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EP 711 (Sub-No. 1)

Written Comments of Canadian Pacific (CP), EP 711 – Reciprocal Switching

Dear Ms. Brown,

CP hereby submits written comments in this proceeding, which I intend to present during the March 15-16 hearings. I hope that these comments will be informative and useful to the Board in its deliberations on this important matter.

Overview of CP's Position

Canadian Pacific believes that robust competition between the railroads has been a key force in the remarkable renaissance of the North American rail transportation industry over the last four decades. This competitive environment stems in large part from the deregulation in the 1980s. Deregulation enabled railroads to compete vigorously on price and service with each other, and with other modes of transportation. Because of deregulation, railroads have been able to rationalize our systems, reinvest in our networks, increase safety, productivity, efficiency and reliability, add new innovative service offerings and maintain low rates—all to the benefit of our shippers, employees, and the larger economy. This competitive environment is also the result of developments and innovations in other transportation modes and the reality that many shippers, even some shippers who are served by only one railroad, have other transportation options.

CP understands that some amount of regulation is an important component of the North American railroad landscape. As the custodians of the regulatory environment, the Board must continually balance the tension between promoting natural competition and protecting against abuses of market power.

The US and Canadian regulators share these broad objectives, but they have chosen somewhat different paths to achieve them. CP is in a position where it has experience under both the US and Canadian regulatory regimes. Happily, we have found that is possible to compete, invest and grow under both

approaches. We have learned that, while market regulations are a blunt and imperfect tool, they are an important part of the landscape. However, every regulatory tool comes with attendant costs and unintended consequences.

CP believes that the regulation that is successful at achieving its aims of improving on market outcomes is that which is structured to ensure that undesirable consequences are avoided or significantly and demonstrably outweighed by concrete regulatory benefits. This is a difficult proposition. Even after years of experience it may be difficult to say absolutely that a given regulation has had the intended impact. It is that much more difficult to judge when considering the adoption of a new regulation.

If the Board were to consider moving to a more regulated switching environment in the United States, we urge the Board to weigh carefully, and guard against, the potential consequences of a regulated switching program which could have unintended consequences of making railroads less competitive on an intramodal and intermodal basis.

CP hopes that some of our observations and learnings over many years under Canadian interswitching will be instructive to the Board. CP would like to leave the Board with three lessons from Canada's 100+ years during which there has been a statutory mandate to provide regulated Interswitching:

1. Interswitching has shaped the evolution of Canada's rail network over the last century. Shippers and railroads have had time to adapt as the industry has grown up with interswitching. It would not be possible to predict the effect of new interswitching regulations in the United States by looking to the Canadian experience.
2. Interswitching in Canada is not widely used by shippers as a rate remedy. Interswitching was not implemented as a method to reduce freight rates, but rather as a method to physically shape Canada's railway network. Only a tiny fraction of Canadian interswitching actually takes place under mandatory interswitching orders. The vast majority is simply required in order to complete the movement.
3. As with any regulatory intervention, in addition to any social benefits, there are real costs associated with interswitching.

Interswitching Has Shaped Canada's Railroad Industry

Interswitching regulations have existed in Canada for over one hundred years. The regulation allows any person to make an application for an interswitching order from, or to, any rail facility that is within 30km of an interchange.

Interswitching is part of the fabric of railroading in Canada. This has been a process of evolution, beginning during the infancy of the industry. Decisions made by shippers, railroads and regulators have been influenced by the regulations, and the cumulative impact has compounded over the decades. For example, the existence of an interswitching regime was likely an important consideration in the decision of the Government of Canada to allow CN to assume operations of the entire North Shore of the Port of Vancouver from the Port Authority in 1953. That decision has had far-ranging implications for Canada's transportation market in the years since.

Indeed, the interswitching regulation has had a profound impact on the entire Canadian rail market over the last 118 years. Over this time the regulation has influenced decisions of railroads and shippers alike in locating and expanding their facilities. For example, CP estimates that 88%¹ of all customer shipping origins on CP's network are currently sole-served by one railroad – namely CP. CP believes that there would be far fewer sole-served shippers but for the interswitching regulation. Many of these shippers rely on interswitching between CP, CN and other railroads in order to reach their customers.

Not only has the interswitching regulation shaped the physical structure of Canada's railroads, it has also influenced how we operate. Interswitching adds complexity into an already complex system. Canada's railroads have developed intricate interswitching agreements and operating protocols over the years, in order to manage this complexity and reduce congestion. These agreements involve significant operational re-alignments and sharing of assets in many cases. For example:

Vancouver Co-Production: CN and CP have an agreement in the Vancouver Port terminal area, whereby unit-trains are handed off outside the edge of the terminal boundary. The receiving road will then operate the train as if it were its own, using its own crew and track, to the destination. This significantly reduces congestion within the terminal area, and avoids over filling the interchanges which were not designed to handle that level of volume.

