



Guidelines for British Columbia Ferry Services Inc. For Applications under Section 55 of the Coastal Ferry Act

1. Statutory Requirements

The purpose of these guidelines is to advise British Columbia Ferry Services Inc. (“BC Ferries”) of the information required by the Commissioner in an application by BC Ferries for a declaration under section 55 of the Coastal Ferry Act (the “Act”) that a proposed capital expenditure is "reasonably required".

Bill 47 of 2012 amended the Act as follows:

Commissioner to consider capital deployment and expenditures

- s.55 (1) Subject to subsections (2) to (5), before deploying capital assets on, or incurring capital expenditures in connection with, a designated ferry route or terminal, the ferry operator may apply to the commissioner and the commissioner must, within one month after the application, declare whether the capital assets proposed to be deployed on, or the capital expenditures proposed to be incurred in connection with, the designated ferry route or terminal are reasonably required.
- (2) A ferry operator must not incur a major capital expenditure without first obtaining the commissioner's approval of the expenditure.
- (3) A ferry operator may apply to the commissioner for approval of a proposed major capital expenditure and the commissioner must respond to the application within 2 months after its receipt by the commissioner.
- (4) The commissioner may approve a proposed major capital expenditure if the proposed major capital expenditure is
- (a) reasonable,

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- (b) prudent, and
- (c) consistent with
 - (i) the current Coastal Ferry Services Contract, and
 - (ii) any long term capital plan established by the ferry operator.

- (5) For the purposes of this section, a capital expenditure of a ferry operator is a major capital expenditure if it meets the criteria
- (a) established from time to time by the commissioner, and
 - (b) most recently provided by the commissioner to the ferry operator.

Also, section 41 (principles applicable to price cap review) states, in part:

s.41 (3) the commissioner must, in setting a price cap for a route group....

- (c) determine whether it was reasonable, in the commissioner's opinion, acting reasonably, for the ferry operator to have incurred capital expenses in relation to a designated ferry route included in the route group, and take into account only those capital expenses that
 - (i) are determined under this paragraph to be reasonable, or
 - (ii) had been approved under section 55,
- (d) attribute to capital assets deployed within or in support of the route group a value that, in the commissioner's opinion, acting reasonably, is appropriate in all of the circumstances.

Ferry Commission Order 12-04, dated September 30, 2012, is "An Order to Establish the Criteria to Determine When a Capital Expenditure is Deemed to be a Major Capital Expenditure for Purposes of Section 55", and reads in part as follows:

1. For purposes of section 55(5), a major capital expenditure is defined as any capital expenditure which exceeds \$30 million, inclusive of component programs and interest during construction, and irrespective of the level of expenditure, any new vessel or terminal, and any vessel life extension which extends the life of the vessel by more than 5 years.
2. In addition, upgrades to information technology (IT) systems in excess of \$5 million which support ticketing and reservations, are considered a major capital expenditure.
3. The commissioner's review and approval or disapproval of a major capital expenditure will be based solely on a determination that the project is or is not: reasonable, affordable, prudent, consistent with the approved and current five-year capital plan as submitted to the commissioner; consistent with the current Coastal Ferry Services Contract; and consistent with any government approved long term vision for the future evolution of marine ferry services.

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4. All capital expenditure plans for new vessels and all vessel life extensions which involve engine replacement must include consideration of conversion to LNG fuel.

For purposes of applying the requirements of section 55, as amended, the Commissioners will be guided by the following definitions:

“Reasonable”, is defined as:

“An intelligent approach supported or justified by reason; fair, proper, sound behavior that avoids needless error and steers clear of extremes.” (BusinessDictionary.com)

“Prudent”, is defined as:

“Good judgment or wisdom gained from experience, expressed in a realistic and frugal attitude. Prudence, however, is not the same as grave caution or wariness concerned only with preserving the status quo.” (BusinessDictionary.com)

2. General

BC Ferries is encouraged to provide all relevant information consistent with the intent of these guidelines.

In view of the time constraint set out in the Act, it is desirable that the initial package of information provided to the Commissioner be as complete as possible. If the Commissioner considers that the information provided does not meet these guidelines, the Commissioner will ask BC Ferries to supplement the initial submission.

BC Ferries should try to ensure that all the questions/topics listed under headings 3 through 5 are addressed, although not necessarily in the order shown.

The Commissioner may, in any declaration issued under section 55 of the Act, include a limit on the capital costs which may be recognized for purposes of setting the price caps, based on the information provided by BC Ferries.

