

# IS THE RUNNING RIGHTS PROVISION AS A FORM OF RAILWAY COMPETITION DEAD? COMPETITIVE ACCESS - III

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## **I. Introduction**

No issue on competitive access in rail has provoked more controversy than open running rights. The Working Group referred to it as the most divisive subject during their consultative process. Even with the recommendations in the Estey Report, the Working Group or Kroeger Reports and the CTAR Panel Report, Bills C-26/C-44/C-58/C-8 appeared silent on it. It appears that the timing is just not yet right for full competition as the railways have argued that the needed investment in infrastructure by them is unlikely if mandated running rights are forced upon them. Further, they have indicated that the North American railways are one of the few efficient and profitable railway systems in the world and if the system is not broken don't fix it. Yet provision for running rights is not new. It has been in the *Railway Act* since 1888.

In this paper, one of the competitive access provisions, running rights (RR) is examined. First, the concept of RR and the objectives of the RR will be examined. Second, the RR provision will be examined together with issues in decisions on RRs of particular interest. Third, the underlying theory for open RRs will be reviewed. Fourth, various arguments against RRs will be examined. Finally, a few concluding remarks will be made.

## **II. The Concept and Objectives of Running Rights**

### *a) The Concept of Running Rights*

Running Rights (RR) are rights obtained by a railway, either through agreement or through application to the Agency, to operate its trains over the tracks and to use the facilities of another railway. The concept of running rights can be traced back to 1888 wherein the *Railway Act* allowed a railway to apply to the regulator to take possession of, use or occupy any lands belonging to any other railway company "for the purpose of obtaining a right of way ... and for obtaining the use of tracks, stations or station grounds of another company." This provision was needed, as the railways did not have the expropriation powers for land from another railway company.

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\* The views expressed here are those of the author and are not purported to be those of the Commissioner or the Competition Bureau, Industry Canada.

*b) The Objectives of Running Rights*

The objectives of running rights have not been stated in the legislation but have to be inferred. Perhaps, it is best to group them into historical and modern objectives.

*Historical:* The first historical objective may best be described as the need to avoid duplication of railway construction where existing lines could be used. In the late 1800's, a number of railway companies were faced with financial difficulties and were facing bankruptcy. They had general expropriation powers of land but this did not apply to another railway. To avoid construction and building of duplicate tracks, where existing lines existed the running rights provision was enacted. This is also apparent from the fact that most applications under this section in the early 1900s dealt with occupying the property of another railway. It was seen as an expropriation of property.

The second historical objective was the need to provide efficient routing pattern by reducing total mileage: The objective of an efficient routing path was usually implied or imbedded in requests for right of way.

*Modern:* The first modern objective is to provide an efficient routing pattern by reducing total mileage and time in transportation so as to improve service. This objective is typically advanced when many railways enter into running right agreements between them. Recent examples of this are the CN and Ontario Northland routing protocol in 2005, the CN and BNSF Railway agreement in 2006, the CPR-CN railway agreement in 2006, etc. It reflects in part the old objective.

The second modern objective is to reduce transportation cost. The Minister in his document *Freedom to Move* when providing a reason for extending the running rights provision to include Governor-in-Council action stated: "This power would be used only in exceptional circumstances where significant efficiencies and cost savings would be certain to result. The objective would be to keep transportation costs to users as low as possible and thereby enable them to maintain their competitiveness in their marketplaces." [1] This indicates that costs or prices to users is also an objective of this provision. It can also be inferred from s. 116 which provides protection to grain shippers that are dependent on branch lines.

The third objective is to develop short line railways and markets. This objective developed with the Estey Report when it "recommended that the provisions relating to various methods of seeking access to other connecting rail lines be simplified ... The general object of this recommendation is the opening up of the Canadian rail system to competition by and between all competent railway operators, including short-line railways." [2]

The final objective is to increase competition among railway lines through access. The CTARP indicated “Notably absent were references to the provision being a measure to increase competition. ... In the latter half of the twentieth century, the regulator ordered no running rights, and traffic solicitation rights ... were neither requested nor granted.”[3] It is worthwhile noting that s. 116 also provides for traffic solicitation. It could perhaps also encompass intermodal competition i.e., competition between the railways and trucking which was a major concern in the post war period (see MacPherson Report).

