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Ms. Cynthia Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423

RE: Rail Transportation of Grain, Rate Regulation Review, STB Docket No. Ex Parte No. 665 (Sub-No.1)

Dear Ms. Brown:

Enclosed for filing in the above referenced proceeding is the Written Testimony of James Clements for Canadian Pacific Railway Company, Soo Line Railroad Company, Delaware and Hudson Railway Company, Inc., and Dakota, Minnesota & Eastern Railroad Company (collectively "CP").

During Mr. Clements' oral testimony at the June 10, 2015 hearing, Mr. Clements was asked when Canada introduced final offer arbitration for rail disputes. By this letter, CP confirms that final offer arbitration was introduced in Canada in 1987 by the National Transportation Act, S.C. 1987, Ch. 34.

Respectfully Submitted,

David F. Rifkind

Attorney for Canadian Pacific Railway Company

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 665 (Sub-No. 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATIONS REVIEW

JUNE 10, 2015 HEARING

WRITTEN TESTIMONY OF JAMES CLEMENTS FOR CANADIAN PACIFIC RAILWAY COMPANY, SOO LINE RAILROAD COMPANY, DELAWARE AND HUDSON RAILWAY COMPANY, INC., AND DAKOTA, MINNESOTA & EASTERN RAILROAD COMPANY

I am James Clements, Canadian Pacific Railway Company Vice President Strategic Planning and Transportation Services. I have over 20 years' experience at CP and relevant to this hearing this includes more than 3 years in various roles in Grain marketing and sales and more than 3 years as director of our U.S. Grain marketing and sales team.

We are grateful to the Board for the opportunity to present the comments of Canadian Pacific Railway Company on its own behalf and on behalf of Soo Line Railroad Company, Delaware and Hudson Railway Company, Inc. and the Dakota, Minnesota & Eastern Railroad Company, which I will refer collectively to as "CP." CP's last appearance before the Board was to provide testimony on rail service issues pertaining to the movement of grain. We responded promptly in the spring and summer of 2014 to clear the backlog created during the prior winter, and we are proud of the service we continue to perform for the grain industry.

Today, I will address the proposal made by the National Grain and Feed Association ("NGFA") in this proceeding that the Board should consider revenues and costs of CP's combined U.S. and Canada system operations when determining revenue adequacy in rate reasonableness challenges of grain shipments. While my testimony today is focused on the NGFA's grain-related proposal, I note that the issues raised by the NGFA proposal and my remarks apply more generally to all CP business and to the Board's revenue adequacy determinations for any purpose.

Policy Concerns

The NGFA proposal is bad policy. It focuses only on the immediate allegedly positive impact on revenue adequacy determinations for purposes of making it easier for U.S. grain shippers to obtain a rate prescription from the STB, and fails to take into account unintended and adverse policy implications.

Firstly, the proposal would distort the measure of financial health of United States rail operations and undermine the Board's ability to regulate effectively the rail operations subject to it jurisdiction. In its 2001 deliberations regarding consolidated reporting for commonly controlled Class I carriers (Ex Parte No. 634), the Board recognized that due to "different regulatory and labor regimes [in Canada and the U.S.] which can affect the cost structure and earnings of railroads," requiring railroads to report on their non-United States operations may distort the results of the U.S. operations subject to Board regulation. *Proposal to Require Consolidated Reporting by Commodity Controlled Railroads*, Ex Parte No. 634, at 4 (STB served Nov. 7, 2001). To avoid such distortion, the Board confirmed it would continue to require reporting only on rail operations within the United States.

Secondly, the proposal would make U.S. regulatory decisions sensitive to Canadian regulations and economic environment. If the Canadian regulatory and economic conditions create superior financial performance for the Canadian rail entity, the proposal would essentially amount to a cross-border subsidy to U.S. shippers. If those conditions create inferior financial performance for the Canadian rail entity, the proposal would make it more difficult for U.S. shippers to obtain a rate prescription.

