

**BRIEF TO:**

**Canada Transportation Act Review:**

**ENHANCING RAIL COMPETITIVE ACCESS**

**BY:**

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## **Executive Summary**

### **The Need For a Cost-Effective and Competitive Rail Industry**

CFI is a resource-based industry heavily dependent on the railways to move our goods to domestic, offshore and U.S. markets. The changes proposed by the CFI to the rail competitive access provisions of the Canada Transportation Act will continue and reinforce the policy objectives of the Act, foster increased rail-to-rail competition and help Canadian shippers to maintain and enhance their global competitiveness in both domestic and exports markets.

CFI further believes that the Canadian legislative model, with some improvements and revisions as recommended herein, should be the model upon which the North American railway industry operates into the 21<sup>st</sup> century.

The following principles are, in CFI's view, a requisite to the continuation and enhancement of the competition policy objectives of the CTA:

- The common carrier service obligations contained in the *CTA, 1996*, are the foundation upon which all of the competitive access provisions are built. Without reasonable assurances of adequate rail service, rate levels are largely meaningless;
- Final Offer Arbitration (FOA) is the single most important provision in the CTA which assists captive shippers in securing competitive rates and services. The additions of any barriers or thresholds to use of the FOA provision must not be tolerated;
- The competitive access provisions must be viewed as an integrated package of options, as they were initially designed to be. A shipper must be able to utilize the competitive provision that best addresses its unique circumstances.

### **The Need to Correct the Deficiencies in the CTA Competitive Access Provisions and to Remove Barriers to Relief**

The "*rail competitive access*" provisions were designed by Parliament to recognize the unique needs of Canadian shippers, especially those operating in the resource sector, captive to and dependent upon a single railway. CFI submits that there are however a number of deficiencies and flaws in those provisions as well as unnecessary, time-consuming and costly barriers to their use. The deficiencies and flaws need to be corrected and the barriers need to be removed. CFI's proposals address both of these aspects of the legislation.

## CFI Recommendations:

1. Section 27 (2) and (3) of the Act requires the Agency, when making a decision regarding a transportation rate or service, to determine that the applicant will suffer "*substantial commercial harm*" if the relief requested is not granted. This subjective determination can result in contested proceedings before the Agency and constitutes a significant deterrent to a prospective applicant. The section also represents overregulation and additional administrative burden, and therefore should be repealed;
2. Section 112 of the Act further requires that any rate or condition of service established by the Agency must be commercially fair and reasonable to all parties. Section 112 of the Act constitutes an unnecessary barrier to Agency relief and should be repealed;
3. Agency-established maximum interswitching rates are an important component of the competitive access provisions of the Canada Transportation Act and reflect the broader policy objectives set out in Section 5 of the Act. The existing interswitching provision should be broadened to permit the transfer of rail cars at all interchanges in Canada, irrespective of the ownership of the lines over which traffic is moved to and from the interchanges;
4. Various reviews and surveys have confirmed that Canadian railways have effectively declined to compete with one another through competitive line rates (CLR's), and as a result the provision is largely inoperative in Canada. In CFI's view, the current provision is complex, it does not promote competition between the local and connecting carrier, and it is subject to the unnecessary section 27 test of substantial commercial harm. In order to correct the flaws and deficiencies in the provision, sections 129 -136 of the CTA should be repealed and replaced by a provision known as a **competitive access rate** ("CAR").
5. Section 138 of the CTA should be broadened to allow '*any person*' to make an application to the Agency for the right to operate trains and crews over the lines of a federal railway company. The onus should be placed on the owning railway company to satisfy the Agency, through a reverse-onus public interest investigation, that the granting of the requested running rights to a short line will not be in the public interest.
6. CFI is a member of the "*Shippers' Summit*", a coalition of major Canadian shipper associations, and strongly endorses that submission.

## Conclusion

CFI's proposals should be viewed as an integrated package of options. Our national transportation policy requires a minimum of regulation in the absence of effective competition. Such minimal regulation is necessary in order to protect shippers and to sustain a viable Canadian fertilizer industry, which must compete in global markets.

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**Appendix 1:**

Historical Overview of Ineffectiveness of CTA Competitive Access Provisions

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| Proposed Amendments to Competitive Line Rates Provisions<br>(Sections 129-136 CTA) | 1. |
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| CFI Active Members | 1. |
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## **1. Introduction**

### **1.1 Industry Overview**

CFI represents the basic manufacturers of nitrogen, phosphate, potash, and sulphur fertilizers in Canada, as well as the major retail distributors. As such, our manufacturers include companies in the resource and manufacturing sectors. CFI members produce 24 million metric tonnes of fertilizers annually, some 20 million are transported by Canada's railways, making fertilizers the third largest customer group of CN and CP.

A few points illustrate the rail transportation challenges faced by our industry:

- CFI members ship to 19,000 origin–destination pairs across North America;
- Roughly 58% of the destinations are captive to one railway;
- Out of 50 production facilities, over half (26) have dual rail access and 9 (18%) have access through regulated interswitching;
- The remaining 30% of our Members' plants (15) are captive to one railway.

This information is highly significant, since it demonstrates that while some 70% of our members have access to more than one railway at the origin, over 80% of their traffic is nevertheless captive.

In terms of magnitude, the fertilizer industry would be characterized as medium-sized, with an annual production value of \$5.5 billion, and domestic retail sales of \$2 billion to Canadian agriculture. Our Members' position in Canada's international trade is also significant. With exports to 40 countries representing some 75% of our total production, global competitiveness is a critical issue. Canadian fertilizer manufacturers supply approximately 40% of total world potash demand and 25% of total North American nitrogen fertilizer requirements. Canadian sulphur, a raw material in phosphate fertilizer production, represents 40% of globally-traded sulphur and is exported to a further 20 countries. In all, Canada provides 12% of the total world supply of fertilizer materials.

Our industry creates about 12,000 jobs, most of these are located in rural regions across Canada - from mines in New Brunswick and northern Ontario to the centre of our industry's production in Saskatchewan and Alberta. A list of CFI Member Companies is attached in Appendix III.

