CTA Review Submission

Building a Grain Transportation System that is

<u>Fair, Responsive, Efficient, Transparent</u>

December 5, 2014

Approved

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Executive Summary

Fair, Responsive, Efficient, Transparent: these are the things all Canadians have a right to expect from a rail system founded on Canadian resources. This system has a unique duty as one of the bedrocks of the Canadian economy. Particularly since agriculture continues to underpin the rural economy, the success of the railways, handlers, and farmers are intertwined. Shippers of all shapes and sizes need access if we are to protect Canada's reputation as an exporter and grow our markets.

Heading into this year's CTA Review, two things are clear: the system needs to adapt to the increasing growing capacity of Canadian farmers, and the system needs to be able to accommodate small volume crops. Access to markets, including those south of the border, flows through our rail lines. To avoid crises, the next iteration of the CTA needs to provide for more collaboration, clearer consequences, and better rewards.

5 Year Forecast

A major factor that contributed to the 2013/14 crisis was a lack of coordinated foresight. As such, we are proposing that all members of the transportation system, including commodity associations, regularly gather to report capacity and demand forecasts. Combining this data together, the Agency should create a 5 year forecast, including movement target levels for commodity and for corridor movement.

Tiered Response Program

Under normal circumstances, POGA fully supports the fact that rail movement should be managed on a free market basis. However, provisions should be made to reflect potential growth and/or failures in the system.

The levels in the 5 year forecasts would be reviewed annually by the agency to account for change, but a system of responses will be in place to deal with movement levels falling below and rising above the targets. If movement levels are within 10% of the target, car allocation remains open to the market. At 10% below target, car allocation should be handled by a 70% historical, 30% open market hybrid so there is some flexibility to adjust to new markets. At 20% below target, an already appointed arbitrator will step in and handle cases where movement levels have dropped and allocate cars. At 30% below target, the financial penalties similar to those established by the Fair Rail for Grain Farmers Act will be implemented. At the same time, POGA supports the WCWGA's proposal for increasing the railway's revenue entitlement as an incentive to perform 30% above target levels.

Monitoring and Transparency

One of the largest issues in the transportation system is the general unavailability of information. This impedes the ability of stakeholders to predict crisis moments and deal effectively with clients, but also creates an asymmetrical relationship in dispute situations. Particularly, information relevant to commodities dependant on movement across the American border is woefully insufficient. This system flaw must be corrected, while respecting market-sensitive information.

Maximum Revenue Entitlement

POGA joins the choir of voices calling for a costing review be conducted as the foundation for the Maximum Revenue Entitlement system.

Fostering Small Volume Shipments and Producer Cars

POGA believes that Producer Cars are a vital capacity for small volume shippers such as oats, and that a mandate to create boutique or commodity car organizations would both help the system deal with the issue of small volume shipments and be in the proud tradition of Canadian farmers working together. As a part of this mandate, special treatment could be given to filling producer car orders of 10 or more cars to improve efficiency.

Preamble

Canada was built on exports. Dating back to Confederation, Canada has relied on trade to build this country. In 2011, imports and exports accounted for 63.3% of the Canadian economy[1]. The empirical benefits of our trade based economy are plain to see, but there are other advantages as well. Having a large export capability allows Canadian producers to take advantage of economies of scale, resulting in lower prices for Canadian consumers while simultaneously bringing money into the Canadian economy. Competing internationally creates producers that are more efficient. Canada's reputation internationally is that of a country rich with resources, and efficient at producing them for the world. This reputation of being a reliable exporter is dependent on the health of our transportation system, and that reputation is vital to our economic health.

The current CTA Review could not be timelier. The winter of 2013/14 saw a transportation crisis that impeded the growth and credibility of our export economy. Real hardship was experienced by farmers due to the failures in the system. For both producers and consumers of Canadian grain, our transportation system could not be relied upon. Shippers who had placed car orders had no idea when those orders would be fulfilled.

Out of all Canadian exports, more than 50% are reliant on rail, and more than 70% of those exports travel to the United States. As Canada grows, this country needs its rail system to evolve, matching these trends. In 2009, Canadian trade exports were valued at $367 billion USD, 74% of which went to the United States. By 2013, that had increased to $479 billion USD, 75% of which went to the United States[2].

2013/14 displayed a system that has failed to adapt to that growth. 2012-13's grain harvest was considered a once-in-a-lifetime crop, only to be topped by 2013-14's. Canadian oil-by-rail exports are up to over 160,000 barrels per day from under 50,000 in 2012. As Canada's economy continues to grow, its transportation system needs to not only grow alongside it, but improve itself as well. POGA believes that a system that is better at communicating, better at working together, plans for the long term, and has both penalties and incentives will serve Canadians best, while maintaining to be built on the principle of competitive market forces.

POGA believes changes to the system are needed to correct the flaws exposed by the 2013/14 crisis in order to prevent future crises. Changes are needed to manage crises if they do occur, but also to build the best possible system for the years in-between.

POGA is advocating policies not aimed just at improving the situation for oat growers, but to create a transportation system that is more:

- **Fair**
- **Responsive**
- **Efficient**
- **Transparent**

[1] Foreign Affairs, Trade and Development Canada
[2] Imports, exports and trade balance of goods on a balance-of-payments basis, by country or country grouping , Statistics Canada - http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/gblec02a-eng.htm

Oat Movement

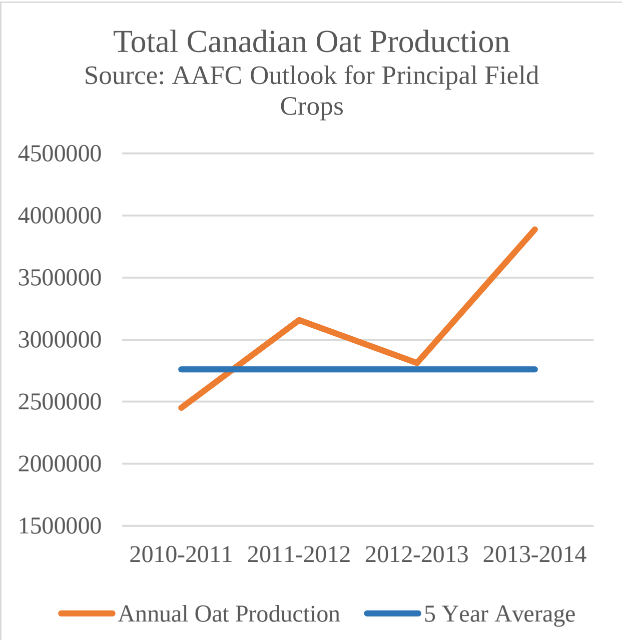
Canada is dependent on trade, and thus on an effective transport system. Canadian oat growers produce more than 2.5 million tonnes of oats annually and ship over half the world's exports of the crop each year. The USA is Canada's largest purchaser of oats, representing over 90% of annual exports.

