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RUNNING RIGHTS AND THE PUBLIC INTEREST

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Introduction

Canada's Class I railways enjoy significant market power over large portions of their rail networks. This market power allows these carriers to set rate and service standards at levels that would not prevail under conditions of effective competition and may lead to inefficient outcomes for the economy generally.

Canada's commodities shippers have contributed significantly to Canada's economic growth in recent years; however, many of these shippers are captive to the rail mode of transportation in general and a single carrier in particular to move their product from its origins to destinations. The combination of carrier market power and shipper captivity is a recipe for inefficiencies. Accordingly, effective and adequate remedies for rate and service disputes are of paramount importance. The current regime provides relatively weak remedies, found solely under the *Canada Transportation Act,* S.C. 1996, c.10 (the "Act").[1] The most useful remedy in the Act has been final offer arbitration ("FOA")[2], which allows shippers to make an application to the Canada Transportation Agency (the "Agency") for "baseball style" arbitration before an independent arbitrator.[3] While it is the most useful of the available remedies, the FOA process is very costly and time-consuming. Further, the rate chosen by the arbitrator only lasts for one year, thus providing only temporary relief from a

carrier's exercise of market power. In some cases, FOA would be required repeatedly to achieve rates that would more closely approximate those found under conditions of effective competition. FOA may also improve service levels in some cases.

Running rights is another remedy prescribed by the Act, although it is rarely invoked and has never been successful.[4] Running rights are extraordinarily difficult to invoke due to the severe limitations on who can apply, but even when a rare applicant can be found, the reasons for the lack of success are many and varied. Among the most significant are the way in which the Agency has interpreted the "public interest" consideration under the Act and the fact that the remedy has been labeled as "exceptional". One decision in particular appears to have effectively foreclosed interested parties from availing themselves of it, even in situations where there is no effective competition.

We begin this paper by outlining the legislative regime surrounding running rights in Canada before moving on to discuss the factors that are considered by the Agency in determining whether or not to grant running rights, including the definition of public interest. We then move on to a discussion of the most current interpretation of public interest in a Canadian running rights application. Finally, we discuss the running rights legislation in Australia and the way in which the public interest is factored into decisions and the lessons that Canadian legislators and policymakers could learn from their Australian counterparts.

The Need for Running Rights

Canada is a resource rich country with significant reserves of valuable commodities, including minerals, coal, potash, forest products and grain. Given the distances involved in transporting commodities from their origins to the coasts for export, rail is generally accepted as being the only viable method of transportation for such products. However, Canada's Class I railways that handle most of this traffic operate monopolies over large parts of their networks, holding shippers captive, and as such, can set rates and

service standards at levels that would not exist if there were effective competition for these services.

Running rights may provide a mechanism for introducing effective competition by granting guest railways access to the lines of these carriers, thereby providing shippers with a choice as to which carrier to use. The expectation is that running rights would lower rates and encourage higher service standards in order for each carrier to retain such traffic. There are legitimate debates as to the total cost and efficiencies of running rights, not discussed here. Instead, our focus is on the public interest component, which has served as one of many other, perhaps unwarranted, barriers to its use.

There are at least two good reasons for the claim that running rights could be in the public interest. First, private enterprise generally expects suppliers to compete for downstream business, which in the case of essential facilities, such as rail, is a critical component of the distribution chain. Second, the expectation is that easing access to established railway infrastructure would improve Canada's international competitiveness and allow resource industries to take part in and increase their role in global value chains.[5]

Running Rights under the Act

Section 138 of the Act provides that:

> 138. (1) A railway company may apply to the Agency for the right to
> (*a*) take possession of, use or occupy any land belonging to any other railway company;
> (*b*) use the whole or any portion of the right-of-way, tracks, terminals, stations or station grounds of any other railway company; and
> (*c*) run and operate its trains over and on any portion of the railway of any other railway company.
>
> (2) The Agency may grant the right and may make any order and impose any conditions on either railway company respecting the exercise or restriction of the rights as appear just or desirable to the Agency, having regard to the public interest.
>
> (3) The railway company shall pay compensation to the other railway company for the right granted and, if they do not agree on the compensation, the Agency may, by order, fix the amount to be paid [emphasis added].

