

**POLICY BRIEF:  
BILL C-30 RAIL FREIGHT INTERSWITCHING PROVISIONS  
WHAT ARE THE QUESTIONS?**

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**BACKGROUND**

On March 26, 2014, the Government of Canada introduced into Parliament Bill C-30, the *Fair Rail for Grain Farmers Act*.<sup>2</sup> As stated in the press release announcing Bill C-30, the intent of the legislation is to “...respond to the challenges currently facing Western Canada’s rail shipping system” and “help the entire grain transportation system reach the goal of getting product to market quickly and more efficiently following a record crop year for Canadian farmers.”<sup>3</sup> Briefly putting this year’s crop in perspective, the Government noted that, “Western Canada produced a record 76 million metric tonnes of grain this year – 50% higher than the average crop since 2002.”<sup>4</sup>

Bill C-30 contains a number of proposed amendments to the *Canada Transportation Act* and the *Canada Grain Act*. As stated in the Backgrounder to the accompanying press release these include, in particular, amendments to the *Canada Transportation Act* (the CTA) to:

“Create regulatory authority to allow the Canadian Transportation Agency to extend the interswitching distances in Saskatchewan, Alberta and Manitoba to 160km, for all commodities, to increase competition among railways and give shippers’ access to alternative rail services.”<sup>5</sup>

It is these changes to the interswitching provisions of the CTA and the related regulations that are the focus of this brief.

Also significant is that Bill C-30 contains a sunset clause, unusual in Canadian legislation. Under this clause, the proposed amendments to the CTA, including the amendments to interswitching, are to be repealed on August 1, 2016, although this may be postponed by a resolution of Parliament.

In addition, the Government announced that it will accelerate the currently scheduled statutory review of the CTA. Under section 53 of the CTA, the review must commence no later than June

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<sup>2</sup> Bill C-30 may be found at < [http://www.parl.gc.ca/content/hoc/Bills/412/Government/C-30/C-30\\_1/C-30\\_1.PDF](http://www.parl.gc.ca/content/hoc/Bills/412/Government/C-30/C-30_1/C-30_1.PDF) >.

<sup>3</sup> Government of Canada, *Harper Government Introduces Legislation to Address Rail Capacity Challenges* (March 26, 2014) at < <http://news.gc.ca/web/article-en.do?nid=829579> >.

<sup>4</sup> Government of Canada, *Backgrounder, Harper Government Introduces Legislation to Address Rail Capacity Challenges* (March 26, 2014) at < <http://news.gc.ca/web/article-en.do?nid=829579> >.

<sup>5</sup> Ibid.

2015, and it must be completed within eighteen months. It now appears that the review will commence this summer.<sup>6</sup>

As suggested by the title of this brief, the proposed changes to the regulated interswitching regime raise a number of questions including:

- How was the new limit for regulated interswitching of 160km determined?
- How did the Government decide that this should apply in the three provinces specified and to all commodities in those provinces?
- How much additional traffic will now be subject to regulated interswitching?
- What is the reason for the unusual sunset clause?
- How much will the changes to regulated interswitching contribute to speeding up grain movements and clearing the backlog?
- What will be the impact on the rail sector and shippers of the proposed changes to regulated interswitching?
- What do the changes to regulated interswitching imply for the other CTA “shipper protection” provisions?

We briefly elaborate on these at the end of the paper.

## INTERSWITCHING

In general, “interswitching” is the transfer of rail traffic by one railway, the local carrier, between a shipper’s facility and an interchange with a second railway. Interswitching rates are the freight rates paid to the local carrier to move the traffic to/from the interchange point. Interswitching can take place at the origin or destination end of a traffic movement.

Sections 127 and 128 of the CTA provide the authority for the Canadian Transportation Agency (the Agency) to regulate interswitching within a radius of 30 kilometres of an interchange. This includes “prescribing terms and conditions governing the interswitching of traffic, other than terms and conditions relating to safety” and “determining the rate per car to be charged for interswitching traffic, or prescribing the manner of determining that rate...” However, the current regulatory authority also includes “prescribing...a greater distance than 30 km from an interchange.”