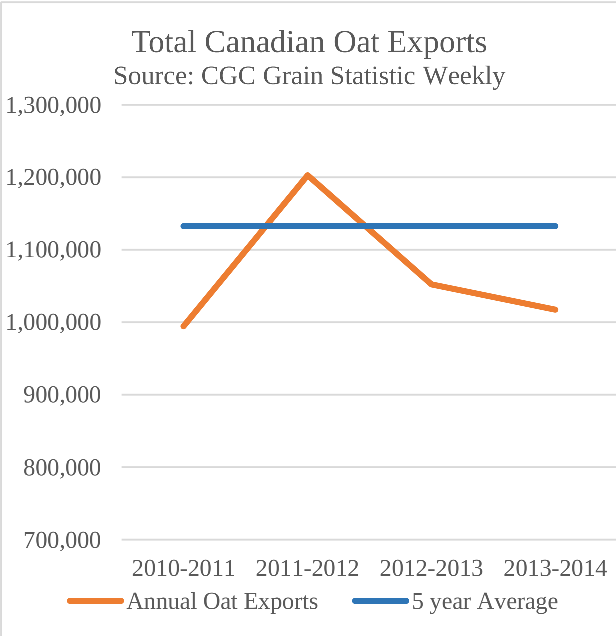
Last year's conditions resulted in the best grain crop Canada has ever seen. The 2013-14 Canadian grain crop, at 90 million tonnes, is 50% higher than average[3]. Oat crops in particular saw their production rise from 2.8 million tonnes to 3.9 million tonnes. As the transportation system was already under stress from last year, an increase of this magnitude is sure to cause problems.

January 1st through February 16th of 2014 saw only 86,000 tonnes of oats exported, compared with 161,300 tonnes from the same period of 2013[4]. The oat sector experienced perhaps the biggest and most serious consequences from the winter's transportation crisis.

Instead of peaking as it usually does, Canadian oats being shipped to the US dropped in August 2013. That month saw less than 100,000 tonnes shipped south, compared to over 250,000 in August of 2012. By the time demand had returned, American purchasing had increased across the entire agriculture sector. Supply from other crops has been occupying rail cars in the system.

The end result is a year with oat exports drastically below its 5 year average, and oat production drastically higher. Canadian grain is sitting in silos because it cannot be moved.

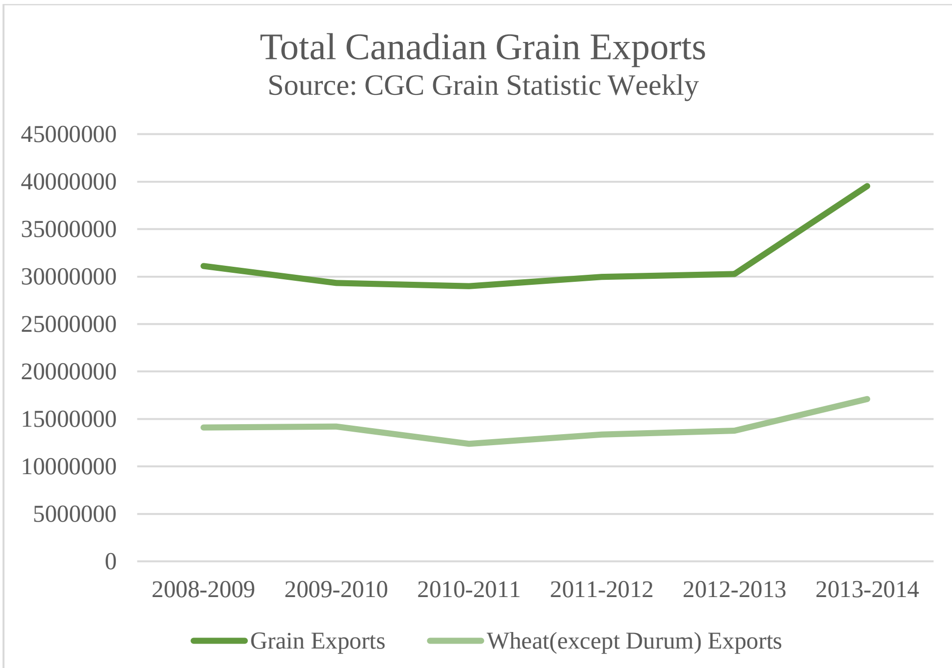




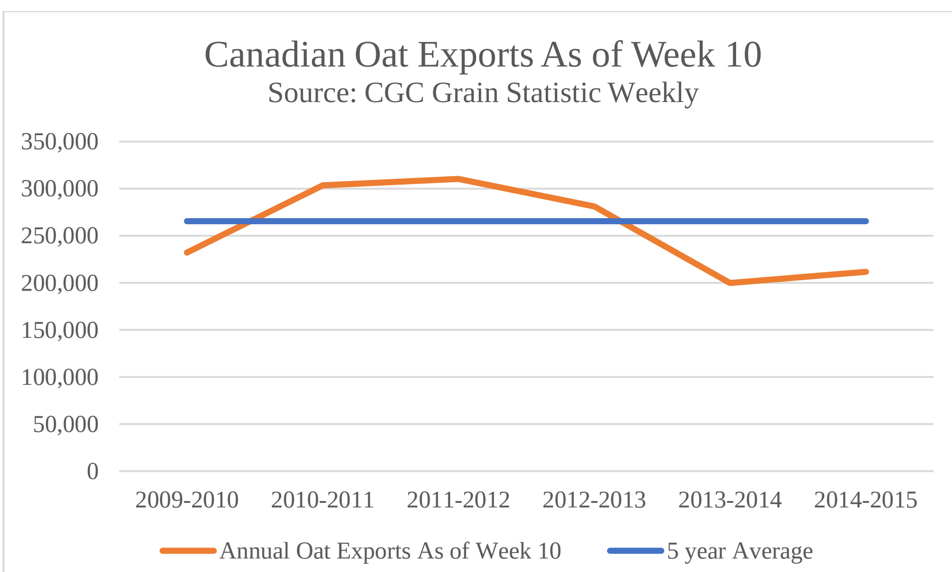
[3] AAFC Outlook for Principle Field Crops, October 17th 2014 - http://www.agr.gc.ca/eng/industry-markets-and-trade/statistics-and-market-information/by-product-sector/crops/crops-market-information-canadian-industry/canada-outlook-for-principal-field-crops/canada-outlook-for-principal-field-crops-2014-10-17/?id=1413899622304

[4] CGC Grain Statistics Weekly - https://www.grainscanada.gc.ca/statistics-statistiques/gsw-shg/gswm-mshg-eng.htm

Smaller volume crops like oats are pushed aside when things get tough. Total Canadian grain exports were up 9 million tonnes against both last year's figure and the 5 year average. The railways and the Canadian Government deserve credit for that increase. Yet productive oat farmers have had record carry-overs.



The flow of oats resumed as the winter thawed, and oat exports have recovered from the worst of the winter, yet have not returned to normal levels.



The damage goes beyond the dire export figures seen during the winter months. Our nation's reputation as a reliable exporter has been tarnished and sales have been lost.

