

***Dual Railway / Shipper
Accountability for Poor Performance***

Prepared for: Rail Freight Service Review

March 2010



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1. Purpose of the Project

On May 30, 2007, the Government of Canada announced the introduction of a Bill, which contained improvements to the shipper protection provisions of the *Canada Transportation Act*. The announcement also indicated that the government would undertake a review of rail freight service.

The overall objectives of this review are to:

- Conduct a review of the rail-based logistics chain (including shippers, terminal operators, ports, and vessels), with a focus on service provided to Canadian shippers and customers by Canadian National Railways (CN) and Canadian Pacific Railway (CP) within Canada, including to and from ports and border crossings;
- Identify problems and issues with respect to railway service including those stemming from other elements of the logistics chain;
- For shippers located on shortlines and experiencing problems with rail service, examine the relationship between shortlines and the main line carriers to determine whether such problems are attributable to service, operating, or marketing practices of the main line carriers;
- Identify best practices and how these can be expanded to address service issues; and
- Make recommendations on how to address these problems and issues, including both commercial and, if necessary, regulatory solutions.

The review is being conducted in two stages. The first stage consists of quantitative and analytical work. In the second stage, draft recommendations are being developed by a Panel of three eminent persons based on the results of the analytical phase and any other relevant information that is available. The Panel will consult stakeholders on the draft recommendations and submit a final report to the Minister of Transport, Infrastructure and Communities.

On July 24, 2008 Transport Canada released the terms of reference for the quantitative and analytical stage of the rail freight service review. This report has been prepared in response to the requirements of the Request for Proposals (RFP) covering the assessment of dual railway and shipper accountability for poor performance. The objective of this report is to provide description of performance incentive and penalty programs in place in the Canadian rail freight logistics system today and to provide commentary on their effectiveness in ensuring reliable and consistent system performance.

2. General Approach

The description of the penalty and incentive programs in this report is based on QGI's independent review of publicly available CN and CP tariffs that contain each railway's performance related penalty and incentive provisions. It is acknowledged that CN and CP may have customer specific penalties and incentives tied to shipper and railway performance thresholds within individual confidential contracts. This information was not available to QGI and therefore this analysis is based solely on the information published in the railways' tariffs. QGI's assessment of the effectiveness of these programs is based on the experience and background of team members as well as discussions with selected system stakeholders. Key areas of investigation included:

- the types of penalty and incentive programs in place for CN and CP customers;
- the differences, if any, of such penalties and incentives by railway line of business;
- the differences, if any, in the types penalties or incentives or their specific provisions for CN and CP; and
- how penalty and incentive programs are administered by the railways.

The list of railway tariffs reviewed includes the following:

For CN:

- CN 9000 Optional Services - Carload
- CN 9001 Switching Services – Canada and United States
- CN 9002 Automotive Services
- CN 9004 Optional Unit Train Services
- CN 9008 Miscellaneous fees
- CN 9100 Optional Service Intermodal
- CN 6060 Extended Asset Use Charges Grain

For CP:

- Tariff 1 Basic Freight
- Tariff 2 Supplemental Services
- Tariff 3 Intermodal Supplemental Services
- Tariff 4 Trans-load Supplemental Services
- Tariff 5 Unit Train Services
- Tariff 6 Private Equipment On CP
- Tariff 9 Automotive Services
- Tariff 10 Miscellaneous Assessorial Charges
- CPRS 7000 Domestic Intermodal Rules
- CPRS 7800 Import Export Rules
- CPRS 4311 – Grain Products within Canada and Canada to the United States
- CPRS 4312 – Performance Penalties applicable on Movement of Grain from Western Canada

3. Overview

In recent years North American railways generally, and CN and CP specifically, have simplified and standardized the basic freight transportation offering to their customers. The railways have defined the specific service components a customer receives for the basic freight transportation charges (rates) they pay. Freight charges are published in either confidential contracts or public railway tariffs and reflect the applicable rates per unit of freight (railcar, ton, container) for each origin – destination combination served by the railway either directly or through joint movement with their railway partners and any conditions applicable to those rates.¹

Generally speaking CN and CP define their basic freight transportation service to include:

- the supply and placement of an empty railcar or container² at the shipper's location by the railway for loading within a prescribed loading time;³
- the pickup by the railway of a loaded railcar or container from the shipper's facility;
- the transporting of the loaded railcar or container from origin to destination (or railway interchange location) in accordance with the billing instructions received from the shipper;
- the delivery and placement of the loaded railcar or container at the receiver's facility for unloading within a prescribed unloading period; and
- the pickup of an empty railcar or container from the receiver's facility.

