

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

233893

Ex Parte No. 711

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March 1, 2013
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Public Record

**PETITION FOR RULEMAKING TO
ADOPT REVISED COMPETITIVE SWITCHING RULES**

**COMMENTS OF
HIGHROAD CONSULTING, LTD.**

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March 1, 2013

My name is Sandra Dearden, I am President of Highroad Consulting, Ltd. (Highroad), a transportation and logistics consulting firm headquartered in Chicago, IL. I represent the interest of numerous clients that are rail customers, including Diversified CPC International, Inc. and Roanoke Cement Company. Both have filed statements into this proceeding.

My transportation career spans more than thirty (30) years. I started my career in the railroad industry at Illinois Central Railroad as a secretary. During the ten years at IC, I had a series of promotions; my last position was Pricing Administrator, which was the second level pricing position, in the Metals & Machinery pricing group.

I accepted a position as Assistant Rates Manager for Non-Metallic Minerals with Chicago & North Western Transportation Company in 1979. Within a short time, I was reassigned to coal, and later was promoted to Market Manager - Chemicals. Subsequently, I was promoted to General Manager - Sales & Marketing for the Agricultural Commodities strategic business unit.

In that role, I worked extensively with the Canadian railroads and shippers in Canada. I was instrumental in the development of the unit train distribution system for shipments of Canadian potash to destinations in the United States, and one of my customers was the first to apply for inter-switching under the new regulated inter-switching rules in Canada.

Following UP's acquisition of North Western, I stayed on with Union Pacific through the end of the year and Highroad was launched in July 1996. Our clients

include railroads, purchasers of transportation service, law firms, 3rd party logistics companies and other consulting firms that sub-contract rail projects to our firm.

The experiences I have had working for three Class I railroads, and as a professional consultant, I believe allows me to bring a unique perspective to this proceeding.

BACKGROUND

The NITL proposal provides that competitive switching by a Class I railroad would be mandatory if four conditions are met:

- (1) A shipper or group of shippers is served by a single railroad.
- (2) There is no effective intermodal or intramodal competition (the railroad handles 75% or more of freight volumes) and the RVC on the rail traffic is 240% or higher.
- (3) There is or can be a working interchange within a reasonable distance (30 miles) of the shipper's facility.
- (4) Switching is safe and feasible with no adverse effect on existing service.

In the Board's decision to initiate this proceeding, they posed some broad questions regarding the impact this will have on industry. The purpose of this document is to respond to those questions, and to offer some suggestions to

establish procedures that will be simple so competitive switching is an option for small *and* large shippers.

This statement will focus on the following questions posed by the Board:

1. Impact on rates and service for shippers that would qualify under the competitive switching proposal.
2. Potential impact on rates and service for captive shippers that would not qualify under this proposal.
3. Impact on the railroad industry, including its financial condition and network efficiencies or inefficiencies, including the potential for increased traffic.
4. An access pricing proposal.
5. What would happen if STB modified NITL's proposal, such as changing the 30-mile limit, or the RVC used for conclusive presumption in favor of competitive access relief, or using some other method (vs. the 240% RVC) such as a carrier's 4-year average RSAM benchmark?

THE POTENTIAL IMPACT ON RATES AND SERVICE

1. For shippers that would qualify under the competitive switching proposal –

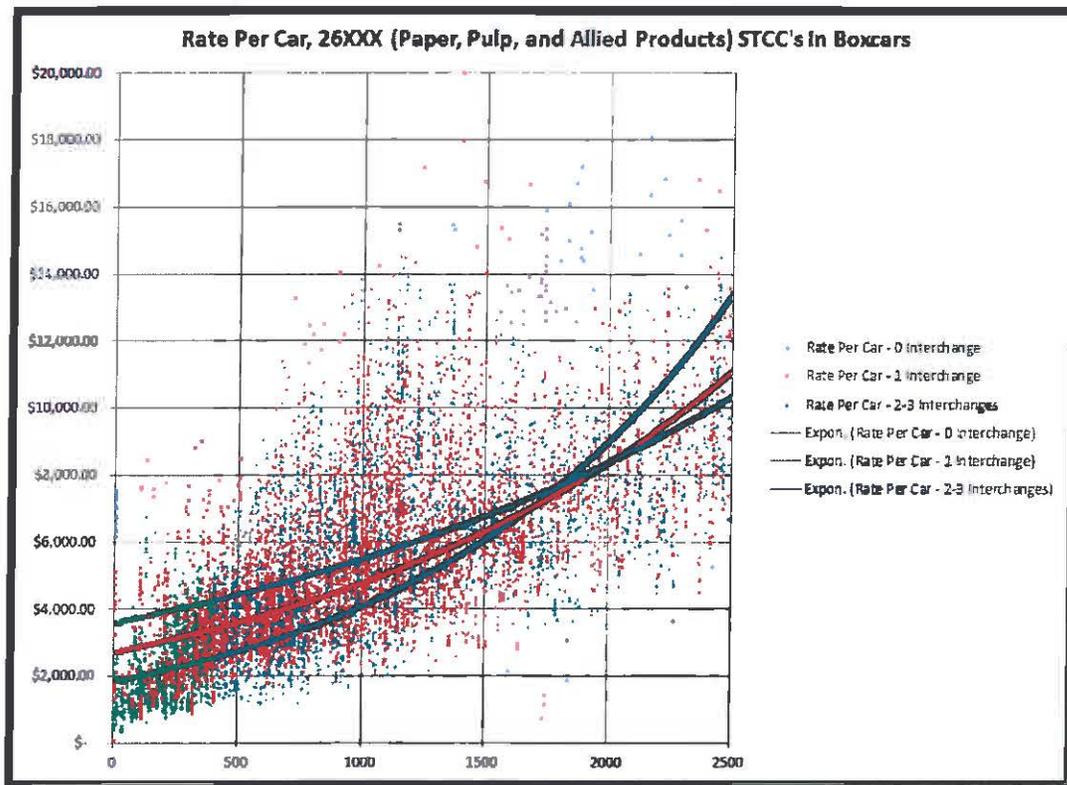
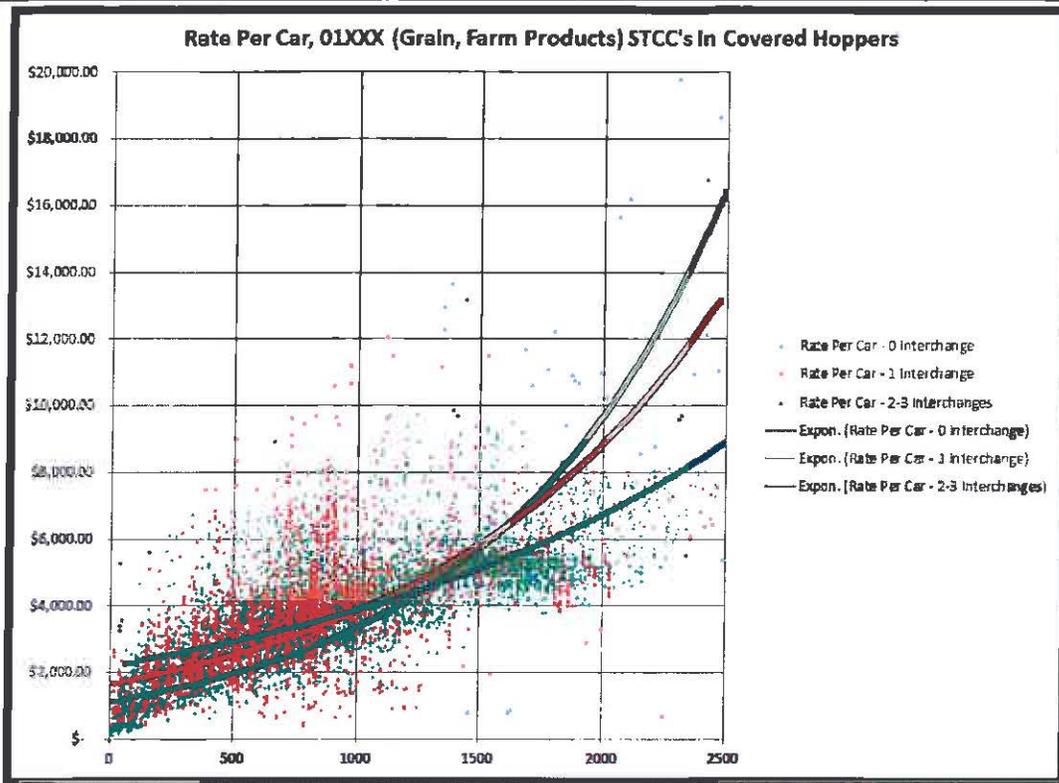
One of the services we provide to clients is VIEWPOINT™, an analytical process to benchmark truck and rail rates. One of the benchmarks we consider for rail benchmarking studies are rates developed in a regression analysis for each lane. Records selected from the Public Use Waybill File for the regression analysis include those for shipments of the same commodity, that have similar shipment

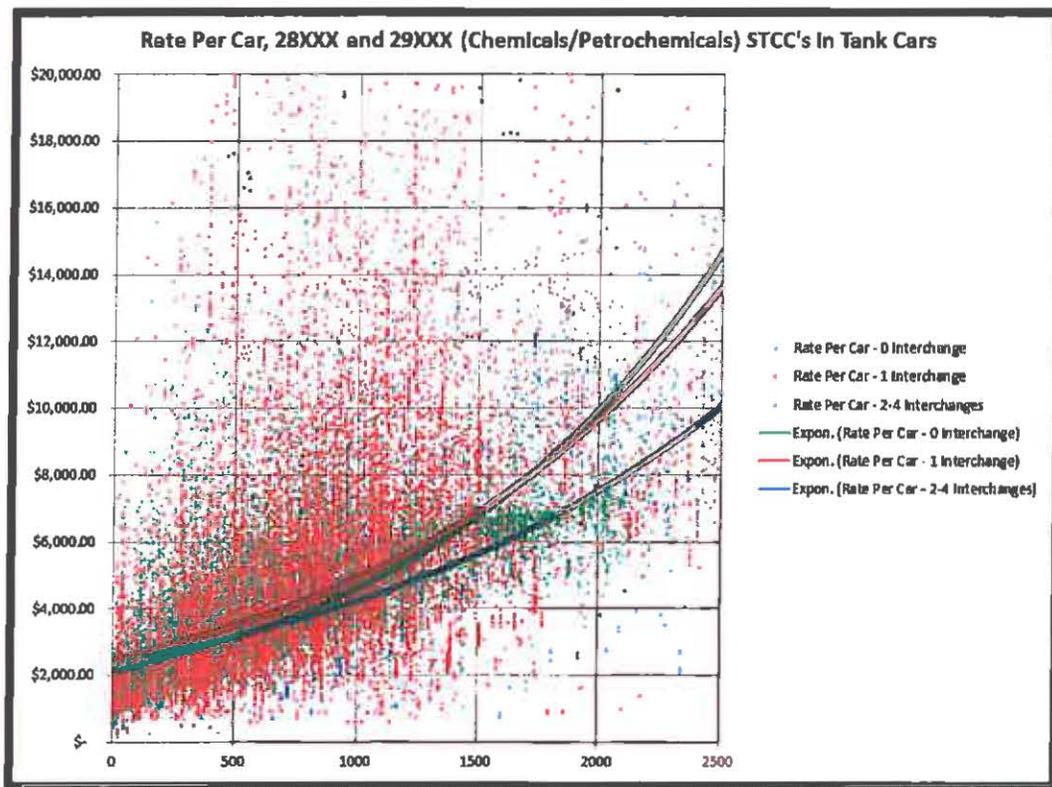
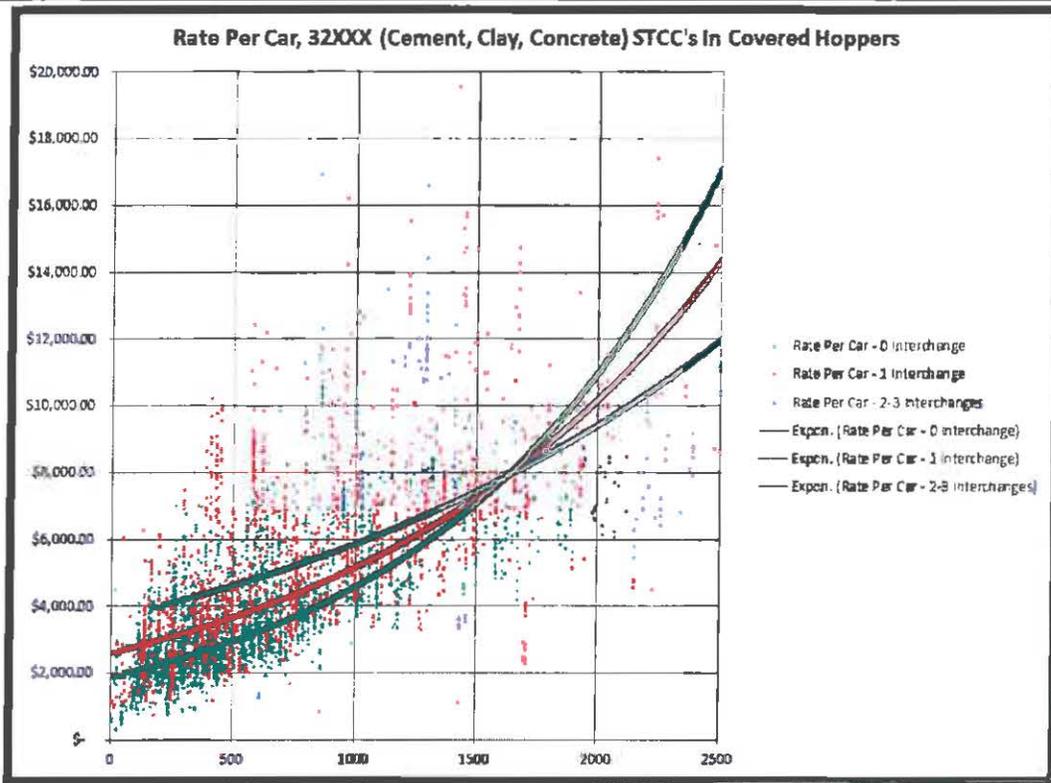
characteristics, including distance, shipment size, car type, car ownership, and number of interchanges in the route. In every case, rates developed in the regression analysis for single line moves are higher than those that are joint line moves of two or more railroads.

