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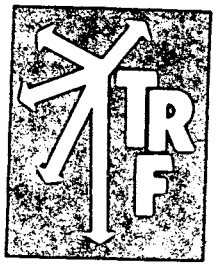

TRANSPORTATION RESEARCH FORUM
In conjunction with

The Demonstration Effect of U.S. Rail Deregulation—Prospects for Rail Deregulation in Canada

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1. INTRODUCTION

In the five years since the passage of the Staggers Rail Act, there have been many dramatic changes to the commercial environment in which U.S. railroads operate. Because of the historically integrated nature of rail traffic between the U.S. and Canada, American rail deregulation has had significant impacts both on transborder rail traffic and potential impacts on Canadian rail regulation.

Revenues accruing to the Canadian railroads from transborder rail traffic amount to about 27% of total Canadian railway revenue. Southbound traffic clearly dominates with about $4 accruing from southbound traffic for every $1 of northbound traffic.[1] While precise tonnage data are not available, it has been estimated that 13 major commodities representing 80% of the value of goods exported to the U.S. by rail totalled 25.5 millions tons in 1980. Of these 13 commodities, four major commodities (potash, lumber, newsprint and woodpulp) accounted for 73%.[2]

The maintenance and enhancement of the free flow of transborder rail traffic is an important element in Canada/U.S. trade. Until the Staggers Act, railroads in Canada and the U.S. were able to operate as if there were no border and were able to conform with the regulatory requirements of both countries without creating any conflicts.

The Staggers Act changed the traditional way in which Canadian shippers and carriers approached transborder rail traffic. The purpose of this paper is to trace the evolution of the impact of the Staggers Act on the Canadian rail regulatory environment. It is argued that the evolution has proceeded in three phases: conflict, accommodation and convergence. The net effect of the Staggers Act is that it has had a demonstration effect on Canadian rail regulation which is likely to lead to at least a portion of Canadian rail regulation paralleling the existing U.S. regime.

II. CONFLICT

Following the passage of the Staggers Act, conflicts arose between the deregulated American rail system and the more regulated Canadian system. These conflicts centered around four areas: first, Canadian collective pricing behaviour versus American independent pricing; second, Canadian rate filing requirements in a "transparent" market versus reduced American filing requirements in a "translucent" market; third, Canadian statutory prohibitions against rebating versus U.S. statutory permission to rebate; and finally, a Canadian statutory exemption for railways from anti-trust law versus increased exposure of American railways to anti-trust law.

These conflicts made it impossible for Canadian railroads to comply with parts of or take advantage of some opportunities afforded by Canadian law without contravening U.S. law. It was equally difficult for Canadian railroads to take advantage of U.S. provisions to compete with U.S. carriers. Canadian railroads attempted to have U.S. legislation changed and regulation implemented whereby the Canadian railroads' uniqueness was recognized and would be allowed to coexist along with a deregulated U.S. system insofar as transborder traffic was concerned.[3] Efforts to persuade Congress and the ICC were not successful and Canadian railroads remain on an equal footing with U.S. carriers within the jurisdiction of U.S. law and ICC regulation.

Canadian shippers were originally reluctant to enter into confidential contracts with U.S. carriers on transborder traffic. Part of this reluctance stemmed from the fact that such contracts were an unknown quantity and partly from the view that the contract provision would be used primarily by smaller railroads to attract traffic and that those railroads would shortly be bankrupt. As will be discussed below, this reluctance was short-lived.

As the impacts of the Staggers Act began to be felt in the U.S., the Canadian federal government, spurred by a renewed interest in a more competitive and less regulated economy, undertook a review of railway collective pricing. This review included a consultative phase involving both shippers and carriers. As the review progressed, it became evident that a number of Canadian shippers whose success depended on actively competing in the U.S. market began both to identify and experience some of the benefits of U.S. rail deregulation—not only confidential contracts, but a more flexible and responsive attitude on the part of American railroads. It became clear that if Canadian firms were to compete effectively in U.S. markets, they would need access to the same tools as their U.S. and offshore competitors had.

By mid-1983, the full extent of the conflict between Canadian and American railway regulation was understood by carriers, shippers and the federal government. In July 1983, the Minister of Transport

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requested that the Canadian Transport Commission inquire into and report on the impact of U.S. rail deregulation on Canadian railways and shippers. This action set into motion a process which would lead to a widely accepted framework for accommodating U.S. rail deregulation in the Canadian system.

