

# Assessment of the Phase 1 Rail Freight Service Review Consulting Reports

*“Connecting the Dots”*

InterVISTAS

strategic  
transportation  
& tourism  
solutions



Prepared for  
CN  
for submission to the  
Rail Freight Service Review Panel

Prepared by  
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## Synopsis

The Minister of Transport has undertaken a two part review of freight railway service quality. The first phase, just completed, commissioned a series of studies. Inter VISTAS Consulting was asked by CN to review these studies and reconcile their findings -- connecting the dots.

The NRG Research Group conducted a series of surveys of shippers. Their survey results indicate that shippers and other stakeholders have a perception of problems with various dimensions of railway service (e.g., transit time consistency and demand fulfillment). However a report by QGI analysed actual data on transit time and order fulfillment, the key service quality dimensions of the review, with a specific focus on whether any freight service problems reflect systemic or structural issues, such as discrimination against captive shippers or shortline originations. In contrast to the NRG shipper survey results, the QGI analysis found no evidence of such systemic structural problems. With very few exceptions, they found that shippers served by only one railway, or whose shipment originates on a short line, were receiving similar levels of service as shippers with access to service by both railways. We observe that this finding of a lack of a structural behaviour problem by freight railway in their service to shippers is consistent with the conclusions of the Canada Transportation Act Review Panel. A third study, by CPCS Transcom, examined potential regulatory solutions for freight railway service problems. The study examined service regulation in other jurisdictions, as well as commercially based remedies, and showed that Canadian railway users already have a regulatory regime that is more stringent than, and provides superior remedies than, the regimes governing U.S. railways, Canadian air, marine, and pipeline carriers, and Canadian non-transportation utilities. They recommend a commercial, rather than regulatory approach to resolving the identified shipper/other stakeholder issues.

Inter VISTAS Consulting's review of the first phase reports concurs that despite shipper perceptions, the evidence does not support a finding of systemic structural problems in the delivery of freight rail service quality by the Class I Railways. In the absence of such evidence, a basis for regulatory intervention on freight service quality issues does not exist. We concur with the CPSC Transcom findings, echoed by many shippers and other stakeholders, that new regulatory powers to address service quality issues are not needed and could be counterproductive. Shippers and supply chains differ in their requirements and a regulatory one-size-fits-all approach would undermine Canada's ability to support the most efficient supply chains in the world. What constitutes a reasonable level of service quality differs by commodity, distance of shipment and shipper/supply chain requirements. Where service quality issues arise, both shippers and carriers are better served by the more flexible commercial approaches to dispute resolution. We note that the use of commercial rather than regulatory remedies has support among many shippers, other stakeholders and the railways themselves. Canada's rail legislation already provides best in class dispute resolution which are less costly and more timely solutions than those found in the U.S. and in other industries. In addition to the dispute resolution measures in the *Canada Transportation Act*, the carriers offer additional commercial based dispute resolution options to shippers which can be tailored to meet the needs of each unique supply chain, and which are especially appropriate for use by small shippers.

New regulatory solutions for service quality are only appropriate when there are systemic and structural issues in railway conduct, but the evidence does not find such abuse. Existing regulatory and commercial dispute resolution options are adequate for addressing railway freight service quality issues.

# 1. Introduction

## Context for the Rail Service Review

When the Government of Canada tabled proposed amendments to the *Canada Transportation Act* (CTA) on 30 May 2007, it announced a commitment to begin a review of railway service within 30 days of passage of the amendments. The amendments (contained in Bill C-8) received Royal Assent on February 28, 2008, and Transport Canada shortly afterwards released its Terms of Reference for the Review.

The Review is being conducted in two stages: analytical work by consultants and development of draft recommendations by a Panel of three experts. The analytical work is now complete and available to stakeholders. On 9 November 2009, interested stakeholders were invited to provide submissions to the Review Panel by 26 February 2010. Due to delays in the analytical work, that deadline was extended to 30 April 2010.

## Objectives of the Rail Service Review

The objectives of the Review were to:

- Conduct a review of the rail-based logistics chain (including railways, shippers, terminal operators, ports, and vessel operators), with a focus on service provided to Canadian shippers and customers by Canadian National Railway (CN) and Canadian Pacific Railway (CPR) within Canada, including to and from ports and border crossings;
- Identify problems and issues with respect to railway service including those stemming from other elements of the logistics chain;
- For shippers located on shortlines, determine if there are any problems with logistics and, if so, the source of the problem including service, operating, or marketing practices of the main line carriers;
- Identify best practices and how these can be expanded to address service issues; and
- Make recommendations on how to address these problems and issues, including both commercial and, if necessary, regulatory solutions.

The Review was to be conducted in the context of the following principles (labelled considerations in the Terms of Reference):

- An effective supply chain is critical to meeting the government's objectives related to strategic gateways and trade corridors and to helping shippers compete in domestic, continental and international markets;
- Shippers need an effective, efficient, consistent, and reliable rail transportation supply chain in order to remain competitive and prosper in domestic, continental, and international markets;

- Some shippers, especially bulk commodity shippers, have few, if any, practical alternatives to rail;
- Railways need sufficient revenues to maintain and improve existing rail services and to invest in additional capacity (infrastructure, equipment and crews) in order to respond to the current and future needs of shippers;
- Commercial solutions are preferable to increased regulation, although effective legislation and regulation can foster an environment that will encourage commercial solutions to service problems and disputes;
- While the railways are a key component of the logistics system, other stakeholders (such as shippers and freight forwarders, terminal operators, vessel operators, and ports) also impact the efficiency, effectiveness, consistency and reliability of the supply chain. Many rail movements begin or end at a port or intermodal facility. Therefore, the total movement may involve other stakeholders besides the railways. The interface between elements is an important dimension of the overall effectiveness of the logistics system;
- There are a number of constraints that impact on railway capacity and operations including: availability of land to expand yards and facilities, especially in urban centres; geographical constraints in the busiest rail corridors; and the behaviour and expectations of municipalities and adjacent landowners; and
- There is limited infrastructure, which serves a variety of commodities shipped by rail. Therefore, setting priorities can be important.

The review was also to address issues such as shipper size, car supply, demand forecasting, peak movements, operating practices, shortline railways, surge capacity/recovery, transportation alternatives, communications, financial impacts, data acquisition and confidentiality, dual railway/shipper accountability for poor performance and any other issues that impact system efficiency and reliability.

## Context for this Report

CN commissioned Inter *VISTAS* Consulting Inc. (Inter *VISTAS*) to review and comment on the findings of two reports commissioned by Transport Canada for the Review: *Analysis of Railway Fulfillment of Shipper Demand and Transit Times* by QGI and *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry* by CPCS Transcom and to provide commentary on the linkages between them in the context of the Review Terms of Reference.

In order to undertake this task, the highlights of the shipper and stakeholder surveys were also reviewed for context, as were the QGI reports *Description of Canada's Rail Based Freight Logistics System* and *Analysis of Operating Practices*.

While this report was commissioned by CN, the views contained within are those of Inter *VISTAS* Consulting Inc. <sup>1</sup>

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<sup>1</sup> This report was prepared by Robert Andriulaitis and Dr. Michael Tretheway.

## Approach to this Report

The heart of the issue is the adequacy of Canada's existing rail regulatory mechanisms. There are generally two opposing views on this. Some shippers, provincial governments and other stakeholders favour stronger, or additional, regulatory mechanisms. The railways and others view the existing mechanisms as adequate, or even more than adequate. The reports commissioned by Transport Canada, when viewed as a whole, can provide some insight regarding this issue.

InterVISTAS took the following approach in conducting this review:

1. Does a problem exist? What is the nature of this problem? The NRG Research Group's two surveys (of shippers and of other stakeholders) shed some light on these questions.
2. If there are problems, are they a reflection of structural or systemic issues in terms of the level of service provided by the railways to shippers (e.g., captive shippers) or is this problem systemic? The QGI report entitled *Analysis of Railway Fulfillment of Shipper Demand and Transit Times* addresses this issue.
3. How should any structural or systemic problems be addressed? Are there any models of commercial and regulatory mechanisms superior to what is in place? The CPCS Transcom study *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry* addresses the latter question.

