Nathan Cato
Assistant Vice President,
Government Affairs - Canada

Suite 1110
81 Metcalfe Street
Ottawa, Ontario, Canada K1P 6K7

T 613-237-1571
nathan.cato@CPKCR.COM

May 3, 2023

Members of the Standing Senate Committee on National Finance
Senate of Canada
Ottawa, ON K1A 0A4

VIA EMAIL: nffn@sen.parl.gc.ca

Dear Senators:

On behalf of Canadian Pacific Kansas City ("CPKC"), I am writing to highlight the harm that will result from the expansion of regulated interswitching rates for rail freight transportation. Division 22 of the government's *Budget Implementation Act, 2023, No. 1 (Bill C-47)*,[1] proposes amendments to the *Canada Transportation Act* ("*CTA*") that would extend the regulated interswitching distance from 30 km to 160 km in the three prairie provinces for a period of 18 months. **We strongly urge Parliament to oppose this damaging policy and amend Bill C-47 to remove the extended interswitching clauses in their entirety.** That said, should Parliament be inclined to adopt the government's proposed legislation, there are two critical amendments required to limit the damaging consequences for Canada, to the extent possible: exclude U.S. carriers and require the Canadian Transportation Agency ("the Agency") to set the regulated interswitching rates based on commercial rates for comparable traffic. We provide background information on extended interswitching and these proposed amendments below.

Extended interswitching will harm Canadian shippers and Canada's economy.

Extended interswitching is harmful public policy because it will incentivize inefficiencies in Canada's supply chains, resulting in increased transit and dwell times, lower rail capacity, higher greenhouse gas emissions, and increased increase transportation costs for all shippers. This policy will deter investment in capacity-building railway infrastructure in Canada. Ultimately, extended interswitching will harm all shippers and the Canadian economy.

Canada experienced the harmful consequences of extended interswitching when it was in place from 2014 to 2017. There is no need for another pilot program to study this damaging policy. Extended interswitching was thoroughly studied by the Hon. David Emerson in his statutory review of the *CTA* in 2016. His report concluded that extended interswitching should be sunset. Transport Canada ("TC") agreed with this recommendation and reached out to railways and shippers to help craft long-haul interswitching ("LHI") as an alternative, so that shippers would have access to a so-called competitive access regulatory remedy, but without the damaging consequences of cost-based (and in some cases non-compensatory) regulated rates under extended interswitching. LHI remains available to shippers in the CTA today.

The proposed resurrection of extended interswitching is contrary to the longstanding statutory National Transportation Policy, articulated in Section 5 of the *CTA*, to allow competition and market forces to be the prime

[1] https://www.parl.ca/DocumentViewer/en/44-1/bill/C-47/first-reading

agents driving the rates, terms, and conditions of rail transportation, and to refrain from regulatory intervention unless there is a failure of competition and market forces. There is no demonstrable failure of competition and market force and therefore no basis to impose regulatory interswitching rates in place of market rates for rail movements beyond 30 km of an interchange.

Interswitching is inherently an inefficient practice because it introduces more operating complexity to the movement of railcars. Since railways operate a network, all shippers, including those that do not access regulated interswitching, are harmed by inefficiency. Public policy should not incentivize inefficient railcar movements where they can be avoided. This runs counter to the government's own stated goals of improving supply chain capacity and reliability and improving affordability. **At a macro-level, the inefficiencies introduced by extended interswitching will result in higher transportation costs for all, at a time when Canadians are already suffering from high inflation.**

Additionally, under the government's proposed legislation, U.S. rail carriers will, once again, be able to reach further into Canada to solicit traffic for interchange at a regulated cost-based rate. We saw this harmful practice when extended interswitching existed previously. This puts Canada's Class 1 rail carriers, CPKC and CN, at a competitive disadvantage relative to U.S. carriers. There is no similarly regulated interswitching regime in the U.S. **This will result in Canadian investment dollars and jobs moving to the U.S.** We struggle to understand why the Government of Canada wants to re-establish this competitive harm that so clearly advantages U.S. carriers.