Thunder Bay Agreement: The Thunder Bay port area on Lake Superior is another significant rail export destination. In this area CP and CN have agreed to handle their own interchange traffic to destination for designated grain terminals. For example, when CP has traffic terminating at a designated CN-served terminal, it will run the traffic using its own power and crew to the destination over CN track where required. This significantly improves the efficiency and throughput in this busy terminal area, and avoids extra delays of cars waiting to be picked up at the interchange.

Interchange Consolidation Agreements: In other regions CP and CN have agreed to alter our operating protocols in order to rationalize operations. With these agreements we are able to operate the most efficient and expedient routes. We avoid physically using legacy interchange locations that have become outmoded because they cannot be expanded, or which no longer align well with modern operations. But even though we do not use the inefficient interchange locations, we continue to recognize and protect our customers' right to interswitching based on their proximity to those locations. With these agreement our customers' traffic is delivered to its final destination quickly and cost effectively.

¹ Estimate excludes intermodal traffic. Estimate based on shippers that moved >2000 carloads in 2021, representing 95% of CP's total Canadian carload traffic.

It has taken time for the railroads to learn what works and what doesn't, and to learn how to cooperate along some dimensions of interswitching while simultaneously competing with each other in the wider market.

We would encourage the Board to consider the full history of Canadian interswitching, in all of its complexity. The Canadian railroad network has been broadly shaped by the regulations over nearly 120 years. Canadian railroads and shippers have had time to adapt their interswitching practices as the market has evolved.

This history does not exist in the United States railroad market. It will not be possible replicate today's Canadian interswitching environment in the US by implementing a broad regulatory interswitching program. Indeed, if the Board does decide to propose a new regulation, it should be specific to situations where a market failure has been observed, and where interswitching would clearly address the problem.

Regulated Interswitching Is the Exception, Not the Rule

While it is true that the vast majority of interswitching activity in Canada does occur at CTA designated interchange locations, very little of this activity is the result of a mandatory interswitching order. Interswitching activity is only truly Regulated (with a capital "R") when it results from a shipper making a request for an interswitching order, and the Agency granting the order. Despite the long history of Interswitching under the governing statutory framework in Canada, such applications are very rare.

The Canadian Transportation Agency has heard only six² such applications since 2010. In that time, the Agency has only granted one interswitching order to a shipper originating on CP's network. While we cannot publicly disclose volumes moving under this order, it is safe to say that there is very little interswitching activity that is the result of a direct Agency intervention in response to a shipper's request. In practice, the vast majority of interswitching activity in Canada occurs with no direct involvement of the Agency.

CP and CN interchange thousands of carloads each year. In 2021, for example, CP and CN billed each other for approximately 355 thousand carloads³ at the prescribed CTA interswitching rate. Much of this

² i) CTA CONF-18-2018: Richardson Intl. at Lamont and Westmor AB, CN ordered to interchange at Scotford AB and Clover Bar AB. (Upheld on review CTA 62-R-2021)

ii) CTA CONF-15-2018: Paterson Global Foods Inc. at Morris AB, CN ordered to interchange at Emerson MB.

iii) CTA CONF-11-2016: Emerson Milling Inc. at four locations in Manitoba, CN ordered to interchange traffic at Emerson MB.

iv) CTA CONF-4-2016: Richardson Intl. at Mollard (Brunkild) MB, CN ordered to interchange traffic at Winnipeg MB.

v) CTA 466-R-2013: Richardson Intl. at Red River South, CN ordered to interchange traffic at Emerson MB.

vi) CTA 165-R-2013: Parrish & Heimbecker Ltd. At Milk River AB, CP ordered to interchange traffic at Coutts AB.

³ Includes carloads moving under the Thunder Bay trackage-rights arrangement. Excludes traffic switched at non-CTA rates.

interswitching is simply required as a practical matter. As noted above, most CP shippers only have access to a single railroad at origin. Many of these shippers would simply be unable to reach their intended destination without passing through an interchange.

Such interswitching activity is not a result of immediate market forces, or a shipper's concerns with respect to freight rates. Rather, it might be thought of as "structural" interswitching. That is, the Canadian railroad network is structured such that this activity is required. Structural interswitching would likely continue to occur even if the Canadian interswitching regulations were abolished today.

Since there are very few shipper requests for interswitching, it seems that most shippers are not using interswitching as a means to secure lower rates. This strongly implies that shippers are generally satisfied with their service levels and rates. The fact that no shipper has yet filed for a Long Haul Interswitching order in the more than three years since this tool was made available is also compelling.

Interswitching in Canada is rarely used by shippers as a rate remedy. The Canadian experience does little to inform us about the usage case for reciprocal switching as a shipper remedy in the United States.

The Cost of Regulated Interswitching: Traffic-flow Blindness

As with all regulations, in addition to any social benefits conferred by regulated interswitching, there are also attendant costs. Some of these costs can be measured in terms of dollars and hours – we will touch on those a little later. Other costs are less quantifiable, but no less real.