Further, “In determining an interswitching rate, the Agency shall consider the average variable costs of all movements of traffic that are subject to the rate...” The rate, in other words, is based on the system-wide average of the railways’ costs for such switching movements (including a contribution to fixed costs). While the Agency has established different rates based on zones within the 30 km radius and on the numbers of cars switched,<sup>7</sup> the rate is the same no matter at which location the move occurs, nor does the rate vary by market conditions.

<sup>6</sup> Standing Committee on Agriculture and Agri-Food, *Evidence Number 20* (March 31, 2014) available at <<http://www.parl.gc.ca/HousePublications/Publication.aspx?DocId=6498645&Language=E&Mode=1&Parl=41&Ses=2>>.

<sup>7</sup> Canadian Transportation Agency, *Interswitching Rates* at <<https://www.otc-cta.gc.ca/eng/interswitching>>.

Where the origin or destination of interswitched traffic is located within a radius of 30 kilometres of an interchange (or a prescribed greater distance), federally regulated railways must, under section 127(3), adhere to the regulations. Stated differently, within a radius of 30 km (or a prescribed greater distance), the CTA gives shippers the right to access a second railway at the Agency-determined interswitching rates which are based on the average costs of such switching activity. Taking advantage of the interswitching provisions is automatic and does not require a regulatory proceeding unless there is a dispute between the parties involved.<sup>8</sup>

It is sometimes believed that under the CTA shippers are allowed to access a second railway only within the regulated interswitching limit.<sup>9</sup> This, however, is wrong. The CTA does not preclude a shipper from accessing a second railway beyond the regulated interswitching limit, but it is something that would be done through commercial negotiation rather than as a right.

## INTERSWITCHING IMPACT

Determining the impact of regulated interswitching is difficult and has never been unequivocally established. However, some evidence was compiled by Transport Canada at the request of the *Canada Transportation Act Review (CTAR)* as part of examining competition in the rail freight sector.<sup>10 11</sup> Specifically, CTAR determined the proportion of rail freight tonnage within 30 km of interchanges with a competitive railway, i.e. the traffic with access to interswitching. The data included CN and CP traffic for 1999. The analysis was done both for the national level and for grain specifically.

CTAR estimated that the percentage of total rail freight tonnage with access to interswitching at origin or destination was 91.4%, while the percentage with access to interswitching at both ends was 38.7% (see Figure 1). These figures include transborder traffic. They indicate that, at a minimum, about two-fifths of Canadian rail freight traffic has access to direct rail competition through interswitching.

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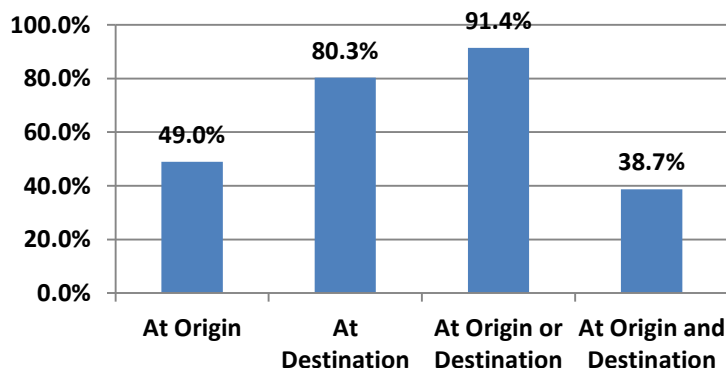
<sup>8</sup> The Agency has recently ruled on the matter of interswitching at Coutts, Alberta (Decision 165-R-2013) and Emerson, Manitoba (Decision 466-R-2013). These cases have been brought before the Agency under the current interswitching limits, and in both the Agency ruled in the shipper's favour. The cases are now before the Federal Court of Appeal. The cases demonstrate that there is sometimes room for interpretation in determining where an interchange exists for regulatory purposes.

<sup>9</sup> See *The Globe and Mail, Move it or lose it* (March 28, 2014), p. A10.

<sup>10</sup> *Canada Transportation Act Review, Note on the Evidence About Competition in the Rail Freight Sector*, available on the compact disc accompanying the CTAR Panel's final report *Vision and Balance* (June 2001).

<sup>11</sup> Disclosure: The author was Co-Director, Research for the *Canada Transportation Act Review* during 2000-2001.

