



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

December 30, 2019

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Introduction

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

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

In view of the time constraints set out in Section 55 of 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 relating to class of asset listed in these guidelines are addressed, although not necessarily in the order shown.

The Commissioner may, in any declaration issued under section 55(1) 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.

Statutory Requirements

Coastal Ferry Act

The relevant sections under the *Act* guiding the Commissioner in the deliberation of applications from BC Ferries for capital expenditures are 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,

(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.

Section 38 of the Act was amended in May 2019 and states, in part:

s. 38 (1) that the Commissioner must undertake the regulation of the core ferry services in the public interest; and

s.38 (1) (a.1) ferry operators are to be encouraged to meet provincial greenhouse gas emission targets in their operations and when developing capital plans;

Finally, section 54 outlines the obligation of the Commissioner to keep information confidential unless disclosure is consistent with the *Freedom of Information and Protection of Privacy Act*.

Order of the Office of BC Ferries Commissioner

The Commissioner Order 19-03, dated January 25, 2019, and titled “*Section 55 and Section 67 of the Coastal Ferry Act and establishment of the criteria for a Major Capital Expenditure*”, reads in part as follows:

For purposes of Section 55(5):

1. *Any capital expenditure for any new vessel or mid-life upgrade to a vessel (“Vessel Expenditure”) is a major capital expenditure if the expenditure exceeds \$50 million inclusive of vessel related component programs and interest during construction;*
2. *Any capital expenditure for new terminals, terminal upgrades, information technology systems or other non-vessel capital expenditures (Non-Vessel Expenditures”) is a major capital expenditure if the expenditure exceeds \$25 million, inclusive of non-vessel related component programs and interest during construction;*
3. *In the case where a single project (“Project”) planned by a ferry operator includes capital expenditures of a type referenced in both paragraphs (1) and (2) above, the entire capital expenditure for the Project will be a major capital expenditure if either the Vessel or Non-Vessel expenditure exceeds the applicable threshold;*
4. *When estimating the amount of a planned capital expenditure for purposes of this Order, a ferry operator may exclude the amount of any third-party contributions;*
5. *The commissioners’ determinations of a Section 55(2) application for approval of a major capital expenditure, as defined in paragraphs 1 and 2 above, will be based on whether or not the proposed capital expenditure project is:*
 - a) reasonable, affordable and prudent;*
 - b) consistent with the approved and current 12-year capital plan submitted to the Commissioner for the current performance term;*
 - c) consistent with the current Coastal Ferry Services Contract; and*
 - d) consistent with any government long-term vision for the future evolution of coastal ferry services;*
6. *The definition of a major capital expenditure under paragraphs (1) and (2) above, excludes any Project for which a ferry operator has already obtained an approval under Section 55(1), where:*
 - a. the ferry operator has determined that the total estimated capital expenditure required to complete the Project now exceeds the estimated capital expenditure of the Project, as described in the ferry operator’s Section 55(1) application submitted and approved by the commissioner (“Original Project Cost”), and the revised estimate of the Vessel Expenditure or Non-Vessel Expenditure of that Project, as applicable, exceeds the applicable threshold established in either paragraph (1) or (2) above by less than 5%; and*

- b. despite the subsequent increase in expenditures over the Original Project Cost, the scope and the justification for the Project have not materially changed;*
- 7. *Where the total estimated capital expenditure required to complete any Project for which a ferry operator has already obtained an approval under Section 55(1) exceeds the Original Project Cost and the requirements set out in sub-paragraphs (6) (a) and (b) above are not met, the ferry operator must submit a Section 55(2) application for approval of the amount of the capital expenditure that the ferry operator now estimates will exceed the Original Project Cost.*

For purposes of Sections 67(1) and (2)

- 8. *The operator shall deliver a report to the commissioner within 30 days following board approval of any capital expenditure exceeding \$25 million, detailing the purpose of the expenditure and providing answers to the relevant questions set out in the Commissioner's Guidelines for Section 55 applications. This requirement is waived for any capital expenditure or major capital expenditure which will be the subject of an application under Section 55 (1) or (2).*