## 2. Is There a Rail Freight Service Problem?

### The NRG Survey Results

**Overview.** NRG Research Group conducted two surveys in support of the Rail Freight Service Review. The first involved 262 shippers, while the second involved 28 other stakeholders (14 terminals, eight port authorities and six shipping lines). On the basis of these surveys, NRG concludes that shippers and other stakeholders believe that problems do exist. The NRG report also offers some shipper/stakeholder suggestions on how best to address these problems.

In reviewing the results of the survey, however, we do note that the approach taken may have influenced the results obtained. A cover letter from Transport Canada to the shippers/other stakeholders began by noting that:

*"The rail freight service review is being undertaken by the Government of Canada in response to complaints from shippers and other stakeholders about railway service over the last few years."<sup>2</sup>*

This focus on "complaints" as the driver for potential change may have set the stage for respondents to respond more negatively than would otherwise have been the case, in hopes that this might encourage the Review Panel to recommend regulatory changes that would force lower rail rates and/or higher service levels. Notwithstanding our concern with the approach, the results of the surveys indicate concerns among some shippers and other stakeholders.

**Shipper Survey.** NRG found a relatively low level of satisfaction among most shippers. The shippers identified concerns with: on-time delivery of cars at origin and destination; timeliness of pick-up of cars after unloading; reliability of car supply; consistency of transit times; and responsiveness of railways to problems.

Suggestions as to how to improve accountability of railways range from commercial (commercial dispute resolution) to interventionist (regulatory penalties and more government regulation in general). Interestingly, NRG found that when shippers were asked how railways should be held accountable for their customer performance, the most commonly cited approach (22% of mentions) was commercial dispute resolution mechanisms, with government regulation receiving only 16% of mentions.<sup>3</sup> **Among shippers, there appears to be support for a commercial approach to addressing concerns that exist.**

**The NRG survey found a low level of satisfaction among shippers ... but among shippers, there appears to be support for a commercial approach to addressing concerns that exist.**

It is also interesting that there was still some call for more regulation, even though more than half of the shippers said they were not knowledgeable about the CTA, and of those that were, NRG note

<sup>2</sup> NRG Research Group, *Survey of Shippers*, p.78.

<sup>3</sup> NRG Research Group, *Survey of Shippers*, p.50.

that "very few take CTA Level of Service actions because they view the process as cumbersome and expensive."<sup>4</sup>

The question policy makers need to address is whether adding more regulation is an effective approach when many beneficiaries prefer a commercial approach, do not take the time to understand the existing regulations, and even when they do, many still do not bother to make use of them. Regulation by definition is burdensome and expensive, and the trend is to eliminate regulation where possible (other than those related to safety/security) rather than add to it. The definite shipper interest in commercial dispute resolution offers a very promising alternative avenue to address any issues that exist.

NRG found that there are indeed mixed feelings among shippers about the impact of railway re-regulation. While some felt this would significantly or somewhat improve rail freight service, others felt it would have no effect or that it would somewhat or significantly worsen service.<sup>5</sup> NRG note, however, that when shippers supporting re-regulation were asked whether they would still support this approach if it significantly impacted the railways' ability to re-invest in the rail system, some changed their position and said that regulation would not lead to an improved system, while others were unsure.<sup>6</sup>

The shippers' suggestions to railways outlined in the NRG report offer some useful insights into potential solutions as well. Having access to knowledgeable customer service representatives is clearly a win-win situation requiring no government intervention – it is merely good business sense. Greater consistency in transit times is also of mutual interest. More accurate forecasts of and responses to the need for extra rail cars is an interesting issue, since this involves not only the railways, but the shippers as well.

**Other Stakeholder Survey.** The other stakeholders (terminals, port authorities and shipping lines) generally were more satisfied than shippers, but again there is evidence of dissatisfaction among many of these parties in the survey results. Key areas of concern were similar to those of shippers: timeliness of car delivery, getting the right number of cars, and access to knowledgeable and helpful customer service.

The suggestions for improvement were clear: railways need to provide accurate and reliable information about their operations; stakeholders need to enter into formal operating agreements with the railways; and all parties must work together as partners in the logistics system, rather than as independent parties.

**All the approaches raised by the other stakeholders have a clear commercial orientation.**

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<sup>4</sup> NRG Research Group, *Shippers' Survey Highlights*, p.2.

<sup>5</sup> NRG Research Group, *Survey of Shippers*, p.50.

<sup>6</sup> NRG Research Group, *Survey of Shippers*, p.51.

### 3. Are the Problems Perceived by Shippers Verified by Quantitative Analysis?

#### The QGI Analysis of Railway Fulfillment of Shipper Demand and Transit Times

While the NRG survey results show some shippers and other stakeholders perceive problems, the QGI report sheds valuable light on the issues raised by the NRG surveys and places them in the proper context. This section provides an overview of our review. Appendix A provides the details.

#### Order Fulfillment.

QGI examined two aspects of order fulfillment: forecast vs. actual volumes, and empty car supply.

**Forecasting.** With respect to forecasting, QGI found the aggregate level forecast to be within 10% for both CN and CP, and that "performance to plan was consistent across the major lines of business for both railways with all business lines performing below forecast levels with the exception of CP's Intermodal segment that was 4.5% better than forecast in Year 1."<sup>7</sup>

At the individual shipper origin/commodity flow level, QGI find wider variation, ranging from -100% to more than +100% of forecast. Given that some of these individual shipments represent irregular small shipments, some wide variations are not unexpected. Indeed, Figure 6 in the QGI report shows that at the actual shipment level, the majority of traffic falls in the tighter ranges of variability, with 46% of total shipments falling within +/-10%, 70% of shipments falling +/-20% and 84% of shipments falling +/-30%.<sup>8</sup>

The QGI analysis and report shows no evidence that railways are discriminating against particular shippers regarding railway forecasting of car supply. **To us, this absence of discrimination indicates that there is no evidence of systemic or structural problems in the rail industry.**

**Car Order/Supply.** The second component was an analysis of empty car supply. Due to data limitations, only demand for and supply of grain cars and merchandise cars were included.

**The QGI analysis and report shows no evidence that railways are discriminating against particular shippers regarding railway forecasting of car supply.**

**To us, this absence of discrimination indicates that there is no evidence of systemic or structural problems in the rail industry.**

<sup>7</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 8.

<sup>8</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 30.

QGI note that with respect to grain cars:

*"...annual car order fulfillment rates for both railways do not vary significantly regardless of the size of a customer's weekly order. Neither were differences in annual performance noted based on competitive access nor province of origin. However, for the weekly fulfillment performance, the tables show that CP customer locations with the smallest weekly orders (average of <10 cars per week) only received at least 90% of the cars they ordered 32% of the time while customers with larger orders received at least 90% of their cars over 50% of the time."*<sup>9</sup>

Again, from this observation from QGI, **there is no compelling case for government intervention, as the QGI analysis presents no evidence to suggest structural or systemic problems in respect of railway order fulfillment.**

With respect to merchandise cars, as in the case of grain cars, there is considerable volatility in demand, with 36% of CN customers changing their orders after the cut-off date.<sup>10</sup> Figure 25 in the QGI report indicates that this ranges from complete cancellation of orders through partial cancellations to increases of over 160%.<sup>11</sup> This does not necessarily reflect poor planning by rail customers – QGI note: "Changes in car demand from day to day and week to week will be affected by such factors as: railway performance in meeting previous demand requirements, final demand changes by the customers' customers, changes in customer operations and upstream logistics and supply processes."<sup>12</sup>

**There is no compelling case for government intervention, as the QGI analysis presents no evidence to suggest structural or systemic problems in respect of railway order fulfillment.**

In assessing CN's average annual car supply, QGI observe that:

*"When considered across size of car order, network/shortline/competitive status and province of origin, there is very little variation in the overall car order fulfillment rate for CN customers."*<sup>13</sup>

QGI do find that "the sample data suggest that CPR customers located at competitive origins receive somewhat better car supply than customers without access to direct rail competition."<sup>14</sup> QGI note, however, that there are limitations in the CPR data and that the sample is much smaller than CN's, we observe that this result should be considered cautiously.