During the winter months, when oat exports had slowed to a trickle, American oat customers went looking elsewhere for solutions. Ships loaded with oats from Sweden supplied our American customers while Canadian oats sat in silos a few hundred kilometres away. Australian oats have supplied Mexican customers.

Though all commodities felt the strain on the system, oats were marginalized in the already competitive space.

It is easy to look at the data and conclude that this year's crisis was a temporary one, which the government's action helped alleviate. This is ignoring the larger issue, and though POGA is greatly appreciative of the government's action, more is needed to prevent this from happening again next winter.

Typically, the quantity of grain remaining at the end of a crop year (carry-out) from one year to the next is 5 million tonnes. This year Canadian farmers face a carry-out of 17.9 million tonnes for grain. A normal year's oat carry-out is somewhere around 500,000 tonnes, but AAFC projects a 1.03 million tonnes carry out for this growing season, with that number projected to stay as high as 600,000 tonnes the year after that.

In its report commissioned by the Paszkowski Canada Transportation Act Review Panel, titled "Description of Canada's Rail Based Freight Logistics System"[5] QGI Consulting said:

> ***Railways, due to the natural barriers to entry of competitors in many of their transportation markets, enjoy a degree of market power and therefore economic regulation of the industry includes a number of shipper protection measures in the Canada Transportation Act (CTA) which are designed to protect shippers from railways unlimited exercise of this power. These measures include: interswitching, final offer arbitration, competitive line rates, and a level of service complaint process. In addition, the CTA requires railways to provide "adequate and suitable accommodation" for traffic offered for movement and requires that traffic be moved "without delay, and with due care and diligence." The adequacy of these shipper protection measures and the ability of railways to use their market power in ways that disadvantage shippers is a major concern of Canadian rail shippers. In 2001, the Canada Transportation Act Review panel (CTAR panel) assessed the level of competition in the Canadian freight rail market. At that time the CTAR panel concluded that Canada's rail system did not seem anti-competitive and that there was no systemic abuse of market power by railways. However, since that time, some of the indicators that the panel used in their determination (railway rates and profitability) have changed such that they may not provide unconditional support to the conclusions on railway market power that were reached in 2001.***

[5] http://www.qgiconsulting.ca/pdf/railbasedfreightlogisticssystemdescription.pdf

5 Year Forecasting

A system as complicated as Canada's transportation system needs to be built on the spirit of cooperation. The number of stakeholders and the demand on the system are going to continue to grow. POGA recommends that the system there allows for consultation between parties, and for that consultation to result in a forecast.

In the regulatory package for the implementation of Bill C-30, the Government outlined mandatory movement levels for the rest of the calendar year past November. These levels were determined internally by the CTA. However, there exists no formal process for such determinations, and the process is not institutionalized. POGA believes that the best way forward is to establish a mechanism to allow for consultations with rail transportation stakeholders to forecast in the long term, even after the minimum movement levels provision is not being utilized.

The next iteration of the CTA should include provisions for such forecasting. Consultations should occur every 5 years, and result in forecasts for targets and capacity. Consultations should include producers, handlers, and railways and be conducted by the Agency itself, reporting jointly to the Ministers of Transportation and Agriculture. They should be transparent and value the input of all stakeholders equally – including non-grain commodities. A 5 year forecast for grain rail movement that does not account for expected oil-by-rail traffic would fail to stabilize the system.

These consultations will result in the creation of 5 year forecasts which establish grain movement targets. **These targets would be set for movement by commodity as well as by corridor.**

Through February of 2014, total grain exports to the US were up, both from last year and against their 5 year average. But the number of oat exports to the US through February was down to a 6 year low. Bumper crops have the ability, as this last year has shown, to shove smaller volume crops out of the picture, resulting in lasting damage to both our international markets as well as our credibility as reliable exporters. All crops are important to Canada, and forecasting needs to capture that.

Growers set ambitious targets for growth – and generally meet them. It is in this spirit that POGA believes targets should be set. Achievable, but ambitious.

The Agency should review the 5 year forecast on an annual basis, and use its own reporting systems and input from the railways, shippers and growers to determine if that forecast is still appropriate. These annual reviews afford the agency the opportunity to respond to short-term changes in the transportation environment, and make corresponding changes to movement targets.

<u>Background</u>

The importance of communication is highlighted in QGI's "Description of Canada's Rail Based Freight Logistics System"[6], commissioned for the 2011 Paszkowski Report:

> ***Ineffective communication processes and a lack of collaboration between system partners can and does lead to problems within the rail system that can affect the operations of both railways and their customers. In the area of communications; railways and their partner stakeholders have a shared interest in the continued development of a railway logistics system that provides accurate planning and operational information to all partners.***
>
> **…**
>
> ***The planning and operational processes of railways and their customers are deeply intertwined. This leads to the need for a high degree of collaboration amongst rail freight supply chain partners and a need for a high level of awareness of each player's capabilities, strategies and limitations. Railway operational processes connect directly to shipper and receiver processes through the movement of shippers' inventory, and through the direct interface of railway crews and equipment at Canada's mines, mills, ports, warehouses, manufacturing plants and through railway intermodal services to all manner of commercial enterprise in Canada. In all of the operations of the system it is a deeply linked process with railway and shipper activities interdependent upon each other for their effectiveness.***

[6] http://www.qgiconsulting.ca/pdf/railbasedfreightlogisticssystemdescription.pdf

Tiered Response Program

The targets established by the 5 year forecasts would not be the same mandatory volume requirements the government established with Bill C-30. Although the establishment of mandatory volume levels should remain an option for the Minister, it is a drastic measure that should only be employed in severe situations such as the winter of 2013/14. However the 5 year forecasts would provide an invaluable opportunity to trigger consequences for non-performance and future legislation should set out methodical and known means to prevent harm to the Canadian economy.

Penalties: In so far as is possible, POGA prefers to see market responses correct the system. Failing to meet these targets will result in measures to return movement levels to their targeted level. POGA proposes as follows:

> **At Target:** In the normal operating environment, car allocation is open to the free market.
>
> **10% Below Target:** When levels fall 10% below their targets, car allocation will be handled by the railways according to a hybrid of historical levels and free market acquisition. 70% of the cars available will be allocated based on historical levels, and the remaining 30% will be free to the open market. This hybrid system will attempt to stabilize movement.
>
> **20% Below Target:** An arbitrator, who has already been appointed and whose authority and mandate is established through the Act, will step in and handle specific cases where levels have dropped. This arbitrator should be able to allocate cars in times of scarcity, as recommended by the 1998 Estey Commission Report[7]. This role could, perhaps, be filled by the Grain Monitor.
>
> **30% Below Target:** Similar to the current mandatory volume requirements, when movement levels fall 30% below the targets, an Order in Council can set financial penalties each week the railways fail to rise above 30% below the target.

