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Review of Commodity, Boxcar, and TOFC/COFC Exemptions: Comments of Canadian Pacific Railway

Thank-you for this opportunity to provide feedback on the Board's proposed approach to review commodity, boxcar, and TOFC/COFC exemptions. In the Board's recent proposal (Ex Parte 704, Sub-No. 1), the Office of Economics suggested a new approach for evaluating regulatory exemptions for certain commodities and classes of traffic.

Soo Line Railroad Company, a Class I railway, together with Delaware and Hudson Railway Company, Inc., Dakota, Minnesota & Eastern Railroad Corporation, and Central, Maine & Quebec Railway US Inc., are wholly owned subsidiaries of Canadian Pacific Railway Company (collectively doing business as CP), which provide service to the Midwest and East Coast of the United States. CP fully supports the American Association of Railroads' (AAR) comments in response to the Board's proposal. CP applauds the Board's proposal to apply objective, information-based analysis to its assessment of traffic exemptions. Like the AAR, however, we also caution against the blind application of this analysis via the proposed Indicator Dashboard, for the same reasons eloquently presented by the AAR in its comments.

In addition to the AAR's comments, CP provides additional observations. In particular, CP would like to emphasize that aggregated metrics like R/VC and RPC are poor tools for assessing railway market dominance in every situation. As discussed below, these measures may fluctuate in response to competitive market factors that are unrelated to railway market power. The railroad industry today is significantly different from that of 1992, which the Board is using as a reference period for comparison.

Evolution of the Railroad Industry and Service

Since the movement towards deregulation in the 1980s, the industry has progressively moved towards a service-oriented business model, increasingly offering premium services to its customers at competitive rates. As a result of increased intermodal competition, consolidation of producer markets and complex handling requirements, railroads are incentivized to offer customized, premium services tailored to individual customers.

R/VC generally reflects the increased revenue associated with the premium price paid for premium service, but fails to reflect either the increased cost of providing such service or the increased value of the service to the customer. The Board's regulatory costing tool, URCS, which is used to estimate variable costs for rail movements is based on system average costs and does not allocate the specific costs associated with premium service activities for a specific movement. The R/VC for the traffic will

increase when premium services are provided. In our experience, customers often willingly paying for such premium services in their freight rates. In these instances, the R/VC is inflated as a result of the shipper's desire for higher levels of service from its rail provider, and not from an increase in CP's market power.

Following are several examples of how CP delivers premium services in cement, steel, and scrap metal lines of businesses.

CP's Premium Service for Cement Customers

CP serves numerous cement producers in the U.S. Midwest, Canadian Prairies, and Eastern Canada. CP and producers work together to serve the U.S. domestic construction market. For example, CP works with a large international conglomerate with plants across Canada and the U.S.

One particular plant in the Canadian Prairies ships large volumes of cars per month with CP-destined for markets in Canada and the U.S. Due to the high monthly rail traffic volumes, this shipper requires active care by CP to reduce congestion at the customer's rail facilities. To proactively manage the fluidity of this customer's supply chain, CP provides two forms of premium services for this customer – dedicated customer service representatives and additional switching at the customer's facility.

This customer has a dedicated Service Delivery Representative who is responsible for only a handful of large accounts. The employee is responsible for proactively reaching out to the customer and acting as a bridge between local operations and the customer. As a result, CP and the customer are able to continuously monitor the status of the customer's supply chain, and CP is able to provide flexible and responsive service to this customer.

This customer also receives frequent switches per week at its facilities beyond the industry's standard level of service. The extra switching work provided by CP allows this customer to optimize its loading operations and increase the throughput of its facility.

CP also serves a large cement plant in the Midwest U.S. This particular customer has facilities throughout the U.S. and uses a number of railways to meet its transportation needs. It ships several hundred cars per month with CP alone. This customer has high volumes of production, but its facilities have a constrained capacity to handle cars. As a result, the customer receives upwards of six switches from CP per week, which exceeds the industry's standard. The additional service enables the customer to smoothly manage its logistics requirements, while not congesting its own facility.

Both cement customers mentioned above are sophisticated market players in the building material industry and have facilities throughout North America. Since they utilize multiple modes of transportation, those customers understand the rates they pay for rail and trucking. They can successfully negotiate rates and demand better services. They work closely with the railway to maximize the efficiency of their logistics. Instead of electing for the lowest price option and receiving normal levels of service, the customer receives superior service in exchange for higher but nevertheless competitive freight rates.

CP's Premium Service for Steel Customers

CP also has a significant footprint in the U.S. Midwest steel market, providing a transportation service to steel manufacturers. Similar to the aforementioned cement customers, CP provides customized premium services to some of these manufacturers.

For example, CP serves a large steel producer in the U.S. Midwest shipping outbound finished steel products. This customer ships more than 500 cars per month and has complex logistics requirement. CP offers premium services by providing continuous logistics tracking, frequent switching, and close coordination with service design. This customer receives daily dashboards for monitoring car supply and product movements. CP provides customized Key Performance Indicators and pipeline monitoring services. CP also provides a dedicated logistics coordinator, and responds to this customer's concerns on a real-time basis. CP also communicates with this customer on a daily basis to ensure that car supply needs are met.

Due to the nature of localized rail facilities, this customer receives CP rail services seven days per week, including two separate switches per day. If this shipper were unwilling to pay premium rates for this level of service, then the aforementioned premium services would not be possible. The customer is willingly paying for such services, while closely working with CP.

CP's Premium Service for Scrap Metal Customers

Also, CP has a significant role for providing services scrap metal recycling mills in the Canadian Prairies. CP provides a logistics solution connecting scrap yards in the Western U.S. to Western Canada. For a customer in the Canadian Prairies, CP transports scrap metals from the U.S. into Canada.

CP provides this customer with premium services in the form of frequent switching and a dedicated logistics coordinator and tracking system. This customer receives seven days-per-week rail service and seven switches per week. Again, this service level is beyond CP's standard level of service.

Additionally, CP provides this customer with a dedicated service coordinator. The coordinator reports daily car supply dashboards back to the customer. Also, the coordinator holds strategy meetings with customers twice a week to ensure that the car supply needs are adequately met.

This kind of dedicated care and service would not be possible if CP were to compete solely on price against other modes of transportation. This is another example where a relatively higher freight price is not a sign of market dominance.

Neither R/VC nor RPC is a Good Tool for Measuring Abuse of Market Power

R/VC is a measure derived from aggregate metrics to measure the profitability of an individual movement of traffic. The aggregate measure does not capture CP's increased costs due to customization and premium service offering. As a result, R/VC may lead to erroneous conclusions about CP's market dominance.

When shippers willingly pay for premium levels of service, this is not a sign of market failure or dominance enjoyed by the railways. The customers discussed above are large and sophisticated organizations. That means they have numerous sources of information available due to their experience dealing with other railways and alternative modes of transportation. They can use such pricing and service level information to negotiate with CP. In lieu of demanding the lowest possible price, the aforementioned customers have chosen to pay for a customized rail-service solution .

From our experience dealing with those customers, CP believes that there is no evidence of market failure or lack of competition to justify revoking the exemption status. As it currently stands, customers receive excellent service from CP, receiving a premium product at a competitive price.

Once again, CP would like to thank the Board for the opportunity to present our position. We will be happy to provide additional information if needed to aid the decision Board's making process.

Respectfully submitted,

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