To illustrate the effect this has on rail rates, we developed regression graphs for four commodity groups:

- STCC 01 – Grain and Farm Products
- STCC 26 – Paper, Pulp and Allied Products
- STCC 32 – Cement, Clay and Concrete
- STCC 28 – Chemicals

As seen in the charts below, the common trend is that, on a per-car basis, single-line moves are on average significantly higher than moves with more than one carrier for distances greater than roughly 1600-1700 miles, depending on the commodity. Above that threshold, adding more carriers tends to decrease the average rate per car. Notably, in STCC's 28 and 29, rates decline when three or more carriers are involved in a move beyond 500 miles.





We acknowledge that some single line moves are from or to stations that may be jointly served or open to reciprocal switching, but that simply means the impact on rates for captive moves is even greater than shown on the regression graphs.

The other question posed by the Board, is what the potential impact would be on rail service. I do not foresee any negative impact on rail service and it is likely that the efficiency of rail operations will improve.

Highroad manages rail transportation for one of our clients, Diversified CPC International (Diversified). Diversified has a distribution terminal in Ajax, ON which is served by Canadian National Railroad; however, Canadian Pacific Railway also has access to the terminal through inter-switching. Diversified also has a manufacturing plant at Sparta, NJ, which is served by New York Susquehanna & Western Railway (NYSW). Sparta is in the Conrail *shared asset* territory, so NYSW connects with Norfolk Southern and CSXT. The railroads provide good service, and rail service for shipments to and from Ajax and Sparta has been consistent and the only delays have been weather related.

Finally, rail service in Canada has actually improved since regulated inter-switching was enacted. This topic is addressed in detail in a report prepared by one of our consultants, Neil Thurston. Mr. Thurston's curriculum vitae and report are attached to this statement.

2. For captive rail shippers that would not qualify under this proposal –

The Board is asking if we should be concerned that carrier(s) might charge remaining captive customers more to make up for lost traffic.

First of all, we should not necessarily assume that the railroads will lose traffic and revenues as a result of new competitive switching rules. As presented in Mr. Thurston's report, Canadian carriers have continued to increase business under regulated inter-switching.

Further, there are opportunities for carriers to secure additional business if rates are market competitive. An example is one of Diversified's plants that is currently served by a single rail carrier, shipped only one rail car in 2011 – the remainder of the outbound shipments moved via truck. This plant was established to serve customers in the region but rail rates have been so high that shipments moved by truck and shipments to one high volume receiver moved rail from another Diversified CPC plant that is 835 miles more distant.

In 2012, we finally convinced the railroad to work with us on the rates so rail can become a viable option. Assuming we will succeed, the railroad will secure increased volumes and revenues.

My career with the railroads spanned more than twenty-five (25) years. During that time when I was responsible for marketing and business development for Class I railroads, I cannot remember a time when we had a strategy meeting to shift revenue responsibility to shippers left behind. Instead, we were focused on

increasing business, not penalizing customers because they are captive and which could have resulted in lost business. I do not believe that this should be a valid concern. I know the railroads can be tough at times, but it has been our experience that railroad officials have integrity and I doubt that this would be a consideration.

In ICC Ex Parte No. 347 (Sub-No. 1) *Coal Rate Guidelines*, the Commission adopted "Constrained Market Pricing" (CMP) to serve as guidelines for determining the reasonableness of rail captive coal rates. The decision issued August 8, 1985, the Commission stated, "a captive coal shipper should not be required to pay more than is necessary for the rail carrier(s) involved to earn adequate revenues. Nor should it pay more than is necessary for efficient service. A captive coal shipper should not bear the costs of any facilities or services from which it derives no benefit..." (underscore for emphasis).

This topic has been reviewed numerous times since and CMP has been applied to other regulated commodities. However, the argument of cost shift from one group of shippers to another is no longer relevant, because railroads are now pricing to market and not cost, and revenue levels are so far above costs that a slight shift in costs would probably not be a consideration.

Potential Impact on the Rail Industry

First of all, if we develop an estimate based on the Canadian experience, the number of rail customers in the U.S. that will request competitive switching will be

minor. In Canada, the number of cars that are inter-switched is less than 4%.¹ While the number of cars inter-switched increased significantly over a 19-year time span, the growth came about as a result of improved operating efficiencies in the collective switching operations.

Railroad Operations professionals have experience managing operations at locations that are served by more than one carrier, and locations that are open to reciprocal switching. During my tenure at North Western, I attended the daily "morning meeting". Participants included senior management, including the CEO, COO and others, and all of the line managers on the system through a teleconferencing system. The purpose of the morning meetings was to address the problems of the day, and the primary focus was on maintaining efficient operations and achieving performance standards. Numerous customers served by North Western had facilities open to reciprocal switching and they received the same attention and quality of service as closed industries.

The railroad industry has responded to change positively in the past. They are innovative and accomplished at identifying opportunities to improve the efficiency of operations and to grow their businesses. We should not expect less here.

There are a number of areas that present opportunity for the railroads to increase business. Business that could be secured with market competitive rates, that is moving by other modes or from alternative origins, is low hanging fruit that

¹ The number has fluctuated between 2.5% and 4%. See Thurston report Section 3.1, pp 18.

is currently available. Other growth opportunities that could develop if competitive switching is established include:

- Diversion of traffic from transload operations to direct rail. Some shippers have established transload operations near their plants, giving them the ability to access additional carrier(s). If the business is diverted to direct rail, the rail carrier that secures the business could realize increased revenues that previously covered the costs of trucking to the transload and transfer costs. While transload operations have become very efficient, product degradation and product shrink occurs for some commodities. For those commodities, the shippers and the railroads will benefit if the business moves rail direct.

Finally, diverting traffic from a transload to direct rail will help to address driver shortages. In a study released by the American Trucking Association (ATA) in November 2012, they reported that 90% of for-hire truckload (TL) carriers said they cannot find enough drivers who are capable of meeting Department of Transportation (DOT) requirements. The current shortage of drivers is estimated to be in the 20,000 to 25,000 range which is deemed as significant. However, ATA estimates that at the current trends, the shortage could balloon to as much as 239,000 by 2022.²

- Some shippers that are served by a single railroad, lose business because of inadequate car supply. When business is lost, this is also business lost by the railroad. If a shipper is served by more than one railroad, or if they can access a second carrier through competitive switching, the shipper will not be

² Truck Driver Shortage Update, American Trucking Association, November 2012

dependent on one railroad for car supply and increased volumes will move on rail.

- Increased carloads and revenues for short line railroads. While a customer may not have access to a second Class I railroad because the second carrier is not within the proposed 30-mile limit, a short line railroad that connects with a second Class I railroad may be within the established limit.

As mentioned above, the railroads are innovative; no doubt they will identify additional opportunities to increase business if competitive switching is established. These are only a few examples.

Access Pricing Proposal

This is a complex question that may not be resolved in this initial proceeding. However, we could open discussion by reviewing the format of the pricing schedule that is in place for inter-switching in Canada.

Agency Prescribed 2004 Interswitching Rates

Inter-switching Distance Zones	Rates per car for interswitching a block of less than 60 cars			Rates per car for interswitching a block of 60 or more cars		
	Current 1997 Rates (\$)	New Rates (\$)	Variation (%)	Current 1997 Rates (\$)	New Rates (\$)	Variation (%)
Zone 1	210.00	185.00	-11.9	65.00	50.00	-23.1
Zone 2	230.00	200.00	-13.0	70.00	60.00	-14.3
Zone 3	275.00	240.00	-12.7	90.00	75.00	-16.7
Zone 4	365.00	315.00	-13.7	105.00	90.00	-14.3
Rate per kilometre	4.20	3.75	-10.7	1.60	1.45	-9.4

Agency Proposed 2012 Interswitching Rates

Inter-switching Distance Zones	Rates per car for interswitching a block of less than 60 cars			Rates per car for interswitching a block of 60 or more cars		
	Current 2004 Rates (\$)	Proposed Rates (\$)	Variation (%)	Current 2004 Rates (\$)	Proposed Rates (\$)	Variation (%)
Zone 1	185.00	229	23.8	50	46	-8.0
Zone 2	200.00	248	24.0	60	55	-8.3
Zone 3	240.00	284	18.3	75	65	-13.3
Zone 4	315.00	251	20.3	90	74	-17.8
Rate per kilometre	3.75	3.38	9.9	1.45	1.20	-17.2

As you can see, the table provides rates for four distance zones; rates for blocks of less than 60 cars, and rates for a block of 60 or more cars. It is important to note that the prescribed rates are maximum rates. When Bill C-8 received Royal Assent on February 29, 2008, the new changes affecting rail transportation dealt primarily with shipper protection provisions, which included clarification that the Agency be allowed to prescribe maximum rates for regulated inter-switching, thereby allowing parties to agree to lower rates for inter-switching.

The advantage of this pricing methodology is it is simple and easy to use. Parties are not required to perform complex analyses to develop switch charges and everyone knows what to expect.

On the other hand, reciprocal switch charges in the United States are not consistent. Some are relatively low, most are considered fair, but others are very high and it is obvious the intent is to eliminate competition.

Decisions for pricing reciprocal switching are typically strategic in nature but the customers do not have any input or control over those decisions. I know of several instances where serving railroads have terminated reciprocal switching agreements without notice, thereby eliminating competition.

During my tenure at North Western, when another carrier would apply an aggressive increase on a switch charge (which eliminated North Western as a competitor) we would determine if our company was a net seller or purchaser of reciprocal switching to that carrier before deciding if we would be forced to accept the increase, or if we could retaliate by increasing switch charges against that carrier at other locations. Shippers feel the negative impact under both scenarios as the increased costs can price their facility out of business.

Whatever the pricing method, there are a number of factors to consider including railroad costs (switching minutes can vary depending on geography, e.g., metropolitan vs. rural areas). Costs can also be impacted by number of cars switched, car ownership, frequency of service (per diem), and loading/unloading times. Also, costs should be compensatory but the level of compensation needs to be established.