The term "public interest" is not defined in the Act or anywhere else in federal transportation legislation; however, in the *National Transportation Act, 1987* (the predecessor to the Act), it was defined in §4 as follows:

> … "public interest" means the public interest that is consistent with
> (a) the national transportation policy set out in subsection 3(1)
> (b) policy directions, if any, issued under section 23…

It is not clear what Parliament intended by taking out the foregoing words when the Act was revised in 1996, but we are left with Parliament's intent regarding transportation and the economy by referring to the current National Transportation Policy as outlined at §5 of the Act:[6]

> It is declared that a competitive, economic and efficient national transportation system that meets the highest practicable safety and security standards and contributes to a sustainable environment and makes the best use of all modes of transportation at the lowest total cost is essential to serve the needs of its users, advance the well-being of Canadians and enable competitiveness and economic growth in both urban and rural areas throughout Canada. Those objectives are most likely to be achieved when
>
> (*a*) competition and market forces, both within and among the various modes of transportation, are the prime agents in providing viable and effective transportation services;
>
> (*b*) regulation and strategic public intervention are used to achieve economic, safety, security, environmental or social outcomes that cannot be achieved satisfactorily by competition and market forces and do not unduly favour, or reduce the inherent advantages of, any particular mode of transportation;
>
> (*c*) rates and conditions do not constitute an undue obstacle to the movement of traffic within Canada or to the export of goods from Canada;
>
> (*d*) the transportation system is accessible without undue obstacle to the mobility of persons, including persons with disabilities; and
>
> (*e*) governments and the private sector work together for an integrated transportation system.

Despite the presence of the National Transportation Policy as a guide to the interpretation of public interest, in its 2001 final report the

Canada Transportation Act Review Panel found the lack of definition of the term "public interest" in the Act's running rights provision to be problematic.[7] This Panel recommended that, at a minimum, the Agency consider the following factors in determining whether or not a running rights application fulfills the public interest requirement:[8]

(a) the adequacy of existing service;

(b) the existence of competitive alternatives;

(c) the impact on all users and shippers on lines where running rights are sought;

(d) the impact on system efficiency;

(e) the financial and operational capability of the applicant;

(f) the willingness of the applicant to allow reciprocal access to its lines where applicable; and

(g) the impact on the financial viability of the infrastructure owner.

These recommendations were not incorporated in the subsequent amendments to the legislation. We are thus left with jurisprudence on the subject.

The *Ferroequus* Decision

The most recent and thorough interpretation of the application of Canada's running rights provision and the public interest component contained therein is found in the 2002 *Ferroequus* decision,[9] where, in a 4-1 ruling, the Agency ruled against granting access by the guest railway to the incumbent railway's lines. Upon an appeal to the Federal Court of Appeal, the Agency's decision was upheld on jurisdictional grounds.[10]

In its application, the Ferroequus Railway Company Limited ("FRCL") requested the right to run and operate its trains on and over specified lines of Canadian National Railway ("CN") in order to transport Canadian Wheat Board ("CWB") grain from the prairies to

the port at Prince Rupert, British Columbia. FRCL submitted that its proposal would satisfy the public interest requirement of §138(2) in a variety of ways including:

(a) introducing competition for the movement of the traffic in question;

(b) providing flexible, timely and low cost service;

(c) improving the system's efficiency;

(d) lower costs for both the rail operator and the shipper;

(e) lower or no marine and rail demurrage charges;

(f) timely and enhanced revenue for the shipper;

(g) developing the potential of the underused Port of Prince Rupert; and

(h) easing congestion at the Port of Vancouver.

