BC Ferry Commissioner PT4 Preliminary Price Cap Decision

AVICC April 2015

Context

Coastal Ferry Act (Part IV)

- Defines the role of the Commissioner
- Sets the principles Commissioner to follow in performing his duties
- Sets the process and guiding principles for price caps
- Allows the Commissioner to review one or more aspects of BCF operations
- Requires BCF to submit a capital plan
- Requires BCF to submit an efficiency plan
- Allows Commissioner to require Fuel Deferral Account

Price Cap Timeline to date

- By September 30, 2015 BCF must submit to Commissioner, Authority, MOTI
  - A report containing the information required under sec 40(1) of the Act
  - The efficiency report
  - The capital plan
- The Commissioner must promptly post this material to website – does not have to post material that FOIPPA does not allow
- By March 31, 2015 Commissioner must:
  - Request and review public input
  - Submit a report to MOTI and BCF of his review of material and determination of preliminary price cap
  - Make report public (Press conference, on website March 18)

Principles/Guidelines followed as Act requires

"the primary role of the commissioner is to balance, in the manner the commissioner considers appropriate,

(i) the interests of ferry users,

(ii) the interests of taxpayers, and

(iii) the financial sustainability of ferry operators;"

In setting a price cap the commissioner must review the expenses and capital costs to ensure they are reasonable in his mind and be guided by the following principles:

(a) the price cap must allow for a return sufficient to enable the ferry operator to recover

- (i) operating expenses
- (ii) administrative expenses
- (iii) the reasonable capital costs

(b) the price cap, must allow for a return sufficient to enable the ferry operator to

- (i) meet its debt obligations, and
- (ii) maintain access to borrowing rates that, in the opinion of the commissioner, are reasonable in all of the circumstances;

(c) the price cap must take into account the productivity gain the commissioner considers achievable

Province's Vision for Coastal Ferry Service

Guiding principles to keep BC Ferries sustainable

- *The government of B.C. is charting a new course for our coastal ferries' future. The guiding principles behind all future decisions to affect coastal ferry service will be based on an affordable, efficient and sustainable system which protects basic service to coastal communities for future generations.*
- *Affordable responds to the top priority expressed in the public engagement process. The B.C. government will take actions so that ferry fare increases trend toward the Consumer Price Index (CPI).*
- *Efficient describes a ferry system that embraces innovation, adopts new and emerging technologies, continues to find operational efficiencies, and strives for continuous improvement. Examples of initiatives currently underway or being explored at BC Ferries include the use of a cable ferry serving Denman Island, the use of liquefied natural gas to fuel vessels and a new reservation and point-of-sale system to improve customer service.*
- *Sustainable speaks to a commitment to ensure that future generations have safe, reliable transportation connections to coastal communities. Standardizing vessels for greater interoperability, more "no frills vessels", and seeking federal infrastructure funding to renew the fleet all contribute to a sustainable system.*
- *These guiding principles are a framework for BC Ferries and the BC ferry commissioner as they consider and implement changes to increase operational efficiencies and develop and implement long-term capital plans. It is a long-term vision that will help ensure that coastal ferry services are affordable, efficient and sustainable for future generations.*

From Backgrounder to February 5, 2014 Provincial News Release

Reviews by PwC

- Assessment of BC Ferries' PT4 Submissions
  - Information re core services, revenues, expenses for PT3
  - Long Term Capital Plan
  - Efficiency Plan
- Performance Review of the Efficiency of BC Ferries
- Performance Review of BC Ferries' Fuel Management
- Performance Review of BC Ferries' Homeporting Arrangements
- Performance Review of BC Ferries Vacations

Commissioners' Comments re Pt3

Reviewed all that happened so far, his report, legislation, removal of cross subsidy prohibition a key piece and noted progress BCF had made:

- Positioned to exceed the PT3 efficiency target of $54 million
- Lowered administrative costs by $5 million since 2009
- Reduced executive compensation levels by $1.2 million per year
- Reduced overtime costs
- Implemented safety improvements leading to reductions in WorkSafeBC premiums
- Achieved positive labour relations, with no disruptions for more than 12 years
- Initiated capital projects on time and on budget
- Commenced development of new technology systems to support flexible pricing and expanded reservation systems
- Achieved continued growth of ancillary revenues, resulting in revenue that has relieved pressure on fares.

Capital Plan, key comments included

- BCF operates 35 vessels from 47 terminals
- Since 2003 have invested $2.1 billion ($1.4 bill in vessels)
- To date in PT3 $330 mill invested
- Received Commission approval for $500mill of projects: Cable ferry, 3 ICF, Spirit Class MLU, and Fare Flexibility and Digital Experience Initiative
- Over next 12 years plans to invest over $3 billion
  - Based on service levels, capacity, routes etc. as per current CFSC
  - Replacement of 18 vessels, some associated with Horseshoe Bay
  - 3 IT projects, 700 minor projects
  - Major infrastructure replacement in Horseshoe Bay, 200mill+
- Challenged BCF for PT5 planning to reduce plan by $100mill

Efficiency Plan, 4 elements,

1. LNG
   - Single largest opportunity within terms of existing CFSC
   - 3 new ICF, Spirit class conversion will be dual fuel
2. New Customer focused IT systems
   - underway with order 15-01
3. Major Routes Strategy(requires CFSC amendment)
   - Relates to Horseshoe Bay $200mill, major vessel replacements and mid-island corridor service
   - Commissioner indicates review should continue assuming vehicle service between Horseshoe Bay and Nanaimo and significant public consultation
4. Southern Gulf Islands Strategy (requires CFSC amendment)
   - New ICF the catalyst,

Based on this review, the commissioner is satisfied that overall efficiency in the areas assessed by PwC is generally good.

