



Submission to the Rail Freight Service Review Panel

Railway Association of Canada

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1. BACKGROUND

1.1. The Railway Association of Canada

The Railway Association of Canada (RAC) has some 50 railway members and represents virtually all freight, tourist, commuter, and intercity passenger railways operating in Canada. The RAC membership also includes the U.S. Class I railways operating in Canada. CN and CP (members of RAC) also own and operate extensive railway operations in the United States. RAC members play a key role in promoting the safety, viability, and growth of the railway industry within Canada.

The RAC conducts the research, policy development and the advocacy necessary to promote the efficiency of rail. The association informs all levels of government and transportation-related businesses about the advantages of rail. The RAC endeavours to ensure equity treatment among other modes.

The headquarters for the RAC is located in Ottawa. The RAC also has technical field staff located in Vancouver, Edmonton, Toronto and Montreal.

1.2. The Importance of Freight Rail to Canada

Canada is a trading nation. Total trade accounts for 61 per cent of GDP and rail is critical to the facilitation of our trade flows. As such, railways are vital to Canada's economy and society. They are an extension of the country's communities, and industrial and resource bases.

Railways provide a seamless system linking the regions to national, NAFTA and global markets through major centres, borders and port-gateways. In 2009, the global or port-related business of the two Class 1s amounted to approximately 30 per cent of their total freight revenues. In the recent years, we have seen a significant increase in U.S and North American trade with China. Canadian exports and imports move to and from ports mostly by rail. Canadian railways are also moving Chinese exports destined to the U.S., through British Columbia port facilities.

The Canadian rail system extends throughout the country and across North America, with a total network comprising of nearly 50,000 kilometres of operated track.

Freight railways contribute \$10 billion annually to the economy and directly employ more than 35,000 people. Railway suppliers employ an additional 50,000 people in Canada. Rail plays an important role in the Canadian transportation market, each year moving:

- 346.5 B revenue tonne-kilometres of freight, a 14.7 per cent increase since 1999
- 4.0 million carloads of freight
- 0.8 million containers and trailers

There are approximately 40 short line railways in Canada operating on about 16,000 kilometres of track and providing an important service to local economies. Short line railways play a significant role in the Canadian economy, feeding and receiving traffic to and from the long haul, high volume main line railways. Short lines carried about 23 per cent of originated carloads in 2008.

The railway industry provides many exceptional benefits to the quality of life of Canadians. In addition to providing essential transportation services, rail is environmentally friendly. In Canada, approximately one-quarter of national greenhouse gas (GHG) emissions are from the transportation sector. Rail carriers move 75 per cent of surface tonne kilometres of freight, but only produce 3 per cent of transportation greenhouse gas emissions. Rail can move one tonne of freight 180 kilometres with just one litre of fuel. As such, reducing GHG emissions within the transportation system can be achieved by shifting freight from truck to rail.

1.3. Benefits to Government, Canadian Railways and Shippers of the Current Regulatory Environment

The evolution that has resulted in the current regulatory environment has been a tremendous success and has provided substantial benefits for rail customers. In the decades prior to the passage of the *Canada Transportation Act* (CTA) (1996), rail infrastructure and equipment were in increasingly poor condition because rail profits were insufficient to invest in needed upkeep and replacement. As such, the Canadian rail system was not adequate to service the needs of the economy.

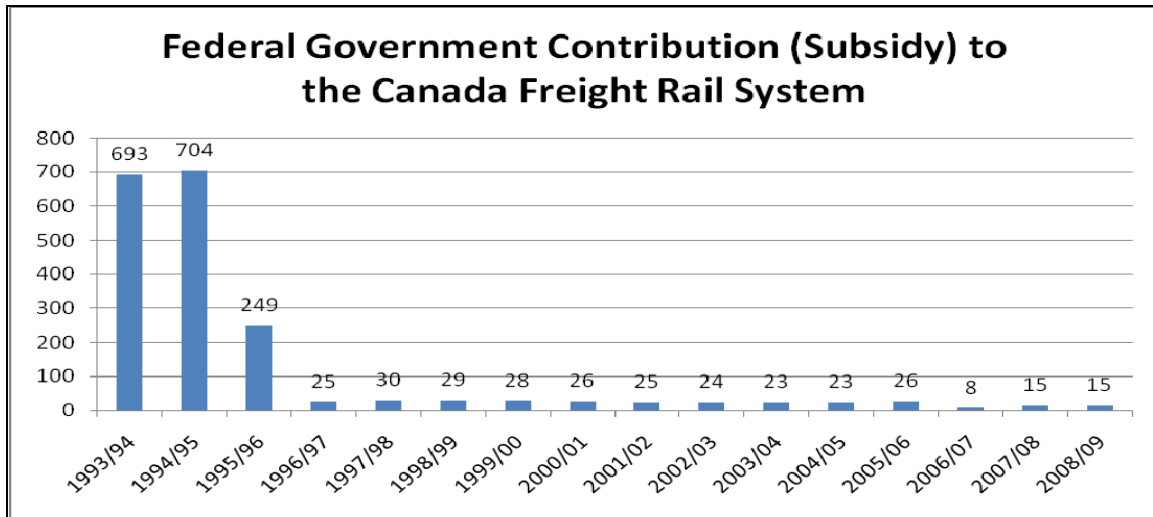
1.3.1. Benefits to Government

Prior to the passage of the CTA the federal government provided extensive contributions to assist in the operations, maintenance, and investment of Canada's freight rail system. As illustrated in Figure 1 "Federal Government Contribution to the Canada Freight Rail System, 1993-94 to 2008-09", prior to the privatization of CN in 1995 and the passage of the CTA in 1996, the federal government contributed approximately \$700 million annually to Canada's freight rail system. It should be noted that even though the federal government was allocating significant public resources to Canada's freight rail system, the level of investment was inadequate to maintain the railways capital stock. For example, between 1985-1995 capital depreciation for the rail system exceeded investment every year by a figure ranging from \$100 million to \$700 million; 1997 was the first year since 1985 that investment exceeded the level of depreciation.¹ Following 1995/96 the federal annual contribution to Canada's freight railway system has ranged from a high of \$30 million to a low of \$8 million. Between 1996/97 -2008/09 a majority of federal investment in the railway system has been dedicated to rail/road crossings, where there have been clear public benefits realized, by decreased incidents, through these investments.

