of December right through until March. It should be noted that this period generally coincides with the weeks in which Dawson Creek did not receive all of the rail cars that it requested (beginning in Week 20, which began December 15, 2013).

81. As discussed above, reasonableness must pervade the service obligations of railway

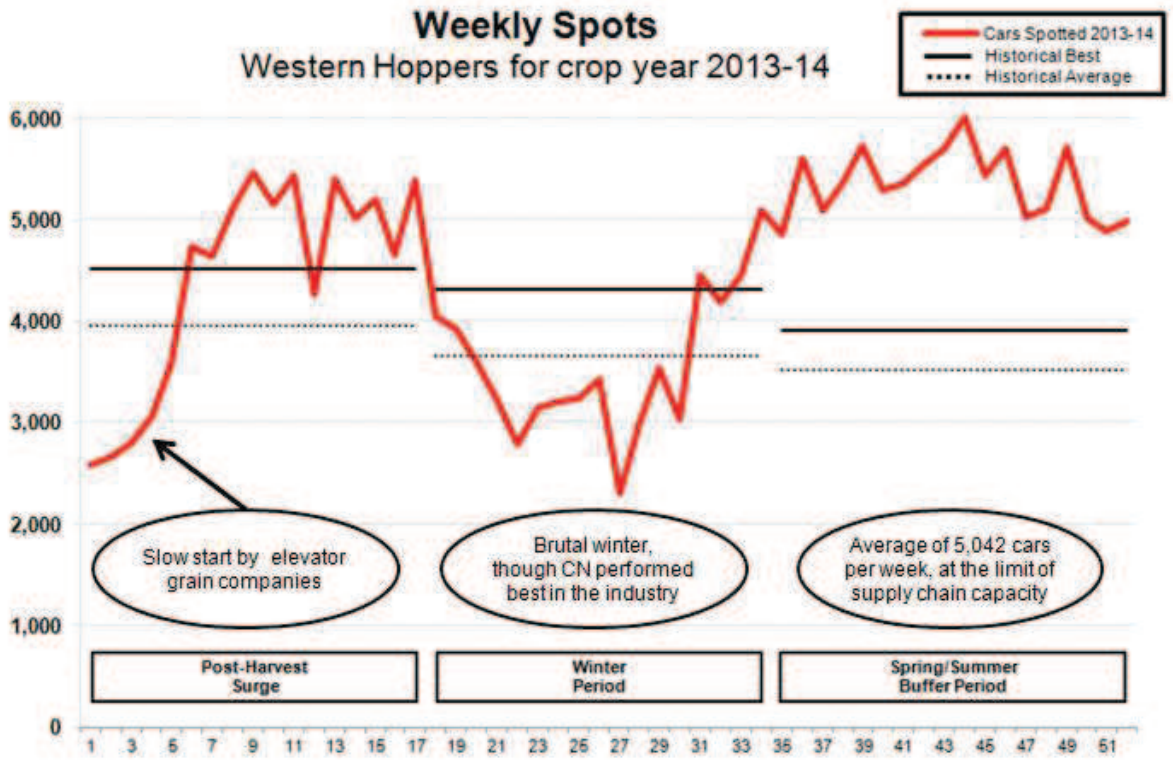
companies. To assess the reasonableness of CN's performance, it is useful to compare same to that of other railway companies during the same period. Doing so will underscore that CN outperformed the rest of the industry despite being the most exposed to the polar vortex. The following table presents key publically available data points that illustrate CN's performance relative to its competitors when adverse weather conditions were prevailing in 2014.

Q1 2014 vs Q1 2013	CN	Industry Average[1]	
Train Speed	-5.3%	-10.7%	Reduced train speeds
Terminal Dwell	-11.5%	-21.9%	Longer dwell times

[1] Weighted industry average includes: CP, CSX, NS, KCS, BNSF, UP
Source: AAR

Best in the face of a brutal winter even if most northerly railroad

82. Despite these significant challenges, all of which were beyond CN's control, CN still managed to provide an exceptional performance at the industry level. As the graph below demonstrates, CN delivered a record performance when demand was present and the winter was over. In particular, CN moved 27% more grain than average during the post-harvest period when orders picked up and 52% more grain than average during the spring/summer period.