The Agency established a non-statutory, previously unknown "jurisdictional threshold" to determine whether to grant running rights, namely, an abuse of market power or market failure in terms of existing rates or services in the relevant markets. The majority ruled that FRCL had not met the threshold and also found that there was adequate competition for CWB grain movements from the prairies to west coast ports as both CN and Canadian Pacific Railway ("CP") competed for a large portion of this traffic and that, accordingly, granting FRCL's application would not eliminate or alleviate any lack of adequate and effective competition.[11]

In upholding the Agency's decision, the Federal Court of Appeal did not set out a test or provide guidelines that would assist decision-makers in determining whether running rights should be granted in any particular case. Instead, the Court highlighted the fact that §138(2) is couched in open-ended language, confirming that the Agency's powers are discretionary,[12] and that the Agency *must* consider the "public interest" considerations set out in the National Transportation Policy.[13] The Court went on to agree with the

Agency's finding that running rights are an "exceptional remedy" and without analysis said that it was:[14]

> difficult to take issue with the rationality of the Agency's principal reason for concluding that [FRCL] had not demonstrated a lack of competition, or the effects thereof, that would support a finding that the grant of running rights was in the public interest.

The Court focused on the characterization by the majority decision at the Agency that the remedy is exceptional as grounds for saying that the Agency had met the reasonability standard in denying the grant of running rights, without defining the public interest:[15]

> A statutory running right is an exceptional remedy. Its exceptional character is supported on many fronts: it is expropriative in nature; there are significant operational problems to be expected in its application; there will likely be a continuing need for regulatory intervention; it may lead to the fragmentation of railway markets; it may create disincentives for the host to invest in infrastructure and may have capital funding implications for the host railway company. As well, there may be other less intrusive remedies available under the law.

If we are to take the foregoing as valid considerations of the public interest, the Court did not say so. The best that can be said is that they were articulated as reasons for the exceptional nature of the remedy. Nevertheless, would-be applicants are left without a definition of the public interest, in an industry with very high barriers to entry and a bias against new entry.

In contrast to this approach, Australia is a jurisdiction where the legislation allows for running rights and at the same time, defines the public interest factors that are to be taken into consideration.

Australia

Australia's economy, like Canada's, has experienced an export boom in recent years and has largely weathered the economic turmoil that has plagued much of the rest of the world. Also similar to Canada, Australia's continued economic fortune is significantly tied to its vast reserves of valuable commodities, including iron ore, thermal and metallurgical coal and concentrates. Although distances to tidewater

for exports in Australia are much shorter than those in Canada, given the enormous quantities of commodities that are transported (often from remote regions) to export facilities on its coasts, rail is the only viable method of transportation.

The structure and ownership of Australia's railways are complicated and contain a mix of vertically and horizontally separated structures with a combination of state-owned and privately-owned track infrastructure (below rail components) and railway operations (above rail components) in the different states. A discussion of how such a system works and is regulated is far beyond the scope of this paper; however, suffice it to say that there are mechanisms available whereby a guest railway can seek running rights over the lines of another railway.[16]

Section 44H of the *Competition and Consumer Act 2010,* (the "Australian Act")[17] contains the pertinent provision concerning the factors that must be satisfied in order for a running rights application to be approved, including how public interest factors are considered:

> The designated Minister cannot declare a service unless he or she is satisfied of all of the following matters
>
> (a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
>
> (b) that it would be uneconomical for anyone to develop another facility to provide the service;
>
> (c) that the facility is of national significance, having regard to:
>
> (i) the size of the facility; or
>
> (ii) the importance of the facility to constitutional trade or commerce; or
>
> (iii) the importance of the facility to the national economy;
>
> (e) that access to the service:
>
> (i) is not already the subject of a regime in relation to which a decision under section 44N that the regime is an effective access regime is in force (including as a result of an extension under section 44NB); or
>
> (ii) is the subject of a regime in relation to which a decision under section 44N that the regime is an effective access regime is in force (including as a result of an extension under section 44NB), but the designated Minister believes that, since the Commonwealth Minister's decision was published, there

> have been substantial modifications of the access regime or of the relevant principles set out in the Competition Principles Agreement;
>
> (f) that access (or increased access) to the service would not be contrary to the public interest [emphasis added].