Under the current regulatory environment, the railways (in particular the Class 1 railways) have been able to earn an income and thus pay income tax to the federal government. In 2008, Canada's railways paid \$196 million in federal income tax.

¹ Canada Transportation Act Review Panel, "Vision and Balance", pg 45-46, 2001

Figure 1: Federal Government Contribution to the Canada’s Freight Rail System, 1993-94 to 2008-09



Source: Transport Canada, “Transportation in Canada, Annual Reports”

1.3.2. Benefits to Railways and Shippers

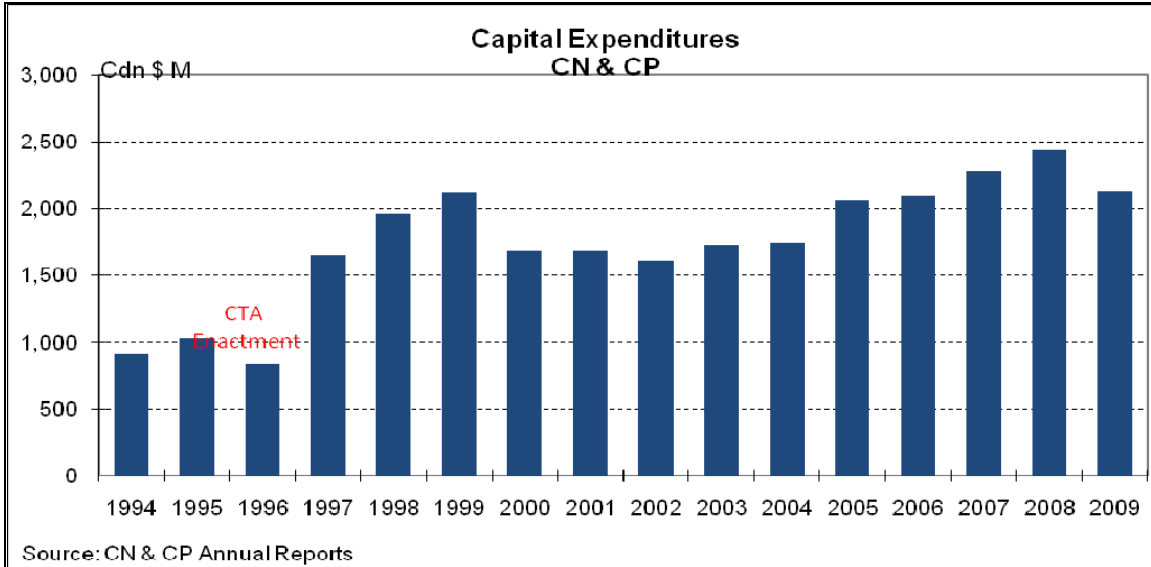
Since the passage of the CTA, regulatory stability has increased and railways were able to attract capital to invest in their infrastructure. As illustrated in Figure 2 “Capital Expenditure CN and CP, 1994-2009”, since 2005 CN and CP annual capital investment has exceeded \$2.0 B.

In addition, with the passage of the CTA, the Class 1 freight railways were able to divest and transfer low density rail lines to short line railways. It was recognized that these lines might be viable if operated by independent smaller railways which are in a position to negotiate lower labour costs, and tailor services to meet shipper needs. Consequently, the relative importance of short lines in the national transportation network has increased. In 2008, 23 per cent of originated carloads in Canada come from short line railways.

Short lines provide a direct link to rail networks for shippers located on branch lines - a win/win situation. They are highly customer focused and strive, in conjunction with their Class 1 partners, to provide seamless transportation service from points of origin to destination. These operators have provided an advantage to shippers as a result of their general ability to react quickly to customer needs and concerns, tailor service to local customer requirements, and provide flexible and reliable rail service with a strong desire to grow carload business. Many shippers have been

able to realize savings by returning to rail or switching from other modes to rail as a result of the flexibility of the smaller operators, and the focus on customer service needs.

Figure 2: Capital Expenditure CN and CP, 1994-2009 (Cdn \$ million)



Due to increased capital investment, productivity has increased resulting in benefits which have been shared with shippers. The lower costs derived from the improvement in productivity allowed the railways the flexibility to better compete against trucks and other modes. These productivity gains also allowed railways to generate an adequate return which allowed them to attract the necessary capital to further invest in their infrastructure and rolling stock.

Further, growth of intermodal services has also occurred within the current regulatory environment. Integrating transportation modes into an optimal and environmentally sustainable system is a key to growing this market. In addition, railways have the option to negotiate confidential contracts with shippers.

Railways are continually working with shippers to develop solutions to improve service and to ensure that they remain competitive. By working together, railways are able to better manage their operations and shippers are able get their product to market in a timely manner at a competitive rate. This relationship is resulting in a win-win situation for both the railways and the shipping community.