### **1.2 About the CFI**

Over the past three years the CFI has developed and presented a package of recommendations for strengthening the rail competitive access and dispute-resolution provisions of the Canada Transportation Act. We have met with both Mr. Justice Willard Z. Estey and Mr. Arthur Kroeger during their respective

reviews of Canada's Grain Handling and Transportation System. Our views have been consistently communicated to both Mr. Estey and Mr. Kroeger as well as to Transport Canada, the Canadian Transportation Agency, the railways, other shippers, especially grain, and other transportation stakeholders in both Canada and the United States.

Each time a CFI position has been advanced it has been built on the foundation previously established. Improvements have been made based upon feedback from other shipper associations, legal consultants and transportation regulatory experts. Recently, CFI joined forces with a number of other Canadian shipper associations to create a "Shippers' Summit" submission paper which will be jointly submitted to the Review Panel. This alliance, representing some 80% of all goods transported in Canada, will be submitting a joint brief, which CFI strongly endorses.

We believe that the changes which we are recommending will foster increased rail-to-rail competition in Canada and, at the same time, help Canadian shippers to maintain and enhance their global competitiveness in both domestic and offshore markets.

### **1.3 Our Reliance on Rail**

Canada is a trading nation and, to a large extent, a resource-based economy. CFI is a resource-based industry and our members have invested heavily in world scale production facilities with economies of scale which make us very dependent on efficient rail transportation to move large volumes over long distances. Competition in our end markets both within North America as well as internationally is very intense with many of our competitors in other countries located directly at deep water ports.

In order to survive and prosper, we need our railway partners to be highly efficient and operating in a regulatory environment which facilitates the maximum amount of competition possible. Given the size of Canada and our reliance on trade to drive our economy, it is absolutely imperative that we lead the world in effective rail competition.

In order to do this we need a regulatory framework that fosters and promotes rail competition despite the highly consolidated nature of the rail industry.

Both CP and CN have played an integral role in the development of Canada since our country was created in 1867. In fact, the railways were in large measure, responsible for the economic development of our country. We are pleased that, today, we have a healthy and vibrant railway industry to rely on in getting our goods to market.

## **2. A Comparison of U.S. and Canadian Transportation Needs**

### **2.1 The Uniqueness and Importance of Canada's Rail Regulatory Structure as a North American Model**

With a small domestic market, Canadian shippers have historically been more dependent on cost-effective rail access to export markets than their U.S. counterparts. The fertilizer industry, for example, exports some 75% of its total production. Canada's international competitiveness continues to hold a much greater priority in national policy, and to play a much greater role in our commercial success.

Because of this historical difference, Canadian shippers have always had very distinct and different policy and legislative needs than their U.S. counterparts as well as a very different set of railway laws and regulations to effect those needs. Our rail legislation, since 1987, has recognized the unique needs of Canadian shippers, especially those operating in the resource sector.

### **2.2 The Changing North American Railway Landscape**

A comparison of the transportation maps in Canada and the United States yields some interesting facts. In much of Canada, transportation choices have always been limited for shippers of resource-based or bulk products. Unlike in the U.S., we do not have a large navigable river running down the middle of our country which provides effective competition to railways, nor three coasts around which we can ship goods year-round. Furthermore, we do not have an extensive inter-state system of highways as in the U.S. Even in the rail sector, we have never had the multitude of carrier choices which were, until recently, available to U.S. shippers.

In 1980, when the Staggers Rail Act was enacted in the United States, over forty Class 1 railways competed with one another for the traffic of shippers. A major structural change, however, has and is occurring. Over the past twenty years there has been considerable consolidation in the North American rail industry, particularly in the U.S. This trend has accelerated during the last five years with recent mega mergers. We now have only two major rail carriers in the Western U.S. and two in the eastern U.S. In this context the U.S. rail map no longer looks that much different from Canada's. Many U.S. shippers now often find themselves having only one railway at their disposal to move their goods, often over large distances to market, a situation now beginning to parallel that of Canadian shippers.

Coincident with this increased industry concentration has been a serious erosion of options available to U.S. shippers. This has had a cumulative effect of lessening rail-to-rail competition.

U.S. shippers and policy makers, in increasing numbers, are now looking north to Canada for ways to inject greater competition into a rail system which no longer meets the competitive needs of its shippers. Shipper groups such as the Alliance For Rail Competition (ARC) and Consumers United for Rail Equity (CURE) are presently lobbying the U.S. government for changes to rail legislation which will instill much needed rail-to-rail price and service competition back into the U.S. system. We believe that U.S. policy makers and legislators can learn much from the Canadian system. We also believe that the Canadian legislative model, with some improvements and revisions as recommended herein, should be the leading edge model which raises the bar for improved rail-to-rail competition throughout North America into the 21<sup>st</sup> century.

### **3. The CTA National Transportation Policy Statement**

#### **3.1 The Need for Transportation "*at the lowest total cost*"**

Section 5 of the Canada Transportation Act, 1996 (CTA, 1996 or the Act) sets out the National Transportation Policy. Section 5 states that "*..a safe, economic, efficient...network of viable and effective transportation services...that makes the best use of all available modes of transportation **at the lowest total cost** is essential to serve the transportation needs of shippers...*" [emphasis added].

Section 5 further states that "*..those objectives are most likely to be achieved when all carriers are able to compete, both within and among the various modes of transportation...*"

CFI would note that many shippers in Canada, however, are served by only one railway at origin or destination and have no other realistic way to ship their products. These shippers must have access to more than one railway company to obtain the benefits of competition.

