Submission to the Standing Committee on Transportation and Infrastructure February 28, 2013

Effective, reliable and consistent rail freight service is a key determinant of the mining industry's ability to compete internationally, attract the investment necessary for growth, expand its robust economic performance and continue its significant contribution to the Canadian economy.

The following brief articulates why rail freight service matters to both miners and the Canadian economy alike, and the context for our committee appearance and continued advocacy in pursuing amendments to Bill C-52, *The Fair Rail Freight Service Act*.

Context

In 2011, the mining industry contributed $35.6 billion to Canada's GDP, employed 320,000 workers, paid $9 billion in taxes and royalties to provincial and federal governments and accounted for 23% of Canada's overall export value. Operating from coast-to-coast-to-coast, the industry is important to remote communities, and generates prosperity in our major cities, notably Toronto, Vancouver, Montreal, Edmonton, Calgary and Saskatoon – each of which serves as a centre for global mining excellence for various types of mining.

Looking forward, proposed, planned and in place mining projects in Canada amount to upwards of $140 billion of investment over the next 5-10 years. Across the country, major projects are seen in mined oil sands, coal, copper, gold, iron ore and diamonds, among other sectors, with large investments also occurring in environmental and processing areas.

To enable the industry to become an even stronger contributor to Canadian prosperity, the industry needs government policy support to meet anticipated long-term demand for Canadian minerals. The efficiency of the logistics supply chain is a major determinant of industry's contribution to the Canadian economy and rail freight service is a major determinant of the effectiveness of the logistics supply chain. Although MAC appreciates the government's initiative through Bill C-52, it is our view that the bill will not deliver on the government's promise "to enhance the effectiveness, efficiency and reliability of the entire rail freight supply chain" unless it is amended.

Why Rail Freight Service Matters to Miners

Of particular relevance to the House of Commons Standing Committee on Transportation and Infrastructure as it considers Bill C-52 is that the Canadian mining industry is the single largest industrial customer group of Canada's railways by far. Canadian miners consistently account for over half of total rail freight revenue in Canada, and the majority of total volume carried by

350, rue Sparks Street • Suite 1105 • Ottawa, ON K1R 7S8 • Tel/Tél 613.233.9391 • Fax/Téléc 613.233.8897

Canadian railways annually. In 2011, the most recent year for which data is available, the mining industry accounted for 54% of rail freight revenue and 48% of volume carried. As such, transportation legislation has a significant impact on the Canadian mining industry.

According to Transport Canada's *Transportation in Canada (2011)*, "the rail transport industry generates approximately $10 billion per year—95% of which comes from rail freight operations." Given that the mining industry accounts for 54% of rail freight revenues, miners expend more than $5.1 billion yearly out of the approximate $9.5 billion total annual freight expenditure. The remaining $4.4 billion is accounted for by all other railway freight customers combined, nationwide.

From a volume perspective, Canadian railways carried 275.6 million tonnes of commodities in 2011. Of that total, miners alone accounted for 132.8 million tonnes (48%) of freight. The next largest industrial customer group by volume is grain, accounting for 13% of the overall total, or just over 35 million tonnes. The remainder is accounted for by all other railway freight customer groups combined.

Why Rail Freight Service Matters to the Canadian Economy

For the majority of miners, the remote location of their operations, or the relatively low per unit value of their products, or the sheer volume produced – or, in many instances, all three – make rail the only medium to transport freight both to and from their operations. The effectiveness of secondary links in the supply chain (vessels, terminals, other facilities, etc) are heavily contingent on the ability of the rail carrier to consistently handle the volumes miners produce and deliver them on time.

The difference between moving mined and refined products more or less effectively can mean billions of dollars of lost productivity and economic output for the Canadian economy. For example, consider one miner's economic input and the impact that the quality of rail freight service has on the success of their business model. This miner ships 24 million tonnes of coal to ports each year. At about 105 tonnes per rail car, that amounts to 225,000 rail cars annually. At 152 cars per unit train, that equates to 1,500 unit trains per year or five unit trains per day. At, say, $150 per tonne[1], that translates to $15,750 per car, or $2.4 million per unit train, for a total of $12 million of coal shipped daily. When placed in context, it becomes clear how much rail freight service failures can cost miners and, in turn, the Canadian economy as a whole.