Overall, today's shippers are able to move more goods at a much lower cost; this directly benefits the shippers and the Canadian economy as a whole.

1.4. Addressing Public Comments Related to Railway Service

The Panel has no doubt received recommendations from various groups, representing the interests of certain shippers, on how rail service can be improved. In order to provide balance to the points that shippers have raised, the RAC would like to specifically address public comments recently made by the Forest Products Association of Canada (FPAC) and the Federal Rail Freight Service Review submission by the Government of Alberta.

FPAC has placed the blame on Canada's railway industry, through appearances to various House of Commons Committees and commentary in national newspapers, for making the forestry industry uncompetitive. Accusations against the railways include: being monopolistic, providing bad service, and overcharging customers. Further, FPAC has also blamed government policy for giving the railways monopoly power. FPAC's accusations are not founded in fact and are simply misguided.

The impression left by FPAC, in their public comments, is that Canada's transportation system consists of two freight railways and that these railways are the only players in the transportation supply chain. The transportation system is best defined as a modern supply chain with many players including originating terminals (often referred to as transload facilities), trucking companies, logistics service providers, freight forwarders and marine terminals to name a few. FPAC's characterization of Canada's railway industry is best described as a 1950's version and not the 2010 reality – one that includes many important players each with their own niche and role.

As previously mentioned in the submission, there is strong competition taking place between railways and the trucking sector. Many forest product facilities have access to another rail carrier through regulated interswitching. In some cases, even marine transport can be a competitive alternative. Another important competitive option used to a large extent by the forest products customers is regional transloads. These transloads are regional hubs to which forest products shippers truck to, that generally have service provided by another railway than the one serving the plant at origin and in many cases even access to two other rail carriers. A shipper can also decide

to truck the product to the final destination or to use the rail carrier of choice through one of these transloads. US railways are also part of the route in delivering goods to the North-American market. Those also have a significant impact on the level of service performance and on the total rail rate charged to the customer for their segment of the move.

Further, as stated in the submission, shippers have regulatory recourse to protect against unfair treatment by railways. Through the CTA, shippers can avail themselves of a number of options including final offer arbitration, competitive line rates, review of ancillary charges, and level of service complaints in order to redress legitimate rate and service concerns through regulatory recourse.

FPAC has publically stated that rail carrier practices are costing the forestry industry approximately \$300 million per year in extra expenses. As far as the RAC can ascertain, that figure was derived from a study commissioned by FPAC in 2007 entitled “An Estimate of the Freight Rate Consequences and Rail Captivity to Rail Shippers of Canadian Forest Products”. The RAC has reviewed the study and has concluded that it is both methodologically and factually incorrect in a number of areas and should not be relied upon for advice in this matter.

Specifically, the report does not recognize the investments that railways have undertaken in their infrastructure and equipment that is used to serve forest product producers. Further, the report also assumes that, unlike the forest products sector, railways should not be entitled to a market based return. Such a move would have dire consequences for investment in rail infrastructure. Railways are among the most capital intensive industry in Canada and invests about 20 per cent of their revenue every year back into their business. FPAC’s flawed analysis, if implemented by policy makers, would negatively impact Canada’s rail logistics supply chain and therefore all Canadian industries that use this critically important conduit to export markets.

Finally, FPAC has stated that a solution to the industry’s issues is to have governments radically change Canada’s rail supply chain by imposing mandatory “running rights” on rail carriers. In addition to FPAC, the Government of Alberta also made representations in their submission that rail service concerns are caused by a fundamental lack of competition in the market for rail transportation services and that the railways operate in a monopolistic and duopolistic manner, to the detriment of Alberta based shippers. As a solution, the

Government of Alberta state that they “...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”.² In the opinion of the RAC, the Government of Alberta is recommending competitive forced access.

This concept has been extensively studied in the past by policy makers and rejected for a number of reasons, the two most important being:

- Negative experiences in other jurisdictions (the United Kingdom and European Union in particular); and
- The significant negative impact such a move would have on investment, where in fact the industry would have to revert back to rely on massive government subsidies to support the investments that are needed.

Increased government intervention would have very serious negative effects on rail investment. Unlike other modes, rail provides and maintains its own infrastructure – encompassing a network of 45,000 kilometres of track in Canada alone. As previously mentioned, the capital expenditures necessary to maintain, upgrade and expand this system make Canada’s rail industry the most capital intensive in Canada. There is simply no evidence to support the notion that Canada’s railways are recording excessive profits under the current regulatory regime. The facts are clear: Canada’s transportation system is highly competitive, and the CTA provides recourses to protect shippers in cases where they believe it is not.

There are numerous examples of the implications and impacts on regulated forced access. Given the intent of regulated forced access is to create artificial rail competition; a regulator can be relied upon to determine a low access fee, that is below the full costs of the landlord railway. The subsequent loss of traffic for the landlord railway, coupled with the less than full payment for the use of the landlord rail infrastructure will have the following consequences: In the short-term, a reduction in rail infrastructure investment by the landlord. Train operations will become fragmented resulting in cost inefficiency, a loss of productivity and innovation will decline or cease to exist. In the longer term, forced competitive access will cause financial distress for the landlord and there will be a need for a government subsidy.

² Ibid.

Countries such as the UK and trading blocs such as the European Union have undertaken a vertical separation of train operations from rail infrastructure. This policy has been driven partially from a desire for intra-rail competition, even as there is extensive competition from trucks and marine. All examples of regulated competition have one commonality, that is, the rail infrastructure receives less than the full costs from the train operators and receives extensive government subsidies. In some cases, even the train operations receive operating subsidies.

