AG TRANSPORT COALITION

Frequently Asked Questions from SLA Workshops
Spring 2014

Shipper Protection Measures

Q. What is the difference between Final Offer Arbitration, Service Level Arbitration and a Level of Service complaint?

A. Final Offer Arbitration (FOA) is provided for under sections 161 to 169.3 of the Canada Transportation Act. Final offer arbitration is a means for shippers to resolve disputes regarding rates or services with railways. FOA applies to any movements of railcars (generally not Intermodal traffic) in Canada. Under FOA proceedings, a shipper and a railway submit their final offers to an arbitrator including all proposed rate and service conditions for the traffic in question. The arbitrator then chooses either the railway or the shipper offer.

The arbitration is not a proceeding before the Canadian Transportation Agency (Agency) and the shipper and carrier generally agree on the arbitrator in advance. The resulting service conditions are either published in a tariff or a confidential contract and are valid for one year. Reasons for an arbitrator's decision are generally not provided and decisions are generally confidential. The shipper and carrier share equally in the cost of the arbitration proceeding and pay their own legal and professional advisors' costs.

Service Level Arbitration to obtain a service level agreement (both abbreviated SLA) is governed by Section 169.31 to 169.43 of the Canada Transportation Act. A service level arbitration cannot be used to determine a rate for the movement of traffic nor a charge for incidental services. A service level arbitration is conducted by the Agency. At present, if proceedings are held in the National Capital Region the Agency will provide the arbitrator and facilities for the arbitration at no charge to either party. Each party is responsible for their own advisors' costs.

The decision of the arbitrator is not limited to choosing between one of the parties submissions as in FOA. Like FOA, the decision of the arbitrator will be in force for one year and is confidential.

A level of service complaint (LOS complaint) is an application filed by any person to the Canadian Transportation Agency that a railway has not fulfilled their service obligations. The Agency will assign one or more of its members to adjudicate the case and the Agency has broad powers to order a railway to take action to redress matters if it finds that the railway has not met its service obligations. Under Section 116(4) of the Act the Agency may:

(*a*) order that
- (i) specific works be constructed or carried out,
- (ii) property be acquired,
- (iii) cars, motive power or other equipment be allotted, distributed, used or moved as specified by the Agency, or
- (iv) any specified steps, systems or methods be taken or followed by the company;

(*b*) specify in the order the maximum charges that may be made by the company in respect of the matter so ordered;

(*c*) order the company to fulfil that obligation in any manner and within any time or during any period that the Agency deems expedient, having regard to all proper interests, and specify the particulars of the obligation to be fulfilled;

(*c.1*) order the company to compensate any person adversely affected for any expenses that they incurred as a result of the company's failure to fulfill its service obligations or, if the company is a party to a confidential contract with a shipper that requires the company to pay an amount of compensation for expenses incurred by the shipper as a result of the company's failure to fulfill its service obligations, order the company to pay that amount to the shipper;

An LOS complaint can be expensive for shippers as it is a quasi judicial proceeding that can involve significant legal and internal resources from the complainant. The Agency has up to 120 days after receipt of the complaint to make a determination.

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Common carrier obligations

Q. What are railway common carrier obligations for service to shippers?

A. A common carrier is a carrier that must offer services to any shipper under regulated service conditions. Canada's national rail carriers are common carriers under law and their service level obligations are spelled out in sections 113 to 115 of the Canada Transportation Act. Section 113 requires a railway to furnish "adequate and suitable accommodation for the receiving and loading of all traffic offered for carriage on the railway" and it requires a railway to "without delay, and with due care and diligence, receive, carry and deliver the traffic."

With regards to the level of service that a railway must provide, it can be said that a shipper should expect from a carrier, service that would be obtained in normally competitive transportation markets. However, as virtually all rail transportation markets in Canada do not meet this competitive standard, it has been up to the Canadian Transportation Agency and its predecessor agencies to establish guidelines for acceptable service levels within the context of the Act.

The Agency does not currently have the authority to establish specific service levels for railways, except in the context of a service complaint that may be brought before the Agency for adjudication under section 116 of the Act. Therefore, in order to understand what service level a shipper might reasonably expect from their rail carrier, shippers can review past decisions of the Agency in service level complaints.

Recently, the Agency made a decision in a complaint by Louis Dreyfus Commodities Canada against Canadian National (Case No. 14-02100). The CTA decision in this case laid out a very clear explanation of railway level of service obligations and how they should be applied. The Agency also provided an evaluation approach that can be used to determine whether or not a railway is meeting their obligations in any particular circumstance. Some of the key principles included in such an evaluation include:

- If a shipper establishes and communicates a clear demand for service and the railway does not meet that demand, the onus on establishing that a particular service failure is justified, is upon the railway.
- Transportation being a derived demand, freight railway companies do not operate except to carry goods that are produced by shippers and it is the financial health of shippers and receivers that is protected by sections 113 to 115 of the CTA. Therefore railways should be able to accommodate the natural growth of business and not impose a constraint upon it.
- Running a very lean operation ("sweating the assets") must not impair a railway company's ability to manage surges in demand or operational challenges and therefore railway resource levels should respond to predictable shipper demand.
- Superior service to one shipper is not a reason to deny service to other shippers.
- Historic service levels cannot be used alone to determine current service obligations.
- A railway company's obligations to satisfy shippers' requests could include hiring additional staff, modifying the frequency and timing of service as well as making arrangements, short term or otherwise, for the acquisition of cars or motive power.