Development of an access pricing model should involve in-depth analysis and careful consideration to confirm that the objectives set forth by the Board are met. It is our recommendation that a special committee be assigned to this task, with representatives of parties that will be affected.

Potential Modification of the NITL Proposal

The Board has asked what would happen if the STB modified the NITL proposal, such as changing the 30-mile limit, or the RVC used for conclusive presumption in favor of competitive access relief, or using some other method (vs. the 240% RVC) such as a carrier's 4-year average RSAM benchmark.

The 30-mile limit. Of the lanes that we analyzed for clients for this proceeding, all except one were within the 30-mile limit (the one exception was 42.1 miles). However, that location is the client's only production plant; if the client does not have potential access to a second carrier at origin, then all of their rail shipments will continue to be captive. We request that the Board consider changing the limit to 45 miles. Also, the rules should be clear, regarding existing interchanges, potential new interchanges, what is practical or not practical, so the rules are not open to interpretation.

The 240% RVC. We are not in favor of rules that will require customers to prove market dominance, or for the rates to be higher than a designated benchmark, whether a RVC or RSAM benchmark. The objective should be to establish procedures that are simple and easy to implement, that do not unnecessarily inflate costs for consultants and attorneys, so competitive switching will be a practical option for large *and* small shippers. This will be discussed in more detail in the next section, The Canadian Model.

However, if the Board elects to include in the new rules and procedures calculation of a regulatory benchmark, the benchmark should be fair to all parties. The problem with URCS continues to exist; URCS needs to be updated or replaced as it produces costs that are not accurate and the costs are over-stated. On the other hand, RSAM could produce even higher benchmarks, so neither option is ideal.

If those are the only two options, we would be in favor of a RVC benchmark, but the regulatory threshold should be consistent with that in place for other STB proceedings, i.e., 180%.

The Canadian Model

Knowing the inter-switching rules in Canada have been successful, I asked one of our consultants, Neil Thurston, to prepare a report and to produce evidence so we can show the positive changes that have occurred since regulated inter-switching was established Canada. Mr. Thurston's report is attached to this statement.

The Board of Railway Commissioners in 1918 ruled that inter-switching is a "*right*" not a "*privilege*". Since that time, inter-switching has been reviewed and regulations updated and the Canadian Transport Agency's (CTA) first set of regulated inter-switching rates were approved on December 17, 1987. They were subsequently revised on February 16, 1989 to add rates for blocks of 60 or more cars.

The rates were revised again on November 20, 1997 and the CTA determined “the continued regulation of inter-switching rates was integral to the competitive access provisions of the CTA, and any reduction in protection.... would be contrary to the National Transportation Policy.” No other changes were made other than adjusting rates based on costs.

In 2002, a cost analysis indicated costs for each category of inter-switching had decreased significantly from 1997 levels (ranging from -13% to -16.7%).

During the time period, 1988 - 2007, less than 4% of rail cars were inter-switched in Canada, fluctuating between 2.5% and 4.1%. In a June 2001 report, a panel indicated that almost 40% of Canadian rail tonnage in 1999 had access to direct rail competition under expanded inter-switching limit to 30 kilometers, yet traffic actually inter-switched is relatively minor (less than 4% annually).

The number of cars inter-switched between 1988 and 2007 increased from 131,982 to 279,900 cars , with the biggest increase in Zone 4. The growth in Zone 4 was attributed to improved operating efficiencies in the collective switching operations (61% of cars inter-switched in Zone 4 moved in blocks of 60 or more cars.) Inter-switching in Canada is deemed a resounding success. CN and CP freight revenues, net income, and traffic handlings increased while service improved.³ The table below shows the efficiency gains achieved by Canadian National and Canadian Pacific between 1995 and 2012.

³ Quotes from Mr. Claude Mongeau, Executive Vice President and Chief Financial Officer, who later became President and CEO of Canadian National; and Mr. Clifford MacKay, President of the Railway Association of Canada, Thurston report, pp. 21

CN, CP Efficiency Gains⁴
(Operating Ratios and Employee Productivity)

	CN	CN	CN	CP	CP	CP
	Operating ratio (%)	GTMs/Employee (000)	GTMs/Gal (US)	Operating ratio (%)	GTMs/Employee (000)	GTMs/Gal (US)
2012	62.9	16,354	987	83.3	17,400	879
2011	63.5	15,572	973	81.3	17,500	847
2010	63.6	15,533	959	77.6	17,491	855
2009	67.3	13,981	931	81.1	15,381	840
2008	65.9	14,975	893	78.6	15,182	820
2007	63.6	15,539	887	75.3	16,014	826
2006	61.8	15,977	880	75.4	15,424	833
2005	63.8	15,414	851	77.2	14,719	847
2004	66.9	14,811	851	79.8	14,727	833
2003	69.8	14,246	838	79.8	13,759	833
2002	76.0	13,329	838	76.6	12,895	800
2001	68.5	12,964	837	77.3	12,431	794
2000	69.6	12,831	845	76.9	11,729	769
1999	72.0	11,684	832	78.2	10,031	725
1998	75.1	10,542	773	79.2		
1997	78.4			81.4		
1996	85.0			83.0		
1995	89.0					

The issues addressed by the regulators in Canada are not unlike those that have been addressed in STB Ex Parte 705, *Competition in the Railroad Industry*, and those that are being addressed by the STB in this proceeding, i.e., what steps should the Board take to increase rail-to-rail competition?

The Canadian model is very interesting from the standpoint that it is very simple, yet it was proved to be successful when addressing a national issue. Access

⁴ **Source:** CN and CP Annual Reports and 4th quarter financial statements

to competition is automatic and inter-switching is considered a right, not a privilege.

If the objective is to simply address the need to enhance competition, and we acknowledge the success of the Canadian model, why should we not consider similar rules and methodology for pricing competitive switching in the U.S.?

Rail customers in Canada are not required to prove market dominance or prove rates exceed a regulatory benchmark; they do not have to prove anything. They simply have access to competition if they need it.

Our industry continues to be challenged when addressing the standards and rules for small rate cases. The expense associated with litigating a "*small rate case*" are high and filing a small rate case is not a practical option for small or even medium size shippers.

We should consider the experience with small rate case procedures when developing new rules for competitive switching. The new rules should be simple and easy to implement, so shippers are not required to incur unnecessary costs for attorneys and consultants to file for competitive switching. By doing so, this will be an option that will be a practical solution for small shippers and will not be limited only to corporations with large budgets.

Conclusion

There is a need to address competition in the rail industry. If new competitive switching rules are adopted, rail customers will have access to competition if needed. Analysis has proven that facilities served by a single carrier

have higher rates. The experience with regulated inter-switching in Canada indicates that competitive switching is a practical solution to inadequate competition in the United States.

If we develop an estimate based on the Canadian experience, the number of rail customers in the U.S. that will request competitive switching will be minor.

We do not believe competitive switching will have a negative impact on the efficiency of rail operations and service. Railroads are currently providing quality service to industries that are open to reciprocal switching, and railroads in Canada have improved the efficiency of operations since regulated inter-switching was put into effect.

We should not expect to see a shift of costs to captive shippers that will not have access to the new rules. The argument of cost shift from one group of shippers to another is no longer relevant, because railroads are now pricing to market and not cost, and revenue levels are so far above costs that a minor shift in costs would only be a minor consideration.

Reciprocal switching charges in the United States are not consistent. Customers do not have input into potential changes in the rates, and they have no control over the charges for serving their facility. Carriers can and do price reciprocal switch charges, and they have terminated reciprocal switching agreements, to eliminate competition. The Board should have jurisdiction over decisions to terminate existing reciprocal switching agreements.

The Access Pricing Model should be developed based on analysis, and possibly by a special committee with representatives of the stakeholders.

We support the proposed 30-mile limit; however, the rules should be clear, however, regarding existing interchanges, potential new interchanges, what is practical or not practical, so the rules are not open to interpretation.

We are not in favor of rules that would require customers to prove market dominance or to prove that the rates exceed a regulatory benchmark. However, if the Board elects to include in the new rules and procedures calculation of a regulatory benchmark, the benchmark should be fair to all parties. If the only options are a RVC or RSAM benchmark, we would be in favor of a RVC benchmark, but the regulatory threshold should be consistent with that in place for other STB proceedings, i.e., 180%.

Assuming the objective is to address the lack of competition in the rail industry and simply to establish competition, we request that the Board consider regulated inter-switching in Canada as a model for similar rules and procedures to be established in the United States. Rail customers should not be required to prove market dominance or prove rates exceed some regulatory benchmark based on designated RVC's, RSAM, or other calculation. The new rules should take into consideration the impact rail rates can have on the future of manufacturing operations and jobs in the United States. The objective should be to establish procedures that do not unnecessarily inflate costs for consultants and attorneys, so competitive switching will be a practical option for large *and* small shippers.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Sandra J. Dearden". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

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CURRICULUM VITAE

NEIL G. THURSTON Executive Consultant Highroad Consulting, Ltd.

OVERVIEW

Well-rounded professional with extensive senior management and analytical experience in the rail transportation business, including economic, financial, policy, legislative and regulatory matters affecting rail freight service, gained from increasingly responsible positions in private industry and the federal government.

Strong management skills with exceptional attention to detail and deadlines to ensure quality deliverables within budget and schedule.

Strong leadership with technical competence and effective interpersonal, written and oral communication skills.

Strong experience in directing secretariats in support of unique reviews of rail freight issues.

Experience in and knowledge of current employment, management, ethics, and access to information policies and procedures in the Public Service of Canada.

POST RETIREMENT

Transport Canada

Executive Director, Rail Freight Service Review Secretariat – June 2009-December 2010

Transport Canada

Strategic Advisor, Surface Policy Directorate – November 2008 - June 2009

EMPLOYMENT

CANADIAN TRANSPORTATION AGENCY and its Predecessors

Director, Rail Economics Directorate – 2000-2006

Director, Costing Rates and Payments Directorate – 1992-1997

Director, Rail Rationalization Directorate – 1989-1992

Manager, Rail Rate Complaints & Investigations- 1988-1989

Senior Research Economist – 1982-1988

TRANSPORT CANADA

Acting Director, Rail Policy Branch – 1999

Director, Kroeger Grain Review Implementation - 1999

Director, Western Grain Review Secretariat - 1998

Advisor, Office of Economic Regulatory Reform – 1985-1987

SULTRAN LTD.

Transportation Planning Analyst – 1980-1982

CAREER HIGHLIGHTS

Rail Freight Service Review, Transport Canada

- Responsible for managing and directing all facets of the Secretariat support function to the Rail Freight Service Review Panel appointed by the Minister including: budget development and administration; accommodations; communications' plans; industry consultation planning; Panel orientation and advice; conducting research and analysis; and, providing support for the draft and final Panel reports.
- Developed and implemented a management plan for the Ministerial appointment of a Panel to review the quality of railway freight service in Canada including the development of the Panel's terms of reference, panel selection criteria, Secretariat establishment, and research and analysis requirements.

Canadian Transportation Agency and its predecessors

- Directed the management of the Canadian Transportation Agency's statutory rail economic and rail rationalization program responsibilities including the determination of railway revenue caps for the movement of western grain, rail costing, freight rate setting, financial and economic analysis and monitoring activities, and assessment of railway abandonment and conveyance applications under various regulatory instruments governing federally-regulated railways.
- Ensured equitable federal compensation to railway companies for the movement of western Canadian export grain and for imposed public duties in operating uneconomic rail lines while protecting the disbursement of public funds totaling upwards of \$700 million annually.
- Managed the National Transportation Agency's rail rate and service dispute resolution program responsibilities by providing technical expertise on issue analysis, decision writing and industry communications of Agency decisions on complaint matters.
- Provided expert advice and technical expertise in the Government of Canada's defense of the economic regulatory provisions governing the export movement of Canadian western grain before the World Trade Organization hearings into the matter.
- Recognized formally by industry representatives for initiative and integrity in the delivery of the Agency's rail economic regulatory responsibilities.
- Appeared as a witness before various Parliamentary and Senate committees on rail transportation matters and provided program delivery results to industry executives, government officials and public forums.