Overall, competitive forced access has been extensively reviewed and rejected in Canada. Other countries that have implemented one form or another of competitive access have done so due to an unnecessary desire to create artificial intra-rail competition; have found it necessary to provide extensive ongoing government (public) subsidies; have found it difficult and complex to manage and have found those complexities make the rail system inefficient from a cost perspective.

Shippers have numerous remedies, as we will discuss in detail in the Submission, such as Final Offer Arbitration (FOA), interswitching, Competitive Line Rails (CLR) and level of service complaints, which make forced competitive access unnecessary.

With regard to railway service, the Government of Alberta has demonstrated a clear bias in the favour of shippers, as there was no attempt made in their submission to understand and balance the interests of both the railways and Alberta based shippers. As such, the RAC would caution the Panel in their assessment of validity of the survey responses.

2. INTRODUCTION

The Railway Association of Canada (RAC) understands that the Rail Freight Service Panel has been mandated to identify issues and develop solutions that will result in practical, sustainable improvements in the Canadian rail supply chain. Overall, the RAC views this review as an opportunity to provide a sound fact base of railway service in Canada. To date, evidence related to rail service, as provided by rail shippers, has been anecdotal in nature.

A primary object of the RAC and our members is to ensure that the Canadian rail freight system is safe, efficient and effective, and that it continues to be the best railway system in the world.

The RAC will provide recommendations that our members believe will accelerate further improvement to the rail freight supply chain. The Panel's stated objectives are as follows: (i) to conduct a review of the rail-based logistics chain with a focus on service to Canadian shippers; (ii) to identify problems and issues with respect to railway service including those arising from other elements in the logistics chain and to identify best practices and how they might be expanded and importantly (iii) to make recommendations to address the problems that will include commercial solutions and if necessary, regulatory ones.

The Panel must recognize and appreciate that there are costs associated with increased regulation, including direct costs of regulatory compliance and indirect costs, including increases in cost of capital which arise from regulatory uncertainty. The RAC supports the identification, implementation and sharing of best practices as an approach to improving railway service.

2.1. Railway Competition in Canada

The Canadian freight railway industry is highly competitive; in fact it is recognized as the most competitive system in the world. According to the Organization for Economic Development and Cooperation (OECD) "The clearest example of competition between integrated railroads occurs in Canada where the two incumbent railroads operate two largely overlapping networks capable of providing a wide range of substitute (competing) services".³ Railways, including Class 1 freight and short line and regional railways, United States railroads, trucks, pipelines and water

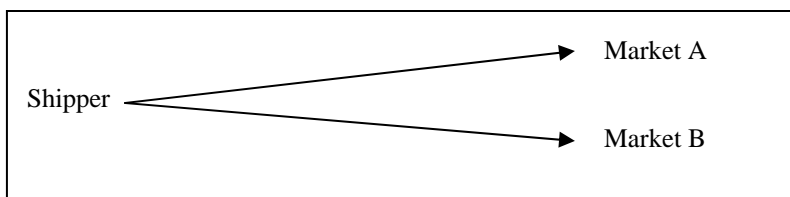
³ Organization for Economic Cooperation and Development, "Structural Reform in the Rail Industry", December 21, 2005, pg 8.

carriers operating on the Great Lakes, compete directly with one another. The majority of shippers have options to transport their goods by different combinations of carriers or their rates are subject to robust forms of competitive pressure.

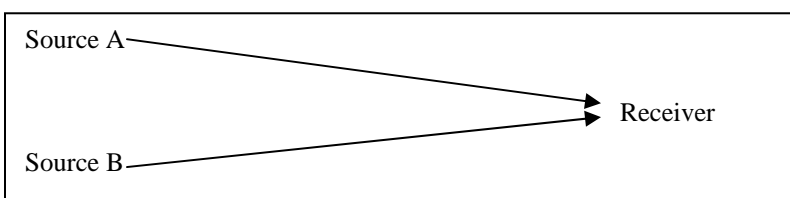
Trucking is the most prevalent form of intermodal competition with railways. Trucks benefit from continued public investment and expansion of the highway and road system combined with increases in the allowable gross vehicle weights and dimensions. These actions have significantly enhanced the competitiveness of the truck mode. Specifically, trucking is a significant competitor to railways in the transportation of goods over long distances. There are also forms of multimodal competition, for instance in the case where railways compete with the combined services of the trucks, and reloads served by another railway.

There are other forms of competition that may not be as visible as intra-rail competition or intermodal and multimodal competition, but are nonetheless strong forms of competition. A summary of additional types of competition that railways faces are as follows:

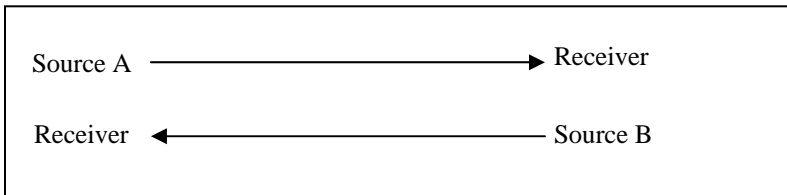
Destination Competition: A shipper located at origin has a choice of destination markets. As such, the railways that serve each market compete with each other for the business of the shipper. An example is a shipper that sells their products to various markets, if the shipper does not receive competitive rail services to one market, it can choose to ship their product to the other market.



Source Competition: Receiver located at destination has a choice of sources. Railways are aware of the extent of source competition, which is very common, and compete with railways and other modes of traffic to facilitate the movement of goods from a particular source. An example is coal traffic destined to Asia; Canadian railways compete with Australian railways as Asian countries can choose to source coal from Australia.