At the same time the railways have also defined the optional or supplementary services they offer their customers that are beyond this basic freight service and the applicable fees for each such service.⁴ Both CN and CP publish these optional services in publicly available tariffs. Also included in these publications are the penalties and incentives applicable to shippers, and in some instances the railways, related to each party's performance in a number of areas ranging from timely loading and unloading of railway owned equipment to meeting railway requirements for shipment documentation.

The railways have a number of objectives in defining their service offering in this way. First they are seeking to clearly identify their own as well as their customers' responsibilities with respect to shipping related activities. Secondly the railways want to ensure clarity with respect to what services they offer their customers and the costs for each ensuring that they are compensated for all services they provide to their customers.

The penalty and incentive structures developed by CN and CP are designed to reinforce and incent behaviour among their customers and transportation partners that encourage the efficient use of railway assets and to discourage

¹ Standard conditions associated with published freight rates include the minimum commodity weight, equipment type, currency of funds, and route.

² Depending on the specific service offering selected by the customer the basic freight rate may or may not include the delivery and pickup of containers by the railway at customer locations.

³ Allowable free time for loading and unloading activities is specifically defined in CN and CP's Extended Asset Use provisions contained in their respective optional / supplementary services tariffs.

⁴ While CN uses the term optional services and CP the term supplemental services they are also commonly referred to as ancillary or incidental services.

behaviour that contributes to the inefficient use of assets or that is unsafe. It is the railways' position that the efficient use of their assets whether railcars, locomotives or railway yards provides benefits to all railway customers by maximizing the available capacity in the system and directly impacting the level of service the railways can provide.

Shippers have expressed concerns in recent years that railways are effectively downloading their costs onto shippers through these optional service offerings and that penalties are unbalanced in favor of the railways and that the railways lack transparency and accountability in their administration of such programs. It is not the objective of this report to assess or comment on the appropriateness of these penalty provisions but rather to provide a description of the principal performance related penalties and incentives that are in place today and to comment on how such programs can be beneficial to ensuring reliable and consistent service.^{5 6}

⁵ A detailed discussion of issues related to ancillary service charges and balanced accountability between railways and shippers is contained in QGI's report prepared for the Rail Freight Service Review *Analysis of Operating Practices* October 2009.

⁶ In 2008 the Government of Canada amended the Canada Transportation Act adding a new section 120.1 which empowers the Agency upon receipt of a complaint by a shipper to investigate the terms and conditions for the movement of traffic and incidental services that are governed by open tariffs applying to more than one shipper.

4. Penalty and Incentive Provisions

4.1 Penalty Programs

CN and CP have each instituted fees to penalize shippers for performance that reduces the efficient use of railway assets or results in the railways incurring incremental costs. This section of the report will provide a description of the major types of penalties currently in place for CN and CP in four areas: shipment documentation, cancellation of customer orders for railcars and containers, delays in loading and unloading and safety of operations and condition of railway equipment.

4.1.1 Shipment Documentation

The movement of railway shipments - whether individual railcars, blocks of cars, Intermodal containers or unit trains of bulk commodities - requires the shipper to provide the railway with shipping instructions. These instructions are submitted by shippers in the form of Bill of Lading (BoL) documents that provide the necessary information about each shipment to allow the railway to move it to destination and complete the commercial transaction including pricing and invoicing.⁷ For some shipments such as trans-border or hazardous commodity shipments additional documentation is required.

CN and CP each require shippers to submit shipment instructions electronically either through the railways' Internet based EBusiness systems or through direct electronic data interchange (EDI).⁸ Since the early 1990s the railways have made significant investments in technology in all areas of their business including investing in infrastructure to efficiently manage commercial transactions with their customers. Key among these has been the automation of shipment documentation processing to eliminate the need to process paper documents. Automating these processes provided the railways with benefits in a number of areas: reduced administrative costs; elimination of data entry errors resulting from manual transcription of shipment information into railway systems; and reduced operational costs associated with unnecessary handling or misrouting of shipments resulting from such errors.

If a shipper fails to provide the railway with both accurate and complete BoL information for each shipment it results in the need for manual intervention by railway staff and can result in railcars being held in railway yards which in turn creates additional cost for the railways and can create delays for other traffic. To make shippers accountable for the inefficiencies that stem from failures in documentation processes, the railways have established penalties payable by

⁷ Key information elements required to be communicated include: railcar initial and number, shipper name and address, consignee name and address, origin, destination, route, commodity description, commodity weight.

