



British Columbia Railway Company

**Submission to the
Canada Transportation Act Review Panel
on
Competitive Rail Access**

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PART I

BACKGROUND

British Columbia Railway Company is a group holding company, often referred to as the BCR Group of Companies, comprised of three separate business units; BC Rail, BCR Marine and BCR Properties. The company, owned by the Province of British Columbia, was first incorporated under the British Columbia Railway Act. Its predecessor companies were first incorporated in 1912.

BC Rail, Canada's third largest railroad by revenues, operates 2,315 kilometres of mainline track and 740 kilometres of industrial and yard track and sidings throughout British Columbia. In addition, BC Rail owns and maintains a separate 37 kilometre rail line connecting Canadian National Railway (CN), Canadian Pacific Railway (CP) and Burlington Northern Santa Fe Railroad (BNSF) to the west coast's largest coal terminal and the new Deltaport container terminal at Roberts Bank. BC Rail is provincially regulated and competes fully within the private sector in a market environment without government subsidy.

BC Rail's customers sell their commodities throughout the world. The overwhelming majority of the tonnage originated by BC Rail is transported beyond the border of British Columbia. Overseas markets are accessed primarily through port facilities located in Vancouver, Squamish and Prince Rupert. The North American market is reached by interchanging freight cars onto connecting railroads at Prince George and North Vancouver. Working with other members of the Association of American Railroads (AAR), BC Rail has the ability to forward its customers' shipments to all rail-served points in Canada, the United States and Mexico. Approximately 40 per cent of the rail shipments originating on BC Rail are forwarded to other North American railroads. By contrast, loaded rail cars forwarded to BC Rail by other railroads account for only 2 per cent of all loaded rail cars handled (note: these figures are exclusive of terminal switching within the port of Vancouver). This imbalance in traffic results in operating an inordinate number of train-miles without revenue loads.

BC Rail's only direct rail link is with CN at Prince George and North Vancouver. To gain access to the North American rail network, the railroad must rely on interchanging to CN at Prince George and North Vancouver. CP and BNSF are accessed through CN in North Vancouver. As well, a connection with the Union Pacific Railroad (UP) is maintained through a rail car barging operation between North Vancouver and Seattle, Washington.

Freight traffic involves originating approximately 200,000 revenue carloads annually from more than 200 customer facilities. In 1999, transportation of forestry, mining, energy and agricultural products accounted for about 80 per cent of the \$329 million revenue generated by BC Rail. Freight traffic for the year totaled 193,000 carloads and 5.1 billion revenue ton-miles.

BC Rail's traffic mix is fundamentally different from most other railroads with nearly 80 per cent of the freight revenue tied to forest products and coal. Unlike Class I railroads, BC Rail has little traffic from the movement of containers, automobiles, potash, grain and manufactured goods.

Meanwhile, revenue generated from barging, passenger services, intermodal operations and car-hire for use of BC Rail cars by other railroads accounted for the remaining 20 per cent of revenue.

Traffic movement at BC Rail encompasses operating approximately 12,000 freight trains and 1,000 passenger trains annually.

As an originating carrier for shipments destined all over North America, BC Rail owns, leases and maintains a disproportionately large rail car fleet of over 9,500 cars. A fleet of this size is required to enable the railroad to meet shippers' needs for cars on a timely, reliable basis. Approximately 50 per cent of the fleet spend the majority of their service life off BC Rail's system.

BCR Marine includes the recently merged operations of Vancouver Wharves and Canadian Stevedoring. Vancouver Wharves, located at the southern terminus of BC Rail in North Vancouver, operates one of the largest deep-sea bulk-loading terminals in North America. Canadian Stevedoring provides stevedoring services at 22 locations along B.C.'s coast and operates the Fairview Terminal in Prince Rupert. Through its third operating unit, Casco Terminals, BCR Marine also operates the Centerm container terminal on the south shore of Vancouver's inner harbour. Incidentally, BC Rail receives in interchange nearly 3 million tons annually from Class I railroads for terminal switching to and from Vancouver Wharves.

