

GRAIN GROWERS
OF CANADA



LES PRODUCTEURS
DE GRAINS DU CANADA

Rail Freight Service Review Panel Submission

April 30, 2010

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Rail Freight Service Review Secretariat
Suite 808 – 180 Elgin Street
Ottawa, ON
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Grain Growers of Canada submission to Rail Freight Service Review Panel

Dear Rail Freight Service Review Panel,

The Grain Growers of Canada (GGC) are pleased to have the opportunity to submit our comments to the Rail Freight Service Review Panel. We recognize this is a large undertaking and thank the Panel for taking the time to consider our submission.

The Grain Growers of Canada is a national organization comprised of major grain, pulse, and oilseed commodity groups from across the country, representing over 80,000 farmers. We are devoted to representing their producers' interests in national policy development.

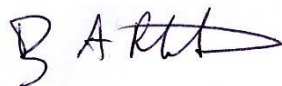
It is our belief that the government does not owe farmers a living, but it does owe them a policy environment that will let them make a living. The rail-based logistics system is an important part of that policy environment for our members. Farmers are heavily reliant on railway shipping and inefficiencies in the system are hurting the grain industry.

When grain is not delivered in its full quantities on time, it means higher costs for farmers. It means lost grain sales domestically and internationally. It means lost revenue when farmers have to sell grain outside of peak price periods. In more serious situations, it also means a loss of confidence in Canadian shippers.

For these reasons, we have accepted your invitation to submit our comments to the Rail Freight Service Review Panel. In our submission, we will have two main sections: Issues and Solutions. Under Issues, we will identify the key problems that exist today with the rail-based logistics system. Under Solutions, we will provide practical and realistic ways to address those problems. It is our hope that this analysis will help the Panel come to conclusions that benefit our members and all shippers across the country.

Thank you for this opportunity and please feel free to contact us if you have any questions, comments or concerns with our submission.

Sincerely,



Doug Robertson
President



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Alberta Grain
Commission

Alberta Oat Rye &
Triticale Association

Alberta Pulse Growers

Alberta Winter Wheat
Producers Commission

Atlantic Grains Council

British Columbia Grain
Producers Association

Canadian Canola
Growers Association

Manitoba Corn Growers
Association

Prairie Oat Growers
Association

Western Barley
Growers Association

Western Canadian
Wheat Growers
Association

Issues

In most industries, the free market will generally force a provider to achieve a high quality of service or performance, or risk being overtaken by competitors. The railways do not face this competition, and due to the nature of the industry, ending the monopoly is unlikely. As a result, the railways do not face the free market pressures to achieve a high quality of service.

Instead, the railways face internal pressures to reduce costs and maximize returns. In a free market, this is assuredly a good business model because competition would force them to do this while providing a high quality of service. In a monopoly setting, service suffers in exchange for these reduced costs and maximized returns. This is not a theory but rather a proven reality. Both CP and CN increased revenues and decreased spending in the first quarter of 2010, resulting in 74 and 21 per cent increases in profits respectively.

The result is an incredibly poor level of service that has left shippers incredibly dissatisfied. On a scale from 1 to 7, only about 17 per cent of those surveyed by the NRG Research Group rated their satisfaction level a 6 or 7. These surveys typically generated about 50-70 per cent in this range. More importantly, 62 per cent of those surveyed said they had suffered a serious financial impact as a result of poor rail freight service. Without a doubt, there is serious work to be done to improve the quality of rail freight service in this country.

The system in its current form presents a serious imbalance between the rights of shippers and the rights of the railways. For example, a shipper can face penalties for failing to load and unload cars on time, but the railway faces no repercussions for failing to spot cars or deliver cars on time. These failures have a serious effect on shippers, whose only recourse is an expensive, time-consuming appeal process that is almost never cost-effective. Without any alternative method to transport their goods, shippers have no way to hold the railways accountable.

This systematic problem manifests itself in two primary ways. The first is a large discrepancy in the number of cars requested and the number of cars received. The second is poor overall railway service performance, which includes a regular failure to meet deliver and pick up cars on time. Both of these issues negatively affect farmers in their day-to-day lives.

