



# **Report on the Final Price Cap Decision For the Fifth Performance Term**

*Prepared and submitted in accordance with  
Sections 40 and 41 of the Coastal Ferry Act  
of the Province of British Columbia*

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## Table of Contents

Introduction .....	3
1. Governing Legislation under the <i>Coastal Ferry Act</i> .....	3
2. Commissioner’s Consideration of Additional Information .....	3
a) Amendments to the Coastal Ferry Services Contract.....	4
b) Additional information received from the ferry operator .....	4
c) Updated financial information from ferry operator .....	6
d) Additional information received from the provincial government .....	6
e) Public Comments.....	7
f) Performance review on efficiency and the long-term capital plan of the ferry operator .....	7
g) Consideration of Public Interest.....	9
3. Commissioner’s Determinations .....	12
4. Final Decision on Price Caps for Performance Term 5 .....	13
5. Appendices.....	13
A. Statutory Requirements for Establishing Price Caps .....	13
B. Supplemental Submission .....	13
C. Ministry Letter.....	13
D. Public Comments.....	13
E. Performance Review of the Efficiency of BC Ferries .....	13

## **Introduction**

Pursuant to Section 40 (2) (d) of the *Coastal Ferry Act* (the “*Act*”), the British Columbia Ferries Commissioner (the “*Commissioner*”) issued a report on April 1, 2019 to establish a preliminary decision on price caps for the fifth performance term (“*PT5*”). The *Report on the Preliminary Price Cap Decision* for *PT5* was posted to the Commissioner’s website the same day, setting out reasons for the preliminary decision. A copy of that report can be found here [Report on the Preliminary Price Cap Decision for PT5](#).

In accordance with Section 40(4) of the *Act*, the Commissioner and the Deputy Commissioner have issued a final decision for price caps in *PT5*, and this report sets out their reasons.

### **1. Governing Legislation under the *Coastal Ferry Act***

The statutory requirements for establishing price caps are set out in the *Act*, specifically in Sections 38, 40 and 41. Since the preliminary price cap decision was issued, the *Act* was amended effective May 25, 2019. Relevant changes to the determination of the final price caps include: Section 38 (1), which states that the Commissioner “*must undertake that regulation in the public interest*”; Section 38 (1) (a.1) that “*ferry operators are to be encouraged to meet provincial greenhouse gas emission targets in their operations and when developing capital plans*”; and the addition of Section 21.01 (1) “*The [BC Ferry] Authority, as sole voting shareholder of BCFS [BC Ferries Services Inc.], is to oversee the strategic direction of BCFS in support of the public interest, including the public's interest in safe, reliable and affordable coastal ferry services in British Columbia.*”

These sections of the *Act* are set out in Appendix A.

### **2. Commissioner’s Consideration of Additional Information**

Pursuant to Section 40 (4) (a) of the *Act* the Commissioner must reconsider the preliminary price cap decision “*in light of (i) the Coastal Ferry Services Contract; (ii) any additional information received by the Commissioner from the ferry operator or from the government; and (iii) any public comment received on the report.*” In addition, the Commissioner considered the performance review of BC Ferries’ operating efficiency and long-term capital plan conducted by PricewaterhouseCoopers LLP (“*PwC*”) and amendments to the *Act* made after the preliminary price cap decision was issued.

Accordingly, the price caps for the next performance term have been reconsidered by the Commissioner as follows:

**a) Amendments to the Coastal Ferry Services Contract**

In accordance with Section 40 (3) of the *Act*, on July 2, 2019 the ferry operator (“BC Ferries”) filed with the Commissioner the amending agreement to the Coastal Ferry Services Contract (“CFSC”) which constitutes the latest version of the CFSC. A copy of the amending agreement can be found here [Amending Agreement #15](#).

The amendments to the CFSC which impact the price caps are:

- i. The annual ferry transportation fees set at \$194,045,882 for the performance term, inclusive of base ferry transportation fees of \$164,045,882 and notional fees for the seniors’ discount of \$30,000,000. Any unused portion of the annual notional fee for the seniors’ discount will at each year-end be allocated to designated routes based on the same proportion of the annual base fee received by each route;
- ii. The ferry transportation fees include \$5.8 million for increases in service as per the March 18, 2019 service level agreement and \$0.3 million for Route 11 (Prince Rupert/Skidegate) service adjustments; and
- iii. The continuation of one single consolidated route group, with the condition that the consolidated route group will revert to Major, Minor and Northern route groups at the end of the performance term, unless otherwise agreed to in writing by the parties.

The Commissioner confirms that the changes to the CFSC were assumed and taken into account in the preliminary price cap decision and therefore have no impact on the final decision on price caps for PT5.

