

RESEARCH AND ADVICE ON RISK MANAGEMENT IN RELATION TO THE SUBSIDY OF FERRY SERVICES

Deliverable 3: Non-EU Case Studies

Report - FINAL

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1. INTRODUCTION

Objective of the report

- 1.1 This report constitutes Deliverable 3 “Research and Advice on Risk Management in Relation to Subsidy of Ferry Services” study for The Scottish Executive Enterprise, Transport and Lifelong Learning Department (the Executive) before the tendering of the Clyde and Hebrides Lifeline Ferry Services. The study analyses how the EU Maritime Cabotage Regulations rules are applied within the European Union (EU), with particular regard to the way in which risks are managed.
- 1.2 This report is a factual summary of the different approaches adopted in British Columbia (Canada), Norway and Japan to support of their domestic island ferry services.

Rationale

- 1.3 We chose to focus on Canada, Norway and Japan because they all have sparsely inhabited off-shore islands that are linked to the mainland through subsidised passenger and freight ferry services. We believe that the arrangements that they have put in place to safeguard these services are of particular relevance to our study.
- 1.4 Canada, Norway and Japan are OECD countries whose economic and government institutions are comparable to those found in the European Union. These are, namely, ensuring a suitable standard of transport connection; ensuring ferry fares and freight charges are not excessive; and ensuring efficient delivery of services at the minimal amount of public subsidy.
- 1.5 In addition, information regarding ferry services exists in the public domain for these countries, which greatly facilitates the research process.
- 1.6 The subsidised ferry market structures in the three countries fall within a wide spectrum. In British Columbia, one operator dominates the market under a long contract (60 years) with the Government. In Japan, the market structure is diametrically different, with many operators providing services in a highly fragmented market of over 600 individual routes. In Norway, the concept of PSO / Lifeline services does not formally exist. Ferry services are regarded as part of the road network. Services, however, are governed by contracts that stipulate ticket prices and frequency of service.
- 1.7 We feel that the recent institutional restructuring and types of services provided in these countries would make them valuable case studies to inform the tender of the Clyde and Hebrides services in Scotland.

2. METHODOLOGY

- 2.1 We adopted a desk-based research approach that consists primarily of the review of existing published data (either in print or on the internet). The data in the three different countries is not homogenous, and while British Columbia has very comprehensive websites and much information is readily available, others do not.
- 2.2 In the case of Norway, in order to fill information gaps, the research approach was complemented with one of our native Norwegian team members conducting direct telephone interviews with identified representatives of the key organisations. We also obtained information and case studies from our collaborator in Norway - the Institute of Transport Economics.
- 2.3 The case study on Japan was primarily carried out by our collaborator Public Planning & Policy Studies, Inc. in Japan.
- 2.4 Table 2.1 is a list of the organisations we researched / contacted in order to complete this report.

TABLE 2.1 NON- EU COUNTRY CONTACTS

Country	Department
British Columbia, Canada	British Columbia Ferries Commission
Norway	Public Roads Administration Institute of Transport Economics, Norwegian Centre for Transport Research
Japan	Public Planning & Policy Studies, Inc.

3. BRITISH COLUMBIA, CANADA

- 3.1 There are 25 regulated and contracted ferry services in British Columbia, Canada, carrying 21.6 million passengers and 8.3 million vehicles each year. In 2002/2003, the services generated \$490 million in revenue.
- 3.2 The set-up and operation of subsidised ferry services to the British Columbia islands were reformed in 2003. The Coastal Ferry Act, which governs the remit of the British Columbia Ferry Commission, places priority on the financial sustainability of the ferry operators, the adoption of a commercial approach to ferry service delivery, fair and open competitive process, operational efficiency without compromising safety compliance, and a movement towards greater reliance on a user pay system to reduce to service fee contributions by the government.
- 3.3 The British Columbia Ferry Services Inc. (BC Ferries), is the sole operator of regulated ferry services to the islands of British Columbia. Other operators enter the market either as a sub contractor of BC ferries, or by serving unregulated route (e.g. Bamfield - Barkley Sound - Port Alberni).
- 3.4 Through a 60 year contract, the government pays BC Ferries a defined annual subsidy or “service fee” in return for making specified numbers of ferry sailings on specified routes, with a maximum total value of some \$106 million per year. The major routes (the three routes between Vancouver Island and the BC Lower Mainland) are self-supporting and receive no service fee from provincial taxpayer funds.
- 3.5 The current contract has not been tendered. The result represents the end of the natural process of the provision of services in British Columbia.
- 3.6 The case study on British Columbia is in **Appendix A** of this report.