83. Even during the winter months when operating restrictions were in place, CN delivered only 1% less grain than during the same period in 2013.

84. In the end, CN moved 25% more volume than an average crop year and ***13% more than the previous historical record moved in 2012-2013***. The total export program for Western Canada reached a record of 42 MMT during 2013-2014. Furthermore, the carry-out at the end of the 2013-2014 crop year was 15.7 MMT, only 3 MMT above normal levels. Considering the exceptional size of the 2013-2014 crop, addressing the backlog and ending the crop year with this carry-out is indicative of a very strong performance.

85. The service provided to LDC at its Dawson Creek facility is consistent with this industry level performance.

86. LDC's facility at Dawson Creek is located on CN's Dawson Creek subdivision. CN currently provides train service to this area four times per week. During the summer of 2014, the frequency of train service was increased to six times per week as a result of increased demand for rail service.

87. The siding at Dawson Creek can accommodate a 48-car spot. Given this capacity, CN has agreed to treat deliveries of 48 cars as being eligible for the multi-car incentive rates that are usually applicable to blocks of 50 cars. As a result, the service at Dawson Creek has been designed for a weekly service of 48 cars.

88. The number of cars ordered and delivered at Dawson Creek are summarized in the table found at paragraph 42 of LDC's Application. As that table demonstrates, during the vast majority of the complaint period, CN delivered all of the cars ordered by LDC.[27] In addition, there were 8 weeks in which LDC did not receive the number of cars it ordered, but the shortfall was very quickly and diligently restored by CN in the following week or weeks.[28]

89. During the complaint period, CN delivered [redacted] of the [redacted] cars ordered by LDC at Dawson Creek, leaving a shortfall of [redacted] cars. However, included in that shortfall are [redacted] cars

[27] Being Weeks 1-7, 9-12, 14-16, 19, 21, 25-27, 30, 33, 39-51, 1, 3-5, and 7-9.
[28] Being Weeks 8, 13, 17, 18, 24, 43, 2, and 6.

ordered in Week 52 which CN diverted from Dawson Creek to Rycroft ***at LDC's request***, thus reducing the shortfall to [redacted] cars. Furthermore, after consistently ordering [redacted] (or zero) cars over a period of 29 weeks, LDC tripled and then doubled its ordering pattern during the two weeks immediately prior to filing this complaint. As described above, the timing of these orders suggests that they were placed simply in an attempt to "bolster" the complaint. If those orders are scaled down to the [redacted] car capacity at Dawson Creek, the total shortfall becomes just [redacted] cars, meaning that over 86% of the cars ordered were delivered. If the excessive orders are removed altogether, then the shortfall is further reduced to just [redacted] cars, meaning that 90% of all cars ordered were delivered.

90. The adequacy of the level of service provided to Dawson Creek is further illustrated when it is compared to other more relevant service benchmarks.

91. Using historical service as a key benchmark, the Application establishes that CN delivered significantly more cars to Dawson Creek during the complaint period than it had in previous crop years. Specifically, Table 3 and Appendix "J" of the Application show that CN delivered a total of [redacted] cars to the Dawson Creek facility during the 2012-2013 year. This figure jumped to [redacted] during the 2013-2014 crop year, an increase of over 18%.

92. The Agency has previously indicated that an increase in rail service is not an absolute defence against level of service complaints. This may be the case in certain limited circumstances, but it remains that a review of the service received by other shippers is essential as it provides necessary context for assessing the level of service to a particular shipper. During that same period, grain exports increased from 36 MMT in 2012-2013 to 42 MMT in 2013-2014, an increase of 16.7%. As such, the number of cars provided by CN to the Dawson Creek facility was consistent with (and, in fact, exceeded) the total increase in the amount of grain being moved during that period. As such, LDC received more than its fair share of the total increase in demand during the 2013-2014 crop year. There is no legitimate reason why the Dawson Creek facility should receive more cars than the rest of the industry.