Transport Canada

- Directed the management of Transport Canada's Rail Policy Branch including:
 - the development of departmental positions on complex policy initiatives affecting railway transportation in Canada;
 - the negotiation of a \$2.1 million railway annual operating subsidy for Algoma Central Railway.

- Directed the management of the Kroeger Review in support of the former Arthur Kroeger who was appointed by the Minister and given the task of seeking a consensus among grain handling and transportation industry stakeholders on the implementation of Justice Estey's recommendations stemming from the Grain Review.
- Directed the management of the Grain Review Secretariat in support of the former Chief Justice Willard Estey who was appointed by the Minister of Transport to review the policies governing western grain rail transportation and to make appropriate recommendations for change.
- Provided technical expertise as part of the Minister's Office of Economic Regulatory Reform for the implementation of policy proposals for the economic regulatory reform of rail transportation.
- Consulted widely with interested and affected parties in developing legislative changes and provided technical expertise during the passage of the National Transportation Act through Parliament.

Sultran Ltd.

- Developed and assisted in the negotiation of rail rate and service arrangements for the movement of sulphur products from Alberta gas plants to export locations by CN and CP.
- Designed, developed and implemented all facets of a management information system for the operation and maintenance of Sultran-owned rail equipment.

EDUCATION

- Bachelor of Science – Mathematics and Statistics, University of Manitoba, 1973

MANAGEMENT COURSES

- Managing in Transition, Quality Forum, Quality Management , Business Process Re-Engineering, Single Operating Budgets

**Assessing Canada's Regulated Interswitching Impact
on Rail Operations and Service to Customers**

Neil Thurston

February 17, 2013

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1.0 EVOLUTION OF RAIL TRANSPORTATION POLICY AND REGULATION IN CANADA

1.1. Prior to 1967

Canada's railways have been in existence for well over the past 150 years. In the early years, Governments of the day saw the development and expansion of railways as a means of enticing various provinces into Confederation. Promoters and entrepreneurs were given large grants of land and government-backed loans to encourage extensive development and expansion of railways far beyond the needs of the country at the time. The inevitable outcome was an enormous excess and duplication of rail line capacity, much of which took over 100 years to eliminate.

Canada's railways were fundamental in the development of Canada's economic growth during the first half of the twentieth century. The railways provided essential services to the developing forest, mining and agricultural industries and were instrumental in the settlement of western and remote regions of the country through the provision of passenger services.

During this period, the railways were seen as an instrument of public policies to promote regional and industrial development and the encouragement of international trade, but at a cost. For example, statutory freight rates for the movement of western grain to offshore export and tariff reductions for the movement of certain commodities in Eastern Canada eventually caused a spiraling level of government subsidy payments to the railways.

The rapid growth of the railways and their virtual stranglehold on transportation had also led to a formal regulatory process under a Railway Commission for the establishment and control of rail rates and service. This process of rate regulation steadily aligned itself with the Interstate Commerce Commission in the US and evolved into the transport economic policy that remained in place until 1967.

1.2. The Period 1967 to 1987

In 1959, the federal government appointed the MacPherson Royal Commission to investigate transportation policy and the needs for a viable transportation system in Canada. By this time, the rail system suffered from freight-rate inequities; internal struggles over competition between the government-owned Canadian National Railways and the privately-owned Canadian Pacific Railway;

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the need to deal with the a burgeoning state of uneconomic railway lines; and, the state of intermodal competition between railways and the motor carrier industry.

Following the release of the MacPherson Royal Commission report in 1961 and an exhaustive review, the federal government put in place the *National Transportation Act (NTA)* in 1967. The *NTA* was designed to promote an efficient transportation system, emphasizing the importance of cooperation and harmony between existing modes while recognizing the need for a healthy and competitive intra and intermodal environment. The *NTA* envisioned a network of transportation services provided on the basis of public convenience and necessity and included provisions to ensure that railways providing essential services were compensated for any losses incurred in these services. The *NTA* also recognized the need to reduce regulatory control which led to the establishment of the Canadian Transport Commission (CTC). The CTC was instructed: to provide regulation without restricting competition among the modes of transportation; to ensure fair distribution of costs of services provided at public expense; to provide compensation for services that carriers were required to provide in the public interest; and, to ensure that rates set by carriers should not be unfair.

As a result of the *NTA*, the Canadian rail industry received new sources of government assistance to indemnify them for the loss of revenues in the provision of essential services.

By the 1970s, CN and CP's passenger rail services were resulting in substantial losses despite the provision of federal compensation. In 1977, the federal government took over full responsibility for inter-city passenger service by creating VIA Rail. In 1983, the government put in place the *Western Grain Transportation Act* which provided hundreds of millions of dollars in benefit payments annually to CN and CP for handling western grain export traffic given the regulated rate structure for such traffic at the time.

Pressures for regulatory change over the railways continued throughout the 1970s and into the 1980s. As well, economic deregulation of transportation in the United States had started in the late 1970s and had encompassed all modes of transport. This was having an increasingly negative impact on Canadian shippers and carriers involved in US/Canada transborder and international export traffic given the heavier regulatory control over Canada's system.

The process of deregulation of rail transportation in Canada began with the enactment of the *National Transportation Act 1987 (NTA, 1987)*. This Act recognized the need for a more open transportation system, increasingly sensitive to the competitive forces of market supply and demand. As a result,

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Canadian rail carriers were allowed to negotiate confidential contracts with shippers and were permitted to abandon up to four percent of their total track each year until 1992 when the restriction was removed from the legislation. Shippers captive to the lines of one railway were also granted the ability to seek competitive access alternatives to other rail carriers through the introduction of competitive line rates (CLR) for the interlining of freight.

1.3. The Period 1987 to 1996

It was soon recognized that the *NTA, 1987* did not go far enough in resolving market distortions in the railway transportation sector. In late 1994 and early 1995, Transport Canada held consultations with the rail industry participants and the Provincial Governments in order to simplify and update the legislative framework governing transportation in Canada. In addition, the Federal Budget of February 1995 reduced or eliminated most of the rail subsidy programs and included an announcement that Government intended to privatize CN. Subsequently, CN was privatized on November 28, 1995 by an initial public offering of its shares on the Toronto, New York and Montreal stock exchanges.

Following the Government's aforementioned consultation with industry participants and the Provinces, the *Canada Transportation Act (CTA)* was enacted on July 1, 1996 to modernize and streamline transportation and to enhance the viability of Canada's major rail carriers. The *CTA* replaced both the *NTA, 1987* and the *Railway Act* and renamed the National Transportation Agency as the Canadian Transportation Agency (Agency) with a reduced regulatory role.

The focus of the new provisions were on the development of a healthy short line industry, cost reduction of the major Class I carriers through rationalization, and provision of opportunities for retaining rail services.

- The *CTA* eased the entry of smaller, lower cost rail carriers into operations in concert with CN and CP. The basic intent was to encourage the development of short line railways as they complement the mainline carriers as feeders of traffic.
- The *CTA* introduced a new statutory requirement for federal railways to issue a three-year network plan in order to protect the public interest by providing an opportunity to interested parties to purchase lines to be discontinued or sold. Railways were required to offer the lines scheduled for abandonment to other potential short line operators first and, failing any

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purchase, to the various levels of provincial and municipal government. If there was no interest from these participants, the line could be abandoned.

- Other changes were made including:
 - the repeal of non-compensatory rates;
 - the requirement of the Agency to assess whether a shipper would suffer “substantial commercial harm” prior to considering the shipper’s application for the requested regulatory action against the railway;
 - the removal of the public interest test for certain competitive access provisions and level of service complaints but retained for the granting of running rights; and,
 - the requirement that any rate or condition of service established by the Agency must be “commercially fair and reasonable”.

1.3. The Period 1996 to 2001

The *CTA* had included a provision for the repeal of the regulatory regime governing the rail transportation of western grain for export purposes following a statutory review of the efficiency of the grain handling and transportation system and the extent of sharing of such efficiency gains between railways and shippers. A review was conducted into these matters by the Honourable Willard Estey who submitted his report to the Minister of Transport in December 1998. Subsequently, the Government appointed Arthur Kroeger, a seasoned former Deputy Minister of numerous government departments, in 1999 to assess whether the Estey recommendations could be implemented.

Following receipt of Mr. Kroeger’s report, the Government implemented amendments to the *CTA* on July 26, 2000. The main amendments included:

- a significant reduction in the allowable revenue cap for the movement of western grain to offshore export markets given the concern over the railways’ non-sharing in productivity gains raised during the Kroeger process;
- a provision for a quicker final offer arbitration process for disputes totaling less than \$750,000 between shippers and railways; and,
- several provisions to facilitate the rationalization process involving grain dependent branchlines.

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The *CTA* also included a provision requiring a comprehensive review of the Act to be undertaken no later than July 1, 2000 into the operation of the Act regarding the economic regulation of transportation in Canada. The Government appointed a panel on June 30, 2000 with a one year mandate to assess whether the existing legislation provided Canadians with an efficient, effective, flexible and affordable transportation system and to provide recommended amendments.

1.4. The Period Post 2001 to Present

Following receipt of the Canada Transportation Act Review Panel's final report in June 2001, the Government moved ahead with further Bills to amend the *CTA*, largely based on the Panel's recommendations. None of the Bills made it through to enactment given federal election processes until Bill C-8 received Royal Assent on February 29, 2008.

New changes affecting rail transportation dealt largely with shipper protection provisions and included:

- the removal of the requirement for the Agency to assess whether a shipper would suffer "substantial commercial harm" before giving the shipper access to a regulatory remedy against the railway given the concern by shippers that its former existence contributed to the non-use of the affected remedies;
- the extension of the final offer arbitration process to groups of shippers that seek common relief in disputes under \$750,000, as well as, the suspension of any final offer arbitration process, if agreed to by the parties;
- Agency authority, upon complaint by a shipper, to conduct its investigation on charges, including ancillary charges, and to establish new charges;
- clarification that the Agency be allowed to prescribe maximum rates for regulated interswitching, thereby allowing parties to agree to lower rates for interswitching;
- the improvement of the provisions governing regulated rates for shippers to interchange points with a second carrier by removing the obligation requiring shippers to have an agreement with the connecting carrier;
- the requirement to publish a list of rail sidings available for grain producer car loadings together with a 60 days' notice before removing such sidings from operation; and,
- a provision to ensure that the rail line discontinuance process applies to railway lines that are leased to local railway operators and subsequently revert to a federal railway.

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At the time the Government tabled Bill C-8 in 2007, it announced a commitment to commence a review of railway service once Bill C-8 was passed into law. This commitment was made in response to a blossoming of shipper concerns over the quality of rail freight service and the Government's interest in ensuring that Canada has a rail system it needs to support a strong economy and domestic and international trade. The Government appointed a 3 person Panel which undertook an extensive consultation process with industry participants and produced a final report in December 2010.

On March 18, 2011, the Government accepted the Panel's commercial approach to address shipper concerns over rail service, including its four key elements:

- that railways should provide 10 days' advance notice of service changes;
- that railways and stakeholders should negotiate bilateral service agreements as an effective way of bringing more clarity, predictability and reliability to rail service;
- that a fair, timely and cost-effective commercial dispute resolution mechanism should be developed; and,
- that supply chain performance should be monitored through enhanced bilateral performance reporting between shippers and railways, and through public performance reporting.

The Government subsequently appointed a Facilitator in October 2011 to work with shippers and railways to flesh out the details of a service agreement template and to establish a fair, balanced, timely and cost-effective commercial dispute resolution process that could be used by shippers and other stakeholders to address their service and logistical issues with CN and CP. At the same time, the Government also indicated its intent to table a bill to give shippers the right to a service agreement with the railways and provide a process to establish such an agreement should commercial negotiations fail.

On December 11, 2012, the federal government tabled Bill C-52 to fulfill this commitment since the facilitation process did not result in agreement between shippers and railways regarding the facilitation process objectives. The Bill included provisions that:

- require a railway company, upon a shipper's request, to make the shipper an offer to enter into a contract respecting the manner in which the railway company must fulfill its service obligations to the shipper; and,

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- create an arbitration process to establish the terms of such a contract if the shipper and the railway company are unable to agree on them.