⁸ CP does permit shippers to submit Bill of Lading information in a non-electronic format and there is a \$55 per car charge assessed to the shipper for CP personnel to enter this information into CP's systems.

shippers when incomplete or inaccurate billing information is provided. At a minimum CN will charge the shipper \$105 per rail car or container and CP will charge \$131 per railcar or container. For CN customers an additional fee of \$440 per railcar will apply if inaccurate or missing shipment information results in the railway having to stop the car enroute and place it in hold status pending correction of the shipment information.

4.1.2 Order Cancellations

The railways' carload and Intermodal customers order empty equipment for loading from CN and CP. The processes and rules that govern the ordering of railway supplied equipment differ by railway and by business line.⁹ CN and CP have implemented equipment ordering processes in order to obtain advance views of short term demand to facilitate operational planning. Railway car distribution and fleet managers use the order data submitted by shippers to plan the distribution of empty cars to shipper facilities.

There are operating costs to the railway of directing empty cars to a specific shipper location and subsequently having the shipper cancel the request. These include costs associated with train movement, terminal switching in the railway's classification yard, and switching of cars to and from the customer's siding. While the order processes and railway commitments regarding supply and rules regarding customer order cancellations differ for Merchandise, Grain, Intermodal and Bulk commodity shippers, they all have one thing in common – cancellation of orders outside the permitted windows defined by the railways results in penalties being levied by the railway.

Merchandise Shippers

CN and CP Merchandise shippers - including grain shippers using boxcars and excluding shippers served through assigned pools¹⁰ - order railcars through the railways' Internet based car ordering systems. Generally speaking customers place and confirm their orders with the railways by a defined cut-off date in the week prior to the week for which the railcars are required. Customers using CN's Guaranteed Car Order (GCO) program are provided with a guaranteed supply by day of week while CP does not guarantee the number of cars to be supplied either for a specific day or for the order week in total.

The railway cut-off dates – Wednesday for CN and Monday for CP – serve a dual purpose. First they establish the day and time by which customers must confirm their orders and second they establish the latest time that customers may reduce or cancel their orders without penalty. The railways will consider any of the following actions by a customer to constitute an order cancellation:

- Request by a shipper to reduce the number of cars to be delivered;

⁹ A more detailed discussion of railway car ordering and supply processes can be found in QGI's report prepared for the Rail Freight Service Review – *Railway Car Order and Car Supply Processes*, QGI Consulting March 2010.

¹⁰ Some railway customers in the Automotive and Merchandise business segments on both railways use specialized equipment where fleets are sized and placed in exclusive pools for the use of these individual customers and there is no on-going car order process.

- The inability of a shipper (loader) to accept an empty car for placement when offered by the railway and subsequently released empty by the order party; and
- The non use and release by the shipper of an empty car placed or constructively placed the railway.

Shippers that cancel orders after the railway defined cut-off time are subject to penalties from the railways. CN will apply a \$100 debit fee¹¹ and in cases where the car was actually placed or constructively placed will charge an additional \$150 switch fee per car. CP charges its customers a switch fee ranging from \$457 - \$527 per car depending on the location.

CN provides its GCO program shippers with some degree of reciprocity in the event that it fails to meet its commitment with respect to supplying the number of guaranteed cars by the guaranteed time. If CN fails in meeting its commitment to provide the guaranteed number of cars by the date for which they were ordered it provides the customer with a credit of \$100 per railcar. As noted earlier, CP does not guarantee supply to its Merchandise shippers and is not subject to penalties in cases where it does not supply cars for all customer orders.

Western Canada Grain Shippers

For Western Canadian grain shippers using covered hopper railcars both CN and CP commit to supply railcars against 100% of confirmed allocation by the Tuesday following the week for which the cars were ordered. As with Merchandise shippers grain customers are required to confirm orders by established cut-off dates and times following which they are not entitled to cancel or change their orders without being subject to penalty.

As is discussed in detail in QGI's report on *Railway Car Order and Car Supply Processes* the grain programs for CN and CP are very different in structure as are the penalty provisions applicable to both shippers and railways. For CN, shippers are subject to a \$100 per car penalty if an order is reduced or cancelled after cut-off and prior to railcar placement and if a change is made to the destination corridor or origin of the shipment after the order is confirmed. In cases where a shipper bills a car to a destination that is different from the order that in turn affects the physical handling of the shipment to destination the shipper is subject to a \$135 per car penalty.¹²

CP's penalty structures for grain car order cancellations are more complex and are specific to the grain service product for which the cars have been ordered. Penalties for cancellation of confirmed orders, failure to use a confirmed order or cars placed and released empty range from \$150 - \$300 per car.¹³ In addition, for all CP grain service products, other than its BaseMax and ReadyMax programs, shippers are required to load the complete block of cars provided by the railway.¹⁴ Partial loading of a block of cars is considered a default on the entire block and penalties are calculated

¹¹ CN's GCO program operates on a credit / debit system which is invoiced or paid out on a monthly basis based on the net debits or credits accumulated for a single shipper at an individual loading location.