<sup>9</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 51.

<sup>10</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 53.

<sup>11</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 54.

<sup>12</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 55.

<sup>13</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 56.

<sup>14</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 68.

Once again, **we conclude that no case for government intervention exists, as there is no clear evidence to suggest structural or systemic issues.**

## Transit Time Analysis

QGI undertook an extensive analysis of the average transit time as well as the consistency of transit time. They found:

*"In general, depending on the traffic characteristics being assessed there were considerable differences in transit time for movements with similar lengths of haul. However, for a number of variables where one might expect there to be differences in performance based on the service or shipper characteristics, there was remarkably little differentiation in service performance. Examples where major systemic differences in performance were not found were*

- o *Shipper size*
- o *Flow size*
- o *Access to rail competition*
- o *Core versus non-core railway origins*
- o *Shortline versus CN and CP origins"*<sup>15</sup>

These are extremely powerful findings. **The analysis and results provided by QGI offer strong evidence that while problems may exist, this is not the result of systemic bias by either railway.**

This is not to downplay the fact that improvements may be needed; it does, however, provide guidance to policy makers as to what solutions are most appropriate to address the problems. QGI make a key observation in the Executive Summary of the report. They note:

*"... this report and the service review process in general recognize that the performance of the rail freight logistics system in Canada is not only a railway responsibility but a joint effort of all key stakeholders in the system. As part of the service review process QGI prepared a report on operating practices in Canada's rail freight logistics system. In that report QGI used the Supply Chain model of logistics as a framework to describe Canada's rail freight logistics system and to guide the analysis. A Supply Chain is the set of processes, activities, agreements and systems that operate between and within the various organizations and stakeholders in a logistics*

**These are extremely powerful findings.**

**The analysis and results provided by QGI offer strong evidence that while problems may exist, this is not the result of systemic bias by either railway.**

<sup>15</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 18.

*system. As was described in that report, all supply chains involve the close integration and collaboration in the planning and operations activities of supply chain participants."*<sup>16</sup>

As the performance of the rail freight logistics system is not solely the railways' responsibility, but rather is the joint responsibility of all stakeholders, commercial approaches to issues and concerns are best. Regulatory approaches, including imposition of monetary penalties, become an onerous effort as determination of "fault" is a complex matter.

**The performance of the rail freight logistics system is not solely the railways' responsibility. It is the joint responsibility of all stakeholders. Thus commercial approaches to railway freight service issues are best.**

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<sup>16</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 5.

## 4. How Should any Problems be Addressed?

### The CPCS Report on Service Issues in Regulated Industries Other than Canadian Rail Freight Industry

Policy makers need to ask themselves: how should any problems that exist be addressed? Are there any models of commercial and regulatory mechanisms superior to what is in place? The CPCS Transcom study *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry* provides some insights into this issue, particularly the latter question.

In considering this question, however, it is important to keep in mind the findings of the QGI report, which provided no evidence that there are structural or systemic problems.<sup>17</sup> The starting point for

a decision to create additional regulation, or add to existing regulation, would be that there is a systemic problem, or, in the parlance of economists, evidence of abuse of market power. In the absence of such evidence, there is no basis for additional regulation, though streamlining existing regulation is potentially possible. Of course, mechanisms for resolving disputes are still required, as specific issues will inevitably arise. The review of the existing remedies in comparison to alternative regimes elsewhere

**The review of the existing remedies in comparison to alternative regimes elsewhere simply needs to be done in the context of the absence of any systemic or structural problems.**

simply needs to be done in the context of the absence of any systemic or structural problems.

**Usage of Existing Remedies.** The CPCS report examines statutory remedies, but does not comment on the frequency of use or on the effectiveness of these provisions, as that was outside its mandate. We examined the usage of the various dispute resolution mechanisms, based on various Canadian Transportation Agency Annual Reports, and show the results below:

Year	Incidences of Use of Available Dispute Resolution Mechanisms			
	Resolved via Facilitation	Resolved via Mediation	Resolved via Formal Adjudication	Referred to FOA
2008-2009	15	15	6	3
2007-2008	NA	25	7	3
2006	NA	10	0	5

<sup>17</sup> We also note that the 2001 Canada Transportation Act Review found no evidence of structural or systemic problems.

Year	Incidences of Use of Available Dispute Resolution Mechanisms			
	Resolved via Facilitation	Resolved via Mediation	Resolved via Formal Adjudication	Referred to FOA
2005	NA	10	0	1
2004	NA	3	0	3
2003	NA	6	2	1
2002	NA	2	2	0
2001	NA	13	0	2
2000	NA	0	0	0

Source: Canadian Transportation Agency Annual Reports.

Note: 2008-2009 was the first year statistics for Facilitation were provided separately from Mediation.

These results are interesting in light of some of the findings of the NRG Research Group from the Shipper Survey they conducted for the Rail Freight Service Review. NRG found that:

*"Over half of the shippers interviewed believe that there are no or very few measures in place to hold railways to account for their customer service performance. They feel there is no real recourse for them to hold the railways to account for breakdowns in service.*

*Fifty-seven percent of the shippers interviewed felt they are **not** very knowledgeable about the Canada Transportation Act (CTA). Of shippers who are aware of the CTA, very few take CTA Level of Service actions because they view the process as cumbersome and expensive."<sup>18</sup>*

**There is in fact a relatively high level of usage of existing dispute resolution mechanisms. They are not merely "academic" recourses but are real and effective options in which shippers see value.**

NRG did note that the smaller shippers tended to be less aware of the CTA than larger shippers, which is not a surprise and which could account for the large number indicating lack of knowledge about the CTA.

While it is difficult to quantitatively assess the effectiveness of these mechanisms, we observe that **there is in fact a relatively high level of usage of the existing mechanisms. This suggests**

<sup>18</sup> NRG Research Group, *Shipper Survey Highlights*, p.2

**that these are not merely "academic" recourses but are real and effective options that both shippers and carriers see value in.** The Agency website description of these mechanisms also suggest their usefulness.

Moreover, we observe **the fact that the various recourse options available to shippers are readily employed provides them with an even greater degree of influence.** Railways are aware of the readiness of shippers to engage in the various dispute resolution mechanisms – some of which are rather costly and time-consuming. The readiness of shippers to employ these mechanisms gives railways incentive to resolve issues on a commercial basis to the satisfaction of shippers up front, without reverting to the more formal dispute resolution mechanisms, in order to save time, costs and effort. The real "threat" posed by shipper willingness to engage in the formal dispute resolution mechanisms available to them can only act as a curb on railway behaviour. This is also fully compatible with the Terms of Reference for the Review which lists as a principle that "commercial solutions are preferable to increased regulation" and supports the Government of Canada's principle that "effective legislation and regulation can foster an environment that will encourage commercial solutions to service problems and disputes."