BCR Properties manages all lands not directly required for railroad operating purposes. In addition it leases industrial lands adjacent to the railroad, including many to key rail shippers.

BCR Ventures, a subsidiary of BC Rail, was created in 1996 to develop new rail traffic through joint ventures in resource development projects along the BC Rail system. It is presently involved in a joint venture to develop a potential new semi-soft coal mine along BC Rail's right of way.

Although the BCR Group continues to diversify its revenue base, rail freight remains the company's core business. BCR Group operates as a commercial entity with all operating companies competing fully with the private sector in a market environment. Over the next few years, the key challenge facing the corporation is the need to diversify its revenue base to offset anticipated reductions in traffic from traditional resource-based commodities. In particular, the loss of all northeast coal traffic is forecast by 2004. As recently as 1997, annual revenue of \$54 million was derived from coal shipments originated near Tumbler Ridge. The company took a special charge of \$617 million to 1999 earnings resulting from an asset impairment review relating to the investment infrastructure to service northeast coal and of other northern rail assets.

PART II

INTRODUCTION

The continued ability to remain competitive is a matter of great concern to both BC Rail and its shippers. The specific concerns relate to access to competing railroads, the trend towards concentrated market power within the rail industry, and the need to generate sufficient economic returns to sustain the required capital expenditures. In this respect, the *Canada Transportation Act* (CTA) Review Panel's mandate to consider ways to enhance competition in the railroad sector in Canada is most timely and critical.

While it is the Review Panel's mandate to consider rail competition enhancement proposals, it is also important to preserve the existing competition within Canada and avoid the burdens associated with new approaches. For instance, if CTA interswitching regulations were applied not only to large railroads but also to regional railroads and shortlines, the effect on the smaller carriers would be devastating. Eventually, a loss of competition could result, as railroads such as BC Rail may be unable to maintain a presence and service to its shippers.

To mount competitive service for shippers, regional railroads must be able to obtain reasonable access – on reasonable terms and conditions - to competitive railroads' lines for the purposes of interlining cars for subsequent shipment to market and to access export docks within rail terminal areas for the purpose of unloading shipments bound for overseas markets. In this regard, BC Rail could consider similar access to the large, federally regulated railroads.

To be clear, BC Rail does not recommend rate re-regulation, access to shippers located on other railroads, or open access to new "any person" entrants. All of these oft-cited mechanisms could adversely affect the fundamental economics of the industry, thereby leading to a long-term deterioration of the rail network and the undermining of service provisions.

BC Rail's business model involves stimulating demand for rail service by offering rates and services that provide shippers with efficient access to key markets, while concurrently providing an economic return on the railroad's investment. Applying this model within the British Columbia transportation marketplace, BC Rail currently promotes true competition – both intermodal and intramodal - for shippers and communities. At the same time, we feel strongly that many inherent inefficiencies do exist in the status quo. The suggested recommendations to address these inefficiencies would assist in promoting and preserving competition in the rail transportation system in British Columbia for British Columbia shippers.

PART III

THE CURRENT COMPETITIVE ENVIRONMENT

In its market region, BC Rail promotes and creates competition both i) between trucks and railroads, and ii) between railroads themselves. The competitive environment exists within both the local and interline segments.

In terms of the local market segment, BC Rail provides an effective alternative to truck transportation for shippers requiring service to export docks and domestic consumers. A large, vibrant trucking industry within British Columbia provides a formidable competitive force, evidenced by the significant share of truck shipments within BC Rail's market region. It is noteworthy that BC Rail maintains its own infrastructure from rates charged to customers while truck competitors use a publicly-subsidized network of major highways to access those same customers.

Truck transportation also provides strong competition in BC Rail's interline market. Most shippers who are unable to negotiate what they feel are competitive prices are able to easily access alternatives. Since the vast majority of BC Rail's originated, interline shipments is single-carload and short-haul (in terms of BC Rail's portion of the through

movement), trucks can be readily used to access several Class I railroads' rates and services through the use of reload (or transload) facilities. Sometimes, this truck-to-railroad alternative provides better customer service levels given that BC Rail must build trains with the traffic of multiple customers, which requires considerably more time than trucking the short distance to competitor railroads. The use of forest product reload facilities in Edmonton, Alberta (served by CN and CP), greater Vancouver (served by BNSF, CN, CP, and SRY) and Kamloops, BC (served by CN and CP) provides clear evidence that BC Rail faces demanding competition for traffic within its market region. These substitute transportation alternatives place a ceiling on the price BC Rail may charge and immediately discipline any non-competitive behaviour.