Shifting from a single operation to an industry-wide perspective, the scale of the issue takes greater shape when this single company is situated as one mining operation among more than 220 operating mines[2] across Canada, the majority of which ship their products by rail. Further, the economic impact that rail freight shipping has on the mining industry increases significantly depending on the value of the commodity shipped. According to Index Mundi as of January 2013, for example, zinc is valued at $2,032.42 US per metric ton, copper at $8,053.74 US per metric ton, and nickel at $17,494 US per metric ton. When compared to the price per tonne of coal, and considering the number of mines producing them, the significant value of the

[1] Though accurate for an example, this value per tonne is subject to market conditions.
[2] This number excludes operations producing clay products, peat, and most construction materials (mostly stone, sand and gravel).

movement of mined products starts to take shape. More importantly, the impact that freight service has on the movement of these products, and the broader economy, becomes clearer.

Overcoming Canada's vast geography to deliver products effectively to and from mines, ports and smelters is crucial, especially considering the Canadian mining industry competes against countries with significantly shorter logistical supply chains. In this respect, the effectiveness of Canada's rail freight service is a key component of the mining industry's ability to compete internationally.

As stated above, new mining projects in Canada could amount to upwards of $140 billion of investment over the next 5-10 years. But this investment cannot be taken for granted. An effective domestic operating environment is crucial for delivering these projects and the benefits of increased employment and royalties that strengthen the Canadian economy. When companies are deciding in which jurisdiction to invest in, the effectiveness of the logistical supply chain is a weighted consideration.

Beyond attracting crucial investment dollars, rail freight service has a significant impact on the broader Canadian economy by affecting the broader logistics supply chain. To illustrate this point, consider mining's contribution to the bulk marine shipping industry. Coal accounts for 39% of the total volume handled at the Port of Metro Vancouver, which moves shipments to China, Japan and other strategic Asian markets with whom the government is currently negotiating freer trade. Potash and fertilizer represents another 12% of the port's volume, and minerals and ores 9%. Once tallied up, mining accounts for 60% of the total volume of Canada's largest and busiest port.

Overall, Canada transported $60.5 billion in industrial exports by ship to non-US countries in 2010. Of that, non-ferrous products and alloys ($6.8 billion), coal ($5.7 billion), iron ore ($2.7 billion), non-ferrous metals ($2.1 billion) and potash ($2 billion) were the most valuable mining products. Together, these products account for $19.3 billion or nearly 32% of marine exports to non-US countries. The sale and shipment of these products are negotiated and contracted between miners, customers, ports and bulk shippers, all of whose operations depend on the reliable and timely delivery of goods to meet their respective obligations to customers. All of them incur additional costs when service is inadequate. These additional costs impact the broader Canadian economy at large.

Why We Are Before You Today

Between 2005 and 2009, shippers issued an increasing number of complaints to government pertaining to poor rail freight service. Shippers identified a number of chronic and widespread problems, including poor railway performance in the overall supply of cars and spotting performance of cars, in particular cars supplied versus cars ordered, and the inability of railways to recover from service disruptions because of the railways' practice of aggressive asset utilization and allocation of crews and power.

To address these complaints, the government launched the Rail Freight Service Review (RFSR) in 2008 to develop recommendations to address the issues with respect to service within the rail-based logistics system.

Among other things, the rail freight market is not a normally-functioning competitive market. It is dominated by two suppliers whose networks are characterized by instances of monopoly where they enjoy significant market power (dual monopolies) with some other parts of the rail freight service market characterized by a rail duopoly. The Panel recognized this fundamental challenge and, as stated on page 41 of its final report, expressed:

"This railway market power results in an imbalance in the commercial relationships between railways and other stakeholders."

On March 18, 2011, Transport Canada Minister, The Honourable Denis Lebel, on behalf of the Government of Canada, responded to the RFSR Panel's Final Report and, among other measures, announced the government's intention to table legislation to address shippers' concerns. In his testimony before this Committee on February 12, 2013, Minister Lebel referenced the above conclusion and stated:

"It is essential for the committee to understand why this legislation is necessary. We are not dealing with a normal free market. The reality is that many shippers have limited choices when it comes to shipping their products. It is therefore necessary to use the law to give shippers more leverage to negotiate service agreements with the railways."