93. Using service to other shippers as a benchmark, LDC's facilities received [redacted]% of all cars delivered by CN during the complaint period, which represents a significant increase

from its historical market share. The table below provides a summary of CN's car allocation during the complaint period for all grain customers and the respective variations relative to each grain customers' target allocation guideline.

Analysis of CN Shipments against Allocation Guidelines
Week 1 of 2013/14 to Week 11 of 2014/15

Shipper	Allocation Guideline[1]	Actual CN Shipments	Distribution of Shipments	Shipments vs Guideline	No. of Cars Below/Above
[redacted]					
Totals	100%	282537	100%	0%	0

1 Distribution of Shipments in Weeks 8-22 of Crop Year 2012/13

94. As this table demonstrates, LDC received a greater level of service than any other shipper during the complaint period. In total, LDC received [redacted]% of all cars delivered by CN, which is [redacted]% more than its historical market share of [redacted]%. Stated differently, LDC was handed an increase of nearly 60% in its market share during the complaint period – it received an excess of nearly [redacted] cars above CN's allocation guideline. In these circumstances, the suggestion by LDC that it did not receive "adequate and suitable accommodation" flies in the face of reason and common sense.

95. In this respect, in assessing these issues the Agency stated as follows in *LDC #1*:

> While the Agency is, under the CTA, the body responsible for determining whether a railway company has fulfilled its level of service obligations, the Agency may only intervene to remedy a breach of a railway company's level of service obligations when it receives an application. This means that the Agency can only address applications on a case-by-case basis, even though the issues raised in an application may be indicative of system-level problems.
>
> ***As the level of service provisions are remedial on a case-by-case basis, their purpose cannot be achieved, for example, by assessing a railway company's compliance with its level of***

> ***service obligations using a benchmark expressed in relation to its overall average levels of service to all shippers across the network or based on "historical levels"*** when it has been demonstrated that a shipper's needs have not been accommodated. For the Agency to be satisfied that a railway company has not breached its level of service obligations, the railway company must bring before it application-specific evidence of the efforts it has made to furnish adequate and suitable accommodation for the movement of the shipper's traffic or it must provide compelling reasons why the shipper's request cannot be reasonably accommodated.[29]

96. However, in the RIL Decision, the Agency stated as follows:

> While the Agency deals with level of service applications on a case-by-case basis, ***it cannot do so without regard to the overall service obligations that railway companies have to shippers across the rail network***. The Agency recognizes that railway companies have an obligation to all shippers, and that is why rationing was used during the application period, so that all shippers would be treated fairly and equitably in receiving a portion of their actual service demand.
>
> That being said, however fair and equitable a method of rationing is in principle, a railway company may be in breach of its level of service obligations if that method is not implemented fairly and consistently. In this case, RIL received less than its share, ***which would mean that other shippers received cars that should have gone to RIL***. This cannot be invoked by CN as justification for its failure to deliver to RIL its proportionate share of the car supply.[30]

97. With respect, the decisions are contradictory. It is clear that level of service applications are received by the Agency on a case-by-case basis, and that any relief flowing therefrom is similarly limited. However, assessing a railway's service to a particular shipper cannot be undertaken in isolation. The RIL Decision makes it clear that level of service complaints must be viewed by "…assessing a railway company's compliance…using a benchmark expressed in relation to its overall average levels of service to all shippers across the network or based on 'historical levels' …". This is expressly contrary to *LDC #1*.[31]

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[29] At paras. 30-31 [emphasis added].
[30] RIL Decision at paras. 175-176.
[31] See e.g. para. 31.

98. As all of the foregoing demonstrates, it was primarily LDC who received the cars that should have gone to other shippers, such as RIL and VIT. Applying the rationale from the RIL and VIT decisions, LDC should have received fewer cars during the complaint period, not more.