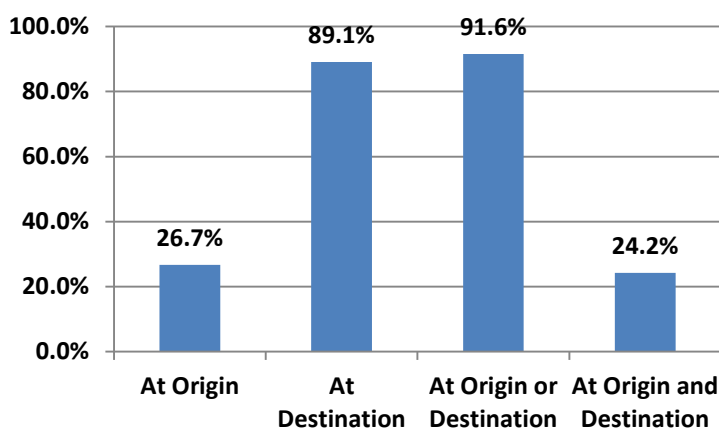
**Figure 1: Percentage of Total Rail Freight Tonnage, 1999 within 30 km of Interchanges (including border points)**



Source: Transport Canada, for *Canada Transportation Act Review*

With respect to grain, CTAR estimated the percentage of tonnage with access to interswitching at origin or destination was 91.6%, while the percentage with access to interswitching at both ends was 24.2%. These figures also include transborder traffic (see Figure 2). As may be seen by comparing Figure 1 and Figure 2, grain's smaller percentage of traffic with access to interswitching at both ends is due to the smaller percentage of originating traffic that is within the interswitching limits.

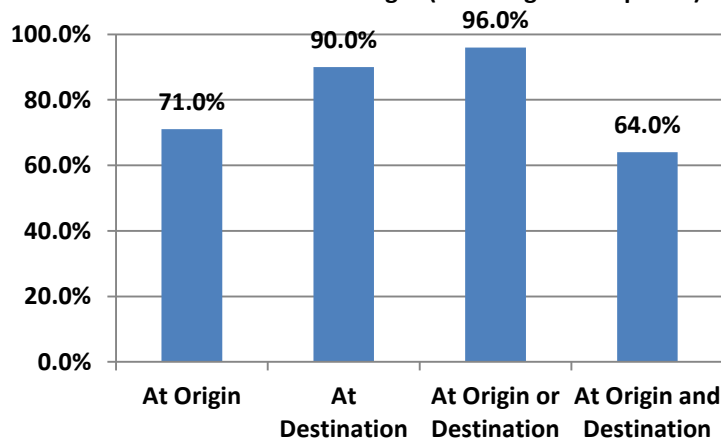
**Figure 2: Percentage of Rail Freight Tonnage of Grain, 1999 within 30 km of Interchanges (including border points)**



Source: Transport Canada, for *Canada Transportation Act Review*

CTAR also undertook a sensitivity analysis to determine the impact of interswitching distances greater than 30 km. With an assumed interswitching limit of 50 km, the tonnage of grain with direct rail access to a second railway at origin increased to 40.5% from 26.7%. If 100 km were used as the interswitching limit, 71.0% of originating grain traffic would have direct rail access to a second railway. Compared with the 24.2% of grain traffic originating and terminating within 30 kilometres of interchanges, 64.0% had access at both origin and destination (Figure 3).

**Figure 3: Percentage of Rail Freight Tonnage of Grain, 1999 within 100 km of Interchanges (including border points)**



Source: Transport Canada, for *Canada Transportation Act Review*

The analysis reported above used tonnage as the basis for measuring access to interswitching. Other possible ways to measure the impact would be to take the percentage of shippers' facilities that are within the interswitching limits, or the numbers of rail cars that are actually interswitched as a percentage of railcar loadings.

### **INTERSWITCHING UNDER BILL C-30**

Under subsection 128(1)(c) of the CTA, the Agency may, as noted above, prescribe an interswitching limit of greater than 30 km. Bill C-30 proposes to amend the CTA by adding the following after subsection 128(1)(c):

- “A regulation made under paragraph (1)(c) may prescribe different distances for the regions or goods that it specifies.”

