

Submission of the Halifax Port Authority to the Rail Freight Service Review Panel



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EXECUTIVE SUMMARY

The Halifax Port Authority (HPA), entrusted with the development of the Port as a vital Canadian Gateway, is pleased to be able work with CN, one of North America's top railways. Since the creation of the Authority, HPA has worked continuously with CN to ensure the vitality of this rail link. Given the distance to market, the Port's success is heavily dependent on the CN rail link to the heartland of USA and Canada and thus, rail service at the Port is a top strategic issue for HPA's Board of Directors and its management team. HPA will continue to work with CN to achieve optimal service with prices that are competitive.

The Port of Halifax has a unique position in the Canadian Transportation system. Halifax is the only Canadian east coast port capable of handling Post-Panamax container ships of 6000-8000 capacity (TEU). These vessels will become the "work horses" of the North Atlantic trade. Continued development of the Port of Halifax as an East Coast North American (ECNA) "Big Ship" port, combined with the CN's critical rail link to the Canadian and US heartland is a key element to the development of Canada's transportation corridors.

The supply chain serving our markets consists of many players. HPA believes that those players impacted by service issues are best positioned to determine, in negotiation with the railway, what measures or steps are needed to improve service. The HPA also believes that the best time to deal with a service issue is in advance of a service problem.

"Customers using Halifax have their pick of ports; Halifax has only one choice for a railway. Seamless, timely railway connections with the rest of North America are essential as "Big Ship" services which avoid Halifax, avoid the East Coast of Canada."

Karen Oldfield, President & CEO,
Halifax Port Authority

In compiling this submission, HPA has sought feedback and input from stakeholders, Port users, operators and members of the business community. Our recommendations are intended to be productive, measured and grounded in the operational aspects of our business, all with a view to furthering Canada's success as an export nation and to the viability of the Atlantic Gateway. These recommendations may be summarized as follows:

- That railways be encouraged to deal with the principle players in the logistics chain on service issues and that dispute resolution mechanisms be available to those players.
- That railways be encouraged, on request, to engage in bona fide negotiations with logistics chain members to reach agreement on service levels to be provided.
- That the existing complaint provisions of the *Canada Transportation Act* be strengthened to allow for disputes on railway service levels and penalties that might be imposed for failing to meet them, whether occurring before or after service delivery, be eligible for mediation and/or commercial arbitration at the request of a member of the logistics chain. The Government of Canada should establish a system of ongoing monitoring of service and rate levels.
- The Government of Canada establish a system of ongoing monitoring of service and rate levels.

PORT OF HALIFAX – CANADA’S ADVANTAGE

In 1999, the Halifax Port Authority (HPA) succeeded the Halifax Port Corporation. Halifax was one of the first of 18 Canadian ports to implement this administrative change as required by the *Canada Marine Act*. As an Agent of the Crown under the direction of the Minister of Transport, the Halifax Port Authority is responsible for administering Halifax Harbour with a mandate "to develop, market and manage its assets in order to foster and promote trade and transportation and serve as a catalyst for the local, regional and national economies." The Port Authority's President and Chief Executive Officer reports to a Board of Directors made up of leaders from the Nova Scotia business community and beyond.

HPA operates on a commercial basis and is mandated to be financially self-sufficient. It exercises management authority over Halifax Harbour and federal real property in the Port. In addition, the HPA owns other property and equipment related to the operation of cargo and cruise operations at the Port of Halifax. The principal source of HPA revenues are fees on vessels, cargo and passengers using the Port of Halifax as well as lease payments for facilities under HPA management.

The Port of Halifax, and its diverse areas of business, is a major contributor to the economy of the Halifax region and Nova Scotia. Direct and spinoff (indirect and indirect) impacts from port-related activities include \$1.58 billion in gross output and \$671 million in Gross Domestic Product (GDP).

The Port has an annual employment impact on over 15,000 indirect and indirect jobs. Wages and salaries which result from port activity approximate \$505 million and the average wage for direct and indirect jobs is \$45,000 which is 29% above the provincial average.

PORT OF HALIFAX AT A GLANCE

- One of the deepest and largest natural harbours in the world Ice-free year-round and minimal tides
- Strategically located on the Great Circle Route
- Deepest container berths along East Coast North America
- Most easterly North American full-service container port
- First inbound, last outbound port to North America from Europe and the Mediterranean/Suez
- Serving major lines on transatlantic, Suez and pendulum routings including: Europe, Middle East, Southeast Asia/Indian Subcontinent and the Far East
- Serving more mainline global container services to more continents than any other Canadian Port
- Connects Atlantic Canada to 150 countries around the world- A Canadian Export Gateway

PORT FACILITIES

Halifax has one of the largest natural harbours in the world. It boasts an outer harbour two kilometers in width and eight kilometers in length with a channel leading to a huge inner harbour - Bedford Basin. With a depth of 18 metres (60 feet) at low tide, Halifax also has one of the world's deepest harbours.

Halifax Harbour is approached directly from the sea and is very close to the Great Circle Route. The harbour is sheltered and spacious, and has minimal currents and tides. The absence of ice leaves the harbour accessible year round.

The Port of Halifax is the first inbound port and the last outbound port on the North American continent enabling the shortest ocean voyage for ships operating on the North Atlantic. Halifax is strategically located near major shipping lanes. Post-Panamax vessels as large as 5,900 TEU currently call at Halifax.

The Port has two container terminals. The Fairview Cove Container Terminal (operated by Cerescorp Limited) is a 70 acre facility with six cranes (three of which are Super Post-Panamax Size) and two berths. The South End Container Terminal (operated by Halterm Limited) comprises 72 acres, six cranes (two Super Post-Panamax) and three berths.