99. The Agency is now well aware of all of the facts and circumstances plaguing rail operations during the 2013-2014 crop year. The Agency also has all of the data demonstrating, with the benefit of hindsight, how all cars were allocated during that period. One may disagree with CN's reasoned allocation decisions, but one cannot escape the fact that this is truly a zero sum game. If the Agency concludes that LDC should have received more cars during the complaint period then it must necessarily determine who among the remaining shippers ought to have received less.

100. LDC will no doubt argue that all of these benchmarks are irrelevant, or that they were dismissed by the Agency in *LDC #1*. However, the Agency's ultimate findings in that decision were based squarely on the particular terms of a confidential contract, which is not in issue in this case. The service benchmarks discussed herein have been cited by the Agency in its previous decisions.[32] They are the most objective and credible basis by which to measure the service provided to a given shipper. They are certainly more objective than relying solely on unconstrained car orders.

101. For all of the foregoing reasons, CN submits that the level of service it provided to LDC at its Dawson Creek facility during the complaint period was more than adequate. The Agency should view this application for what it is: yet another attempt by LDC to increase its market share and obtain a competitive advantage through a regulatory order. That is not the purpose of the level of service provisions of the *CTA*.

D. CN Did Not Breach The Consent Agreement

102. LDC claims that CN has failed to comply with the terms of the Consent Agreement and that such failure constitutes a breach of CN's statutory level of service obligation under the *CTA*.

[32] See e.g. RIL Decision.

103. In its notice of motion dated November 3, 2014, CN applied to dismiss this portion of LDC's complaint on the basis that the Agency does not have jurisdiction to review CN's performance under the Consent Agreement. That agreement is the equivalent of an order of the Competition Tribunal and it is enforceable as such. Therefore, the responsibility for determining and enforcing CN's compliance with the Consent Agreement lies with the Competition Tribunal and/or the Commissioner of Competition, and not with the Agency.

104. In the decision it released in respect of the notice of motion, the Agency agreed that its role is not to enforce the terms of the Consent Agreement. However, the Agency did not agree that its jurisdiction to consider the level of service complaint was completely ousted by the Consent Agreement. Furthermore, the Agency indicated that the service levels established by the Consent Agreement and CN's performance in respect thereof ***may*** be relevant to the determination of whether CN complied with its level of service obligations under the *CTA*.

105. The Consent Agreement was entered into between CN and the Commissioner of Competition when CN acquired BC Rail. As the statement of principle at Article 6.1 indicates, the purpose of the grain commitments set out in the Consent Agreement is to ensure that the grain market in the Peace River Area remains competitive. The purpose is not to ensure a particular level of service vis-à-vis individual shippers. To the contrary, the performance standards in the Consent Agreement are applied system-wide and evaluated on an aggregate as opposed to shipper-by-shipper basis. Those performance standards cannot be used to assess the level of service provided to an individual shipper, nor can they be used to determine whether that level of service complies with the provisions of the *CTA*. Indeed, the Consent Agreement is irrelevant to the application.

106. In any event, CN is not in breach of the Consent Agreement. Article 7.1 of the Consent Agreement states that CN shall only be deemed in breach of its covenants if it fails to perform any covenant ***and*** such default continues for at least sixty days after receiving written notice of default from the Commissioner of Competition. CN has never been provided with any such notice.

107. As to the switching frequency at Dawson Creek, the Consent Agreement requires CN

to provide three switches per week for ***all*** BCOL Grain Shippers at an aggregate level, not for ***each*** shipper at ***each*** of its facilities. Requiring three switches per week to each shipper at each of its facilities would be beyond what is practical and reasonable. The Dawson Creek facility provides a perfect example. LDC lists 12 weeks in which it states that CN failed to provide a minimum of three switches at Dawson Creek. During 1 of the 12 weeks, LDC ordered [redacted] cars. During 9 of the 12 weeks, LDC ordered [redacted] cars, which can be accommodated at Dawson Creek in a single spot.