In its simplest form, aggressive asset utilization – the *modus operandi* of the railways – consists in maintaining the minimal railway capacity necessary to maximize profits. This practice caused the complaints that led to the RFSR in the first place, and it persists today, despite a great deal of talk surrounding improved service. Contrary to railway assertions, inadequate service continues today.

Examples, having occurred as recently as last week, include one miner receiving only 58% of their car allocation for two of their operations. Similar car shortfalls have been experienced by this miner for weeks. Another miner has expressed that performance in the northern supply chain is unsatisfactory with vessel wait times currently being approximately four times as long through Prince Rupert as through Vancouver. Both miners express that their customers are very critically questioning the continued shipment shortfalls as their own schedules are being impacted. Costs continue to rack up for all parties involved.

Limiting the supply of cars, crews and power has predictable effects: the rationing of an already limited supply among shippers that raises price and reduces the overall economic output. Further, by stretching their fleets the railways adversely affect the ability of shippers to meet their customer obligations, and send negative signals and costly ripple effects throughout the entire logistics supply chain. Due to service failures, miners are frequently left with inadequate railcar capacity (fewer cars/trains supplied versus cars/trains ordered) to ship the volume of goods they require delivered. As insufficient car supply persists, the miner's inventory increases at considerable costs, vessels and customers must wait and pay, and Canada's reputation suffers. Meanwhile, the problem is exacerbated as the miners' demand on an inadequate number of rail cars increases in an attempt to ship backlogged inventory.

Rail customers most often do not know what they are getting for the rates they pay. The remote locations of many mining operations often leave them captive to one of two railways —Canadian National or Canadian Pacific—and frequently stranded without an alternative mode of shipping.

Their captivity, coupled with the railways' power to unilaterally impose rates and conditions of service, enables the railways to raise prices and reduce or even eliminate service without risk of losing their customers. This captivity characterizes the imbalance inherent in Canada's monopolistic rail freight bargaining structure. It is the combination of shipper captivity and an ineffective regulatory framework that permits the use of railway market power.

The current framework, the *Canadian Transportation Act* (the "Act"), has largely been ineffective in protecting shippers against inadequate service. Currently, a rail carrier is not required by the Act to provide any particular elements of service to a shipper unless that railway so chooses. Furthermore, in instances where a carrier does choose to offer an element of service to a shipper, the railway is not required to provide any particular level of service.

Bill C-52: *The Fair Rail Freight Service Act*

Despite the recommendation of the Rail Freight Service Review to include elements of service in service agreements, and the broader shipping community's request for the same to be included in Bill C-52, the legislation before us today remains silent on this crucial issue.

In the legislative consultation, shippers sought amendments that would establish:

1. A base level of service by requiring the railways to provide specific elements of service; and,
2. A way to guide the Canadian Transportation Agency (or appointed arbitrator) in their interpretation of the "adequacy" and "suitability" of the level of service provided by a railway company.

Bill C-52 falls short because these critical components of service remain absent. Consequently, neither the Canadian Transportation Agency nor an arbitrator has guidance regarding the adequacy and suitability of a particular level of service, or even whether an element of service must be provided by a rail carrier.

The terms "adequate and suitable accommodation for traffic" and "service obligations" from sections 113-115 of the Act, and the associated level of service (LOS) provisions are weak and vague. As a result, these obligations have been insufficient to address the service failures that gave rise to the Rail Freight Service Review in the first place. Given that these provisions remain unaddressed in Bill C-52, it is our view that shippers will remain disproportionately and unreasonably subject to railway market power and that service failures will continue into the future.

By giving shippers a statutory right to a Service Level Agreement as Bill C-52 has done only goes half way: it gives shippers a right to service without defining that service. What is a right to a Service Level Agreement if service itself isn't defined by the law? Without including the specific elements of service a shipper needs, Bill C-52, at best, subjects the quality of a shipper's rail service to the discretion of an arbitrator in a process that, unless amended, weighs heavily in the railway's favour.