¹² This type of change is considered a diversion by the railway and applies if the change is made once the bill of lading information provided by the shipper has been entered into CN's systems.

¹³ For CP's AdvanceMax and Train AdvanceMax products that operate on the basis of penalty/positive bid systems the shipper is subject to a penalty equal to the level of the penalty bid submitted by the shipper up to maximum dollar amounts as defined by each program. A detailed discussion of these penalty structures can be found in QGI's report prepared for the Rail Freight Service Review *Railway Car Order and Car Supply Processes*, March 2010.

¹⁴ For CP's AdvanceMax, TransMax and Flex Max programs cars can only be ordered in blocks ranging from 25 – 56 cars.

against all orders regardless of whether they are filled.

As noted earlier both CN and CP commit to grain shippers that they will supply railcars for 100% of confirmed orders no later than 2359 Hrs on the Tuesday following the order week. If the railways do not meet this target they will pay a penalty to shippers for each car not supplied. For the most part the penalties payable by the railways are equivalent to those they charge shippers with the following notable exceptions:

- For its ReadyMax program CP assesses penalties to shippers of \$150 and \$300 per car for order cancellations and cars refused at time of placement but does not incur penalties if it fails to fulfill its commitment to supply 100% of confirmed orders within the designated time; and
- For CP's AdvanceMax and Train AdvanceMax programs shippers can be subject to penalties equal to the full amount of their penalty bids – up to \$3000 and \$500 per car respectively – however CP's maximum penalty for failure to supply 100% of cars is limited to \$250 per car plus any positive bid amount.

Bulk Commodities Shippers – Unit Trains

Canadian shippers of bulk products such as coal, potash, dry sulphur and fertilizers ship much of their traffic in unit train volumes and do not generally use the same formal car order and car supply processes as shippers of carload and grain products. As opposed to placing orders on a weekly basis, unit train operations are generally managed on a monthly basis with customers providing detailed monthly demand outlooks to each railway at the origin - destination commodity level. Both CN and CP employ dedicated staff that communicates directly with their largest bulk shippers, usually on a daily basis, to coordinate the movement of both loaded and empty train sets to meet shipper demand.

For some unit train operations such as coal movements, the loading, transit from origin to destination and unloading operations will typically use dedicated locomotives for each train. In addition, at some shipper sites railway crews are required to handle the trains during loading operations. Trains for these customers will often operate in “closed loop” systems that will see them cycle solely between a single origin and destination or between a few origins (e.g. individual mine sites) and a limited number of destinations (e.g. bulk terminals). When the normal flow of unit train cycles are disrupted because of a shipper or receiver's inability to accept the train when offered for loading or unloading it may require the railway to hold trains on railway track.¹⁵

Both CN and CP assess fees to shippers for the cancellation or temporary storage of unit trains at customer request or for reasons beyond the railways' control. Most fees for these shippers are time based with charges assessed on an hourly basis.

For loaded or empty trains that must be held on railway tracks CN assesses a fee of \$700 per hour per train¹⁶ and CP charges \$1,000 or \$1,400 per hour per train depending on where the train is held.¹⁷ In addition CN imposes a flat

¹⁵ In some cases a shipper may be able to accommodate the empty train on its site but the railway will incur costs for the movement of crews and locomotives from the loading site back to a railway terminal and the subsequent return movement of crews and locomotives to the shipper site to manage loading operations or retrieve the loaded train for movement to destination.

¹⁶ This charge applies to railroad supplied cars. Shipper owned or private railcars are subject to a hold fee of \$600 per hour per train.

charge of \$2,750 per train in cases where an empty unit train has been cancelled by the shipper or the railway is required to retrieve a train previously stored empty at the shipper's site. There are no penalties payable by CN or CP with respect to unit train shippers.

Intermodal Shippers

CN and CP segregate their intermodal business into two distinct categories – domestic intermodal where shipments originate and terminate within Canada and import – export traffic that moves between the railways' inland intermodal terminals and container terminals located at the major ports. These business lines are further differentiated by the type of equipment used and who supplies the equipment. Domestic Intermodal traffic moves in containers that are owned and supplied by either the railway, the shipper, or a third party service provider such as a trucking company. Import - export traffic moves exclusively in international marine containers owned and supplied by shipping lines.