Commissioner's Determinations

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

- A. Is the proposed project reasonably required?
- B. Does the proposed capital expenditure demonstrate good judgment, based on wisdom, experience and good sense?
- C. Does the proposed capital expenditure indicate a wise use of resources?
- D. Does the proposed capital expenditure show due consideration for the future?
- E. Has it been demonstrated that the proposed capital expenditure would not reasonably be considered excessive?
- F. Does the proposed capital expenditure provide good value, at a moderate and fair price? Is it affordable?
- G. 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?
 - iii) Does the scope of the proposed capital expenditure differ in any respect from what was approved in the latest capital plan approved by the Board?
- H. Is the proposed capital expenditure consistent with the requirements of the Coastal Ferry Services Contract?
- I. How does the proposed capital expenditure support the government approved long term vision for the future of coastal ferry services?

- J. Is the proposed capital expenditure in the public interest? Specifically, does the capital expenditure ensure, or enhance, a ferry service that remains safe, reliable and affordable?
- K. Does the capital expenditure contribute to reduction in GHG emissions?

Further, the Commissioner 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)

Submission Requirements

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

Reasons for the Proposed Capital Expenditure

State the reasons for the capital expenditure and why it is needed at this time. Specifically:

- What is driving the capital expenditure (e.g. replacement, expansion, upgrade, regulatory requirements, reduction in GHG emissions)?
- Is the proposed capital expenditure provided for in a board approved capital plan?
- How has this capital expenditure project been prioritized relative to other capital expenditure projects within the long-term capital plan?
- Have there been service disruptions due to inadequacy of the existing capital asset?
- Have there been complaints from the public, or other stakeholders, about the existing capital asset?
- What sources of expertise and experience have been relied upon in deciding to proceed with this capital expenditure?
- Why is the proposed capital expenditure required now and what are the consequences of delay or if the application is rejected?
- Is the proposed capital expenditure consistent with the Coastal Ferry Services contract?
- How does the proposed capital expenditure support the provincial government's approved long-term vision for coastal ferry services?
- Is the proposed capital expenditure considered to be in the public interest?

Options

Outline in some detail the options that were considered in arriving at the proposed capital expenditure. Specifically:

Vessel Replacement or Expansion

- Has a used vessel option been considered?
- 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?
- Can an existing vessel be reassigned instead?
- Has BC Ferries considered any alternative to building and owning the new vessels?
- Were non-vehicle vessels (e.g. passenger only ferries, barges, other) or a mix of vessel types considered?
- Will a new or replacement vessel require any modifications to any terminals? If so, at what additional cost?

- If age of the existing capital asset is a factor, what is the estimate of future costs of continuing its use?
- In the case of a replacing an existing vessel with 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?
- Would investments in technology, such as an expanded reservation system, better IT systems or a yield management program allow for a smaller sized or different type of vessel?
- For shorter routes were non-vessel options considered, such as a fixed link?
- Does the vessel align with the concept of standardization of the fleet?

Terminal Upgrades or Expansion

- Have future changes to mix of traffic serviced by the terminal been contemplated?
- Have changes to the type and size of vessels operating out of the terminal been contemplated?
- Have smaller vessels been considered to reduce terminal capital?
- Do the terminal improvements align with the concept of asset standardization?
- Were new technologies or innovations contemplated? If so, why are they considered necessary?

IT Projects

- What options other than IT solutions were considered?
- Is the proposed IT solution custom made or ‘off the shelf’? If custom built, why was it chosen?

Option Analysis

Assess the net overall benefit or cost of the identified options taking into account the net present value on a life-cycle basis and the impacts on customers, operations, the environment, social/communities and the broader economy. Specifically:

Financial

- What are the total estimated capital expenditures by year by option?
- What is the estimated IDC?
- What are the estimated operating costs for each option?
- What are the estimated maintenance costs for each option? Where there are large differences, please explain.
- How were the capital, operating and maintenance cost estimates derived? Entirely with BC Ferries’ staff or was there an external review?
- Does BC Ferries intend to capitalize any of its own internal costs with respect to the capital expenditure?
- *New Vessels:* If tenders are to be sought from foreign shipbuilders, what is the applicability of custom tariffs on importation of the vessels?
- *Vessels and Terminals:* Does the vessel/terminal design have any impact on labour costs? If so, how?
- *New Vessels:* Do any of the proposed passenger amenities require crewing levels to be higher than what is required by Transport Canada regulations?