The government still has an opportunity to get this right and achieve Bill C-52's stated objectives of economic growth, job creation and expanded trade opportunities. The amendments we seek

correspond to those of the broader shipping community as determined in consultation with the Coalition of Rail Shippers (CRS).

Specifically, MAC endorses six amendments detailed in the appendix of this document, with specific focus on the following three:

1. **Amendment One**[3]: Define "adequate and suitable accommodation" and "service obligations". Amendments are being proposed to sections 115 and 115.1 of the *Canada Transportation Act* to define those terms.

2. **Amendment Two**: Delete the word "operational" from the expression "operational term" in the proposed section 169.31 of the Act.

   In the proposed section 169.31 of the Act, the wording "operational term", which is undefined in the Act and in Bill C-52, is intended by Transport Canada officials to eliminate conventional non-operational items from being addressed in a Service Level Agreement. For all such provisions, there is no ability for a shipper to negotiate them, but their terms can be unilaterally imposed by a rail carrier without consideration of the impact on a shipper. The CRS recommends striking out the word "operational" before the word "term" throughout the proposed section 169.31.

3. **Amendment Six**: Delete sections 169.37(d) – (f) of Bill C-52.

   Current section 169.37(d) - (f) of the bill subjects the shipper's needs for service to the effect they have on a railway company's network. By making the railway's network a mandatory consideration for the arbitrator, an arbitrator erodes the most basic service obligations of a rail carrier under a contract with a shipper. A railway's contractual obligations to a shipper are rather meaningless if a railway has an "out" due to its obligations to others. The CRS recommends striking sections 169.37(d) – (f) from Bill C-52. Nothing will prevent a railway company from raising these network effects for consideration by an arbitrator.

There is an opportunity to fix this problem. By implementing the above recommendations, the government can allow for commercial negotiations, maintain Canada's export success, and deliver revenues and jobs across the country without incurring any cost. Miners want to be able to work in partnership with the railways in the movement of their products. To do so, however, requires the changes we are seeking.

Mining currently accounts for approximately 3% of Canada's GPD and is a major economic contributor to both urban and remote regions across Canada. Given the medium to long term bullish outlook for minerals and metals, this contribution is likely to increase. To enable the industry to become an even stronger contributor to Canadian prosperity, industry needs government policy support to meet anticipated long-term demand for Canadian minerals. Acting to strengthen Bill C-52, through the proposed amendments, would enable this legislation to deliver for shippers as the government intends.

---

[3] The numbering of the amendments corresponds to the order in which they appear in the attached appendix, and where more information on the rationale for the implementation can be found.

Appendix: Recommended Amendments to: The *Fair Rail Freight Service Act* (Bill C-52)

The problem	Why it's a problem	The fix
1. There is no statutory guidance on how a railway is to fulfill its "service obligations" and the jurisprudence regarding the words "adequate and suitable" is ineffective. The current LOS complaint remedy, and particularly the definition of "adequate and suitable", has been ineffective for shippers, allowing the very significant service failures that gave rise to the rail freight service review in the first place. A significant shortcoming is the lack of guidance to the Agency to assess those failures.	In the absence of a provision like proposed s.115(2), an arbitrator has no idea, under s.169.37, by which standard to judge whether a service should be provided by the railway company or the level at which such service should be provided. Although proposed s.115(2) may only codify the current jurisprudence, because it is not codified, shippers are currently required to fight this point in every case. Adding this provision would assist in alleviating an unnecessary, costly and burdensome hurdle. One of the main benefits of the Federal Rail Freight Service Review was to recommend elements of service that railways should provide. The main purpose of defining "service obligations" is to provide guidance to the arbitrator as to the service obligations of the carrier. In the absence of this definition, the arbitrator does not know whether a carrier is obliged to perform proposed items (a) to (e).	Define "adequate and suitable accommodation" and "service obligations", as follows: **115.** (2) For the purposes of sections 113 and 114, a railway company shall fulfill its service obligations in a manner that meets the rail transportation needs of the shipper. Service Obligations **115.1** For the purposes of this Division, service obligations, without restricting the generality of the term, include obligations in respect of (a) the timeliness and frequency of the receiving and delivery of traffic by the railway company; (b) dwell times, estimated times of arrival, transit times and cycle times regarding the carriage of traffic; (c) the quantity, condition and types of rolling stock to be provided by the railway company; (d) accommodation and facilities for the exchange of information regarding the billing, receiving, carriage and delivery of traffic; and (e) car order fulfillment, car spotting performance and car placement at destination.