Some shippers and their political associations argue that extended interswitching is necessary to enhance competition by extending their access to other railways. This argument fails for two reasons. First, competition requires a level playing field, which does not exist when U.S. carriers can solicit Canadian traffic, but the reverse is not true on the U.S. side of the border. CPKC welcomes intense competition in the marketplace, but this requires a level playing field for all players. Second, under the *CTA*, shippers already have LHI, which gives them access to regulated interswitching up to 1,200 km, but at a market rate based on comparable traffic. Against this backdrop, extended interswitching is simply about shippers wanting to access below-market rates for a longer portion of the traffic movement.

Canada already has the lowest average freight rates virtually anywhere in the world. On average, Canadian freight rates are 11 percent lower than those in the U.S., and Canadian grain and grain products move at rates that are approximately 30 percent lower than the Canadian average rate.[2] In addition to regulated interswitching up to 30 km, and LHI up to 1,200 km, the *CTA* already imposes many other regulatory mechanisms, including the Maximum Revenue Entitlement, final offer arbitration on rates, the statutory right to a service level agreement, service arbitration, and running rights. Given these facts, we fail to see how the government can justify even more rate regulation through extended interswitching.

The government's proposed resurrection of extended interswitching comes after CPKC broke records for the transportation of Canadian grain and grain products through this past fall and winter. Our strong performance is driven by significant capital investment, including our investment of more than $500 million in new, high-capacity hopper cars, built in Hamilton, Ontario. Canada needs a regulatory environment that encourages more private sector investment, rather than policies that chase investment dollars and jobs outside the country.

[2] International Comparison of Railway Freight Rates, CPCS Study, January 31, 2023: https://www.railcan.ca/wp-content/uploads/2023/02/International-Comparison-of-Railway-Freight-Rates.pdf

Proposed amendments

Given the harm this policy will cause for Canada's supply chains and Canadians everywhere that depend on efficient, low-cost rail transportation, we urge Parliament to reject this policy outright and remove the extended interswitching clauses from Bill C-47. If Parliament is committed to moving forward with the government's policy, then following two amendments must be incorporated to limit the most damaging consequences of this policy, to the extent possible.

1. **Exclude U.S. carriers from the extended interswitching limit.** U.S. carriers do not invest in Canada, and, unlike CPKC and CN, have no stake in Canada's success. CPKC welcomes intense competition, but this requires a level playing field. Canadian railways cannot effectively compete against U.S. carriers when Canadian law is designed to put them at a disadvantage. If U.S. carriers are once again given a reach of 160 km to solicit Canadian traffic at regulated, cost-based rates, while the reverse is not possible under U.S. law, the outcome will be a loss in Canadian investment dollars and jobs.

2. **The Agency must be compelled to establish regulated rates for the extended interswitching limit based on commercial rates for comparable traffic.** Cost-based rates deter railway investment in capacity-enhancing infrastructure because they do not allow railways to generate profit for the movement of traffic. Cost-based rate regulation is not a recipe for successful supply chains. Parliament created LHI to correct this flaw in 2018. If Parliament is going to implement extended interswitching again, the policy logic that led to LHI should apply to rate calculations.

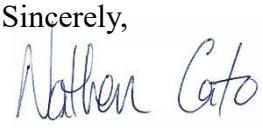
Parliament must also preserve the automatic sunset clause to ensure this harmful policy expires after an 18-month period. Do not support any proposals to remove the sunset clause or extend the duration of this "pilot" program.

CPKC strongly urges Parliament to do what is right for Canada's supply chains and reject the government's proposed legislation contained in Division 22 of Bill C-47 to resurrect extended interswitching. The goals of low-cost freight transportation and maximizing supply chain capacity, throughput and efficiency are fundamentally incompatible with extended interswitching. The amendments outlined above can only partially limit the harmful consequences.

Please do not hesitate to reach out if you have any questions.

Thank you for your consideration.

Sincerely,



Nathan Cato
Assistant Vice President, Government Affairs – Canada
CPKC