Bill C-30 would, then, expand the authority of the Agency to permit the establishment of interswitching limits that not only exceed 30 km (authority which it already has) but that also differ by region and/or by commodity. Thus, while the Government has, in announcing Bill C-30, clearly signaled that its policy is to have the interswitching limit extended to 160 km in Saskatchewan, Alberta and Manitoba, and to have this apply in these provinces to all commodities, these specifics are not actually contained in Bill C-30.

These are the only changes being proposed to the interswitching provisions. Significantly, no modifications are being proposed to the legislated guidelines used by the Agency in establishing the interswitching rates.

As an aid to visualizing what interswitching would look like under Bill C-30, the map below compares an interswitching limit of 160 km with the present 30 km limit and highlights the provinces to which the 160 km distance would apply under the new amendments.

LEGEND

Regulated interswitching limits

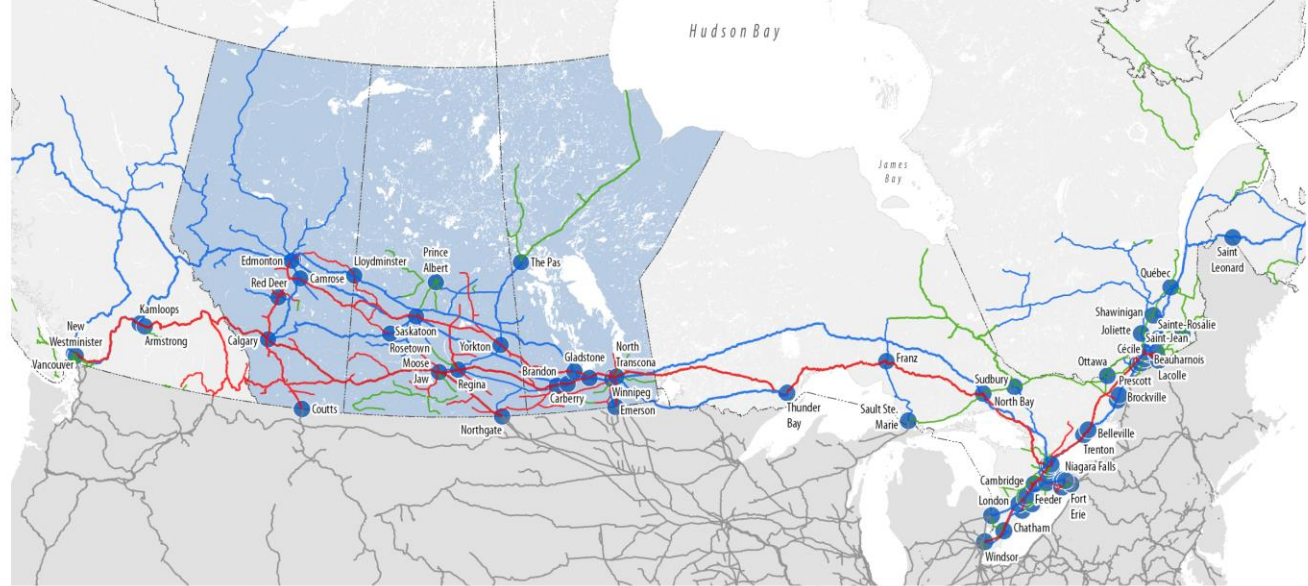
- Current and new limits (30km & 160km)
- Affected provinces

Proposed changes to regulated interswitching distances would apply to Alberta, Saskatchewan and Manitoba only (highlighted) and would apply to all commodities.

