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Rail Freight Service Review Secretariat
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The following document is the submission of Keystone Agricultural Producers (KAP) to the Federal Rail Freight Service Review panel.

Sincerely,

Ian Wishart, President
Keystone Agricultural Producers

Summary of Recommendations for the Federal Rail Freight Service Review Panel

- Increased penalties for service failures, comparable to those charged by the railways to ensure high performance levels by shippers.
- Revised Level of Service complaint process and mediation to make it more accessible to small shippers.
- Time restrictions on Agency reviews and decisions.
- An in depth analysis of the overall impact of railway operation rationalization on the grain handling and transportation system in Western Canada.
- A mechanism in the Revenue Cap program to ensure that scope of service reductions are followed by reductions in the cost of service.
- All recommendations applied to railway service at grain elevators should be extended to producer car shipments.
- The legislation that governs the abandonment of producer car loading sites requires change to better protect the infrastructure.
- The Minister of Transportation, Infrastructure and Communities should place a moratorium on the salvaging of rural rail sidings until a study can be undertaken to assess the value of these sites.

Introduction:

On behalf of Keystone Agricultural Producers (KAP) and our farmer members, thank you for inviting industry to make comments and present recommendations for the Federal Rail Freight Service Review.

KAP's submission is based on the experience of our members as indirect shippers of grain and other crops through the elevator grain handling and transportation system and as direct shippers through the producer car network. The information contained in this submission provides the basis for our recommendations and was collected through interviews with individual producers and producer car shipping associations; consultation with government and industry groups; as well as from the consultant studies done for this review as well as other publically available reports on Canada's grain handling and transportation system.

Background to Issues:

Due to our geographic location and dependence on export markets, Western Canadian farmers are forced to transport grain and other crops to port for overseas sales and delivery. To be competitive with international sellers, the only cost effective shipping option available to prairie farmers is bulk rail transport. These realities make grain shippers a captive market to the two mainline carriers, Canadian National Railway and Canadian Pacific Railway.

A captive customer, minimal competition and substantial barriers to entry into the industry has granted these mainline railways substantially more market power than their customers. It is KAP's position that many of the railway service failures are founded in this lack of competition in the marketplace. In Section 3.2 of the report *Description of Canada's Rail Based Freight Logistic System*, commissioned for this review, independent analysis confirms that effective competition for grain shipping does not exist, leading to a situation where the railways are not compelled, or driven to provide service and pricing levels comparable to those that would exist under a competitive system.

Because of the problems associated with limited competition industries, government has a responsibility to regulate the activities of the railways to ensure the long term economic sustainability of shippers, and subsequently the railways' long term survival. Regulation of the shipment of Western Canadian grain is focused on cost of service and is currently done through the Revenue Cap program. The Revenue Cap program guarantees the two mainline carriers a profitable rate of return on their operations cost for shipping Western Canadian grain but limits the total revenue allowed to be collected, preventing an outright abuse of dominant market position. Additional information is available on pages 67-68 of *Description of Canada's Rail Based Freight Logistic System* and should be carefully considered as an example of effective (though flawed) regulation of railway operations.

Issues with the level of service provided by the railways have largely been unregulated to date. As several of the consultant studies have indicated, service levels provided by the mainline carriers are not adequate. Service failures impact farmers negatively in multiple ways.

Due to unequal market power, farmers are price takers in their commercial relationships, including with grain elevator companies. Because of this fact, any additional cost the elevator companies incur due to service failures are passed on to their farmer customers through the basis costs factored into sale and delivery contracts.

This submission will provide a summary of issues and consequences related to service failures that directly impact farmers as grain shippers. Broadly they will be categorized as car fulfillment, delivery and transit issues; accesses to delivery point issues; and producer car issues.

Car Fulfillment, Delivery and Transit – Issues:

Farmers' experiences supports the data collected and reported in the QGI Consulting report *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*. Both railways have been incapable of meeting their own forecasted service performance and constantly deliver ordered cars late. Many of these specific issues are outlined in Section 2.2.5 of the above mentioned report and should be carefully examined by the panel. We anticipate that the Western Grain Elevator Association (WGEA) will be able to provide technical details regarding service failures and we encourage the panel to review the WGEA submission carefully.

Costs to the elevators include extra staffing requirements, costs for trucking service that go unused and demurrage. As mentioned previously, the extra costs that the elevators incur when the delivery of ordered hopper cars is delayed costs farmers directly. Farmers also incur additional costs when there is a late delivery of hopper cars to the elevator related to the cost of storing and transporting the grain as well as relating to increased difficulty with managing a farm business.

