

# Review of Coastal Ferry Act

## *Commissioner's Discussion Paper #3*

The BC Ferry Commission (“the commissioner”) has been mandated under Bill 14 to conduct a review of the Coastal Ferry Act and to make recommendations to the Minister of Transportation and Infrastructure on potential changes which would better enable the commissioner to balance the financial sustainability of the ferry operator and the interests of users. The commissioner is conducting public consultation meetings in coastal communities served by BC Ferries and is inviting additional input via written submissions or comments on a number of key issues.

This is the third of several discussion papers to be published on key issues to be considered by the commissioner during his review. This paper deals with financial sustainability and how it is applied.

One of the principles contained in the existing regulatory framework is that priority is to be placed on the financial sustainability of the ferry operators. Financial sustainability is not explicitly defined in the Coastal Ferry Act. The commissioner has instead relied on practices as they are applied in other regulatory frameworks.

In situations of regulated monopolies, such as the case with BC Ferries, the normal regulatory practice is for the regulator to set a regulated rate of return on equity in order to achieve financial sustainability. Equity includes share capital and retained earnings and the return on equity is a measure of profitability required to cover all costs including interest on debt obligations and to provide a return to the shareholder. In some circumstances the regulator can also assess the overall cost of capital, while allowing the company to develop an appropriate capital structure to achieve financial sustainability. Regulators are guided by the generally accepted definition that financial sustainability is achieved when service and infrastructure levels are delivered and maintained according to a long-term plan without the need to increase rates other than for inflation or to reduce services and the company can efficiently finance its capital and operating requirements.

In the case of BC Ferries, the commissioner has established a rate of return for the company based on a comparison of the rates of return and risk profiles of the ferry industry internationally and the regulated utility industry in Canada. In its assessment, it also considers the nature of the services contract between BC Ferries and the provincial government.

The theory behind this approach is that it allows BC Ferries to generate sufficient revenue to sustain its business over time by recovering the costs associated with its fixed capital assets. Aspects of this approach include the following:

- Through the price cap system, the regulatory framework does not provide excessive returns, reward less than efficient operations, or provide bail-out.
- Within these constraints, BC Ferries should be able to:
  - fund its long term capital requirements and maintain its assets;
  - secure financing in a timely way and at a reasonable cost in order to facilitate the delivery of its regulatory obligations; and
  - generate sufficient cash flows to meet basic financial ratio tests, based on the way credit rating agencies assess whether a company is investment grade.

Under some regulatory regimes, the regulator has placed a limit on the level of debt the company can raise by limiting the debt to equity ratio in order to improve the financial resilience of the company and ensure it can deliver essential services. This demonstrates that the assessment of user interests can be beyond the prices charged to encompass wider considerations such as maintaining service levels and ensuring that a service can be provided to users.

The commissioner is interested in obtaining public feedback on the following:

- Is the generally accepted definition of financial sustainability appropriate for BC Ferries?
- The appropriateness of the regulated rate of return on equity in establishing fares.
- Whether alternatives exist that can address the financial sustainability of ferry operators and provide affordable service for ferry users.