Legislation requiring railways to meet demands of shippers such as the grain industry can have unintended consequences in the supply chain. CN photo

Rail Legislation: Unintended Consequences

Jean Patenaude

Canada's National Transportation Policy sets out to create a competitive and efficient transportation system based on market forces. But as Jean Patenaude writes, recent legislation to improve rail service goes against that policy, and has consequences for railways and shippers alike.

For railways in Canada, providing suitable service to all of their customers isn't only good business. It's the law.

For more than a century, Canadian railways have been legally required to move goods offered to them by their customers. Sections 113 to 115 of the *Canada Transportation Act* (CTA), often referred to as the railways' "common carrier obligations," compel railways to "furnish adequate and suitable accommodation for the receiving and loading of all traffic offered for carriage."

Despite various reviews and numerous amendments to railway legislation during the last century, the wording of the level-of-service obligation provisions has remained relatively unchanged. Under these provisions—part of a regulatory framework based on competition and market forces—Canada's railways provide efficient, low-cost service to customers, while generating the revenues needed to grow their network.

However, over time, shippers have complained about inadequate or inconsistent rail service, leading to questions about what, in fact, are the service obligations of railways. These complaints have resulted in government initiatives, and subsequent leg-

islation, favouring regulation over commercial forces. Despite the conclusion of the last statutory review of the CTA in 2001 to the effect that "Canada's rail freight transportation system works well for most users most of the time" and that "the basic elements of a competitive and efficient rail transportation system are in place," the federal government proceeded to make amendments which expanded the authority of the Canadian Transportation Agency (the Agency) in resolving rail service disputes. The Rail Freight Service Review (RFSR) and the subsequent Dinning Facilitation Process proposed the development of a service agreement template and a dispute resolution framework to resolve complaints about railway services.

Recent government decisions have also introduced new regulatory restrictions and further expanded the reach of existing remedies available to shippers. The *Fair Rail Freight Service Act* of 2013, gives shippers the right to request a service level agreement (SLA) with railways—stipulating specific performance standards for receiving, loading, carrying, unloading and delivering traffic—and establishes an arbitration process in the event the shipper and the railways cannot agree on the terms of the SLA.

In 2014, grain transportation issues, caused by unusually harsh winter weather and an unforecasted 50 per cent increase in export grain volumes, led the government to introduce Bill C-30, the *Fair Rail for Grain Farmers Act*. This legislation gives the Agency the authority to define the specific railway operations for inclusion in service agreements. It also gives the minister of transport the authority to order Class 1 railways to move minimum volumes of grain each week, and to impose financial penalties in the event of a railway's failure to do so. The legislation also extends the distance limit for interswitching—the switching of traffic at regulated rates between a local railway's line and the line-haul carrier's line—to 160 km from 30 km in the Prairies.

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The CTA has been amended four times since 2007, mostly in response to specific issues, with each change introducing additional regulatory measures or remedies. The current CTA review undertaken by former industry minister David Emerson—whose report should be released imminently—provides an opportunity to examine how recent amendments have been implemented, and to consider the extent to which they have furthered the goal of the National Transportation Policy to achieve a competitive and efficient transportation system based on competition and market forces. That policy states that regulation and public intervention should only be used as a last resort and, in the words of 2001 CTA Review Panel, "should be used only to solve instances of market failure." Where public intervention is required, it should foster and be consistent with commercial outcomes, not undermine them.

Not only does recent legislative action encourage detailed government intervention and threaten to hinder the efficiency of the rail-based supply chain, it has resulted in a piling up of shipper remedies that are disconnected from commercial reality. Prior to the enactment of the *Fair Rail Freight Service Act*, shippers had the ability to raise service issues through Final Offer Arbitration (FOA) provisions. The FOA process establishes a connection between rates and service by allowing a shipper to raise either or both elements within the same process. Most shippers, however, have only used this recourse to establish a rail rate. They have expressed concern that using this process for service issues might compromise their ability to obtain the lowest rate possible. The resulting situation is that, in the event of a disagreement between parties, one arbitrator will set the terms and conditions of service (i.e. through SLA arbitration) and a different arbitrator will set the rate in separate and independent proceeding (i.e. through FOA). Whether purchasing transportation services or any other type of service, terms and conditions of service and rates are inescapably linked. Yet, the divorce between service and pricing was the result when the Fair Rail Freight Service Act came into force.

Another consequence of the SLA provisions of the Fair Rail Freight Service Act is that they create a silo approach. Each shipper's level of service is established in isolation, without consideration for the overall supply chain. Railways have used the "bus vs. taxi" analogy to illustrate this issue. As with a bus system, railway services are designed to best accommodate the overall needs of all the users of the specific service. The service-arbitration process should recognize this aspect of railroading, and should not be used to restructure the bus service to meet the needs of a specific shipper at the expense of the others.

In recent years, Canada's railways have taken the initiative, often in collaboration with other logistics partners, to improve service for the benefit of the supply chain. With respect to grain transportation, for example, CN has introduced an initiative through which customers can

incorporate private cars into the railway's fleet, in return for a commercial, year-round business and volume commitment. CP has implemented a program for its grain customers designed to better align supply and demand, as well as drive reciprocal accountability and provide greater certainty for customers.

Contrary to allegations by shippers that legislation and regulatory measures are required to force railways to address service issues, the above initiatives are clear examples of the railways' attempts to address issues through innovative programs and service offerings.

Previous reviews of the CTA undertaken by the federal government have confirmed that the vision for transportation policy based on competition and market considerations is the right transportation policy direction for Canada. These reviews documented the benefits accrued by shippers, carriers and the overall Canadian economy as a result of replacing detailed regulatory controls with a reliance on market forces.

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However, recent legislative action (the *Fair Rail Freight Service Act* and the *Fair Rail for Grain Farmers Act*) has reversed this trend by encouraging detailed regulatory interventions. These new measures are available to all shippers without prior conditions or thresholds, and not only as a last resort in the event of abuse by a railway. They also transfer detailed operational decisions away from railway management to an arbitrator/regulator with little to no consideration for the network nature of railway operations, and for the impact on other users of the service. As a result, the remedy imposed by the regulator in one case can create service issues for the other users of the service, leading to additional complaints. Finally, by decoupling railway service and price, these regulatory measures undermine, and indeed, contradict the fundamental principles of commercial and market-based considerations set out in the National Transportation Policy. P

Jean Patenaude is a former lawyer for CN, and former vice chairman of the Canadian Transportation Agency.