Issues at port including late delivery, delays in unloading or slow transit times also cost farmers substantially. Much of Canada's international grain sales are time sensitive for delivery. Processors often have relatively limited storage for inputs and need a lean supply chain to ensure that their operations run efficiently. Edible bean exports are especially time sensitive, needing to be delivered and consumed during a very short holiday season. When product reaches customers late due to railway service failures, the Canadian producers in turn either receive a discounted price or lose the sale entirely. As a result of the inability of Canadian exporters to supply product on time consistently due to railway service failures, Canada's reputation as an international seller is damaged despite our high quality products.

Car Fulfillment, Delivery and Transit – Recommendations:

KAP would like to offer the following recommendations to the panel for consideration. We support the use of regulation that would mimic a competitive marketplace for rail freight service for all sectors.

Increased Penalties for Service Failures:

As reported in *Dual Railway/Shipper Accountability and Poor Performance* “the railways are subject to very few penalties for failing to meet their commitments to shippers.” The Canadian Transportation Agency needs to be legally endowed with the power to further mediate the commercial relationship between the railways and shippers. This must include the ability to order the railways to pay penalties to shippers for service failures that are equitable with the penalties that the railways use to ensure high performance levels on the part of shippers.

Further, recognizing that service failures cost the entire grain production and marketing industry, KAP encourages the panel to recommend that the Canadian Transportation Agency (the Agency) assess the feasibility of adding penalties to an underperforming railway by making reductions in their maximum revenue entitlement under the Revenue Cap program. KAP also insists that no penalties be allowed as deductions from capped revenues for the shipment of grain as to not allow the railways to recover penalties when maximizing their revenues under the cap.

Level of Service Complaint Process:

The present Level of Service complaint process used to mediate issues including service failures is still too onerous for most shippers. This is especially true in the case of producer car shippers who have very limited time and none of the financial or legal resources that the railway companies have access to. The Agency must be responsible for a larger portion of the Level of Service complaint process, including the ability to record and track unresolved complaints. When trends in these complaints are found, the Agency should then be able to initiate a Level of Service complaint on behalf of a shipping industry as a whole with penalties going to an appropriate industry research organization.

The mediation process that the Agency is suggesting for many issues is a positive program but there must be a degree of compulsion on the railways behalf to participate. KAP has attempted to engage CN in this process to open the lines of communication on an issue but to date CN has refused all mediation with us. KAP suggests that the panel recommend that the Agency be authorized to force a mainline rail carrier to initially engage in the mediation process and hear the issue being raised.

Finally, time limits on Agency decisions regarding level of service must be put in place. In the past, railway companies have been accused of intentionally delaying the Agency decision process in order to push the consequences into future crop years.

Access to Delivery Points – Issues:

Section 1.21 *Network Rationalization*, of the *Description of Canada's Rail Based Freight Logistics System* report outlines how both mainline carriers have been reducing the scope of their operations to focus on mainline service to improve their own operational efficiency, a process commonly referred to as the rationalization of operations. Since 1996, 1862 miles of track have been discontinued in the prairies mainly due to the abandonment of grain dependent branch lines. The above mentioned report describes shortline railway companies filling the service gaps created by this rationalization process but it must be understood that shortlines are operating in a limited number of regions and do not compensate for the total grain handling system losses. The rationalization of mainline carrier operations has resulted in an overall reduction in the service provided for Western Canadian grain producers. Grain companies have adapted and joined the railway companies in this rationalization process by abandoning many smaller branch line elevators and focusing operations on the mainlines with high throughput elevators. It is farmers who pay the additional costs associated with transporting grain further from the farm to elevator delivery sites.

In a truly competitive industry, the only justification for reducing service for a customer would be an accompanying price reduction, otherwise a firm willing to accept a lower profit margin would provide better service, or a lower price. This has not been the case with the rationalization of railway operations and is key to understanding how the level of service and cost of service are so closely related as issues in the rail freight service industry.

Railways have pushed their operational rationalization by providing multicar block incentive rates to grain companies. Grain companies in turn provide a portion of this incentive to farmers as trucking incentive for delivery to high throughput elevators on mainlines, reducing traffic on grain dependent shortlines, consequently justifying their abandonment. While it may appear that both grain companies and farmers are benefiting from this process, as an aggregate farmers take a substantial loss as a result.

Under the Revenue Cap program, railways are entitled to reduce their capped earnings by their multicar block incentive payments. Because the railways have historically been maximizing their allowed revenues under the cap, they recover all incentive payments through freight rates, essentially forcing farmers to finance the program responsible for reducing their rail freight services. No single producer can afford to refuse these trucking incentives because they are trapped in a classic economic prisoner's dilemma where an individual stands to lose substantially without the guaranteed cooperation of other individuals.

Rationalization of railway operations has not necessarily improved the efficiency of the grain handling and transportation system as a whole. Railway costs have simply been passed on to other members of the system. Farmers pay the cost of trucking grain further to delivery sites, a far less efficient method of transportation compared with shipping by rail. Provincial governments and taxpayers in turn bear the cost of highway maintenance and upgrades associated with the additional heavy truck traffic. The end result of the

mainline railway companies' operational rationalization has been a reduction in service and addition of cost to farmers specifically, without corresponding reductions in charges for service.