In sum, the objectives have to be inferred from government or other reports on the subject. It largely reflects the concerns of the time. The older objectives were concerned with avoiding duplication of existing facilities and the right of way. The modern objectives or most of them have evolved from the recent discussion on competitive access. However, since the provision on running rights or amendments to it have not been accepted other than the overall emphasis of competition in the statement of national transportation policy, it could be argued that the weight given to the older objectives continues to dominate.

### **III. The Running Rights Provision**

The running rights provision first appeared in the *Railway Act* of 1888 as section 102 under the title of 'power to take or use land and materials defined and limited'. In 1903, this section appeared in the *Railway Act* of 1903 as section 137 in two subsections. In 1919, it appeared in the *Railway Act* of 1919 under section 193 in five subsections. From 1919 to 1986 the number of this provision changed a few times from 193 to 196 in the *Revised Statutes of 1952* and then to 134 in the *Revised Statutes of 1970*, however, the text remained the same. It was repealed from the *Railway Act* in 1987 but appeared in the *National Transportation Act* 1987 as sections 148 and 149. Section 148 contained three subsections based on the first three subsections of section 134. Section 149 contained seven new subsections.[4] This section also contained provision for determination of appropriate compensation for the use of the right-of-way where the companies concerned cannot agree on the amount of compensation.

#### *a) The Running Rights Provisions in the Canada Transportation Act 1996*

Running Rights (RR) are rights obtained by a railway, either through agreement or through application to the Agency, to operate its trains over the tracks and to use the facilities of another railway. Sections 138 and 139 of the CTA 1996[5] (formerly sections 148 and 149 of the NTA)[6] contain provisions on how RR may be obtained.[7] The text of subsection 138 was largely the same as 148(1) except that the final paragraph was eliminated and the text of section 149 was reduced considerably to three subsections from seven, however the intent of the provisions remained the same in the 1996 legislation as that contained in the 1987 legislation.

Section 138 contains three basic elements: the application by a railway company; the test of public interest and the imposition of any conditions by the Agency; and the payment of compensation.

The application by a railway company is defined in section 87 of the CTA as one within the legislative authority of Parliament. Accordingly, running rights under the CTA may only be granted with respect to a railway company under 'federal' jurisdiction. This would exclude any person or regional carrier from applying as the latter does not fall within the legislative authority of Canada.

The test of public interest (and imposition of any conditions by the Agency) is not defined in the Act but is conventionally regarded as being the National Transportation Policy as defined in section 5. The Agency stated "... the national transportation policy appearing in section 5 of the CTA offers an expression of the public interest as a preamble to the statute ... It advocates, instead, a balancing of the various objectives ..."

The payment of compensation under the running rights provision would have to satisfy section 112 (Rates and conditions of service) which requires a rate or condition of service established by the Agency to be commercially fair and reasonable to all parties.

Section 139 applies to actions of the Governor-in-Council on application by a railway company, a municipal government or any other interested person or on the initiative of the Governor-in-Council where it improves the efficiencies and effectiveness of rail transport and would not unduly impair the commercial interests of the companies. So far no regulations have been made under the running rights provision.

In light of the above, the Grain Handling and Transportation Review recommended that the provisions of the CTA relating to various methods of seeking access to other connecting rail lines be simplified and clarified so as to better serve the national interest in obtaining competitive and efficient transportation by rail. The general object of this recommendation is the opening up of the Canadian rail system to competition by and between all competent railway operators, including short-line operators. To give effect to the recommendations of the Review, the government appointed Arthur Kroeger who in consultation with various stakeholders examined the matter. The Working Group on this matter considered wide-ranging interpretations of the recommendation ranging from partial open access to full open access.[8] The Working Group proposed that "a 'reverse-onus' public interest test for 'running rights' applications be implemented, and further study of full open access be undertaken." [9].

In 2000, section 116 was amended (Bill C-34) to protect grain shippers. It is only available when a railway company breaches its level of service obligations (ss. 116(4)(e)(i)) in respect of a grain-dependent branch line. It provides a remedy with traffic solicitation. It contains language similar to section 138 but is considered as a remedy provision rather than a competitive access provision.[10]

To date no further changes have been made or are expected to this provision as the Bills C-44/C-58/C-8 which were introduced on March 24, 2004/May 30, 2007/October 29,2007 did not introduce any amendments to this provision.