#### **3.2 The Need for a Viable Railway System**

Section 5 (h) of the CTA also states that the policy objective of competition should be brought about under conditions that ensure that "*each mode of transportation is economically viable.*"

CFI notes that CN and CP are both now operating more efficiently and effectively than ever. The operating ratios of both CN and CP have improved dramatically since the Canada Transportation Act came into effect in July, 1996. It is also important to note that this is the first review of the legislation under which both Canadian Class 1 railways are publically traded companies. The following figures, from CN's and CP's Annual Reports, reveal that operating ratios have improved dramatically since 1995:

<u>Year:</u>	<u>CN Operating Ratio(%)</u>	<u>CP Operating Ratio(%)</u>
1995	89.0	87.4
1996	85.0	83.0
1997	78.4	81.4
1998	75.1	79.2
1999	72.0	78.2
2000 [2 <sup>nd</sup> quarter]	68.6	77.4

A railway's operating ratio is the benchmark measurement of operating performance in the North American railway industry. It measures the amount of each dollar of revenue which is consumed by the railways' operating expenses to earn it. The lower the ratio, the lower the percentage of revenues required to meet expenses.

As illustrated above, both CN's and CP's operating ratios have declined dramatically since 1995. In comparison with three of the largest Class 1 U.S. railroads, CN and CP's operating ratios were considerably better than their U.S. counterparts. For the second quarter of 2000, Burlington Northern Santa Fe's operating ratio was 76.5, Union Pacific's was 80.5, and Norfolk Southern's was 82.4. It is significant to note that no comparable competitive access provisions exist in the United States. From CFI's point of view, the Canada Transportation Act, 1996, has acted as a catalyst in bringing about such positive change in operating results for the railways.

### **3.3 The Need for Regulatory Constraints to Protect Captive Shippers**

Parliament, since 1967, has recognized that captive shippers in Canada require protection from unreasonable rates and service.

- **The National Transportation Act, 1967**

The National Transportation Act of 1967 contained both a public interest appeal and a maximum rate provision for captive shippers. During the period 1967 - 1985, however, both of these provisions were found to be ineffective in protecting shippers.

In 1985, the government issued its white paper '*Freedom to Move*'. *Freedom to Move* recognized that more effective and less regulatory measures were needed to meet the needs of captive shippers.

- **The National Transportation Act, 1987**

The National Transportation Act, 1987 replaced the NTA, 1967 on January 1, 1988. While the new legislation gave the railways much greater freedom to price their services, it also introduced a 'basket' of *competitive access* and *dispute-*

*resolution* provisions in order to provide captive shippers with competitive options and choices in rates and services as well as timely and cost-effective avenues of dispute-resolution when negotiations broke down. These included an expanded regulated interswitching distance, a new "*extended*" interswitching provision, a new competitive line rate (CLR) provision and a new dispute-resolution provision called final offer arbitration (FOA).

- **The Canada Transportation Act, 1996**

The competitive access provisions were carried forward into the CTA, 1996. At present, with the exception of regulated interswitching there are serious flaws with these provisions which have rendered them ineffective in promoting rail-to-rail competition.

The access provisions take on an even greater importance for Canadian shippers moving goods in an environment characterized by differential pricing where railways are at liberty to price according '*to what the market will bear*'. With modifications, as advanced in this submission, CFI believes that the competitive access provisions can be repaired.

#### **4. Basic Principles Supporting CFI's Recommendations**

The CFI submits that the following principles are requisite to the continuation and enhancement of the competition policy objectives of the CTA:

##### **4.1 Common Carrier Service Obligations - the Foundation of Competitive Access**

The common carrier service obligations contained in sections 113 - 116 of the *CTA, 1996*, are the foundation upon which all of the competitive access provisions are built. Without reasonable assurances of adequate rail service, rates are largely meaningless. Accordingly, the recommendations for competitive access, which are contained in this submission, are predicated upon the continuation and effectiveness of the level of service provisions in the Act.

##### **4.2 Final Offer Arbitration - an Integral Adjunct to Competitive Access**

In our view, Final Offer Arbitration (FOA), is the single most important provision in the CTA. It can assist captive shippers to securing competitive rates and services without regulatory intervention. Through Bill C-34, enacted in July, 2000, the federal government introduced positive changes to the Final Offer Arbitration process that are balanced, fair and reasonable. The FOA process is effective because is it timely (30-day or 60-day processes), commercial as opposed to regulatory (it is "*not a proceeding before the Agency*" [s. 161 (4)]), and unencumbered by statutory tests or barriers to relief.

It is important that the current FOA process continue in its present form and that the recent revisions made to the FOA process through Bill C-34 be allowed to take their course. The addition of any barriers or thresholds to use of the FOA provision, such as the application of the CTA section 27 "*substantial commercial harm*" test, or the section 112 "*commercially fair and reasonable*" rates test, must not be tolerated.

It is essential that policymakers be given the opportunity, through time, of valuating the effectiveness of the process enacted earlier this year. It is inappropriate to consider further changes to FOA at this time.

### **4.3 The Competitive Access Provisions – an Integrated Package**

The competitive access provisions are an integrated package of options, as was intended when first introduced in the National Transportation Act, 1987. A shipper must be able to utilize the competitive provision that best addresses its unique circumstances.

Inasmuch as shippers have different requirements, one access provision alone will not suffice. Each of the recommendations made in this presentation will be effective for some shippers, but not for others. Even for an individual shipper, different provisions will be required to address different situations. These provisions are an integrated package.

## **5. CFI Recommendations for Change**

### **5.1 Sections 27 (2) and (3)**

To obtain relief from the Agency with respect to a transportation rate or service, it is currently necessary for the Agency, when conducting an investigation, to determine that the applicant will suffer "*substantial commercial harm*" if the relief requested is not granted (subsection 27(2)). This subjective determination can result in contested proceedings before the Agency and constitutes a major deterrent to a shipper.

The section 27 test applies to complaints and applications filed by shippers with respect to the following:

- Extended Interswitching (s. 127 & 128)
- Competitive Line Rates (s. 129 - 136)

The section 27 determination must also be made by the Agency in all complaints involving railway services under sections 113 - 116 of the Act.

CFI submits that the section 27 (2) and (3) test should be repealed because it is:

- an unnecessary burden for a captive shipper seeking relief from an unreasonable rate or service level;
- a time-consuming test which requires both parties to a dispute to prepare and cross-examine arguments with one another and the Agency;
- a costly exercise for both parties to a dispute;
- a test which, to our knowledge, requires a determination of harm which is undefined in law, and;
- a test which promotes unnecessary litigation and formal hearings, and is confrontational.

