



Speaking Notes

Mr. Gord Macatee

Commissioner

Coastal Ferry Act Review

British Columbia Ferry Commission

January 24, 2012

Victoria, British Columbia, Canada

Please Check Against Delivery

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- **Good morning.**

Introduction

- **Today we're releasing the final report on the Ferry Commission's review of the Coastal Ferry Act.**
- **The mandate for this review was provided in Bill 14, which was passed last June.**
- **It required the commissioner, on or before January 24, 2012, to review the Act and deliver recommendations to the Minister of Transportation and Infrastructure for amendments to better balance the interests of ferry users with the financial sustainability needs of the ferry operators.**

Background

- **First, a bit of background on how our system ferry is regulated.**
- **The Coastal Ferry Act created the Ferry Commissioner role as the regulator.**
- **Every fourth year, the Commissioner is required to establish price caps which the operator must comply with. Price caps are used around the world to regulate rail systems, airports, ferries and public utilities. They set a bar for weighted average fares. Some fares can be higher than the cap, as long as the weighted average is at or below the cap. The caps apply to a four-year performance term.**
- **We are presently at the end of performance term two - referred to as PT2. Performance term three (PT3) starts on April 1, 2012,**

and continues until March 31, 2016.

- The Act is very prescriptive about the price cap setting process.
- The Commissioner first applies a specified formula to calculate the regulated Return on Equity which the operator is entitled to earn for PT3. This calculation resulted in a regulated pre-tax Return on Equity of 12.7% per year.
- We then review a set of projections provided by the operator, for operating costs, financing, efficiency plans, capital plans, and a ridership projection.
- A separate price cap must be calculated for each of the route groups, without allowing for any cross subsidization between them.
- There are presently four route groups - the major routes run between Vancouver, Victoria and Nanaimo; the northern routes are north of Port Hardy; the minor routes take in everything else - the Gulf Islands, Sunshine Coast, and northern Vancouver Island; and the Horseshoe Bay-Langdale route.
- At the end of March 2011, the Commissioner was required to publish a preliminary price cap decision for the next term, followed by a three-month period for public comments.
- At the end of September 2011, a final decision would normally have been announced. However, to allow time for this review, Bill 14 established a system-wide price cap for the first year of PT3.
- We will be setting price caps for the remaining three years in September 2012.

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- **With that as background I'll explain why we felt this review was necessary.**

Need for a Review

- **Over the last nine years, BC Ferries has invested \$1.9 billion in new vessels and terminal upgrades and over the next 12 years, plan to invest another \$2.5 billion.**
- **These huge investments are happening in a relatively condensed period of time due to under-investment in the past and many of the vessels in the fleet will soon have to be retired. At the same time, ferry ridership in BC is down, and trending in the wrong direction.**
- **This is a matter of serious concern.**
- **The cost of servicing all this debt does not go down when ridership drops and as a result of declines in last couple of years, the company is presently in a loss situation.**
- **In March 2011, the Commissioner issued the preliminary price cap decision for PT3, with price cap increases of 4.15% per year on the major routes, and 8.23% per year on the others.**
- **The public response was very negative and highly concerned about such large increases.**
- **In actual fact, the preliminary price caps were quite a bit lower than what the Act strictly provided for, which I'll explain.**
- **An amendment to the Act in 2010 added a requirement for consideration of the interests of ferry users. With that**

requirement in mind, the Commissioner decided to make several adjustments to the price cap calculations.

- He smoothed them across route groups, spread them evenly across the four years, provided for \$18.5 million in productivity improvements, and chose not to use replacement costs in valuing assets.
- The operator responded with a legal opinion that those adjustments were not permitted in the legislation, and that the price caps had therefore been set too low.
- A re-calculation based on that legal opinion produced price cap increases for the first year of PT3 of 16 per cent on the major routes, 43 per cent on the minors and 81 per cent in the north.
- We did not think the Act intended or expected to produce annual increases of such magnitude.
- Faced with making a price cap decision which would stand for four years we felt strongly that a review was needed, and with some urgency. So we took our concerns to the Minister responsible for the Act - Minister Blair Lekstrom. He shared our concerns, and agreed that a review was needed.

Public Consultation Process

- We started our consultations on June 7, 2011 in Alert Bay and Sointula. We visited 27 ferry dependent communities between Victoria and Masset. About 2,000 people attended 40 public meetings and we received over 200 written submissions. We also engaged the services of Price Waterhouse Cooper to look at price cap models in other sectors and ferry system regulation in other parts of the world.