The Australian Act governs competition, fair trading and consumer protection across a wide variety of industries and as such "declaring a service" is not solely concerned with the granting of running rights; but rather, with enabling a third party to obtain access to services provided by "essential facilities", of which existing railway lines are included.[18] Interestingly, the Australian Act further distinguishes the public interest consideration from factors such as promoting a material increase in competition. As such, the Australian Act requires the decision-maker to first consider the specific criteria in subsections (a) through (e) before embarking on the more general public interest inquiry in subsection (f),[19] which on its face contains a reverse onus.

Application of the Australian Act

The most recent statement of the interpretation and weight given to public interest in a running rights application under the Australian Act comes via the complex and lengthy Pilbara Infrastructure litigation. This matter involves an application by Pilbara Infrastructure Pty Ltd. (a wholly owned subsidiary of Australian mining concern Fortescue Metals Group Ltd.)[20] to obtain access to four railway lines privately owned by BHP Billiton Iron Ore Pty Ltd. ("BHP") and Rio Tinto Ltd. ("Rio Tinto") to haul iron ore from its mines in the Pilbara region of Western Australia to Port Hedland on the Western Australia coast. In the initial application to the National Competition Council,[21] the Treasurer of the Commonwealth of Australia declared a service for three of the four lines,[22] which had the effect of granting running rights to Fortescue over the lines of BHP and Rio Tinto. Rio Tinto and BHP then appealed to the Australian Competition Tribunal ("ACT").[23]

While not setting out a precise test for the operation of §44H(f), the ACT gave a fulsome discussion of the manner in which the public

interest provision in §44H(f) was to be considered. It outlined several guidelines to assist its interpretation of public interest. In doing so, the ACT made it clear that defining what constitutes the "public interest" goes beyond a mere cost-benefit analysis:[24]

> For criterion (f) to be satisfied (although it is expressed as a negative), it is not sufficient for the net costs of access to exceed net benefits, ie even if that is the result of the inquiry, the making of a declaration may yet not be contrary to the public interest. Other factors might carry the day.

With respect to the types of factors that the ACT would consider it went on to say that:[25]

> The factors which the Tribunal proposes to take into account will not be confined to strict cost-benefit issues. The Tribunal will also have regard to broader issues concerning social welfare and equity, and the interests of consumers. Where possible the Tribunal will distinguish between criterion (f) issues and discretionary factors, although the distinction is not always easy to draw.

And:[26]

> ... the Tribunal should consider *consequences that are likely to arise as a result of access*, giving them a weight that pays regard to their degree of likelihood [emphasis added].

The ACT ultimately determined that there were only four factors that had a significant bearing on the public interest requirement – two benefits and two costs. First, access to some lines had the potential to "unlock" some stranded deposits and even for deposits that are not stranded, granting Fortescue access may have provided a significantly cheaper form of transport and allowed greater volumes of iron to be transported.[27] Second, there were obvious capital savings that arose from accommodating third party demand on an incumbent's existing line rather than on a new railway.[28]

With respect to the potential costs, the ACT found that access likely would discourage the development of new lines.[29] The second critical cost espoused by the ACT was that granting access likely would lead to delays in the incumbent making changes on its lines, including by way of expansions, adopting new operating practices or introducing new technology.[30]

After evaluating the aforementioned factors, the ACT ultimately concluded that the public interest requirement was not satisfied in respect of one of the two lines over which Fortescue had previously been granted access.[31]