In summary, a railway's service should meet any clearly established service demands that have been communicated to the railway in advance by a shipper. In addition, of course, a railway company cannot be required to provide service at rate levels that do not allow the railway to make a reasonable financial return on their investment. In practice, the timing of shipper demands for increased service and the sustainability of such demands will be factors that will determine whether or not a shipper's service request is reasonable but, in general, the railway has an obligation to provide service that meets individual shipper's commercial needs.

Q. If a railway can make more money moving oil or another commodity than moving grain, is it reasonable to expect the railway to use its resources for grain and forgo the higher returns on another commodity?

A. As a common carrier, a railway has a statutory obligation to invest in sufficient resources to be able to handle the needs of all shippers shipping all commodities, as long as such service demands pay in excess of the railways long term variable cost of handling the traffic, and such demands can be reasonably foreseen. No individual shipper's service needs can be sacrificed because of a conscious decision to shift resources to another type of shipper. Common carrier obligations apply to all individual shippers equally.

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Frequently Asked Questions from SLA Workshops
Spring 2014

Railway challenges to SLAs

Q. What grounds might a railway use to challenge an SLA request?

A. Certain issues are not eligible for service level arbitration under the Canada Transportation Act. These include matters that are governed by a written agreement, including a confidential contract, to which the shipper and the railway company are parties or is the subject of an order made by the Agency pursuant to a level of service complaint under section 116 of the Act or that are subject to a previous arbitrators service level arbitration decisions.

In addition, a railway may argue that no sincere attempt has been made by the shipper to resolve any of the matters under dispute before the shipper submitted the matter to the Agency for arbitration.

A railway may also argue that the matters submitted for arbitration fall outside of the scope of issues that the Agency may consider in service level arbitration. These matters as defined in section 169.31 of the Act are:

(a) the operational terms that the railway company must comply with in respect of receiving, loading, carrying, unloading and delivering the traffic, including performance standards and communication protocols;

(b) the operational terms that the railway company must comply with if it fails to comply with an operational term described in paragraph (*a*);

(c) any operational term that the shipper must comply with that is related to an operational term described in paragraph (*a*) or (*b*);

(d) any service provided by the railway company incidental to transportation that is customary or usual in connection with the business of a railway company; or

(*e*) the question of whether the railway company may apply a charge with respect to an operational term described in paragraph (*a*) or (*b*) or for a service described in paragraph (*d*).

For further information on 'operational terms' see the "Regulations on Operational Terms for Rail Level of Services Arbitration" which are available at www.laws-lois.justice.gc.ca

Q. I'm a captive shipper. Why would a railway negotiate a service agreement with me when they know I have no other transportation option?

A. A railway may prefer not to have its service level subject to the demands of an arbitrator and may prefer a negotiated agreement. Service level arbitration imposes costs on both shipper and railway and while the relative magnitude of the cost might be bigger for a shipper it still requires railway marketing and legal resources.

Shippers should remember that railways are bound by the service obligations outlined in Sections 113 to 115 of the Act and as well outlined in the recent Canadian Transportation Agency in the 2014 Louis Dreyfus case which is referred to under the Common Carrier Obligations questions in this FAQ. A railway will prefer not to have service level precedents set by outside agencies (arbitrators) that may provide precedents for other dissatisfied shippers.

This is not to argue that the current service level arbitration provisions in legislation and regulation are ideal. They would be significantly strengthened by allowing shippers to include financial consequences for non-performance in arbitration and by strengthening the force majeure provisions currently in regulation. However, if a railway is convinced of a shipper's determination to achieve improved service through arbitration and if the shipper is well prepared and reasonable in their demands, a railway will engage more seriously in negotiation to avoid arbitration and the uncertainty that is brings.

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The Maximum Grain Revenue Entitlement – (Revenue Cap)

Q. What is the Revenue Cap really called and how does it work?

A. The revenue cap, more properly called the Maximum Grain Revenue Entitlement (GRE) is provided for in sections 150 and 151 of the Canada Transportation Act. It is NOT a fixed cap on railway revenues for grain.

The GRE ensures that any escalation in railway grain revenue from year to year reflects railway cost inflation, the volume of grain moved and the average length of haul of the movement. Railways make more money if they move more grain and they obtain 100% of any cost efficiency improvements that they achieve in the movement of the grain from one year to the next. The GRE only applies to grain routed for export through Canadian west coast ports, and eastern shipments ending at Armstrong and Thunder Bay. It does not apply to grain originating in Canada and shipped to the United States or Mexico, or east of Thunder Bay. The formula to determine a railway's maximum grain revenue entitlement is:

$$[A/B + ((C - D) \times \$0.022)] \times E \times F$$

Where:

- *A* is the company's revenues for the movement of grain in the base year;
- *B* is the number of tonnes of grain involved in the company's movement of grain in the base year;
- *C* is the number of miles of the company's average length of haul for the movement of grain in that crop year as determined by the Agency;
- *D* is the number of miles of the company's average length of haul for the movement of grain in the base year;
- *E* is the number of tonnes of grain involved in the company's movement of grain in the crop year as determined by the Agency; and
- *F* is the volume-related composite price index as determined by the Agency.