CN is the sole provider of rail services to the Port. CN connects with the rest of Canada and other federally regulated railways in Montreal and with the New Brunswick Southern Railway in Saint John, New Brunswick. 80% of the Port's container traffic is moved by rail and there are four miles of on-dock railway tracks in use on the two container terminals. Additional on-dock rail is in use at the common-user cargo terminals at Ocean Terminals.

The HPA will invest over \$225 million in port infrastructure in the next five years, with the bulk of the spending on cargo-related projects added to more than \$100 million invested in the past five years. In addition, private companies have continued to make significant financial investments in port-related infrastructure.

HALIFAX RIVALS ANY OTHER EAST COAST NORTH AMERICAN PORT

POSITIONED TO COMPETE

- Vessel transit time advantages from target markets in Europe and Asia—1-2 days faster on-water than North American competitor ports
- In-land transit time advantages by rail to Canadian and U.S. Heartland—on-dock, double-stack service on uncongested CN mainline

WORLD-CLASS INFRASTRUCTURE

- Able to accommodate the largest ships afloat—handles Post-Panamax vessels and is Super Post-Panamax ready
- Deepest container berths on the East Coast of North America —Both terminals dredged to 16-plus metres
- Room to grow —Capacity to triple container volumes to 1.4million TEUs over the next 15-20 years, then expand to 2.5 million TEUs

PORT OF HALIFAX CONTAINER SERVICE

The overseas container business at the Port of Halifax runs on a weekly cycle with significant peaks falling on the weekends. This cycle reflects the requirements of major shipping lines using the Port. Most overseas lines using the Port have Halifax as their first ECNA port of call before proceeding down the eastern seaboard of the U.S. Likewise Halifax is their last port of call before proceeding overseas after having served U.S. ports. This means that both inbound and outbound container ships tend to congregate at Halifax toward the end of the week peaking over the weekend.

One of the principal reasons these lines call at Halifax is to provide their customers with the premium service associated with Halifax's geographical location and excellent rail link which permits time sensitive shipments to reach inland points sooner than if containers are unloaded in U.S. ports. The same advantage exists in reverse for exports.

10 of the world's 15 top container lines that serve over 150 countries on every continent call at Halifax.

THE OPPORTUNITY FOR CANADA

Conditions in the North American economies are improving and should support modest volume growth in the container port sector during 2010. Current forecasts, however, suggest that aggregate port volume levels in North America will not return to pre-recession levels until the end of 2014.

Within this economic context, significant new vessel capacity will be delivered to the shipping lines with major implications for the Port of Halifax. Three hundred and fifteen new Post-Panamax (PPX) and Super Post-Panamax (SPPX) vessels will be delivered between now and the end of 2012. With slow economic recovery, the container carriers will attempt to deploy their new Post-Panamax and Super Post-Panamax vessels in a manner that will not destabilize the demand and supply for slot balance and revenue rate recovery.

It is clear that ocean carriers will be strongly incited to deploy Post-Panamax vessels between now and 2014 in trades that have adequate volumes and infrastructure to support these larger vessels. Given the constraints of the Panama Canal until 2015, and the geographic location of Halifax, there are essentially only three relevant vessel service corridors with any near-term potential for the deployment of PPX and SPPX ships: the US East Coast—Med—Suez Canal—Indian Subcontinent/Far East corridor; the US East Coast—North Europe corridor and the US East Coast—East Coast South America corridor.

The North Europe and the Asian-Suez markets as far east as the Pearl River Delta through South East and South Asia have proven to be and remain valid markets for Halifax. These markets provide sufficient volume to use Halifax as a gateway port connecting an inland heartland centered in Toronto, Montreal, Chicago and Detroit. Additionally, the cargo volume in these trade corridors is sizable enough for the "roll up" of smaller vessel strings into the deployments of single PPX and SPPX vessel strings. The consolidation scenarios for both of these trade corridors will allow container carriers to achieve significant operating cost savings while maintaining the balance of supply and demand.



In order to best capitalize on the near-term opportunities that could arise from carriers deploying Post-Panamax ships on selected routes, Halifax will need to exploit its relative strengths, which include superior port/rail infrastructure.

Only Halifax and Norfolk on the Atlantic Coast are positioned as gateway ports with existing port and rail infrastructure, water depth and air draft to efficiently handle the new generation of PPX and SPPX vessels requiring sailing conditions of 15 metres of depth and 49 metres of air-draft clearance.

Currently, there is a window of opportunity, which should last for the next 30 to 36 months, for Halifax to be highly competitive in securing new PPX/SPPX vessels that are deployed in order to “roll-up” smaller and less economical vessel strings. This opportunity is driven by the fact that New York has relatively little PPX/SPPX terminal capacity, but the Port Authority of NY/NJ is working to address this deficiency.

Halifax is the only East Coast Canadian gateway port that can currently handle traffic flows to/from Ontario, Quebec and the USA Midwest on new PPX/SPPX services that are expected to be deployed in the Transatlantic and Suez/Asia.

The recent announcement by the CKYH Alliance is one service which has already made this strategic decision, with Halifax as first inbound port of call. The Port also has a number of options to cost-effectively expand its capacity for these classes of vessels. Thus, Halifax represents Canada’s best existing and future resource to insure that Canadian import and export supply chains moving in Atlantic/Suez trade corridors on new PPX/SPPX services continue to flow over Canadian ports.



