

**Government of Alberta Submission to
The Federal Rail Freight Service Review**

January 2010

Alberta Transportation's Submission to the Federal Rail Freight Service Review

Introduction:

The success of Alberta's economy is contingent upon a safe, reliable and efficient transportation system that connects producers and consumers with domestic and international markets: Over 60% of Alberta's economic output is exported outside the province and over 75% of this production volume is shipped out of Alberta by rail. As a result, Alberta's economy is highly dependent on a world class rail transportation system.

Due to the importance of rail transportation to the provincial economy, Alberta Transportation has taken the opportunity to consult with shippers from a cross section of different industries to gauge their experience with rail service over the past three years. The consultation involved a survey requesting information about the shippers' business activities, experience with railway service, the effects of rail service on their operations, and their experience in using the *Canada Transportation Act* (CTA) shipper protection provisions. While every rail shipper in Alberta was not contacted, the consultations solicited input from shippers accounting for approximately 75% of the total rail volume originating in the province.

While some shippers have had positive experiences with their rail service providers, the majority of shippers, especially those in geographically isolated industries or in industries that ship into competitive international markets, have had negative experiences with rail service. This submission contains two specific and separate components. The first section provides Alberta Transportation's specific concerns and recommendations on how the federal government should address rail service issues. The second section, developed from responses to the shipper survey, identifies Alberta-based shipper experiences with rail service and shippers' recommended solutions to address rail service issues in Alberta.

Alberta Transportation's Concerns Regarding Railway Competition:

Alberta Transportation has received a significant amount of feedback from shippers through the survey consultation completed in the fall of 2009 in addition to letters sent to the Ministry from shippers over the past few years. The province has heard extensively about poor rail service and examples of inadequate capacity in the rail transportation system to get Alberta originating products to market. Alberta Transportation believes that the cause of rail service concerns in this province, and across Canada, is caused by a fundamental lack of competition in the market for rail transportation services.

A duopoly exists in the rail transportation industry in Canada that stifles competition in many geographic markets. In Alberta's most competitive market for rail services, the Calgary-Edmonton corridor, a duopoly exists where Canada's two Class 1 railways compete for freight transportation business. Outside of this region, virtually no intra-modal competition exists in the market for freight rail transportation services. One railway maintains a geographic monopoly in the rural northern half of the province and the other holds a monopoly in the rural south.

Many bulk commodity shippers in these regions are dependent on rail as their only cost effective means of transporting products to domestic and international markets. The economic health of many shippers, industries and communities are dependent on a competitive rail freight transport marketplace that encourages innovative and reliable service options. From trends identified through consultation with shippers, it is the view of Alberta Transportation that monopoly and duopoly markets in the province are limiting the quantity and quality of rail services available to shippers. Of particular concern to Alberta Transportation are comments by some shippers that they have directed investment and resulting jobs to other jurisdictions due to a lack of competitive rail services in this province.

A significant amount of work on the issue of rail competition and the contestability of the Canadian freight rail network has been done in the past, including work completed by the 2001 Canada Transportation Act Review Panel (CTAR). The existing regulatory system that supports monopolies and duopolies will always result in capacity rationing and poor service to Canadian and Albertan shippers. Any solutions prescribed in this review that work within the existing federal policy and regulatory framework will only mitigate some of the symptoms of the current problem, which is a lack of competition in the Canadian railway industry. Fundamental changes to the CTA would need to be made to increase competition on federally regulated railway rights-of-way.

Alberta Transportation's Recommendation:

Section 138 of the CTA contains provisions allowing for running rights on track owned by federally regulated railways. Under the CTA provisions, the Canadian Transportation Agency (the Agency) can approve running rights applications and can fix compensation levels for railways operating on rail lines owned by another railway. The 2001 CTAR Panel recommended expanded running rights provisions be added to the CTA that would allow running rights with traffic solicitation rights. Alberta Transportation supports those recommendations. As a result, Alberta Transportation would like to see the current CTA provisions changed to make it easier for running rights applications to be approved by the Agency as a way to foster competition in the railway industry in Canada.

Shipper Comments Regarding Rail Competition:

Extent of Rail Service Issues in Alberta:

The following comments and recommendations were raised by shippers as problems affecting rail service in Alberta and ways to address those issues. These comments provide alternate feedback and solutions for Transport Canada to consider as it moves forward to address rail service issues facing shippers in this province.