CN, unlike CP, requires its Intermodal customers to reserve a spot on a train for each container to be shipped regardless of whether it is a domestic or export movement. Cancellation or modifications to confirmed reservations after 0700 on the day for which the train service has been reserved is subject to a penalty of \$200 per modification or cancellation.

CP customers are subject to penalty if an order is cancelled after equipment has been ordered and dispatched, confirmed, or delivered and the order is cancelled. Penalties also apply if equipment is supplied and the shipment is not tendered for movement on CP in accordance with the order for which the equipment was supplied. CP penalties in such instances are \$200 per container plus any applicable drayage charges for the movement of a container to and from the customer's facility.

Neither CN nor CP provides for the payment of penalties to their customers if they fail to provide the reserved space on the train or the equipment requested.

Automotive Shippers

The North American automotive industry uses specialized equipment and car management processes for the movement of finished vehicles including cars and light trucks. The railcar ordering, allocation and supply processes for these customers are managed by the Reload division of the TTX Company, which is in turn wholly owned by the largest North American railways, including CN and CP. Shippers neither place their orders nor receive their railcar allocations from the railways that serve them. CN and CP therefore do not provide for any penalties related to order cancellations for these customers.

¹⁷ For trains held in or west of Calgary CP charges \$1400 per hour to a maximum of \$14,000 per day whereas for trains held east of Calgary or in the United States the applicable charge is \$1000 per hour to a maximum of \$10,000 per day.

4.1.3 Extended Asset Use - Delays in Loading and Unloading

For all customers in all business segments the railways have established rules regarding the free time allowable to shippers and receivers for the loading and unloading of railway owned and private equipment. The table below provides a summary of the free time provisions for CN and CP by business segment.

| Segment | Activity | Free Time Permitted | |
|-------------------------------------|--|--|--|
| | | CN | CP |
| Merchandise ⁽¹⁾ Grain | Railcar Loading at Origin | 24 Hours | 24 Hours |
| | Railcar Unloading at Destination | 48 Hours | 48 Hours |
| Bulk - Unit Trains | Unit Train Loading at Origin | 6 Hours ⁽²⁾ 8 Hours ⁽³⁾ | 5 Hours |
| | Unit Train Unloading at Destination | 6 Hours ⁽⁴⁾ 8 Hours ⁽⁵⁾ | 8 Hours |
| Intermodal | At Origin <ul style="list-style-type: none"> Equipment used in domestic service Steamship / marine container Private container | 24 Hours 48 Hours n/a | 48 Hours |
| | At Destination <ul style="list-style-type: none"> Equipment used in domestic service Steamship / marine container Private container | 24 Hours 48 Hours n/a | 48 Hours 48 Hours ⁽⁶⁾ n/a |

- (1) For CN free time provisions also apply to privately owned railcars loading and unloading on a CN Team Track
- (2) For loading of trains operated by CN crews
- (3) For loading of trains operated by loader's crew at sites where the same CN crew delivers and picks up the train
- (4) For unloading of rotary gondola cars or rapid discharge hopper cars
- (5) For unloading of all other types of cars
- (6) Applies to terminals in Calgary, Edmonton, Vaughan, Montreal and all terminals in the United States. At other CP terminals free time is 72 hours

When shippers or receivers exceed allowable free time they are subject to extended asset use fees.¹⁸ For carload shippers CN and CP both assess a fee of \$87 per railcar per day¹⁹ for railway owned equipment loading at customer facilities. CN also charges \$57 per railcar per day for privately owned equipment loading or unloading at a CN team track²⁰ whereas CP charges \$87 per railcar per day regardless of car ownership if loading or unloading at a CP team

¹⁸ These fees are commonly referred to as demurrage charges.

¹⁹ For CN customers in the Vancouver area asset use fees are \$117 per railcar per day which reflects a \$30 premium as compared to other locations implemented in January 2009.

²⁰ A team track is a track provided to customers that do not have their own rail served facility for the loading and unloading of rail cars.

track. CP provides its customers with additional free days for selected statutory holidays including Christmas Day, New Years Day, Labour Day and Good Friday.

For Intermodal customers CN charges \$75 per container per day for domestic equipment and between \$15 and \$50 per day for steamship owned containers depending on whether or not they are provided with a container chassis. CP's fees are similar starting at \$75 per day and escalating to as much as \$300 per day depending on equipment type if containers are held for more than five days.