The base year values *A, B*, and *D* are established in the Act separately for CN and CP so the only year over year variables that affect the determination are the carriers' maximum revenue in a particular year are the volume of the movement, the average length of haul and the change in the volume-related composite price index.

Q. Does the maximum grain revenue entitlement result in a reduction in the quality of grain service – or a reduction in the investment that railways make in grain transportation? Would removing the GRE result in increased railway investment in grain transportation?

A. There is no evidence that railway investment in grain service is affected by the GRE. On the contrary, grain shippers do not see better service on shipments originating in Canada that are destined to the United States or Mexico, even though these movements do not fall under the GRE program. Therefore, based upon grain shippers' experience in commercial non-regulated corridors, it seems unlikely that the removal of the GRE, on its own, will result in any railway investment in service improvements

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Administrative Monetary Penalties (AMPs)

Q. How is the AMP amount determined?
Who receives the AMP in the SLA arbitration?
How is the AMP assessed and will it be published?

A. The level of service arbitration provisions of the Canada Transportation Act provide that the Agency can make regulations designating that the contravention of any requirement imposed on a railway by an arbitrator's decision be a violation in accordance with sections 179 and 180 of the Act. These sections of the Act empower the Agency to assess administrative monetary penalties for any such violations and subsection 177(1.1) establishes the maximum amount payable for each such violation to be $100,000.

While $100,000 per occurrence is the maximum amount that will be assessed, the actual amount of any fine is likely to be less, and will be based upon the severity of the violation and the magnitude of the impact of the violation on the shipper.

In order for the Agency to investigate a potential violation of a service level agreement, the shipper must make a request for investigation, to the Agency. The Agency will not initiate an investigation on its own motion or on the basis of requests by third parties.

Following a request, the Agency will designate an enforcement officer with the power to request the parties to produce documents or data that may contain relevant information. Hearings or other representations do not normally take place during such investigations.

Following the investigation the enforcement officer will, if appropriate, issue a notice of violation setting out the penalty.

A penalized railway can appeal the decision to the Transportation Appeal Tribunal of Canada (TATC). Final decisions of the TATC are not appealable but they are subject to judicial review by the Federal Court.

AMPs are not assessed as damages and are payable to the Government. They are administrative fines that are intended to encourage and enforce compliance with regulatory requirements, in this case service level arbitration decisions.

The Agency may choose to publish some information about any AMPs that are assessed but such information is expected to be subject to the confidentiality provisions of the service level agreement that was arbitrated and would likely be at a summary level.

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Bill C-30 – Changes to Interswitching

Q. What changes were made to Interswitching and how might this impact a "captive shipper?"

A. Bill C-30, which amended the Canada Transportation Act in May 2014, gave the Canadian Transportation Agency authority to establish extended Interswitching zones beyond the current 30 km radius from a shippers' facility to a railway other than the railway that serves the shipper. The Bill also permits the Agency to establish different distances for different regions or different goods. These new provisions are subject to a sunset clause which would allow the changes to be repealed on August 1, 2016 unless there is a resolution in Parliament for their extension. Subsequent to this change in the Act, the Agency has published regulations with a new zone 5 interswitching zone of up to 160 km for all commodities shipped from origins in the three Prairie Provinces.

Railways are required under interswitching regulations to provide a level of service equal to the service they provide to their own line haul traffic, on interswitched traffic. In theory therefore, the new Interswitching zone should introduce significant new competitive pressures which might be expected to result in greater service options for shippers. However, the Canadian railway market is a duopoly with both national railways enjoying approximately equal and stable shares of the grain transportation market. In addition, both railways are operating close to their current capacity, as was clearly demonstrated by the significant grain shipping delays experienced in crop year 2013/2014. In such an environment, it is not expected that the new interswitching regulations will generate significant competitive pressures that result in improved service, as the rail transportation market lacks the type of effective competitive pressures that are required to motivate the railways to respond with improved service.

The only circumstance in which these extended interswitching zones may result in real increased effective competition, is where a railway that is not part of the dominant duopoly gains access to new traffic.

For example: Burlington Northern railway (BNSF) may gain access to new traffic in the southern areas of AB, SK and MB. However, whether or not the BNSF seeks additional market share through interswitching will be dependent in part on their capacity to do so without harm to their existing traffic base. Given the well-publicized problems of BNSF in serving their own grain customers in the northern tier states in recent months, it will likely be some time before they are in a position to aggressively pursue incremental Canadian traffic through interswitching.

For additional information please contact the Ag Transport Coalition at contact@agtransportcoalition.com.