Consider a situation where a Canadian regulatory decision that lowers rail rates for moving Canadian grain and negatively impacts CP's financial performance. The Canadian regulatory change could then have a negative effect on the revenue adequacy calculation effectively making it more difficult for U.S. grain shippers to obtain rate relief under NGFA's proposal. The end result is that U.S. grain shippers would be at a competitive disadvantage -- in some instances, doubly disadvantaged -- due to a change in Canadian regulations.

Thirdly, NGFA's proposal could penalize and discourage corporate structures that enable railroads to provide more efficient cross-border service and realize economies of scale. Consolidation of management, back office, and other functions translates into lower costs for operating entities on both sides of the border. These lower costs are reflected in the U.S. operating entities' data reported in the R-1 and, in turn, in the revenue adequacy determination and in URCS.

Fourthly, the proposal is discriminatory as it focuses only on CP and CN. It ignores financial performance of the foreign operations of railroads affiliated with other U.S. Class I's.

Regulatory and Economic Differences

A summary of the differences in the Canadian and U.S. regulatory and economic environments highlights the potential that Canadian changes could distort U.S. rail regulation determinations under the NGFA proposal.

Regulatory Differences

CP's operations are affected by differences in the labor laws of the United States and Canada. Differences in those laws and related regulations mean we have different work rules and separate labor agreements for our U.S. and Canadian work forces. The result is that the cost structure and operations of the Canadian operating entity are different from those of the U.S. operating entities. Likewise, the potential financial and operational impacts of labor disputes in the two countries differ.

The approach to rail policy and regulation in the two countries also differ significantly. Canada tends to take a more heavy handed approach to regulation than the United States. The Canadian policy objective stresses the need for competition to achieve the lowest total cost for all modes of transportation and to advance the overall the well-being of Canadians irrespective of the impacts on the rail industry. While the overall goal of U.S. policy is similar, there is an explicit recognition that rail carriers require adequate revenues to ensure survivability, to maintain the rail system, and to attract capital. There is no explicit provision in the Canadian legislation or supporting regulations to review and consider rail revenue adequacy. This difference is manifested in Canadian regulatory rate challenges, where the impact of disputed rates on shipper finances is deemed relevant but the effect on rail finances is not.

Regulatory differences are evident at the technical level as well. CP reports separate ledgers of the relevant entities under the Canadian Uniform Classification of Accounts, U.S. Uniform System of Accounts, and for tax treatment in both Canada and the U.S. These differences can have material impacts on company finances. For example, Canadian rail pensions and other employee benefits are recognized on a cash basis as opposed to an accrual basis in the United States.

U.S. rail regulation has been fairly stable in the post-Staggers era. In contrast, during this same time period, the Canadian rail regulation has experienced numerous significant changes. In fact, the Canadian Transportation Act mandates regular comprehensive reviews of the Act. Such a review by the federal government is currently underway, and recommendations for changes are due in December. The changes could affect any component of the law or regulations.

Most significantly from a grain transport perspective, the regulation of our Canadian export grain business takes the form of a revenue cap that is adjusted annually to reflect changes in costs and volume.

Economic Differences

Differences between the Canadian and U.S. economies likewise affect the financial performance of CP's Canadian and U.S. entities.

At a high level, a key difference is that Canada is heavily dependent on primary resource industries, including agriculture. As Canada has a relatively small domestic market, Canadian producers are more heavily dependent on export markets.

Currency value fluctuations create two types of variability. Changes in the Canada/US exchange rate directly affects the measured financial performance of CP measured in Canadian dollars. Those changes also affect the competitiveness of CP's export-oriented customers.

CP's traffic mix reflects the export-orientation of the Canadian economy. Only about one-third of CP's freight revenue is earned on traffic that originates and terminates in Canada. Traffic that crosses the Canada-U.S. border accounts for another third, and traffic that ultimately originates or terminates in an offshore country accounts for the final third of CP's freight revenue.