Given the relatively small population and manufacturing base of Nova Scotia and the Atlantic region, the Port of Halifax must function as a gateway for exporters/importers in Quebec, Ontario, and mid western provinces/states. Further, given the distance between Halifax and these markets, rail intermodal service is the only economically and commercially viable surface transport link for large blocks of container movements. Halifax currently has an in-land transit time advantage via rail and it is imperative that HPA and CN continue their long-standing partnership to deliver cost and time competitive service.

The Port of Halifax is very cognisant of the unique challenges of operating at great distance to market. These challenges include cost of fuel, the fluctuation of the Canadian dollar and the ever-increasing competitive threats posed by the US east coast ports, particularly New York/New Jersey and Norfolk. These are shared challenges, faced by all members of the supply chain, including CN.

In recognition of their synergistic relationship and the need to meet these challenges together to fully capitalize on the opportunities, CN and HPA have moved forward in innovative ways more fully described on pages 12-14 of this submission.

RAILWAY SERVICE AT THE PORT OF HALIFAX – A TOP STRATEGIC INITIATIVE

Halifax's advantage of being the first and last North American call for shipping lines depends a great deal on speedy rail connections and particularly efficient direct cross dock movement of containers from ship to railway intermodal car and vice versa. Rail service changes at the Port over the past three years have impacted the Halifax advantage. First, CN does not provide service which mirrors the weekly traffic cycle seen at Halifax. Rather, it has moved to "smooth" rail demand by offering fixed daily capacity on trains to and from central Canada and the US Midwest. The railway's decision to operate one train daily in each direction to and from the Port does smooth demand but serves to limit the daily capacity available to import-export containers on each of these trains. These changes have the effect of "averaging" capacity to carry traffic on a daily basis rather than to service the weekly cycle seen at Halifax. (CN can also use capacity on these trains for its own domestic intermodal business which can, in effect, compete for slots with container traffic using the Port).

Secondly, the supply of empty intermodal cars has been reduced through the implementation of the IMX system several years ago. This change has had the result that cross-dock movements of containers direct to rail have been reduced substantially.

These changes have led to increases in the number of containers grounded¹ increasing the dwell times of containers in the Port particularly on weekends. While it is positive that the railway has increased its efficiency and profits, it has come at the expense of reduced overall supply chain efficiency and eliminated the natural time advantage of the Port. Optimum service must minimize unnecessary dwell time and grounding of containers and be able to recover quickly from disruptions, and it is anticipated that the level of service agreement (see page 14) will assist in this regard.

Other service problems arise in the switching of railcars within the Port. Differences in container flows exist between the two major container terminals necessitating the switching of empty railway cars within the Port. Internal changes at CN have affected the resources dedicated to switching to the point where the problems of container grounding and dwell time described above can be exacerbated because of the lack of timely switching of Port traffic.

Finally, the reduction in the weekly number of trains means that when the inevitable disruptions or late arrival does occur because of weather, derailments or other problem on the line, capacity to recover quickly is diminished.

The adverse impacts of demand smoothing on customers have yet to be fully solved by the members of the Supply Chain and can threaten Canada's competitiveness as a major international trader. The Level of Service Agreement more fully described on page 14 is a positive step toward solving these challenges.

"As the sole provider of rail service, CN has the power to decide who wins and who loses. It is only through rebalancing and working together that everyone can win."

K. Oldfield, President & CEO
Halifax Port Authority

¹ "Grounded" means a container which is removed from a ship or railway intermodal car and temporarily stored in the terminal and then moved again when an empty slot on a ship or railway car becomes available.

THE PROBLEM WITH RAIL DEMAND SMOOTHING

The HPA believes that the supply chain has optimum chance for success if the railway “smooths demand” with input and agreement from the players. In a highly functioning market place suppliers of transportation services provide services that customers demand, not services that they, as suppliers, are willing to provide. In a functioning market, it is the front-haul demand for transportation services that is supplied. Carriers that are not willing to provide the front-haul quickly go out of business as back-haul opportunities go to others who provide the front-haul and thus have better cost structures. The absence of an effective market for railway transportation services means that a carrier can “smooth demand” and lower **its own costs** by short supplying the market on the front-haul (not to mention possibly raising prices due to the short supply). CN Operations personnel have worked constructively on individual problems matching car supply to demand with the HPA and the terminal operators, particularly over the last year. However, the overall framework of the IMX system limits the ability of possible solutions and timely recovery for major service disruptions.

The Port of Halifax has worked directly with CN on a number of occasions on behalf of shippers seeking export reservations on CN intermodal trains to Halifax. The focus on balanced export/import traffic has resulted in export container traffic being delayed to subsequent vessel sailings or lost altogether to other ports. Unlike some bulk commodities which can sit and wait when there is no capacity, intermodal traffic, and particularly intermodal traffic using the Port of Halifax, is time sensitive, and shippers who are unable to obtain a slot must immediately look to alternatives. Too many such occurrences can lead to concerns on the part of shipping lines that a port is not reliable. Such a reputation, once gained is very hard to shake. Shippers who ship through ECNA have options available to them and can “vote with their feet”. They have options which they can exercise to the Port’s detriment and ultimately, because of Halifax’s unique position as a port, to the detriment of Canada. While HPA has had some success working with CN on behalf of shippers who are unable to obtain capacity, the fact that HPA has to do this at all, indicates all parties have further work to do to better secure the supply chain.

