

Response to Bill C-49 the *Transportation Modernization Act*

Submitted by the

Saskatchewan Wheat Development Commission

Agricultural Producers Association of Saskatchewan

Saskatchewan Barley Development Commission

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About the Producer Coalition

The producer coalition is comprised of the Saskatchewan Wheat Development Commission (Sask Wheat), the Agricultural Producers Association of Saskatchewan (APAS), and the Saskatchewan Barley Development Commission (Sask Barley). The coalition represents the large majority of Saskatchewan grain producers in policy initiatives related to the grain handling and transportation system.

Changes to Canadian transportation policy will have a direct impact on the profitability and competitiveness of Saskatchewan grain producers. Therefore, the producer coalition has provided the following comments to the Standing Committee on Transport, Infrastructure and Communities in response to Bill C-49 the *Transportation Modernization Act*.

Introduction

Western Canadian grain producers are heavily reliant on Canada's rail transportation system to move their products to port in a timely and efficient manner to maintain their competitiveness in export markets. Western Canadian producers lack alternative, cost-effective options to move their grain to port, and therefore are held captive by the rail industry. This dependency on rail service and lack of control over their transportation position can have serious economic consequences for producers.

Due to the monopolistic structure of the rail industry and the oligopolistic structure of grain handling industry, all additional costs in the grain handling and transportation system are ultimately passed on to producers. These additional costs are incredibly burdensome during periods of constrained rail service. A lack of rail service directly impacts producers through lost marketing opportunities, increased storage costs, and elevated export basis levels. Export price basis is the difference between the export terminal port price and the price at local elevators in the country. Export basis normally reflects transportation costs, country and terminal handling costs, interest on grain purchases, demurrage costs, and grain company margins. In times of constrained rail capacity, grain companies widen the basis in an effort to discourage producers from delivering grain. However, the need for cash flow forces producers to deliver grain whenever the opportunity exists, even if the basis is wide.

The economic consequences of constrained rail service and widened basis levels was felt greatly by producers in the 2013/2014 and 2014/2015 crop years. Research conducted by Dr. Richard Gray of the University of Saskatchewan showed that elevated basis levels in the 2013/2014 and 2014/2015 crops years cost western Canadian producers \$5 billion to \$6.7

billion dollars¹. These numbers illustrate the magnitude of the costs that producers can face due to inefficiencies in the grain transportation system.

While the grain handling and transportation system has performed well in the past crop year, setting a record for grain movement in 2016/2017, additional capacity is still needed in the system to avoid future backlogs. Analysis done by Dr. Mohammad Torshizi and Dr. Richard Gray shows that future production trends will continue to increase and outstrip capacity in the near future, unless significant investments and improvements continue to be made. Torshizi and Gray estimate that without increases in rail and port capacity, production increases will lead to an expected loss for producers of \$10.8 billion dollars from 2016-2025.² The authors recommend that investments into public infrastructure and timely and efficient regulatory processes will help to facilitate investments in increased port capacity.

These studies illustrate how western Canadian grain producers will be directly impacted by reforms to transportation policy. Therefore, it is crucial that any changes made will directly benefit producers.

Background

The producer coalition has been actively involved in consultations to reform Canadian rail transportation legislation. The coalition provided feedback and recommendations during the review of the *Canada Transportation Act (CTA)*, and we continue to voice our concerns and emphasize that any changes to the Canadian rail transportation system must benefit producers.

The preliminary recommendations for the CTA review panel developed by the producer coalition were submitted in December, 2014.³ Following the release of the CTA Review Report, the producer coalition again provided feedback to the CTA review panel in September, 2016⁴. In May, 2017, the producer coalition sent a letter to Minister Garneau calling for the extension of Bill C-30, the *Fair Rail for Grain Farmers Act*, in the event that the new federal transportation

¹ Gray, R. 2015. The Economic Impacts of Elevated Export Basis Levels on Western Canadian Grain Producers 2012/13, 2013/14 and 2014/15. <http://www.saskwheatcommission.com/wp-content/uploads/2015/09/The-Economic-Impacts-Of-Elevated-Export-Basis-Levels-On-Western-Canadian-Grain-Producers-2012-2015.pdf>

² Torshizi, M., Gray, R. 2017. An Economic Analysis of Western Canadian Grain Export Capacity. Forthcoming Article Canadian Journal of Agricultural Economics.

