SUBMISSION TO TRANSPORT CANADA
ON THE REVIEW OF THE ST. LAWRENCE SEAWAY

June 21, 2018

Introduction

The Shipping Federation of Canada is the voice of the owners, operators and agents of the foreign flag ships that carry Canada's imports and exports to and from world markets. Our members represent over 200 shipping companies whose vessels make thousands of voyages between Canadian ports and international markets every year. A significant number of our member companies operate in the St. Lawrence Seaway system and have made substantial financial investments in ships that are specifically designed for Seaway navigation.

As the representative of the ocean-going, foreign flag vessels that trade through the Seaway, we have a strong interest in ensuring the waterway's long-term viability as an international trade route. From our perspective, it is impossible to isolate the locks, bridges and connecting channels that make up the Seaway proper from the larger marine transportation ecosystem in which it operates. That ecosystem, which extends from the Gulf of St. Lawrence through all five of the Great Lakes and connects the North American heartland with markets overseas, is made up of many moving parts that are regulated by multiple authorities under various national, provincial and state jurisdictions. This reality, which speaks to both the system's complexity and its interconnectedness, highlights the importance of identifying realistic and achievable measures to enhance competitiveness and long-term viability from a system-wide, holistic perspective with all the various parts working towards a common end.

Commercial and Economic Evolution of the Seaway System

The formula on which the St. Lawrence Seaway was conceived and constructed - to carry Prairie grain from Great Lakes ports to North American and overseas customers on the down bound voyage, and to carry iron ore from ports along the lower St. Lawrence as well as steel from overseas suppliers on the upbound voyage - proved to be extremely sound for the first 25 years of the system's operation. Indeed, cargo volumes steadily increased over that period, with the 5 million tons of grain and iron ore that moved on the Montreal-Lake Ontario section of the waterway in 1958 quintupling to 25 million tons by 1980. However, changes in international markets – including reduced European and Soviet demand for foreign grain and a significant growth in demand from Asian markets - caused a profound disruption to that model from the 1980s onward, particularly with respect to the transportation of grain. By the 1990s, 70 percent of Canadian grain exports were being handled by ports in British Columbia, and over 90 percent of US grain exports were being handled by ports along the Mississippi River and the US west coast. That pattern remains more or less relevant today and is unlikely to change in the foreseeable future, given the current configuration of world markets and the ongoing growth in demand emanating from the Asia Pacific region.

Despite these changes in markets and volumes, the Seaway remains an essential marine transportation corridor that is strategically connected to the North American industrial heartland and complements the region's rail and highway network by offering a safe, efficient and environmentally sustainable means of moving raw materials, agricultural commodities and manufactured products. Over 160 million metric tons of cargo is moved on the St. Lawrence Seaway – Great Lakes system every year, with dominant cargoes including iron ore for steel production, coal for power generation, limestone and cement for construction, and grain for both domestic and international consumption.

Although the market shifts that occurred in the 1980s generated a number of significant challenges for the Seaway, they also had the effect of creating a system that today has a substantial amount of surge capacity, with most terminals and elevators operating at an average of about 50 percent of their demonstrated capacity over the past two decades. This provides a tremendous benefit to the transportation system as a whole, particularly in a context where the Port of Vancouver - Canada's largest trade gateway - has faced ongoing capacity challenges in recent years, and both CN and CP rail continue to be plagued by systemic capacity issues (as evidenced by the delays and backlogs that were experienced this past winter). The need to maintain the Seaway as an outlet to relieve pressure on other parts of the system and to capitalize on unexpected surges in demand cannot be underestimated and underscores the importance of ensuring that the system continues to be fully and adequately funded and maintained in the future.

The Importance of Cost Control

Economic and market forces – combined with size and seasonality factors – have made it challenging for the Seaway to diversify its cargo base beyond the (relatively) low value bulk and breakbulk commodities that remain its bread and butter. Given that the routing decisions of the shippers of such commodities are primarily driven by price, cost control is clearly a key factor in ensuring the Seaway's system's competitiveness as a viable transportation option in the future. This is particularly true in an environment in which the transportation service provider (the ship owner or operator) has a huge range of costs with which to contend - including ship, crew and fuel costs, Coast Guard charges, Seaway tolls, tug services, and marine pilotage fees, among others – while the cargo owner has a number of competitive transportation alternatives at his or disposal, including moving the cargo by rail to US east coast ports (or to the west coast) or moving the cargo by ship visa the Mississippi route.

It is worth noting in this respect that according to the *Canada Transportation Act* (CTA) review panel, marine user fees in Canada amounted to $857 million in 2013-2014 (with port, pilotage and Seaway fees accounting for more than 90 percent of this total) and have increased by an average of more than five percent per year over the past 15 years. The panel also makes the observation that the U.S. does not impose fees for vital services such as icebreaking or dredging – nor does it charge Seaway tolls - and that Canadian user fees are considered high by comparison, despite the fact that they only recover part of the cost.