**b) Additional information received from the ferry operator**

On September 5, 2019 BC Ferries filed a submission titled “*Additional Information for Consideration For the Final Price Cap Decision For the Fifth Performance Term*’ submission prepared in accordance with Section 40(4) of the *Coastal Ferry Act*” (“Supplemental Submission”). A copy of the Supplemental Submission can be found in Appendix B.

The Commissioner reviewed the Supplemental Submission and is not persuaded that the approach to setting the price caps should be altered at this time based on the following reasons:

- iv. The late filing of BC Ferries' Supplemental Submission prevented the Commissioner from inviting, receiving and considering public comments on this submission in time for the final price cap decision.
- v. The main theme of the Supplemental Submission is that the Commissioner should take a long-term perspective and look beyond the next performance term when setting the price caps for PT5 and to adjust the preliminary price caps upward to account for the substantial capital expenditures beyond the next performance term. BC Ferries submits that the preliminary price caps for PT5 "*would place significant upward pressure on price caps for PT6.*"

The *Act* requires the Commissioner to set price caps for the next four-year performance term and in doing so the Commissioner must undertake that regulation in the public interest and be guided by Section 38 (1) (a) of the *Act* to balance the interests of ferry users, taxpayers and the financial sustainability of the ferry operator.

Basing a price cap decision on what may happen to revenues and expenses beyond the next performance term, five to nine years out into the future, is rife with uncertainty. Changes to economic conditions, inflation rates, traffic forecasts, etc. will affect BC Ferries' revenues and expenses, positively or negatively. Future changes to the ferry system itself as a result of the vision to be developed by the provincial government, advances in technology (such as electrification of vessels) and changes to the fleet composition (e.g. passenger-only ferries), will further add to uncertainties about the future. Any prospective changes to the ferry transportation fees will also impact future price caps beyond PT5.

- vi. The Commissioner also deems it to be in the public interest to set price caps at a level where the ferry operator is held accountable for controlling their costs and operating as efficiently as possible during the next performance term.

The Commissioner will invite public comments on BC Ferries' Supplemental Submission for further consideration in setting the price caps for the performance term following PT5.

**c) Updated financial information from ferry operator**

On September 3, 2019 BC Ferries submitted updated financial information and traffic forecasts. The Commissioner reviewed the information, which indicates that traffic volumes are expected to be lower than the previous forecast used for the preliminary price cap decision. The Commissioner believes the long-term interest rate assumptions provided by BC Ferries for PT5 are too conservative based on current market consensus forecasts.

**d) Additional information received from the provincial government**

On September 13, 2019 the Ministry of Transportation and Infrastructure (“the Ministry”) submitted a letter (“the Ministry Letter”) in response to BC Ferries’ Supplemental Submission. The Ministry states that it does not agree with BC Ferries’ request for a modest, but unspecified, increase in the preliminary price caps because of uncertainty of future events over the next five years. A copy of the Ministry Letter can be found in Appendix C.

The Commissioner has considered the Ministry Letter and concludes that it does not contain any information pertaining to further changes to the CFSC and therefore has no impact on the decision for the price caps for PT5. However, the Commissioner does have the following comments:

- i. As with BC Ferries’ Supplemental Submission, the late filing of the Ministry Letter prevented the Commissioner from inviting, receiving and considering public comments in response to the Ministry Letter in time for the final price cap decision.
- ii. The \$225 million referenced in the Ministry letter are net earnings generated within the price caps set by the Commissioner and are largely due to unanticipated traffic growth. The net earnings have taken some pressure off price caps for PT5 and enable BC Ferries to finance its large capital program. Without generating necessary earnings, the ferry operator would become dependent on increased funding from ferry users and/or taxpayers to sustain the coastal ferry system.
- iii. The Province states in their letter that the “unanticipated traffic growth puts BC Ferries in a strong financial position for both PT5 and PT6.” The Commissioner agrees that while traffic growth has contributed positively towards price caps for PT5, it is likely that price caps for the following

performance term (PT6) will experience significant upward pressure in order for BC Ferries to maintain a strong financial position.

**e) Public Comments**

Twelve public submissions or comments were received by the Commissioner following the release of the preliminary price cap decision on April 1, 2019. Most of the comments related to service levels or operational issues have been, or are being, addressed by the provincial government or the ferry operator respectively. Only one comment was specific to fares: “I urge you to consider keeping ferry fares as affordable as possible. It is like a highway system, and with gas prices as high as they are, higher ferry fares is a kind of double whammy....” A copy of the public comments can be found in Appendix D.

The Commissioner has considered the request to keep price caps on fares as affordable as possible, but must do so in light of additional information received from the ferry operator and from the provincial government. The Commissioner concludes that this information does not have an impact on the final price cap decision and that price cap increases for PT5 are being kept as affordable as possible.