Unit train customers that exceed the allowable free time for loading and unloading operations are subject to penalties, for railway owned railcars and locomotive and train crew costs. CN charges \$700 per hour per train for railway owned cars and \$600 for private cars – this latter charge is only for locomotive and crew costs on the train. CP customers, for trains with dedicated locomotives, are subject to a fee of \$500 per hour for the locomotives and applicable asset use fees of \$87 per car per day for rail cars.

Furthermore both railways reserve the right to remove the locomotives and crews from unit trains delayed in the loading and unloading processes. In such cases CN charges a locomotive removal fee of \$5,500 and CP will charge a switching fee up to \$5,027 to return to pick up the train at a later date.²¹

4.1.4 Shipment Safety and Condition of Equipment

Shipment Safety

CN and CP place upon their customers the responsibility for ensuring that railcars and intermodal containers are loaded in such a manner as to be safe for movement by the railway. There are two specific areas with respect to the safety of shipments that are addressed in the railways' tariffs: overloaded or improperly loaded equipment and leaking equipment carrying dangerous goods or hazardous materials.

A railcar or intermodal unit is deemed to be overloaded when it is loaded to a weight that exceeds the maximum weight allowable for the equipment.²² An improperly loaded railcar or container is one where the load has shifted, is unbalanced or the load is improperly secured. Dangerous, hazardous or environmentally sensitive commodities that are shipped by rail move principally in shipper owned tank cars. Such commodities may also move in a packaged form in containers. When the railways identify leaking railcars or containers they may choose, at their sole discretion, to move the equipment to an isolated location to be secured. For safety related issues that are attributable to customers the railways will impose penalty fees.

For overloaded railcars CN will determine whether or not the car is able to continue on its journey safely. If it can proceed the shipper is assessed a \$1,000 penalty per railcar however if the railcar must be set out to have its load

²¹ In cases where CN opts to remove the locomotive and crew from the train and charge a locomotive removal fee the extended asset use fees for railway owned cars are reduced from \$700 to \$400 per hour.

²² For railcars specifically a car is also deemed to be overloaded if the gross weight of the loaded railcar exceeds the track weight limits for the route that the shipment will take.

adjusted or reduced the penalty is \$2,000 per railcar and escalates with each occurrence to a maximum of \$10,000 per railcar by the fourth such incident for a shipper. Penalties for similar incidents involving containers are similar at \$2,500 per container plus any additional operating expenses (e.g. switching and lift fees) incurred by the railway in resolving the problem. CP's penalty structure is identical whether involving railcars or containers with each incident subject to a fee of \$3,000 per unit plus additional costs related to adjusting or reducing loads to acceptable levels.

Railway penalties for leaking equipment carrying dangerous commodities are also significant. CN charges shippers \$5,000 and \$2,500 for incidents involving railcars and containers respectively. CP penalties range from \$5,500 for containers to \$10,000 for railcars.

Condition of Equipment

Railway owned and supplied equipment, including railcars and containers, are shared by many railway customers throughout CN and CP's networks. CN and CP rely on and expect their customers and to release back to the railway railcars and containers that are clean, free of dunnage²³ and suitable to be provided to the next customer for loading. When customers do not release clean empty equipment it may be rejected by the shipper to who it is subsequently provided for loading. When this occurs the railways incur reduced asset utilization and incremental operating costs associated with cleaning the equipment to make it suitable for loading.

When customers do not adhere to the standards established by the railways in this regard they are subject to penalties. CN penalties in this regard are \$320 per railcar and \$300 per container. CP penalties are a minimum of \$1000 per railcar and \$500 per container with the total cost to the shipper determined by CP based on the condition of the equipment and the work required for cleaning.

4.1.5 Railway Interchange Partners

It is noteworthy that CN and CP hold their railway partners to certain standards of performance much as they do their customers. Railways will regularly interchange both loaded and empty railcars with connecting railways at origin, destination and en route.

CN and CP rely on their interchange partners to provide them with railcars in interchange service in an operationally efficient and safe manner that will not disrupt the normal flow of operations for subsequent movement or delivery to the customer. This requires that all cars received in interchange be mechanically sound and that all required documentation necessary for furtherance of the car to destination be made available at the time of interchange. When CN or CP receive cars in interchange in error, without proper forwarding instructions or with mechanical issues they will assess penalties to their connecting railway partners in the amount of \$435 per railcar.

²³ Dunnage refers to any blocking, bracing, strapping or other materials used in railcars or containers to secure a load.

4.2 Incentive Programs

The tariffs published by CN and CP contain limited incentive provisions for shippers. Specifically there are only two incentive programs made available by the railways to shippers each pertaining to grain shippers in Western Canada. Both CN and CP offer incentives to grain shippers for loading cars on weekends and continue to offer multi car block loading incentives. This section of the report will provide a description of these two programs.