Incentives: In February 2014, the Western Canadian Wheat Growers Association proposed the adoption of an Incentive-Based Revenue Cap System[8]. From their proposal:

> ***The Wheat Growers propose an incentive be built into the maximum revenue entitlement to encourage the railways to add extra grain shipping capacity during the peak post-harvest shipping period (i.e. September to January). We propose the revenue entitlement for each railway be adjusted upward if the number of grain cars shipped by the railway during this period exceed a predetermined threshold by a certain percentage. The incentive entitlement***

[7] "In times of scarcity of cars, there may be a need for a standing referee available to the shipper, appointed by the federal Minister of Transport, to hear the complaint and the railway's response and with the overriding power of directing allocation, spotting, and pick up of cars across the prairies." – 1998 Grain Handling and Transportation Review Final Report, honourable Willard Z Estey, CC, QC

[8] http://www.wheatgrowers.ca/images/E0334801/Feb_10_14_WGProposeGrainTransportationSolutions.pdf

could also be designed such that the incentive increases as the amount above threshold increases – in effect, the greater the shipments, the greater the incentive.

POGA supports the implementation of this proposal. POGA believes that a system including the Tiered Response System outlined above should include incentives to mirror the penalty structure, and so the "threshold" in the WCWGA proposal should be set at movement levels rising 30% above the targets.

Background

As in this past winter, there was a major disruption to the flow of grain in the winter of 1996-97. This lead Minister Collenette to call upon the Hon. Willard Estey to review the GHTS.

The 1998 Estey Report[9] stated that

Almost all stakeholders concede that the most complicated segment of this industry is the allocation of hopper cars to shippers as and when required and their recovery in the shortest possible time from the port of export.

The Report went on to make the following recommendation:

Cars supplied by the railways should be allocated on the basis of conditions published by the railways. Notice requesting cars should be given on a timely basis by the shipper, or within a minimum period of notice as set out in the railways' published conditions. The railways should provide special arrangements for longer-term reservation of cars, in which case a prescribed fee may be applied. In times of scarcity of cars, there may be a need for a standing referee available to the shipper, appointed by the federal Minister of Transport, to hear the complaint and the railway's response and with the overriding power of directing allocation, spotting, and pick up of cars across the prairies. This authority should extend to both Board and non-Board car requirements. The disposition of the complaint should be limited, for simplicity and timeliness, to (a) a rejection of the application by the shipper where the railway is found not to be responsible for the unavailability or delay; (b) an order to the railway to obtain such cars as are necessary from leasing companies or like sources, loans from other railways and any other available sources; or (c) where no such cars are reasonably available and the unavailability is attributable to the breach of contract by the railway, an order to the railway to pay reasonable compensation for loss or damage actually incurred by the shipper. Where the shipper and the railway are not able to agree with respect to fees or damages, it is recommended that the dispute be settled according to the Final Offer Arbitration system described herein in Recommendation 9.

Overall, a system that responds to market forces works well. On the issue of car allocation, the 2011 Paszkowski Report makes no formal recommendation.

However, it is clear that the system remains unable to handle logistical crises like those in 1996-97 or 2013-14. The proper allocation of cars when the system is under strain is a major issue for

[9] http://data.tc.gc.ca/archive/eng/policy/report-acg-esteygrainii-phase_ii_final_report-227.htm

the transportation system going forward. The “special arrangement” cited in the Estey Report represents a need for stability.

It is noted that Bill C-30 provides precedents to several of the tiers foreseen.

Bill C-30, as a response to the winter’s transportation crisis, included a change to the Canada Grain Act which permitted the regulation of contracts relating to grain, and arbitration of disputes arising from these contracts. This change establishes the mandate for the 20% Below Target response tier.

Bill C-30 also created the legislate capacity to enforce the 30% Below Target response tier. Though meant to be a temporary measure, the bill establishes that these minimum movement levels may be re-established, and this would be consistent with the proposal for actions when levels fall 30% below the targets.

Monitoring and Transparency

POGA firmly believes that one of the largest contributors to inefficiency in the rail transportation system is a lack of transparency. With the regulatory package for C-30, it was announced that the Transportation Information Regulations would be amended to improve the Government's ability to procure performance data for the rail transportation system. POGA acknowledges the need for the government to improve its own reporting capabilities, particularly the Grain Monitor.

Asymmetry

The current system of access to information is highly asymmetrical. The railways have all of the available information. The CTA has some, shippers have less than that, and producers have virtually none. It’s important to recognize that market sensitive information must remain confidential in the interest of market competitiveness, but producer and handler groups are expected to pursue grievances through service level disputes and other formal adversarial systems. This information gap leads to unequal footing in proceedings that are the mechanism for holding other groups accountable in the system.

Transparency, Timeliness, and Thoroughness

Often performance data available to the public is weeks out of date, incomplete, or extremely difficult to find. When it was announced that CN was facing a fine for failing to meet their mandatory grain movement levels as mandated by Bill C-30, Claude Mongeau, President of CN Railway, defended his company by claiming that there was not enough demand to fill 5,000 railcars in one week[10]. However there is no way for their partners in the value chain to confirm this. Wade Sobkowich of the WGEA claimed that there is still a railcar backlog of 25,000 cars. To have such a large discrepancy about the simple question of demand on the system is indicative of the larger issue.

The 2001 Flemming Report[11] to the CTA Review Panel states that

> ***“the Panel recognizes the paucity of transportation data and the misfit between data collected and changes in the domestic and global economies,” and “better information could be made available, and indeed is available in most developed countries.”***

This reflects a long-standing issue that needs to be addressed.

A transparent and coordinated monitoring system is vital, particularly in a system that involves forecasting, however that system must also provide information that is much timelier than the information available now. Transportation information should be as timely as the Grain Statistics Weekly. Providing information that is months or years behind does not provide any benefit to producers.

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[10] http://www.theglobeandmail.com/report-on-business/cn-fined-for-failing-to-move-enough-grain/article20647807/

[11] 2001 Report of the Canada Transportation Act Review Panel, Brain Flemming - http://publications.gc.ca/collections/Collection/T22-107-2001E.pdf

Information such as up-to-date railcar movement should be made available to the rest of the value chain. The Grain Monitor's report should be made public, particularly shared with shippers and commodity groups. At a minimum, all third party arbitrators should have access to the information to allow for a fair system.

As a step in this direction, The Canada Transportation Agency should collect waybill samples as they are provided in the U.S. and make them available to the public. This is information that producers and shippers in the U.S. have used to much more effectively negotiate fair contracts, including Freight Revenue and Transit Charges[12]. CN and CP are already providing this data to the U.S. Surface Transportation Board for their U.S. and cross-border traffic.

Other data that should be made public includes the Agency Manuals and railway costing inputs.

Commodities and Corridors

A primary desire of commodity groups such as POGA is to see more commodity specific data, as well as destination specific data. Destination specific data is particularly important, above and beyond interchange data, because it provides insights into cycle times.

For a country that is so heavily dependent on trade with the United States, the lack of specific information regarding where our product goes once it crosses the border is astounding. The 2001 Flemming Report[13] stated:

> ***Another deficiency in rail data occurs for Canada-U.S. traffic, where distance is reported only for the domestic leg of a transborder movement.***

For producers reliant on trade with the US, comparative performance information for US destinations is just as, if not more, important as Canadian Terminal Information.