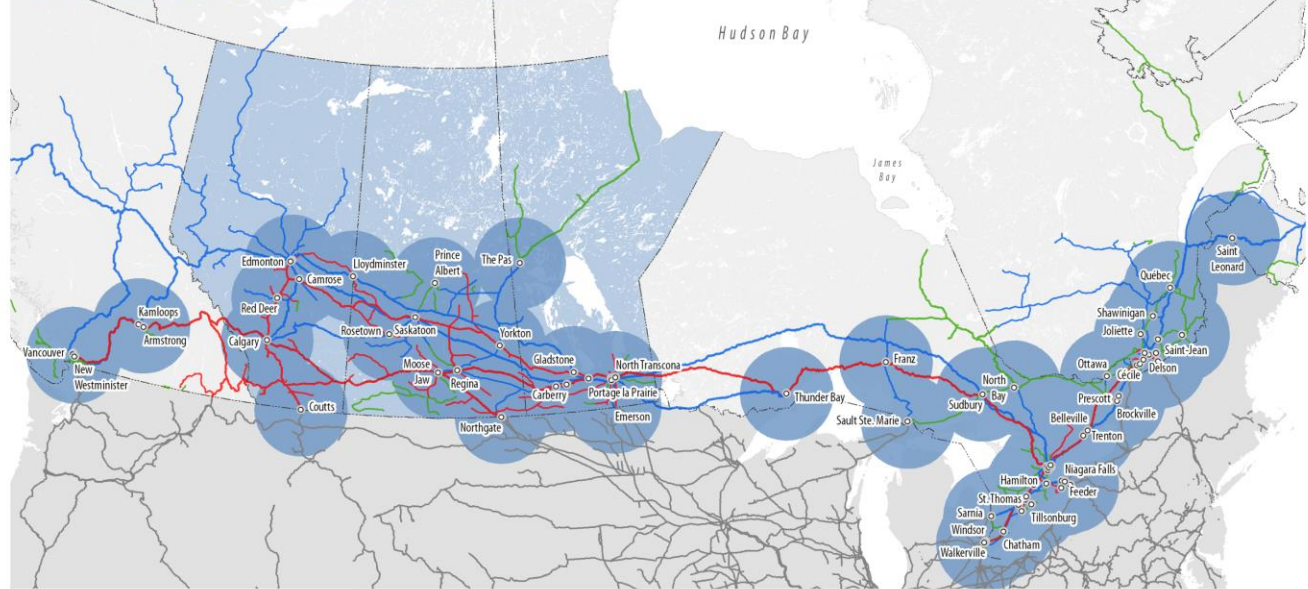
Railway ownership

- CP
- CN
- Other railways
- US class "I" railways

CURRENT REGULATED INTERSWITCHING LIMIT (30km)



PROPOSED REGULATED INTERSWITCHING LIMIT (160km)



Limitations

Regulated interswitching zones on the map are indicative based on straight-line kilometers rather than railway kilometers.

CPCS does not warrant the accuracy of the map.

Source: CN CTA Interchange Points - Canada, effective Dec. 11, 2007.



## THE QUESTIONS

The interswitching amendments of Bill C-30 raise many questions. Obvious ones include how the new limit for regulated interswitching of 160km was determined and how did the Government decide that this should apply in the three provinces specified to all commodities?<sup>12</sup> Nothing has been made available in the way of back up for these decisions. Also, how much additional traffic will now be subject to regulated interswitching?

But there are other, perhaps more difficult, questions as well.

First there is the sunset clause. This appears to reflect the Government acknowledging the large uncertainty around the impact of the announced changes to regulated interswitching.<sup>13</sup> At the same time, it also appears to fit in with the plan to accelerate the upcoming CTA review. The date for the repeal of the temporary provisions of Bill C-30 is August 1, 2016. By commencing the CTA review this year, the Government will have in hand the panel's report and recommendations, and can decide how to respond while the Bill C-30 provisions to amend the CTA are still in force. Reinforcing this is the Government's announcement that it will accelerate the CTA review "...with a view to further improving Canada's grain handling system over the long term in order to achieve improved capacity, predictability, planning and accountability for all parties in the supply chain."<sup>14</sup> Consideration of the grain handling and transportation system will, it appears, be part of the mandate given to the new panel. Other issues that could be part of the mandate include the grain revenue cap and, more broadly, the capacity of Canada's export commodity logistics chains and how to incent investment in that capacity.<sup>15</sup>

Second, there is the matter of the time that it will take to amend the interswitching regulations which, unless it can be expedited, will probably be years in this case. The normal procedural steps include: development of a regulatory proposal (in this case by the Agency); central agency review (by Privy Council Office, Treasury Board Secretariat, Department of Justice); pre-publication; making or approval; registration; coming into force; publication; distribution; parliamentary scrutiny.<sup>16</sup> However, in order to even draft the regulatory proposal the Agency will have to first undertake complex, time consuming and potentially controversial studies, including the necessary costing studies which have not been done before, to establish the required additional interswitching zones and associated cost-based interswitching rates.