Cars requested versus cars received

The railways do not provide sufficient car supplies to shippers. In Canada Transportation Act Level of Service decision no. 488-R-2008, the Canadian Transportation Agency found that some car orders requested on a weekly basis were confirmed at rates below 60 percent. As the agency suggested, this is not a reasonable level of performance.

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The Canada Transportation Act s. 113(1) suggests that a railway provide “adequate and suitable accommodation for the carriage, unloading and delivering of the traffic.” This is a vague term, and until the aforementioned level of service decision, there was no real precedent as to what an “adequate and suitable accommodation” was.

In that decision, the Canadian Transportation Agency ruled that the confirmation of 80 percent of the cars is an acceptable and reasonable level of service standard. The rationale seems to have been that this is a middle ground between the 60 percent (or less) that the railways were providing and the 100 percent that shippers are expecting. This may seem like a reasonable compromise, but it is not a reasonable level of service standard.

The *Analysis of Railway Fulfillment of Shipper Demand and Transit Times* prepared for this review suggests that the railways may not even meet this requirement. Railways were determined to have delivered 90 per cent of the cars requested within a week only half the time for grain shipments. This is unacceptable.

Shippers do not prepare for 80 percent of their cars to show up. They prepare 100 percent of the labour needed. They schedule 100 percent of the time it will take to load their cars. They prepare to ship 100 percent of their goods. When the railway spots only 80 percent of the necessary cars, shippers are losing 20 percent of their labour costs, 20 percent of their preparation costs, and 20 percent of their valuable time. Such a poor level of service standard costs shippers money.

We recognize that there is a natural incentive for railways to keep the number of cars available low. The amount of cars needed is both seasonal and variable from week to week. It costs money to keep more cars available than are necessary, and because of the monopoly, the railways will get the business sooner or later.

It is also important to recognize, however, that in a competitive market scenario, a railway that operated this way would cease to exist. It is hard to imagine another industry where 80 percent service is acceptable. A bus cannot show up 80 percent of the time, an airplane cannot fly across the country with 80 percent of its required fuel, and a shipper cannot ship with only 80 percent of its required cars.

It is equally important to recognize that the railways are a derivative business, which only exists because of shippers. Service benchmarks should be linked to shipper requirements on performance, as they would be in an open marketplace. It does not make sense to link the benchmark to how poorly the railways are performing. Shipper requirements are certainly not 60 percent, and they are not 80 percent either. Shippers require 100 percent of the cars they request to help maximize their own efficiencies.

Of course, this comes with increased cost to the railways. Currently, the railways and their shareholders have increased profits by reducing the size of their railway car fleets and reducing

the number of loading origins. They have failed to pass these cost savings back to shippers, as they would have to in an open market. The railway has unfairly capitalized on its monopoly, and shippers are the ones paying for it.

Railway service performance – Effects on Shippers

Railways consistently provide a substandard level of performance that would not be acceptable in an open market. In addition to not sending enough cars, these cars are consistently late. Estimated times of arrival for both empty spotting and pick up are consistently wrong. In Canada Transportation Act Level of Service decision no. 488-R-2008, it was estimated that about 20 percent of rail cars were delivered three or more weeks after the date they were requested. This is an extraordinary failure.

As with the Canadian Transportation Agency's ruling on the number of cars delivered, they attempted to find a middle ground here as well. They decided "it seems reasonable that CN can deliver at least 90 percent of rail cars it has committed to deliver" within three weeks of the date they are supposed to arrive. Again, this decision is a compromise, but it fails to set a standard which is actually reasonable. Shippers cannot afford to be waiting for a car to arrive nearly a month late, especially when there is a vessel waiting at port for one hundred percent of the shipper's cargo and demurrage charges are accumulating.

These delays create a variety of problems for shippers. The grain industry is very time sensitive and when shipments are late, it can cause serious financial loss. The buyers often have a just-in-time system to keep their domestic food processing industries running at capacity and that requires them to receive timely shipments. In addition to the potential for significant vessel demurrage bills, repeated delays that have become commonplace can cause our customers to do business with other countries where they have more assurance of timely shipping and deliveries. When shipments are frequently three weeks late or worse, it is reasonable to expect a significant loss of business and damage to Canada's reputation.