Access to Delivery Points – Recommendations:

KAP offers the following recommendations realizing that this is an issue unique to the shipment of bulk grain.

Impact Study:

We suggest that the panel make a recommendation that the Agency or a hired consultant do an in depth analysis of the overall impact of railway operation rationalization on the grain handling and transportation system in Western Canada. Issues to be assessed must include the added cost to farmers through increased trucking to delivery points; environmental impact of the additional trucking distances compared with use of rail; impact on rural communities due to the loss of infrastructure and economic activity; cost to provincial government and taxpayers for increased highway repair and upgrades; and the exclusion of incentives paid by a railway company from capped revenues and the resulting impact on the grain handling and transportation system.

Further, the Agency should suggest regulatory amendments based on the study that would reduce negative impacts associated with reductions in the scope of railway service to rural communities.

Reduction in Charges Accompanying Reductions in Service:

KAP recommends that the Revenue Cap program be amended to include a costing review mechanism to ensure that when a railway company reduces the scope of their service and their subsequent costs, freight rates are reduced accordingly to mimic a competitive marketplace.

Producer Cars – Issues:

The producer car shipping network provides farmers the option of bypassing the elevator handling network and shipping grain by rail directly to port for export. Farmers can save money on elevation fees through this process but it does require substantial effort on their part. Often producer car shipping associations are formed when farmers in the same region are able to commit to using producer cars and are able to share costs at loading sites and combine shipments for efficiency.

Even when producer cars are not being commonly utilized in a region, their availability is critical to maintaining a competitive grain handling industry. The option to ship producer cars forces elevator companies, who have a market advantage over farmers, to be

competitive with their pricing and incentives for fear of losing customers to producer car shipments.

The volume of grain shipped by producer car has been consistently increasing in Western Canada. According to the *Third Quarter Report of the Monitor – Canadian Grain Handling and Transportation System*, between the 07-08 and 08-09 crop years alone, there was 13.9% growth in the volume of grain shipped by producer car. This growth has occurred despite a decrease in the number of sites available for loading producer cars from 709 to 454 over the past nine years, largely due to a reduction in the number of mainline carrier owned and operated sites.

As with smaller elevators on grain dependent branch lines, the mainline railway companies prefer to focus their operations away from smaller block movements of producer cars. While shortline carriers have been able to fill some of the service gaps left by railway operational rationalization again, there are still issues that need to be addressed to ensure that producers retain the ability to ship producer cars.

Many of the service issues at elevators reviewed in the consultant studies and in shipper submissions extend to producer cars orders as well. Constant delays and late delivery of cars are endemic in the producer car shipping process.

Mainline carriers must be capable of serving the needs of producer car shippers as a part of their service obligations. The current trend of delisting and salvaging rail sidings used for loading producer cars impedes this ability. Without access to a loading site within a reasonable distance, the option and benefits of loading producer cars is lost along with other rural economic development opportunities.

Producer Cars – Recommendations:

KAP urges the panel to ensure that all recommendations applied to railway service at grain elevators be extended to producer car shipments.

Further KAP urges the panel to make recommendations regarding a change to the legislation that governs the abandonment of producer car loading sites to ensure that farmers throughout the prairies continue to have access to this valuable shipping option. Our specific recommendation is that section 151.1(1) of the Canadian Transportation Act, be amended to expand the requirements for delisting and salvaging rural rail sidings used for producer car loading to include;

A minimum of three years formal notice of intention to delist and salvage a site to be provided to; The Canadian Transportation Agency, both Federal and Provincial Ministers of Agriculture and Transportation, the Canadian Wheat Board, the Canadian Grain Commission, provincial and national grain, oilseed and pulse commodity groups and general farm organizations, relevant municipal councils and mayors and any known producer car loading groups in the region.

An offer to sell the site for no more than salvage value to any of the above listed or other groups.

Compensation to affected municipalities if a site is salvaged.

A minimum service obligation to non-railway owned sites with penalties for non-compliance.

We also urge the panel to recommend that the Minister of Transportation, Infrastructure and Communities place a moratorium on the salvaging of rural rail sidings until a study be done by the Canadian Transportation Agency on the overall value of rural rail sidings to the grain handling and transportation system as well as overall rural economic development.

Conclusion:

Many rail freight service issues can be traced to the lack of competition in the market, specifically in grain shipment where customers are a captive market to the mainline railway companies. Without more competitive options available to shippers, government must regulate the operation of CN and CP to ensure that shipper industries remain viable. The accuracy, cost and scope of railway services are integrated issues that must be addressed as a whole.

We welcome any questions that the panel may have regarding this submission and encourage the panel to carefully review and consider the recommendations made by other Western Canadian grain shippers and their representatives.

Thank you.