4. NORWAY

- 4.1 There are three types of ferries operated by over 20 operators in the Norwegian domestic market:
- A large Coastal Voyage, which runs once a day from Bergen in the south to Kirkenes in the north, taking 11 days round trip. These ferries take both vehicles and freight;
 - Fast ferries, which operate along the coast, usually taking vehicles and only light freight;
 - Car ferries, which operate shorter journeys as a part of the road network. These are used to cross fjords or give access to islands not connected to the mainland with bridges. They sometimes also carry freight.
- 4.2 The local authorities/county councils in Norway have the main responsibility for regulating buying services from ferry operators. They issue licenses and enforce license conditions.
- 4.3 Car ferries, which are a part of the main road network, are administered more directly by central government through the Public Roads Administration. The Coastal Voyage is regulated directly by the Ministry of Transport and Communication. The ferry services are operated mainly by private ferry companies, with each ferry company being a monopolist on a bundle of crossings.
- 4.4 None of the ferry services are formally regarded as lifeline services or PSO. In order to get a license to run a service, however, the operator needs to sign a contract with the county council or Public Road Administration. Stipulated in the contract are the ticket prices and frequency of service. This is to ensure a satisfactory level of service for people who depend on it.
- 4.5 Subsidy amounts are set out by the central government in their annual spending plans and each county council is given a budget which they can spend on ferry subsidies. The subsidies are currently given to operators based on their concession area. Most operators serve in areas that consist of both profitable and loss making services. This makes it possible for an operator to cross subsidise - transferring money from a profitable service to a loss making service.
- 4.6 In the past 10 years, 10% to 15% of the routes have been put out to open tender as a trial. From 2005 onwards, this will become a permanent arrangement. The new tendering process intends to prevent cross subsidisation from happening, as contracts are for routes and not areas.
- 4.7 The responsibility of tendering ferry services has fallen on subsidiary road authorities at the local and regional level, resulting in different designs of the tendering process, as well as contractual arrangements. There is a combination of net cost and gross cost contracts currently in place in Norway.
- 4.8 Thus far, the experience in Norway has had the following market implications:
- Lower subsidies for ferry transport;
 - More efficient and better structured ferry transport organising;

- Lower operational costs and more flexible shift systems;
- More ferry capacity with better supply quality and frequency;
- Low bidding prices (at even below the no profit level) by incumbents to prevent market entry by outside operators;
- Increase in transaction costs related to contract negotiations and renegotiations; and
- Collusion by companies already operating in the same areas when bidding for contracts, effectively creating monopolies to keep out other competitors.

4.9 Although not an EU country, Norway's maritime practices are fully compatible with the EFTA Surveillance Authority (ESA) with an open procurement process. ESA procurement rules are similar to those in the EU.

4.10 The Norway case study is in **Appendix B** of this report.

5. JAPAN

- 5.1 Japan has one of the world's largest networks of island ferry services. It is also one of the most fragmented markets, with small operators running 279 island lines serving 350 island routes.
- 5.2 Most remote island ferry services in Japan suffer from problems such as imbalanced traffic flows, traffic seasonality, and low levels of vessel utilisation. "Designated Sea Routes" are sea routes where there are no other transport modes other than vessels, such as a route connecting remote islands. The objective of the "Designated Sea Routes" is to maintain a minimum level of ferry service to maintain the daily and social life of residents on or around the designated routes. "Designated Sea Routes" are determined by the Minister of Land, Infrastructure and Transport (MoT) after consulting with related prefecture governor(s).
- 5.3 110 of the "Designated Sea Routes" in Japan, operated by 106 different operators, received subsidies from the central government in 1998. In addition to these national grants, each prefecture has its own means of subsidies, as the national subsidies do not cover all loss making routes.
- 5.4 The domestic ferry market in Japan is not very profitable compared to the other modes, and as such is not very competitive. Subsidised routes are exclusive by definition, as the government would not subsidise any route where there is more than one operator.
- 5.5 Subsidies in the Japanese ferry market are a form of guaranteed top up to meet the losses of the operating companies. Factors such as the relative remoteness of a particular island, access, journey time, cancellation rate, availability of alternative transport, etc., are also taken into account when calculating the subsidy amounts. The concession period is one year, and operators must reapply for the subsidy each year.
- 5.6 The operation of ferry services in Japan is based on a notification system as opposed to a contractual one. As such, there is no tendering process.
- 5.7 A case study on Japan is in **Appendix C** of this report.