³ December, 2014. Producer Recommendations on the Future of Canada's Transportation Act. http://www.saskwheatcommission.com/wp-content/uploads/2016/01/Dec-2-2-14_Farm-Coalition-Group-Submission1.pdf

⁴ September, 2016. Producer Coalition Submission to the Canada Transportation Act (CTA) Review Panel in Response to the CTA Review Report. http://www.saskwheatcommission.com/wp-content/uploads/2015/08/Producer-Coalition-CTA-submission-September-16-2016_Final.pdf

legislation would not be passed prior to the House rising in June.⁵ Furthermore, the coalition has commissioned several academic studies which provided us with unique contributions to the CTA review process. These studies are outlined in Appendix 1.

In addition to written submissions, producer coalition members have participated in many face-to-face meetings regarding transportation reform. Coalition members travelled to Ottawa in February and April 2017 to meet with federal officials with Transport Canada and Agriculture and Agri-Food Canada (AAFC), as well as Members of Parliament. We also participated in roundtable discussions with federal officials regarding transportation reform in August and October 2016.

In the producer coalition's submissions to the CTA review, we developed our recommendations based on broader objectives for the grain handling and transportation system. These objectives are:

- fostering competition;
- increasing market transparency;
- positioning the system for future growth;
- and ensuring producers have a voice in the transportation system.

These same objectives support our review of the *Transportation Modernization Act*.

Assessment of the *Transportation Modernization Act*

Maximum Revenue Entitlement & Inter-Switching Provisions

Upon introduction of the *Transportation Modernization Act*, the producer coalition was pleased to see the retention of the Maximum Revenue Entitlement (MRE). Maintaining the MRE is crucial to protecting western Canadian producers from excessive railway rates and also ensures a fair return to the railways for the movement of grain. The initial long-term recommendation in the CTA review report to eliminate the MRE within seven years would have been incredibly harmful to producers allowing the railways to extract monopolistic rents at their expense.

However, some of the short-term recommendations to adjust the MRE put forward in the CTA review were included in the *Transportation Modernization Act*. The coalition feels that these short-term recommendations fail to address the issue of market power in the rail transportation system. Under the proposed changes in the *Transportation Modernization Act*,

⁵ May, 2017. Producer coalition seeks extension of Bill C-30.

<http://www.saskwheatcommission.com/newspost/producer-coalition-seeks-extension-of-bill-c-30/>

containerized movement and inter-switching would be excluded from the MRE calculation. Excluding containers from the MRE will create incentives for the railways to move towards containerized shipments, which would result in reduced service for producers who have few shipping alternatives.

Excluding inter-switching from the MRE calculation could further reduce competition in areas that are only serviced by one railway. The long-haul inter-switching provisions included in the *Transportation Modernization Act* should help to eliminate this impact on captive shippers; however, until the new inter-switching provisions are in place we cannot be certain how well they will function. Furthermore, the coalition understands from conversations with government officials that only the distance and revenue from rail movement to the nearest inter-switching point would be excluded from the MRE calculation. Once the second carrier is moving the grain, the MRE would account for the revenue from that movement. This is an important distinction to keep freight rates in check.

The producer coalition supports maintaining and expanding inter-switching provisions to encourage competition and provide shippers with a bargaining tool. This will likely increase competition between railways in years of excess capacity; however, it is uncertain whether these provisions will increase competition in years of tight capacity. As well, the coalition has uncertainties regarding the long haul inter-switching rates based on comparable traffic. This could have a significant impact on freight rates that will be passed on to producers. These comparable rates should be set based on the MRE in order to keep cost-based freight rates and comparable-based freight rates in line. Finally, in order for long-haul inter-switching to be effective, it needs to be accessible to all grain shippers including shortline railways.

Need for a Costing Review

One of the major recommendations put forward by the producer coalition in our CTA review submissions was the need for a full costing review. Regular costing reviews are necessary to ensure that the costs built into the MRE accurately reflect the actual costs of moving grain. However, regular costing reviews have not been performed, with the last full costing review for grain movement being completed in 1992. Since that time, elevator consolidation and large rail car spots have created cost saving efficiencies that need to be accounted for in the MRE.