Railway service performance – Effects on Farmers

There are substantial costs to farmers from delayed shipping. When a grain company or pulse processor is expecting substantial shipping in a week, they must then also make arrangements for producer deliveries to either ensure adequate supplies for cleaning, or to ensure adequate supplies of various grades for blending and/or shipping, often in unit trains.

We would like to put some numbers in perspective to you:

- A typical unit train of 100 cars, contains about 9,000 tonnes of grain
- This is approximately 300 farmer deliveries @ 30 tonnes per semi-trailer

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So, for each and every train that is delayed or cancelled, 300 truckloads of grain have been stalled, which then causes the following problems:

- Reduced cash flow to meet operating loans and other creditors
- Increased interest costs on outstanding debt and loans
- Costs of booking custom truckers and or hiring additional help to load grain
- Possible loss of grade gains, depending on mix of deliveries

Delays also cause distinct seasonal disruptions to the management of our farm operations:

- August – October: complicates harvest planning and operations
- November – March: costs of snow removal and preparing equipment for cold weather operation
- April: road bans come into effect, limiting weights and increasing the number of loads needed to haul the grain
- May – June: complicates seeding and spraying operations
- July: means rolling Canadian Wheat Board crops over into next crop year, sometimes at a substantial price discount

Finally, as farmers we depend heavily both on world prices and access to world markets for our income. We are the fourth largest agri-food exporter in the world, and in a normal year we export over 50 per cent of our wheat and over 70 per cent of our canola and pulses.

Across Canada, 92 per cent of farms are directly dependent on export markets – they either export their products or sell them domestically at prices set by international marketplaces. This represents 210,000 farms and includes the majority of farms in every province.

Within any one month period there are always price fluctuations up and down, meaning there are always opportunities to lock in profits on both spot markets and seasonal markets.

However, without reasonable surety in access to transportation, grain companies either are hesitant to bid, or they have to widen their basis (allowance for risk) which decreases the returns to farmers. For example, a normal sales contract requires the grain to be in position by a certain date and if it isn't then one of two things happen. Either the company buys grain from another exporter at port position (often at a premium), or it pays penalties for non-compliance in its contract.

Either way, the potential costs and risks are factored into the basis, which directly reduces the price we receive as producers. It is a direct cost to our bottom line.

There is also the lost opportunity costs of our exporters not even bidding on premium spot markets from time to time when the risk of not getting product to port is so great that the basis would be so wide, producers would refuse to deliver. We don't have quantitative numbers for how often this happens, but have received plenty of anecdotal information to support our assertion.

We must fix these problems.

Solutions

Without any legal or financial consequences, and acknowledging that the nature of railways will not allow significant competition in the market, the railways will continue to operate in a way that protects their own bottom line at the expense of quality of service. Therefore, it is necessary to pass legislation that will increase the quality of service and create a more equitable balance between the rights of shippers and the rights of railways. To be clear, we are not looking for an overhaul of existing legislation or any sort of excessive regulation. We are looking for a framework that allows shippers to transport their goods without the threat of serious financial loss due to an incredibly poor level of service from the railways.

Simplify Level of Service complaints

The main barrier to holding railways accountable is the cost of dispute resolution. More often than not, the costs associated with dispute resolution, including human resource and financial costs, exceed the possible gains from a Level of Service action. Currently, the Canada Transportation Act does not give the Canadian Transportation Agency any right to award damages, either punitive or related to costs incurred and lost opportunity.

If the government empowered the Canadian Transportation Agency to award damages, the railways could be easily held accountable when they fail to meet Level of Service standards. Rather than undertaking an expensive arbitration process, shippers would be able to seek financial compensation for the broader systemic issues that currently exist, and the railways would be forced to address those issues in time. This is not an unprecedented step as the Canadian Food Inspection Agency also has powers to award damages when food producers fail to meet similar level of service standards. Furthermore, these damages should be applied in a way that would not affect any calculations related to the grain revenue cap.

To make matters fair, shippers will also have to be subject to penalties from the Canadian Transportation Agency. It will be necessary to ensure shippers' orders are placed with certainty so railways are not sending cars that are not needed. Shippers will have to be subject to penalties for cancelled car orders, ensuring the integrity of the system.