A full review of the CPCS report is provided in **Appendix B.**

## 5. Conclusion: Is There a Case for Regulatory Reform?

Based on the review of the NRG shipper and other stakeholder surveys, the QGI report entitled *Analysis of Railway Fulfillment of Shipper Demand and Transit Times* and the CPCS Transcom study *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, and our own compilation of the usage of the existing remedies, we note that taken together, they provide some very useful conclusions:

- Some shippers and other stakeholders perceive problems in the rail industry. The complexity of the rail logistics supply chain almost makes that inevitable.
- These problems, however, do not stem from structural or systemic issues in the behavior of the railways against shippers. In the absence of such evidence, there is no basis for additional regulatory intervention. The problems that do exist are individual problems that are best addressed by commercial means.
- The regulatory options for Canadian rail shippers that currently exist do in fact get used (despite what the NRG report said) and appear to be effective in constraining inappropriate railway behaviour.
- The Canadian rail regulatory regime already offers more for Canadian rail shippers than their counterparts in other regulated industries. The LOS obligations that apply to U.S. rail shippers, Canadian air, water and pipeline carriers, and Canadian non-transportation utilities (where they exist at all) are less stringent than those applicable to Canadian federal rail carriers. As well, the remedies available to Canadian rail shippers with respect to service issues are vastly superior to those available in these other industries.
- The trend is to move away from more prescriptive forms of regulation.
- Commercial solutions are preferable to regulatory interventions, and are increasingly being relied on over statutory solutions wherever possible, and are likely to be welcome by railways, many shippers and the other stakeholders such as terminal operators, port authorities and shipping lines.

We would conclude that commercial solutions should be the direction for the Canadian rail industry. We recommend the following:

- Implementation of mandatory mediation;
- Retention of existing LOS provisions, with consideration for adding an exemption provision as is done in the U.S.; and
- Completing the development of the commercial dispute resolution mechanism CN and CPR began.

This may obviate the need for regulatory measures, but until proven to do so, the existing regulatory provisions should be kept to give shippers a wide range of options and to ensure railway commitment to CDR.

## Appendix A: Analysis of Railway Fulfillment of Shipper Demand and Transit Times

QGI prepared the report entitled *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*. This report assesses the extent to which Canada's two Class I railways meet shipper demand for service through a) an analysis of the railways' fulfillment of *forecasted* demand for the movement of shippers' traffic and b) an assessment of the railways' transit time performance. As QGI note:

*"The choice of these two key factors for assessment in the quantitative analysis phase of the review - transit time consistency and demand fulfillment was reinforced by the findings of the customer satisfaction survey conducted by NRG Research for the rail freight service review. This survey identified transit time consistency and car supply (which is a key component of demand fulfillment) as very important factors influencing shippers' satisfaction with railway service."*<sup>19</sup>

While the NRG survey results show some shippers and other stakeholders perceive concerns about rail service, the QGI report sheds valuable light on the issues raised by the NRG surveys and places them in the proper context.

### Order Fulfillment Analysis.

QGI examined two aspects of order fulfillment: forecast vs. actual volumes; and empty car supply.

**Forecasting.** The first component was an analysis of forecasting performance. QGI found the aggregate level forecast to be within 10% for both CN and CPR, and that "performance to plan was consistent across the major lines of business for both railways with all business lines performing below forecast levels with the exception of CP's Intermodal segment that was 4.5% better than forecast in Year 1."<sup>20</sup>

QGI did note that "there was a higher degree of variance to plan at the individual commodity subgroup level with annual forecast accuracy varying by as much as 40% reflecting both positive and negative variances to plan."<sup>21</sup> The report, however, notes that of the six commodity groups examined, four had more than 85% of traffic volume fall within a +/-30% range of forecast. Of the two that did not (fertilizers and merchandise), QGI go on to note:

*"The performance of merchandise and fertilizer traffic is consistent with the composition of these business segments that are characterized by a higher percentage of individual car and small block shipments as compared to the automotive, bulk and grain segments."*

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<sup>19</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 5.

<sup>20</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 8.

<sup>21</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 8.

*These smaller volume car block shippers typically present greater challenges to the railways in forecasting traffic levels accurately.”<sup>22</sup>*

**This indicates there is no bias in the forecasting activities of Canada’s Class I Railways that needs to be addressed by government.**

At the individual shipper origin/commodity flow level, QGI find wider variation, ranging from -100% to more than +100% of forecast. Given that some of these individual shipments represent irregular small shipments, some wide variations are not unexpected. Indeed, Figure 6 in the QGI report shows that at the actual shipment level, the majority of traffic falls in the tighter ranges of variability, with 46% of total shipments falling within +/-10%, 70% of shipments falling +/-20% and 84% of shipments falling +/-30%.<sup>23</sup>

QGI also go on to make a final comment on forecasting:

*“Lastly the accuracy of railway forecasts as described above should be viewed in the context of how such forecasts are constructed and the many factors that can impact traffic volumes and traffic patterns through the course of a year. Railway forecasts use a combination of input factors including shipper demand estimates, historical shipment patterns, commodity specific market intelligence and macroeconomic assumptions. They are constructed using the best available data and information available at the time and may not anticipate changes in customer sourcing and production patterns or changes in individual commodity markets. Even the best forecasts will therefore be only an estimate of actual volumes realized.”<sup>24</sup>*

The QGI analysis and report, **shows no evidence of structural or systemic issues where the railways discriminate against particular shippers regarding railway forecasting of car supply.**

**Car Order/Supply – Grain.** The second component was an analysis of empty car supply. Due to data limitations, only demand for and supply of grain cars and merchandise cars were included.

QGI found that “the analysis of car order cancellation rates for grain suggests that volatility of car orders is relatively high” and went on to note that “this relatively high level of order volatility will impact railway empty fleet distribution managers’ ability to ensure that empty grain car orders are filled according to shippers’ requirements.”<sup>25</sup>

Combined with all the other factors and interactions complicating car supply, it is not surprising that while the railways perform well on an annual basis (with CN fulfilling 98% and CPR fulfilling 97% of total orders), the performance is far more variable on a weekly basis. Nevertheless, QGI note that with respect to grain cars:

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<sup>22</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 33.

<sup>23</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 30.

<sup>24</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, pp. 35-36.

<sup>25</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 45.

*"... annual car order fulfillment rates for both railways do not vary significantly regardless of the size of a customer's weekly order. Neither were differences in annual performance noted based on competitive access nor province of origin. However, for the weekly fulfillment performance, the tables show that CP customer locations with the smallest weekly orders (average of <10 cars per week) only received at least 90% of the cars they ordered 32% of the time while customers with larger orders received at least 90% of their cars over 50% of the time."* <sup>26</sup>

Again, from this observation from QGI, **we see no case for government intervention, as the QGI report shows no evidence to suggest there are systemic or structural issues.**

**Car Order/Supply – Merchandise - CN.** Due to the difference in the order process for CN and CPR, separate analyses were conducted. As CPR does not track changes to car orders and has a much smaller sample size, we focus on the results for CN.

As in the case of grain cars, there is considerable volatility in demand, with 36% of CN customers changing their orders after the cut-off date. <sup>27</sup> Figure 25 in the QGI report indicates that this ranges from complete cancellation of orders through partial cancellations to increases of over 160%.<sup>28</sup> This does not necessarily reflect poor planning by rail customers – QGI note: "Changes in car demand from day to day and week to week will be affected by such factors as: railway performance in meeting previous demand requirements, final demand changes by the customers' customers, changes in customer operations and upstream logistics and supply processes." <sup>29</sup>

In assessing CN's average annual car supply, QGI observe that:

*"When considered across size of car order, network/shortline/competitive status and province of origin, there is very little variation in the overall car order fulfillment rate for CN customers."* <sup>30</sup>

QGI do find that "the sample data suggest that CP customers located at competitive origins receive somewhat better car supply than customers without access to direct rail competition." <sup>31</sup> QGI note, however, that there are limitations in the CPR data and that the sample is much smaller than CN's, we observe that this result should be considered cautiously.

Once again, **we conclude that there is no case for government intervention, as the QGI report shows no evidence to suggest systemic or structural issues.**

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<sup>26</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 51.

<sup>27</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 53.

<sup>28</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 54.

<sup>29</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 55.

<sup>30</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 56.

<sup>31</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 68.