All members of the transportation system - producers, handlers, and railways - need to be equipped with the information they need in order to maximize the system's efficiency.

<u>Background</u>

Currently, the information available on rail transportation is regulated by the Transportation Information Regulations (TIR). These regulations allow for the collection of data on rail movement, collected bi-annually, aggregated on a monthly basis, by commodity, origin, and destination (though in some cases, not specific destination). These regulations have proven time and time again to be woefully insufficient. The complete lack of information on demands means that in disputes with the railways, shippers are not properly capable of making proper cases.

The Order-in-Council in early 2014 included the ability to obtain additional traffic data. This demonstrates that the current TIR regulations are insufficient to meet the needs of both the Government and the shippers in times of crisis. An extensive overhaul of the rail information

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[12] http://www.ctre.iastate.edu/research/bts_wb/cd-rom/freight/rail.htm
[13] 2001 Report of the Canada Transportation Act Review Panel, Brain Flemming - http://publications.gc.ca/collections/Collection/T22-107-2001E.pdf

system is needed to allow for changes in rail demands or capacity to be properly foreseen and reported.

Maximum Revenue Entitlement

POGA, while recognizing its flaws, believes in the Maximum Revenue Entitlement system, often called the "cap". It is an equalizing force in the system. However, POGA believes that some reflection on the system is needed:

Costing Review: A costing review of the revenue cap is long overdue. A review inquiring into the allocation of cost in rail shipping relationships by the government is needed to determine if the revenue cap is creating fair relationships between shippers and the railways. So far, through 2014, grain transportation accounted for 23% of Canadian Pacific's revenue, but only 17% of their carloads.

Background

The 2011 Paszkowski Report noted that stakeholders believe railways are earning excessive revenues from the regulated movement of Canadian grain, and that they propose that a costing review be conducted to bring revenues into line with levels under the former Western Grain Transportation Act. It also states that the cost of shipping has primarily been borne by the shipper. However, the Panel determined that the consideration of the Revenue Cap was outside of its mandate.

The goal of shipping price protection remains a key priority for all shippers, but it is unclear if the present system accomplishes this goal at the expense of the shipper.

From the CTA's backgrounder on the Western Grain Revenue Cap Program[14]:

> ***The revenue cap is a limit on the overall revenue that can be earned by the Canadian National Railway Company (CN) and the Canadian Pacific Railway Company (CP) shipping regulated grain from Prairie elevators or U.S. origins, to terminals in Vancouver, Prince Rupert, Thunder Bay as well as movements of grain up to Thunder Bay or Armstrong, Ontario destined to Eastern Canada or for export. It is based on a formula that can also be described as a limit to the average revenue per tonne for a given length of haul that prescribed railway companies, CN and CP, can earn, adjusted for the level of inflation of railway input prices.***

From the CTA's Q&A: Revenue cap for the transportation of western grain[15].

> ***The revenue cap applies to the movement of western grain by rail.***
>
> ***Movement involves the carriage of grain by a prescribed railway company over a railway line from a point on any line west of Thunder Bay or Armstrong, Ontario, to***
>
> ***1. Thunder Bay or Armstrong, Ontario, or***

[14] https://www.otc-cta.gc.ca/eng/publication/backgrounder-western-grain-revenue-cap-program
[15] http://www.otc-cta.gc.ca/eng/qa-revenue-cap-transportation-western-grain#toc-tm-2

2. Churchill, Manitoba, or a port in British Columbia for export.

It does not include the carriage of grain to a port in British Columbia for export to the United States for consumption in that country.

Note: Churchill-bound movements

Churchill is an eligible western grain destination. However, the Churchill-bound movements do not currently qualify to be included under the Revenue Cap Program because the CTA requires the carriage of western grain to be by a "prescribed railway company" and the only railway company at Chruchill "involved in the movement of western grain" (or) "that performs western grain movements" is Hudson Bay Railway Company, which is not a prescribed railway company.

Grain includes any grain or crop included in Schedule II (or any product of those grains or crops) that is grown:

- ***in the Western Division***
- ***outside Canada and imported into Canada for export through a Canadian port.***

Below is a table showing the proportion of revenue and carloads that Grain accounts for both Canadian National and Canadian Pacific.

Canadian Pacific Railway:

	Grain Revenue (as % of total)	Grain Revenue Ton-Miles (as % of total	Carloads of Grain (as % of total)
1st Quarter 2014	23%	26%	17%
2nd Quarter 2014	22%	25%	18%
3rd Quarter 2014	22%	24%	16%
January-September 2014	23%	25%	17%

Canadian National Railway:

	Grain and Fertilizer Revenue (as % of total)	Grain and Fertilizer Revenue Ton-Miles (as % of total	Carloads of Grain and Fertilizer (as % of total)
1st Quarter 2014	16%	21%	10%
2nd Quarter 2014	18%	23%	12%
3rd Quarter 2014	17%	21%	11%
January-September 2014	17%	22%	11%

Service Level Agreements

In the continued spirit of an open and fair market, there exists a need for oversight to ensure that complaints against parties can be addressed in an appropriate manner. In an NRG Research Group survey, only 17% of respondent shippers rated their satisfaction with Rail service at a 6 or a 7, using a one to seven scale, with seven being very satisfied. 62% of shippers reported financial consequences as a result of poor performance[16]. There is a strong need for the ability of shippers to seek solutions to problems raised during their interaction with the railways.

In order to effectively address issues that occur in the fulfillment of service level agreements, the complaint mechanism must allow not only for shippers to seek arbitration efficiently and fairly, but also allow for each party to be on equal footing.

During the passage of Bill C-52, the Coalition of Railways Shippers made several recommendations, which POGA supports:

> ***The CRS is proposing six amendments to Bill C-52 that will strengthen it and make it more likely to effectively re-balance the commercial relationship. The recommendations are detailed in our written submission, which has been provided to the Committee. A brief introduction to each of the six recommendations follows.***
>
> ***1. Definition of "adequate and suitable accommodation" and "service obligations". Amendments are being proposed to Sections 115 and 115.1 of the Canada Transportation Act to define those terms.***
>
> ***2. In proposed section 169.31 of the Act, the wording "operational term" would eliminate other non-rate items from being addressed in a Service Agreement. The CRS recommends striking out the word "operational" before the word "term" throughout proposed section 169.31.***
>
> ***3. A shipper would not be allowed to request a mechanism for a determination of a breach of a service agreement and the consequences flowing from such a breach. The CRS recommends a modification to proposed section 169.31 (1) (b) to include the right to such a mechanism***
>
> ***4. Section 120.1 of the Act provides the right for shippers to file complaints against a railway for penalty or ancillary charges where such charges are published in a tariff "that applies to more than one shipper". The CRS recommends striking out the words "that applies to more than one shipper" so that this provision could be used to public tariffs that apply to only one shipper.***
>
> ***5. The introductory words to s.169.37 make it possible that an arbitrator would allow a consideration of items raised by a railway company that a shipper did not include in its submission. It allows a railway company to require one or more conditions to provide the service in relation to a shipper requirement, thereby making the railway's service obligations***

[16] Freight Rail Service Review, Final Report, page 16

conditional. The CRS recommends amending s. 169.37 (1) to allow the shipper to frame the matter(s) in dispute.

