

FOREST PRODUCTS ASSOCIATION OF CANADA

SUBMISSION

TO THE

RAIL FREIGHT SERVICE REVIEW

April 30, 2010

INTRODUCTION

The Forest Products Association of Canada (FPAC) welcomes the opportunity to participate in Transport Canada's Rail Freight Service Review, which was announced by the Federal Government in May 2007 when it tabled amendments to the shipper protection provisions of the *Canada Transportation Act (CTA)*. Bill C-8 received Royal Assent on February 28, 2008 at which time the Review was initiated.

The forestry industry makes up two per cent of Canada's gross domestic product and generates \$65.7 billion in total revenues annually. It exports \$30.2 billion worth of goods and invests \$405-million in innovation. The industry employs 274 thousand in direct jobs and another 420 thousand in indirect jobs. The forest products industry is one of the largest users of rail freight services in Canada and represents close to 20% of CN's revenues and 5% of CP's revenues.

The cost of transportation is a significant component in the delivered price of our products. Most of the industry's facilities are located in the remote regions of Canada, where forest resources are located, but where the distance to markets is great. Accordingly these facilities have little choice but to ship by rail and as a consequence the reliability of the rail carrier and the price charged to move the goods are vital to the economic well-being of the facilities and the communities in which they operate.

For many years, the forest products industry and other captive shippers have been plagued by poor, costly, unreliable and inconsistent rail service. A pulp and paper facility ordinarily manufactures a consistent volume of product most days of the year and requires sufficient rail equipment to transport that volume on a consistent and reliable basis from the mill to its customers. When fewer cars are received than are required to ship a day's production, the excess volume must be stored at significant additional cost because the volume that cannot be loaded directly into the car must be placed on the floor and shipped at a later date. The product is more prone to damage due to increased handling and sales may be lost.

At the request of the railways and to help ensure an ongoing adequate supply of cars, mills only order the cars that they require. In addition, under their optional services tariffs, the railways penalize shippers who over-order empty cars.

Some shipper facilities are such that a service or car supply failure on a given day cannot be recovered on subsequent days due to either physical mill constraints or the inability of the railroad to provide additional switches or to provide missing cars due to a car shortage. The immediate result in these cases is that product must be either trucked to final destination or to a competing rail head. In both cases, the increased cost and the risk of damage is absorbed by the shipper.

Some of FPAC's member companies ship to their own facilities. For example, a containerboard mill may ship rolls of paper to a box plant it owns that will use the paper in the manufacture of corrugated boxes. These box plants are advised by the receiving railway that loaded cars are on its siding and that the receiving railway is awaiting instructions on how many to bring into the plant for unloading. If the plant advises that it wants 5 cars brought into the plant for unloading, it expects the railway to fulfill its obligation. Frequently, the railway fails to provide the required number of cars and also fails to advise the plant that it cannot serve the plant and bring in the cars to be unloaded. The only notification the plant receives is the non-arrival of the cars!

Similar activity is seen with respect to inbound empty cars. All railroad provided data points to a specific set of cars and placement dates. The shippers set crew levels accordingly only to find

placement of fewer cars. Often the shipper will find that cars have simply disappeared from the report. Anecdotal evidence often points to cars being “re-assigned” to another shipper due to an overall car supply shortage.

Because most of the mills are in remote regions of the country, they have no other choice but to ship their products by rail. Many of our members are served by only one rail carrier and are captive to CN or CP. Truck transportation is not an option for the large volumes produced by a mill and also because of the trucking costs and long distances to market. Railways seem to believe that if they don’t provide service to a customer on one day, they can do so the following day with no repercussions. If they don’t pick up a shipment on day one it will be there on day two as the customer has no effective, viable alternative.

The railways recognize the captivity of our members and, accordingly, can and do charge higher freight rates than they would charge shippers who enjoy competitive alternatives.