## Transit Time Analysis

QGI undertook an extensive analysis of the average transit time as well as the consistency of transit time. They found:

*"In general, depending on the traffic characteristics being assessed there were considerable differences in transit time for movements with similar lengths of haul. However, for a number of variables where one might expect there to be differences in performance based on the service or shipper characteristics, there was remarkably little differentiation in service performance. Examples where major systemic differences in performance were not found were*

- *Shipper size*
- *Flow size*
- *Access to rail competition*
- *Core versus non - core railway origins*
- *Shortline versus CN and CP origins"*<sup>32</sup>

**These are extremely powerful findings for the question of whether there are structural or systemic issues.**

**Shipper Size.** For CN non-intermodal traffic, the coefficient of variation (CV) is similar for all four categories of shipper size. In fact, the statistics actually showed the smallest coefficient of variation (which measures the typical variation in transit time as a percentage of the mean transit time) for small shippers, followed by very small, medium, and large shippers.<sup>33</sup> Clearly there is no bias being exhibited by CN. For CPR, the CV is highest for very small shippers. The CV is lowest for large shippers, next highest for small shippers, and third highest for medium shippers. QGI note that while "the shorter length of haul of the very small shippers in the sample data may have impacted the calculation of the CV for this group, the much higher absolute range of typical transit times of this group versus the other shipper size groupings shows that very small shippers at CP must cope with higher variation in service levels than larger CP shippers."<sup>34</sup>

For intermodal traffic, the statistics for CN once again show no discernible pattern. Moreover, for CPR, the ranking of the very small shipper has reversed. The CV is lowest for the very small shipper, followed by small, medium and large.

**On balance, we observe that there is no evidence to indicate systemic bias by the railways against smaller shippers.**

**Flow Size.** The QGI analysis also looked at size of flow (cars or containers per year). The results for CN show "remarkably little differentiation in service levels."<sup>35</sup> Indeed, the CV was lowest for

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<sup>32</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 18.

<sup>33</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 91.

<sup>34</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 105.

<sup>35</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 93.

shippers in the lowest flow category, those moving 30-100 cars per year. For intermodal services, there was again little differentiation by size of flow, with 101-500 cars showing the lowest CV.<sup>36</sup> The same lack of differentiation is evident in the CPR statistics as well, with car flows of 501-1000 and 30-100 being virtually identical and close to the other two ranges.<sup>37</sup> For CPR container movements, the CV was lowest for movements in the 1001-5000 range, followed by that of the smallest flow range (30-100), but again, there is no clear pattern of differentiation among different flow sizes.<sup>38</sup>

**Access to Rail Competition.** The finding that access to rail competition did not affect transit time performance is of key importance to policy analysts considering regulatory options. QGI did find some examples by province and commodity group where performance was better for traffic at competitive points than it was for non-competitive points (QGI cites grain from Alberta, grain and merchandise from Saskatchewan, and merchandise from B.C.) but that is to be expected in an analysis of a normal population. **What is clear is that there is no systemic favouring of shippers with access to a competing rail line as would be expected if there were structural or systemic issues.** In fact, QGI note:

*"As can be seen from Figure 58, when considered as a group, while it might be expected that shippers with competitive access would have better service, there is no advantage in terms of transit consistency for CN customers with access to direct rail competition, as compared to those at non - competitive origins. In fact, shippers from non - competitive origins have somewhat better transit time consistency."<sup>39</sup>*

This is not limited to CN. QGI also found that:

*"...while it might be expected that shippers with competitive access may enjoy better service, CP shippers at locations that provide access to competitive rail services do not have an advantage at an aggregate level in terms of transit consistency. In fact shippers at locations without competitive access have a relatively shorter and more consistent transit time."<sup>40</sup>*

**Mainline vs. Branchline.** QGI found that at an aggregate level:

*"...at a high level when all non-Intermodal traffic is considered together, there is no advantage to a shipper to be on the CN core network, in terms of transit time consistency and CN's service was actually more consistent for traffic originating at non - core stations. However, these summary data somewhat mask differences which do exist in performance at the Major Commodity Group level. For both Automotive traffic and for Grain traffic,*

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<sup>36</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 94.

<sup>37</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 107. Note that no statistics could be provided for the fifth and largest flow category (over 5000) due to the small sample size.

<sup>38</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 108.

<sup>39</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 108.

<sup>40</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 114.

*transit consistency was better for traffic originating at stations on the core network. The advantage for Automotive traffic was substantial while it was nominal for grain shippers.*"<sup>41</sup>

We note that it is not unexpected to have the results show an advantage to shippers located on the core mainline over those located on branch, non-core lines. The fact that overall, there is no advantage to being on the core line is indicative of a lack of systemic bias. The QGI analysis of CPR backs this up: once again the results show "no apparent difference in transit time performance for a shipper located on CPR's core network versus those located on the non-core network."<sup>42</sup>

**Own Line vs. Shortline.** Yet again, QGI find no evidence of systemic bias in treatment at an aggregate level by either railway. QGI note:

*"...Merchandise and Automotive traffic on both railways has better levels of consistency from shortline origins whereas grain traffic has lower levels of transit consistency when originating on shortline railways."*<sup>43</sup>

QGI, however, do include one caveat:

*"It is important to note that shortline traffic is measured from the time that it is received in interchange by CN or CP and not from the time that it departs a customer's siding. In some cases, this can give a measurement advantage in terms of transit time to the shortline traffic as the activities associated with industrial switching and wayfreight movements are not included in some of the shortline traffic but are included in CN or CP originated traffic."*<sup>44</sup>

It would appear then that grain traffic originating on some shortlines does in fact experience poorer service than grain traffic originating on the railway's own network. QGI note:

*"At a more detailed level of analysis, the only commodity group and region where transit consistency for traffic from shortline origins was materially different than from CN and CP origins, and where the characteristics of the traffic in the sample were very similar, was for grain traffic originating on shortlines in Saskatchewan. For both CN and CP origins, grain traffic originating on shortlines has significantly poorer levels of transit consistency than traffic originating on CN and CP."*<sup>45</sup>

It would appear that this is a potential area of examination by both railways, along with their shortline partners. **This, however, appears to be a specific, rather than systemic issue, and is best suited to a commercial approach. This is not indicative of a need for regulatory redress.**

<sup>41</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 99.

<sup>42</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 113.

<sup>43</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 101.

<sup>44</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 101.

<sup>45</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 101.

**Shipper origin.** Although QGI did not highlight shipper origin as an area where no system differences were found, we note that the QGI calculations also show that there is "little differentiation" in performance by CN of non-intermodal movements by province of origin, with the exception of Québec. QGI note, however, that this:

*"...is primarily due to the presence in the sample of a small number of very short haul movements of plastics in the Montreal area. These short haul movements have low mean transit times which can create misleading results with respect to the calculation of coefficient of variation of transit time. When flows have low average transit times in the range of 2 - 10 hours but are subject to delays of 1 - 2 days in transit – the calculation of coefficient of variation of transit time will be very high. This is the case with this traffic. When these 6 plastics flows are excluded from the calculation, the CV of transit time for CN's Quebec originated traffic drops from 37.0 to 24.1."*<sup>46</sup>

We note that adjusting for this puts Québec's results as best in the nation. Looking at CN's intermodal performance again show little variation by province of origin, with the best performance coming from Ontario and Québec, where CN has high-volume terminals located (Toronto and Montréal).<sup>47</sup>

CPR's results parallel that of CN's in that there is little differentiation, and Manitoba and Saskatchewan fare slightly better than the other locations for non-intermodal, and Ontario and Québec fare better than the others due to the high-volume terminals located in Toronto and Montréal.<sup>48</sup>

**Overall assessment. The analysis and results provided by QGI offer strong evidence that while problems exist, this is not the result of systemic bias by either railway.**

This is not to downplay the fact that improvements are needed; it does, however, provide guidance to policy makers as to what solutions are most appropriate to address the problems. QGI make a key observation in the Executive Summary of the report. They note:

*"..., this report and the service review process in general recognize that the performance of the rail freight logistics system in Canada is not only a railway responsibility but a joint effort of all key stakeholders in the system. As part of the service review process QGI prepared a report on operating practices in Canada's rail freight logistics system. In that report QGI used the Supply Chain model of logistics as a framework to describe Canada's rail freight logistics system and to guide the analysis. A Supply Chain is the set of processes, activities, agreements and systems that operate between and within the various organizations and stakeholders in a logistics system. As was described in that report, all supply chains involve the close integration and collaboration in the planning and operations activities of supply chain participants."*<sup>49</sup>

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<sup>46</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 100.