Location Competition: Shipper has a choice of locations on different railways and can negotiate terms and conditions before fixing its location decision. An example is a multinational forest products company that has the ability to shift product to the location where they receive the most preferable rail rates and service.



2.2. Shipper Protection Provisions

There are numerous provisions under the CTA which can be used to protect shippers when it is deemed that inadequate competition exists. Regulated *Interswitching* is available to all shippers that are located within 30 km from the interchange with another federally regulated railway in Canada.

On request, all federally regulated railways are obligated to quote rates to any interchange location with another railway.

Finally, shippers can submit a rate to *final offer arbitration (FOA)*. FOA is by shippers to challenge the rate offered by the railway through the negotiation process.

Overall, these provisions as stated above provide the appropriate balance of the interests of railways and the shippers that they serve.

2.3. The Importance of International Trade

Canada is a trading nation, as total trade accounts for 61 per cent per cent of Canada's GDP. Given the recent growth of demand for Canadian resources, products and services, coupled with the development and evolution of our transport system, the Canadian economy is now the 10th largest in the world. The Canadian economy is one of the most reliant export economies in the world.

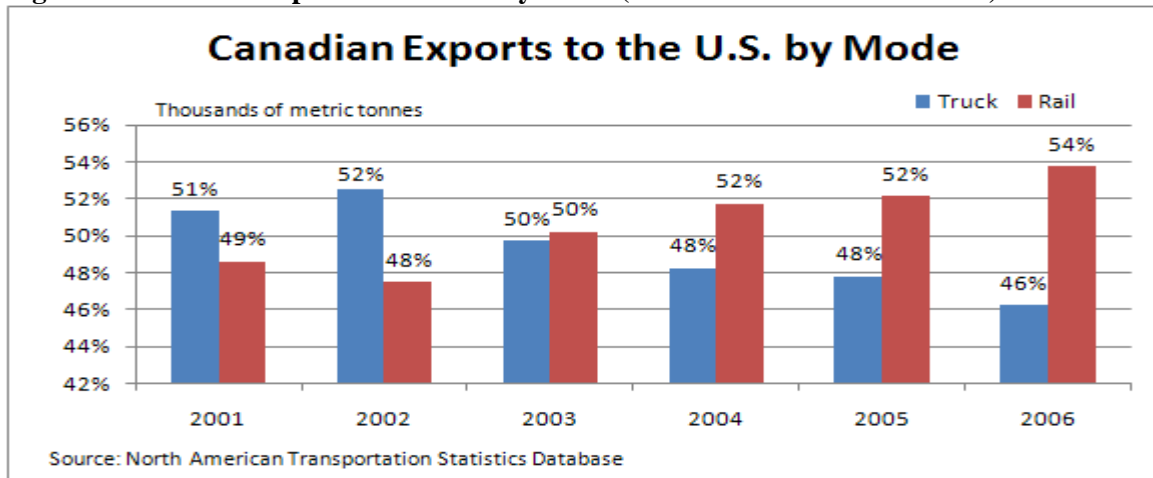
However, in 2009, as illustrated in Figure 5 “Canadian International Merchandise Trade” Canadian merchandise exports fell dramatically, and were down to \$369.7 billion in 2009 from \$489.7 billion in 2008. In contrast to the 24.5 per cent decrease in exports, imports of goods were more resilient falling only 15.5 per cent down to \$374.2 billion. This eliminated the \$46.9 billion trade surplus of 2008 and resulted in Canada’s first trade deficit since 1975. Further, a strong Canadian dollar is eroding Canada’s surplus with the United States, even as the balance with other countries improves. Canada’s railways were negatively impacted by the drop in trade; volumes, as measured by revenue tonne kilometres were down approximately 15-20 per cent in 2009.

Figure 5: Canadian International Merchandise Trade (Millions of Canadian Dollars)



Of importance to railways is the changing nature of the trade flows and modes of transport utilized to facilitate Canada’s trade. Notably, the movement of exports to the U.S. by volume is changing, as rail has been steadily gaining market share vis-a-vis trucks. As noted in Figure 6 “Canadian Exports to the U.S. by Mode” railways now enjoy a 54 per cent market share over trucks, in terms of the volume, of exports to the U.S.; this is up from 49 per cent market share in 2001.

Figure 6: Canadian Exports to the U.S. by Mode (Thousands of Metric Tonnes)



Further, the most fuel-intensive and polluting modes of freight transport (air and road) are growing and are expected to grow in the future in terms of facilitating trade. The potential impact of this forecasted growth is that it will place further pressure on our public infrastructure and increase emissions from the burning of fossil fuels. Rail should be seen as a solution to both these problems as it uses private infrastructure and is a much more energy efficient mode of transportation as compared to air and trucks.

Finally, supply chains need modern transportation systems that rely on intermodal connections. The value of the supply chain is more than the sum of its individual parts. An integrated supply chain is one that is able to make greater use of system capacity and is an alternative to costly expansion of congested systems, especially highways. In other words, smart integration can lead to more efficient and effective traffic flows at lower total cost.

Given Canada's integrated economy, it is crucial that Canadian transport policies must be international in vision.

2.4. Evolution of the Transportation Supply Chain in Canada

It is without question that over the last several decades the world economy has undergone major structural change. One of the most important developments has been the growth in trade and the emergence of Asia, especially China, as a major driver of world economic growth and, in particular, the Canadian economy. As mentioned, Canada is a trading nation, 61 per cent of our GDP is dependent on trade.

Expansion in world trade accelerated in the 1950s with removal of various trade barriers and the establishment of trading blocks. Trade was and continues to be facilitated through improvement in transportation services and productivity to meet this growing demand. The world's developed economies also began to locate their manufacturing process throughout the world, making transportation the enabling element of this strategy. As a result, the world supply chains have lengthened and their complexity has increased.