*b) The Use of the Running Rights Provision*

From 1987 to date only seven applications for RR were made to the Agency. Three (i.e., Ontario Midwestern Railway Company Limited, Victoria County Railway Company Limited and VIA Rail Inc.) were denied by the Agency on grounds that the applicants were not federal companies and one (i.e., M.O.Q. Rail Inc.) was withdrawn as it was subsequently obtained by negotiations. The other three applications were by: Hudson Bay Railway Co.; Ferroequus Railway Company Limited; and Bangor and Aroostook System. The first was dismissed as it was beyond what could be legally granted. The second was denied as no public interest would be served. The third was denied due to lack of information. Thus, the effect that these provisions have had in enhancing competition has been very limited.[11]

*c) Issues on Running Rights Applications of Particular Interest*

1. Is the RR provision (section 148) restricted to railway companies that are within the legislative authority of Parliament? The Agency indicated that 'a railway company' as stated in section 2 of the *Railway Act* is limited to railway companies within the legislative authority of Parliament. Therefore unless the applicant comes under federal jurisdiction by way of federal incorporation or some other means, the applicant does not qualify to make an application under section 148. Arguments such as the recent policy direction encouraging development of short rail lines, federal jurisdiction where federal and provincial rail lines cross or connect, sections of the *Railway Act* that permit running rights between federal and provincial companies, etc. do not apply. [12]

2. Is the request for RR with traffic solicitation beyond the scope of the RR provision? In determining whether traffic solicitation falls within the scope of this section, the Agency followed the guidelines stated in *R. v Gladue* (1999) i.e., "...the proper construction of a statutory provision flows from reading the words of the provision in their grammatical and ordinary sense and in their entire context, harmoniously with the scheme of the statute as a whole, the purpose of the statute, and the intention of Parliament."

First, subsection 138 (c) most applicable to this issue ‘to run and operate its trains over and on ...’ makes no mention of traffic solicitation. The word ‘operate’ as used elsewhere in the Act does not suggest any interpretation nor does any industry accepted code or definition. Therefore, the Agency could not conclude that the grammatical and ordinary sense of the phrase includes traffic and solicitation rights.

Second, regarding statutory context, the Agency reviewed various parts of the Act, Part I does not offer any real assistance in suggesting whether section 138 should be interpreted broadly or narrowly nor does Part II, IV or Part V or VI. Part III which contains other competitive access provisions that surround section 138 is limited in ambit, suggesting a narrow interpretation to section 138 although it complements the other competitive access provisions. In 2000, section 116 was amended containing language similar to section 138, part of which is constrained. In the absence of this constraint in section 138, it has been suggested that section 138 should be given the same meaning as section 116. The Agency indicated that different meanings to the same wordings in different provisions (s. 138 and s. 116) are warranted if their purposes are different. This is so for the two sections.[13]

Third, the Agency also considered whether the grant of solicitation rights would fit in harmoniously with the other provisions (level of service, competitive line rate, final offer arbitration, transfer and discontinuation process and revenue cap and whether it would result in creating an unlevel playing field, resulting in inequity and requiring enabling provisions) and indicated that they do not as the provisions do not extend to cover the plethora of operational disputes that could arise.

Fourth, in considering the purpose of the statute, the Agency reviewed the policy objective of the Act. It indicated that the policy statement does not represent a unidimensional pursuit of competition at all costs. It advocates a balancing of objectives.

Fifth, regarding the intent of Parliament, the original intent (1888 or 1919) was not to grant open access to another carrier and that wording changes over time (such as deletion of ‘full right and power’ and ‘enjoy’) suggest a narrowing of philosophy. The modern intent as advanced in 1987 was not commented on.

For the above reasons, the Agency concluded that the impact of regulated broad traffic solicitation rights is potentially so pervasive that section 138 does not support such a broad interpretation to imply that traffic solicitation falls within the scope of this section.

3. Is the principle of competition sufficient without evidence of market abuse or

failure for granting of RR? It is not sufficient. The Agency in its decision on the *Ferroequus Railway Company Limited* (i.e., FE) application for RR: summarized the submissions on the application; the circumstances of the application of section 138 of the CTA; and the other elements of public interest.