Research completed by Travacon Research Ltd. for the producer coalition showed that for the 2013/2014 crop year, based on the MRE, Canadian National Railway (CN) and Canadian Pacific Railway (CP) combined earned a contribution over variable costs from statutory grain of \$478.4 million. This was \$322 million, or \$8.36/tonne, in excess of the 20% contribution level over

variable costs that was deemed fair under the Western Grain Transportation Act (WGTA). Travacon also believes that the 20% contribution level is the maximum that could be earned under effective competition.

Completion of a full costing review was not included in the *Transportation Modernization Act*, therefore assessing what changes need to be made to MRE will be ill-informed. The producer coalition will continue to advocate for a full costing review to be completed so the MRE reflects the costs of moving grain in the current operating environment.

Rail Oversight & Planning

The producer coalition was also pleased to see increased transparency measures added in to the *Transportation Modernization Act* through data disclosure and agency inquiry provisions. Making more data and metrics on performance, service, and rates publicly available is necessary for the grain handling and transportation system to function effectively. However, additional reporting of grain handling, marketing, and transportation information is still required so producers can make informed decisions in the marketing of their grain. For example, reporting of export quotes by port and grade is required for price discovery to occur in grain markets.

Rail oversight and planning is another important tool for the grain handling and transportation system to function effectively. In our CTA submissions, the coalition recommended that a rail oversight/planning group, that includes agricultural producer representation, be created to establish performance targets and assess ongoing operations of the railways. Currently, there is no coordinated or transparent industry consultations for rail capacity planning. Instead, railways plan for capacity based on their own operational requirements and profit motivation, not the industry's need for capacity. Producers will be most adversely affected by a lack of capacity in the grain handling and transportation system, and therefore they should have representation through an industry planning process. The *Transportation Modernization Act* does not introduce any provisions for an industry wide process to plan for capacity and the producer coalition will continue to advocate for the creation of an industry capacity planning group.

Discontinuance Provisions for Producer Car Loading Sites & Branch Lines

In our previous CTA submissions, the producer coalition called for stronger protections for producer car loading sites and greater transparency in the rail abandonment process. These issues have not been adequately addressed in the *Transportation Modernization Act*.

Under the *Canada Grain Act*, grain producers are granted the right to order rail cars through the Canadian Grain Commission. The right to a “producer car” is meant to ensure market access for producers through Canada’s rail network. In the last decade, mainline carriers have been closing public loading sites at an accelerated rate. CP Rail’s decision to close 17 loading sites across western Canada suggests that producers are at risk of losing this competitive shipping alternative. The continuing closure of producer car loading sidings also highlights the need for a costing review. The maintenance of producer car loading sites is included in the base year revenue of the MRE formula which is calculated using 1992 costs. As a result, the railways are compensated for maintaining the same number of sidings that existed in 1992. Without a costing review, the railways will continue to be compensated for expenses they no longer incur.

The producer coalition requests stronger legislative protections for producer car loading sites be included in The *Transportation Modernization Act*. Specifically, we request the Act address longstanding discrepancies that exist between the discontinuance provisions for urban and rural rail sidings. The closure of producer car loading sites should be subject to the same consultation and notification requirements that are in place for sidings in metropolitan areas. Furthermore, the producer coalition requests a moratorium on further site closures until a costing review is completed.

In our initial CTA review submission, the producer coalition also called for the CTA to be empowered to investigate and rule on a railway’s genuine commercial interest in underserved and unused rail lines in which other parties have expressed an interest. Since it is up to the railways to determine which lines will be discontinued, situations have developed where a rail line remains in the railway’s operational network but is not maintained and operational for grain shipments. The *Transportation Modernization Act* provides an opportunity for the Federal Government to ensure that interested parties are given meaningful opportunities to acquire and operate grain dependent branch lines that would otherwise remain underutilized and underserved. This would also allow the CTA to ensure the discontinuance process happens quickly, as the transition of assets will be best achieved if the transfer occurs before assets deteriorate or shippers make long-term plans.

Conclusion

The producer coalition comprised of APAS, Sask Wheat, and Sask Barley, appreciates the opportunity to comment on Bill C-49, the *Transportation Modernization Act*. The producer coalition was encouraged to see both the MRE and inter-switching provisions maintained in the *Transportation Modernization Act*. However, the effect and need for the changes to the MRE outlined in the *Transportation Modernization Act* cannot be fully understood without the

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completion of a full costing review. The producer coalition strongly recommends that a full costing review be completed prior to the enactment of the regulations for the *Transportation Modernization Act* in order to accurately represent the costs of shipping grain in the MRE and adjust other provisions accordingly.