Demand smoothing as practiced by the railways, is not always a case of providing appropriate incentives to users of transportation services to offer their traffic in the most efficient fashion, rather sometimes it is the deliberate shaping of railway operations to increase overall contribution without regard to the requirements of the shipper. This practice ignores the reality of the transportation business; the supply chain does not always match the “perfect train”. By necessity there must be a little slack in the system to accommodate the inevitable changes in demand, whether it is for periodic but predicable variations in traffic, or interruptions routinely caused in Canada by winter weather.

THE RAILWAYS’ POINT OF VIEW

“From the railways’ perspective, finding ways to encourage shippers and receivers to balance their shipping demands across the days of the week, and even across seasons, is a key objective. Railways argue that it is unfair for them to bear the investment risks associated with spending on standby capacity that may be required to handle wide day of week variations in traffic levels. They believe that total supply chain costs are reduced when demand variations are smoothed out and they do not believe that current railway profitability levels support additional investment in standby capacity beyond that which exists today. While the railways acknowledged their responsibility to make investments in service capacity to handle reasonably predictable seasonal weather variations – they also believe that while the current system is not “bullet-proof” they argue that spending on additional rolling stock, track, avalanche and slide prevention and human resources cannot be commercially justified.” Source: Rail Freight Service Review Consultant Report: ***Analysis of Operating Practice*** October 2009, p. 29

STAKEHOLDER CONCERNS – UNDERSTANDING THE PAST

In mid-December 2009 the HPA convened a series of meetings with the Port's users and stakeholders with the objective to obtain feedback and input on service levels provided by CN and to obtain recommendations from the users and stakeholders which would make a positive contribution to this review and to the supply chain generally.

At each session feedback was solicited on:

- the importance of rail service to their businesses;
- changes in rail service which have been positive;
- changes in rail service which have not had a positive effect;
- impacts of changes in rail service on their businesses;
- suggestions to improve rail service to the Port.

The stakeholders with whom the Port met included the following users of the Port:

- National Gypsum (Canada) Ltd.
- Montship Inc. (Ship Agents/Brokers & Operators)
- Logistec Stevedoring (Atlantic) Inc.
- Furncan Marine Ltd. (Shipping Agents)
- Halterm Container Terminal Limited
- Cerescorp Company (Container Terminal)
- Atlantic Container Line
- Empire Stevedoring
- Halifax Chamber of Commerce
- Province of Nova Scotia (Transportation)
- Atlantic Canada Opportunities Agency
- Halifax Gateway Council

The concerns, interests and suggestions, expressed at these sessions with respect to CN's services to the Port can be summarized as follows:

CN'S SERVICES ON CONTAINER AND CARLOAD TRAFFIC

- All agreed that this national rail service review was “*overdue*” and there was a consensus that Atlantic Canada’s rail service needs can best be fulfilled through a national approach to rail service issues without the need for regionally focused policies.
- A general consensus that the existing rail service model in place at the Port “*works well for CN, but not, for us, its customers.*” CN is very focused on its long-haul, hook and haul, scheduled train operations and related revenue profitability whereas stakeholders seek increased attention on the ‘*needs*’ and ‘*wants*’ of the customer at the point of loading/unloading at the Port. More attention must be devoted to the services of CN “*at the Port*”, “*on the dock*” and “*on the pads*”.
- Stated in other terms, there is a need for the Port to be recognized ‘*higher up in the food chain*’ as a bona fide customer of the railway and, more explicitly, as “*a person*” under the Canada Transportation Act (“CTA”).
- A stakeholder feeling that “*they cannot win against CN*” when it comes to operations involving the placement and handling of containers at the port. CN’s rigid adherence to its unilaterally imposed train scheduling and switching operations to and from the terminals and its unwillingness to adapt its train and car switching services to the needs and work schedules of the terminals has required the terminals to invest in both infrastructure and resources.
- Stakeholder acknowledgement that operators must continually adjust in an effort to fit CN’s changing operations in Halifax – this has led to the downloading of considerable costs onto the terminals in the form of additional labour and capital works.
- There are bottlenecks in the container logistics chain at CN’s container facility at Brampton ON and stakeholders queried whether CN has the necessary infrastructure at that location required to handle the containers there.
- Some of these operational challenges at the Port stem from the change in CN’s train operations to/from Halifax from two trains to one train per day. When service problems occur with only one-train-a-day service, they are accordingly exacerbated.
- Stakeholders stated that missed CN train switches and inbound/outbound car deliveries have been an issue of concern. The fact that one company had lost business because of CN’s service failures was disturbing. It also concerns stakeholders that there are no penalties imposed upon CN when CN fails to provide adequate service, yet the firms are penalized in the form of demurrage charges when they fail to load, unload and/or release cars back to CN within CN’s strict time limits as set out in CN’s demurrage and car storage tariffs.

CN'S CARLOAD RAIL SERVICES

- The views and concerns expressed with respect to carload rail services at the Port for the most part echoed those respecting container. Shippers of carload products through the Port are of the view, however, that CN’s crews are more dedicated to intermodal services within the Port than to carload services. This was most evident during the recent CN labour disruption involving CN’s 1,700 locomotive engineers.

CN'S COMMUNICATIONS

- The local communication channels that do exist at Halifax are primarily between CN's operating personnel who are located at the CN terminals in Halifax and stakeholders. These channels work to a degree at the purely 'local' level but could be strengthened to address major system service failures which occur because of events beyond the immediate boundaries of the Port - in which cases more senior officers are needed 'on the ground' to address the service failures.
- Currently, there are no senior CN officers located in Halifax. Stakeholders commented that there is an urgent and significant need for CN to position senior operating and/or marketing personnel "on the ground" at Halifax – the fact that there are no senior CN personnel at Halifax has been and continues to be a major concern.
- When service failures occur at Halifax, in the form of delayed or missed train switches, CN's recovery from such failures tends to take longer than necessary or reasonable because of the absence of senior CN officers on site.
- At the local level CN's operating personnel generally respond to local operating problems to the best of their ability.