APPENDIX A
BRITISH COLUMBIA (CANADA) CASE STUDY

A1. FERRY LEGISLATION AND LICENSING

Introduction

A1.1 The British Columbia, Canada, ferry market has historically been a monopoly, where the Crown Operation BC Ferries has been the sole operator. The Coastal Ferry Act of 2003 ratified the situation. Under the new Act, the ferry market aims to:

- Adopt a more commercial approach;
- Increase efficiency;
- Eliminate cross-subsidy;
- Move towards greater user pay and less subsidies; and
- Charge reasonable tariffs.

A1.2 There are currently two types of ferry routes in British Columbia: designated routes and unregulated routes. The 25 designated routes are under the jurisdiction of the BC Ferry Commission, which regulates the prices and services along these routes. An operator that wishes to operate on the regulated routes must enter into a contract with the British Columbia government.

A1.3 British Columbia Ferry Corporation (BC Ferries) is the current contracted operator for the regulated routes under a 60-year Coastal Ferry Services Contract (dated April 2003), with the British Columbia government.

A1.4 Eight unregulated routes (e.g. Bamfield-Barkley Sound-Port Alberni) do not come under the Commission's jurisdiction. BC Ferries is responsible for negotiating and administering contracts with independent operators on certain unregulated routes. Under the Coastal Ferry Services Contract, the Province provides funding to BC Ferries to supplement the revenue from such unregulated services, in return for a guaranteed sailing pattern / schedule. The Ferry Commission, however, has no part in these contracts.

A1.5 During the 2002/03 fiscal year, the major operator BC Ferries (as its predecessor, the British Columbia Ferry Corporation), carried 21.6 million passengers and 8.3 million vehicles, generating CAD\$490 million in revenue.

Domestic ferry services

A1.6 BC Ferries operates almost all of the ferry services in British Columbia. This is despite the Coastal Ferry Act, which allows "entities which have been authorised to operate ferries on more routes under contracts with the Province". In truth, only BC ferries is regulated under this Act.

TABLE A1.1 MAIN FERRY ROUTES IN BRITISH COLUMBIA

Route	Operator	Figure	Other information
Northern British Columbia			
Prince Rupert Ferry Terminal Skidegate, Queen Charlotte Islands	BC Ferries	1.1	Vehicles and Passengers Sailing Time: 6 hours Sailings: 6 round trip sailings per week during summer (June to September). 3 round trip sailings per week from effective September to January.
North Vancouver Island			
Port Hardy to Prince Rupert Ferry Terminal	BC Ferries	1.1 & 1.2	Vehicles and Passengers Sailing Time: 15 hours. Schedule in Effect: May to September
Port Hardy to Bella Coola & Discovery Coast	BC Ferries	1.1	Vehicles and Passengers Sailing Time: 15 hours. Schedule in Effect: May to September
Port McNeill/Sointula/Alert Bay	BC Ferries	1.1	Vehicles and Passengers Sailing Time: Port McNeill - Alert Bay- 45 minutes (7.5 miles) Alert Bay - Sointula - 35 minutes (6.5 miles) Sointula and Port McNeill - 25 minutes (5.5 miles)
Central Vancouver Island/Sunshine Coast			
Campbell River to Quadra and Cortes Islands	BC Ferries	1.2	Vehicles and Passengers Sailing Time: 10 minutes between Campbell River and Quadra Island. 45 minutes between Quadra Island and Cortes Island. Sailings: 18 sailings daily between Campbell River and Quadra Island. 6 sailings daily between Quadra Island and Cortes Island.
Powell River/Comox/Texada Island	BC Ferries	1.2	Vehicles and Passengers Sailing Time: 1 hour 15 minutes from Powell River to Comox 35 minutes from Powell River to Texada Island