## 5.2 Section 112

Under this section a rate or condition of service established by the Agency must be commercially fair and reasonable to all parties. While no one argues with the concept of “fair and reasonable” rates or services, the necessity of having to satisfy this threshold on a case-by-case basis concerns railway customers and adds unnecessarily to the time and expense of the process. Accordingly, CFI is of the view that section 112 constitutes an unnecessary barrier to Agency relief and should be repealed.

## 5.3 Regulated Interswitching

Regulated interswitching allows some shippers who are served by a single railway at the origin or the destination to secure rates and services from competing railways. For many years, regulated interswitching existed in Canada, primarily in urban areas, as a means of obtaining rail competitive access. In 1987, the regulated interswitching distance was increased from 4.0 miles (6.5 kilometres) to 30 kilometres.

Agency-established maximum interswitching rates are an important component of the competitive access provisions of the Canada Transportation Act and reflect the broader policy objectives set out in Section 5 of the Act. The success of the regulated interswitching provisions is also discussed in the 1998 Ekos Survey where it is stated that:

*"Excluding carriers, most respondents believed that interswitching does contribute to competition."* (Source: Ekos Survey Executive Summary)

Similar support for the regulated interswitching provisions was reflected in the Agency's 1998 Annual Report which stated that:

*"Each year about 150,000 cars are transferred between the lines of CN and CP at regulated interswitching rates. Railways have argued that these rates should be negotiated on a commercial basis, while most shippers and governments surveyed maintained that they should continue to be regulated. In our opinion, there is little likelihood that the system will change in the near future given that interswitching is acknowledged as a simple and effective way to create rail service competition."* (Source: 1998 Annual Report of the Canadian Transportation Agency, Chapter 3)

The CFI strongly supports the continuation of the regulated interswitching provisions.

### **5.3.1 Broadening Interswitching to Permit Transfer Cars at All Interchanges**

CFI submits that the existing CTA interswitching provisions should be broadened to permit the transfer of cars at all interchanges irrespective of the ownership of the lines over which the traffic moves. Currently, the definitions<sup>1</sup> of "interchange" and "interswitch" in section 111 of the CTA depend on track ownership. Regulated interswitching accordingly only applies only to traffic which is switched between the lines of two different railways.

There are instances in which railway companies do not own the rail lines on which they operate; i.e. they may operate over those lines on a lease or running rights basis. It makes no sense to preclude interswitching of traffic between two railways simply because one railway owns the track on which two different rail services are operated. This deficiency could be cured by minor amendments which remove the concept of track ownership from the definitions and substitute the transference of traffic between railways.

<sup>1</sup>"Interchange" is defined; "as a place where the line of one railway company connects with the line of another railway company and loaded or empty cars may be stored until delivered or received by the other railway company". "Interswitch" means "...to transfer traffic from the lines of one railway company to the lines of another railway company...".

### **5.4 Competitive Access Rate (CAR) - Addressing the Deficiencies of the Competitive Line Rate (CLR) Provision**

An historical overview on the failure of CLR's is contained in Appendix I(a).

#### **5.4.1 CN and CP Refuse to Compete Using Competitive Line Rates**

The 1993 report of the National Transportation Act Review Commission found that the major railways "have effectively declined to compete with each other through Competitive Line Rates (CLR's), and as a result the provision is largely inoperative in Canada. " Since then, shipper surveys have confirmed that CLR's are not being used.

There are probably a number of reasons for this but primarily, the current provision is complex, it does not promote competition between the local and connecting carrier, and it is subject to the unnecessary section 27 test of substantial commercial harm.

#### **5.4.2 The Present CLR Structure Discourages Effective Rail-to-Rail Competition**

CFI believes that railways operating in a duopoly environment will actively avoid participating in formal proceedings before a regulatory tribunal in order to access traffic off of each other's lines. History would support this belief.

Shippers are also of the view that a connecting carrier is more likely to offer competitive rates and/or services from an interchange if the shipper already has a rate from the originating carrier over the captive portion of the movement. As a precondition of requesting a CLR, the current legislation requires the shipper and the connecting carrier to reach an agreement on the rate, terms and conditions governing the movement of the traffic. As indicated in Appendix 1(a), coming to such an agreement with the connecting carrier is virtually impossible to achieve. In order to obtain a CLR, a shipper must make an application to the Agency, which can be both time-consuming and costly.

The existing CLR provision does not stimulate competition between the local and connecting carrier as the existing interswitching provision does. Regulated interswitching is a given right of captive shippers. No formal application to the Agency is required in order to use the provision to access a competing carrier's rates and services at an interchange. With CLR's, however, this is not the case.

The required formal CLR application, by its very nature, lends itself to opposing legal arguments, public disclosure and cross-examination of evidence, confrontation, time and expense.

In addition, the section 27 test, which must be satisfied before the Agency can establish the CLR, creates uncertainty and simply compounds the confrontational environment and the complexity of the proceeding. In our opinion, no one, whether they are the shipper, the railway to which the shipper is captive, or the competing railway at the interchange, wants to participate in such a confrontational regulatory process. In our opinion, it is rare in the field of commerce that anyone should have to go to such lengths to obtain a competitive price.

The existing CLR provision does not create an environment for good faith negotiations and actually discourages rather than encourages intra-rail competition. Once a CLR is established, the traffic is "lost" - the originating carrier has no further opportunity to compete for it as they would have in an interswitching situation. Hence, the existing CLR provisions does not stimulate competition between the local and connecting carrier.

#### **5.4.3 CFI Submits that the CLR Provision Needs to be Repealed and Replaced by a Competitive Access Rate (CAR)**

In order to foster the increased competition between railways which was intended by the legislation, the deficiencies in the current CLR provision need to be addressed by bringing the competitive access principles of interswitching into CLR's. This is an essential element to creating good-faith negotiations in a non-regulatory, business environment.

The CFI recommends that, in order to clearly identify this shift in philosophy to a non-regulatory environment, the entire CLR concept must be repealed and replaced by a provision known as a "*competitive access rate*" or "*CAR*".