Reciprocal Penalties

Currently, shippers face financial penalties if they do not meet performance standards while loading and unloading cars. These penalties are given because inefficiencies can have a commercial impact on the railways and all those that are serviced by them. Shippers are committed to loading and unloading cars with a very high level of performance as a result of these punitive measures.

On the other hand, railways face no such penalties when they fail to provide the shipper with reasonable service. At the very least, this creates a very uneven playing field and hurts shippers.

Given the success of penalties aimed at shippers' inefficiencies, it makes sense to impose equal penalties on the railways when they fail to provide reasonable service. Specifically, the railways should be penalized when they agree to spot cars and fail to deliver them within a specific timeframe, and once the cars have been loaded, the railway should be penalized if they fail to arrive at the destination within a specific timeframe.

Fast-tracked arbitration

Level of Service reviews can be very costly, time consuming and tarnish relations between the railways and shippers. One way these can be avoided is to have a fast-tracked arbitration process, where the timeframe for the process is significantly reduced and the arbitrator would be forced to choose either the shipper's or railway's final offer. This would force parties to come up with reasonable solutions, reduce costs, and ensure that awards are distributed quickly. This solution would not replace Level of Service or Final Offer Arbitration procedures, but rather would be an additional option that railways and shippers could pursue.

Independent monitoring

While the statistics currently available clearly indicate a problem with the railways, it is hard to say with certainty how severe these problems are. Furthermore, while the Canadian Transportation Agency has made estimates as to what a reasonable level of service is, there seems to be little data available as to whether or not the railways are meeting these levels of services.

The Canadian Transportation Agency should establish an oversight body that recommends operational targets and monitors the actual performance of the railways. This body could be comparable to what the Grain Monitor does. The body could also make recommendations to the Canadian Transportation Agency on penalties and damages awarded for both shippers and railways. Ideally, the body would have the authority to launch and undertake investigations on its own. The body would also issue periodic reports, preferably yearly or more frequently. To ensure its independence, the body should be subject to a formal review every five years.

GPS tracking for rail cars

While a failure to spot the correct amount of cars is always a problem, this issue could be mitigated by increased communications between the shippers and the railways. If the shippers know they will not receive all the cars they ordered, at least they will be able to reduce their costs by sending workers elsewhere and adjusting their preparations in advance.

One possible solution would be to require railways to install GPS tracking on cars and make that data available in real-time to shippers. This is a relatively inexpensive way to track cars and could save shippers enormous amounts of time and money. This is relatively standard in the private shipping industry by companies like UPS, but has also been done in the public sector by Canada Post. This would be a valuable service that would greatly reduce some of the hassles faced by shippers when planning their schedules. Moreover, this would help the railways more accurately plan their deliveries, improve their estimated times of arrival, and ensure that cars are going where they need to go.

Essential Service

The railways are a vital service that Canadian farmers rely upon for their living. Any shut down of the railways, no matter how temporary, has a significant financial impact on farmers as grain delivery opportunities quickly end.

We would respectfully ask the panel to recommend a review of the merits of essential services, to shipments overall and then on grain shipments specifically. The reality is that when major work disruptions occur in our rail system, there are immediate calls from many shippers and businesses for “back-to-work” legislation with mandatory arbitration. The end result is a dispute resolution process largely identical to that of essential services in the first place.

Conclusion

The railways currently operate at very low level of service standards, which has a significant financial impact on shippers. While farmers are losing millions of dollars from late shipments, lost customers and extra demurrage fees, railways are cutting costs despite profit increases. There is a serious imbalance under the current framework, which manifests itself in two primary ways:

1. Railways do not provide the correct amount of cars requested
2. Railways do not provide cars in a timely manner



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We have proposed several solutions that would help restore the balance between a shipper's and a railway's rights.

1. Simplify Level of Service Complaints
2. Penalties for railways and shippers who fail to meet performance standards
3. Introduce fast-tracked arbitration as an alternative to Level of Service complaints
4. Create an independent monitoring body to track and enforce Level of Service standards
5. Improve communications between railways and shippers through a GPS tracking system.
6. Investigate whether or not the railways should be considered an essential service

Thank you for taking the time to consider our submission. Please feel free to contact the Grain Growers of Canada with any questions or comments you may have.