HALIFAX PORT AUTHORITY AND CN ACT TO IMPROVE RAILWAY SERVICE – MOVING FORWARD

Rail Service at the Port of Halifax is a Strategic Priority:

- The HPA, CN and the terminal operators have executed an agreement outlining the framework for service levels at the Port. The parties have agreed to work together to achieve Key Performance Indicators on customer focused service benchmarks. Each Party has committed to doing what it takes to regularly achieve these benchmarks. A dispute resolution mechanism has been agreed to solve any problems which may arise under the agreement. See next section for a full description of the agreement;
- HPA has, together with CN, developed a sophisticated to none electronic based Daily Service Benchmarking and Reporting System to track grounded containers and dwell times together with other key service metrics such as vessel arrival and departure times, percentage of railway cars stripped by the terminals, percentage of high capacity railway cars provided in intermodal trains, train arrivals and surplus or shortfalls in daily rail car supply. HPA believes that the best solutions to railway service issues are found with those affected. This system allows HPA, the terminals and CN to accurately determine the root cause of problems



without finger-pointing;

- The HPA convenes quarterly meetings with CN Management and Port Stakeholders;
- Annually the HPA leads the effort to develop the annual winter operating plan with all players and then monitors and manages the operational issues which inevitably arise;
- The HPA created the position of Manager, Cargo Operations in 2002. The main function of this operational position is to ensure the smooth operations of the port and particularly the rail/terminal interface and to troubleshoot daily operational problems.

HPA has made important rail related improvements:

- Extension of on-dock rail capacity at Fairview Cove Container Terminal from 6,000 to 12,000 feet. Cost - \$7 million;
- Upgrading of tracks at South End Container Terminal in 2009. Cost - \$1 million;
- Construction of a state of the art truck marshalling gate at Fairview Cove to improve terminal efficiency – 2007. Cost - \$2.5 million;
- Agreement to upgrade the truck marshalling gate at South End Container Terminal in 2010. Cost - \$10 million.

While these financial investments have been made by HPA, CN has been at the table through the planning and execution of these improvements – all for the betterment of these projects.

HPA and CN have worked together with the container terminals in Halifax on business development and marketing initiatives. This collaborative effort has increased noticeably over the last year with CN becoming more engaged in directly supporting measures to grow the intermodal traffic through the Port of Halifax. Continuation of this level of engagement is imperative for the success of the Atlantic Gateway. Specifically, this level of engagement with CN includes:

- Production and distribution of joint marketing material;
- Joint participation in targeted trade missions abroad;
- HPA initiated joint sales calls with freight forwarders and beneficial cargo owners;
- Sharing of market data and commercial intelligence.

As well, HPA has conducted various studies with a view to finding ways to innovate and productively assist CN in improving rail service at Halifax:

- *Analysis and Assessment of Rail Line Rates Issued by CN on Containers Originated and Destined at the Port of Halifax* – TL Maville & Associates – 2009
- *Yard Switching Service Study* – DRE Transportation Solutions – 2009
- *Port Utilization Indicators* – Ottawa Working Sessions – 2009
- *Trucking/In-Land Terminal Study* – MariNova Consulting – 2005
- *Rail Service Optimization Strategy* – Booz Allen Hamilton – 2004

LEVEL OF SERVICE AGREEMENT – A BIG STEP FORWARD

Together, CN and the HPA have recently embarked on an initiative to work with the Port's container terminal operators to improve the terminal/rail interface as a key step in enhancing the Port's effectiveness. Taking steps to ensure that the Port of Halifax is a preferred North American east coast intermodal logistic gateway servicing Ontario and Quebec Provinces and the USA Midwest markets centered on Chicago, Detroit and Memphis, is recognition of the mutual interest of the HPA and CN. The parties have agreed to work together to achieve Key Performance Indicators (KPI) on service to and from the Port.

Specifically it has been agreed that:

- 90% of the eligible import containers will be loaded to rail and released to CN by the terminal operator within 72 hours the completion of vessel operations. This measure tracks both terminal efficiency and the adequacy of rail car supply.
- 90% of loaded import containers will be delivered to inland CN terminals available for customer pick-up within 60 hours to Montreal, within 70 hours to Toronto, and within 112 hours to Chicago of effective release to CN by the terminal operator.
- Terminal operators will release 95% of export cars to CN with loaded import containers, empty containers or empty cars from the terminal for redeployment no later than 48 hours after placement of flatcars by CN on the terminal pad.
- 95% of most loaded export containers will be placed on-terminal by the commencement of the final work period of the vessel alongside the dock to ensure the opportunity to be loaded on to the vessel within the vessel's scheduled completion, provided these containers are received by CN in accordance with the stipulated inland rail terminal cut-off times.

HPA and CN have agreed that disputes under the Level of Service Agreement will be resolved through a process leading to the most senior executive officers in their respective operations.

This is an innovative and progressive means by which the parties recognize the importance of securing the supply chain and are working in concert to do so.

WHAT ELSE NEEDS TO BE DONE TO IMPROVE RAILWAY SERVICE?

While HPA has had positive success in addressing its rail service issues with CN, in recent months, stakeholders have raised concerns that there is nothing in place which compels railways to cooperate similarly in the future. HPA believes more can be done to ensure great railway service in the future.