#### **5.4.4 How "CAR" Works**

The "*Competitive Access Rate*" (CAR) provision eliminates the flaws of the existing CLR provision by removing the elements that discourage competition and replacing them with measures that foster competition between railways in a manner comparable to interswitching:

- CFI proposes that the CAR calculation be based on the system average revenue-per-tonne-kilometre of the commodity at issue, as opposed to the "cost plus" calculations characteristic of interswitching rate development;
- CFI proposes that both the 'home' railway and the connecting carrier need to be able to compete at the interchange for the traffic over the long haul for all of the business, and likewise face the risk of losing some, or all, of it;
- CFI proposes that the shipper must be able to determine what portion, if any, of the business will go to either railway in a dynamic framework of negotiations;
- CFI proposes that the rate calculations to enable the shipper to move the traffic to the interchange must promote competition and the procedures to establish that rate must be predictable and straightforward without the requirement for a formal hearing before the Agency.

#### **5.4.5 How "CAR" is Calculated**

Like interswitching, CAR is designed to be a *'rate-on-demand.'* Also, like interswitching, CAR would be made available to a captive shipper, once the shipper decided to request it. No formal application would be required, although the shipper would need to allow thirty days for the Agency to set and issue the CAR.

CAR would be calculated much like CLR's are, using the home railway's system average revenue-per-tonne-kilometre, applied over the distance to or from the interchange with the connecting railway. Like CLR's, the CAR calculation would include an amount equal to the regulated interswitching rate for the first 30 kilometres of the movement.

#### **5.4.6 "CAR" Encourages Rail-To-Rail Competition**

CAR is, most importantly, designed to allow the home railway to continue to compete for the traffic over the long haul once it reaches the interchange. Unlike a CLR, where the traffic is lost to the originating carrier once an agreement is made with the connecting carrier at the interchange, CAR allows for the possibility of the traffic remaining on the home railway's line after it reaches the interchange. In other words, once the traffic reaches the interchange, the option still remains for the home railway to quote a competitive rate for movement beyond the interchange.

The option also remains for the shipper to accept a more competitive level of rates and services offered from the connecting railway for some or all of the traffic. CAR, in this respect, is much more pro-competitive in make up and application than a CLR. This is also more in harmony with the national transportation policy objectives set out in section 5 of the Act, "... competition and market forces are, wherever possible, to be the prime agents in providing viable and effective transportation services."

#### **5.4.7 "CAR" Eliminates the Need for Extended Interswitching**

CAR should eliminate, in most cases, the need for the extended interswitching provision set out at section 127 (4) of the CTA. This provision currently enables any shipper located outside the regulated 30-km radial distance of an interchange to apply to the Agency, on a case-by-case-basis, for a determination to be deemed to be within the regulated 30-km interswitching radius. The Agency, for each such application, however, must satisfy itself that the shipper will suffer substantial commercial harm if the relief requested is not granted. CAR also eliminates the burden of a formal Agency hearing into such matters.

Draft amendments to sections 129 through 136 designed to implement the “CAR” provision are attached as Appendix II.

## **5.5 Limited Running Rights**

An historical overview of the inadequacy of the CTA running rights provision can be found in Appendix I(b).

### **5.5.1 Weaknesses of Current Running Rights Provision**

One of the major objectives of the Canada Transportation Act is to encourage the development and growth of short line railways. The preamble to the Act states that: "*This enactment reforms and modernizes transportation regulation formerly established by the National Transportation Act, 1987 and the Railway Act. The key components of the enactment include: a more... commercially oriented process for railway companies to sell or lease surplus rail lines to new operators, rather than discontinue service.*" This policy objective has been met, but with an unexpected negative side effect. Several new short line railways have been created in Canada since the Act came into force. The vast majority of them, however, have been created under provincial jurisdiction outside the federal CTA arena. As such, these new railways are denied the right to apply for running rights over the lines of federal carriers, rights which are available only to federal railways.

Precluding short line railways from applying for running rights over the lines of federal carriers also impacts directly on shippers. Shippers who were previously located on the lines of federal carriers and who now find themselves situated on the line of a provincially regulated railway also find themselves now denied the opportunity to have their traffic switched from their short line to competing railways using the running rights provision.

Many short line railways in Canada operate over a relatively short distance and connect to either CN or CP. These railways are, in essence, captive to the federal railway to which they connect. The short line cannot, on its own behalf or on behalf of the shippers on its line, switch the traffic to a federal railway other than the one to which it is directly connected.

### **5.5.2 CFI Proposed Changes to CTA Running Rights Provision**

CFI submits that it will be both consistent with national transportation policy and practical to amend section 138 of the CTA. The section should be changed to enable *any person* to apply to the Agency to operate trains and/or crews over the lines of a federal railway.

The contemplated change will permit short line railways, in particular, to apply to the Agency to operate over the lines of the federal railway, with which they connect, to interchanges with other connecting railways. This will provide shippers relocated from federal to provincial short lines with alternative competitive rate and service options.

Under section 138, the onus of establishing public interest presently rests with the applicant. Any railway opposing a running rights application should be required to establish that granting the remedy would not be in the public interest (reverse onus). This “reverse onus” requirement is not unusual, it existed in the NTA, 1987 line transfer and discontinuance provisions.

By placing the onus on an opponent to a running rights order to demonstrate that the order is not in the public interest, effect will be given to the pro-competitive intent of expanded running rights while conferring discretion upon the Agency to deny an order where appropriate.

Any railway utilizing running rights should be required to demonstrate that it has adequate insurance and is prepared to meet the applicable safety and operating requirements.

## 6. Concluding Remarks

In summary, neither the competitive line rate (CLR) nor running rights provisions of the CTA encourage or provide for a competitive rail system in Canada even though competition is the objective of that legislation. Changes to these particular competitive access provisions are essential to give meaningful effect to the purpose of the CTA.