Similarly, in the context of the NGFA proposal, there are a number of noteworthy differences in the Canadian and U.S. grain markets. The United States produces eight-times as much cereals, coarse grain and oilseeds as does Canada. Canada exports a much larger portion of those crops. For example, in 2014, the value of Canada's exports of these crops was one-third the value of the US exports of these grains. CP moves large volumes of grain in both Canada and the United States. In 2014, CP originated 291 thousand carloads in Canada and 173 thousand carloads in the United States. Reflecting the dominance of the export trade in Canada, 75% of the grain originated in Canada was delivered to a terminal for offshore export. In contrast, 28% of the US originated grain traffic terminated at an offshore export position.

CP's Canadian originated grain is dominated by wheat (31% share), canola (18%) and durum (17%), with the three commodities accounting for two-thirds of the total. CP's U.S. grain traffic is even more concentrated on a commodity basis, with wheat (24% share), corn (21%) and soybeans (17%) accounting for almost three-quarters of the total. Of note while corn and soybeans account for 38% of our U.S. originated shipments they account for only 1% of Canadian originated shipments.

Reporting Integrity

I also want to address and to reject any implications that CP may artificially understate the revenue adequacy of its U.S. operations.

The CP group offers a highly integrated rail transportation service in North America to its customers. The high degree of integration requires centralized management that benefits the entire CP rail network.

In accordance with its Intercompany Policy and as administered by an internal transfer pricing committee, CP follows consistent practices from year to year for its head office management service allocation of costs. CP consistently uses the services cost method in accordance with the IRS Treasury Reg. Section 1.482-9(b) to allocate head office costs that benefit the U.S. operations. Canada has similar tax regulations requiring such allocation. CP has undergone tax audits from both the Canadian and U.S. tax authorities to ensure that such allocations have been reasonably made.

As a check, the transfer pricing committee reviews the operating ratio of the Canadian operations and the U.S. operations to ensure reasonableness and will investigate any unusual variances for remediation. In 2013, the operating ratio of CP's Canadian operations was 70.3% and the operating ratio of CP's U.S. operations was 68.5%. The difference in operating ratios was not unusual and is illustrative of the impact on the bottom line of the numerous differences between the Canada and the United States.

Jurisdiction

The change proposed by the NGFA is fundamentally inconsistent with the Board's statutory authority and mandate. The Transportation Act of 1920 is clear that jurisdiction of the Interstate Commerce Commission applied only to transportation within the United States, with jurisdiction over trans-border moves essentially ending at the border. In 1945, the U.S. Supreme Court noted that the U.S. Congress, through the limiting provisions of 1920 Act, chose not to give the ICC "the authority to regulate rail transportation in foreign countries." *U.S. v. Pennsylvania R. Co.*, 323 U.S. 612, 621 (1945). Since then, Congress has declined to expand the ICC's and STB's jurisdiction to empower it to regulate rail transportation in foreign countries. Accordingly, the STB lacks authority over rail transportation in Canada, and lacks authority to require Canadian entities to report Canadian financial data for Canadian rail operations and to use that data as the basis for regulatory actions.

~~In practice, the STB has properly limited reporting requirements to finances of U.S. rail~~ operating entities and excluded from its financial reporting requirements data from companies an operations that are outside its regulatory jurisdiction. In 2001, the Board rejected the notion that the STB regulatory decisions should take into account Canadian rail operations. *See* Ex Parte No. 634, at 4.

Conclusion

NGFA's proposal ignores the *long* term negative implications of making U.S. shipper access to rate relief dependent in part on the performance of Canadian rail operating entities. NGFA's proposal is an effort to manipulate the revenue adequacy determination in order to make it easier for shippers to obtain a rate prescription at the Board. NGFA's proposal ignores the fact that the Board lacks statutory authority to regulate Canadian rail transportation and ignores the STB's prior decision rejecting such a proposal. The changes that NGFA proposes are neither lawful nor in the long term interest of United States rail carriers or shippers.