Bill C-52 is currently being moved through the parliamentary process and is expected to be implemented into law in 2013.

1.5. Conclusion

The evolution of the Canadian rail industry including Government policies and regulations affecting the industry have combined to create what most believe is a healthy and vibrant rail transportation system in Canada which has created vibrant economic growth and prosperity.

2.0 HISTORICAL OVERVIEW OF RAILWAY INTERSWITCHING REGULATIONS

Regulated interswitching allows shippers who are captive to the lines of a single railway to have physical access to the rates and services of a second competing railway, at rates that are reasonably close to the cost of moving the traffic to or from the interchange point, without the threat of rate or service abuse from the monopoly rail carrier to which they are otherwise captive.

2.1 At the Turn of the Twentieth Century

Regulated interswitching of rail cars between railways in Canada dates back to the turn of the previous century. The first interchange point was built in Toronto, Ontario and allowed the Grand Trunk Railway (GTR) and CP to access each other's lines. When the second interchange between the two companies was constructed at London, Ontario in 1904, the GTR refused to interchange traffic until the question of adequate compensation for the switching activity was determined. CP turned to the regulator, the Board of Railway Commissioners (Board) for an Order against GTR under the *Railway Act* to provide proper facilities for interchange including a determination of an adequate interswitching rate. In 1905, the Board ordered the GTR and CP to interchange traffic as it considered it in the public interest and convenience, and set the rate at \$0.01 per hundred pounds with a minimum charge of \$5 per car. The charges were applicable to traffic moving to/from GTR's sidings within a specific area of the city.

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Following the London Interswitching decision, the Board received a number of complaints regarding interswitching practices and charges. As a result of these complaints, the Board's Chief Traffic Officer undertook an investigation into the interswitching issue. The objective was to develop a standard interswitching charge for the convenience of shippers and railways in order to curtail the frequent complaints about excessive switching charges. The Board accepted the Traffic Officer's report and proceeded with the establishment of the first General Order on Interswitching, Order # 4988 dated July 8, 1908, later called General Order No. 11. The Order adopted, as a nation-wide rule,:

- a charge of \$0.01 per hundred pounds based on the principle of giving reasonable compensation for service furnished by the respective railways;
- an interswitching limit of 4 miles from the point of interchange between two railways;
- absorption of a minimum of 50% of the interswitching charge by the line haul railway.

The Traffic Officer's report also commented on the issue of intramodal competition. The report indicated that the railways' historical practice was to absorb switching charges on competitive traffic which, as a result, produced competition in rail service and rates. The Board's first Order endorsed such competition and declared that it was lawful for the contracting railway to absorb the interswitching charges.

Over the next ten years, the Board had to deal with complaints regarding the applicability of its first Interswitching Order. The Board undertook a review of the matter in 1918 and ruled that interswitching was a "right" not a "privilege".

2.2 Between 1918 and 1987

From 1918 until the early 1980s, regulated interswitching remained virtually unchanged other than a slight increase in the regulated rate to 1 ½ cents per 100 pounds prior to 1951. During this period, significant population growth in Canadian cities occurred resulting in the relocation of industries away from city cores into suburban areas. Much of this relocation was to areas outside the traditional regulated interswitching 4-mile limit. Consequently, a shrinking proportion of shippers had eligible competitive access to a second railway through the regulated interswitching provision. As well, railway costs of providing service increased significantly over this period with the result being that

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the regulated rate for interswitching fell far short of the railways' financial needs, especially for railways that were net providers of interswitching service.

In 1983, given these escalating concerns that the existing interswitching regulations did not reflect reality, the Rail Transport Committee (RTC) of the Canadian Transport Commission undertook an enquiry into the regulations. The process evolved through 1984 and 1985 with the RTC developing a staff report which identified the issues that needed to be addressed, including options to address them, through a set of new regulations. These issues included:

- the extent to which the interswitching limits should be extended with options ranging from no change to the 4 mile limit to a limit of up to 25 miles with provision for future flexibility to address future requirements;
- the level of interswitching charges, whether there should be a single interswitching charge or range of charges by zone given the physical differences in interchanges across the country, and the basis for determining the charges;
- the degree to which line haul railways absorb the interswitching charges; and,
- some general areas of concern, including whether interswitching charges should be a per-car charge or based on weight; whether charges should be based on single car switches or reflect the economies of multiple car switches; whether charges should be based on track mileage from or radius around an interchange; and, whether all physical track connections between railways should be considered an interchange for interswitching purposes.

Before the RTC could finalize a decision on the matters, the federal government moved ahead with transportation policy changes with the implementation of the *NTA, 1987*.

2.3 Between 1987 and 1996

The *NTA, 1987* provided a general policy objective to encourage competition for rail traffic. The corresponding competitive access included an extension of the limit for regulated interswitching from 4 miles to a radial distance of 30 kilometres. The new interswitching provisions were designed to foster competition where it did not previously exist with the result being that some resource-based

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industries, as well as manufacturing-based industries, obtained the competitive benefits of interswitching for the first time. The extension of the interswitching limit to 30 km recognized that the very nature of the railways traffic base had changed dramatically.

The *NTA, 1987* set out the Agency's powers to make regulations prescribing the terms and conditions subject to which the interswitching of traffic may occur and prescribing the rate per car to be charged for interswitching traffic. The *NTA, 1987* required the interswitching rates to be compensatory (established at levels above Agency-approved long run variable costs), and for the rates to reflect any reductions in costs that might result from transferring multiple cars to or from an interchange at the same time.

The Agency established its first set of interswitching rates under the *NTA, 1987* immediately following passage of the Act. The established interswitching rates were the same at each interchange location across the country and were expressed on a per-car-basis regardless of the commodity shipped. The interswitching limits of 30 kilometres were divided into four concentric zones and a different rate was prescribed for each zone since the costs incurred by the switching railway increase the further the distance between the customer's siding and the interchange. There was an additional per-kilometre charge if the distance between the interchange and the customer siding was less than 30 kilometres as the "Crow flies", but greater than 40 kilometres by line of railway. This charge was intended to compensate the switching railway for the costs associated with the additional distance beyond 40 kilometres. Additionally, a separate rate was prescribed for each zone for cars switched in single blocks of 60 or more cars given the efficiency and lower cost in switching larger blocks of cars.

The Agency's first set of regulated interswitching rates were approved by Order-in-Council on December 17, 1987 and are set out in Table 1.

Table 1

Agency Prescribed 1987 Interswitching Rates

Interswitching Distance Zone	Rate per car for interswitching traffic to/from a shipper's siding	Rate per car for interswitching a car block of 60 or more cars
	\$	\$
Zone 1	165	85
Zone 2	185	85
Zone 3	210	85
Zone 4	250	85

Notes:

Zone 1: Sidings located wholly or partly within 6.4 km of an interchange

Zone 2: Sidings located beyond 6.4 km and wholly or partly within 10 km of an interchange

Zone 3: Sidings located beyond 10 km and wholly or partly within 20 km of an interchange

Zone 4: Sidings located beyond 20 km and wholly or partly within a 30 km radius of an interchange

The structure of the interswitching rates and their uniformity at all interchange locations reflect the railways' position that the burden of administering a multitude of different rates at different locations plus the expense incurred to develop the individual switching costs would have been prohibitively expensive and time consuming. As well, rate equality meant that a shipper located in one city was not advantaged or disadvantaged through lower or higher interswitching rates compared to a competing shipper located in another city for switching movements of the same distance.

The *NTA, 1987* required the Agency to review the regulations if circumstances warranted but no later than five years after the regulations came into force. In its annual process of approving railway unit costs, the Agency determined in 1989 that the interswitching rates established in late 1987 should be revised. While applicable unit costs had increased by 5%, system productivity improvements achieved by the railways reduced the net effect of the cost increase. Rates per car for blocks of cars less than 60 cars increased by between 2 ½ % and 4 ½ % in comparison to the 1987 rates across the various zones with much of the increase resulting from rate rounding requirements. A slight increase of \$5 per car for interswitching blocks of 60 or more cars was determined.

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Accordingly, the Agency's revised interswitching rates received Order-in-Council approval on February 16, 1989, as set out Table 2.

Table 2

Agency Prescribed 1989 Interswitching Rates

Interswitching Distance Zone	Rate per car for interswitching traffic to/from a shipper's siding	Rate per car for interswitching a car block of 60 or more cars
	\$	\$
Zone 1	170	90
Zone 2	190	90
Zone 3	220	90
Zone 4	260	90

2.4 1997 Changes

In 1996, the *NTA, 1987* was replaced by the *Canada Transportation Act (CTA)* on July 1, 1996. Among the changes which were implemented included the requirement that any rate or condition of service established by the Agency must be "commercially fair and reasonable". The Agency undertook a review of the interswitching rates in 1997 in light of this policy requirement and established a revised set of rates. The new rates incorporated the Agency's annual review of railway unit costs, changes in interswitching activity by zone and by car block size as well as the establishment of a 7.5% level of contribution toward fixed costs given the "commercially fair and reasonable" clause. The contribution to fixed costs in previous regulated interswitching rate determinations since 1988 included only a minor amount.

Rather than continuing to administer one single rate independent of the distance travelled by the traffic, the Agency proceeded in establishing different rates for the switching of car blocks of 60 or more cars by zone. The Agency determined that this approach would provide a better representation of the actual pattern of the traffic interswitched in blocks and a more appropriate level of compensation for this type of traffic, given that rates previously established by the Agency under the *NTA, 1987* were only required to be compensatory.

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Similarly, the Agency decided to develop different rates for additional kilometres in excess of 40 kilometres from an interchange that would apply specifically to the traffic moving in blocks of 60 or more cars and the traffic moving in blocks of less than 60 cars. These rates could be used in addressing any shipper applications for extended interswitching rates beyond the 30 km radius. The Agency determined that these changes in the rate structure would ensure that all interswitching rates included a uniform contribution toward fixed costs and were based on a consistent rate-setting methodology.

Table 3 illustrates the rate changes for each interswitching distance zone which received Order-in-Council approval on November 20, 1997.

Table 3

Agency Prescribed 1997 Interswitching Rates

Interswitching Distance Zone	Rate per car for interswitching traffic to/from a shipper's siding	Rate per car for interswitching a car block of 60 or more cars	Add'l rate per car for single cars	Add'l rate per car for car blocks of 60 or more cars
	\$	\$	\$	\$
Zone 1	210	65	-	-
Zone 2	230	70	-	-
Zone 3	275	90	-	-
Zone 4	365	105	4.20	1.60

2.5 2004 Changes

In its 1997 determination, the Agency indicated that it would continue to develop interswitching costs on an annual basis, but would only revise the corresponding rate structure contained in the Regulations when the circumstances warranted. By 2002, it had been over 5 years since any changes had been made to the Railway Interswitching Regulations and the Agency was required to undertake a statutory review.

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In addition to its review of costs and rates for 2002, the Agency also assessed whether the Regulations accurately reflected current commercial practices and standards of the industry within the framework for interswitching prescribed by the *CTA*.

A number of issues were raised by system participants, including: the continued need for regulated interswitching rates; the appropriate rate levels and the inherent compensation toward railway fixed costs; the redefinition of the interswitching zones and car blocks; the monitoring of interchanges eligible for interswitching; the applicability of interswitching among railway companies, and the level of service provisions applicable to interswitching.

After reviewing submissions on these issues, the Agency determined that the continued regulation of interswitching rates was integral to the competitive access provisions of the *CTA* and that any reduction in the protection offered by this approach would be contrary to the National Transportation Policy. Accordingly, the Agency did not make any further changes to the interswitching regulations, other than adjusting the rates given its 2002 cost analysis, when it posted its 2004 rates. However, the Agency did indicate it was prepared to continue to evaluate the establishment of additional rate categories for different car block sizes and a review of the level of contribution toward railway fixed costs. The Agency indicated it would pursue more in-depth consultations with interested parties before making a determination on these matters.