In conclusion, CFI submits the following recommendations for changes to the CTA rail competitive access provisions for consideration by the CTA Review Panel:

- Sections 27 (2) and (3) and 112 of the Canada Transportation Act constitute unreasonable and unnecessary barriers to Agency relief and should be repealed;
- The existing interswitching provisions contained in sections 127 and 128 of the CTA should be broadened to permit the transfer of rail cars at all interchanges in Canada, irrespective of the ownership of the lines over which traffic is moved to and from the interchanges;
- In order to correct the deficiencies in the competitive line rate (CLR) provision contained in sections 129 – 136 of the CTA , those sections should be repealed and replaced by a provision known as a *competitive access rate* (“CAR”);

- Section 138 of the CTA should be broadened to allow *'any person'* to make an application to the Agency for limited running rights. This would allow short line operators, in particular, to secure access to competing federal railways.

CFI strongly supports the national transportation policy objectives contained in the Act. CFI believes in a safe, economic and efficient railway system at the lowest total cost. CFI further believes that competition should, whenever possible, be the main catalyst to bring about such objectives. However, if such competition is not present within the rail industry, CFI submits that “minimum regulation which effectively facilitates good-faith negotiations as the primary rate-setting vehicle”<sup>1</sup> needed. CFI's proposals should be viewed as an integrated package of options requiring only a minimum of regulation in the absence of effective competition. Such minimal regulation is necessary in order to protect shippers and to sustain a viable Canadian fertilizer industry, which must compete in global markets.

The members of the CFI appreciate the opportunity to outline their views and proposals for enhancing competition in the railway sector and, specifically, for addressing the deficiencies in the CTA rail competitive access provisions. We look forward to the opportunity to discuss our views and proposals as the review proceeds.

<sup>1</sup>: CFI Policy Objective

## Appendix I

### Historical Overview of Ineffectiveness of Existing CTA Competitive Access Provisions

Many shippers in Canada are served by only one railway at origin or destination and have no other realistic way to ship their products. Resource-based shippers, such as the membership of CFI, are primarily “*captive*” to the rail mode of transportation due to the mammoth volumes associated with world scale production and the long distances to ports and, ultimately to our end markets. Other modes, while important for local distribution, are not able to meet the primary needs of resource-based shippers.

The current rail competitive access provisions were designed to encourage rail-to-rail competition where only one railway serves a shipper. This has not, however, been the case. At present, the competitive access provisions contained in the CTA are with the exception of regulated interswitching ineffective for shippers. An examination of the use of the other competitive access provisions contained in the CTA bears this out.

#### a) The Failure of CLR's

When first created, the expected strength of the CLR provision was viewed to be in the leverage which the provision would give shippers in their negotiations. The provision was expected to create a balance at the negotiating table between the revenue needs of the railways and the competitive transportation needs of shippers.

In surveys conducted by the National Transportation Agency of Canada in the years immediately following the passage of the new legislation, some captive shippers responded that they were of the view that the new CLR provision had fostered greater “willingness” on the part of CN and CP and other railways to compete for their traffic. In addition, the 1993 National Transportation Act Review Commission (NTARC) also reported that the CLR provision, in spite of its limited use, was held in high regard by the shipping community.

In its report to the Minister of Transport, dated January, 1993, the Commission reported that “*The NTA, 1987 contains a number of ...devices intended to encourage competition, such as competitive line rates (CLR),....However, while these devices appear to be well regarded, we saw little evidence that they were being broadly used, although shippers claim that they are important bargaining tools.*” (Pg. 27).

The view that railways were very eager to compete was never particularly strong. This is borne out by survey data contained in the National Transportation Agency of Canada Staff Report entitled “*Rail Captive Shippers*”, dated April, 1992.

From the survey, it was concluded that in the four years immediately following the passage of the Act, less than 30% of shippers surveyed were of the view that railways were very eager to compete using CLR's.

A further wake-up call to the failure of the provision was received in 1993. It was obvious by this time that CN and CP were, in fact, not interested in competing with each other for captive shippers' traffic. This was substantiated by NTARC, which reported that, "*CN and CP Rail have effectively declined to compete with each other through CLR's, and as a result the provision is largely inoperative.*" (P.131)

The belief that railways were not interested in competing for captive shippers traffic was also expressed four years later in the 1997 Annual Report of the Canadian Transportation Agency where the Agency stated at page 66:

*"One condition of the CLR application is prior agreement with a second federal railway, the line haul carrier, for the movement of traffic from the interchange. To date, major Canadian carriers have not attempted to capture each other's traffic by offering attractive line haul rates to be used in conjunction with CLR's. This condition is seen as discouraging the usage of CLR's and is, arguably, one reason why there have only been six CLR applications - four by one shipper - to the Agency in ten years, five of which involved an American railway as the line haul carrier."*

In the 1997 Annual Report, the Agency further stated that it hoped "*to consult more fully with the community to add greater depth to its assessment...*" of the effectiveness of the competitive access provisions of the Act. To help fulfil this objective, the Agency hired Ekos Research Associates Inc. (Ekos) to survey members of the railway transportation community during 1998.

The Ekos survey was based on 30 key informant interviews (three were with carriers, 16 were with shippers and 11 were with government representatives and other experts), and, in addition, a total of 183 telephone interviews. These 183 individuals represented 16 different organizations and were composed of 20 carrier representatives, 81 government and 82 shipper representatives. Respondent groups held quite disparate views on many of the issues explored in the research and, not surprisingly, offered comments which defended these particular positions.

This polarization of opinion was reflected in the following survey observations:

*"Competitive Line Rates...there was a strong tendency towards seeing CLR's as being ineffective and most... survey respondents indicated that they ...had not taken advantage of them. One explanation for this limited use appeared to be a lack of willingness on the part of carriers to quote rates. The study did not reach definitive conclusions on whether or not*

*carriers quoted rates for CLR's; while the qualitative component pointed to the lack of quotes as the overriding problem, here were some respondents in the survey who indicated that their carrier quoted rates.*

*Other shippers and government respondents also pointed to the substantial commercial harm provisions of the Act as being a significant hurdle to the use of CLR's, assuming that a second rate could be secured. By contrast, carriers do not perceive there to be the same deterrents to the use of CLR's as do shippers and governments or that there is an ongoing need for the provisions."*

Source: Ekos Survey Executive Summary

More recent evidence of CN's and CP's failure to compete using the CLR provision is contained in the Report of the Hon. Justice Willard Z. Estey, CC, QC, in his review of Canada's grain handling and transportation system.