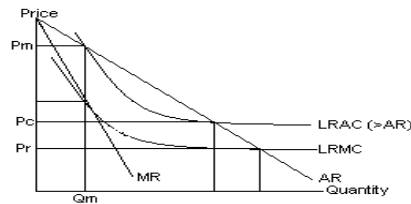
Regarding the circumstances, the Agency reviewed several arguments. The arguments of FE and the Canadian Wheat Board indicated that providing running rights would have positive competitive effects. Those of CN and CP indicated that there was no evidence of failure of the carriers to fulfill its service obligations or that the current rates were non-competitive. Those of Western Grain Elevator Association and Prince Rupert Grain Ltd. indicated that adding a another carrier will create system inefficiencies and disrupt the transportation system. The Agency therefore found no convincing evidence that there is any public interest need in terms of existing railway rates or services for the imposition of running rights. It therefore denied the application. It went on to conclude that “a statutory running right is an exceptional remedy that requires actual evidence of market abuse or failure before an application under section 138 of the CTA may be granted. More particularly, ..., FE has not established the existence of a rate or service problem in the relevant markets nor has it established that the granting of running rights would eliminate or alleviate any lack of adequate and effective competition.”[14]

Regarding other elements of public interest, the Agency concluded that granting of: 1) the application would have a negative impact on many of the participants in the grain handling and transportation system; 2) the business plan of FE is overly optimistic; 3) the proposed interchange of traffic would create inefficiencies in the grain handling system and to the surrounding pipe companies; and, 4) the inefficiencies imposed on the system participants would not be offset by FE’s operating efficiency.

#### **IV. Running Rights As a Competitive Access Provision**

##### *a) Differential pricing and the Need for Constraints On It*

The underlying reason why differential pricing is used in railway pricing will be briefly discussed followed by the need to place constraints on it through the granting of access. Differential pricing refers to the fact that railways charge different rates to different shippers for the same service with the same cost generally based on the shippers dependency on rail.



Under decreasing long run average cost, which the railways can be characterized as, it has been argued that the determination of price and output is inefficient. This is because an efficient allocation of resources under competition requires that a firm undertake production where price equals long run marginal cost (LRMC). At this point, price and long run marginal cost would be below long run average cost [LRAC] (see diagram) and in consequence the firm would suffer a loss. Two choices exist for the firm: one is to produce at this point (price=LRMC) and recover the loss from consumers or shippers or to scale back production to the point where price is equal to LRAC (see diagram). The latter choice has been discounted on grounds that it does not meet the optimal social criteria. The issue then is how should the firm recover the loss or the difference between the long run average cost and the long run marginal cost. One way to do this, that is efficient is through Ramsey prices. This is described hereafter.[15]

In the context of the railway industry “... the average costs always being in excess of their marginal costs. ... the railways need to capture from each shipper, a ‘contribution’ to their fixed and common costs. ... Railways determine the allocation of their fixed and common costs by varying their pricing to shippers on the basis of ‘elasticity of demand’ of the shipper for railway service. ... This means of pricing is called ‘Ramsey pricing’, after the economist who first explained the concept. Only firms with relatively substantial market power are able to engage in Ramsey pricing, as firms in competitive markets are compelled by market forces to price at or near long run marginal costs.”[16]

This method of recovering the loss would seem reasonable not only because it is efficient but also because consumers or shippers would pay for the loss according to the value of the services to them. However, it is not always true that shippers would pay according to the value of the services to them.[17] For example, a shipper of high value goods might be willing to pay a higher rate or price for shipping but if he is at a point where there is a competitive railway or trucking service he may have to pay a lower rate as railways may not be able to practice Ramsey pricing in these markets. As indicated by the Working Group “Thus, the elasticity of demand for rail services varies not only with ‘value of service’, but also with the price of competitive alternatives available to the shipper.”[18]



The consequence of this is what the firm or railway cannot recover from those shippers where there is competition, it has to recover from those shippers where there is no competition. As indicated by the Working Group “The unfortunate consequence for shippers of bulk commodities captive to rail, particularly where rail intra-modal competition is limited, is that they have been called upon to make relatively greater contributions. *This is an inequity of current railway economics: the lowest value commodities, facing the most intense market competition [source], and having the least ability to pay, have increasingly borne a greater share of the railways fixed and common costs.*” [19] It is therefore not surprising that such captive shippers have called for constraints to be placed on the ability of the railways to engage in differential pricing. One way to achieve this, that has been advocated is the grant of running rights.