<sup>47</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 96.

<sup>48</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 110.

<sup>49</sup> QGI Consulting, *Analysis of Railway Fulfillment of Shipper Demand and Transit Times*, March 2010, p. 5.

As the performance of the rail freight logistics system is not solely the railways' responsibility, but rather is the joint responsibility of all stakeholders, commercial approaches to issues and concerns are best. Regulatory approaches, including imposition of monetary penalties, become an onerous effort as determination of "fault" is a complex matter.

## Appendix B: *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*

CPCS Transcom conducted a study entitled *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*. This study provides some insights into the adequacy of the existing Canadian rail regulatory regime. The key points follow.

What follows is an overview of our review of the CPCS report; Appendix B provides the details.

### LOS Obligations of Canadian Federal Railway Companies.

The CPCS report notes that Section 113 of the CTA indicates that a railway company "must provide, according to its powers, adequate and sufficient accommodation for the receiving, loading, carrying, unloading and delivering of all traffic offered for carriage on the railway."<sup>50</sup> (Note that the CTA uses the word "shall" rather than "must".) The CPCS report goes on to note, however, that under Canadian jurisprudence, the word "shall" should only be interpreted as "shall reasonably."<sup>51</sup> The CPCS report further notes that the Patchett case before the Supreme Court established that the performance of duty by a private agency is permeated with reasonableness and that the Agency decision in *Canadian Wheat Board et al v. CN* confirmed the obligation of a carrier is only to supply a "sustainable" level of service and not at a level to meet all demand, especially at peak periods.<sup>52</sup>

**In our view**, this is the correct interpretation. It is fully consistent within the context of the Review's mandate. In particular, a **requirement to supply a level of service**

**sufficient to meet any peak demands would result in long periods where there would be considerable underutilized capacity, idle equipment and resources and unneeded labour. This would not produce an effective or an efficient rail supply chain**, as mandated in the Terms of Reference. It would also violate the Terms of Reference acknowledgement that railways need sufficient revenues to maintain and improve existing rail services, as generating sufficient revenues to cover idle resources is problematic. It also ignores the reality of constraints impacting

**In our view, a requirement to supply a level of service sufficient to meet any peak demands would result in long periods where there would be considerable underutilized capacity. ... This would not produce an effective or an efficient rail supply chain.**

<sup>50</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.3.

<sup>51</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.4.

<sup>52</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.4.

capacity and limited infrastructure (bullets seven and eight in the Terms of Reference – Considerations).

The CPCS report also notes that the Agency introduced something new in the Canadian Wheat Board case – setting a performance benchmark. We concur with the finding of CPCS that "it will be important to see how this approach evolves over time or what difficulties may possibly emerge with its application."<sup>53</sup> One difficulty CPCS highlights is that since the "benchmarks are necessarily established ex post and apply only to the particular complainants, the railway company can not be certain as to what service levels measured in terms of the benchmarks will be deemed satisfactory in serving other customers."<sup>54</sup> We concur, and note that **a benchmark set for one particular shipper that could be quite reasonable under those particular conditions at the time could be very excessive when applied to another shipper**, or even that same shipper at a later point in time.

Moreover, InterVISTAS has examined the issue of the use of benchmarking in regulation of firms in a number of industries with economies of scale. **It is our view that benchmarking is inappropriate as a basis for regulating service standards in most sectors.** Operating conditions differ enormously between service providers in the same sector, and the characteristics and needs of individual shippers. Benchmarking can be counterproductive and divert regulated firms from providing the services individual customers need to a misguided approach of an unvarying, externally determined standard applied to all customers.<sup>55</sup>

**Benchmarking is inappropriate as a basis for regulating service standards in most sectors**

CPCS note that this continues a trend towards dealing with what are perceived to be systemic failures by a finding specific to a particular plaintiff. CPCS indicates that industry-wide solutions may be required in future instead of traditional regulatory relief.<sup>56</sup>

### **Mechanisms for Resolving Rail Service Issues in Canada.**

The CPCS report briefly reviews the various mechanisms available:

- complaint under Section 116;
- mediation and arbitration;
- final offer arbitration; and

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<sup>53</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.5.

<sup>54</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.5.

<sup>55</sup> See "Methodology Choices for Benchmarking Airports" Ian Kincaid and Michael W. Tretheway, 12 November 2009. presented at German Aviation Research Society workshop on Airport Benchmarking.

<sup>56</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.5.

- contractual service provisions.

The CPCS report also notes that in 2006, "the Minister of Transport, Infrastructure and Communities challenged CN and CPR to develop a commercial dispute resolution (CDR) process that could be used in addressing railway-shipper disputes."<sup>57</sup> The railways developed a CDR, but could not achieve agreement with the other parties. **The authors of the CPCS report note that "an effective commercial dispute resolution process could be an important tool."**<sup>58</sup> **We would concur, noting that such an approach would undoubtedly provide a more timely and less expensive means of effectively addressing disputes and could obviate the need for further regulatory approaches,** consistent with the principle in the Review Terms of Reference that commercial solutions are preferable to increased regulation. The fact that commercial dispute resolution was also put forth by shippers as the most commonly cited mechanism for how railways should be held accountable in the NRG shipper survey lends further support to this conclusion.

### **LOS Obligations of U.S. Federal Rail Carriers.**

CPCS reviews the U.S. railway situation, and note the common carrier obligations on U.S. railways are permeated with the term "reasonable." Indeed, CPCS note that the obligation to carry has a double test of reasonableness: the request from the shipper must be reasonable (i.e., specific); and the obligation of the common carrier is subject to "reasonable limitations and conditions."<sup>59</sup>

### **Mechanisms for Resolving Rail Service Issues in the U.S.**

CPCS reviews the mechanisms available to U.S. shippers:

- complaint to the Board;
- mediation and arbitration;
- informal complaint;
- contractual service provisions;
- exempt commodities; and
- the AAR-HGFA arbitration agreement.

The last two items are of particular interest.

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<sup>57</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.9.

<sup>58</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.10.

<sup>59</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.12.

The CPCS report notes that "the Board can exempt certain statutory provisions if it believes this serves the public interest."<sup>60</sup> The rationale is that these markets are sufficiently competitive such that regulatory oversight was unnecessary. Indeed, CPCS note that the "merits of the commodity exemption are, of course, that government regulation is removed from situations where it is not needed, allowing market forces to determine outcomes, along with the elimination of the costs associated with regulation."<sup>61</sup> We believe this is an important observation, and note that it is completely consistent with the Review Terms of Reference, which indicate a clear preference for commercial solutions over increased regulation. CPCS note that the challenge is to enable expeditious exemptions "not only completely but also in individual cases."<sup>62</sup> We again concur with this observation, as well as with the CPCS conclusion: "In Canada, where there is no general commodity exemption provision, and exemptions such as the one pertaining to confidential contracts in the U.S. also do not exist, the introduction of a commodity exemption provision would be profound."<sup>63</sup>

The CPCS report also notes that the Association of American Railroads (AAR) and the National Grain and Feed Association (NGFA) agreed in 1998 that several major U.S. railroads would use the NGFA Arbitration System. CPCS note: "Notwithstanding that the AAR-NGFA agreement remains unique and the model has not been adopted more widely, we would reiterate the comments above ... regarding the value of an effective commercial dispute resolution process."<sup>64</sup> We observe that while it might be difficult to replicate this in Canada, it illustrates that a commercial process can be effective and reduce or even eliminate the need for more costly and time-consuming regulatory approaches. Canada could move in this direction, as the initiative to develop a commercial dispute resolution mechanism by CN and CPR has already started the process.