STAKEHOLDER VIEWS

Port of Halifax Stakeholders made several recommendations for change during port stakeholder sessions hosted by the HPA in mid-December 2009:

- There was recognition that the overall success and growth of the Port and the livelihood of the stakeholders themselves, is inextricably linked to the actions and services of our rail partner, CN. Comments were productive and intended to assist the service review panel.
- It was proposed that CN define the service level which it will provide at the Port. The preferred vehicle by which to do this would be through a *'commercial'* service agreement formulated between CN, the Port, its terminals and customers. The agreement could establish service performance benchmarks, which encompass accountabilities for both good, and bad service levels. Subsequent to the stakeholder sessions, such a commercial agreement has, in fact, been concluded through the Level of Service Agreement.
- CN's communication channels between it, the Port and its customers need to be strengthened over *'the first and last mile'* (at the point of loading and unloading). Stated another way, there was consensus among stakeholders that there is much emphasis placed by the railway on its *'hook and haul'* long-distance services with more attention required by the railway on service *'at the Port'*.
- Improving the lines of communication between CN and its customers at the Port should commence with the reassignment by CN of a senior officer *'back on the ground'* at Halifax. The selected individual must, it was stressed, have the authority and power to make decisions respecting on-going CN levels of service and changes to service plans when deemed necessary, and; equally important, to act upon them immediately.
- All agreed that there is a crucial and urgent need for more effective systems to be established between CN and the Port which will accelerate the movement of *'the boxes'* between CN's rail yards at Halifax and *"the ship."* It is extremely frustrating and costly - from both a *time* and *resource* perspective - to see a container sitting



immediately adjacent to the terminal as opposed to on the dock. What is required and which the parties must work toward is a CN service model that consistently, reliably and effectively *'places the box on the pad'* at the Port. [Note: Addressed in LOS Agreement]

- Stakeholders agreed that CN should be required to define its rail service levels in its freight tariffs and in all confidential contracts entered into between the railway and its customers.
- It was proposed that the CTA be amended at s. 116 (the section which addresses levels of services disputes to the Canadian Transportation Agency) to explicitly define "any person" to include a port authority in Canada.
- There was a stated desire for a system to track and gauge CN's service after the Service Review is completed and recommendations for service changes have been put into place and activated.

PRINCIPLES FOR POLICY AND LEGAL CHANGE

1. *Solve service problems before they arise by negotiation*
2. *Make it "right" when problems do occur*
3. *Give all players a seat at the table*
4. *Railway service issues should be regularly monitored by policy makers*
5. *Results need to resemble those which would be achieved in the market*
6. *Recognize the national interest importance of rail service*

PRINCIPLES FOR CHANGE

Railways play an important and unique role in our economy. There are many component pieces of the transportation and logistics supply chain which can be further strengthened to secure and optimize the Canadian supply chain. This particular review addresses rail service. HPA has developed a set of principles around which any proposals for policy and legal changes could be evaluated.

First there needs to be a paradigm shift away from dealing with service problems *after they occur*, which is often characterized by bitter, urgent negotiations with the railways or legal proceedings before the Canadian Transportation Agency, to a more commercial style relationship where rail service can be tailored to the concerns and needs of stakeholders *in advance of service problems* by problem-solving negotiations between parties.

Secondly, stakeholders need to know what is going to happen to make it "right" when rail service problems do arise. This may be by way of effective dispute resolution mechanisms or otherwise.

Thirdly, the role of all players in the logistics chain to work together to solve rail service problems needs to be recognized. Shippers, shipping lines, terminal operators, port authorities and industry associations all have a legitimate place at the table when dealing with rail service issues.

Fourthly, the current examination of railway service issues has led to an increased focus on rail service and a bona fide effort by all members of the chain to identify such productive solutions. It is believed that some form of monitoring by policy makers of these questions following the review would have the same salutary effect.

Fifthly, solutions need to be found that lead to the same result that would be achieved in a robust market: buyers and sellers get fair prices and service and supplies are commensurate with demand.

Finally, rail service needs to be recognized as a matter of national importance to the long-term economic viability of the Canadian economy and treated accordingly. Rail service is not simply a private matter between the railway, its customers and its investors. This does not imply a return to wholesale regulation. As CN and HPA's recent successes have established, service improvements can be made by willing parties.

RECOMMENDATIONS FOR CHANGE

HPA respectfully submits that the recommendations of the Rail Freight Service Review need to address four broad areas:

1. Clarify the standing of players in the logistics chain to engage the railways in service level discussions, agreements and dispute resolution;
2. Encourage members of the supply chain, including railways, to define service levels in advance in agreement with other members of the logistics chain
3. Develop dispute resolution mechanisms to obtain agreement on service levels and which address a service failure;
4. Ongoing monitoring of railway service & rate levels.

GIVE STANDING TO PARTIES IN THE LOGISTICS CHAIN

Despite the fact that the level of services provisions of the *Canada Transportation Act* allow any "person" to complain about railway service issues, some jurisprudence of the Canadian Transportation Agency suggests that the right to apply for a remedy may be limited to direct customers of the railways. While there has been a recent loosening of this narrow interpretation by the Agency, its decision in this regard is under appeal by CN to the Federal Court of Appeal.

HPA holds that the Act needs to be clarified to ensure that everyone with a legitimate interest in the logistics chain including terminals and port authorities have the clear right to deal with the railway on service issues including access to all relevant dispute resolution provisions.

HPA therefore recommends:

1. THAT RAILWAYS BE ENCOURAGED TO DEAL WITH ALL PLAYERS IN THE LOGISTICS CHAIN ON SERVICE ISSUES AND THAT DISPUTE RESOLUTION MECHANISMS BE AVAILABLE TO THOSE PLAYERS.