**f) Performance review on efficiency and the long-term capital plan of the ferry operator**

PricewaterhouseCoopers LLP (“PwC”) was engaged to assist the Commissioner in setting the price caps for the next performance term. As part of their engagement, PwC conducted a performance review on BC Ferries’ efficiency and long-term capital plan for consideration by the Commissioner in making the final price cap decision for PT5. A copy of PwC’s report can be found in Appendix E.

PwC conclusions include the following:

- i. *“BC Ferries is generally efficient in managing its labour costs. Its executive compensation appears to be appropriate for an organization of its size and complexity. Their executive compensation guidelines comply with the provincial government’s Public Service Employers’ Council (PSEC) guidelines.*
- ii. *BC Ferries has been effective with fuel management. The conversion to LNG with new vessels has reduced fuel costs. Further reduction is*

*anticipated with newer fuel-efficient vessels and electrification of some new vessels in the Capital Plan.*

- iii. *Cost management of Administration appears adequate and cost increases are reasonably explained.*
- iv. *Finance expenses appear reasonable and are efficiently managed. Finance expenses have trended downward with lower interest costs.*
- v. *BC Ferries appears to have a reasonably strong culture of efficiency, based on its sound budgeting process, and alignment of performance pay with corporate objectives. Lacking is a corporate Key Performance Indicator(“KPI”) around cost control and how this cascades down through departmental KPIs.”*

On BC Ferries’ long-term capital plan, PwC comments as follows:

- vi. *“There are some opportunities to lessen the impact of the capital plan by deferring major terminal work and the maintenance facility, but these may represent short term deferrals only.*
- vii. *According to BC Ferries management, the Coastal Ferry Services Contract restricts the ability to reduce system costs by requiring excess capacity on certain routes. There may be potential to reduce ferry system costs with more flexibility built in to the service plan.*
- viii. *While some of the more significant areas for reducing costs in the ferry system in the long term are associated with electrification and automation they require further study.*
- ix. *The Province is initiating a long-term visioning process for the ferry system. This is timely as some of the more significant opportunities for cost reduction over the longer term points to system-wide or structural changes that require cooperative efforts with government and stakeholders. These efforts should involve BC Ferries working with the provincial government and other stakeholders, such as BC Hydro, municipalities, regional districts and port authorities on addressing necessary supporting infrastructure needs for electrification.”*

Overall PwC concludes that:

*“While BC Ferries is exhibiting good cost control, it needs to continue with its current efforts to manage costs and increase efficiency. Based on the assessment, the 1% efficiency target established by the Commissioner in its Preliminary Price Cap Decision for PT5 is considered achievable, as opportunities exist to achieve operational efficiencies across several OM&A cost areas.*

*Recommendations for the short term include setting and tracking of efficiency targets and introducing a corporate KPI target based on OM&A cost per AEQNM”.*

The Commissioner accepts PwC’s conclusion that confirms that the 1% efficiency target, set by the Commissioner and included in the preliminary price cap decision, is achievable. Further, the Commissioner concurs with the recommendation that BC Ferries should track the 1% efficiency target.

**g) Consideration of Public Interest**

The *Coastal Ferry Act*, section 38 (1) was amended after the preliminary price cap decision was issued on April 1, 2019 to include that the Commissioner “*must undertake regulation in the public interest*”.

The concept of public interest is complex and shifts over time. It is contextually determined in scope and purpose and has no overarching or generally accepted definition in public administration.

Accordingly, the Commissioner has determined that the meaning of the “public interest” must be in the context of the *Act*.

Specifically, as set out in Section 21.01(1) of the *Act*: “*The Authority, as sole voting shareholder of BCFS, is to oversee the strategic direction of BCFS in support of the public interest, including the public's interest in safe, reliable and affordable coastal ferry services in British Columbia.*”

The Commissioner interprets this provision as an indication of the provincial government’s view that safe, reliable and affordable ferry services are in the public interest.

The Commissioner also considered Section 38 (1) (a.1) of the *Act*, which states that “*ferry operators are to be encouraged to meet provincial greenhouse gas emission targets in their operations and when developing capital plans*” and the

Commissioner takes this to mean that provincial government views a reduction of GHG emissions to be in the public interest.

The Commissioner concurs that a safe, reliable, and affordable ferry system that strives to reduce GHG emissions is in the public interest. In addition, the Commissioner views the financial sustainability of the ferry operator also to be in the public interest to safeguard the continuation of a safe, reliable and affordable coastal ferry system.

**i. Safe**

BC Ferries maintains that safety is their highest value. This is as it should be for a transportation service provider that carried over 22 million passengers and 8.9 million vehicles in fiscal 2019. Vessel requirements and crew and passenger safety are subject to Transport Canada regulations. The Commissioner does not have direct authority in this area, but recognizes the public's interest in safety.

The Commissioner has noted that passenger safety has improved over the past 6 years, with the passenger injury rate declining by 48% since 2010. The Commissioner is satisfied that BC Ferries, by steadily setting improved targets for employee and passenger injuries, are focused on maintaining and improving safety.