An optimal supply chain is a low-cost, high performing system that incorporates:

1. Balance: Creates consistency and stability through asset balance and effective utilization of available resources for all supply chain participants.
2. Workload levelling: Creates consistency through reduced variation of workload day to day, week to week, which results in better resource availability all the time, at lower total cost.
3. Capacity utilization: Limited total network capacity combined with high capital cost associated with expansion indicated that effective utilization of network capacity is key to long term industry viability.

Specifically, the following are characteristics of a well functioning supply chain:

1. Motivation to be globally competitive: Competition, by each supply chain participant, drives performance, which positively benefits the overall performance and attractiveness of the supply chain.
2. Commercial accountability: Each member of the supply chain has an understanding of their defined role and is accountable, on a commercial basis, if they do not meet their obligations.
3. Accurate, timely and transparent demand forecasting: In order to allocate capital and resources, in the short and long term, to maximize the return on the capital and performance of the entire supply chain there is a need for accurate, timely, and transparent forecasting of average demand, not temporary peaks.
4. Continuous improvement process: In order to fully realize investment made within a supply chain, all participants must continue to strive to improve their performance.
5. Demand pull philosophy: Matching capacity to average demand is essential to maintaining a well functioning, low cost supply chain. Participants in the supply chain

should be positioned to respond to average demand. Participants cannot be expected to size their assets and resources to meet sporadic peak demand periods.

6. Motivation to work as a group: Supply chains are complex entities. Each supply chain participant must recognize, in order for a supply chain to succeed, that all members must work together.
7. Visibility and ease of information flow: Good operational and investment decisions depend on reliable information and data within the supply chain.
8. Performance monitoring and reporting: Measuring performance is essential to managing a supply chain. It is the responsibility of supply chain participants to determine the monitoring and reporting elements and thus the management of the supply chain.
9. Strength of key stakeholders: Key stakeholders such as railways, ports, transload facilities, borders, etc. are major components of a supply chain as they facilitate a majority of the freight volume within the supply chain. If one of the key stakeholders is unable to perform its expected functions, all members of the supply chain will be negatively impacted.
10. Manageable infrastructure constraints: Within the transportation system there will be infrastructure constraints; no system is designed and built to accommodate unlimited demand. Further, efforts should be made, where feasible, to smooth demand within the supply chain as it contributes to optimization of infrastructure assets within the supply chain.
11. Government policy alignment: Government policy has a major impact on the operation and the functionality of a supply chain. Federal, provincial and local governments must develop and align policies that facilitate the movement of goods. For example, the federal government has a clearly defined policy for the development of the Asia Pacific Gateway and Trade Corridor (APGTC); however, local governments have policies intended to improving quality of life of their citizens. As such, local policies and regulations may restrict the hours of operations of members of the supply chain (i.e. ports), which may not be aligned with the overall policy of the APGTC.

Overall, supply chains are complex in nature. Many elements, as listed above must work in cooperation in order for the supply chain to function optimally. Further, there is a great deal of interdependency as the actions or failures of a member within the supply chain will impact all other supply chain participants. It should be acknowledged that railways are just one component, albeit an important one, within a complex supply chain. Railways have to continually respond to

a number of unforeseen events outside of their control; examples include, a delay or early arrival of an ocean going vessel, late unloading or loading by a shipper, labour disruptions, and weather events, to name a few. In order for supply chains to succeed, each participant and governments must have a common understanding of the goals of the supply chain, interdependencies, its limitations and challenges that need to be overcome.

2.4.1 Improved Coordination with Short Lines and Ports

Canada's short line railways are important players in Canada's rail freight supply chain as they typically provide service at the first and last miles of the rail movement. It should be recognized that they do not control car allocation and time of pick up at interchange. In cases where railcars are not allocated as expected or delivered at interchanges at the time arranged, the short lines encounter logistical problems and must deal directly with frustrated shippers.

Currently, short line railways and their Class 1 partners are attempting to find means of measuring performance at interchanges. The RAC has been directed by its members to play a role in bringing together the Class 1 freight and short line railways to determine performance measures that both parties agree to, and find market based solutions to resolving outstanding concerns between Class 1 freight and short line railways. Overall, the railway industry recognizes that a well functioning rail supply chains involves good cooperation between Class 1 freight and short line railways.

Canadian ports are important focal points with Canada's supply chains, as they link Canadian shippers to international markets. The growth in port throughput has created challenges which have increased the importance of "supply chain management". It is without question that there is a need for better coordination among the participants in the supply chains, including ports. Without improved coordination, Canada will be unable to fully utilize our transportation system and it will lead to unnecessary and unproductive costs with the supply chain itself, thus reducing the competitiveness of the Canadian economy.

As such, it is the opinion of the RAC that better coordination is needed to maintain Canada's strong trading relationships. In efforts to achieve this goal, RAC member railways have entered into numerous agreements and undertaken initiatives with supply chain participants including ports and terminals. Specifically, these efforts outline the expectations of the partners; provide

performance indicators, monitoring, and compliance and update mechanisms. The RAC views these initiatives as a part of the solution to improve the rail supply chain and encourage the Panel to consider these efforts when developing their recommendations.

3. RAC RECOMMENDATIONS

3.1. The Current Regulatory Provisions Properly Balance the Interests of Railways and Shippers

Recommendation: The Panel should acknowledge that the current regulatory regime balances the interests of railways and shippers and functions well. Thus no additional regulation is required.