108. As to the allocation of cars to Canadian Wheat Board zones 7 and 20 as compared to the Benchmark Territory, the Consent Agreement is only directed at evaluating the allocation of cars to each of those zones or territories on an aggregate level. It does not contemplate or require CN to provide the exact number of cars to LDC's Dawson Creek facility as the number provided to each facility in the Benchmark Territory. Furthermore, the "benchmark" presented by LDC is seriously flawed. LDC relies on only two facilities, which does not illustrate the level of service across the entire Benchmark Territory. In fact, the two facilities listed (being LDC's Lyalta and Joffre facilities) were anomalies insofar as they were receiving at the relevant time an additional and unwarranted allocation of cars pursuant to the Interim Order. Finally, the allocation of cars is subject to Force Majeure and, contrary to LDC's assertion, nothing in the Consent Agreement requires CN to give notice of an event of Force Majeure.

109. In summary, the Agency's role is not to interpret, apply, or enforce the terms of the Consent Agreement. CN's performance in respect of that agreement is simply not relevant to assessing the level of service provided to LDC at its Dawson Creek facility. In any event, LDC's Application has failed to establish that CN has violated the terms of the Consent Agreement.

E. New Car Allocation Policy

110. In its Application, LDC also argues that the implementation of CN's 2014-2015 car allocation policy (the "**New Allocation Methodology**") will result in a breach of the level of

service regime.[33] Unlike the balance of the Application, it is clear that this aspect of the complaint is prospective. LDC speculates that it "…will sustain significant damages as a result of the changes set forth…" in the New Allocation Methodology.[34]

111. CN offers two responses to this suggestion.

112. First, the New Allocation Methodology is irrelevant. CN does not rely upon the New Allocation Methodology as a justification for the alleged service failures. As such, its only relevance is in relation to matters that had not occurred when this complaint was filed, and are not spoken to therein. This leads to the second point.

113. A level of service complaint cannot be founded on prospective or theoretical conduct. It is not possible for CN to have a policy, business directive, or management decision that contravenes ss. 113-115 of the *CTA*. The level of service regime ***deals with services***. Thus, the Agency cannot determine that an operations decision, such as the New Allocation Methodology, will result in a breach of CN's common carrier obligations at large and in the abstract.

114. LDC is simply seeking preferential treatment in the form of an exemption from the New Allocation Methodology, without providing any basis for such sweeping relief. LDC advanced the exact same argument under the auspices of another complaint, namely Agency File No. 14-05609. That matter is pending before the Agency. As such, CN incorporates by reference its submissions in that proceeding, dated November 10, 2014 and November 21, 2014, respectively.

115. LDC goes on to refer to exchanges with Mr. Mongeau, CEO of CN.[35] The relevance of this reference is unclear. LDC appears to suggest that CN's alleged failures at the Dawson Creek facility were an attempt to "punish" it for obtaining the LDC Interim Order, by arbitrarily allocating cars away from the Dawson Creek facility to satisfy the order.[36]

[33] Application at para. 57-69.
[34] Application at paras. 63.
[35] Application at paras. 75-78.
[36] See esp. Application at para. 78.

116. This suggestion is completely meritless. The LDC Interim Order related to 2013-2014 crop week 40 through to 2014-2015 crop week 9. LDC's Application indicates that it ordered [redacted] cars to the Dawson Creek facility during this period. CN delivered [redacted].[37] Immediately after the expiry of the LDC Interim Order, LDC tripled its weekly order at Dawson Creek and ordered [redacted] cars.

117. This data hardly suggests that CN, or Mr. Mongeau, attempted to "punish" LDC, as alleged. Rather, it neatly demonstrates LDC's attempts to manipulate the level of service regime to suit its own commercial objectives.

118. LDC's allegations in this respect go beyond zealous advocacy. They are an abuse of process. Accordingly, CN seeks solicitor and client costs on a similar basis to that in Agency File No. 14-05609.

F. Remedy

119. As described above, section 116(4) of the *CTA* gives the Agency broad powers to remedy a breach of a railway company's level of service obligation. In its complaint, LDC requests the following relief from the Agency:

a) An order determining that CN has failed to fulfill its level of service obligations for the receiving carrying and delivering of railcars to and from LDC's elevator facility at Dawson Creek;

b) An order requiring CN to fulfill its level of service obligations to and from Dawson Creek; and

c) An order requiring CN to acquire additional hopper cars, motive power, and personnel as is necessary to fulfill its service obligations to LDC.