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- The issue we heard about more than any other was affordability of fares. Over the last nine years, fares have gone up 47 per cent on the major routes, 78 per cent in the north and 80 per cent on the minor routes.
 - During that time provincial CPI, or inflation, has gone up about 15 per cent.
 - We heard that a tipping point on fare increases has been reached.
 - Some people asked for roll backs or a freeze which we realize was not likely to be realistic or affordable in the present economy.

Review Recommendations

- We learned that in other parts of the world there is a common expectation that price cap increases will rise at roughly the rate of inflation (CPI).
- We think CPI (consumer price index) is a reasonable proxy for affordability and are recommending that BC's goal for future price cap increases be CPI.
- Continuing that commitment for at least two performance terms will provide a needed level of certainty and confidence among ferry users, tourism operators and other businesses.
- In truth, we think a CPI limit on price caps is necessary for the sustainability of the ferry system itself as there is an urgent need to prevent any further declines in ridership. If ridership does continue to decline, the financial challenges we are already

facing are going to get much larger - by over \$5 million for every 1 per cent decrease.

- I will come back to this shortly.
- Achieving the goal of holding price caps to CPI is going to be a tremendous challenge.
- I have already talked about the huge bulge in capital spending that is planned which drives very large increases in financing and amortization costs. Operating costs also continue to rise, and especially for fuel which accounts for 20 per cent of total costs.
- Capacity utilization in the ferry system is low, and trending down and service levels have been largely unchanged for many years.
- We have done extensive modeling of BC Ferries' financial projections. We laid in the capital plans on a year-by-year basis for the next 12 years.
- If we assume that ridership will be flat; assume no change in service levels, new sources of revenue, and major cost savings, and price caps at CPI there will be \$58 million per year gap between revenues and expenses in each year of PT3. That number grows to \$114 million per year in PT4, and to \$143 million per year in PT5. After that, once the bulge has worked through the system, the picture starts to become more favorable again as capital spending tapers off to a steady state situation.
- We have considered every reasonable possibility to reduce the size of the gap.
- We believe we have assembled a balanced set of recommendations which will require contributions from all of

the principle stakeholders in the ferry system.

Ferry Users

- Ferry users have asked for affordable fares and as a result we are recommending a CPI limit on price caps for the next two performance terms.
- In return, we are asking ferry users to accept some reasonable reductions in service levels to improve capacity utilization of the fleet. We have outlined a fairly modest reduction in PT3 of 4 per cent on the major and most minor routes – with no reductions on the northern routes or the minor routes with small numbers of daily crossings. That is an average of one round trip per day for one-third to a half of the year, targeting sailings with very low ridership.

Ferry Operator

- The operator needs a return to financial viability and a way to address the gaps referred to earlier.
- We have tried to address those needs.
- In return, we are recommending increased accountability, more explicit authority for the regulator, a more independent relationship with Ferry Advisory Committees, provision for routine performance audits, more oversight on the capital plan, and a change to the provisions for return on equity.

Taxpayers

- Taxpayers need the ferry system to be affordable too, and also well governed, accountable and financially sustainable.

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- We are asking the province to take the lead in creating a vision for the future of ferry service in BC, and to consider additional subsidy support in PT3, a degree of risk management of fuel cost volatility, and a commitment to work closely with the operator and the regulator to bring down the size of the gap we see ahead in both Performance Terms 4 and 5.
 - We have identified opportunities for new sources of revenue.
 - We discuss opportunities to further reduce costs such as consideration of a conversion to LNG fuel with potential savings across the fleet of \$28 million per year.
 - We have proposed a mechanism for destination marketing programs in partnership with ferry communities as a way to increase ridership and a role for municipal and regional governments in making ferry fares more affordable if they choose to do so.
 - We have suggested a significant improvement to customer service by moving to a system-wide reservation model, featuring free reservations and additional charges for passengers without reservations. This would provide passengers with more certainty as to boarding, will reduce ferry lineups, and give the company a better ability to plan and prepare for the service their customers require.

Conclusion

- Many of our suggestions will require time to implement.
- The immediate challenge, however, is to reverse the decline in ridership, to restore the company to financial viability, to make

ferry travel more affordable and to improve overall accountability.

- **We consider a commitment to holding price caps to CPI to be the essential element, and in the best interests of users, taxpayers and the operator.**
- **We urge all of the principle stakeholders of the ferry system to do their part to make that goal possible.**
- **In conclusion, I would like to recognize and thank the many people who have participated in this review, and especially the chairs and members of the Ferry Advisory Committees up and down the coast of BC.**
- **Our ferry system faces some serious challenges, and it is reassuring to know there are so many thoughtful people working hard to find solutions.**
- **Thank you.**