- *New Vessels:* 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 higher operating costs.
- What is the revenue impact?
- Are financing costs included in the cost estimate between first payment to the supplier and the in-service date?
- Is there an allowance in the estimate for inflation from the date of acceptance of a proposal to the completion date (escalation clause)?
- Is the net present value analysis done on a lifecycle basis for relevant comparison of options?
- What is the rationale for the discount rate used?
- Has a sensitivity analysis been done on key assumptions, such as costs, revenues, discount rate, timing and inflation?
- *Vessels and Terminals:* Have "ancillary services", including catering and retail concessions, been considered? If so, provide estimates of the incremental operating costs to provide the ancillary services and the incremental revenue expected to be generated from those services.
- *Terminals:* Will BC Ferries be sub-contracting or entering into partnerships with other entities to provide services and infrastructure at the terminal (e.g. parking, catering, retail)?
- What are the major risks? Have they been taken into account in the NPV analysis?

Customer Service and Operations

- How does the capital expenditure affect customers?
- How are the needs of commercial traffic being considered and accommodated?
- How are the needs of cyclists and foot passengers being considered and accommodated?
- *New Vessel:* Is vessel capacity sufficient to meet current and projected future demand? Is the vessel the right size and how has the capacity requirement been determined?
- *New Vessel:* Will the new or replacement vessel be appropriate if the ratio of vehicle to foot passenger traffic changes in future?
- *Terminal:* Is the terminal capacity sufficient for future demand and mix of traffic?
- *New Vessel and Terminal:* What methodology has been used to determine future demand?
- *New Vessel and Terminal:* What passenger amenities will be provided, and why are they considered appropriate?
- *New Vessel:* What are 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?
- *New Vessel:* 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?
- *Terminal:* Have the connection to transit and other transportation options been considered? If not why not?
- *New Vessel and Terminal:* Will there be improved access for disabled/mobility challenged passengers?

- *New Vessel:* Are engines sized for efficient operations, fuel consumption and ability to recover schedule?
- *Terminal:* Will the facility accommodate passenger-only ferries, water taxis and/or barge operations?
- *New Vessel:* Will the project contribute to flexibility and interoperability within the fleet?
- *Terminal:* Will there be any improvements to ferry marshalling?
- *Vessel and Terminal:* Will there be any improvements to loading, unloading and turnarounds?
- Will the capital expenditure project affect BC Ferries operations? If so what is the impact on operations?
- *IT Projects:* Is there a project plan and appropriate governance in place?

Environment

- *New Vessel:* Will there be provision for a conversion to an alternative to marine diesel engines, such as LNG or hybrid electric?
- *New Vessel:* How fuel efficient will the new vessels(s) be?
- *New Vessel:* Is dual fuel capability planned? If so provide the rationale.
- *New Vessel:* Will the new vessel reduce noise? How much?
- Will the project result in a more efficient and/or reduction in overall energy usage?
- Will alternative energy sources be used?
- Will the project help to reduce GHG emissions? How?

Social/Community Impacts

- What are the impacts of the proposed capital expenditure on the local community and other stakeholders?
- *Terminal:* What are the impacts on local traffic patterns?
- Provide detail on completed and/or planned consultations with affected customers, stakeholders and communities.
- Has the provincial government been apprised of or consulted on the proposed capital expenditure? Provide details.

Preferred Option Procurement and Risks

Outline how the Proposed Project will be procured and how major risks will be managed. Specifically:

- What is the expected in-service date? How was it determined? How confident is BC Ferries of the in-service date?
- What are the consequences of a delay in the in-service or deployment date?
- What is Plan B if the project is delayed?
- Is the total cost different in any respect from what was approved in the capital plan?
- 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?
- What is the estimated impact of the proposed capital expenditure on future price caps assuming no change in non-passenger related revenues?

- What would have to be sacrificed to reduce total costs by 10%, and by 20%?
- Does the proposed project include significant features that are innovative or untried?
- Describe any major risks that could affect the project's success.
- Describe mitigation strategies for major risks that have been identified.
- What are the procurement options and process?
- What are the procurement risks and how will they be mitigated?
- *New Vessel*: Will BC Ferries require the contracting shipyard to bear the design and construction risk?