The report entitled *Service Issues in Regulated Industries other than Canadian Rail Freight Industry (Regulated Industries Report)* commissioned by the Panel presents an assessment of regulated industries in Canada as well as the rail regulatory regime in the United States. Specifically, the report investigated the level of service regulatory treatment in these other jurisdictions. Overall, the RAC commends the outcome of the report, as the study concluded:

“... we have found none of the legislative regimes reviewed, including the regulation of level of service (LOS) in the U.S. rail freight services industry as well as in the non-rail industries covered by this study, to be clearly superior in an overall sense to the regime for regulating LOS in the Canadian rail freight services industry”⁴.

The Study also found that the statutory service provisions in the Canadian rail industry are “... Vastly superior ... to those available to shippers of freight by air, water or pipeline”⁵.

In the opinion of the RAC, the service solution mechanisms for rail shippers are more useful than what exist within other industries and elsewhere. The *Review of Regulated Industries Report* concludes that the LOS protections set out in the CTA, when combined with the Class 1 freight railways commercial dispute resolution programs and mediation program, offer to shippers a range of effective and efficient remedies.

⁴ Service Issues in Regulated Industries other than Canadian Rail Industry by Joseph Schulman, CPCS Transcom Ltd. , at page 39

⁵ Ibid Executive Summary at page x (10)

3.2. Shippers Should be aware of the Statutory and Commercial Provisions Available to them

Recommendation: Shippers should be aware of the provisions available to them, regarding rates and service, under the Canada Transportation Act and be encouraged to use the Class 1 Freight Railways Commercial Dispute Resolution (CDR) Process.

The RAC believes that one of the most significant finding from the reports commissioned during Phase I of the review came from the report entitled “Survey of Shippers” which stated that only 8 per cent of shippers profess knowing the CTA very well.⁶ This is a striking finding considering that certain shippers are advocating for additional regulatory measures under the CTA. The RAC believes that shippers should be knowledgeable of the regulatory provisions available to them under the CTA. Current regulatory measures should be used, if need be, to protect the interests of shippers.

The Class 1 freight railways have developed individual CDR programs that permit dispute resolution in a mediation and/or arbitration model. During the development of the CDR process, the railways received input from shippers. The CDR process is affordable, effective, user friendly, timely and collaborative. The RAC believes that CDR is the right approach in resolving disputes, as they arise, between railways and shippers. The RAC has promoted the benefits of CDR in its communications with shipper groups.

3.3. Balanced Accountability

Recommendation: The Panel should recognize the complexities associated with the notion of ‘balanced accountability’.

The RAC has concerns with any assertion that there is an imbalance in favour of railways in the Canadian rail freight system. There are a number of reasons for this concern.

During the course of the Rail Freight Service Review, shipper interests have raised an issue around the perceived lack of balanced accountability between shippers and railways – railways

⁶ Survey of Shippers, Prepared for the Rail Freight Service Review, NRG Research Group, November 30, 2009, pg 7.

impose financial penalties on shippers for performance failure but shippers are not compensated for their additional costs due to performance failure by railways.

This issue demonstrates a misunderstanding of the asymmetric relationship between railways and shippers. Railways are a network industry that is required to serve the whole community of shippers, and this rail structure is subject to economic regulation whereas most shippers are not subject to economic regulation, in recognition of the fundamental structural differences that exist in their industries.

Railways impose ancillary charges such as rail demurrage. However, the purpose of this type of charge is to provide an incentive for individual shippers to conduct business in a manner that serves the interests of all supply chain participants. Demurrage charges are not intended to be a revenue source for railways. Railways would prefer demurrage generated no revenue at all, which would imply the highest level of asset utilization, rail operational efficiency and fluidity.

Any suggestion or recommendation that shippers should be compensated for performance failure by railways must address the complexities that such a regime would imply. For example, it is well recognized and understood that rough seas can delay a vessel arriving at port, that rain can delay the loading or unloading of a grain vessel, and that avalanches occur in the Rocky mountains delaying the movement of trains. Weather events, and acts of god, are a fact of transportation life and fault cannot be reasonably assigned.

It would therefore be appropriate for any shipper compensation scheme, that root causes for service disruptions, such as weather events or labour disruptions elsewhere in the supply chain, be excluded, otherwise all transportation costs would rise which would impede the flow of trade generally. However, a very practical problem then arises: how to determine primary causes and which to compensate and which to exclude.

Any imposition of a simplistic scheme of penalties upon the railways regardless of a determination of fault, would not only be inappropriate but would imply increased costs to the railways that would eventually be passed on to all shippers through increased freight rates.

Any regulatory scheme devised to determine fault, assess damages and assign compensation would be extremely complex and may be unable to determine compensation in many instances.

The significant transaction costs to railways, shippers, other stakeholders in the supply chain, and government, would not, in the opinion of the RAC, warrant the minimal benefits from shipper compensation.

Improved communications between railways and shippers, additional commercial mechanisms through contractual arrangements, and refinement of ancillary charges, and improvements to existing practices offer the best route to addressing the concerns of individual shippers, combined with a dispute resolution process to deal with contentious issues. This is the approach strongly recommended in the RAC submission.

3.4. Build upon the Success of the Asia Pacific Gateway and Corridor Initiative

Recommendation: The Panel should acknowledge the successes and best practices from the Asia-Pacific Gateway and Corridor Initiative. Best practices include assessment of total supply chain processes, implementation of supply chain improvements, winter planning, performance tables and infrastructure improvements. These best practices to improve coordination should be implemented, where appropriate and required, in the Continental Gateway and the Atlantic Gateway.