### **Comparison of Canadian and U.S. Rail LOS Regulation.**

CPCS note that railways in both nations are common carriers, but that railways in the U.S. have the ability "to become contract carriers with respect to shippers with whom they have entered into transportation contracts."<sup>65</sup>

In comparing Canadian LOS provisions with their U.S. counterparts, CPCS note that a major difference is that "while the scope of application of the U.S. provisions has been – starting with

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<sup>60</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.21.

<sup>61</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.21.

<sup>62</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.21.

<sup>63</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.22.

<sup>64</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.22.

<sup>65</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.23.

deregulation 30 years ago – considerably narrowed, the legislative scheme set out in sections 113 to 116 of the CTA has changed very little over that same period.”<sup>66</sup>

Three examples are provided by CPCS:

1. a shipper entering a contract for specified services under specified rates and conditions loses his statutory rights;
2. the Board can exclude commodities and forms of rail transportation from the protections normally provided; and
3. some rights or remedies are available only if there is no competition or if anti-competitive behaviour can be established.

We agree with this interpretation, and suggest it offers a rationale for consideration of a similar move in Canada.

**From the CPCS analysis, it can be concluded that the existing provisions extended to Canadian shippers are more extensive than what exists in the U.S. rail industry. Coupled with the findings of the QGI analysis, this suggests that rather than considering adding to the statutory provisions, Canada should focus on streamlining existing statutory provisions and emphasizing non-statutory, commercial, alternatives.**

**LOS Obligations of Canadian Non-Rail Federal Carriers.** CPCS examined various alternative regulatory schemes in Canada for other modes of transportation. CPCS concludes:

*“The LOS obligations that apply to federal air, water and pipeline carriers (where they exist at all) are less stringent than those applicable to Canadian federal rail carriers. Similarly the remedies available to shippers of freight by rail with respect to service issues are vastly superior as a consequence to those available to shippers of freight by air, water or pipeline.”<sup>67</sup>*

**From the CPCS analysis, it can be concluded that the existing provisions are more extensive than what exists in the U.S. rail industry.**

**This is a key finding.**

**Not only are the existing provisions available to Canadian rail shippers more extensive than what exists in the U.S. rail industry,**

**they are more extensive than what users of other Canadian modes of transport have available.**

**This is a key finding. Not only are the existing provisions available to Canadian rail shippers more extensive than what exists in the U.S. rail industry, they are more extensive than what**

<sup>66</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.23.

<sup>67</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.x.

**users of other Canadian modes of transport have available.** The following briefly notes points related to each of the other Canadian modes of transport.

- **Air Carriers.** The CPCS report notes that "air carriers are not deemed by legislation to be common carriers, and the legislation governing air transportation, in particular Part II of the CTA, imposes very little on air carriers that might be considered to be LOS obligations."<sup>68</sup> CPCS note that while the CTA regulates tariffs, and tariffs include the terms and conditions of carriage, the terms and conditions of carriage themselves have "very limited meaning covering only such things as limits or restrictions on the weight or size of baggage, compensation for lost, delayed or damaged luggage, compensation for denied boarding (bumping) and the carrier's rules concerning the carriage of persons with disabilities or minors."<sup>69</sup> Where the Agency has power to deal with an issue, it has broad authority, but the CPCS review suggests that Canadian rail shippers have greater options for recourse than Canadian air transport users.
- **Water Carriers.** The CPCS report notes that water carriers also are not deemed by statute to be common carriers, and that they are mostly unregulated, except for liability.<sup>70</sup> CPCS note that while there are some superficial similarities between the *Marine Liability Act* and section 113 of the CTA, the purpose and scope are different. Under the CTA, aggrieved persons have a right of action against a railway "whether or not goods are carried, let alone lost or damaged."<sup>71</sup> CPCS note that there are no actionable obligations on water carriers, and liability for failure to do so only comes into play if goods are lost or damaged. Again, the conclusion is that Canadian rail shippers have greater options for recourse than Canadian marine transport users.
- **Pipeline Carriers.** The CPCS report notes that the "National Energy Board (NEB) may make orders with respect to all matters related to traffic, tolls or tariffs."<sup>72</sup> Furthermore, companies are required to charge tolls that are either specified in a tariff filed with the NEB, or approved by an order of the NEB and such tolls "shall be just and reasonable, and shall always, under substantially similar circumstances and conditions with respect to all traffic of the same description carried over the same route, be charged equally to all persons at the same rate."<sup>73</sup>

The NEB may also require a company to provide adequate and suitable facilities for the receiving, transmission and delivering of product, storage, and junction of the pipeline with other facilities. (Section 71(3) of the *National Energy Board Act*.)

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<sup>68</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.24.

<sup>69</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.24.

<sup>70</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.25.

<sup>71</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.26.

<sup>72</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.26.

<sup>73</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.26.

At first blush this might seem a model that provides greater shipper recourse than what exists for rail shippers. It should be noted, however, that while pipelines carrying oil are common carriers, pipelines carrying gas are not considered common carriers but rather are contract carriers (unless the NEB makes an order to the contrary). A few other observations are noteworthy, however.

CPCS note that while section 71(3) of the *National Energy Board Act* approximately corresponds with section 113(1) of the CTA, there is a difference:

*"...while the obligations of a railway carrier under section 113(1) of are unconditional, albeit subject to the test of reasonableness, those of a pipeline company operating a pipeline for the transmission of hydrocarbons arise only if the NEB requires the pipeline company to provide adequate and suitable facilities ... after it has found: (1) necessary or desirable to do so in the public interest and (2) that no undue burden will be placed on the pipeline company by requiring the company to do so."*<sup>74</sup>

We observe that the approach for pipelines, in its explicit use of the public interest and in the requirement for no undue burden, may offer some useful parameters for the test of reasonableness in the rail industry.

Moreover, the CPCS report notes that while the NEB can require a company to sell gas to any person or municipality legally authorized to engage in the local distribution of gas to the public, it cannot compel a company to sell gas to additional customers if that would impair its ability to adequately serve existing customers. Given the existence of rail capacity constraints, this is an important caveat.<sup>75</sup>

The overall assessment by CPCS is that **the LOS obligations of rail carriers are more stringent, and the remedies available to rail shippers are superior, to what exists in the Canadian pipeline industry.**<sup>76</sup>

An interesting discussion appears regarding regulation of rates. The CPCS report quotes from the NEB's webpage, regarding the historical use of cost-of-service regulation to determine pipeline company revenues:

*"Proceedings to determine the cost of service and tolls are generally adversarial and time consuming, requiring legal counsel and presentation of expert witnessed.*

*For some time, the NEB has been concerned with reducing the cost of regulation and developing alternatives to the cost of service model. Through initiatives such as its Guidelines for Negotiated Settlements of Traffic, Tolls, and Tariffs and its complaint-based*

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<sup>74</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.28.

<sup>75</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.29.

<sup>76</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.x.

*regulation [established to reduce the regulatory burden on smaller companies in particular], the Board has been a leader in developing or encouraging alternatives to the traditional cost-of-service methodology. In the process, the NEB has facilitated and supported consensus building between pipeline companies and their shippers.”<sup>77</sup>*

We observe this to be a powerful warning about the very high costs of a return to a more highly regulated environment. The regulatory framework for pipelines, a competitor to rail for some product, is moving to a more commercial basis and away from a regulatory focus. Rail must move in the same direction.