The Agency's 2002 cost analysis indicated that the costs for each category of interswitching traffic had decreased significantly from earlier levels. Accordingly, the Agency revised the interswitching rates which showed that rates for blocks of less than 60 cars decreased, on average, by 13.0 percent while the rates for blocks of 60 or more cars declined, on average, by 16.7 percent from the 1997 levels. Table 4 illustrates the rate changes for each interswitching distance zone.

Table 4

Agency Prescribed 2004 Interswitching Rates

Inter-switching Distance Zones	Rates per car for interswitching a block of less than 60 cars			Rates per car for interswitching a block of 60 or more cars		
	Current 1997 Rates (\$)	New Rates (\$)	Variation (%)	Current 1997 Rates (\$)	New Rates (\$)	Variation (%)
Zone 1	210.00	185.00	-11.9	65.00	50.00	-23.1
Zone 2	230.00	200.00	-13.0	70.00	60.00	-14.3
Zone 3	275.00	240.00	-12.7	90.00	75.00	-16.7
Zone 4	365.00	315.00	-13.7	105.00	90.00	-14.3
Rate per kilometre	4.20	3.75	-10.7	1.60	1.45	-9.4

Between 2004 and 2012, the Agency continued its annual assessment of railway interswitching costs and the need for any revisions to the rate structure for regulated interswitching. By 2009, no changes had been made to the Regulations and, as a result, the Agency was required to conduct another five year statutory review.

2.6 2012 Changes

In responding to this statutory review, stakeholders primarily focused on the following topics:

- the contribution toward railway companies constant costs;
- the methodology for the determination of the interswitching variable costs; and
- the cost methodology for interswitching block trains.

Based on the Agency’s review of its previous costing methodologies relevant to the above concerns of stakeholders, a number of fine-tuning modifications were made to improve the Agency’s accuracy in reflecting the actual costs of providing interswitching services by the railway companies. These modifications included the use of actual data recently collected by the Agency for railway operations, which allows for greater accuracy in setting rates.

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With methodologies developed to address and implement these new revisions, the Agency submitted the following rate structure set out in Table 5 for Order-in-Council approval on June 30, 2012. Approval has not yet been granted so regulated interswitching activity is conducted under the last changes made in 2004.

Table 5
Agency Proposed 2012 Interswitching Rates

Inter-switching Distance Zones	Rates per car for interswitching a block of less than 60 cars			Rates per car for interswitching a block of 60 or more cars		
	Current 2004 Rates (\$)	Proposed Rates (\$)	Variation (%)	Current 2004 Rates (\$)	Proposed Rates (\$)	Variation (%)
Zone 1	185.00	229	23.8	50	46	-8.0
Zone 2	200.00	248	24.0	60	55	-8.3
Zone 3	240.00	284	18.3	75	65	-13.3
Zone 4	315.00	251	20.3	90	74	-17.8
Rate per kilometre	3.75	3.38	9.9	1.45	1.20	-17.2

In the latest Canada Gazette posting for public comment regarding the Agency’s proposed rate structure, the Agency indicates *“that the table presents for comparative purposes the current regulated rates, which became effective on November 5, 2004, and are based on the interswitching variable cost estimates for the year 2002 and a contribution towards constant costs of 7.5%, as well as the present proposal, which has been developed on the basis of the 2009 interswitching variable cost estimates and the increase in the level of the contribution to railway constant costs to 20.3%”*. The Agency determined that a contribution of 20.3% of variable costs represents, at this time, an appropriate compensation for railway constant costs. The Agency is satisfied that the resulting rate levels represent the right balance, a balance which ensures the maintenance of effective competitive access through interswitching while providing rail carriers with fair and reasonable compensation for services provided as an imposed public duty. The Agency considered that the rates established under the new methodology are commercially fair and reasonable to all parties.

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2.7 Conclusions

Regulated interswitching has evolved extensively over the past century. In the early years, interswitching limits did not keep pace with the expansion of Canadian cities and the relocation of business to suburban areas, much to the detriment of shippers who were captive to one railway at origin or destination. As well, over these years, regulated rates for interswitching fell far short of the compensatory needs of the railways. With the passage of the *NTA, 1987*, regulated interswitching limits were expanded to a radius of 30 kilometres of an interchange between competing railways and regulated rates were required to be fully compensatory, thereby ensuring the provision remains current with the needs of all parties. With the passage of the *CTA* in 1996, regulated interswitching was maintained with regulated rates no longer required to be “compensatory”, but “fair and reasonable” to all parties. The Agency reviews railway unit costs annually as it assesses the need to revise the regulated rates. As a result of the legislative provision requiring rates established by the Agency to be “fair and reasonable”, the Agency has revised methodologies in establishing regulated rates by adjusting the level of contribution to constant costs. As a result, regulated interswitching rates established by the Agency included a 7.5% level of contribution since 1997 with the level being revised to 20.3% in the revised Regulations which are currently awaiting Order-in-Council approval

Today, interswitching represents an important part of the competitive access provisions that are available under the *CTA*. Regulated interswitching rates benefit shippers by extending their access to the lines of competing railway companies at rates that cover the cost of moving the traffic to/from the interchange point. Regulated rates thus ensure that rail shippers derive, where available, the benefits of price competition, improved service levels and varying routing options. The railway companies receive, in turn, fair and reasonable compensation for the costs in providing interswitching services.

3.0 ASSESSING THE IMPACT ON RAIL OPERATIONS AND CUSTOMER SERVICE

According to the latest Transport Canada annual report entitled “Transportation in Canada 2011, A Comprehensive Review”, CN and CP are the two dominant freight rail carriers in Canada with each accounting for 50% and 35%, respectively, of total Canadian rail transport industry revenues in 2011. The two railways represent more than 95% of Canada’s annual rail tonne-kilometres, over 75% of the industry’s trackage and 75% of overall tonnage carried by the rail sector. CN generates \$5.5 billion in annual freight revenues in Canada and employs 22,000 people. CP generates almost \$4 billion in

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annual revenues in Canada, operates 22,500 route-kilometres in 6 provinces and 13 States, and employs 15,000 people system-wide.

3.1 Extent of the Use of Regulated Interswitching

Operational rail statistics related to regulated railway interswitching is very limited and generally not made publicly available on a routine basis in Canada through Statistics Canada, Transport Canada or the railways.

However, in its various reviews of the regulated railway interswitching regime over the past 15 years, the Canadian Transportation Agency has provided statistical information regarding the number of rail cars interswitched under the regulated rates. Such information was provided for the following periods of time:

- 1988-1990, when the Agency was reviewing the Interswitching Regulations following the change of the interswitching limits from 4 miles to 30 kilometres under the
- *NTA, 1987*;
- 1998-2001, when the Agency was reviewing the Interswitching Regulations following the implementation of the *CTA* in 1996; and,
- in 2007, the last year that information is public, when the Agency was conducting its latest statutory review of the Interswitching Regulations in 2009/2010.

Table 6 sets out the corresponding number of CN and CP rail cars interswitched for these periods. As well, the table illustrates the total number of rail carloads handled annually across CN and CP's respective systems and the percentage of interswitched cars relative to total system carloads.

Table 6

**Total CN and CP Rail Cars Interswitched
Under the Railway Interswitching Regulations**

Period	Year	CN, CP Cars Interswitched¹	CN, CP Annual Freight Carloads²	% Cars Interswitched
1	1988	131,982	3,240,000 ³	4.1 %
	1989	143,989		
	1990	133,772		
2	1998	144,269	4,728,000	3.0 %
	1999	144,753	5,975,000	2.4 %
	2000	157,957	6,191,000	2.6 %
	2001	188,160	6,244,000	2.5 %
3	2007	279,900	7,442,000	3.8 %

A relatively small amount of rail traffic handled by CN and CP is actually switched between the two railways under the Railway Interswitching Regulations. As Table 6 illustrates, the proportion of CN's and CP's total annual freight car loadings that have been interswitched under the Interswitching Regulations between the railways has fluctuated between 2.5% and 4.1% between 1988 and 2007.

The growth in the number of cars interswitched under the Regulations from 2000 to 2007 has largely arisen from cars being interswitched in zone 4 of the Regulations (ie. for sidings located outside 20 km of an interchange and wholly or partly within a 30 km radius of the interchange). Table 7 illustrates the changes in the cars interswitched within the regulated zones 1-4 since 1988.

¹ Canadian Transportation Agency-sourced statistics

² CN and CP Annual Reports

³ Railway Association of Canada, Railway Trends 1993

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Table 7
Total CN and CP Rail Cars Interswitched in Zones 1-4
Under the Railway Interswitching Regulations⁴

Year	Zone 1 (0.1 to 6.4 km)	Zone 2 (6.4 km to 10 km)	Zone 3 (10.1 km to 20 km)	Zone 4 (20.1 km to 30 km radius)	Total
1988	87,844	15,685	17,503	10,910	131,982
1989	76,268	19,137	33,131	15,403	143,939
1990	66,095	14,175	37,259	16,243	133,772
2007	58,326	38,203	27,965	155,406*	279,900

*95,132 of the 155,406 cars were moved in blocks of 60 or more cars at a time

This growth, especially in zone 4, has largely come about as a result of the way in which CN and CP have improved their efficiencies in their collective switching operations which has benefitted shippers who are having the railways handle car blocks of 60 or more cars at a time.

3.2 Extent of CN and CP Rail Traffic Exposed to Regulated Interswitching

While Table 6 illustrated that less than 4% of the total carload freight traffic handled by CN and CP annually is actually interswitched between the two railways under the Interswitching Regulations, much more than that proportion of traffic is actually “exposed” to regulated interswitching.

During the various policy development reviews of transportation legislation in Canada over the past 25 years, the Government has examined the extent of rail traffic “exposed” to the Canadian regulated interswitching regime on several occasions. One examination, which provided an assessment from a revenue perspective, was undertaken in 1987 prior to passage of the *NTA, 1987* and a further examination, from a traffic perspective, was undertaken in 2001 during the *Canada Transportation Act* Review process. The results of these assessments are discussed below:

- Examination prior to *NTA, 1987*

In 1986, Transport Canada contracted with Travacon Research Limited to assess the extent to which CN and CP’s freight revenues would be exposed to the competitive access provisions,

⁴ Canada Gazette: Regulatory Impact Analysis Statement - Regulations Amending the Railway Interswitching Regulations, Canadian Transportation Agency June 30, 2012

one of which dealt with expanding the interswitching limits from 4 miles to 30 kilometres, contained in Bill C-18, the proposed *NTA, 1987*.

In its report⁵, Travacon analyzed CN and CP's 1985 freight traffic excluding western grain traffic moving under the *Western Grain Transportation Act* and intermodal traffic not subject to the competitive access provisions contained in the Bill. Travacon reported that 17.5% of CN and CP's combined freight revenues would be exposed to the expansion of the interswitching limits from 4 miles to 30 km, as illustrated in Table 8.

Table 8

CN and CP Freight Revenues* Exposed to Expanded Interswitching Limits (\$000,000)

	CN	CP	Total
Revenue Derived from Currently Competitive Traffic	678.8	743.8	1,422.6
Revenue Exposed from Expanded Interswitching	457.0	293.8	750.8
Total Freight Revenue	2,530.5	1,756.9	4,287.4
% Revenue Exposed from Expanded Interswitching to Total Revenue	18.1%	16.7%	17.5%
% Revenue Exposed to Competition (Expanded Interswitching + Currently Competitive)	44.9%	59.1%	50.7%

*Excluding WGTA and intermodal traffic

Table 8 also illustrates that \$1.4 billion or 33.2% of CN and CP's combined freight revenue (excluding western grain and intermodal revenues) was derived from currently competitive situations. This would have been a result of traffic already moving within the 4 mile interswitching limit at the time, as well as traffic that would have had access to both railways at origin. With the extension of the interswitching limits to a radius of 30 km, Travacon

⁵ "An Analysis of the Revenue Impact Upon the Canadian Railways of the Competitive Access Provisions of Bill C-18, February 1987

concluded that 50.7% of CN and CP's combined freight revenue (excluding western grain and intermodal revenues) would be exposed to competition.