In his final report on the Grain Handling and Transportation Review, dated December 21, 1998, Justice Estey stated the following with respect to railway competition in western Canada:

*"Many of those appearing before the Review, with the exception of the railways, maintained that there is no competition in the real sense of that term between the two railways in the delivery of transportation services across this industry in Western Canada. Furthermore, according to that view, the current CTA does not adequately address the effect of this apparent lack of competition on the development of, or the opportunity to develop, short line railways..."* (Page 35)

Most recently, Justice Estey's review was followed up by Mr. Arthur Kroeger, a retired senior civil servant. Mr. Kroeger was charged, in May, 1999, with determining how best to implement Justice Estey's recommended changes to the grain system, which were sanctioned by the government.

In his letter referencing his final report to the Minister of Transport, dated September 29, 1999, Mr. Kroeger also recognized the concerns of shippers in western Canada over the level of railway competition for the movement of their products. At page 5 of his letter he stated that:

*"One of the most divisive subjects discussed during our process was what measures were called for to produce an appropriate level of competition between railways. CN and CP took the position that competition between them was already strong and would increase still further as system rationalization proceeded; consequently no special measures were called for. Most other participants held a contrary view, some of them strongly."* (Emphasis added)

The "*other participants*" Mr. Kroeger was referring to included shippers of grain and other resource-based commodities in western Canada, shipper associations and farmers.

Similar views were reported in a national rail shipper survey conducted by the *Canadian Industrial Transportation Association (CITA)*, the *Canadian Fertilizer Institute (CFI)* and the *Canadian Chemical Producers' Association (CCPA)* in late 1999. In the survey, conducted by Compas Centre For Survey Research, "*Bulk shippers responded that they were much more concerned over issues reflective of captivity: monopolization, physical captivity to a single carrier, competition between carriers, and lack of cooperation between carriers. A third (33%) of the bulk shippers surveyed reported these concerns.....Almost 60% of bulk shippers (57%) responded that the railways don't compete for their traffic.... Almost 50% of non bulk shippers reported likewise.*" (Emphasis added). When one considers that this survey included shippers who have dual rail access or regulated interswitching, as well as captive shippers, these findings are significant.

In conclusion, CLR's are ineffective, and in serious need of repair.

#### **b) The Inadequacy of the CTA Running Rights Provision**

Running Rights is seen as an extraordinary solution in view of the requirement that an applicant prove that the granting of a running rights order is in the public interest. Moreover, that remedy is only available to a federal railway company and not to the many provincial shortline railways which have been developed over the past number of years.

Running rights can be ordered by the Canadian Transportation Agency under section 138 of the CTA:

- Section 138 (1) provides that, upon application to and approval by the Agency, a railway company may possess and occupy lands of any other federal railway company; to use the right-of-way, tracks, terminals, stations or station grounds of any other federal railway company; and to run and operate its trains over the tracks of any other federal railway company.
- Section 138 (2) gives the Agency the authority, having regard for the public interest, to make orders and to impose conditions on either railway in respect of the privileges referred to in subsection 1.
- Section 138 (3) allows the Agency to order the compensation to be paid if the two railways do not agree on compensation.

The above-noted sections have remained essentially unchanged in legislation for over thirty years and have, most recently, been carried over in their entirety from the National Transportation Act, 1987 to the Canada Transportation Act, 1996.

Only five applications for imposed running rights have been processed by the Canadian Transportation Agency and its predecessor, the National Transportation Agency of Canada since 1987:

- Two, filed before the National Transportation Agency of Canada in 1991, involved requests from provincially incorporated railways to operate their trains over the lines of federal railways. Both applications were denied on the grounds that the applicant railway (wanting the running rights over CN and/or CP) was not a "railway company" within the meaning of the Act.

The fact that only railways operating under the jurisdiction of Parliament (federally incorporated) are permitted to apply for mandated running rights over the lines of other federally regulated railways in Canada is now considered to be a major weakness of the provision.

- A third application, involving a request by VIA Rail to use CPR's maintenance facility at Victoria, was denied by the Agency.
- A fourth application involved a formal request by CPR to operate over CNR's lines at Quebec City. That application was recently placed on hold at the request of CP until further negotiations could be pursued between the two Class 1 railways.
- Of the five applications, only one ever received full Agency consideration. It involved a company called M.O.Q. Rail Inc. ["Maritime, Ontario & Quebec"] which formally applied to the NTA for authority to operate its trains and use CN's facilities between points in New Brunswick and Quebec and Ontario. The company involved did not have any physical assets at the time and the application was ultimately withdrawn by the applicant in 1991 when CN purchased its letters patent.

Considering the significant growth in the Canadian short line rail industry, the CTA running rights provision needs to be brought into the 21<sup>st</sup> Century.

## Appendix II

### Proposed Amendments to S129-136 of the Canada Transportation Act, Creating a Competitive Access Rate (CAR) Provision

**Sections 129-136 of the CTA to be revised.** All references to *A competitive line rate(s)*≡ to be revised to *A competitive access rate (CAR)*≡

**Sections 129 (1) and (2) to be restated and retained.** These sections stipulate that the competitive access rate is only applicable to shippers having *A Ψ access to the lines of only one railway company at the point of origin or destination..*≡ *and that* competitive access rate applies over the remaining portions of federal railway lines which have been transferred to short line operators outside of federal jurisdiction.