- BC Ferries is demonstrating good cost control, especially in the area of administrative expenses;
- Cost control has been achieved while maintaining good outcomes with customer satisfaction and safety;
- BC Ferries appears to have a strong culture of efficiency;
- Executive compensation is comparable with provincial crown corporations and appears to be appropriate for an organization of its size and complexity;
- Public Sector Employers Council guidelines are followed regarding executive holdbacks, organizational layers and the number of direct reports to the CEO;
- Administrative expenses and unscheduled overtime costs have declined by 15% and 16%, respectively. Employee absentee rates are below the average for comparable businesses, while turnover has declined from 10.14% to 2.94%;
- Executive compensation has declined significantly from $3 million in 2009 to $1.8 million in 2014, and is at the low end of the four largest provincial Crown corporations;
- A higher percentage of management-exempt labour has provided the company with more flexibility to manage overall labour costs.

The commissioner considers BC Ferries' fuel management policies and procedures to be generally acceptable.

PwC reviewed BC Ferries' policies and procedures regarding fuel management, and found:

- Significant measures to manage fuel consumption have been implemented;
- Fuel procurement policies and procedures appear to be appropriate;
- BC Ferries' fuel hedging strategies may be advantageous to ferry users when used to limit increases in fares to the rate of inflation;
- BC Ferries' fuel deferral mechanism – an accounting tool that corrects the set price of fuel over time to reflect actual pricing – serves as a hedging tool which helps to mitigate fuel price risk, and still allows the company to purchase fuel at a price which is most beneficial to reducing fares.

The commissioner is satisfied that BC Ferries Vacations is making a positive contribution to net income at BC Ferries and as such, is helping to keep fares lower than they would otherwise need to be.

PwC reviewed the BC Ferries Vacations business model and financial performance to date and found:

- BC Ferries Vacations is meeting its intended goals;
- Gross and net revenue expectations have exceeded initial targets;
- The contribution and costs of a centrally located service centre in downtown Vancouver do not appear unreasonable; and
- The business line has yet to reach a mature state and has potential to expand further.

The commissioner agrees that some homeporting arrangements may not be ideal; however, there is no compelling reason to alter arrangements at this time.

PwC conducted an assessment of the rationale and efficiency of current BC Ferries homeporting arrangements and any alternatives for enhancing efficiencies and found:

- Existing homeporting arrangements are not necessarily the most efficient choice, but changing them now would be cost-prohibitive;
- Future homeporting decisions should only occur when major decisions are being made on existing routes;
- A homeporting policy should be developed for future guidance, when new routes are established, or existing routes are faced with major changes;
- Crew accommodations on new vessels may allow BC Ferries to achieve savings without changing homeporting arrangements.

Preliminary price cap set at 1.9% per year

Based on:

- One route group for price cap calculations
- Province will maintain service fees at fiscal 2016 levels
- Productivity gains of $4.9mill plus $2mill per year total $27.6 mill
- Traffic projections 5% increase over 2016 levels by 2020
- BCF expected to manage operating and administrative costs at or below inflation, assumed 2%
- Labour cost settlements are assumed to be consistent with public sector agreements
- Federal contract amount will remain at current levels indexed by 2%
- Fuel deferral accounts will be maintained and must be brought to zero once during PT4 (this recognizes unpredictability of fuel prices now)
- The set price for marine diesel is 91.5 cents per litre and LNG at 46.4 cents per litre
- Achieves a debt service coverage ratio of 2.5 or higher and equity not lower than 17.5% of total capitalization

Comments made in press conference

- From Minister Stone
  - Will maintain the current historic, all time high level of funding moving forward, referred to 180mill
  - Not contemplating any further service reductions
  - Suggestion to Federal government for additional support by looking at crewing levels
  - Opportunity for public to weigh in with comments and suggestions to both the Commissioner and the province
  - No intention of closing either of the terminals in Nanaimo

From Gord Macatee

$5mill taxpayer infusion is a 1% reduction (very rough numbers. So a sustained 1% reduction established in year one would $20mill over PT4

What happens next

- Commissioner has invited comments until June 30,2015
- The province and BCF will review the CFSC and BCF must deliver to the Commissioner the contract that will apply to PT4 that indicates changes if any to core service levels or service fees
- By September 30, 2015 the Commissioner must deliver the final price cap decision
- PT4 starts April 1, 2016