3. Project Description

- a) Describe the proposal for the capital expenditure, and provide a comparison to the capital currently in use, in terms, for example, of size, capacity and staff and/or crew requirements.

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- b) In the case of a new vessel, has an independent marine surveyor provided a condition assessment of the current vessel and is that assessment factored into the business case supporting the requested capital expenditure?
- c) Is there a regulatory driver for the proposed capital expenditure?
- d) Provide information on the operating costs of the vessel, terminal, information technology or other capital asset to be replaced and/or to be upgraded, covering the most recent three year period, including the current year.
- e) Compare the annual maintenance costs of the existing capital asset with those expected for the replacement and explain any significant variances.
- f) Have there been service disruptions due to inadequacy of the existing capital asset?
- g) If age of the existing capital asset is a factor, what is the estimate of future costs of continuing its use?
- h) Have there been complaints from the public, or other stakeholders about the existing capital asset?
- i) Provide an estimate of the total capital costs associated with the proposed investment.
- j) How was the cost estimate derived? Entirely with BC Ferries' staff or was there an external review?
- k) In the case of a new vessel was the international ship broking industry contacted to determine if there are existing vessels available for purchase that may, with adaptation, be appropriate?
- l) Provide an estimate of the incremental capital costs to provide "ancillary services", including catering and retail concessions, and provide estimates of the incremental operating costs to provide the ancillary services and the incremental revenue expected to be generated from those services.
- m) In the case of a new vessel, demonstrate on a lifecycle cost or present value basis that the decision to build a new vessel versus the cost of acquiring a second hand vessel, if applicable, is a net benefit. Include sensitivity analysis in case of cost overruns.
- n) Does the proposal include significant features that are innovative or untried?
- o) Is there an allowance in the estimate for inflation from the date of acceptance of a proposal to the completion date (escalation clause)?
- p) Are financing costs included in the cost estimate between first payment to the supplier and the in-service date?

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- q) Compare the operating costs of the existing capital asset with those expected for the replacement, to include, in the case of vessels, fuel costs, crew costs and depreciation.
- r) Does BC Ferries intend to capitalize any of its own internal costs with respect to the capital expenditure?
- s) Identify any parts of the capital expenditure that are to be provided by BC Ferries or its subsidiaries.
- t) In the case of vessels, if tenders are to be sought from foreign shipbuilders, what is the applicability of custom tariffs on importation of the vessels?
- u) In the case of vessels, will BC Ferries require the contracting shipyard to bear the design and construction risk?

4. Timing and In-service Date

- a) For new or replacement vessels what is the expected in-service or deployment date and how was it derived?
- b) Were potential builders, for example shipyards, contacted to determine if the proposed date is reasonable?
- c) What are the consequences of a delay in the in-service or deployment date?

5. Rationale and Explanations

When considering a section 55 application the Commissioners will base their decision on the following tests:

- a) Does the proposed capital expenditure demonstrate good judgment, based on wisdom, experience and good sense?
- b) Does the proposed capital expenditure indicate a wise use of resources?
- c) Does the proposed capital expenditure show due consideration for the future?
- d) Has it been demonstrated that the proposed capital expenditure would not reasonably be considered excessive?
- e) Does the proposed capital expenditure provide good value, at a moderate and fair price? Is it affordable?
- f) Is the proposed capital expenditure provided for in a board approved capital plan?

- i) Is the total cost different in any respect from what was approved in the capital plan?
- ii) Is the total cost different in any respect from what was indicated in the BC Ferries' last submission to the Commissioner for price cap setting purposes?
- g) Is the proposed capital expenditure consistent with the requirements of the Coastal Ferry Services Contract?
- h) How does the proposed capital expenditure support the government approved long term vision for the future of coastal ferry services?

6. Specific Questions

To assist the Commissioners in making their determination, an application for section 55 approval of a proposed capital expenditure should address the following specific questions, along with any additional information the applicant deems appropriate:

a) Does the proposed capital expenditure demonstrate good judgment, based on wisdom, experience and good sense?