**Sections 130 (1), (2), (3), (4), (5) and (6) to be restated and retained.**

**Section 131 (1) to be repealed.** This section of the CTA presently requires that the shipper and the connecting carrier *A agree Ψ on the terms and conditions governing their movement of the traffic, including the applicable rate.*≡ before a competitive line rate can be established. In our opinion this removes the common carrier obligation of the connecting carrier to issue a rate. No such agreement will be required before securing a CAR to or from an interchange, therefore the common carrier obligation to issue a rate at the interchange will continue to rest on the connecting carrier. A CAR may be obtained before securing a rate and/or service quotation from a connecting railway. Even after a CAR is obtained, the shipper may elect to continue to move the traffic beyond the interchange where the CAR ceases to apply and to continue to route the traffic over the line of the local carrier, but at a commercially negotiated rate level.

**Section 131 (2) to be restated and retained.** This section precludes the establishment of a competitive access rate over a portion of a movement for which regulated interswitching rates can apply.

**Section 131 (3) to be restated and retained.** This section precludes the establishment of a competitive access rate *A for the movement of trailers on flat cars, containers on flat cars or less than carload traffic, unless they arrive at a port in Canada by water for movement by rail or by rail for movement by water.*≡

**Section 131 (4) to be restated and retained.** This section states that a competitive access rate shall not be established over *A 50 per cent of the total number of kilometres over which the traffic is moved by rail or 1200 km, whichever is greater.*≡

**Section 131 (5) to be restated and retained.** This section states that a competitive access rate may be established for a greater portion of a movement

if the Agency is satisfied that no interchange exists within the maximum portion referred to in subsection (4).

2.

**Section 131 (6) to be revised.** This section should provide for a CAR at either or both ends of a given movement.

**Section 132 (1) to be revised.** This section sets the maximum statutory time allowed by the Agency to process and establish the CAR at 30 days. During this time, the Agency will establish the amount of the CAR, the route and interchange where traffic is to be switched to or from the connecting carrier and the manner in which the service obligations of the local carrier are to be fulfilled if agreement on such has not been reached between the local railway and the shipper. This section currently requires the Agency to make the same determinations but within a period not exceeding 45 days of the application.

**Section 132 (2) to be restated and retained.** This section provides that "*If a matter is established by the Agency under this section, the shipper is not entitled to submit the matter to the Agency for final offer arbitration under section 161.*"

**Section 133 (1) to be revised.** This section sets out the current formula for establishing a CLR. A CAR shall be established by the Agency at the written request of a shipper, using the regulated interswitching rate established by the Agency for the first 30 kilometres of the movement, and the local carrier=s system average revenue-per-tonne-kilometre for the commodity for the balance of the movement.

**Section 133 (2) to be restated and retained.** This section states that if a shipper performs any of the activities in respect of which the interswitching rate applies, the interswitching rate shall be adjusted to account for the performance of those activities.

**Section 133 (3) to be repealed.** This section enables the Agency to establish alternative methods for setting CLR=s where the formula set out in subsection (1) is found to be deficient. With the simplified CAR formula, there will be no need for the Agency to make orders establishing alternative methods of establishing a CAR. This change eliminates the potential need for a hearing.

**Section 133 (4) to be repealed.** This section requires the Agency to set CLR=s at levels which exceeded the variable costs of moving the traffic. Using the local carrier=s own system average revenue-per-tonne-kilometre for the commodity at issue to set the CAR, plus including an allowance for interswitching at the interchange ensures that the CAR is compensatory.

**Section 134 to be repealed.** This section will be repealed and replaced by a section which requires a CAR to be set out in a confidential contract in the event that the CAR is deemed to be confidential by the Agency.

**Section 135 to be restated and retained.** This section sets a CAR period at one year or such other period as may be agreed to by the shipper and the local carrier.

**Section 136 (1) to be restated and retained.** This section requires the connecting railway to provide the equipment for the CAR movement as well as the portion beyond the interchange. This provision presently requires the connecting railway to provide the cars for all movements for which CLR=s are set. Since it is conceivable that under the CAR proposal, some or all of the traffic might continue to be routed over the line of the “home” railway beyond the interchange, each carrier will supply equipment for its portion of the business.

**Sections 136 (2) (a) and (b) and (3) to be restated and retained.** This section requires the connecting railway to be responsible for a prorated share of the costs of operating and maintaining the interchange as well as the capital costs of any changes or additions to the interchange that may be necessary for transferring the traffic only if the traffic is ultimately switched over to a connecting railway at an interchange once the CAR is set. These provisions presently requires the connecting railway to share in such costs for all movements on which CLR=s are set.

**Section 136 (4) to be revised.** This section requires the tariff or confidential contract setting out a CAR to specify the manner in which the “home” carrier issuing the tariff or confidential contract shall fulfill its service obligations.

## Appendix III

### CFI MEMBER COMPANIES (ACTIVE MEMBERS)

#### ***Basic Manufacturers***

Agrium  
CF Industries Inc.  
Fernz Sulfer Works Inc.  
Hydro Agri-Canada L.P.  
IMC Global  
Nitrochem Corp.  
Orica Canada Inc.  
Pacific Ammonia Inc.  
Potash Corporation of Saskatchewan  
Inc. (PCS)  
Saskferco Products Inc.  
Sherritt International Corporation  
Simplot Canada Limited  
Terra International (Canada) Inc.  
Tiger Industries  
Westco Fertilizers

#### ***Wholesalers/Distributors***

Agrico Canada Limited  
Agricore  
Agro-100 Ltée  
Agronomy Company of Canada  
Border Chemical Company Limited  
Cargill Limited  
Cavendish Agri Services Limited  
Ceres Fertilizers  
Chaleur Fertilizers Ltd.  
Coopérative fédérée de Québec  
CropMate-Division of Con Agra Ltd.  
GROWMARK Agronomy  
H.J. Baker & Bro. Inc.  
International Commodities Export Company  
of Canada (ICEC)  
Imperial Oil Limited  
International Raw Materials, Ltd.  
James Richardson International Limited  
Kent County Fertilizers Ltd.  
McCain Fertilizers Ltd.  
Nexus Ag. Business Inc.  
Saskatchewan Wheat Pool  
Shur-Gro Farm Services Ltd.  
Sylvite  
Transammonia Inc.  
United Grain Growers Limited  
W.G. Thompson & Sons Limited  
William Houde Limitée