What will be accomplished by mandated access according to some studies? The primary benefit of allowing independent train operators access to track infrastructure is that by enhancing the scope for competition, it enhances the probability that rail services which consumers desire will be produced efficiently and sold at efficient prices with on going investment. The Bureau of Transport and Regional Economics (BTRE) explains the competition benefits of mandated access in the rail sector as follows: “Mandating access to rail infrastructure can ... encourage on-rail technical and dynamic (or production) efficiency. ... This infusion of competition and new operators fosters innovation. Lower train operating costs then enable operators to offer lower freight rates and more freight customer-responsive services. This also acts to improve train services competitiveness relative to road services.” [20]. A second important benefit of mandating access to the track infrastructure is that it allows a greater scope for seamless provision of rail services. BTRE states “Since the development of railways, freight trains have tended not to extend beyond the track owner’s network. ... Separation of control of trains from track enables separate development of (seamless) train operations across infrastructure networks and increases rail’s geographic market reach. These improvements would therefore enhance rail’s competitiveness” [21] A third reason is that it could lower costs due to economies of density. Several authors have noted the existence of economies of density in railway operations. Given the existence of source competition for most captive shippers, loss of markets would lead to increased rail costs. The OECD report concludes that “Overall ... our expectations about the likely level of in-the-market competition that will arise in a regime of mandated access should, ... be suitably modest.” [22]

There are however costs of mandating access. The CTA is silent on how compensation is to be established. There tends to be widespread agreement that an access charge should be based on a incremental cost imposed on the host

railway and a contribution to cover common costs. Various methods have been used to calculate the latter.[23] Its choice depends on what one wishes to achieve [efficiency at least of the host, competitive entry, market power reduction, etc.] and whether it is practical.

*b) Views on Running Rights as a Competitive Access Provision*

*1. Competition Bureau:* The Competition Bureau in its submission [24] to the Panel indicated that the current running rights provision is not effective in facilitating competitive access. Two major factors contribute to this. First, the provision is limited to federal railways. Since most of the short line railways in Canada fall under provincial jurisdiction, they are denied the right to apply for running rights over the lines of federal carriers. Second, the provision contains a public interest test. Public interest is not defined in the CTA and would include a number of factors. The onus is clearly on the applicant railway to establish that the granting of running rights is in the public interest, which serves as an impediment to the effectiveness of this provision. It therefore recommended that the provision should apply to any person (i.e., federal railways or provincial railways) so long as that person meets a fitness test. It also recommended that the public interest test be eliminated from the running rights provisions of the CTA (however if retained a reverse onus test be required which includes competition considerations). However, a fitness test should be retained and the hosting railway should be adequately compensated for these access rights.

*2. Conference Board Study:* This study [25] took a different view than that of the Competition Bureau. It indicates that differential pricing for the railroads is needed otherwise government subsidies or regulation of prices will be needed. With an access regime, some type of a access pricing will have to be developed and with a drop of revenue and quality of service some type of differential pricing would be needed in developing an access price regime. If a modified Efficiency Component Pricing Rule (which incorporates differential pricing) is used to determine access pricing, it would work only if the railway seeking access is more efficient than the incumbent. There is no evidence that this will be so. In addition, competitive access requires a lot of regulation to address pricing issues at the margin. It would also severely disrupt efficient railway operations; and it could increase cost by eroding economies of scale. Therefore, in light of this and the availability of alternative forms of relief or remedies to deal with monopoly power such as final offer arbitration (FOA) and competitive line rates, granting RR is redundant and would likely cause more problems than it resolves.

*3. Saskatchewan Agriculture and Food Study:* This study [26] provides an assessment of open access in the Australian railway system. It was undertaken because of concern with the lack of competition. “Since the introduction of open access in Australia, the experience has been mixed. Where traffic volumes and/or

distances are large, open access in terms of both rates and services have been a success. For example, on the interstate line, there are now five operators and rates have fallen by 40% while the level of service has improved. For coal movements in New South Wales (NSW), the threat of competition from other carriers has forced the current rail operators to drop its rates by 25%.’’ The logical comparison whether open access could work for grain movement in Canada would be the interstate line as it has the two characteristics of the interstate line: long distances and large volumes. Therefore if open access is to have any chance of success in Canada, a regulatory and institutional framework must be established to address: barriers to entry and exit; access fees (regulated, transparent and reasonable); creation of an independent agency (to establish access fees and time slots); safety and operational standards (to be known to all); and institutional constraints which inhibit access.