6. Current section 169.37(d) - (f) of the bill raises the status of the railway company's network as a mandatory consideration for the arbitrator. The requirement that an arbitrator consider these network effects erodes the most basic service obligations of a carrier under a contract because an arbitrator would be compelled to examine whether the railway company's commitments in that contract are hindered by network effects, including obligations to other shippers. If the effects on a carrier's network prevail over the shipper's needs, the railway's service obligations under s.113 of the Act will be eroded. The CRS recommends striking sections 169.37(d) – (f) from C-52.

POGA also recommends establishing an expanded multi-party Final Offer Arbitration process, including full confidentiality and commonality of issues.

<u>Background</u>

Any mechanism granted for producers or shippers to settle disputes with the railways is inherently grounded in the legislation that grants that mechanism. Therefore, the language used in this legislation must be as clear as possible for the mechanism to function properly.

Section 115 of the CTA reads:

For the purposes of subsection 113(1) or 114(1), adequate and suitable accommodation includes reasonable facilities

(a) for the junction of private sidings or private spurs with a railway owned or operated by a company referred to in that subsection; and

(b) for receiving, carrying and delivering traffic on and from private sidings or private spurs and placing cars and moving them on and from those private sidings or private spurs.

There is currently no definition of adequate and suitable. This definition, be it formed through precedent, regulation, or provision, will be vital to the future of service level agreements and the arbitration of disputes resulting from them in the grain transportation industry.

In its submission to the Paszkowski Panel[17], the Canadian Canola Growers Association stated:

The Canada Transportation Act states that the railways must provide 'adequate and suitable accommodation' of traffic. The vagueness of this definition makes it difficult for either side to prove or defend their case in a Level of Service complaint. As a result, this complaint process tends to be long and drawn out, and requires extensive time and money to follow it through to completion as the parties must prove their case in the context of this loose definition of service. The investment required in launching a Level of Service complaint is a significant deterrent for many shippers to utilize this tool provided in the act.

[17] http://www.tc.gc.ca/media/documents/policy/TP_15042_Final_Report_EN_WEB.pdf

The Panel's report would go on to view that bilateral approaches in service agreements, along with a more effective dispute resolution process were more appropriate mechanisms to address issues with Level of Service obligations.

The WGEA and other groups have proposed that the definition be set as

> ***a railway company shall fulfill its service obligations in a manner that meets the rail transportation needs of the shipper[18].***

This was furthered during passage of C-52 when the Coalition of Railway Shippers, made the following comments[19]:

> ***The CRS has identified several areas where the bill can be strengthened in a way that will minimize uncertainty, give more explicit guidance to arbitrators, and limit the opportunity for railways to mount legal challenges designed to frustrate the intent of Parliament, delay decisions and lead shippers, both large and small, into expensive legal battles. The Competitive Line Rates provision (s.129–136) of the current Act is an example of a competitive provision that has been rendered ineffective by railway actions. The intent of the CRS proposed adjustments is to prevent this from happening to Bill C-52.***

[18] http://www.parl.gc.ca/HousePublications/Publication.aspx?Language=E&Mode=1&DocId=6033388
[19] http://www.ggc-pgc.ca/docs/2013-02-26-CRSCommentsandRecommendationsTransportComm.pdf

Fostering Small Volume Shipments and Producer Cars

Small volume shipments are an important aspect of grain transportation in Canada and should be stated in the Act. Crops that were once specialty are now a major part of the crop mix that supports Canadian grain. Tracking movement not only by corridor, but by commodity as well, and ensuring that there is reasonable ability to target movement to a broad array of customers is vital to the improvement of the grain transportation system.

The majority of producer car controls fall under the Canada Grain Act and not the Canada Transportation Act, however POGA believes that given the general mandate of the review, producer cars are a major issue worthy of the panel's attention.

Producer Car Organization

For small commodities such as oats, this past winter's crisis showed that in the current transportation environment, the dangers of reduced rail capacity are not limited merely to a reduced level of flow from Canadian farms, but also the very real possibility of damage to oat export markets. American oat customers mere hundreds of kilometres away from silos full of oats in Saskatchewan and Manitoba had to turn to Sweden and Australia to fulfill their demand. The stability and security of our export abilities is now a very real concern. The Estey Commission Report[20] foreshadowed solutions:

> ***"There have been at least two occasions in the past year [1998] where farmers have banded together, on branch lines and otherwise, to collectively fill up to 80 cars in one session… Indeed, at least one group of producers has informally organized an operating group of delivering grain to market in this way."***

The report looks favourably upon this action, and for small commodities such as oats, an ongoing option to have such a function would be a good way to not just recover more costs for the farmer, but perhaps primarily ensure that the flow of such commodities is never diminished to the levels of crisis seen this past winter.

As such POGA advocates the establishment and sanction of boutique or commodity producer car operations. Priority should be given to filling producer car orders of 10 or more cars at one destination at one time, which would also improve efficiency for the railways. This could include the creation of producer organizations whose purpose it is to organize the effective operation of producer cars for one commodity exclusively, and an added capacity for shippers to introduce private cars into the system, be they producer organizations or others.

[20] http://data.tc.gc.ca/archive/eng/policy/report-acg-esteygrainii-phase_ii_final_report-227.htm

Arbitration

POGA also believes that the system should allow for the standard dispute settlement protocols in the producer car systems. The CGC website[21] currently states that:

> ***You are primarily responsible for settling any disputes that you may have with:***
>
> - ***The railway (contact the railway directly or the Canadian Transportation Agency)***
> - ***The elevator that receives your grain***
> - ***The buyer of your grain***

This dispute resolution process unfairly increases the requirements on producers that would seek to use producer cars, and increases the burden of producers who are already at a disadvantage in dispute situations. POGA recommends that the CGC create an arbitrator specifically assigned to producer car shipments for orders of 50 cars and below. This, along with several other recommendations, represents an overall need for an increased arbitration capacity.

An arbitration process would have the ability to direct service to crops and corridors that are underserviced.

Farmers have historically been rewarded for banding together in Canada. It is clear that producer cars are not the only solution to our transportation issues. However, they are a strong check on the system, one which not only provides market stability and flexibility for producers in times of crisis, but an immensely important tool for smaller volume commodities such as oats.

Trucking

During crises, smaller commodities relied on an already over-worked trucking system. Trucking was a vital outlet that should be recognized as such. As an example, during the 2013-14 crisis, there was a 250,000 tonne gap between the projected level of oat exports and the normal level of oat exports. This gap represents 10,000 truckloads of one grain commodity alone. The trucking system, while a valued option for grain farmers, cannot be relied upon to make up these massive deficits resulting from crises of this nature. Where needed, extension of road limits and support for trucking programs may be options.