4.2.1 Weekend Loading Advantage Program

CN and CP each offer incentives to grain shippers to load hopper cars on weekends. These programs are designed to improve asset utilization and smooth demand for railroad assets and resources more evenly throughout the week. The program applies to Western Canadian grain elevator operators that load and ship railway supplied covered hoppers cars on weekends to specified destinations.

While both programs strive to achieve similar benefits there are notable differences between the two including:

- CP's program is applicable in all export and commercial corridors whereas CN limits its program to shipments destined to the ports of Vancouver, Prince Rupert, Thunder Bay, Montreal and Quebec City;
- CN places no minimum on the number of cars that must be loaded whereas CP's program applies only on multi car blocks of 25 cars or more;
- CP, unlike CN, requires shippers to commit to scheduled weekend loading for the entire crop year with penalties assessed to the shipper for failure to load on a scheduled Saturday or Sunday;
- CN provides shippers with the two weekend days for loading²⁴ whereas CP applies the same rules in place for multi car block loading incentives that require shippers to load 56 car blocks in 10 hours and 112 car blocks in 24 hours; and
- CP provides shippers with the opportunity to benefit from weekend loading incentives on statutory holidays that fall Monday to Friday.

The railways also differ somewhat in the level of incentive paid to shippers. CN's incentive payment is \$30 per railcar for all cars loaded within the established parameters of the program. CP's incentives²⁵ are structured by block size as shown below:

| Number of Cars | Incentive Rate |
|-----------------------|-----------------------|
| 25-49 cars | \$ 625 |
| 50-99 cars | \$ 1250 |
| 100 or more cars | \$ 2500 |

For any given car block category the incentive payment is worth \$25 per car as compared to CN's \$30 per car incentive (e.g. \$625 / 25 cars = \$25 per car). However, the incentive per car diminishes in value the more cars that are loaded beyond the minimum within a given car block category – e.g. \$625 / 49 cars = \$12.75.

²⁴ CN requires shippers to be able to load and release back to the railway by Sunday all cars placed by the railway after 1700 local time on Friday.

²⁵ As published in CPRS 4311 Item 20015.

4.2.2 Multi Car Block Incentive Rates

Since 1987, CN and CP have provided grain shippers in Western Canada with freight rate incentives for loading multi car blocks of hopper cars. The program is designed to encourage grain shippers to load blocks of cars as opposed to single cars from individual origins for movement to single destinations. Multi car block operations provide the railways with efficiencies in switching and car distribution activities and for grain companies encourage the use of elevators with higher car loading capabilities.

The railway incentives provide per car rate differentials (discounts) for cars loaded in minimum block sizes with the size of the discount or rate incentive available to shippers increasing for larger car blocks.²⁶ Each of CN and CP's incentive programs operate under defined rules established by each railway. While the rules differ somewhat for CN and CP, eligible shipments are generally defined based on the following criteria:

- Minimum block sizes – for CN 50 or 100 cars and for CP 56 or 112 cars;²⁷
- Applicable to eligible commodities only as defined in the railways' respective tariffs;
- All cars in a block must be loaded at a single origin facility and released and shipped at one time to a single eligible unloading facility
- Origin and destination facilities are subject to certain efficiency criteria including:
 - Origin facilities must be located on rail lines that have maximum gross weight on rail capabilities that exceed a minimum threshold;
 - Origin facilities must have rail sidings of sufficient capacity (car spots) to accept delivery of all empty cars for loading in a single switch movement provided by the railway

In addition CP places specific time restrictions on its shippers to load multi car blocks. Generally speaking CP provides shippers with 10 hours to load and release multiple car blocks of less than 81 cars and up to 24 hours to load car blocks of 81 cars or greater.

The rate incentives offered by CN and CP vary based on the destination corridor for the traffic, the commodity being shipped and the maximum commodity weight per railcar.²⁸ Each railway has structured its incentive payments around groups of commodities based on the loading weight or density of the commodity – high, medium and low density commodities. This is intended to reflect incentive levels on a per car basis that are reflective of the maximum loading weight that can be achieved for each type of commodity in the same size car.

Examples of per car incentives in selected corridors are provided in the table below:

²⁶ During the 2007–2008 crop year CN and CP completed the conversion of tariff rates for grain from per tonne charges to per car charges. At this time the multi car block incentive rates previously published by the railways as per tonne discounts were re-structured and offered in the form of lower per car charges as compared to single car rates.