As well, the producer coalition recommends that an industry rail capacity planning group, with producer representation, be created to add transparency into the system. The financial burden of constrained capacity within the grain handling and transportation system falls directly on producers; therefore, producers should be involved in the planning process.

Finally, the producer coalition is calling for changes to the *Transportation Modernization Act* to increase transparency and equality of discontinuance provisions for producer car loading sites and grain dependent branch lines.

Again, we want to emphasize that any changes made to rail transportation legislation must benefit producers.

The producer coalition invites you to contact us if you have any questions regarding this submission.

Sincerely,



Bill Gehl
Chair, Sask Wheat



Todd Lewis
President, APAS



Jason Skotheim
Chair, Sask Barley

Appendix 1: Background

The producer coalition is made up of the Saskatchewan Wheat Development Commission (Sask Wheat), the Saskatchewan Barley Development Commission (Sask Barley) and the Agricultural Producers Association of Saskatchewan (APAS). Our group has made several unique contributions to the discussion around the CTA Review Process including:

- Research commissioned by Sask Wheat and carried out by Dr. Richard Gray (University of Saskatchewan) indicates that **constraints in the grain handling and transportation system, in the 2013/14 – 2014/15 crop years, resulted in a loss of farmer revenue amounting to \$5-6.7 billion.** (<http://www.saskwheatcommission.com/wp-content/uploads/2015/09/The-Economic-Impacts-Of-Elevated-Export-Basis-Levels-On-Western-Canadian-Grain-Producers-2012-2015.pdf>)
- Research commissioned by the Producer Coalition and carried out by Travacon Research Ltd shows that for the 2013/14 crop year, based on the maximum revenue entitlement (MRE), **CN and CP combined earned a contribution from statutory grain of \$ 478.4 million, which was \$ 322 million in excess of the contribution level of 20 % that was deemed fair and adequate under the *Western Grain Transportation Act (WGTA)*, and which Travacon believes is the maximum that could be earned under effective competition.** (<http://www.saskwheatcommission.com/wp-content/uploads/2015/03/Estimated-Contributions-Earned-by-Railways-from-Handling-of-Statutory-Grains-and-Grain-Products.pdf>)
- Research commissioned by Sask Wheat and carried out by Dr. Mohammad Torshizi and Dr. Richard Gray indicates that **without increases in rail and port capacity, production increases will lead to an expected loss for farmers of approximately \$10.8 billion for the 2016-25 period.** (http://www.saskwheatcommission.com/wp-content/uploads/2015/08/PolicyBrief_Final-Toshizi-Grey-2016.pdf)
- Results of the same study also indicate that **without the Maximum Revenue Entitlement (MRE), the railways can maximize their profits by reducing their grain transportation services to 25 MMTs, which would result in a shortage of rail capacity and high export basis levels in most crop years.** (http://www.saskwheatcommission.com/wp-content/uploads/2015/08/PolicyBrief_Final-Toshizi-Grey-2016.pdf)
- Torshizi and Gray further conclude that **if incentives to increase rail capacity are developed, it is important that they are done through negotiation with producers groups and shippers and remain within the current MRE structure to avoid the perverse incentives that are created when the railways can drive up service rates by reducing service levels.** It is important that those who benefit from a constraint are not allowed to control the constraint. (http://www.saskwheatcommission.com/wp-content/uploads/2015/08/PolicyBrief_Final-Toshizi-Grey-2016.pdf)
- **Sask Wheat is the only organization that currently reports weekly FOB prices and estimates export basis levels to Canadian port positions.** FOB data is critical for producers as a benchmark for evaluating primary elevator prices and to determine the basis being paid. (<http://www.saskwheatcommission.com/wheat-market-outlook/#FOB>)

- Research commissioned by Sask Wheat and carried out Dr. Richard Gray, Dr. Peter Slade, and MSc. Candidate Devin Serfas indicates **that freight rates at US points remain close to Canada's regulated rates only in areas with significant intermodal competition, which is generally impossible in Canada** due to the absence of a barge system.