BC Rail has very few shippers that would be deemed to be "captive" in the traditional sense. As a result, competitive services provided by trucks and other railroads provide an effective alternative for shippers to access their markets. While it may appear that BC Rail has exclusive control over the shipments originated or destined to facilities on its rail line, this is readily offset by the substitute transportation options. In other words, BC Rail is never in the traditional "bottleneck" carrier role, as we must provide the cars to someone else to get the shippers' goods to market. Unlike our shippers – who have an option to truck to either other railroads or directly to market – BC Rail is fully dependent on rail transportation.

Not only do the large railroads behave as competitors of BC Rail - in terms of partnering with truck and reload operators - they concurrently act as interline partners of BC Rail for much of the same traffic. This "hedged" position of the large railroads provides a further guard against any potential anti-competitive behaviour by BC Rail.

In the process of providing shippers with the most cost-effective access to their markets, BC Rail promotes an open routing policy on all interline, through-rate shipments. To the extent that connecting railroads choose to participate in the routing to certain markets, BC Rail provides shippers access to each of the BNSF, CN, CP and UP networks. The only railroad with a direct connection to BC Rail is CN at either North Vancouver or Prince George. For efficiency reasons, interline forwarded traffic for CN's long haul is

interchanged at Prince George. It is necessary to access the BNSF and CP systems via private arrangements that those railroads have with CN to transport interline shipments originating on BC Rail from North Vancouver to their terminals in the Vancouver area. In the case of UP, a rail car barge service generates the access through hauling traffic between BC Rail's southern terminus in North Vancouver and Seattle, Washington. In this instance, BC Rail works jointly with UP and a local marine freight company to provide additional competitive access for shippers where it normally would not have existed.

Dependency on a single Class I railroad for handling a regional railroad's interline traffic, makes shippers sensitive to the slightest operational breakdown. When difficult operating challenges arise at a key gateway, a Class I railroad is bound to reflect their self-interest at the expense of the effective interchanging on which the smaller carrier must depend. For instance, the inability to switch to another carrier than CN when service problems arise at the North Vancouver gateway often has had an adverse affect on BC Rail and its customers.

It is felt that some of the interchange challenges faced by exclusive Class I connections might be better met if regional railroads had limited, direct access to other carriers. This could effectively prevent further service and competitive problems, thereby allowing interline rail movements to compete effectively with truck-direct and truck-to-reload shipping options. Limiting the traffic density of interline shipments because of service failures at the interchange serves only to improve the relative competitive position of trucks and reloads at the expense of the regional railroad.

In terms of an example of competitive access, BC Rail currently provides a unique role in maintaining access for BNSF, CN, and CP to the west coast's largest coal terminal and the new Deltaport container terminal at Roberts Bank. In addition to owning and maintaining this separate 37-kilometre rail line, BC Rail provides centralized dispatching to ensure efficient and fair access for all other railroads moving shipments to and from Roberts Bank. Maintenance and ownership costs for this separate rail line are covered on a user-pay basis. BC Rail does not currently ship rail cars on this rail line. In the

event that shipments did occur, access between the BC Rail mainline and the Roberts Bank line would have to be handled exclusively by CN.

It is clear that BC Rail is influential in stimulating and balancing competition in the transportation marketplace. Should BC Rail be unable to maintain a presence, competition for British Columbia shippers' goods could be adversely impacted.

PART IV

FUTURE COMPETITION CONCERNS

Several factors serve to raise very significant concerns about regional railroads' abilities to compete effectively over the long-term. These factors can be summarized as:

- A general trend towards larger railroads.
- Market dominance by large railroads is being leveraged more prevalently.

