

Rail rules could boost Buffett

Grain shipment changes may lead U.S. carriers to poach, analyst says

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Ottawa's decision to implement new regulations on grain shipments by rail is aimed at improving service for Canadian farmers. But the new rules may have another unintended beneficiary: billionaire Warren Buffett.

The federal government has proposed a series of changes to the way railways are allowed to operate in Western Canada in legislation it tabled last week.

Among the changes in the Fair Rail For Grain Farmers Act is a proposal to extend the distances for the country's interswitching provisions.

Interswitching is when one railway picks up or drops off freight cars from a shipper's facility that are transferred to and from another railway.

In Canada, the federal government sets the rates for interswitching within a 30-kilometre radius of a captive shipper. These rates fall below market prices, but are intended to help grant fairer access to the rail service for shippers who only have access to one railway in the country.

The federal government has proposed extending the interswitching radius to 160 kilometres for all commodities shipped by rail in Alberta, Saskatchewan and Manitoba.

This would essentially open up the southern portion of Canadian National Railway and Canadian Pacific Railway to poaching by U.S. railways, according to Walter Spracklin, RBC Capital Markets analyst.

Which U.S. railway stands to benefit the most from the changes? Buffett's Burlington Northern Santa Fe Railway.

"A 160-kilometre interchange limit would open up the southern portion of CNR and CP's network to competition from U.S. carriers, especially BNSF," Spracklin said in a note to clients.

"We believe agriculture volumes represent the greatest flight risk as BNSF already serves an extensive grain elevator network south of the Prairie Provinces and bringing on Canadian grain would add density to this operation," he added.

Spracklin noted that unlike market-share shifts between Canadian railways that might also result from the interswitching rule changes, the market-share losses to U.S. competitors would be more permanent because there are no reciprocal interchange provisions in the U.S. "Accordingly, cargo losses to U.S. carriers would disappear from the Canadian supply chain altogether weakening all stakeholders' positions (ports, trucks, etc.)," Spracklin said.

But he said market-share losses are not the only issue that might result from the new rules.

They also threaten to raise costs for Canadian railways by introducing added complexity to their networks and may require extra infrastructure to be added.

In addition, because the new regulations only apply to commodity shippers in the Prairies, those shippers would be granted greater access to Canadian and U.S. railways than others elsewhere in the country.

"Despite our bewilderment around the origination of the bill, it is very likely to pass in the coming weeks. Although we believe the risk is meaningful, the impact of the amendments will be determined by the extent to which new provisions are used," Spracklin said.

Both Canadian railways say the changes proposed do little to address the root cause of the current backlog of grain in the West, which they argue is a result of a bumper crop last year and a record cold winter that slowed their trains and grain shipments.

Last month, federal Transport Minister Lisa Raitt ordered both CP and CN to move 500,000 metric tons of grain per week each to alleviate the backlog within a four-week period or risk fines of up \$100,000 a day.

In addition to the new regulations, the legislation would enable the federal government to set grain volume requirements in the future under extraordinary circumstances.

Keith Creel, CP president and chief operating officer, testified before the Standing Committee on Agriculture earlier this week that the proposed changes could slow down the grain supply chain due to increased handling that would further constrain capacity.

He also argued others stakeholders in the grain supply chain would need to step up if Ottawa wants to alleviate the backlog.