<u>Background</u>

The 2013-14 crisis showed that producer cars are a much needed option for producers faced with a transportation system that is unable to handle a crisis. Over 20,000 producer car orders were placed in the 2013-14 season, compared with the previous modern era record of over 14,000 set in 2011-12, and the average from 2004-05 to 2012-13 of 12,411 orders[22].

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[21] http://www.grainscanada.gc.ca/services-services/cars-wagons/pcm-mwp-eng.htm

[22] Canada Grain Commission

Presently, the CGC is the primary point of contact for the procurement of Producer Cars. From the AAFC[23]:

> ***Grain producers have two options in obtaining a producer car. They can deal with the CGC directly and self-administer their cars, which includes arranging credit for shipping charges with rail companies and paying freight costs; or they can employ the services of an administrator who will perform these tasks and forward the completed producer car application to the CGC on behalf of the producer.***

The system is subject to the annual order, and the producer car order for 2014-15 is as follows[24]:

1. ***Pursuant to sub-sections 87(1) and 87(2) of the Canada Grain Act, R.S.C. 1985 as amended, the Canadian Grain Commission (the Commission) orders that the allocation of producer railway cars be subject to the following terms and conditions:***

2. ***The number of producers who may load a single producer car is limited to five. One of the five shall be designated as the principal producer, and act as the administrator for documentation and communication;***

3. ***The Commission shall, in each week, allocate available railway cars, as determined by the railways, for carriage of grain to a terminal elevator, process elevator, or to a consignee at a destination other than an elevator to:***

    a. ***applications for railway cars for the shipment of all types of grain to all destinations, in the order in which such applications are received, provided that the applicant has demonstrated to the Commission's satisfaction that the grain to be shipped is committed to a confirmed sale and that the railway cars are required to be allocated in that week in order to fulfill the commitment;***

4. ***In any shipping week, for which there are applications for more railway cars than are available for allocation under paragraph 2, applicants shall be allocated railway cars having regard to meeting the objectives of the orderly management of sales contract requirements and the orderly movement of grain.***

5. ***No producer shall load any grain to a railway car, allocated as set out above, containing visible excreta from vertebral column animals including deer, antelope, elk or moose.***

6. ***Any producer loading grain to a railcar, allocated as set out above, shall abide by Order No. 2014-02, Railway Car Fumigation Declaration.***

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23 http://www.agr.gc.ca/eng/industry-markets-and-trade/statistics-and-market-information/by-product-sector/crops/initiatives-supporting-producers/grain-handling-and-transportation-system-producer-cars/?id=1323989251887

24 http://www.grainscanada.gc.ca/legislation-legislation/orders-arretes/general/cars-wagons-eng.htm

Interswitching

Distance

POGA believes the move, by regulation, to 160 km for interswitching is a positive step for our industry, and that it will create more competition in the marketplace. This change will increase the number of elevators able to utilize interswitching from 48 to 261. POGA also supports the extension of this provision to all commodity shippers.

POGA encourages continued monitoring of interswitching and for the Agency to create a resource to help facilitate the negotiation of interswitching arrangements.

Competitive Line Rates Provision

POGA supports the Coalition of Railway Shippers' request to strengthen the competitiveness of the system by dropping sections 129-136 (The Competitive Line Rates provision). The provision is disused, and its intended purpose could be fulfilled with the extension of the Bill C-30 interswitching distance change to all parts of the country.

Background

For Background on Interswitching, refer to Appendix A.

Other Legislative Changes

Infrastructure

This past winter should incite the government to bring a renewed interest in updating and upgrading the infrastructure behind the Canadian railway system. A call for renewed interest in rail infrastructure is needed from this panel, alongside several regulatory changes to allow the system to function more efficiently.

POGA believes that the current standard for the Rail Line Discontinuance requirements are too weak. Producers reliant on rail lines that fall below the current standard for traffic movement are unduly punished for the railways' desire to cut costs. Railways that seek to close lines can affect the traffic levels of those lines to create the conditions to allow for their closure, regardless of their utility to the system. The requirements should include an economic impact on communities affected report, which should be assessed by the agency.

POGA also believes that the hours of operation in major ports such as Vancouver and Montreal should be increased.

Another infrastructure change that the panel should examine is the option of twinning rail lines through National Parks. Though the national parks are among Canada's greatest treasures, and should be protected, the government deemed twinning the Trans-Canada Highway through Banff and Yoho National Parks to allow for more road traffic an acceptable option.

The possibility of twinning rail lines, particularly the Jasper line to allow for greater port access for the North Central Prairie region, should be examined and is based on improvements to existing rail infrastructure. It would be a step in the direction of growing our transportation capacity to match our country's growing production.

APPENDIX A: Interswitching Internationally

Key Highlights:

- In Canada and the United States, the policies give primacy to full cost recovery for its private railway owners; in order to improve economies of traffic density and coordination.
- The Canadian freight network is geared toward export and resource development, while the majority of freight hauled by U.S. railroads, like intermodal, is for internal consumption.
- Other than in the UK, European regimes do not seek anything approaching full cost recovery and are maintained by public subsidy.
- The benefits of mandated access, like in Australia, therefore arise from the difference between the additional benefits and the offsetting costs. Positive net benefits are less likely when the freight market is small and where transaction and coordination costs are likely to be substantial.
- Poorly-structured charges in Britain, under the Railtrack regime, led to under-investment in infrastructure and over-use of track. However, a performance incentive scheme in the British rail network, which (in contrast to Australia) is complex and has numerous train operators, has proved costly and ineffective.

United States

In July 2011, the National Industrial Transportation League set forth a proposal to the Surface Transportation Board of the U.S. requesting that new rules be established regarding switching of freight between Class I railroads on request from captive shippers, if certain conditions were met.

At present, reciprocal switching is not allowed due to the existing competitive access rules which prohibit competing railroads to access each other's' private networks. Reciprocal switching would require open access to private networks between the two switching railroads at the point of interchange. The railroads would charge a "switching fee" and perhaps an additional charge to compensate for the revenue loss.

The motive behind the proposal is to allow captive shippers to benefit from facilities provided by other railroads and also to increase competition within the railroad industry, so that freight rates might decline.

The League is asking the STB to eliminate existing competitive access rules and precedents as they apply to reciprocal switching and replace them with the following conditions:

- the shipper's or receiver's facilities for which switching is sought are served by only one Class I rail carrier;

- there is no effective inter- or intramodal competition for the rail movements;
- there is (or can be) a "working interchange" between a Class I rail carrier and another Class I within a "reasonable distance" of the shipper's facilities; and
- the proposal states that a competitive switching agreement shall not be imposed if either rail carrier can establish that the arrangement is not feasible, or unsafe or, that it would unduly hamper the ability of either carrier to serve its shippers

On March 25, 2014, the Surface Transportation Board again held a hearing regarding the proposal where the National Industrial Transportation League presented a report claiming that once implemented, the "Reciprocal Switching" would lead to a cost saving of $900 million to $1.2 billion for captive shippers. At the hearing, CSX, a leading railroad company in the eastern U.S., and the Association of American Railroads, argued that the loss arising from the proposal far outweigh the benefits. Citing 2010 data from the STB, AAR officials explained that an annual revenue loss of up to $7.8 billion could result from rate reductions NITL is advocating for the benefit of a select group of shippers.