Of the various fees that users of the Great Lakes – St. Lawrence Seaway system face, the most significant – and challenging – by far are those related to marine pilotage services. As an example, a 35,000-tonne bulk carrier making a return voyage through the system (i.e. arriving from Europe to discharge an import cargo in Windsor, proceeding to Thunder Bay to load export grain, and then transiting to the last pilotage station eastward in les Escoumins, for a total of 8.5 days of navigation) would face $12,000 a day - or a total or $105,000 overall – in pilotage fees alone. For some perspective on how disproportionate these fees really are, it is worth noting that the above-noted $12,000 daily pilotage fee is higher than that same vessel's daily fuel costs (which would vary between $5,400 and $10,400 depending on whether the vessel is at sea and burning intermediate fuel or in an Emission Control Area and burning low sulphur fuel), and is equal to or higher than the vessel's total daily operating costs (which would total between $10,500 and $12,000 per day in operation/maintenance and amortization/financing costs).

The problems that are inherent in the current pilotage system were explored in depth in our brief to the Chair of the *Pilotage Act* Review, in which we noted that the pilotage system is unable to control costs or consistently provide users with appropriate levels of service – due mainly to a lack of adequate checks and balances within the *Pilotage Act* to counteract the effects of the monopoly structure under which the system currently operates. In support of this assessment, our brief identified a list of concrete inefficiencies which illustrate some of the areas where improvements are needed, and provides a series of recommendations that are designed to provoke a shift in culture that generates greater focus on efficiency and innovation (in addition to safety), more transparency (including in pilot contracts), enhanced performance standards (to measure productivity and service efficiency), and new accountability for both pilots and pilotage authorities (or any other entity that may be tasked with managing pilotage services).

Although we are cautiously optimistic that the review process will address some of the serious cost and service issues noted above, this will do nothing to alleviate pilotage issues in the U.S. Great Lakes, which are even more egregious than in Canada. The U.S. Coast Guard has overseen an explosive increase in pilotage costs in the U.S. Great Lakes over the past three years, to the point where the cost of using a U.S. pilot is often more than double the cost of using a Canadian pilot. Users have not only been subject to chronic delays, but U.S. pilots have, in some cases, "forced" vessels to take on additional third-party costs, even when not required. The U.S. pilotage system threatens not only the competitiveness of the Seaway, but its reliability and service integrity as well. Consequently, we urge the Canadian government to make representations to their American counterparts at the diplomatic level to investigate this serious issue.

Infrastructure Investment

In addition to cost control, investment in infrastructure is another key component of the competitiveness of the St. Lawrence Seaway – Great Lakes system, and an essential and urgent priority in this respect is the renewal of the Coast Guard's icebreaking fleet, which plays a fundamental role in maintaining trade through the system (as well as other key Canadian trade corridors) during the long and challenging winters. Despite its importance to Canada's trade competitiveness, the icebreaking fleet is currently made up of over-aged vessels which are very thinly spread over a vast expanse of water. Given that the demand for icebreaking services is expected to remain strong in the future, it is essential that the icebreaking fleet have sufficient capacity and capability to ensure safe and efficient commercial navigation for the next several decades.

We have raised this issue with Transport Canada, the Canadian Coast Guard and Public Services and Procurement Canada on numerous occasions over the years, with a view to ensuring that the government moves swiftly in developing a concrete plan for ensuring the fleet's ability to meet the needs of Canadian exporters and importers in the long term. Although we understand that the Coast Guard is working on various fleet renewal measures, including options for obtaining interim capacity as required, we still have yet to see a concrete plan – including costs, timelines and procurement strategies – in this respect. The continued absence of such a plan – and the uncertainty that this creates regarding the system's ability to ensure efficient commercial navigation regardless of weather conditions – also serves to undermine efforts to develop new business opportunities and attract new cargoes to the system.

Seaway Configuration Factors

The fact that the St. Lawrence Seaway closes for roughly three months every winter is sometimes cited as a key hindrance to the waterway's future development. Although it is true that a nine-month operational schedule would be unworkable for a system carrying high value goods along a just-in-time supply chain, this is not necessarily the case for a system that is based primarily on the carriage of relatively low value bulk cargoes. Indeed, regular shippers through the system have adapted to the winter closure by stockpiling inventory in late summer in order to see their operations through until spring, allowing the system to close for the inspection, repair and maintenance work that is so essential to its efficient operation. This, combined with the complexity of operating locks in freezing temperatures and ice conditions, makes it difficult to build a sound rationale for moving towards a year-round operation of the Seaway, at least in the short to medium terms.