Following the ACT ruling, Fortescue appealed to the Full Court of the Federal Court of Australia (the "Federal Court"), which upheld the ACT's decision.[32] While Fortescue argued before the Federal Court that the ACT should have taken a more narrow approach in applying §44H(f), this was rejected and the Federal Court accepted the ACT's view that criterion §44H(f) required it to consider a wide range of factors and reiterated that when determining whether or not to declare a service, the following matters may be taken into account when determining whether or not to declare access to such infrastructure:

(a) costs of the infrastructure owner in providing access (*i.e.* the infrastructure owner's legitimate interests, as distinguished from any potentially anti-competitive interests considered under §44H(a) in not providing access);[33]

(b) costs involved with negotiating access to the infrastructure, including any costs associated with a potential determination of any future access dispute;[34] and

(c) general social costs and benefits in the Australian public interest, including factors such as potential delays to expansions or the retardation of technological development if access is granted.[35]

In reaching its conclusion, the Federal Court highlighted that, had Fortescue's arguments prevailed, it would:[36]

> … radically reduce the power and responsibility of the Minster and Tribunal to reject applications which appear to them plainly to be contrary to the public interest.

Following the Federal Court's decision, Fortescue sought leave to appeal to the High Court of Australia, and on October 28, 2011, leave

was granted.[37] While again, there were multiple grounds on which Fortescue appealed, only the discussion surrounding the interpretation of the public interest provision in §44H(f) is relevant to this paper.

In respect of the interpretation of public interest, in being granted leave to appeal to the High Court, Fortescue advanced the argument that, as a matter of language, the criteria in §44H(f) is expressed as requiring satisfaction that an exclusion does not apply – *i.e.* that granting the service is *not contrary* to the public interest,[38] as opposed to requiring the applicant to positively demonstrate that the declaration of a service *is* in the public interest. In other words, there is a reverse onus in favour of the proposition that the granting of running rights is in the public interest. Subsections 44H (a) to (e) outline the factors that the applicant must show in order to be successful, before proceeding to the final test – that granting the application is *not* contrary to the public interest.

It may be that the facts of the Fortescue litigation do not lend themselves well to making a successful running rights application. While it remains to be seen what approach the High Court will take, regardless of the decision, the Australian Act and related jurisprudence provide valuable insight into the manner in which public interest is defined in a jurisdiction with similar legislation and similar competing interests to be considered when determining whether to grant running rights.

Conclusion

The boom in Canadian commodities in recent years has placed increased pressure on the country's Class I rail carriers to provide an increased level of service at rates comparable to those that exist in jurisdictions with effective competition or substitutes therefor, such as running rights.

Canadian policymakers and legislators can learn valuable lessons from Australia, particularly with respect to the arguably untenable position that running rights is an "exceptional remedy", which seems

to contradict Canada's National Transportation Policy and skews the interpretation of the public interest. Policymakers should direct the Agency to incline itself to give a sufficiently clear interpretation to the public interest in such cases, in advance of the next application, especially if a suitable running rights candidate should come forward. Quite apart from correcting the statutory deficiency relating to who can apply for running rights, legislators might reconsider the tests for granting access in running rights cases, the meaning of the public interest and a declaration as to the party on whom the onus falls to demonstrate it.

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Rail Shipper Protection Under the Canada Transportation Act, Allison Padova (Library of Parliament, Economics Division), 2007