The problem	Why it’s a problem	The fix
2. The expression “operational term”, instead of “term”, unduly narrows what is eligible for an SLA.	The expression “operational term” eliminates the shipper’s ability to address non-rate items in or missing from a confidential contract or tariff, such as *force majeure*, internal dispute resolution mechanism, attornment and dozens of other standard contractual terms. This expression is expected to lead to significant litigation and procedural obstacles raised by carriers. Further, the SLA mechanism was intended to address the failure by railway companies to provide contracts or provision for all service terms, not just operational terms. Lastly, there is no restraint on the carrier from imposing these terms; for example, a carrier can compel the shipper to accept that its obligations are subject to whether it wishes to continue operating service to that shipper (line abandonment).	Strike the word “operational”. Submission for arbitration — confidential contract **169.31** (1) If a shipper and a railway company are unable to agree and enter into, a contract under subsection 126(1) respecting the manner in which the railway company must fulfill its service obligations under section 113, the shipper may submit any of the following matters, in writing, to the Agency for arbitration: (*a*) the ~~operational~~ terms that the railway company must comply with in respect of receiving, loading, carrying, unloading and delivering the traffic, including performance standards, and communication protocols; (*b*) the ~~operational~~ terms that the railway company must comply with if it fails to comply with a~~n operational~~ term described in paragraph (*a*); (*c*) any ~~operational~~ term that the shipper must comply with that is related to an operational term described in paragraph (*a*) or (*b*); (*d*) any service provided by the railway company incidental to transportation that is customary or usual in connection with the business of a railway company; or (*e*) the question of whether the railway company may apply a charge with respect to an ~~operational~~ term described in paragraph (*a*) or (*b*) or for a service described in paragraph (*d*). Matter excluded from arbitration

The problem	Why it's a problem	The fix
3. A shipper is not allowed to include in a SLA request a mechanism for determination of a breach of an SLA and the consequences flowing therefrom.	The practical use of a Service Level Agreement is limited if obtaining a remedy for questions relating to the existence of a breach, and damages flowing therefrom requires the shipper to commence proceedings before the Agency and/or in court or to rely on the proposed AMPS scheme. Shippers do not wish to undertake costly and lengthy Agency and/or court proceedings for damages resulting from a railway service failure. Allowing the inclusion in an arbitrated SLA of dispute resolution mechanisms will enhance railway responsiveness to service problems that arise once an SLA is established. The concept of balanced accountability between shippers and rail carriers can be achieved if mechanisms for compensation to shippers for railway failures can be determined in a simple and expedient fashion. This amendment will allow a shipper who chooses to do so, to submit to the Agency for arbitration, the terms and conditions governing whether or not a service failure has occurred and the manner in which compensation for that failure is to be assessed, in an expedient and cost effective way.	Modify 169.31 (1) (b) to include the right to such mechanism. **169.31** (1) If a shipper and a railway company are unable to agree and enter into, a contract under subsection 126(1) respecting the manner in which the railway company must fulfil its service obligations under section 113, the shipper may submit any of the following matters, in writing, to the Agency for arbitration: (*b*) the terms that the railway company must comply with if it fails to comply with a term described in paragraph (*a*); which may include terms governing the determination of whether or not a service failure has occurred and the manner in which damages are to be assessed and paid to the shipper for losses resulting from such failure;
4. There is no remedy for the imposition by a railway company of a charge respecting a matter that becomes a service obligation of the railway company.	Under current s.169.31(1)(d), the shipper could ask the arbitrator whether a charge should apply to an operational term and the arbitrator could say "no" – that is the best case. If the arbitrator says "yes", the carrier can impose whatever charge it wants pursuant to its unilateral tariff-making power. If the shipper does not include the question of a charge, the carrier can still impose whatever charge it wants through the tariff power. Other than possibly FOA, the only recourse is if a carrier imposes a tariff that applies to more than one shipper, in which case the shipper can contest it under s.120.1. If it applies only to that shipper, such as with a limited distribution tariff, limited competitive tariff, or even a general tariff that could only apply to one shipper's routing and commodity, etc., s.120.1 is not available. Further, if the SLA becomes a confidential contract, s.120.1 could not apply because that complaint mechanism only applies to public tariffs. Lastly, even if an arbitrator imposes the operational term sought by a shipper, there is nothing preventing the railway company from then imposing an obligation on the shipper, via tariff or otherwise, in response.	Modify s.120.1 to include single shipper tariffs. Unreasonable charges or terms **120.1** (1) If, on complaint in writing to the Agency by a shipper who is subject to any charges and associated terms and conditions for the movement of traffic or for the provision of incidental services that are found in a tariff ~~that applies to more than one shipper~~ other than a tariff referred to in subsection 165(3), the Agency finds that the charges or associated terms and conditions are unreasonable, the Agency may, by order, establish new charges or associated terms and conditions.