- **Examination in 2001**

In 2000 and 2001, the *Canada Transportation Act* Review panel undertook its review of the *CTA*, including an examination of the amount of rail traffic "exposed" to rail competition as a result of the expanded interswitching limits to 30 km which had been implemented under the *NTA, 1987* and maintained with the passage of the *CTA* in 1996.

In its June 2001 report⁶, the Panel indicated that almost 40% of Canadian rail tonnage in 1999, including grain traffic had access to direct rail competition at both origin and destination under the expanded interswitching limit to 30 km. The Panel also indicated "*that this figure is similar to CN's estimate in its submission to the Panel that 41% of total CN and CP traffic originates and terminates within 30 km of interchange points*"⁷

Table 9 provides the information from the Panel's report regarding the impact of the 30 km interswitching limit on CN and CP's total rail tonnage depending on the location of an applicable interchange at origin or destination.

Table 9
Percentage of Total Rail Freight Tonnage, 1999 within 30 km of Interchanges (*including border points*)

LOCATION	PERCENTAGE of TOTAL CN and CP Rail Traffic
At Origin	49.0%
At Destination	80.3%
At Origin OR Destination	91.4%
At Origin AND Destination	38.7%

⁶ "Vision and Balance" Report of the *Canada Transportation Act* Review Panel June 2001, Note on the Evidence About Competition in the Rail Freight Sector

⁷ *Ibid*

As indicated above, almost 40% of CN and CP's total freight tonnage in 1999 was exposed to direct rail competition at origin **AND** destination through the regulated interswitching provision. At either origin **OR** Destination, slightly over 90% of total traffic was exposed to the regulated provision.

In summary, since the amount of carload rail traffic actually interswitched between CN and CP is relatively small (less than 4% annually) despite a significant portion of each railway's traffic being "exposed" to regulated interswitching, it can be concluded that the Interswitching Regulation policy appears to be generating rail intra-modal competition where it would, otherwise, not arise.

As well, it would appear that shippers who are captive to either CN or CP see their traffic largely retained by the respective railway to which they are captive at origin or destination rather than being switched over to the competition at an interchange point under the Regulations.

Submissions and presentations by numerous rail shippers and their associations during the various phases of transportation policy development leading to the *NTA, 1987* and *CTA* in 1996 and their subsequent reviews, as well as the independent research work conducted during these activities, and the Agency's ongoing work during its various statutory reviews of the Interswitching Regulations, confirm that regulated interswitching has worked as a mechanism to promote effective intra-modal competition in the rail sector in areas where such competition would not naturally occur.

3.3 Regulated Interswitching Impact on Rail Operations

Regulated interswitching has been the corner stone of the competitive access provisions contained in the *Canada Transportation Act*. In addition to the regulated interswitching provisions, the Act provides shippers with competitive line rates, final offer arbitration and confidential contract provisions to allow for a pro-competitive atmosphere for the negotiation of rates and service packages between shippers and railways. In spite of these provisions which have provided for a pro-competitive rail transport regime where it might not otherwise have existed in previous time, both CN and CP have moved their railway businesses forward over the past 15+ years in a way that has elevated both railways to the top of the scale from an operational efficiency and cost-effective perspective.

These results have been well recognized and acknowledged in appearances by railway industry executives before the federal government's House of Commons Standing Committee's (SCOT)

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numerous meetings dealing with amendments to and various reviews of the governing transportation legislation over the past 10 years.

As an all-encompassing example of the very positive views provided during these sessions, the appearance of CN before SCOT on October 26, 2006 regarding certain proposed amendments to existing shipper protection provisions embodies the highly improved railway performance. In this regard, Mr. Claude Mongeau, Executive Vice President and Chief Financial Officer, who has gone on to become the President and CEO, provided the following observation:

"I think the federal government and your predecessors as members of the transport committee should be proud of where we stand today in the rail industry. CN has transformed itself from a laggard railway ten years ago to a leading railroad in the North American industry. CP Limited has created CP Rail, which is today, a focused, lean railroad covering all of Canada. I invite you to look at the hard facts ... if I take CN's example, for instance, our transit time and the reliability with which we achieve our transit time has improved by more than 50% over the past ten years."

SCOT convened further hearings in November 2007 to study further legislative amendments. Mr. Clifford MacKay, President of the Railway Association of Canada appeared on November 27, 2007 and spoke about the resounding success of "deregulation" in the railway industry. Mr. MacKay stated:

"...particularly in the last 10 years there has been a massive change in the way in which rail services are managed and delivered, not only in Canada but in the whole of North America. We have moved from the days when railways did not run precision schedules, where our capacity utilization was abysmal – if you look at our operating rates back 10 years ago, that clearly proves it – and we're now operating the system much more efficiently, much more fluidly, at much better productivity rates than ever in the past."

Over the past 15 years, both CN's and CP's rail freight revenues, net income and traffic handlings have all grown as illustrated in Table 10. CN has put up some fairly impressive numbers as shown by the overall percentage growth in each category.

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Table 10
Financial and Operating Statistics⁸

	CN	CN	CN	CP	CP	CP
	Carloads (000)	Freight Revenue (\$ millions)	Net Income (\$ millions)	Carloads (000)	Freight Revenue (\$ millions)	Net Income (\$ millions)
1996	2,315	3,911	NA	N/A	3,543	446
1997	2,547	4,283	NA	2,283	3,583	469
1998	3,483	5,137	640	2,245	3,517	362
1999	3,645	5,236	751	2,330	3,496	67
2000	3,796	5,428	937	2,395	3,655	401
2001	3,685	5,457	1,040	2,423	3,699	370
2002	4,075	5,901	800	2,447	3,666	488
2003	4,100	5,694	1,014	2,539	3,661	401
2004	4,578	6,252	1,258	2,699	3,903	413
2005	4,841	6,905	1,556	2,676	4,392	543
2006	4,824	7,929	2,087	2,618	4,427	796
2007	4,744	7,897	2,158	2,698	4,555	946
2008	4,615	8,482	1,895	2,645	4,815	619
2009	3,991	6,632	1,854	2,363	4,280	550
2010	4,696	7,417	2,104	2,661	4,853	651
2011	4,873	8,111	2,457	2,597	5,052	570
2012	5,059	8,938	2,680	2,669	5,550	
% Change	118.5%	128.5%	318.8%	16.9%	56.7%	27.8%

3.3.1 Agency Analysis

As indicated previously, limited statistical information exists in the public domain regarding the impact of regulated interswitching on rail operations. However, some information is provided in the Agency's most recent report⁹ regarding the Review of the Interswitching Regulations as well as the Regulatory Impact Analysis Statement¹⁰ regarding the Agency's proposed regulated interswitching rate changes.

⁸ CN and CP Annual Reports and 4th quarter financial statements

⁹ Decision No. LET-R-66-2010 - Review of the Railway Interswitching Regulations LET-R-66-2010, April 21, 2010
<https://www.otc-cta.gc.ca/eng/decision-no-let-r-66-2010-review-railway-interswitching-regulations>

¹⁰ Regulations Amending the Railway Interswitching Regulations

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The specific objective of the Agency's regulatory review of the Interswitching Regulations is to determine whether the Regulations accurately and effectively reflect current railway company operating practices. Pursuant to section 128 of the *CTA*, the Agency shall, in determining the interswitching rate, take into consideration any costs that, in the opinion of the Agency, result from moving a greater number of cars or from transferring several cars at the same time. The Agency shall also consider the average variable costs of all movements of traffic that are subject to the rate, and the rate must not be less than the variable costs of moving the traffic. Further, the interswitching rates must comply with section 112 of the *CTA*, which states that interswitching rates must be commercially fair and reasonable to all parties.

In its latest review report which sets out the proposed 2012 interswitching rates as previously illustrated in Table 5, the Agency alludes to the achievement of railway efficiencies gained in regulated interswitching services which have resulted in lower interswitching costs, thereby leading to lower regulated rates in some of the interswitching zones. The Agency made the following comments:

"In determining the new interswitching rates, the Agency has considered 2007 traffic distribution patterns and 2009 costs. The assessment of the variable costs associated with trains of fewer than 60 cars produced diverging results. The variable costs associated with Zones 1 to 3 increased from their level in 2002, contributing to an increase in the proposed rates ranging from 18.3% to 24%. Conversely, the variable costs for Zone 4 declined, resulting in a reduction in the proposed rate of 20.3%. The change in the proposed rate for Zone 4 is the result of several contributing factors. It should be noted that, in respect of trains of fewer than 60 cars, Zone 4 constitutes a major part of the total traffic, with approximately one third of the total number of interswitched carloads for this category of traffic. The traffic originating or terminating in Zone 4 is highly concentrated in a limited number of interchanges located in the Vancouver and Edmonton areas. The geography and the operational conditions prevailing at these interchanges and their associated rail yards are such that their inherent work activities and costs are either similar or lower than the system weighted average cost for Zone 3 traffic. But even more significant in the explanation of this

Regulatory Impact Analysis Statement

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disparity is the fact that some major components of the Zone 4 traffic are substantially lower than their comparative counterparts in the Zones 2 and 3 traffic. Overall, five of the eight rate zones will see a reduction and thus will benefit shippers in general, while ensuring railway companies are fairly compensated for the imposed service they provide. The anticipated annual decrease in railway company revenue arising from the interswitching rate proposal is about \$800,000, which is the difference between the current \$49.8 million per year being earned by the railway companies under the current Regulations and an anticipated \$49 million per year under the amended Regulations, nationally."

In other words, railway efficiency gains in the handling of regulated interswitching traffic in some of the switching limit zones where a relatively higher proportion of the total regulated interswitching traffic is handled have resulted in lower costs and therefore lower regulated rates. These lower rates when applied to existing traffic levels handled for blocks of 60 or more cars will result in a reduction in associated interswitching revenues which will more than offset the higher costs for handling blocks of 59 or less cars. In applying the proposed rate structure to existing interswitching traffic levels by zone, the Agency anticipates an annual decrease of about \$800,000 in railway company revenue arising from regulated interswitching.

3.3.2 Railway Productivity and Efficiency Indicators

From a purely task-oriented perspective, switching rail cars between railways at interchange points or within rail yards for train-building or shipper placement objectives is a more time consuming and resource demanding activity than simply hauling trains along a mainline operation. However, such switching activities are part of the everyday life of railway operations, for without such operations, mainline functions would not occur in an efficient manner.

The interswitching of rail cars between railways requires facilities to be adequate at interchange points and procedures to be in place for the planning, coordination and execution of service activities between the respective railway companies. One might consider such demands on the railway system would lead to inefficiencies and significant negative impacts on railway operations but such outcomes do not appear to be apparent.

Over the past ten to fifteen years, both CN and CP have driven forward and achieved significant productivity and efficiency gains in the provision of their respective services to shippers. These gains have been achieved through a variety of measures including:

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- workforce reductions;
- low density branchline rationalization;
- improvements in train control and dispatching;
- acquisition of more fuel efficient locomotives;
- fuel efficiency gains from new train technologies and improved switching efficiency;
- increases in freight car capacities;
- improved car cycle times resulting in increased average mile/car/day; and;
- increases in average length of haul and train lengths

Table 11 illustrates some key metrics that support the fact that both CN and CP have achieved significant gains in reducing costs and running more efficient and timely operations across their respective systems.

Table 11
CN, CP Efficiency Gains
(Operating Ratios and Employee Productivity)

	CN	CN	CN	CP	CP	CP
	Operating ratio (%)	GTMs/Employee (000)	GTMs/Gal (US)	Operating ratio (%)	GTMs/Employee (000)	GTMs/Gal (US)
2012	62.9	16,354	987	83.3	17,400	879
2011	63.5	15,572	973	81.3	17,500	847
2010	63.6	15,533	959	77.6	17,491	855
2009	67.3	13,981	931	81.1	15,381	840
2008	65.9	14,975	893	78.6	15,182	820
2007	63.6	15,539	887	75.3	16,014	826
2006	61.8	15,977	880	75.4	15,424	833
2005	63.8	15,414	851	77.2	14,719	847
2004	66.9	14,811	851	79.8	14,727	833
2003	69.8	14,246	838	79.8	13,759	833
2002	76.0	13,329	838	76.6	12,895	800
2001	68.5	12,964	837	77.3	12,431	794
2000	69.6	12,831	845	76.9	11,729	769
1999	72.0	11,684	832	78.2	10,031	725
1998	75.1	10,542	773	79.2		
1997	78.4			81.4		
1996	85.0			83.0		
1995	89.0					

Source: CN and CP Annual Reports and 4th quarter financial statements

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A traditional measure of railway operating performance is the operating ratio. This measure divides operating expenses by revenues, and identifies the amount of operating expenses paid out for every dollar of revenue received. CN, in particular, has driven its operating ratio down from an 89.0 % level in 1995 to 62.9 % in 2012. CP's operating ratio had dropped fairly well between 1996 and 2007, but has fluctuated upwards since then given unusual winter weather and related flooding impacts on operating expenses, and recessionary world economy impacts on traffic volumes and freight revenues.