In 2007, FPAC commissioned Travacon Research Limited, a recognized expert in railway costing analysis, to determine the cost of captivity of the forest products industry. He concluded that over 90% of production of the industry is captive to one railway. This study also estimated that as a result of this monopoly power, the industry pays \$280 million in excess freight charges, above what it would pay in a competitive system.

FPAC members have experienced poor service and a supply of defective equipment by the railways but have no other alternatives to move their product. They have no choice but to pay excessive prices for poor and inconsistent service.

FPAC RECOMMENDATIONS TO ENHANCE RAILWAY SERVICE

FPAC has considered several proposals outlined below that may improve its members’ ability to obtain adequate rail service.

The Forest Products Association of Canada strongly believes that because of the monopoly power the railways enjoy, there is little incentive for them to provide the service that otherwise would exist if there was competitive access to a second railway. Our members have used the Level of Service provisions contained in the Canada Transportation Act but they are clearly not adequate to resolve chronic and ongoing service failures. Accordingly, FPAC recommends that the Federal Government implements a provision that would impose an Administrative Monetary Penalty (AMP) on a railway when it fails to provide suitable and adequate service to a facility.

A) *Administrative Monetary Penalties*

We believe that one of the best methods to ensure suitable and adequate service is to put in place a mechanism (Administrative Monetary Penalty) that will punish the railways for service failures at a mill's origin or destination the product is being shipped to.

Such a mechanism already exists. Under section 176 of the Canada Transportation Act, the federal government has the authority to administer Administrative Monetary Penalties (AMPs) against airport authorities that contravene provisions of the Act or regulations. We believe that the provision could easily be amended by either legislation or regulation to permit the Government to penalize the railways for egregious behavior. Because of the vast wealth of the railways and their monopoly power over most of their customer base, only a regime of substantial penalties will cause the railways to change their behaviour. Accordingly, FPAC recommends that for a first offence the railway would be penalized a quarter of a million dollars, \$500 thousand for a second offence up to \$2 million for a fourth offence with the monies going to the Federal Government.

An example of a “*service failure*” could be a situation in which a mill or facility did not receive any empty cars and was forced to suspend production or miss serving customers because of a lack of both alternatives and storage space. A shipper could then seek relief under the Level of Service provisions in the Canada Transportation Act and could also apply to the Federal Government asking that an AMP be imposed on the railway.

An AMP could also be imposed on a railway when a receiver of the goods did not receive loaded cars to the extent that it could not serve its customers or was forced to suspend production because of a lack of raw materials.

The AMP could also be applied to a railway whose poor service resulted in severe hardship to a group of shippers or receivers on the same rail line.

B) Railway Fleet Size and Availability – Railway Weekly Report

During the period of time that this Rail Freight Service Review contemplates (2006 – 2008), the Canadian railways “parked” in storage hundreds of centre-beam cars and boxcars so that they were not available to mills. FPAC member companies advised that even with the severe economic downturn, they were still receiving orders for carloads of forest products that they were unable to fill because the railways would not take the cars out of storage and make them available to the mills. It is a major source of frustration that a railway refuses to provide equipment to meet a mill’s demand when there are empty cars nearby but which have been taken out of service by the railway!

Each railway should be required to provide a weekly summary of its fleet size and availability so that shippers across Canada know how many cars should be available for loading, how many are bad-ordered, and how many are taken out of service. Such a list of “metrics” would make car availability more transparent and would reduce the many uncertainties the industry faces with respect to car ordering and car availability.

Specifically, the railways should be required to publish an accurate weekly list of “metrics” by region (eastern/central/western) and by car type (lumber car/boxcar):

1. The number of cars in each fleet including private cars not for exclusive use;
2. The number of cars in storage;
3. The number of cars bad ordered;
4. The number of cars available for loading; and

5. The number of cars off-line.

These metrics would provide shippers with more information with respect to the availability of equipment across the country. Access to this important information will make railway service standards more transparent and allow shippers the tools necessary to allow commercial discussions to take place with the railways and, if necessary, assist in regulatory intervention.