120. For the reasons set out above, CN submits that there has been no breach of the level

[37] LDC does not note that, in 2013-2014 week 52, it requested that its 48-car order be diverted to its Rycroft facility.

of service regime in relation to the Dawson Creek facility.

121. However, in the alternative, CN submits that the Agency cannot fashion a remedy: (i) without considering the interrelationship between these proceedings and those related to it which, collectively, implicate significant portions of the grain handling and transportation system; (ii) that requires CN to obtain more capacity in light of the present state of CN's fleet and the facility-specific nature of the Application; or (iii) that deals with LDC's extraneous reference to its intention to seek compensation.

122. Each will be discussed below.

i. The Agency's rulings and remedies must be consistent

123. As outlined above, in addition to this Application, CN is presently before the Agency in a number of dispute proceedings under the level of service regime, namely: (i) *Richardson International Limited v. CN*, Agency File No. 14-03127; (ii) *Viterra Inc. v. CN*, Agency File No. 14-03260; and (iii) *LDC v. CN*, Agency File No. 14-05609. In addition to the foregoing, CN has also obtained leave to appeal in relation to the *LDC #1* decision.

124. Taken collectively, these proceedings implicate significant market sections and participants, as well as those participants' respective rights relating to the overall grain handling and transportation system. However, the Agency's procedural rulings thus far have prevented a consolidated proceeding and an orderly disposition of level of service issues. The parties have, instead, been subject to a series of fractured and inconsistent considerations against the background of the exceptional circumstances presented by the 2013-2014 crop year.

125. The Agency must view these matters holistically and in context, in order to provide consistent outcomes. Clearly, a case-by-case review is inadequate in this respect.

126. There is no breach of the level of service regime to remediate in the present context. However, insofar as the Agency concludes otherwise, CN submits that the Agency cannot administer a remedy in vacuum. Ordering preferential treatment, such as the LDC Interim Order, creates a cascading effect within the logistics chain and precipitates circular

regulatory proceedings.

127. As stated above, the Agency's remedial powers must be exercised in a manner that is commercially fair and reasonable to the parties. Moreover, the remedy cannot go beyond what is necessary in the specific complaint. It must be proportionate. In addition to this, however, CN submits that the Agency's powers must also be employed in a manner consistent with the rights of other system participants.

ii. Sizing the fleet

128. In its Application, LDC also requests that the Agency order CN to acquire more cars, additional motive power, and hire additional personnel.

129. Put simply, an order requiring CN to acquire any of the above-described assets and personnel would be commercially unreasonable and would, as a result, fall outside of the jurisdiction granted to the Agency under s. 112 of the *CTA*. It would also exceed the relief necessary to remedy issues at a facility of the size and nature of Dawson Creek, which is one of 129 elevators serviced by CN in western Canada.

130. CN makes two additional submissions on this point. First, CN currently has the assets and personnel reasonably required to move grain effectively in an average crop year, as well as the surge capacity to move larger amounts of grain as demonstrated in crop year 2013-2014. In this regard, it is important to reiterate that the 2013-2014 crop was not merely above average, but was an extreme and unprecedented outlier event. Second, increasing capacity in order to handle a crop year such as 2013-2014 would be a significant waste of capital resources and would result in inefficiencies throughout the entire grain handling system. CN must reiterate that a slow start by grain companies and an exceptionally brutal winter reduced CN's capabilities. Absent these impediments, CN could have contributed to the movement of at least 45 MMT with the same assets, instead of the 42 MMT that it actually moved.

131. CN's capabilities are also evidenced by its ability to increase its carriage in response to 2013-2014's record-level production. For the 2013-2014 crop year, CN moved 25% more grain than in an average crop year and 13% more than the previous historical record. Based on this ability to substantially increase its movement of grain when required, it is

indisputable that CN has the surge capacity to deal effectively with above-average crop volumes within a statistically-sound range of volatility. Indeed, CN has helped move a record grain export program twice in the five years preceding last year's outlier crop, which ended again with a new all-time grain movement record.