III. ACCOMMODATION

The CTC Inquiry took place over a period of about 18 months and consisted of four phases. The first phase was the preparation of a staff report during the period July 1983 to April 1984. The second phase was the reaction to the staff report from April to August of 1984. The third phase consisted of the public hearings in September and October of 1984. The final phase followed the Report of the Inquiry in December 1984.

The Staff Report included consultations with shippers and carriers on the impact of U.S. rail deregulation in Canada. Its conclusion that no changes to Canadian law were necessary or desirable was generally considered inadequate by shippers and carriers alike. The report also failed to recognize the view that significant policy and regulatory shifts were necessary to remove the disadvantages which both Canadian carriers and shippers faced in U.S markets.

In light of the response to the Staff Report, the CTC decided that public hearings should be held. Hearings were held in six cities in September and October of 1984. At the hearings, it was widely accepted that traditional rate relationships on transborder rail traffic had been affected by the Staggers Act. Confidential contracts between railways and shippers were advocated (although the railways alone argued that each railway should have access to the other's contracts). it was also argued that railways should have the authority to cancel routes and surcharge transborder traffic; however, the extent to which their actions should be subject to regulatory appeal was not unanimous.

In general, the thrust of the Submissions at the Hearings was to change Canadian law so that rail regulation pertaining to transborder traffic move closely parallels U.S. law. The findings of the inquiry reflected this thrust. They were:

1. The Staggers Rail Act of 1980 has affected traditional rate relationships concerning international rail traffic;
2. Insofar as circumstances in the U.S. dictate, confidential contracts should be permitted on the Canadian portion of the movement of rail freight traffic between Canada and the United States;
3. Canadian railways should not be privy to each other's contracts;
4. Confidential contracts entered into by Canadian railways on international traffic should be filed with the CTC and the Commission should publish summaries of filed contracts;
5. Canadian railways should be allowed to continue to cancel tariff routings for international traffic, but not without shipper recourse to Section 23 of the National Transportation Act;
6. Section 23 should continue to apply in all situations covered by published rates and consideration should be given to maintaining Section 23 with adequate discovery provisions, perhaps by regulation, to cover possible problem areas in confidential contracting;
7. U.S. to U.S. via Canada traffic should no longer be subject to tariff regulation under the Railway Act;
8. Where railways and shippers agree to limit liability they should not require approval to do so, but such agreements should be filed with the Commission.[4]

The CTC also reflected the views of shippers and other parties that deregulation should not be limited to transborder traffic but extended to rail traffic originating and terminating in Canada. The Final Report recommended that the Minister ask the CTC to undertake a separate investigation of the advisability of extending the recommendations regarding transborder traffic to all rail traffic in Canada and the more general question of the advisability of introducing more intra-rail competition in Canada.

Thus, by early 1985, there was a widely accepted consensus that Canadian law should and could be changed to accommodate a deregulated rail sector in the U.S. There was also an emerging view, held largely by shippers with some experience in the deregulated American rail milieu, that there were many features of U.S. rail deregulation which could beneficially be adopted in Canada. This convergence phase was addressed by many shippers, carriers and other parties at CTC Hearings held in the Spring of 1985 concerning the extension of the CTC's recommendations on transborder traffic to all Canadian rail traffic.

IV. CONVERGENCE

In February 1985, the Canadian Minister of Transport, the Honorable Donald Mazankowski, in a speech to the Canadian Industrial Traffic League announced an overall review of transportation policy and followed up on the CTC recommendation to hold an inquiry on domestic rail deregulation by requesting the CTC to do so.[5] The Minister further indicated that he planned to have proposals ready for public review by July 1985.

In March 1985, the CTC announced that it would be holding public hearings on whether its recommendations on transborder rail traffic should be extended to all Canadian rail traffic. It also proposed to deal with the question of extending intra-rail competition by running rights extensions and by no longer allowing collective rate making.

The hearings attracted over eighty participants including rail carriers, shippers and their associations, ports, boards of trade, provincial governments and the academic community. There was strong support from shippers, their associations and from some provincial governments for a deregulated and more competitive rail sector which would include many of the rate reforms now in place in the U.S. This pro-competitive stance was tempered with the observations that many shippers in Canada were captive to rail transportation and that in many cases, since there are two major railroads in the country, to only one railroad.

There was concern expressed that in a deregulated environment where independent instead of collective

pricing was the norm, shippers would be faced with a pricing system based on conscious parallelism. In this case, independent pricing would exist only in legislation and not in the marketplace. Views were mixed on whether this problem could be solved by increased selective regulation or by creating competitive power and rolling stock over existing rail lines for a running rights charge.