C) Car Ordering and Railway Service Database

As has been noted earlier, there is a fundamental disconnect between the number of cars a mill orders and the number of cars that the mill actually receives. Because of penalties that the railways impose, a mill only orders the cars it needs to ship the product that is manufactured during a given day. The volume for which there are no cars must be stored at a significant additional cost and risk.

Establishing a database that contains weekly data on cars ordered, cars confirmed, and cars delivered on a facility basis would make readily apparent to regulators any situations in which the railway failed to provide suitable and adequate service. Any difference between what a mill ordered and what was delivered, less the rejects, would readily illustrate the volume for which no cars were available and that had to be placed on the floor still waiting to be shipped.

Specifically, FPAC also recommends that the Canadian Transportation Agency or another regulatory body collect the following data elements submitted by shippers on a weekly basis:

1. The number of cars ordered;
2. The number of cars confirmed;
3. The number of cars delivered;
4. The number of rejects; and, for receivers:

5. The number of switches guaranteed; and
6. The number of switches received.

FPAC proposes regular meetings be held (such as on a quarterly basis) to review and verify the data.

LACK OF COMPETITION IN CANADIAN RAILWAY SECTOR

In considering proposals to improve rail service to shippers and receivers, the Forest Products Association of Canada believes the fundamental problem is the lack of incentive for the railways to provide suitable and adequate service to FPAC members because, for the most part, these customers have no choice but to ship by rail regardless of the service provided and so are forced to take any service, even bad service, and pay through the nose for it. The railways behave as they do with the full knowledge that the shipper has no choice but to accept the service the railway provides.

- *Rail Line Discontinuance*

Railway line abandonment continues to be a concern to FPAC members, some of whom have first-hand evidence of the economic consequences of having to ship their product at greater expense by truck to a main line. Similarly, short line railways that have acquired branch lines from federal railways have seen volumes decline due to the recession and have ceased operations forcing the shippers to seek more expensive alternatives to get their products to market.

FPAC was well aware that the railways could exhibit such behaviour and expressed concern back in the mid 1990's when Transport Canada was conducting the statutory review of the *National Transportation Act*. The Canadian railways urged the government of the day to streamline the branch line abandonment provisions to make it easier for the railways to shed unwanted track. At the time, FPAC supported the railways' proposal but

cautioned the Government to not allow the railways to use the streamlined abandonment provisions as a means to demarket the line or coerce shippers.

In its submission to the House of Commons Standing Committee on Transport in May 1993 in response to the report of the National Transportation Act Review Commission, the Canadian Pulp and Paper Association (now the Forest Products Association of Canada) stated:

“Should CPPA be satisfied that the Canadian railways will aggressively compete for domestic and international traffic, our members would be prepared to support the proposal advanced by CP Rail in its written submission to your Commission subject to further clarification as to the manner in which it would operate.”

FPAC submits that the conduct of the railways in threatening to discontinue lines is an abuse of the liberal rail line abandonment provisions and results in excessive freight rates.

FPAC accordingly believes that stronger controls should be implemented prior to allowing a railway company to discontinue lines which could include obtaining prior approval from the Agency after all affected have an opportunity of being heard.

- *Competitive Access*

FPAC believes that the most effective method of improving service to captive shippers is to create an environment in which two or more service providers are competing for the captive shippers' business.

FPAC has developed a proposal which is modeled, in part, on the BC Rail Open Gateway Tariffs, which allow shippers to access another rail carrier at predetermined rates set in a published tariff. These tariff rates were agreed to by CN Rail and published using

various zones as a result of an agreement with the Province of British Columbia in relation to CN Rail's acquisition of British Columbia Railway.

CONCLUSION

FPAC strongly believes that the best way to improve the service that the railways provide is to create a more competitive rail environment in Canada. This includes the creation of a competitive access provision which if implemented would go a long way toward resolving many of the service issues captive shippers face.

FPAC also recommends that the three measures 1) Administrative Monetary Penalties, 2) Railway Fleet Size and Availability Report, and 3) Car Ordering and Railway Service Database, be implemented immediately.