132. The current situation is further evidence of the sufficiency of CN's capacity. CN has enough cars already deployed in service to meet the aggregate demand available to deliver another record export program for Western Canadian grain in crop year 2014-2015. At the present time, the supply chain is in balance, with CN's volume run-rate well above last year's record and its waitlist hovering at less than 2,000 car orders (the equivalent of only a few days of grain movement in all corridors). In short, CN's capacity is well in-sync with that of the overall grain handling system. Indeed, CN has moved 18% more grain to date in 2014-2015 than it had in 2013-2014, an exceptional performance when considering that CN's movement of grain in the latter crop year established a new all-time record.[38]

133. Clearly, CN's current assets are sufficient. The only remaining issue is whether CN should be ordered to increase its assets and personnel such that it would be able to move the amount of grain produced in an outlier year, such as 2013-2014, even faster than the 12 months that it took to clear the backlog and return to a normal carry-out.

134. As previously described, 2013-2014 production was not simply larger than average—it was an exceptional harvest that defied all estimates and statistical predictions. The upward projection trend since 1908 was shattered by the 77 MMT production in 2013-2014.[39] The statistical occurrence of such an event is less than 1%, and is above the 90% interval of +/-10MMT from the trend line. Put differently, the 2013-2014 crop production was 20% higher than even the previous all-time record.[40] As a result, the 2013-2014 crop production was truly an exceptional, outlier event.

135. It would be commercially unreasonable to require CN to acquire and finance

[38] See Appendix "F", "CN Continues record-setting grain movements, remains current in all export and North American corridors".
[39] See Appendix "A", Page 10 of "2013-2014:The 100-Year Crop." November, 2014
[40] See Appendix "A", Page 10 of "2013-2014: The 100-Year Crop." November, 2014

additional resources to accommodate what is clearly an exceptional occurrence in a matter of a few months. In any event, more railcars and locomotives are simply not available in the short-term and it is entirely unclear whether adding hopper cars would lead to an increase in throughput for the grain handling system as a whole.

136. Crop sizes vary significantly from year to year and cannot be accurately predicted, a prime example being crop year 2013-2014. In the same way in which 2013-2014 was an outlier high production year, there will inevitably be years where lower than average production occurs. If assets and resources are stored due to a lesser crop than expected, the railways must solely assume the costs of this unused capacity until the market demand returns. This is a real and significant risk for CN, amplified further by the long term nature of the investments where the average life of a rail car is 30 years.

137. CN's current fleet already includes additional cars that are available for use when demand requires, but which remain idle during slower periods. For example, in the summers of 2012 and 2013, 2,552 and 4,004 cars–accounting for 26% and 41% of CN's fleet respectively-- were sitting idle in reserve. If CN were required to add additional cars, and a crop year of merely average production occurs (as is statistically most likely), hundreds of millions of dollars' worth of assets would be sitting idly in reserve waiting for a bumper crop that may not materialize for decades.[41]

138. Finally, the solution is not as simple as ordering CN to add more cars to its fleet. The capacity of the numerous components of the grain handling and transportation chain must each be aligned in order for the system to work efficiently for all. Each component has a built-in capacity that CN takes into consideration when allocating resources. For example, it would be unproductive for CN to send 8,000 cars a week to a port infrastructure where terminals can only unload 5,500 cars per week. As a result, other participants in the grain handling and transportation chain would also have to significantly increase their own capacity for storage and unloading if rail capacity were increased.

[41]See Appendix "A", Page 25 of "'2013-2014: The 100-Year Crop." CN estimates that if it was ordered to purchase 2,400 railcars combined with an average crop year, that the number of cars sitting in storage would reach 7,000. This would result in $560M of assets sitting idle in reserve.