4. *Canada Transportation Act Review Panel (Panel)*: The Panel reviewed the issue on running rights (RR) in its report and [27] made several proposed changes. One, the Review Panel recommended that the RR provisions be applicable to provincial railways besides federal railways. The applicant for RR would be required to advise the infrastructure owner sixty days before the application is made to encourage negotiations. Further, in considering public interest in RR applications, the Agency is to use a seven factor test at a minimum. Furthermore, the Review Panel recommends that compensation for RR be negotiated and if such negotiation is not achieved in ninety days the Agency could be asked to determine it. The holder of RR will be required to provide reasonable notice of termination. Two, the RR provisions will also provide for traffic solicitation rights. In such cases, publication of rights and level of service would be required at the request of a shipper, together with the right to enter into confidential contracts and the authority to limit liability. Three, the Review Panel made recommendations on compensation. For traffic solicitation, the real access charge would be an incremental cost imposed on the host railway and a contribution to the common costs. For track access without solicitation rights, the access fees the Agency determines should be guided by incremental cost imposed, value to users, and whether revenue is more than needed to cover total cost; and in the case of government owned or directed passenger and commuter rail services additional costs including congestion and delay costs. Finally, the Review Panel recommended that the access proposal should comply with applicable requirements of international and internal trade laws. The interswitching, CLR and FOA provisions would not be applicable to RR.

Changes proposed to RR are less than what shippers wanted, as the Review Panel considers the grant of RR an extraordinary step. As a result, RR will not be applicable to any person (for example, a shipper or US railway) other than federal

or provincial railways and there will not be full open access without a public interest test. In addition, the proposed public interest test in RR applications will not be a reverse onus test. In other words, the Review Panel proposed changes to make the existing competitive access provisions more effective without expanding the existing competitive access provisions to any substantial degree.

*c) What Regulatory Reform Has Been Achieved in Other Countries?*

The existing situation will be first described followed by a brief history.

*1. US:* In the US, running rights is permitted in order to protect captive shippers. The regulator uses a stand-alone-cost test to ensure that the shipper with relatively inelastic demand does not pay excessive fixed costs for track usage. The stand-alone-cost is the hypothetical cost that a competitor would incur to make the investment necessary (including an adequate return on capital) to enter the market and provide the service. Competition takes three basic forms: intermodal (use of different modes to one point); end-to-end (from A to B by different rails); and source (from different locations to one destination).

Regulatory reforms began in the 1970s, when several major eastern railroads went bankrupt. The US government took ownership control and restructured them into a single entity, Conrail. In the late 1970s and 1980s, the industry was deregulated with the passage of the *Railroad Revitalization and Regulatory Reform Act* and the *Staggers Rail Act*. Conrail was privatised in 1987 and in 1997 it was absorbed by CSX and Norfolk Southern. The industry has since evolved into four major rail roads and over 550 shortlines. Typically each State has more than one railroad serving it. This has allowed regulators to refrain from regulating most tariffs. As a result, only 20 percent of freight traffic (mainly bulk) is subject to regulation.

*2. Australia:* In Australia by 2000 most interstate rail networks were structurally separated and/or privatized. They are subject to legislated access regimes. Intrastate regional freight networks in some states are private vertically integrated companies subject to legislated mandated access regimes. Metropolitan passenger rail service is retained by government corporations.

The process began in the mid 1990s when governments began commercialization, consolidation and opening the industry to private entry. The policy reform was pursued through the application of the National Competition Policy agreements.[28] Its major policy reforms include: commercialisation, corporatisation and privatisation; separation (vertical and horizontal) structurally; legislation providing for access regimes to essential facilities; institutions for regulatory pricing and rail access oversight; and promotion of competition through specific policies (franchise agreements and contract bidding).

As a result, the structure and institutional arrangements in the rail industry has

markedly changed since the early 1990s when a number of States owned vertically integrated intrastate railways while the Australian government operated interstate freight and passenger services (besides the intrastate railways in Southern Australia and Tasmania).

3. *EU Countries*: In the EU today, regulated access to the track and associated infrastructure, particularly in the case of freight services is permitted. It is a form of access to essential facilities. Regulated access has raised new regulatory issues: pricing of access to infrastructure efficiently; rationing scarce infrastructure efficiently; maintaining incentives for track quality and reliability; maintaining incentives to invest in track; and monitoring train operations to prevent track damage.