CP Rail and CN Rail, while supportive of the changes recommended on transborder traffic, were opposed to extending U.S. style deregulation to Canada. Their view was that the impact would be reduced revenues for them without the ability to reduce costs by way of plant rationalization. As expressed in the Submission of CP Rail, "it would be unfortunate for all if 'price regulation' were not accompanied by 'cost deregulation'."[6] The railways also pointed out that a major goal of U.S. rail deregulation was railroad revenue adequacy. By "importing" deregulation, they argued, Canadian railroads would quickly become "revenue inadequate"—thus arriving at the point where U.S. deregulation began.

At the conclusion of the Inquiry, the CTC was left with several conflicting directions from which they could establish an agenda for rail regulatory reform. From most shippers (primarily transborder shippers with exposure to the impact of U.S. deregulation), the message was to remove existing barriers to intramodal rail competition. Those shippers and their associations which advocated this move argued that Canadian railways were well managed and had proven themselves capable of competing effectively against other modes. Therefore, under a competitive regime in which rail costs were treated in a similar manner to all other costs of marketing, shippers would benefit not only from lower rates but from a more competitive attitude and railways would benefit since incentives to be more efficient should lead to greater profits.

While many shippers wished to move in this direction, two concerns were raised. The first, an issue familiar to persons involved in American rail deregulation, is the captive shipper question. Many shippers in Canada are captive to one railroad (particularly in the four Atlantic provinces where CN Rail dominates). Shippers who are captive to a single rail carrier will derive no benefits from competition between railroads. The second concern, unique to Canada, is that there are only two major railroads. If collective pricing were prohibited, there were fears expressed that instead of competitive pricing, pricing based on conscious parallelism would emerge. In this case, even shippers who had access to both carriers would not automatically have access to independent pricing.

Solutions to these kinds of problems which were advanced at the Inquiry ranged from strengthening existing appeals provisions (including fixing a maximum rate for captive shippers) to new kinds of legislation which would provide for a competitive surrogate such as shippers having running rights over existing rail lines.

While the railroads advanced the status quo with changes to transborder regulation as providing an optimum solution to both shippers and carriers, they also hedged a bit in identifying the trade-offs between the prohibition of collective pricing and the removal of certain obligations which the railroads are now required to perform by statute.

The convergence of American and Canadian rail regulation is likely to be seen first on transborder traffic. This direction is accepted by shippers, carriers and the CTC and reflects the importance in Canada of enhancing the free flow of transborder trade. The convergence of domestic Canadian traffic with the U.S. regime is a strong possibility. The major push behind a more competitive rail sector in Canada is a more competitive world economy in which Canadian shippers will be competing domestically with imported goods and Canadian exporters will be competing aggressively in offshore markets. For many Canadian exporters competitive access to offshore markets is crucial.

V. CONCLUSION

The dramatic changes which rail deregulation have caused in the U.S. have set the stage for similar changes for rail traffic moving between Canada and the U.S. The heightened competition in the rail sector has been welcomed by Canadian shippers with principle markets in the U.S. Other shippers with principle markets in Canada or offshore have had the advantage of a demonstration project on deregulation and for the most part find it sufficiently attractive that they support the extension of U.S. style rail deregulation to Canada. Other shippers, ports and some provincial governments have concerns about protection for shippers who are captive either to the rail mode or to a single carrier.

The prospects for rail deregulation in Canada are generally good. For transborder traffic, prospects are very good. For the balance of rail traffic the extent of rail deregulation will likely be determined by the extent to which the potential for monopolistic pricing can be balanced by regulatory mechanisms to protect certain classes of shippers and/or legislative mechanisms to substitute for or stimulate competition.

ENDNOTES

1. *Preliminary Report: Inquiry into Effects of U.S. Rail Deregulation,* Canadian Transport Commission, Ottawa, Ontario, April 1984, p. 17.
2. *ibid,* p. 45.
3. *Evidence of Canadian National Railway Company* part II, Public Inquiry Into the Effects of U.S Deregulation on Canadian Railways and Shippers, 24 September 1984, pp. 31–62.
4. *Final Report, Inquiry into Effects in Canada of U.S. Rail Deregulation,* Canadian Transport Commission, Ottawa, Ontario, December 1984, pp. 34–36.
5. Notes for an Address by the Honorable Don Mazankowski to the Canadian Industrial Traffic League, Westin Hotel, Ottawa, Ontario, February 21, 1985.
6. *Submission of Canadian Pacific Limited on Domestic and Import/Export Rail Traffic Regulation,* Vancouver, B.C., April 1985, p. 9.