The most vulnerable parties likely to be affected by these trends are the regional railroads' customers and the railroads themselves. For instance, recent Class I merger plans highlighted the potential future problems for BC Rail and its customers. While the planned BNSF/CN combination was generally viewed to be "end-to-end", this was not the case for all British Columbia shippers. While a detailed merger filing did not occur, the initial response underscored significant competitive concerns. Rail industry consolidation will continue to have an effect in reducing competitive options for BC Rail and its shippers without the introduction of specific mechanisms to alleviate the foreseeable harm associated with the planned merger.

Generally, BC Rail's relationships with the large railroads have been cooperative and of mutual benefit. More recently, however, certain interline relationships have been strained due to the unilateral imposition by Class I carriers on BC Rail of new tariffs and

operating conditions. Associated costs and delays to customer shipments are significant.

It is noteworthy that there is no effective regulatory protection against unilateral actions by the dominant Class I carriers. New mechanisms must be developed to ensure that smaller, regional railroads can provide competitive service levels and effectively serve their local markets. Without changes, smaller railroads will be unable to remain a long-term, viable component of the national rail system.

PART V

RECOMMENDED SOLUTIONS

It is clear that the further consolidation of market power by the Class I railroads potentially threatens the continued competitive impact of BC Rail on traffic to and from shippers served by BC Rail throughout the province of British Columbia. Unfortunately, amendments to provincial rail regulation cannot bring about the kinds of changes that are necessary to protect and enhance competition in these circumstances. The question becomes, what amendments can be implemented to existing federal policy and legislation to preserve and enhance a regional railroad's competitive role? We would offer the following for your consideration:

1. **Competitive Access** - consistent with the Estey and Kroeger reports, we support amendments to the Canada Transportation Act which would permit a regional railroad to obtain running rights over the federal railroad to which it connects, for the purpose of creating a competitive access point for the interchange of traffic to destination. The regional railroad should have no right to solicit traffic from customers located on the connecting federal railroad. The purpose of this competitive access is not to permit the regional railroad to target the traffic of the connecting federal carrier - the purpose of this kind of competitive access would be simply to promote

competition for the interchange of traffic, and to counterbalance the market power of the bottleneck federal railroad.

Such an arrangement would eliminate the competitive distortions which exist for BC Rail and its customers throughout the province, and it could – with gained operational efficiencies - result in lower freight rates (not as a result of the consolidation of market power brought about by business combinations among the federal railroads, but as a result of the operation of competition, which is the primary point).

In this case, BC Rail would be required to compensate the host railroad on a reasonable basis. A compensation formula for this purpose would be easy to develop. We would recommend that the Canadian Transportation Agency be empowered to resolve disputes that might arise on the calculation of the compensation formula.

A primary location for the creation of competitive alternatives for BC Rail interchange traffic is Edmonton, Alberta (where CN and CP can interchange B.C. originated traffic for delivery to points in Canada and the U.S.). Much of the BC Rail originated traffic should be routed through Edmonton because of the efficiencies that that route enables. For instance, a rail shipment of lumber from a sawmill in Fort St. John, BC to (or via) North America's railroad hub in Chicago, Illinois must travel anywhere from 24 to 39 per cent further via the North Vancouver gateway than the Prince George gateway (see Table I below, which outlines the mileage involved to Chicago, Illinois through Edmonton as opposed to other routings). Meanwhile, when the same Chicago-destined shipment is trucked from the sawmill for rail car loading at Edmonton, it travels at least 27 per cent fewer miles than if it was shipped all-rail via North Vancouver.