- i) Why is the proposed capital expenditure required now, and what are the consequences of any delay?
- ii) How has this capital expenditure project been prioritized relative to other capital expenditure projects within the long term capital plan?
- iii) What sources of expertise and experience have been relied upon in deciding to proceed with this capital expenditure?
- iv) Provide detail on completed and/or planned consultations, in particular with the provincial government or other stakeholders.
- v) In the case of new vessels, has BC Ferries considered any alternative to building and owning the new vessels?
- vi) Will a new or replacement vessel require any modifications to any terminals? If so, at what additional cost?
- vii) What are the procurement cost risks and how will they be mitigated?
- viii) What are the consequences or the alternatives if the application is rejected?

b) Wise use of resources

- i) Can an existing vessel be reassigned instead?
- ii) For shorter routes were non-vessel options considered, such as a fixed link?
- iii) Were non-vehicle vessels (eg passenger only ferries, barges, other) or a mix of vessel types considered?
- iv) Has a used vessel option been considered?
- v) How does the vessel align with the concept of standardization of the fleet?
- vi) Would investments in technology, such as an expanded reservation system, better IT systems or a yield management program allow for a smaller sized vessel?

c) Showing due consideration for the future

- i) How does the proposed new vessel contribute to overall fleet flexibility?
- ii) What new technologies or innovations will be incorporated, and why are they considered necessary?
- iii) Will there be provision for a conversion to an alternative to marine diesel engines, such as LNG?
- iv) Is dual fuel capability planned and if so provide the rationale?
- v) Will the new or replacement vessel be appropriate if the ratio of vehicle to foot passenger traffic changes in future?
- vi) Is vessel capacity sufficient to meet current and projected future demand?
- vii) What is the estimated impact of the proposed capital expenditure on future price caps assuming no change in non-passenger related revenues?

d) Not excessive

- i) What passenger amenities will be provided, and why are they considered appropriate for the intended use of this vessel?

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- ii) Do any of the proposed passenger amenities require crewing levels to be higher than what is required by Transport Canada regulations?
- iii) Is the vessel the right size and how has the capacity requirement been determined?
- iv) Describe the objectives of BC Ferries' design standards for passenger accommodations for vessels of similar size and scope. Will the passenger accommodations for the replacement vessel deviate from these standards? If so, what is the rationale for the deviation and what impact, if any, will it have on the capital and operating costs of the vessel?
- v) Will the application of logos or other BC Ferries' brand images to the vessel be consistent with BC Ferries' current practice for similar vessels. If not, how will it differ and what will be the effect on capital costs?
- vi) What would have to be sacrificed to reduce total costs by 10%, and by 20%?
- vii) Does vessel design or expected operating speed have any impact on labour costs?
- viii) Are engines sized for efficient operations, fuel consumption and ability to recover schedule?

e) Demonstrating good value at a fair, moderate price

- i) For new vessels what alternatives were considered? Provide the rationale (cost or otherwise) for why the alternatives were not accepted.
- ii) Has the business case been built on a full life cycle costing basis?
- iii) How fuel efficient will the new vessels(s) be?
- iv) Will the new or replacement vessel have any impact on efficient use of labour?
- v) Are the operating costs reasonable?
- vi) How do the operating costs compare with the vessel being replaced?
- vii) Is there any expected impact on revenue?
- viii) Will crew training and certification activities be in excess of that required to meet regulatory requirements? If so, explain the rationale for this approach and whether it will result in incremental operating costs.

f) Terminal (new or upgrades)

- i) Is the proposed capital expenditure provided for in a board approved capital plan?
- ii) Is the total cost different in any respect from what was approved in the capital plan?
- iii) Is the total cost different in any respect from what was indicated in the BC Ferries' last submission to the Commissioner for price cap setting purposes?
- iv) Will the facility accommodate passenger-only ferries, water taxis and/or barge operations?
- v) Will the project contribute to flexibility and interoperability within the fleet?
- vi) Will there be any improvements to ferry marshalling?
- vii) Will there be any improvements to loading, unloading and turnarounds?
- viii) Will BC Ferries be sub-contracting or entering into partnerships with other entities to provide services at the terminal (e.g. parking, catering, retail)?
- ix) Will there be any effect on local traffic patterns, and if so, how will they be mitigated?
- x) How are the needs of commercial traffic being considered and accommodated?

g) Information Technology Projects

- i) Describe the project and provide details of the business case for the project.
- ii) Provide support information for key assumptions in the business case.
- iii) Is the project included in the most recent capital plan?
- iv) Has the project been approved by the board of directors?
- v) Is there a project plan in place?
- vi) Describe any major risks that could affect the project's success.
- vii) Describe mitigation strategies for major risks that have been identified.

h) Coastal Ferry Services Contract

- i) Is the proposed capital expenditure consistent with the current Coastal Ferry Services Contract?

i) Long Term Vision for Coastal Ferry Services in British Columbia

- i) How does the proposed expenditure support the government approved long term vision for the future of coastal ferry services?