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Endnotes

[1] Other remedies include interswitching, competitive line rates and level of service complaints.
[2] Per §161 of the Act.
[3] "Baseball style" arbitration is a form of arbitration whereby the arbitrator must choose one of the positions advanced by the parties and is not able to make their own determination of what an appropriate award would be.
[4] That is, there has never been a successful *contested* running rights application in Canada. Railways often enter into agreements with one another to use one another's infrastructure.
[5] *Abolish the Rail Monopoly: Make Rail Services More Like Other Network Industries,* Francois Tougas, National Post (June 30, 2008).
[6] *Rail Shipper Protection Under the Canada Transportation Act* at p. 4.
[7] See *Vision and Balance: Report of the Canada Transportation Act Review Panel* at p.78.
[8] Ibid, at p.79.
[9] In the matter of an application filed by Ferroequus Railway Company Limited, pursuant to subsections 138(1) and (2) of the *Canada Transportation Act***,** S.C., 1996, c. 10, seeking the right to run and operate its trains on and over specified lines of the Canadian National Railway Company between Lloydminster, Saskatchewan and Prince Rupert, British Columbia and between Camrose, Alberta and Prince Rupert, British Columbia – *Canada Transportation Agency,* Decision No. 505-R-2002 (September 10, 2002).
[10] *Ferroequus Railway Co. v. Canadian National Railway Co*. (F.C.A.) 2003 FCA 454.
[11] Further, the Agency found that one of the proposed interchanges put forth by FRCL could not work as it required the cooperation of CP and the earnings assumptions that FRCL had made in its business plan were overly optimistic.
[12] *Supra,* note 10 at para. 20.
[13] *Ibid*, at para. 21.
[14] *Ibid.,* at para. 34.
[15] *Ibid.*

[16] For a more fulsome discussion of Australia's rail access regime and the regulation thereof, see the Economic Regulation Authority's overview of the system at http://www.erawa.com.au/1/170/48/rail_access.pm (accessed February 18, 2012).
[17] Formerly, (and at the time the Pilbara Infrastructure litigation began), the *Trade Practices Act 1974.*
[18] Section 44B of the Australian Act provides that: *service* means a service provided by means of a facility and includes: (a) the use of an infrastructure facility such as a road or railway line…
[19] See *infra,* note 23, at para. 1162 where the ACT noted that "… criterion (f) is concerned with other considerations, not caught by earlier criteria, which bear upon the public interest.
[20] In this paper, the term "Fortescue" may be used to refer to both Pilbara Infrastructure Pty Ltd. and Fortescue Metals Group Ltd., its parent company,
[21] Application for Declaration of the Goldsworthy, Hamersley and Robe Railway Lines in the Pilbara Region of Western Australia: covering letter to the Treasurer's Decision (October 27, 2008) http://www.ncc.gov.au/images/uploads/TreasurerCoverLetter.pdf.
[22] The time limit for declaring a service on the fourth line ran out, so it was therefore taken to have decided not to declare that service.
[23] In the matter of Fortescue Metals Group Limited [2010] ACompT 2 (June 30, 2010).
[24] *Ibid,* at para. 839. See also para. 1160 where the ACT clarifies that as "the criterion is expressed in the negative, *i.e.* it is not necessary for the Tribunal to positively be satisfied that access is in the public interest".
[25] *Ibid* at para. 1168.
[26] *Ibid,* at para. 1172.
[27] *Ibid,* at para. 1303.
[28] *Ibid.*
[29] *Ibid,* at para. 1304.
[30] *Ibid.*
[31] The ACT concluded that the public interest component in respect of the other line would only be satisfied until 2018, not 2028 or beyond as Fortescue had requested. The appeals before the ACT respecting the third and fourth lines over which Fortescue sought access did not concern the application and interpretation of the public interest provision and, as such, fall outside the scope of this paper.
[32] *Pilbara Infrastructure Pty Ltd. v. Australian Competition Tribunal* [2011] FCAFC 58.
[33] *Ibid.,* at para. 108.
[34] *Ibid.,* at para. 107.
[35] *Ibid.,* at para. 50.
[36] *Ibid.,* at para. 111.
[37] [2011] HCATrans 300. This appeal will be heard by the High Court of Australia on March 6, 2012.
[38] *Pilbara Infrastructure Pty Ltd. v. Australian Competition Tribunal & Anor.,* Appellant's Submissions (November 25, 2011).