139. CN believes that the grain supply chain reaches its maximum end-to-end capacity at around 5,500 cars per week on a sustained basis. Indeed, during the summer, when conditions were optimized and all gateways were opened for service, CN brought into Canada 800 excess hopper cars from its U.S. grain fleet and would have been able to move up to 6,000 cars every week. However, supply chain issues caused by other participants limited the throughput to an average of 5,322 cars and no more than 5,700 cars on a few occasions. In the absence of any hard evidence that would suggest otherwise, the 2014 summer indicates that this is the maximum level of cars that the grain logistics chain can accommodate for CN on a sustained basis.[42]

140. These are merely a few examples of how sizing the fleet for an outlier year is not commercially reasonable. The consequences of sizing for an outlier crop would be far-reaching, as many of the cars would simply sit idly in storage during periods of low demand, and during non-outlier crop years.

141. CN indisputably has the rail assets reasonably required to move available grain for export in a timely manner and to stay in sync with the capacity of other participants in the grain supply chain. Forced investment of capital in non-productive assets is not a sound economic approach and would ultimately result in decreased efficiency and level of service to the system at large.

iii. Compensation Order

142. As described above, LDC *does not* request an order pursuant to section 116(4)(c.1) of the *CTA* for compensation. To the contrary, LDC expressly states in the complaint that it intends to file with the Agency a ***separate*** application seeking an order for compensation, and that the evidence necessary to support its claim for compensation will be provided to the Agency in the context of that separate proceeding.

143. Despite this position, LDC goes on to make numerous allegations regarding the costs it claims to have incurred as a result of CN's alleged breach of the level of service obligations

[42] At the industry level, this translates into overall supply chain capacity in the range of 11,000 to 11,500 cars on a sustained basis.

owed to LDC at Dawson Creek (and Rycroft). In particular, LDC claims to have suffered damages in excess of $[redacted]. These alleged damages are said to include vessel demurrage costs, lost opportunity costs, and reputational harm. However, LDC does not substantiate these allegations with any probative evidence.

144. To provide but one example, LDC has attached numerous invoices for vessel demurrage costs. However, it is impossible to determine from those invoices whether the costs relate in any way to the level of service provided by CN at the Dawson Creek facility during the complaint period. On this point, it is extremely telling that LDC has listed a number of the ***very same demurrage costs*** in its previous level of service complaint relating to four facilities ***other than*** the facilities that are the subject of the current complaint.

145. CN applied to the Agency for an order striking those portions of the application, given that: (i) LDC is not requesting a compensation order in the current dispute proceeding and, as such, the allegations regarding costs are irrelevant and improper; (ii) the allegations regarding costs are completely unsubstantiated; and (iii) responding to the allegations regarding costs would cause significant delay and confusion in the conduct of this dispute proceeding.[43]

146. The Agency refused to provide CN with an extension of time for filing this Answer until after the Agency has rendered a decision on the motion to strike. It would be unreasonable to expect CN to provide a response to these allegations in the circumstances, as responding would render the motion entirely moot. CN does not concede that these allegations are relevant in any manner. However, it reserves the right to provide a supplemental response to the impugned portions of the application in the event that they are not struck by the Agency.

V. RELIEF REQUESTED

147. CN respectfully requests that the application be dismissed. CN requests its costs on a solicitor-and-client bases in light of the unfounded allegations raised by LDC in relation to

[43] Being Application paragraphs 79-82 and 93-95 (including Tables 9 and 10, Figure 4, and Appendices V, W, X, and Y referred to therein).

the conduct of CN.

ALL OF WHICH IS RESPECTFULLY SUBMITTED on behalf of Canadian National Railway Company this 10th day of February, 2015.

MacPherson Leslie & Tyerman LLP
1500, 410-22nd Street East
Saskatoon, SK S7K 5T6
Attn.: Douglas Hodson, Q.C.
Ph: (306) 975-7101
Fax: (306) 975-7145

Per: _____
Douglas Hodson, Q.C.

TO: The Secretary
Canadian Transportation Agency

AND TO: Louis Dreyfus Commodities Canada Ltd.
Attention: Forrest C. Hume