A fall in the market share of rail in the 1960-70s led to attempts to introduce reform. The first attempt resulted in three Commission regulations in 1969/70 but produced little change. In 1989, a new policy statement advocated radical change. However, the 1991 directive implementing this policy was more modest, providing for separate infrastructure and operation accounts with transparent charges for the former and legal rights of access. In 1995, two other directives were issued on: designating state licensing authorities; and defining an infrastructure manager and an allocating path body. The Commission called for stronger action in its 1996 Paper as virtually no open access operations had emerged. This resulted in three packages of reforms.[29] To date the reforms have produced structural separation in a few countries; allowed for competition in the international and domestic freight market; and resulted in the Commission opening competition to international passenger services including cabotage by 2010.

In sum, the competitive reform that is being adopted in various countries largely depends on the structure of the industry ((i.e., vertical integration (monopoly or duopoly) or vertical separation)) and the nature of competition (from inside and from outside the industry). The issue is how to deal with the exercise of market power as the appropriate policy for one structure may not be appropriate for another. The OECD paper concluded that a wide range of experience with different modes of competition and different degrees of vertical separation exist and it is not yet possible to draw a clear picture as to the appropriate role of vertical separation in the overall reform of the rail industry.[30]

## **V. Concluding Remarks**

Mandated access as a form of introducing railway competition appears dead, despite the fact that the running rights provision has been in the *Railway Act* since 1888. This is not surprising. To begin with, this provision was not considered as a way to introduce competition. Further, even with the government's modern policy to actively promote intramodal and intermodal competition, greater

efficiency and lower costs of transportation service, its reports have recommended that the running rights provision be used only in exceptional circumstances.

The recent Bills (C-44/C-58/C-8) to amend the Canada Transportation have appeared silent on it despite the recommendations of the CTAR Panel. Perhaps, the only real benefit from a review of this matter over the last few years is the amendment made in 2000 to section 116 to protect grain shippers when a railway company breaches its level of service obligations. But this is considered a remedy provision rather than a competitive access provision.

The recent decision of the CTA on the *Ferroequus Railway Company Limited* correctly concluded that no breach in the law or availability of other remedies was required at all as a pre-condition to the availability of section 138 of the CTA. However, its use of a test of evidence of market abuse or failure before an application may be granted will undoubtedly severely limit the use of this provision. This tends to suggest that as in the last half of the twentieth century the regulator is unlikely to mandate running rights.

Ongoing developments also suggests that from the policy perspective we are moving in the opposite direction of Europe and Australia. Whether Canada's policy is right or wrong will continue to depend on how the industry evolves (i.e., mergers with US carriers reducing the six US and Canadian carriers to four if permitted by the regulatory agencies) and the type of competition that we believe should exist.

#### Endnotes

1. *Freedom to Move*, p. 37.
2. *Grain Handling and Transportation Review*, Final Report, The Hon. William Z. Estey, Dec. 21, 1998, p. 61.
3. *Vision and Balance*, Canada Transportation Act Review, June 2001, p. 74.
4. As stated in *Freedom to Move* "... a clause will be inserted in new legislation (accompanying Section 134 of the *Railway Act* covering railway-initiated action) to authorize Governor-in-Council in those unusual instances where government intervention is warranted in the national interest. This power would be used only in exceptional circumstances where significant efficiencies and cost savings would be certain to result. The objective would be to keep transportation costs to users as low as possible and thereby enable them to maintain their competitiveness in their marketplace." p. 37.
5. Section 138 provides for application of RR by a railway company; the imposition of any conditions the Agency may deem appropriate having regard to the public interest; and payment of compensation by the applicant for the RR by agreement of the companies or to be determined by the Agency in case of non-agreement. Section 139 empowers the Governor-in-Council to order RR in the 'interest of efficiencies and cost savings' fixing compensation where voluntary agreement cannot be reached.
6. The only difference between the two *Acts* is that under the NTA to be a railway company required a Special Act of Parliament or meeting the requirements to obtain letters patent of incorporation whereas under the CTA becoming a railway company one had to obtain a certificate of fitness which was much easier than the former.
7. The provisions in the older legislation are not significantly different from those in the NTA, 1987 or CTA except that these later *Acts* reflect a pro-competitive intent. They have been in the legislation since at least 1888.
8. Partial open access is a term used to allow provincial carriers access to federal tracks using the reverse-onus public interest test. (There are two variants of the partial open access: with a public interest test; and with a reverse-onus public interest test). Full access is the term used to describe access without any public interest test (there are also variants of this test: without separating the industry into competitive and monopoly segments; separating the industry into segments with vertical integration; and separating the industry without vertical integration) provided a railway meets the safety, fitness and insurance requirements.