ENCOURAGE RAILWAYS TO NEGOTIATE SERVICE LEVELS BEFORE THE SERVICE IS DELIVERED

The current complaint provisions of the *Canada Transportation Act* can only be invoked after a service failure or an out-right refusal on the part of a railway to provide a requested service. This leads to a business environment where planning is difficult. HPA believes it is much more effective for all involved to define their expectations in advance and to plan accordingly. This is the reason HPA has taken the initiative to lead the effort to establish an agreement with the two container terminals in the Port of Halifax, itself and CN. By agreeing in advance on key performance metrics,

all players can make adjustments to their operations to better ensure achievement of the benchmarks. It is understood that an initial attempt to benchmark Key Performance Indicators should also recognize the need to modify and refine these benchmarks through input from users.

The *Canada Transportation Act* does not currently require the railways to enter into agreements on service with parties in the logistics chain in advance of service delivery. However, the U.S. Rail Bill (S.2889) introduced in December 2009 in the U.S. Senate acknowledges the need to define service levels in advance by proposing that railroads in the U.S. be required to publish “reasonable common carrier service expectation ranges” including ranges for normal car cycles, transit times, switching frequency and other service components. Other than the fact that the stated service expectations must be “reasonable”, the provisions leave the question of establishing the service level expectations to the railroad.²

HPA believes that there needs to be a shift from the traditional idea that railways offer a pre-defined service and shippers decide on a “take it or leave it basis” to a modern, commercial based system where a railway engages in discussions with its customers as to how to best meet their needs. Because there is no effective market to enforce this obligation, HPA believes the principle needs to be enshrined in the *Canada Transportation Act*.

HPA therefore recommends:

2. THAT RAILWAYS BE ENCOURAGED, ON REQUEST, TO ENGAGE IN BONA FIDE NEGOTIATIONS WITH LOGISTICS CHAIN MEMBERS TO REACH AGREEMENT ON SERVICE LEVELS TO BE PROVIDED.

PROVIDE FOR DISPUTE RESOLUTION MECHANISMS AND PENALTIES

Whether dealing with the impact of a service failure or the inability to get a service level agreement in the first place there needs to be in place robust, inexpensive, effective dispute resolution mechanisms, including pre-determined penalties where appropriate, which encourage parties to reach agreement. HPA believes that a complementary framework of commercial dispute resolution - mandatory mediation and arbitration together with carefully crafted reciprocal penalties are the mechanisms most likely to lead to the settlement of service issues.

To be effective, dispute resolution mechanisms must be available at the request of the party seeking the agreement and railways must be required to participate.

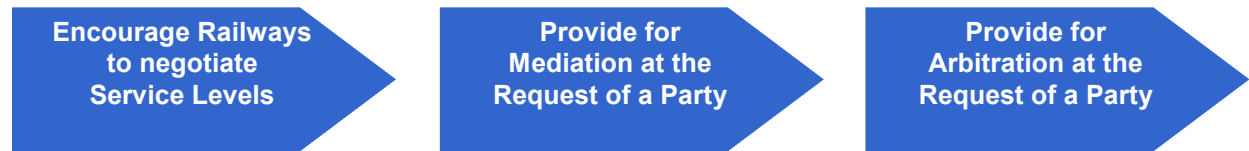
While mediation of rail disputes is available under the *Canada Transportation Act*, a railway cannot be compelled to participate as the process is entirely voluntary. Parties ought to have a means to require the railway to discuss service level issues to ensure that the obligation to enter into discussions is respected. Final Offer Arbitration (FOA) is also available under the Act to establish a first contract with the railway and can, in theory, deal with service issues. However, as practiced, FOA is a highly litigious process which is difficult and intimidating to use. As such, it may not be suited to disputes involving service levels.

Dispute resolution needs to be available at all stages: while negotiating a first agreement on what the level of service should be; while dealing with a railway that refuses to provide a certain level of service; and while dealing with a service failure.

The U.S. Rail Bill (S.2889) introduced in December 2009 in the U.S. Senate has provisions which establish a simplified process of binding arbitration of common carrier service expectation complaints.

² The provisions provide for recourse to the Surface Transportation Board and binding arbitration for those who believe the stated service levels are not reasonable.

The HPA believes that an escalating scheme of dispute resolution progressing in logical steps will strongly encourage parties to settle their differences:



Railways in Canada have long used penalty systems to encourage behavior among shippers. HPA believes that players in the logistics chain should have the same ability as the railways to impose penalties to encourage behavior. Under current law, however, only the railway has the legal power to impose penalties by way of a tariff. The only way logistics chain members can impose a penalty on a railway is if it consents. HPA believes this inequity should be examined and reconsidered.

The HPA therefore recommends:

3. THAT THE EXISTING COMPLAINT PROVISIONS OF THE CANADA TRANSPORTATION ACT BE STRENGTHENED TO ALLOW FOR DISPUTES ON RAILWAY SERVICE LEVELS AND PENALTIES THAT MIGHT BE IMPOSED FOR FAILING TO MEET THEM, WHETHER OCCURRING BEFORE OR AFTER SERVICE DELIVERY, BE ELIGIBLE FOR MEDIATION AND/OR COMMERCIAL ARBITRATION AT THE REQUEST OF A MEMBER OF THE LOGISTICS CHAIN.

MONITOR RAILWAY SERVICE LEVELS & RATE LEVELS

The current Rail Freight Service Review has had a positive effect on service levels and the willingness of the railways to engage in meaningful discussions with the logistics chain on service issues. The key will be a continuation of such a high level of engagement following conclusion of the review. For example, the monitoring, implemented after the grain transportation reforms in 2000, has had a positive effect on the grain transportation and handling system in Western Canada.