1. Alberta's Marketplace for Rail Service:

Most products transported by rail are high-volume and low-cost, which makes them sensitive to input prices like transportation. As a result, only 26% of resource producers surveyed by Alberta Transportation indicated that they have the option to move their products by another mode (e.g., truck) to distant locations. This is due to truck transportation being more expensive on average than rail over long distances. Compounding this problem is that 32% of the shippers surveyed indicated that they have access to only one railway and therefore lack competitive transportation options.

In some transportation markets, despite reduced volumes and reported surpluses of idle equipment due to the recent recession, many shippers have seen rates continue to rise and service issues persist. This does not indicate a competitive marketplace, but rather a market in which the supplier has enough power to maintain high prices and poor service at a time of excess capacity and lower demand. In these situations, shippers are concerned about the ability of their rail service providers to dictate service levels and rates that solely meet railway financial targets instead of meeting the needs of their customers.

2. Shipper Experiences with Rail Service Efficiency:

Only 36% of shippers agreed that their rail service was efficient. Shippers generally agree that rail carriers are efficient when the product moves between the origin and destination. However, inefficiencies exist at the start and end of the trip which can result in delays to their customers. These delays often result in additional costs to the shipper from idle equipment and charges from missed sailings at the port. To improve efficiencies, the railways require shippers to adjust their operations to conform to railway operational practices such as with quick release times for rail cars. Shippers have advised that this reduces the railways' costs, but does so at the shipper's expense as they must now change their production schedules to meet railway operational requirements. These operational changes affect the viability of many shippers due to lost sales and reduced financial performance. Shippers have also indicated the railways do not share the benefits of their improved efficiencies with them.

3. Shipper – Railway Relationships:

Communications, order processing and responding to customer concerns has been cited by a number of shippers as areas of their rail service that requires improvement. Only 50% of respondents agreed that their communications with the railways were good, 59% of respondents

agreed that the railways were good with order processing, while only 30% of shippers indicated that their railway(s) were good at responding to their concerns in a way that resolved problems in a cost-effective manner. Overall communication between the railways and their customers has been poor.

One of the main relationship-related issues shippers have consistently raised has been that of railway ancillary charges. In addition to the financial burden of these charges, shippers have indicated that the systems used by the railways to calculate the charges over-estimate the value of the fees to shippers. A number of shippers have stated that they must employ full-time staff to double check the accuracy of ancillary charges. This leads to additional costs to industry, inefficiency in the economy, and distrust between supply chain partners. The perception among most shippers is that ancillary charges have lost their effectiveness as a tool for improving asset utilization due to their inaccuracies. Despite shippers' efforts to work with the railways on eliminating problems with ancillary charges the issues continue to persist.

4. Ability of Railways to Deliver on Service Attributes:

Service consistency in terms of rail car delivery was raised as a significant issue facing Alberta shippers. Only 20% of shippers surveyed agreed that they receive consistent service from their rail service provider. The key issue cited by shippers was the lack of timely car spots and late pickups for loaded rail cars. Shippers require consistent and timely car spots so that they can schedule staff to load cars when the car arrives at the plant site. If cars are not spotted on time, employees sit idle during their shifts while new crews must be brought in or existing crews get paid overtime to load the cars once they arrive. If the additional labour costs are not paid out to employees to load the cars, the shipper will often have to pay demurrage to the railway for cars that are loaded and released late.

Car placement, in terms of the numbers of cars supplied, has been of particular concern to many shippers with approximately 70% of respondents indicating this was an ongoing problem. Inadequate numbers of cars delivered to shippers can result in lost orders and the inability for shippers to meet demand as they often do not have enough rail cars to move their products to customer locations. Shipments must then be stored at their facilities while they wait for additional cars to be supplied by the railway. This increases shipper costs for two reasons. First, the producer must now use their land and facilities for non-value added storage activities and second, shippers must make more material handling moves as they move the products to storage and again later to load the rail cars when they arrive.

Inconsistent switching of cars into and out of yards, increasing car cycle times, and poor order fulfillment have also been flagged as being significant problems for Alberta-based shippers. Only 27% of shippers surveyed indicated that they received good service in terms of car cycle times and timely car placement, while 31% of shippers indicated that they received good service in terms of order fulfillment. Concerns have been raised by some shippers regarding car cycle times in poor weather during winter months even though poor winter weather tends to occur on a yearly basis and should be anticipated by the railways.

Shippers have indicated that railways are too focused on internal measures to appease financial analysts. As a result, when there is extra equipment available, the cars are parked by the railways and shippers are guaranteed less equipment than required. This decreases the transportation capacity available to shippers while improving rail metrics like car velocity. Parking idle equipment also reduces shippers' access to additional rail cars needed for special projects that require a larger than normal volume of cars. This hurts the shippers' ability to serve their regular customers and compete for new business in highly competitive markets.