²⁷ Under the original terms of these programs loading incentives were also paid for car blocks of 25-49 cars. These incentives were eliminated by CN in 2003-2004 and by CP in 2005-2006.

²⁸ Weight thresholds or criteria used in the per car rates published by the railways will be differentiated either on the basis of the cubic capacity of the railcar or the maximum allowable weight per car.

| Railway | Commodity | Origin | Destination | Single Car Rate | 50 Car Block Rate | 100 Car Block Rate | 50 Car Discount | 100 Car Discount |
|---------|-----------|--------------|-------------|-----------------|-------------------|--------------------|-----------------|------------------|
| CN | Wheat | Aberdeen, SK | Thunder Bay | \$ 3,010 | \$ 2,646 | \$ 2,282 | \$ 364 | \$ 728 |
| | | | Vancouver | \$ 3,223 | \$ 2,859 | \$ 2,495 | \$ 364 | \$ 728 |
| | Barley | Aberdeen, SK | Thunder Bay | \$ 2,813 | \$ 2,493 | \$ 2,173 | \$ 320 | \$ 640 |
| | | | Vancouver | \$ 3,154 | \$ 2,834 | \$ 2,514 | \$ 320 | \$ 640 |
| | Oats | Aberdeen, SK | Thunder Bay | \$ 2,642 | \$ 2,354 | \$ 2,066 | \$ 288 | \$ 576 |
| | | | Vancouver | \$ 2,884 | \$ 2,596 | \$ 2,308 | \$ 288 | \$ 576 |
| | Commodity | Origin | Destination | Single Car Rate | 56 Car Block Rate | 112 Car Block Rate | 56 Car Discount | 112 Car Discount |
| CP | Wheat | Blackie, AB | Thunder Bay | \$ 3,964 | \$ 3,509 | \$ 3,236 | \$ 455 | \$ 728 |
| | | | Vancouver | \$ 2,618 | \$ 2,163 | \$ 1,890 | \$ 455 | \$ 728 |
| | Barley | Blackie, AB | Thunder Bay | \$ 3,707 | \$ 3,307 | \$ 3,067 | \$ 400 | \$ 640 |
| | | | Vancouver | \$ 2,301 | \$ 1,901 | \$ 1,661 | \$ 400 | \$ 640 |
| | Oats | Blackie, AB | Thunder Bay | \$ 3,336 | \$ 2,976 | \$ 2,760 | \$ 360 | \$ 576 |
| | | | Vancouver | \$ 2,180 | \$ 1,820 | \$ 1,604 | \$ 360 | \$ 576 |

5. Summary

CN and CP have established clear definitions for the services shippers are entitled to receive as part of the railways' basic freight service offering. In addition to defining a range of optional or supplemental services they offer their customers for a fee, CN and CP have also defined the responsibilities of their customers with respect to various shipping activities. The failure of customers to perform in accordance with the standards established by the railways results in customers being assessed penalties by the railway. From the railways' perspective these penalties are designed to incent behaviour among customers that promotes the efficient use of railway assets that provides benefits to all railway customers by maximizing the available capacity in the system and directly impacting the level of service the railways can provide.

The review of CN and CP's penalty and incentive provisions clearly shows that there are far fewer incentives than there are penalties with the only commercial incentives for shippers being two programs for grain shippers with respect to weekend loading and multi car block rate incentives. Conversely shippers are subject to a wide range of penalties for not "performing" in a number of areas ranging from the provision of accurate shipment documentation to loading cars provided by the railways in response to customer orders. However, the railways are subject to very few penalties for failing to meet their commitments to shippers. These are limited to per car penalties payable by the railways for failing to supply railcars against confirmed or guaranteed orders within CN's GCO program for Merchandise shippers and the grain programs for both railways.

As part of this analysis QGI discussed with a select group of railway shippers their views on the effectiveness of existing penalty programs in contributing to reliable and consistent service within the Canadian freight logistics system. Shippers were generally in agreement on this issue and do not believe that the penalties in place today, particularly those payable by CN and CP, are meaningful or effective in this regard. Many believe that while shipper penalties can have the effect of instilling discipline in shippers for certain activities they do not believe this necessarily has a positive effect on the level of railway service they receive.

With respect to the penalties in place for railways regarding the supply of empty cars in response to customer orders shippers do not think these penalties are meaningful or effective in influencing railway behaviour. Shippers believe that penalties of \$100 or \$200 per car are too small to influence how the railway performs. Shippers also do not believe that such penalties in any way provide meaningful compensation to shippers that have suffered a commercial loss or incremental operating costs as a result of not receiving railcars when they needed them.