Stimulating New Demand

We applaud the efforts of the St. Lawrence Seaway Corporation to attract new cargo through incentive programs, which can be particularly effective in a context where a shipper has various transportation options from which to choose. As an example, the SLSMC's new business incentive program, which offers a 20 percent discount on cargo tolls over three years for new commodities, generated 51 applications in 2016. This translated into 491 movements of new business such as wind turbines and machinery, which were previously being shipped via other gateways. We similarly support the Seaway's efforts to generate additional tonnage through branding strategies such as the "Highway H2O" campaign, and undertaking marketing initiatives such as trade missions, promotional campaigns and flagship events such as the annual Highway H20 conference.

With respect to stimulating future demand for shipping services through the Seaway system, it is worth noting that one of the federal government's key objectives is the pursuit of an ambitious trade agenda that is based on breaking down existing trade barriers and identifying and developing new markets and opportunities for Canadian exporters, producers and manufacturers. The provisional implementation of the CETA trade deal this past fall and the recent signing of the revised Trans-Pacific Partnership are very positive developments in the respect, and we look forward to similarly positive outcomes from other initiatives that are currently underway, including the MERCOSUR negotiations, exploratory AESEAN talks, and discussions on a potential free trade agreement between Canada and China. Although not all of these agreements target markets that can be served by the St. Lawrence-Great Lakes route, some (including CETA and MERCOSUR) potentially do, and we urge the SLSMC and other relevant authorities to continue working with stakeholders to identify and pursue new markets and opportunities associated with these agreements.

We also urge the SLSMC to continue its proactive approach to trade negotiations in the future, with a view not only identifying potential new markets for Canadian exports or foreign imports routed through the Seaway system, but to also using such negotiations as a means of addressing non-tariff barriers that act as impediments to both trade and supply chain efficiency. The recent CETA trade agreement may be particularly instructive in this respect, insofar as its chapter on maritime services exempts a number of specific activities (including the repositioning of empty containers between Canadian ports and the provision of feedering services between the ports of Montreal and Halifax) from the *Coasting Trade Act* prohibitions that would have otherwise prevented foreign flag ships from engaging in such activities without a coasting trade license. Although the above examples may not be directly applicable to the Seaway, they do illustrate the kinds of gains that can be achieved through an approach to trade negotiations that focuses on increasing demand by reducing both tariffs and other barriers to trade, while also recognizing enhanced supply chain efficiency as a legitimate objective in a trade negotiation process.

Challenges and Opportunities Related to the NAFTA Renegotiation

As an adjunct to our comments on trade agreements, we would also urge the SLSMC, Transport Canada and other authorities to pay close attention to the ongoing efforts to renegotiate the North American Free Trade Agreement. Although the marine mode plays a fairly limited role in directly transporting NAFTA trade, it does play a role in transporting the inputs that fuel NAFTA production, and this is trade that moves on both domestic ships (e.g. aluminum, iron ore) and ocean ships (e.g. steel and steel products). Within such a context, the outcome of discussions on proposals such as the U.S. recommendation to boost North American content in cars and trucks manufactured in the NAFTA zone is of particular interest, as this may impact not only the levels of demand for shipping services (due to lower demand for foreign-sourced input), but also the long-term viability of the Seaway as a key trade route, given that an assurance of sustained demand is an essential element in ensuring the long-term funding that is necessary for the waterway's infrastructure needs. The U.S. government's recent tariffs on steel and aluminum underline the threats to the Seaway system in this respect.

Notwithstanding the above, we also see a number of potentially positive outcomes from the NAFTA renegotiation process, particularly insofar as it represents a much-needed opportunity to modernize Canada-US border processes and facilitate the movement of goods (and conveyances) between the two countries. In this respect, we support several of the "Customs and Trade Facilitation" objectives set out in the US Trade Representative's document of November 2017, which include implementing WTO agreements involving trade facilitation and providing for automation of import, export and transit processes; reducing import, export and transit forms, documents and formalities; and enhancing harmonization of customs data requirements. Although we support these objectives for all cross-border movements, they are particularly important for marine movements through the St. Lawrence Seaway-Great Lakes system, where a ship may have to cross the marine border multiple times during the course of its voyage**.** Specific trade facilitation measures that could be implemented along this route include harmonizing customs and immigration procedures so that that reporting of the vessel, cargo and crew occur at the vessel's point of entry into / exit out the system

Growth Opportunities

Although it is difficult to create new demand for shipping services in an already highly competitive environment, one area in which untapped demand may actually exist lies in the Great Lakes cruise industry. Indeed, we are aware of several operators of foreign flag cruise ships who are potentially interested in establishing cruise services on the Canadian Great Lakes, but who are currently constrained in their ability to do so. This is due to the fact that the *Coasting Trade Act* prohibits foreign flag ships from carrying passengers from any place in Canada situated on a lake or a river to either the same place or any other place in Canada unless they have obtained a coasting trade license – which is a difficult process that often serves as a strong disincentive to pursuing such projects further.

