<u>Coalition for the Factual Analysis of International Rail Rates</u>

Rail Rates in Canada:
A Response to the 2023 CPCS Report

The Coalition has engaged several rail experts in the areas of finance, economics, costing, markets, operations, regulation and policy to respond to a *2023 CPCS Report* [link here] from which certain misleading or false conclusions are drawn by the Railway Association of Canada (RAC) and others.

<u>Gist of Response</u>: In short, both the CPCS Report and the conclusions others reach about that report are incorrect, misleading or incomplete. On this and many past occasions, the RAC has claimed that Canadian freight railways "[o]ffer the lowest rail freight rates among leading trading nations, rates 11% lower than the U.S, showing the robust competition that exists between Canadian railways". The shippers represented by the Coalition know this is incorrect. The Coalition's Response amply demonstrates that the CPCS Report:

- does not support claims that "Canada's rail freight rates are amongst [the] world's lowest"
- attempts to compare rail freight rates between countries whose rail systems are not comparable
- even when comparing Canadian and US rail systems, omits critical differences between them
- fails to account for the financial gains of CN and CPKC at the expense of rail shippers in Canada

<u>Lack of Competition</u>: The fact is that CN and CPKC, on whom rail freight shippers in Canada rely to transport their domestic and export shipments, face very little competition in respect of the majority of traffic on their individual networks. This dual monopoly results in rail shippers paying excessive rates and receiving inadequate service. Producers of mineral, agricultural, forest, energy and other products seek to establish or maintain positions in global markets as price takers while enduring monopolized rail freight rates and services.

<u>Critical Analysis of CPCS Report</u>: A common method of comparing rates between shipments is to measure the revenue earned to move one unit of weight over one unit of distance; for example, cents per revenue-ton mile (or CRTM). CRTMs are not the same as rates. CRTM comparisons are only meaningful for shipments with similar characteristics. The CPCS Report uses the CRTM metric incorrectly and makes several common but critical errors by ignoring those characteristics, which skew individual and aggregated CRTM values, including the following:

- <u>Haul Distance</u>: Holding all other variables constant, average CRTMs are generally lower for long hauls compared to shorter hauls. CPCS makes the common mistake of comparing countries with expansive geographies and long hauls like Canada to countries with small geographies and short hauls. By virtue of geography alone, CN and CPKC should (and indeed do) have lower average costs per RTM. Thus, the CPCS Report solves for distance, not rates.
- <u>Traffic Mix</u>: CN and CPKC move a relatively high proportion of bulk commodities that result in lower CRTMs when compared to railways with a high proportion of manufactured goods resulting in higher CRTMs. It would be challenging enough to compare CRTMs between railways with different traffic mixes in the same country but doing so across jurisdictions is even less informative about comparable rates. The CPCS Report neglects this issue altogether.
- <u>Operating Parameters</u>: Canadian railways benefit from the efficiency of unit trains, longer and heavier mixed trains and higher-capacity railcars, higher clearance, and other developments that result in lower costs for CN and CP. It would be alarming if those lower costs did not result in lower average freight rates and thus lower CRTMs than in jurisdictions where similar measures have not been or cannot be implemented. However, greater railway efficiency does not necessarily result in greater efficiency for shippers, and despite the resulting reduction in rail costs to CN and CP, rail rates they charge shippers in Canada invariably go up, outpacing inflation, as CN and CP regularly announce. Efficiency-enhancing developments are not resulting in lower rail freight rates for captive shippers because those shippers do not benefit from the effects of competitive markets that would compel CN and CP to pass efficiency gains to their customers, as with any other competitive market.
- <u>Maximum Revenue Entitlement (MRE)</u>: The CPCS Report compares the CRTM received by CN and CPKC to transport exported western grain subject to the MRE, which makes up a minority of their traffic, to rates for <u>all</u> traffic in each other jurisdiction. This is a traffic mix error, made worse for three reasons: MRE traffic

(i) predominantly consists of bulk commodities transported (ii) in highly efficient trains (iii) over long distances. It is incorrect to compare MRE traffic to a mix of traffic with dissimilar characteristics. If CPCS had made a correct comparison to similar traffic, the CPCS Report would show that the MRE generates a higher average CRTM for comparable traffic on CN and CPKC.

- Other Flaws: The CPCS Report uses a single railway to represent the national total volumes and revenues for each of Spain, France, Germany and Italy, thereby inflating the CRTM values for these countries. In addition, Canadian rates and CRTMs appear lower than they would if CPCS had accounted for the difficult to quantify but very real costs and risks associated with onerous contract terms that CN and CPKC impose on captive Canadian shippers. Beyond that, the CPCS Report does not attempt to account for the impact of passenger trains, the extent of expansion or contraction of rail infrastructure, and the prevailing sub-competitive service levels experienced by Canadian shippers. Some of these factors are more easily measured than others, but the CPCS Report does not even acknowledge them as issues.

The result is an invalid comparison between rates charged under fundamentally different conditions for fundamentally different rail transportation services in each jurisdiction compared.

Competitiveness of Rail Freight Rates in Canada: The RAC purports to rely on the CPCS Report to draw misleading conclusions about the competitiveness of rail freight rates in Canada. Two significant themes demonstrate the position of shippers and railways in Canada:

- Shipper Captivity: The CPCS Report does not pretend to analyze the extent to which shippers in Canada or any other jurisdiction have access to alternative, effective, adequate and competitive means of shipping freight at origin or destination. Where there is no effective competition, rail rates increase relative to rail costs, which reduces the profitability of the shipper's product. That results in reduced production relative to what would be produced in a competitive market, which damages shippers and the Canadian economy by limiting expansion and shipper investment.
- Return on Equity: The amount by which CN and CPKC have been earning more than their cost of equity capital is staggering. Between 2013 and 2022, CN and CPKC generated $53.8 billion of income in excess of what the Canadian Transportation Agency determined as necessary for their financial viability. If CN's and CPKC's rates were competitive, they would have earned nearer a normal return on capital. On its own, this metric demonstrates their significant market power over shippers in Canada.

By failing to address these important matters, the CPCS Report misleads readers and allows no useful conclusions whatsoever.