Employee productivity gains, measured on the basis of gross ton-miles (GTMs)/employee, have improved 55% for CN over the last fourteen years and nearly 75% for CP over the last 13 years. CN's employee productivity has risen from 10.5 million GTMs/employee in 1998 to almost 16.4 million GTMs/employee in 2012. CP's has risen from 10.0 million GTMs/employee to 17.4 million between 1999 and 2012.

With total fuel expenses for freight operations increasing over 5 times for CN since 1998 and 4 times for CP since 1989, both railways have strived to improve fuel efficiencies with new locomotive acquisitions and improved train operations. As a result, workload fuel consumption as measured by GTMs/gal (US) of fuel has improved by nearly 28% for CN since 1998, rising from 773 to 987 GTMs/gallon, and 21% for CP since 1999, rising from 725 to 879 GTMs/gallon.

Table 12 sets out a comparison between CN and CP of their respective locomotive unit use and workload efficiency.

Regarding locomotive unit use, switching locomotive-kilometres generated from yard and train operations in comparison to total freight locomotive-kilometres are set out for each railway. Between 1998 and 2009, the percentage of switching locomotive-km to total freight locomotive-km for CN has gradually declined from 12.5% to 8.8%. CP's percentage has declined from 12.7% to 10.9% over the same period of time.

Locomotive workload efficiency for switching operations can be measured by determining the proportion of switching locomotive-km per total freight carload. Between 1998 and 2009, CN's proportion of switching locomotive-km/ total freight carload has declined from 5.5 km in 1998 to 2.9 km in 2009. Over the same period, CP's ratio has essentially fluctuated between 5 and 6 km per carload.

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Table 12

**CN, CP Locomotive Unit Kilometres¹¹
And Switching Workload Efficiency**

	CN	CN	CN	CN	CN	CP	CP	CP	CP	
	Total Freight Carloads ¹² (000)	Switching Loco Km (000)	Total Freight Loco Km (000)	% Switching Loco Km	Switching Loco Km/ Carload	Total Freight Carloads ¹³ (000)	Switching Loco Km (000)	Total Freight Loco Km (000)	% Switching Loco Km	Switching Loco Km/ Carload
2009	3,991	11,577.2	130,839.9	8.8%	2.9	2,363	11,767.2	107,560.0	10.9%	5.0
2008	4,615	14,656.0	145,460.7	10.1%	3.2	2,645	14,090.8	135,074.3	10.4%	5.3
2007	4,744	15,236.9	149,504.6	10.2%	3.2	2,698	15,351.3	137,079.4	11.2%	5.7
2006	4,824	14,556.8	161,236.1	9.0%	3.0	2,618	15,779.1	133,535.7	11.8%	6.0
2005	4,841	16,158.6	160,558.9	10.1%	3.3	2,676	16,925.2	130,702.5	12.9%	6.3
2004	4,654	15,292.3	143,452.4	10.7%	3.3	2,699	16,645.7	129,986.2	12.8%	6.2
2003	4,177	14,310.0	140,971.6	10.2%	3.4	2,539	14,660.9	124,886.8	11.7%	5.8
2002	4,153	14,347.4	145,266.3	9.9%	3.5	2,447	14,263.6	113,991.5	12.5%	5.8
2001	3,821	16,303.5	152,986.8	10.7%	4.3	2,423	14,743.9	117,618.4	12.5%	6.1
2000	3,796	17,784.6	150,619.3	11.8%	4.7	2,395	14,848.1	126,831.4	11.7%	6.2
1999	3,645	17,845.8	130,951.3	13.6%	4.9	2,330	13,820.4	126,802.0	10.9%	5.9
1998	3,483	19,281.1	154,190.4	12.5%	5.5		17,845.8	140,732.1	12.7%	

3.4 Regulated Interswitching Impact on Customer Service

3.4.1 Railway Obligations

Railways subject to the *Canada Transportation Act* are required to provide adequate and suitable accommodation for the receipt and forwarding of regulated interswitching traffic at interchanges with other railways, as well as to handle such traffic in due diligence and without delay¹⁴. In other words, railways are required to provide service for regulated interswitching traffic as they would for traffic originating and terminating on their own lines. If a shipper or another railway feel that the railway in question is not fulfilling its obligations to provide an adequate level of service, the shipper or railway may file a level of service complaint with the Canadian Transportation Agency for an appropriate ruling.

¹¹ Statistics Canada – Catalogue 52-216XIE

¹² CN Annual Reports

¹³ CP Annual Reports

¹⁴ Sections 113 to 116 *Canada Transportation Act* – Level of Service provisions

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Over the past 10 years, the Agency has not received such a complaint involving dissatisfaction over the rail service provided for traffic specifically moving under the Railway Interswitching Regulations.

3.4.2 Railway Freight Service Review

As discussed in Section 1.5, the federal government undertook a review of rail freight service in Canada through the appointment of an independent Panel in the Fall 2009. The Panel submitted its final report to the Minister of Transport in December 2010. The federal government released the Panel's report¹⁵ on March 18, 2011.

The impetus for the Review arose from the increasing numbers of complaints being made in 2007-2008 from shippers and others about poor rail service. Complainants identified a number of chronic and widespread problems including poor railway performance in car supply and spotting problems at traffic origins/destinations, and concerns over the railways' aggressive asset utilization and balanced operations' policies which had been invoked by the railways to drive efficiency and financial gains.

The Panel heard many complaints about rail service provided by CN and CP. These complaints dealt mainly with:

- first mile/last mile service issues (poor car-order fulfillment, frequency and timeliness of service, communications, equipment condition);
- concerns over railway market power;
- the need for a more timely service dispute resolution mechanism; and,
- the need for the establishment and reporting of service performance metrics by both shippers and railways.

The extent to which the first mile/last mile service issues may have resulted from problems two railways may have been having when handling regulated interswitching traffic at interchanges was not specifically raised by shippers nor railways, nor analyzed through the Panel process.

¹⁵ http://www.tc.gc.ca/media/documents/policy/TP_15042_Final_Report_EN_WEB.pdf

Again, given that less than 4% of total rail carload traffic is moved under the interswitching regulations annually, the nature of the rail service concerns raised during the Panel process were emanating from shippers and other stakeholders involved in the broader, overall network of CN and CP and not specifically with regulated interswitching services being provided between two railways.

The Panel recommended a commercial approach with a regulatory fallback approach to address the four key elements of shipper concerns over railway service, including:

- adequate service change notification;
- rail service agreements;
- a timely and adequate dispute resolution process to address failure to reach a service agreement and any operational service complaints; and,
- enhanced supply-chain performance reporting.

With respect to the first key element (adequate service change notification), both CN and CP have provided commitments to the Government that each railway will give at least 10 days notice to shippers on any expected service change.

With respect to the second and third key elements (regulatory fallback provisions to address any failure to reach a service agreement, as well as an appropriate dispute resolution mechanism), the Government has recently tabled Bill C-52 to amend the *CTA* to address these two service-related issues. The Bill includes provisions that:

- require a railway company, upon a shipper's request, to make the shipper an offer to enter into a contract respecting the manner in which the railway company must fulfill its service obligations to the shipper; and,
- create an arbitration process to establish the terms of such a contract if the shipper and the railway company are unable to agree on them.

Bill C-52 is currently being moved through the parliamentary process and is expected to be implemented into law in 2013.

Regarding the fourth key element (enhanced performance reporting), the Government has announced that it will establish a Commodity Supply Chain Table, involving supply chain partners that ship commodities by rail, to address logistical concerns and develop performance metrics to improve

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competitiveness. It is expected that this planned roundtable will provide a forum for stakeholders to address logistical issues that affect the performance of the supply chain and to develop public performance reporting metrics. In addition to the Government's Commodity Supply Chain Table approach, both railways have been working directly with customers in the development of confidential performance "scorecards" which include statistics on first-mile/last-mile rail service, car-order fulfillment, overall origin/destination rail service and shipper/customer operational performance and other metrics. This railway/customer collaborative approach regarding bilateral performance reporting along with the Government's effort to facilitate the development of publicly reported railway/customer supply chain performance reporting will go a long way to identifying any service-related problems in the future.

3.5 Conclusion

In light of the efficiency and productivity improvements across CN's and CP's respective systems, as well as the fact that a relatively small proportion of total rail car traffic is actually interswitched between the two railways annually, one can conclude that any inefficiencies caused by the switching of rail cars between CN and CP for regulated interswitching purposes are not significant and that regulated interswitching does not have a negative impact on rail operations or customer service.

On the broader issue of rail service in general, the Rail Freight Service Review has provided an opportunity for all stakeholders involved in the supply chain to raise issues of concern from a rail service perspective and to have them addressed through the Review's recommendations and the Government's response.

4.0 CONCLUSIONS

Over the past 150 years, rail transportation legislation has evolved remarkably. Initial provisions saw railways in Canada as an instrument of public policies to promote regional and industrial development. Current provisions provide for competition and market forces, both within and among the various modes of transportation, as being the driver for viable and effective transportation services with appropriate shipper protections and dispute resolution mechanisms in place to address concerns that may arise.

Regulated interswitching has been a corner stone of the rail competitive access provisions that have developed over this time. Regulated interswitching dates back to the turn of the twentieth century

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when shippers were given access to a competing railway within a 4 mile limit of the interchange between the two railways. With the passage of the *NTA, 1987*, the limit was expanded to a 30-kilometre radius and rates were required to be fully compensatory. With the passage of the *CTA* in 1996, regulated interswitching was maintained. However, the regulated rates for such interswitching are now required to be commercially fair and reasonable to all parties.

Recent transportation policy reviews, along with ongoing Canadian Transportation Agency statutory reviews of the provision, conclude that Regulated Interswitching is a valuable mechanism. It continues to ensure that rail shippers derive, where available, the benefits of price competition, improved service levels and varying routing options. The railway companies receive, in turn, fair and reasonable compensation for the costs, including a fair and reasonable contribution to constants costs, for providing interswitching services, given the Agency's legislative role in this regard.

The extent of CN's and CP's total rail traffic exposed to regulated interswitching was last studied during the statutory review of the *CTA* in 2001. Findings reached indicated that 40% of total rail traffic had access to direct rail competition at both origin and destination under the 30-kilometre interswitching limit while over 90% of traffic was exposed to regulated interswitching at either traffic origin or destination. Despite the broad exposure of total railway traffic to regulated interswitching, only a small amount of traffic (less than 4% annually) is moved under the Regulations. Shippers who are captive to either CN or CP see their traffic largely retained by the respective railway to which they are captive, rather than being switched over to the competition at an interchange point under the Regulations. No doubt, shippers are, therefore, satisfied with the level of rates and service being proposed when negotiating with the railway to which they are captive and decide not to draw in the competing railway through the regulated interswitching provision. In short, the Interswitching Regulation policy generates rail competition where it would, otherwise, not arise.

Both CN and CP have generated significant productivity and efficiency gains across their respective systems over the past 15 years. As well, both have generated operating efficiencies in handling traffic in two of the four interswitching limit zones, where a relatively higher proportion of the total regulated interswitching traffic is handled.

In light of these efficiency and productivity improvements across CN's and CP's respective systems, as well as the fact that a relatively small proportion of total rail car traffic is actually interswitched between the two railways annually, one can conclude that regulated interswitching does not have a negative impact on rail operations nor customer service.

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