It is impossible to talk about service without talking about rate levels. Service and rates go hand in hand. Operating profit on any given movement after operating cost depends on the rate charged. A railway determined to achieve a certain margin on a particular movement, must raise rates if it is has agreed to provide a specified service level more costly than it anticipated. The issue of appropriate levels of financial contribution from railway traffic is beyond the scope of this review. Nevertheless as part of the ongoing process of monitoring service issues, HPA recommends that policy makers ought to have available means of monitoring pricing levels to ensure that rail service in Canada is not improved at the expense of competitive rates. It is worth noting that an analysis of container rates done for the HPA concluded that service to the Port could be improved while maintaining reasonable profit levels.

HPA therefore recommends that:

4. THE GOVERNMENT OF CANADA ESTABLISH A SYSTEM OF ONGOING MONITORING OF SERVICE AND RATE LEVELS.

CANADA'S NATIONAL INTEREST

Canada's National Transportation Policy (*Canada Transportation Act*, s.5) recognizes that it is in Canada's national interest to have a competitive, economic and efficient national transportation system. Canada's very existence as a trading nation depends on attaining these goals. While the Policy states that competition and market forces are the prime agents to achieving viable and effective transportation services, it also recognizes that regulation and strategic public intervention may be used to achieve desirable outcomes which cannot be achieved satisfactorily by competition and market forces. The Rail Freight Service Review consultant studies establish beyond a doubt that rail service in Canada can better reflect the needs of the logistics chain.

Canada's railways have had considerable success under the current regulatory environment and have made a considerable contribution to Canada's economic well being. It is important to learn from past experiences and to build on the successes such as the LOS Agreement if our railways and Canada as a whole are to continue to prosper in the future.

CONCLUSION

The use of larger container ships worldwide and the rebounding North American economy present a unique opportunity for the Port of Halifax and Canada's Atlantic Gateway. The Halifax Port Authority is pleased to have been able to work with the new management team at CN to put into place a benchmark agreement which will allow the Port to take full advantage of this opportunity.

As a leading North American railway, CN's renewed focus on positive customer-centered initiatives is a welcome development and one which will be positive for stakeholders and for CN's ongoing profitability as well. HPA has always maintained that what is good for the Port of Halifax is good for CN and CN's commitment through the LOS Agreement demonstrates that it also believes so.

As a trading nation, Canada requires a strong Port of Halifax and a strong CN linking the Port to the rest of North America. HPA believes that the initiatives it has taken together with CN, combined with the changes recommended in this submission will ensure the ability to secure these requirements and Canada's national interest in the future.

The framing of this submission to the Rail Review Panel has been a delicate task for the Port of Halifax. As has been said throughout, we have only one railway to the continent's heartland. While the Halifax Port Authority does not have commercial contractual relationships with CN, all of our key customers do. To a very large degree, the success of our Port and the massive economic impacts which flow from our Port, are dependent on those private business relationships. Our Port's relationship with CN, and our customers' relationships with CN, are crucial.

In these circumstances, it would have been easy for the Port of Halifax to take either of the following approaches:

- To heavily criticize CN for areas of difficulty in rail service which have arisen in the past; or
- To gloss over the past and optimistically look forward to the perfect future in which all stakeholders are pulling together, at the same time, and in the same direction, to build critical mass for Canada's east coast rail system and port system.

Instead, we have attempted to present a dispassionate analysis of some of the issues which have arisen and to suggest constructive solutions and approaches.

In fact, we are optimistic about the future. We hope and feel that CN's new management team is developing a healthy sense of the opportunity which may exist for Canada's east coast and is showing a willingness to work closely with customers to make this happen.

At the end of the day, we are optimistic there are business solutions which are good for CN's business and also in the public interest. But, the public interest always needs to be protected. We will work hard with CN to develop these win/win solutions which we believe will be good for the future of the Port of Halifax and for Canada.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Karen Oldfield".

Karen Oldfield
President and Chief Executive Officer
Halifax Port Authority
April 30, 2010

APPENDIX 1 - SUMMARY OF RECOMMENDATIONS

1. THAT RAILWAYS BE ENCOURAGED TO DEAL WITH ALL PLAYERS IN THE LOGISTICS CHAIN ON SERVICE ISSUES AND THAT DISPUTE RESOLUTION MECHANISMS BE AVAILABLE TO THOSE PLAYERS.
2. THAT RAILWAYS BE ENCOURAGED, ON REQUEST, TO ENGAGE IN BONA FIDE NEGOTIATIONS WITH LOGISTICS CHAIN MEMBERS TO REACH AGREEMENT ON SERVICE LEVELS TO BE PROVIDED.
3. THAT THE EXISTING COMPLAINT PROVISIONS OF THE CANADA TRANSPORTATION ACT BE STRENGTHENED TO ALLOW FOR DISPUTES ON RAILWAY SERVICE LEVELS AND PENALTIES THAT MIGHT BE IMPOSED FOR FAILING TO MEET THEM, WHETHER OCCURRING BEFORE OR AFTER SERVICE DELIVERY, BE ELIGIBLE FOR MEDIATION AND/OR COMMERCIAL ARBITRATION AT THE REQUEST OF A MEMBER OF THE LOGISTICS CHAIN.
4. THE GOVERNMENT OF CANADA ESTABLISH A SYSTEM OF ONGOING MONITORING OF SERVICE AND RATE LEVELS.