One such cost is caused by a loss in the quality of information available to the railroad regarding the traffic that it is expected to move. All interswitching traffic must be exchanged between the rail networks of at least two independent rail companies. Despite the continual communication between operating employees at CP and CN, we are still two independent companies managing otherwise independent operations. CP does not have direct visibility into the transportation pipelines of CN and other Class-I carriers. As a result, CP has significantly less information about traffic that is received from CN than we do about traffic that originates on our own network. For example, CP cannot see the traffic that CN is originating today, which CP will receive at an interchange tomorrow. This problem of "traffic-flow blindness" essentially means that CP does not have visibility or control over a major portion of the movement of the traffic that it handles via interchange.

When traffic patterns are stable and predictable, this is not a big problem. During such times, railroads are able to predict the volumes and types of traffic that will meet them at the interchange each day. But when traffic patterns change abruptly traffic-flow blindness can become a problem. For example, traffic-flow blindness can exacerbate problems during times of network congestion.

This was the case during an episode of extreme congestion in the Port of Vancouver terminal area in 2018. The problem was serious enough that the Agency conducted an own-motion investigation in early

2019⁴. The problem of congestion was exacerbated by the fact that more than one railroad was feeding traffic into the same interchange facilities as well as directly into some customer facilities. Once these facilities became congested, any further interchange traffic would stack up in local yards or on the mainline, causing congestion there as well.

In order to reduce the congestion both CP and CN issued selective embargoes to prevent traffic flowing into congested interchanges. In one case, CP embargoed a specific customer facility, at the customer's request, in order to reduce congestion there. That facility receives traffic from both CP as well as CN via interchange.

Traffic-flow blindness exacerbated the congestion in this case. Where CP has full visibility of the traffic pipeline, it can work with customers to pace traffic or re-route it at origin when there is congestion at the destination. This is not possible when CP does not have a view of both the origin and destination, as at an interchange facility. In that case, CP cannot react to the congestion until it is already a problem. Once we see that an interchange or customer facility is badly congested we can issue an embargo to help clear the congestion. But by that time the interchanges and local yards will already be badly congested with traffic that cannot move to destination.

It may be said that interswitching regulations have resulted in a transportation network that is somewhat more fragile. It creates more complexity, and reduces the amount of information available to the stakeholders in the system. Interswitching in Canada works fairly well most of the time. But the extra complexity combined with the traffic-flow blindness inherent in interswitching can exacerbate other network fluidity problems.

The Cost of Regulated Interswitching: Operational Inefficiency

No matter how well an interswitched movement is executed, interswitching will introduce some inefficiency. At a minimum, two extra train assignments are required in order to complete the movement. There is also some natural latency as the receiving carrier is notified of the arrival of interchange traffic, and plans an assignment to dispatch it. This reveals itself as extra dwell time of rail cars at the interchange.

Interswitching also creates a not-insignificant overhead cost for the railroads. CP and CN operations staff are in near constant communication in order to manage traffic flows through the numerous interchanges across their networks. Management staff must maintain the interchange agreements, reconcile inter-company billing, issue and pay invoices, and manage the related accounting. Executives must negotiate changes to agreements, and factor the interswitching operations into general decision making. It is impossible to say exactly what all of this costs CP each year, but it is certainly fair to say that interswitching consumes a significant amount of resources.

⁴ CTA discussion and findings can be found in CTA determination CONF-9-2019: <https://otc-cta.gc.ca/node/568575>

Fortunately, the Canadian regulatory framework has been flexible enough to accommodate consensual and reciprocal arrangements among the railways to facilitate shipper access while minimizing operational disruption. In general, our Canadian regulators have allowed the industry to develop creative solutions in order to minimize the delays and congestion caused by interswitching, while preserving shipper rights.

We urge the Board to consider and protect the ability of all market actors to respond to market forces by applying ingenuity and creativity as markets evolve, under whatever regulatory changes the Board might propose today and in the future.

In CP's experience any regulatory program comes with attendant costs. CP would respectfully remind the Board to consider the intrinsic costs inherent in interswitching. This includes the obvious costs such as increased dwell and cycle times. It also includes less tangible costs such as the effort in managing interswitching activity.

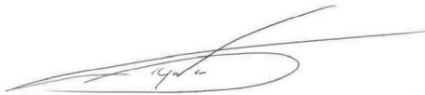
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CP will continue to compete vigorously by providing exceptional service and value to our customers, no matter how the regulatory environment evolves. But we urge the Board to consider carefully not only the anticipated benefits, but also the potential costs and consequences of any rule changes. We hope that our input will assist the Board to do this, and we hope that our experience illustrates that the Canadian rail industry is in a very different place as regards the ongoing impact of interswitching after more than one hundred years of experience with this regulation.

Whatever determination the Board makes in this proceeding, it should seek to balance the key objective of promoting open and fair competition with the objective of ensuring reasonable rates for "market dominant" traffic. Within the space of interswitching, especially, it would be all too easy to unintentionally pick winners and losers, rather than promote the fair competition that has been the key to the ongoing railway renaissance.

We urge the Board to move carefully.

Yours truly,



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