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Client Update

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Rail Update – Government of Canada Issues Grain Transportation Order in Council

On March 7, 2014 the Harper Government imposed significant service obligations on Canadian National Railway Company (“**CN**”) and Canadian Pacific Railway Limited (“**CPR**”). Minister of Transport Lisa Raitt and Minister of Agriculture and Agri-food Gerry Ritz announced that the government has issued an Order in Council pursuant to section 47 of the *Canada Transportation Act*,¹ thereby ordering CN and CPR to increase their shipments of grain.

Under the Order in Council, CN and CPR will be required to each move a minimum quantity of 500,000 metric tonnes of grain – equivalent to 5,500 rail cars – per week. The two rail companies will in addition be required to provide data and reports to the government on a weekly basis, demonstrating their compliance with the Order in Council. Where the mandated levels of grain shipments are not met, the government has indicated that it will prosecute and seek penalties of \$100,000 a day. The Order in Council is valid for 90 days, and will be renewable for subsequent 90-day periods.

The rail companies are granted a four week “ramp up” period prior to reaching the full 5,500 rail car requirement. With both CN and CPR currently shipping approximately 2,500 rail cars a week, rail shipments are required to increase by 200 rail cars in the first week, and with exponential increases

provided in subsequent weeks, until the 5,500 rail car amount is reached in week four.

In addition to the Order in Council, Minister Ritz announced that the Harper Government will table legislation in the House of Commons on March 24th or shortly thereafter, in order to ensure continued efficient movement of agricultural products. The government’s announcement focused on the movement of grain and agricultural products and did not address underperformance of CN and CPR’s shipments of products in other industry sectors. As such, questions remain as to the manner by which the government intends on balancing the interests of those shippers and industries outside of the agricultural sector.

Section 47 Orders

Under section 47 of the Act, the Governor in Council (“GIC”) has special powers to take any step that it considers essential to stabilize the national transportation system. As a precondition of such action, the GIC must be satisfied that “an extraordinary disruption to the effective continued operation of the national transportation system exists or is imminent” and that “failure to act under this section would be contrary to the interests of users and operators of the national transportation system”. In addition, there must be no other provisions that are sufficient or appropriate to remedy the situation and counter the actual or anticipated damage caused by the disruption.

Under section 47, penalties for contravening an order issued by the GIC are, in the case of a corporation, fines up to \$100,000 for each day the order is

¹ *Canada Transportation Act*, SC 1996, c 10 (“**Act**”).



contravened. In addition, while orders made under section 47 are limited to 90 days, subsequent orders or renewals are permitted and have been upheld by the courts, even as part of a “long-standing solution”.² Finally, Orders in Council have been given wide deference by the courts, which have stated that “it would take an egregious case to warrant the Court striking down an Order in Council.”³

Economic Context and Recent Developments

Reliable and effective rail freight service is an integral component of Canadian businesses’ access to markets, with Canadian producers often relying on rail to move goods further into the supply chain. This is particularly true for high volume and low per-unit value commodity products, where rail customers and shippers are often captive to CN or CPR.

In recent years, dissatisfaction by rail shippers with the level of service offered by railways led the federal government to initiate changes to Canada’s rail freight landscape. The Rail Freight Service Review was launched in 2008, and in December 2010 the Rail Freight Service Review Panel submitted a final report after significant stakeholder consultations.⁴

² See for example: *Pro-West Transport Ltd. v. Canada (Attorney General)*, 2006 FC 881, where the Federal Court noted that the “Stability could hardly be achieved if the orders could not facilitate a more long-standing solution.”

³ See for example: *Thorne's Hardware Ltd. v. The Queen*, [1983] 1 SCR 106.

⁴ Transport Canada, Rail Freight Service Review - Final Report, January 2011, TP 15042, online:

The federal government’s response to the Panel’s report indicated that it intended to implement improvements to the rail supply chain and introduce legislation to give shippers the right to a service agreement with the railways and provide a process to establish an agreement if commercial negotiations fail. The federal government’s intentions culminated with the introduction and passage of Bill C-52, the *Fair Rail Freight Service Act*, which received Royal Assent on June 27, 2013.⁵

Despite such federal government actions, issues remain in respect of rail service obligations, with stakeholder groups and rail customers expressing continued dissatisfaction with rail freight service and often expressing frustration at their inability to ship goods in a timely manner.⁶ To compound matters, since June 2012, CPR continued to reduce engines and railcars by 43 percent and 35 percent respectively, taking 400 locomotives and 2,700

http://www.tc.gc.ca/media/documents/policy/TP_15042_Final_Report_EN_WEB.pdf [“**Final Report**”].

⁵ Fair Rail Freight Service Act. SC 2013, c 31.

⁶ See for example: Mining Association of Canada, Submission to the Standing Committee on Transportation and Infrastructure, February 28, 2013

Also see: Brian Cross, “Rail service legislation showing little effect” The Western Producer, February 7, 2014, online: <http://www.producer.com/2014/02/rail-service-legislation-showing-little-effect/>, quoting from Grain Elevators Association executive director Wade Sokbowich.



railcars out of service, and reducing its workforce by 27 percent.⁷

Such reductions in service are further complicated by two recent trends. Firstly, a recent increase in crop production has increased pressure on rail service standards. Western Canada produced a record crop of some 90 million tonnes of grain, oilseeds and pulses in 2013, an increase of 30 percent from 2012.⁸ Secondly, the movement of oil by rail has captured a growing percentage of rail capacity, as regulatory issues continue to delay new pipelines. Specifically, oil producers have increasingly been using rail to ship oil to refineries, with the number of monthly rail carloads increasing from approximately 5,500 per month in November 2008 to nearly 16,000 in November 2013.⁹ CN's 2013 second quarter financial reports noted that the company's oil shipments grew by 150 percent year-over-year, with growth expected to continue over the next 18 months.¹⁰ It is estimated that five percent of rail traffic in Canada is now taken

up by shipments of crude oil – a ten-fold increase in the last three years.¹¹

Should you have any questions, please contact either Ian MacKay or Ben Bedard.

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⁷ Carling Spelhaug, "Morningstar Names E. Hunter Harrison of Canadian Pacific Railway as its 2013 CEO of the Year", Press Release, Morningstar Inc., January 15, 2014, online: <https://corporate.morningstar.com/us/asp/subject.aspx?xmlfile=174.xml&filter=PR5047>.

⁸ Lynn Jacobson, Alberta Federation of Agriculture, Evidence delivered by videoconference to the House of Commons Standing Committee on Agriculture and Agri-Food, February 12, 2014, 41st Parliament, 2nd Session.

⁹ Statistics Canada, CANSIM Table 404-0002, Railway carloadings statistics, by commodity, monthly, last access February 25, 2014.

¹⁰ Scott Haggett and Solarina Ho, "CN Railway profit rises as crude oil shipments increase", Reuters Canada, July 22, 2013.

¹¹ Jen St. Denis, "Canada's crude oil train transportation boom derailing forestry sector", Business Vancouver, May 21, 2013, online: <http://www.biv.com/article/20130521/BIV0105/305219944/-1/BIV/canadas-crude-oil-train-transportation-boom-derailing-forestry-sector>; citing from "Leading Indicators of Industry Profitability Survey", Conference Board of Canada, May 2013 (by subscription).