The Asia-Pacific Gateway and Corridor Initiative (APGCI) has been a successful initiative engaging multiple supply chain components that will have a direct long-term and sustainable benefit on the rail freight supply in Canada. The RAC encourages the application of the APGCI model in developing the Gateways in Central and Atlantic Canada.

One of the important initiatives that was undertaken in the development of the APGCI was the identification of supply chain challenges by supply chain participants. Through this process the participants were directed and encouraged to work in collaboration in addressing and resolving the identified challenges.

The primary issue, in the view of the railways, within these relationships is private/public funding for public infrastructure. The desired result is an improvement in local quality of life (e.g. improved traffic flow through rail/road grade separations). At the same time the partnership encourages private sector investment. These investments improve traffic fluidity and facilitate

economic growth. The RAC believes that this is a leading example of a collaborative approach to identifying and resolving common challenges.

The RAC is aware that ports such as the Port of Metro Vancouver are undertaking extensive efforts to align the activities of supply chain partners. Specifically, they are developing integrated production plans which involve parties such as the port terminals, ocean carriers and railways that will increase throughput, thus increasing the capacity at the port and lowering the costs related to volume variability.

However, even through these efforts there is room for improvement in fully engaging all supply chain participants. A major issue for railways is the unpredictability of the arrival of ocean going vessels. The lack of predictability of steamship lines creates demand peaking for which the railways have to accommodate. In order to move an unforeseen increase in volumes, railways must maintain additional capacity. Additional capacity (i.e. locomotives, labour and rolling stock) represents an increased cost to the railways and ultimately to the railway supply chain. As such, the RAC is of the opinion that greater attention and analysis needs to be undertaken on the impact of unpredictable surge demand on the railway supply chain.

Overall, the issues that need to be resolved are as follows: first, there must be a common understanding of demand, inbound volumes and time of arrivals. In order for a railway to operate in an efficient and cost-effective manner, they must have the ability to establish a resource plan to meet demand. Specifically, railways must strive to smooth demand over a determined period of time. However, in order to do this in an effective manner, stakeholders within the supply chain must understand that there are trade-offs involved, namely costs versus service expectations. Trade-offs must be identified by stakeholders and issues resolved. Secondly, in cases where additional (contingent capacity) is needed (due to accommodate additional vessels or weather), there needs to be a firm understanding that there are costs associated with the additional capacity. As significant funds are required to maintain this additional capacity, similar to any railway asset, a return must be realized.

3.5. Improved Demand Visibility

Recommendation: The Panel should acknowledge that accurate and timely demand visibility for railway services can lead to improvements within the logistics supply chain. As such, the Panel

should encourage all stakeholders within the logistics supply chain, including ports, railways, shipping lines, etc. to develop a transparent process that will improve the understanding of demand.

Good demand visibility is fundamental to well functioning, efficient and low cost supply chains. Accurate forecasting allows railways to ‘right size’ their operations, thus capacity, to meet current and future demand.

Through the use of data, trends and predicted variances can be established and railway operations allocate resources accordingly. For example, railways and their supply chain partners would greatly benefit from the establishment of 3 to 6 month demand for railway services from shipping lines.

3.6. Research and Development to Improve the Efficiency Supply Chains

Recommendation: The Panel should recommend that Transport Canada undertake research and development efforts, in collaboration with railways and supply chain stakeholders, to mitigate the impact of weather on railway and port infrastructure and operations.

Canadian railways operate over extensive and challenging terrain and in extreme weather conditions. As such, railways are constantly challenged to accommodate these factors within their operations. Common weather related incidents that cause delays within the rail system include rain, which can impact a terminal operators ability to unload bulk cargo (e.g. grain) and wash out portions of track, and avalanches, notably, throughout Canada’s Rockies. When these situations arise it affects the entire logistics supply chain.

Collaborative research efforts between Transport Canada and the railway industry in the past have proven to be beneficial to the rail industry and society. A notable example is the extensive research in level rail/road crossing. Numerous technologies and operating practices have been developed and implemented throughout the rail system in Canada. As a result of this research, the number of crossing incidents has steadily decreased over time.

Given the importance of the railway supply chain to the Canadian economy and by extension to society, Transport Canada can play an important role in developing a research program, in

collaboration with participants in the logistics supply chain, to develop technologies and operating practices to mitigate the impact of weather and weather related incidents on the rail supply chain. There is currently a structure, through the new re-established Rail Research Advisory Board (RRAB), to assess research proposals.

The RRAB consists of representatives from Transport Canada, National Research Council, railway industry and railway suppliers. Efforts are currently being undertaken to engage Canadian universities within RRAB activities.

3.7. Extending the Operations of Major Supply Chain Partners

Recommendations: Supply chain participants should make efforts to extend their operations, where needed and is appropriate, in order to improve coordination, capacity and fluidity within the supply chain.

Railways operate 24 hours a day, 7 days a week and 364 days of the year. However, most other supply chain partners, such as ports, terminal operators, shippers, etc., have set hour five days a week operations. This situation does not lend itself to the optimization of the logistics supply chain. As such, in the absence of extended operations at major load and unload points, Class 1 railways must use of 20 per cent to 30 per cent more rail assets, which increases the operating costs of the railways. All supply chain participants would great benefit if all the major supply chain participants extended their operations, where needed and is appropriate, from 5 days a week to 7 days a week.

In addition, the limited capacity of transfer (load and unloading) capacity causes volatility within the rail system and makes it challenging for railways to smooth demand. Further, the current system makes it very difficult for railways to recover weather related incidents (e.g. excessive snow or avalanches) when they do arise. These are challenges that should be addressed in order to improve Canada's supply chain.