9. *Competition and Safeguards*, Appendix C, Working Group #3, September 1999, p. 15. As indicated earlier, the Minister of Transport in his package of reforms of May 1, 2000 did not make any specific reforms in this area other than indicating that the question of open access would be the subject of further study which was later included in the terms of reference to the CTA Panel.
10. See Canadian Transport Decision, No. 505-R-2002, September 10, 2002, p. 24 and p. 52.
11. This should not be taken to imply that there are no running rights between the railways. Hundreds of running rights agreements exist between CN and CP and between them and other railways but these are voluntary commercial agreements.
12. The Agency also noted that jurisprudence on this issue dates back to 1914 where the Board of Railway Commissioners for Canada ruled that granting a provincial railway company running on federal trackage was outside its jurisdiction. The wording of the section then and now has remained roughly the same. See *Victoria County Railway Company Limited vs. CN* (1990/1) and *Ontario Midwestern Railway Company Limited/William E. Kosar vs CN/CP* (1990/1).
13. Section 116 is a level of service obligation and it is only available when contravened whereas section 138 is competitive access provision indicating that the sections were enacted for different purposes. See *Hudson Bay Railway Company (Omnitrax) vs. CN* (2000/1) and *Ferroequis Railway Company Limited vs. CN* (2000/1).
14. See *Ferroequis Railway Company Limited vs. CN* (2001/2).
15. Production at a socially optimal level of output in decreasing cost industries will require the introduction of a two-part pricing scheme. The price per unit must be set equal to MC, and the resulting deficit must be met from a fixed charge imposed on users. One should not force the firm to produce where price equals LRAC, because 1. output is socially suboptimal, and 2. price will be suboptimal, further also actual price will be higher and output lower, because of X inefficiency, Averch-Johnson effects, etc. Market failure can also arise when a single producer is able to supply a number of different products more efficiently than can a number of firms. The basis for declining costs in the case of a multi product firm is that complementarities in production lead to large shared or common costs. In the case of a multiproduct "natural monopoly", policies directed at obtaining an efficient allocation of resources have focused on "Ramsey prices".
16. *Competition and Safeguards*, Working Group #3, Appendix C, September 1999, p. 19.
17. This by no means implies that the theory is wrong. All that it means is that the conditions required by the theory are not satisfied.
18. Working Group, p. 19.
19. *Id.* p. 20.
20. *Structural Reform in the Rail Industry*, OECD, DAF/Comp (2005) 46, p. 47.
21. *Structural Reform in the Rail Industry*, OECD, DAF/Comp (2005) 46, p. 47.
22. *Structural Reform in the Rail Industry*, OECD, DAF/Comp (2005) 46, p. 47.
23. For example, percent of variable cost, efficient component pricing rule, return to replacement value of line, and appropriate cost of capital to the estimated value of the capital stock used by the guest. It should also be noted that the ECPR has a built-in pattern of cross-subsidies or differential prices. The Panel noted 'Differential pricing has a role as part of an efficient pricing regime for track access, but certain constraints are needed'.
24. Submission to the CTARP, Regarding Access and Related Issues, October 6, 2000, Competition Bureau.
25. Canada's Future Rail Policy, Is Politics Derailing Good Economics? *The Conference Board of Canada*, May 2002, pp. 1-5.
26. An Assessment of Open Access in the Australian Rail System, Saskatchewan Agriculture and Food, June 1998.
27. *Vision and Balance*, Canada Transportation Act Review, June 2001.
28. *Structural Reform in the Rail Industry*, OECD, DAF/Comp (2005) 46, pp. 133-142.
29. See Nash, Chris and Rivera-Trujillo, Rail regulatory reform in Europe - principles and practice, presented at the STELLA Focus Group 5 synthesis meeting, June 2004.
30. *Structural Reform in the Rail Industry*, OECD, DAF/Comp (2005) 46, p. 13.