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<sup>12</sup> The 160 km limit and the provinces specified would appear to have been determined by considering the location of Prairie grain elevators. See Standing Committee on Agriculture and Agri-Food, *Evidence Number 20*, op. cit.

<sup>13</sup> Financial Post, *Grain Drain Why Ottawa wants U.S. railways to take our grain south* (April 5, 2014), p. FP3.

<sup>14</sup> Government of Canada, *Harper Government Introduces Legislation to Address Rail Capacity Challenges*, op. cit.

<sup>15</sup> Standing Committee on Agriculture and Agri-Food, *Evidence Number 20*, op. cit.

<sup>16</sup> Privy Council Office, *Guide to Making Federal Acts and Regulations: Part 3 - Making Regulations*, available at < <http://www.pco-bcp.gc.ca/index.asp?lang=eng&page=information&sub=publications&doc=legislation/part3-eng.htm> >.

There is also the question of the impact of the changes to regulated interswitching, on the rail sector, including shortlines, and shippers generally, and on how much the proposed changes will contribute more specifically to speeding up grain movement and clearing the backlog. As regards the movement of grain itself, it is not at all clear that the proposed changes to interswitching will contribute much to alleviating the backlog. First, CN and CP are both experiencing capacity issues in moving the 2013 harvest. It is not as if one railway has excess capacity while the other does not. Second, similar problems are being experienced with rail service in the U.S., limiting the possibilities of re-routing traffic south. In the U.S., this is affecting agricultural, coal and other traffic along the northern tier to the point where the Surface Transportation Board has expressed its concerns to CP and BNSF, and scheduled public hearings for April 10, 2014 to allow interested persons to report on the status of rail service.<sup>17</sup>

A fundamental question also concerns the impact on the Canadian rail sector and shippers of significantly enlarging the traffic base exposed to fixed regulated rates determined on the basis of average costs. Here, we quote for consideration the conclusion of the *Canada Transportation Act Review Panel* in 2001 on the matter of expanded interswitching limits:

“In the Panel’s view, expanding the interswitching limits would worsen the market-distorting aspects of the interswitching rate regime and would be a step backward. The proposal ignores market conditions and the averaging effects of a fixed rate — all shippers pay the same rate, regardless of their circumstances. Although interswitching rates have long been a feature of the regulatory landscape, the Panel sees them partly as an anomaly, representing a trade-off between regulation and the market. On the other hand, they induce an element of competition between connecting railways. The Panel is not convinced that upsetting this balance in favour of further regulation would serve the interests of shippers or Canada.

Government should be involved in regulating commercial relationships only when one party is abusing monopoly power. Proposals to extend the interswitching limit assume that railways are behaving in this manner. No evidence before the Panel suggests this kind of market power exists in every circumstance where expanded interswitching would be available. In any event, the Act already allows the Agency to deem that the origin or destination of traffic is within 30 kilometres of an interchange, if it believes, in the circumstances, that the origin or destination is reasonably close to the interchange. This, along with other existing and proposed measures, would deal more adequately with the potential abuse of market power.”<sup>18</sup>

Finally, there is the question of what implications, if any, the proposed changes to regulated interswitching hold for the other CTA “shipper protection” provisions. This needs serious consideration. The various rail access and other shipper protection provisions do not exist in isolation. The CTA contains a set of provisions that together are intended to provide shippers with appropriately greater leverage in a freight rail industry characterized by two dominant carriers. It

<sup>17</sup> Surface Transportation Board Decision Document, *United States Rail Service Issues*, Docket Number EP\_724\_0 at <  
[http://www.stb.dot.gov/decisions/ReadingRoom.nsf/51d7c65c6f78e79385256541007f0580/646eb423d1b5c90585257cad0066f109?OpenDocument#\\_ftn1](http://www.stb.dot.gov/decisions/ReadingRoom.nsf/51d7c65c6f78e79385256541007f0580/646eb423d1b5c90585257cad0066f109?OpenDocument#_ftn1)>.

<sup>18</sup> *Canada Transportation Act Review Panel, Vision and Balance* (June 2001), pp. 63-64.





is important to recognize that individual provisions, including regulated interswitching, function within a matrix of provisions that aim to strike and maintain a proper competitive balance. A critical part of this consideration is the need to ensure adequate railway industry capital expenditure sustainability.