### **LOS Obligations of Canadian (Non-Transportation) Utilities.**

In addition to non-rail transportation industries, CPCS also looked at regulatory regimes for Canadian non-transportation utilities. The conclusion for non-transportation utilities is the same as for non-rail transportation industries. CPCS note:

*“...the LOS obligations that apply to hydro electric companies, cable and satellite television companies and telephone companies are less stringent than those applicable to Canadian federal rail carriers.*

*The same can be said with respect to the remedies available to enforce those obligations. In certain cases (hydro electric companies in Quebec and telephone companies) there is a further requirement under applicable legislation to contact the company’s customer service department prior to filing a formal complaint with the appropriate regulatory agency. The LOS provisions under the CTA require no such preliminary step.”<sup>78</sup>*

A few observations for the various utilities follow:

- **Hydro-electric Companies in Ontario and Québec.** There are some provisions in Ontario that require non-discriminatory access, service to all along its lines if requested etc., but CPCS note that compliance is not enforced by the Ontario Energy Board, but rather is left to the courts. CPCS note that similar LOS-like provisions exist in Québec, but that the law governing remedies “is vague as to the exact form the corrective action will take.”<sup>79</sup> There is no such vagueness in the CTA.

CPCS note that customers are required to contact the company’s customer service department prior to filing a complaint. There is no such requirement under the CTA, although CPCS points

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<sup>77</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.27.

<sup>78</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.x.

<sup>79</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.31.

out that it "would be very difficult to find a LOS complaint filed with the Agency which was not preceded by weeks, if not months, of discussions/negotiations between the parties."<sup>80</sup>

- **Telephone Companies.** The CPCS report quotes from the Canadian Encyclopedic Digest, which notes: "There is a common law duty on telephone companies to supply service to all who seek it at a reasonable price and without due discrimination which flows from the special nature of the carrier's position as a provider of a service of fundamental importance, though this duty probably subsists only where the carrier can be said to have a practical monopoly on the supply of the service."<sup>81</sup> CPCS goes on to note LOS obligations such as every rate be just and reasonable, and no unjust discrimination, undue or unreasonable preference or disadvantage be provided. The CRTC has the power to determine compliance, and the burden of proof is on the carrier.

We observe that some might attempt to draw a parallel between rail and telephone service, arguing that rail is to "captive shippers" what telephones are to consumers – of "fundamental importance." We also observe however, that where "the Commission finds as a question of fact that a telecommunications service or class of services provided by a Canadian carrier is or will be subject to competition sufficient to protect the interests of users, the Commission shall make a determination to refrain, to the extent that it considers appropriate, conditionally or unconditionally, from the exercise of any power or the performance of any duty under sections 24, 25, 27, 29 and 31 in relation to the service or class of service."<sup>82</sup> We observe that intramodal competition, intermodal competition, and market or source competition are all factors that do in fact serve to protect the interests of users. The parallel between rail and the old model for telephone service, is at best weak, suggesting the case for new more onerous regulation will be difficult to make.

Regarding remedies, the CPCS report notes that consumers first have to take their complaint to the telephone company. If the complaint is not addressed, they can either take the complaint to the Commissioner for Complaints for Telecommunications Services (CCTS), a non-profit corporation funded by, but independent of, telecommunications service providers, or to the CRTC. The CCTS can request the service provider provide an explanation or apology, undertake or cease doing a specified activity, pay compensation (not to exceed \$5,000) or any combination thereof. If these non-binding recommendations are rejected, then the CCTS can issue a binding decision if the complainant accepts it. The CPCS report notes that the CCTS approach is akin to mediation as even at the binding stage, the complainant is free to ignore the CCTS and pursue other remedies.<sup>83</sup>

**The CPCS report does not recommend the creation of a body similar to the CCTS for the rail industry.** The authors argue that given the existing remedies, their recommendation to

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<sup>80</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.32.

<sup>81</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.34.

<sup>82</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.35.

<sup>83</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, pp.36-37.

strengthen the current mediation provisions, and other remedies such as the CPR/CN commercial dispute resolution process, is unnecessary.<sup>84</sup> **We concur with this conclusion**, in part because of the adequacy of existing provisions, and in part because the relationship between shippers and the railways are a far cry from the relationship between individual consumers and the large telephone companies.

The final observation from the CPCS report is that persons who suffer loss can sue for and recover an amount equal to their loss.

### **Conclusion and Recommendations.**

The main conclusion of the CPCS report is that "none of the legislative regimes reviewed, including the regulation of LOS in the U.S. rail freight 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 industry."<sup>85</sup> We concur with this finding, and note that strengthens the argument for a commercial approach rather than a regulatory approach.

The CPCS report does, however, suggest that some elements of LOS regulation in these other areas are worth further consideration. These are covered on pages 40 through 42 of the CPCS report:

1. Consider granting the Agency the power to compel mediation. Currently, the Agency is required to provide mediation only if requested to do so. CPCS note that when first proposed in Bill form, there was provision for this, but it was later removed. The authors also argue that such an approach is not uncommon, being used in US rail rate cases and other situations. **We find this recommendation has merit and would recommend support for granting the Agency the power to compel mediation.**
2. Given that "the legislative scheme governing LOS in the Canadian rail freight industry was first introduced more than a century ago" consider bringing LOS provisions "more into line with how policy and regulation have changed over the past two decades." CPCS suggests that the scope of application potentially should be narrowed to take into account situations where competition is sufficient. The U.S. approach was offered as a potential model. **We again concur with the recommendation to bring LOS provisions into line with the new approach to policy and regulation, noting that changes have been made in the U.S. rail and airline industries, and the Canadian airline industry. It seems appropriate for federal regulation of railways to reflect the new policy approach.**
3. Consider resuming the effort to develop an effective CDR process that the railways and shippers can agree to. CPCS note that an effective commercial dispute resolution process could be an effective tool. **We concur, and note that CDR is consistent with the principle in**

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<sup>84</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.38.

<sup>85</sup> CPCS Transcom Limited, *Service Issues in Regulated Industries Other than Canadian Rail Freight Industry*, August 31, 2009, p.39.

- the Review Terms of Reference that commercial solutions are preferable to increased regulation. We note as well that CDR has the support of both railways and among shippers, as the NRG survey results show.**
4. Given that any person can file a complaint, consider limiting that right to a more limited class. CPCS suggests that there may be alternatives other than the extremes of "any person" and actual customers. **We observe that limiting complainants to actual customers should be sufficient to protect the public interest: if an actual shipper is not sufficiently motivated to file a complaint, why should anyone else intervene? If it is a matter of cost, the non-shipper interests could provide financial support in order to allow the shipper to proceed.**
  5. CPCS note that it has been long recognized that a railways service obligations are not absolute, but are based on "reasonableness." This is based on the Prachett case, but has never actually been made explicit in legislation. CPCS argues that it would be useful to incorporate this explicitly in legislation. **As the principle of "reasonableness" is already well established in Canadian jurisprudence, we are of the opinion that amending the legislation is not necessary.**
  6. CPCS note that section 114 is rarely, if ever considered separately from section 113 in applications before the Agency, and that its usefulness is diluted by other CTA provisions. It suggests this is outmoded. **As this would have limited impact, we suggest this not be a priority.**
  7. Finally, CPCS note that some language is outmoded, and recommends that the CTA language be brought up to date. **Again, as this would have limited impact, we suggest this not be a priority.**

We observe, however, that **even though the Review's Terms of Reference included the principle that railways need sufficient revenue to maintain and improve existing rail services and to invest in additional capacity, the CPCS report makes no recommendations as to how that principle should be taken into account in Final Offer Arbitration proceedings. Making this need more explicit would ensure a better balance between shipper and carrier interests.**

**Even though the Review's Terms of Reference included the principle that railways need sufficient revenue, ... the CPCS report makes no recommendations as to how that principle should be taken into account in Final Offer Arbitration proceedings.**

**Making this need more explicit would ensure a better balance between shipper and carrier interests.**

## Appendix C: Glossary of Terms and Abbreviations

AAR: Association of American Railroads

Agency: Canada Transportation Agency

Board: U.S. Surface Transportation Board

CDR: Commercial Dispute Resolution

CPCS: CPCS Transcom Limited

CTA: Canada Transportation Act

CTAR: Canada Transportation Act Review

FOA: Final Offer Arbitration

LOS: Level of Service

NEB: National Energy Board

NGFA: National Grain and Feed Association

QGI: QGI Consulting



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