Table I
Shipment Mileage: Fort St. John, BC to Chicago, Illinois

<u>Traffic Route</u>	<u>Miles</u>	<u>Relative to BC Rail-Prince George-CN Route Miles</u>
BC Rail-Prince George-CN	2379	
BC Rail-N. Vancouver-CP	2945	+ 24%
BC Rail-N. Vancouver-BNSF	3133	+ 32%
BC Rail-N. Vancouver-UP	3295	+ 39%
BC Rail-Prince George-CN-Edmonton-CP	2520	+ 6%
Truck-Edmonton-CP	2156	- 9%

*(Source: PC*Rail and Rand McNally)*

Because this interchange is located outside of British Columbia, the implementation of our recommended solution would require BC Rail to cross a provincial boundary. In order to avoid any possibility that BC Rail would relinquish its provincial status as a result of the creation of this competitive interchange point, we would recommend that the legislation specify that the carriage of BC Rail's traffic over CN to Edmonton be accomplished by way of haulage rights rather than running rights. In this way, the competitive alternative can be created for interchange of through traffic, without altering the nature of BC Rail's operation or jeopardizing its status as a provincial railroad. Again, any disputes over the money that should be paid by BC Rail to properly compensate CN for these hauling rights to Edmonton could be resolved by the introduction of a new remedy by the Canadian Transportation Agency.

2. **Access to final offer arbitration** - to resolve problems which regional railroads and their customers could potentially face as a result of the unilateral imposition of tariffs and operating conditions by federal railroads, a new mechanism is required. In order to level the playing field, it is recommended that regional railroads be given access to final offer arbitration as a means of resolving these disputes. We view the final offer arbitration provisions of the legislation (as amended recently by Bill C-34)

as being fair and balanced. It provides a forum for the timely and reasonable resolution of disputes.

Access to this remedy for regional carriers could be easily accomplished by following the example set in the Canada Transportation Act for commuter rail authorities (see section 160). The remedy has been tested and it works.

3. **Regulatory oversight for major mergers** - the following is an excerpt from an announcement made by the U.S. Surface Transportation Board October 2, 2000:

“Surface Transportation Board (Board) Chairman Linda J. Morgan announced today that the Board has issued a Notice of Proposed Rulemaking (NPR) proposing new rules for major railroad mergers and consolidations (those involving two or more "Class I" railroads, that is, railroads each with annual revenues of at least \$250 million). The new rules would significantly increase the burden on applicants to demonstrate that a proposed merger transaction is in the public interest, reflecting what Chairman Morgan notes as an awareness of the great risk of failure and the competitive, service, and financial concerns raised in connection with what could be the final round of consolidation in the rail industry. In particular, the new rules would require applicants to show that the transaction would enhance competition, and they would require much more accountability with respect to claimed merger benefits and service. At the same time, in proposing these new rules, the Board indicated that it does not intend to prevent transactions genuinely in the public interest and would continue to look with favor upon private-sector initiatives in the public interest.”

The STB is taking this initiative because of the consolidation of market power which rail mergers are causing. The BNSF/CN combination was the catalyst for this regulatory initiative.

In this latest round of railroad merger mania, many Canadian parties were very concerned that there was no vehicle in Canada for the transaction to receive the kind of regulatory scrutiny that would be required in order to assess how a merger could

potentially affect other Canadian railroads and their shippers. The fact that Canadians appeared in Washington, D.C. to plead their case before the STB is illustrative of the problem. The concerns of those Canadians, based on Canadian public interest and transportation policy, were given a reasonable reception by the STB, but the STB was obviously constrained to assess the situation from an American policy point of view.

BC Rail believes strongly that an effective mechanism should be in place in Canada to require that major mergers be subject to Canadian regulation. The Canada Transportation Act should be amended to empower the Canadian Transportation Agency (in consultation with the Competition Bureau) to review and support or disallow a proposed merger, or to impose pro-competitive conditions on a proposed merger. The primary purpose of this authority should be to preserve and enhance competition. The criteria for the exercise of this authority, in our view, should be:

- 1) The proponent(s) of the merger should be required to demonstrate that the merger would be pro-competitive.
- 2) The proponent(s) of the merger should be required to demonstrate that the merger will not negatively impact existing Canadian competitive access remedies. If the merger will negatively impact existing Canadian competitive access remedies, the proponent(s) of the merger should be required to propose solutions that will fully ameliorate such impacts
- 3) The proponent(s) of the merger should be required to demonstrate that the merger would not be an impediment to the interchange of traffic between railroads, both federal and provincial. If the merger will negatively impact the interchange of traffic between railroads, the proponent(s) of the merger should be required to propose solutions that will fully ameliorate such impacts.