The problem	Why it's a problem	The fix
5. The introductory words to s.169.37 also make it possible that an arbitrator would allow a consideration of items raised by a railway company that a shipper did not include in its submission.	A shipper could include a single matter, or any number of matters, in its submission. A railway company could respond that it requires one or more conditions to provide the service in relation to that matter, thus making the railway's service obligations conditional. The solution is to allow the shipper to frame the matter(s) in dispute.	Revise s.169.37 as follows: Arbitrator's decision **169.37** (1) The arbitrator's decision must establish any ~~operational~~ term described in paragraph 169.31(1)(*a*) or (*b*) or (*c*), any term for the provision of a service described in paragraph 169.31(1)(*d*) or any term with respect to the application of a charge described in paragraph 169.31(1)(*e*), or any combination of those terms, that the arbitrator considers necessary to resolve the matters that were submitted by the shipper to the Agency ~~are referred to him or her~~ for arbitration. In making his or her decision, the arbitrator must have regard to the following: (*a*) the traffic to which the service obligations relate; (*b*) the service that the shipper requires with respect to the traffic; (*c*) any undertaking described in paragraph 169.32(1)(*c*) that is contained in the shipper's submission; ~~(*d*) the railway company's service obligations under section 113 to other shippers and the railway company's obligations to persons and other companies under section 114;~~ ~~(*e*) the railway company's obligations, if any, with respect to a public passenger service provider;~~ ~~(*f*) the railway company's and the shipper's operational requirements and restrictions;~~ (~~*g*~~*d*) the question of whether there is available to the shipper an alternative, effective, adequate and competitive means of transporting the goods to which the service obligations relate; and (~~*h*~~*e*) any information that the arbitrator considers relevant. (2) If a railway company intends to rely on any one or more of paragraphs 169.37(*d*), (*e*) or (*f*), the railway company will notify the shipper and the arbitrator no less than 5 days before its submission under s.169.34 and provide all evidence on which it intends to rely in respect of any of the factors described in paragraphs 169.37 (*d*), (*e*) or (*f*) at the time of its submission under s.169.34.
6. Current s.169.37(d) - (f) of the bill raises the status of the effect of a shipper's needs on a railway company's network, including obligations to others, to a mandatory consideration for the arbitrator.	The requirement that an arbitrator consider these network effects prevents the shipper from arguing it is irrelevant to a consideration of the service to which a shipper is entitled under the Act. Further, it erodes the most basic service obligations of a carrier under a contract by diluting a commercially negotiated railway performance obligation in a contract. This result will occur because an arbitrator would be compelled to examine whether the railway company's commitments in that contract are hindered by network effects, including obligations to other shippers. If a the effects on a carrier's network prevail over the shipper's needs, the railway's service obligations will be eroded, not only to that shipper, but to all those affected by an arbitrator's decision by lowering the standard for that kind of traffic (i.e., geographic proximity, similarity of commodity or similarity of "operating term", etc.). If these provisions are to remain as is, the shipper will require pertinent rail data ; otherwise, a shipper has very limited ability to contest the level or even element of service a carrier claims it can provide, a point that arises frequently in disputes with carriers; hence, new subsection 169.37(2).	