The Commissioner has also noted that some ferry users have raised concerns about safety inside as well as outside the ferry terminals resulting from traffic congestion from waiting traffic. This aspect of safety falls outside Transport Canada jurisdiction and in some cases outside the control of BC Ferries. The Commissioner encourages BC Ferries to address this issue with local communities and the provincial government on a reasonably timely basis.

**ii. Reliable**

BC Ferries' goal is reliable service. The [\*Performance and Accountability Report\*](#) for fiscal 2019 states the goal is to “*deliver core internal fleet maintenance and refit services to support Fleet Reliability Index Target of 99.55%-99.74%*”. The actual performance for reliability in fiscal 2019 was 99.73% and BC Ferries states it is “*among the highest in the world*”.

Based on a review of other global ferry operators the Commissioner is satisfied that BC Ferries' assessment appears to be reasonable.

It is understood by the Commissioner that in order for BC Ferries to continue providing reliable service, aging vessels and infrastructure need to be replaced in a timely fashion.

**iii. Affordable**

The Commissioner is of the view that price caps increases that generally track the rate of inflation to be affordable for ferry users as it represents general cost of living increases.

The ferry transportation fees set by the provincial government, and that recognize the Commissioner's preliminary price cap decision, are presumed to be affordable for taxpayers.

It is important to recognize that there may be times when price caps for a performance term will have to be set above the inflation rate to meet the financial targets and to protect the financial sustainability of the ferry operator, particularly if large capital expenditures are being incurred. Price caps may also have to be adjusted, from time to time, as a result of extraordinary circumstances.

**iv. Reducing Greenhouse Gas Emissions**

According to BC Ferries' Annual Report for fiscal 2019, the ferry operator has invested \$392.5 million in clean vessel technology in the last 5 years. This includes transitioning to LNG fuel systems in certain vessels leading to a reduction of GHG emissions. The cable ferry serving Denman island has reduced GHG emissions by approximately 50% compared to the conventional ferry it replaced.

BC Ferries has also invested in two new Island class ferries with a proposal to add four more, all capable to operate on batteries in the future when shore infrastructure and technology for charging the vessels is in place.

These initiatives to move away from fossil fuels will contribute towards the provincial targets for reducing greenhouse gas emissions.

The Commissioner will continue to encourage BC Ferries to pursue the electrification of the new Island class vessels, to invest in alternative fuels for new and existing vessels, and to work towards establishing GHG reduction targets.

**v. Financial Sustainability of the Ferry Operator**

Financial sustainability has been determined by the Commissioner to be the minimum price cap levels that allow the ferry operator to recover its operating costs and to access capital markets at reasonable borrowing rates to finance its capital expenditures.

The Commissioner in the determination of the preliminary price caps relied on two financial targets: a debt service coverage ratio of at least 2.50:1 and a debt to equity ratio of no more than 82.5%. These targets are to ensure BC Ferries maintains its current strong credit rating to keep debt costs low and remain unchanged in determining the final price caps for PT5.

**3. Commissioner's Determinations**

In reconsidering the preliminary price caps, the Commissioner made the following determinations:

- i. that the preliminary price cap decision for PT5 took into account the aspects of public interest outlined above. The preliminary price caps are still sufficient to operate a safe, reliable and affordable ferry services and, therefore, the preliminary price caps are still valid;
- ii. that based on revising the long-term interest rate forecast to reflect an average of current market consensus, BC Ferries is still able to meet the financial targets for PT5 with price caps of 2.3% and, therefore, the preliminary price caps are still valid;
- iii. that the efficiency target equivalent of 1% of operating, maintenance and administration costs for PT5 included in the preliminary price caps, is achievable and, therefore, the preliminary price caps are still valid;
- iv. that BC Ferries should track the 1% efficiency target on an annual basis;

- v. that after having reviewed updated fuel price forecasts and assumptions, the set price for marine diesel of \$1.03 per litre and \$0.469 per Diesel Litre Equivalent for LNG included in the preliminary price cap decision is still reasonable for purposes of setting the final price caps; and
- vi. that the fuel deferral mechanism is working as intended and therefore will continue in PT5. The Commissioner received no information from the operator or comments from the public, which would require a reconsideration of fuel deferral accounting in PT5.

#### **4. Final Decision on Price Caps for Performance Term 5**

Based on the determinations above, the Commissioner has ordered that the final price caps for PT5 be set at 2.3% in each year, which confirms the preliminary price cap decision.

#### **5. Appendices**

- A. [Statutory Requirements for Establishing Price Caps](#)
- B. [Supplemental Submission](#)
- C. [Ministry Letter](#)
- D. [Public Comments](#)
- E. [Performance Review of the Efficiency of BC Ferries](#)