5. *Distribution of Railway Equipment:*

Shippers have voiced concerns about more favorable allocation of cars to some regions. In particular, shippers have indicated that rail cars tend to be allocated first to areas that have rail competition. Shippers have also advised that larger commodity shippers such as potash, coal and grain from high throughput elevators get priority service over smaller producers. This is due to the scale economies for railways that favour serving larger producers over smaller producers to maximize efficiency and lower costs. Finally, areas with high customer densities also tend to have better access to equipment and quality rail service than do customers in more remote or rural locations.

6. *Effects of Service on Shipper Economics:*

Poor rail service can have significant impacts on the economics of shippers operations. In addition to the costs of additional staff and overtime as well as lost revenues, poor rail service can force shippers to find more costly transportation options to get their goods to customers. Some shippers have indicated that they have had to truck their products to areas that have enough rail cars to meet the customer's needs. The lack of service reduces rail operational costs by pushing the costs onto the shipper who must now truck products to locations with adequate rail capacity at their own expense.

The inadequate provision of cars, late pickups and late car spots can also result in demurrage charges to the shipper for missed vessels and charges for idle port labour. The shipper pays the demurrage penalty for being late but there is no mechanism to ensure railways comply with the shipper's needs for timely service or the number of rail cars necessary to move their product to market. The burden of on-time performance rests solely on the shipper despite the fact they have little control over rail service.

7. *Results of Poor Service on the Operations of Alberta Shippers:*

Over 88% of survey respondents indicated that railway competition was an important factor when making business investment decisions. However, geography and location of resources often leaves shippers with few competitive options for resources extraction (e.g., coal deposits), which leaves companies with a single railway should they wish to access the resource. This leaves many industries without competitive rail services.

Poor rail service has caused two major issues for Alberta shippers. First, a small number of survey respondents in Alberta have seen plant closures due to poor rail service and

uncompetitive rail rates. Second, a larger number of shippers have indicated that they have lost customers due to their inability to provide accurate delivery times to their customers. This often occurs when the shipper cannot access a second railway for service when their rail service provider does not meet its common carrier obligations. Overall, 19% of respondents have indicated that they have either shut down a facility or have directed investment dollars to other jurisdictions due to a lack of rail competition or poor rail service in Alberta. This hinders investment in rural areas of Alberta and impedes the ability to attract new industries to the province.

8. Use of the Shipper Protection Mechanisms in the Canada Transportation Act:

Approximately half of shippers surveyed, 54%, have lodged complaints with the Agency. Shippers have indicated that they see value in shipper protection mechanisms even if they are not used because railways are aware of the potential repercussions of not treating their customers in a fair and equitable manner. The most commonly used mechanisms by Alberta-based shippers were interswitching, Final Offer Arbitration (FOA), and Level-of-Service Complaints. These mechanisms do not work for all shippers however.

A number of shippers have indicated that the limited distance for interswitching rules prevents them from maximizing the benefits of this particular shipper protection mechanism and that they would use interswitching if the distances were expanded above the existing 30-kilometre limit. A number of shippers have also indicated that Competitive Line Rates (CLR) do not work because railways refuse to compete for CLR business out of fear of reprisals by the competing railway. As a result, only one shipper surveyed had used a CLR and this shipper indicated the provision did not work for their firm.

Small companies are unable to use many CTA mechanisms such as FOA and Level-of-Service complaints as they lack both the human resource capacity and financial resources to launch a successful challenge. This also applies to many large shippers in Alberta that sell into competitive international markets with low margin products. These two mechanisms, while effective, are expensive and the potential return to companies when mounting a challenge against a railway is often negative. This prevents many companies from gaining the benefits from the CTA.

Shippers indicate that a number of changes to the CTA in 2008 have made it easier to mount Level-of-Service challenges as the sufficient commercial harm clause has been removed. However, the onus and cost to prove that poor service is being provided by their rail service provider is still placed squarely on the backs of shippers who are already suffering.

9. Provincial Government Concerns Pertaining to Grain Transportation Services:

The Government of Alberta recognizes that producer cars play an important role in the transportation of agriculture commodities. By using producer cars, farmers are able to save on storage and elevation charges. Grain and oilseed producers make considerable investments in car loading sites but have little say in decisions pertaining to the delisting of producer car loading sites. Under the CTA, prescribed railway companies can remove a siding after advertising their