More specifically, in order to obtain a coasting trade licence, a cruise ship operator would first have to submit an application to the Canadian Transportation Agency to ensure that no suitable Canadian vessel or similar Canadian marine service is available for the proposed project. Assuming no suitable Canadian option is available, the operator would then have to advertise for all of the foreign crew member positions on board and obtain a positive labour market impact assessment for each before being able to obtain the necessary permits that would allow them to work in Canadian waters. The operator would also have to pay customs duties for each month or part of the month during which the vessel remains in Canada under a coasting trade license (unless the ship is carrying 100 passengers or more), and also pay GST at a rate of 5 percent of the vessel's monthly duty-paid value.

Not only do these requirements increase costs, but they are also extremely difficult to meet within the timeframes in which cruise ship planning and operations take place – all of which combine to make the option of operating a Canadian Great Lakes cruise under a coasting trade license both unviable and unlikely. Indeed, a review of the Canadian Transport Agency's database of coasting trade applications since 2014 reveals that no applications were received for the temporary admission of foreign flag vessels to engage in coasting trade cruises in the Great Lakes during this period.

Given the unmet demand that exists in this market, we believe that Transport Canada should consider amending the relevant provisions of the *Coasting Trade Act* to enable foreign flag cruise operators to offer cruises that begin and end in the Canadian Great Lakes without having to obtain a coasting trade license in order to do so. It is worth noting that this is an option that is already available to foreign flag cruise operators offering services east of St. Lambert Lock or along any of Canada's seacoasts, all of whom can offer a cruise that begins and ends in Canada provided they make at least one in-transit stop at a foreign port during their itinerary.

Governance

Over the last twenty years, the Seaway has been extremely well operated and managed by the St. Lawrence Seaway Management Corporation (SLSMC), which is governed by a nine-member board consisting of five directors nominated by industry user groups, one director from each of the Federal, Quebec and Ontario governments, and the President and CEO. The Board's composition has served to ensure that the SLSMC has a positive relationship with the Government of Canada – whose assets it manages – while also meeting the needs of users and stakeholders. As a result, the SLSMC has established very strong links with its users, which have played an important role in successfully resolving a variety of operational challenges that have arisen over the years. These have included collaborative efforts to maximize the use of the existing water column in the waterway, cooperation between the industry, the Seaway, Transport Canada and the US Coast Guard to harmonize Seaway inspection procedures, and the development of standards regarding the implementation of AIS (automatic information systems) on board vessels. Given this track record, we strongly support continuation of the SLSMC Board in its current form, particularly with respect to numbers and composition, including majority industry representation.

Maintenance of Assets and Funding

The Seaway commercialization documents set out a number of principles to ensure that the SLSMC manages and operates the locks, bridges and connecting channels owned by the Government of Canada to the highest levels of safety, reliability and sustainability. This is essential given the Seaway's role as a strategic transportation corridor for international and domestic commerce, and the SLSMC has fully delivered on all aspects of its mandate in this respect.

As the owner of the assets that are managed by the SLSMC, the Government of Canada oversees and approves all capital and major maintenance spending through the joint Transport Canada / Corporation Capital Committee, which negotiates the SLSMC's capital budget every five years and reviews its adherence to the budget on an annual basis.

The SLSMC's operating budget – which includes the tolls and fees that users are charged to transit the system – is negotiated with Transport Canada on rolling five-year terms. Toll and fee levels are in no way impacted by the revenues generated by the Seaway, as both sides to the 1998 commercialization agreement recognized and accepted that the SLSMC has neither influence nor control over the movement of international and domestic cargoes that are shipped through the waterway to North America's heartland. As such, the federal government assumes responsibility for all deficits under a principle of "revenue neutrality," which has been fundamental to the SLSMC's success in maintaining its competitiveness not only with other modes, but also with trade routes along the east coast, west coast and Mississippi.

The SLMC's structure and governance provide ample evidence that when carriers (who have invested billions of dollars in modernizing their fleets) and cargo shippers have direct and concrete input into the management and operation of the Seaway's assets, those assets are consistently managed and operated at the highest levels of efficiency and reliability. Given the unique conditions that have defined the Seaway since its inception - and under which it has evolved over the years - a combination of vigilant user oversight and federal government support continue to be the best means of ensuring the system's competitiveness and viability in the long term.

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We thank Transport Canada for the opportunity to provide input into this review of one of Canada's most important and strategic transportation corridors, and we would be pleased to provide any additional information as required.

Sincerely,

M.H. Broad

Michael Broad
President
SHIPPING FEDERATION OF CANADA