Using 2010 statistics, NITL estimates the rule change would allow shippers to annually switch only 1.44 million carloads, or 4.6 percent of total annual carload traffic, and result in $900 million in annual transportation savings. Only shippers that were charged by the "landlord" railroad a transport rate equal to or greater than 240 percent of the revenue-to-variable transport cost or that provide more than 75 percent of their volume to the carrier would be guaranteed reciprocal switching, according to the NIT League proposal.

The Association of American Railroads, however, warned that the entire rail network would be slowed because of increased handling through switching, and the U.S. railroad industry would lose some $7.9 billion in annual net income, or about 13 percent of U.S. railroads' total net income. The Association of American Railroads (AAR) considers that this could lead in United States Class I railroads losing revenue up to 80 percent of their entire capital budgets. And without this income, they said the freight rail industry could no longer invest in maintenance and infrastructure. It has been reported[25] that, since 2000, freight railroads have invested more than $110 billion in privately financed capital improvements to their networks. On top of the revenue impacts, the AAR said that mandatory switching can also lead to local service disruptions, degraded rail service throughout the system, and a decline in rail productivity.

Reference to Canada

The AAR rejected the NIT League position that Canada's more-than-100-year-old experience of limited mandatory switching shows the idea could work in the U.S. Having the rule in place for so long has allowed CN and CP to operate and invest in their networks accordingly, as recently

[25] http://www.logisticsmgmt.com/article/stb_railroad_competitive_switching_hearing_kicks_off_today

highlighted by Phil Ireland, a former CP executive who spoke on behalf of AAR. Forcing U.S. carriers to do the same in a much shorter time frame could cause major strain on the network.26

The populations and markets that the U.S. and Canadian railroads serve are also vastly different, he said. The Canadian population is one-ninth that of the U.S. and has half a dozen major cities, compared to the roughly 50 in the U.S.

USDA Position

In a letter dated April 2011, Edward Avalos, Under Secretary of Marketing & Regulatory Programs of USDA, supported the petition of the NIT League. He noted that reciprocal switching charges typically exceed $500 per railcar but have a variable cost of approximately $100 per railcar, making it uneconomical for shippers to interchange with another railroad.

Mr. Avalos concluded in a report submitted on May, 2013 that: "Competitive switching offers a market based solution to balance the needs of railroads and shippers" and suggested that the threshold for eligibility for agriculture shippers be lowered to a R/VC ratio of 180 per cent from a R V/C ratio of 240 per cent.

Rates

There are no official rates or regulations, and every railway company has the liberty of the establishment of the switching tariffs.

To name one example, Union Pacific ended the Bilateral Switching Agreement with BNSF Railways, explaining that the charges are no longer compensatory for the services provided by UP. The current per car reciprocal switching rates for BNSF effective November 1, 2013, are as follows[27]:

Category/Commodity	New Rate
Non-grain	$295
Manifest Grain (less than 50 cars)	$295
Trainload Grain (50 cars or greater)	$105

[26] http://www.forbes.com/sites/greatspeculations/2014/04/02/reciprocal-switching-may-negatively-impact-railroads-by-eating-into-revenues/
[27] http://www.uprr.com/customers/shortline/recipswitch.shtml

In 2005, rates increased by 7%, the greatest increase in 20 years[28]. Some shippers claimed their rates for individual movements rose more than 100%.

STB regulations provide various options if a shipper believes its rates are unreasonable, in the past 46 shipper complaints filed with the STB since 1996, 37 of the complaints were decided in favour of shippers or settled through commercial negotiations[29].

<u>Australia</u>

Australia is in the vanguard of countries that have adopted mandated access policy. The solution centers on increasing competition among railroads by requiring open access to rail lines. This would allow multiple operators to offer rail services to shippers over the same infrastructure, which in turn would spur innovation, increase productivity, and lower costs. These outcomes would lead to market share gains for the rail industry.

Europe and Australia encouraged railroads to vertically unbundle their operations into above and below rail businesses. In some jurisdictions, the below rail assets have been transferred to a separate infrastructure company; in others, the railroad has remained a single corporate entity, but "ring fenced" the management of the infrastructure functions to provide arms- length and unbiased service to its own above rail operating unit and any other operator that wants to use the line.

Most Australian pricing regimes, by contrast, are market-based (ie pricing according to 'what the market will bear'). Prices are usually negotiated within a wide floor-ceiling band, where the floor price reflects the incremental cost of the access and the ceiling is based on the full economic cost of the relevant infrastructure provision.

<u>Europe</u>

European infrastructure managers have adopted highly transparent cost-based pricing, with charges published; negotiation is generally limited to discussion on train timing.

In some countries, notably in Scandinavia, access charges (with structural separation of trains from track) have been introduced to improve allocative efficiency. The separation of infrastructure costs from train operating costs facilitates cross-modal (road–rail) cost transparency. Charges have been based on marginal social costs. Note that this policy has complemented productive efficiency objectives in these countries, through competitive access.

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[28] General Accounting Office, Freight Railroads: Updated Information on Rates and Other Industry Trends, Washington: 2007 - http://www.gao.gov/assets/100/95145.html
Davidson, Paul. "Freight railroad customers complain about prices, service", USA Today. 27 Sep. 2007 - http://usatoday30.usatoday.com/money/industries/2007-09-26-railroads_N.htm
[29] http://www.joc.com/regulation-policy/transportation-regulations/us-transportation-regulations/canada-us-rail-proposals-could-lower-prices-hurt-service_20140331.html

We should note, however, that North American railways differ from most railway networks elsewhere in the world. First traffic is more freight than passengers, secondly, the volume of (freight) traffic over long distances enables a high level of rail capacity, to the extent that a degree of competing rail infrastructure routes is offered on the major transport corridors.

United Kingdom

Until recently, Railtrack's charges were structured with a high 'entry' fee and a low 'usage' fee. Thus, once an operator paid the entry fee, the additional costs of running extra trains was very low. Conversely, this meant that the track provider received little additional revenue and thus had little incentive to invest. The consequence was over-use of the track but, against rapidly rising traffic, there was little new investment.

Other countries

Railways in Mexico, Japan, Argentina and New Zealand were privatised in the early 1990s. All four systems were kept vertically-integrated but, in the case of the first three railways, the rail networks were horizontally separated into regional-based systems[30].

Sources:

http://www.ctrf.ca/conferences/2012Calgary/Presentations/Cairns2012ctrfpresentation.pdf

http://www.bitre.gov.au/publications/2003/files/report_109.pdf

[30] http://www.bitre.gov.au/publications/2003/files/report_109.pdf