Route	Operator	Figure	Other information
			Sailings: 4 daily round trip sailings between Powell River and Comox 10 daily round trip sailings between Powell River and Texada Island
Qualicum Beach to Lasqueti Island	Private	1.2 & 1.3	Foot Passenger service only. The ferry completes the round trip several times per day, except for Tuesday. In addition, there is no service on Wednesday during the off-season
Buckley Bay to Denman and Hornby Islands	BC Ferries	1.2	Vehicles and Passengers Sailing time: 10 minutes from Buckley Bay to Denman Island 10 minutes from Denman Island to Hornby Island Sailings: 17 daily round trip sailings from Buckley Bay to Denman Island 11 daily round trip sailings from Denman Island to Hornby Island
Nanaimo to Gabriola Island	BC Ferries	1.3	Vehicles and Passengers Sailing Time: 20 Minutes Sailings: 15 sailings daily
Nanaimo - Departure Bay Ferry Terminal	BC Ferries	1.3	Vehicles and Passengers Sailing Time: 1 hour 35 minutes from Horseshoe Bay to Nanaimo Sailings: 8 daily round trip sailings between Nanaimo and Horseshoe Bay
Nanaimo - Duke Point Ferry Terminal	BC Ferries	1.3	Vehicles and Passengers Sailing Time: 2 hours Sailings: 8 daily round trip sailings between Nanaimo and Tsawwassen
West Coast Vancouver Island/Pacific Rim			
Port Alberni to Bamfield and Ucluelet	Private Lady Rose Marine Services	1.2	Passenger, mail and freight service Bamfield & Waypoints - Year Round (Tuesday, Thursday & Saturday). Bamfield & Broken Group Islands - July 2nd to September 3rd (Sunday) Bamfield via Kildonan - July 7th to September 1st (Friday) Ucluelet & Broken Group Islands - June 2nd to September 22nd (Monday, Wednesday, & Friday).
Gold River to Nootka Sound and Tahsis	Private Nootka Sound Service Ltd	1.2	A year-round freight and passenger service

Route	Operator	Figure	Other information
Sunshine Coast			
Powell River/Comox/Texada Island	BC Ferries	1.2 & 1.3	Vehicles and Passengers Sailing Time: 1 hour 15 minutes from Powell River to Comox 35 minutes from Powell River to Texada Island Sailings: 4 daily round trip sailings between Powell River and Comox 10 daily round trip sailings between Powell River and Texada Island
Earts Cove to Saltery Bay & Sunshine Coast	BC Ferries	1.3	Vehicles and Passengers Sailing Time: 50 Minutes Sailings: 10 sailings daily Schedule in effect: June to September
Langdale Ferry Terminal, Sunshine Coast	BC Ferries	1.3	Vehicle and Passengers - Schedule in effect June to September Sailing Time: 40 minutes from Horseshoe Bay to Langdale. Sailings: 8 daily sailings from Horseshoe Bay to Langdale.
Greater Vancouver/North Shore			
Horseshoe Bay to Bowen Island	BC Ferries	1.3	Vehicles and Passengers Sailing Time: 20 minutes from Horseshoe Bay to Bowen Island. Sailings: 14 daily roundtrip sailings between Horseshoe Bay and Bowen Island.
Horseshoe Bay Ferry Terminal, Vancouver	BC Ferries	1.3	Vehicles and Passengers Sailing Time: 1 hour 35 minutes from Horseshoe Bay to Nanaimo. 40 minutes from Horseshoe Bay to Langdale. 20 minutes from Horseshoe Bay to Bowen Island. Sailings: 8 daily roundtrip sailings from Horseshoe Bay to Nanaimo. 8 daily roundtrip sailings between Horseshoe Bay and Langdale. 14 daily roundtrip sailings between Horseshoe Bay and Bowen Island.
Tsawwassen Ferry Terminal, Vancouver	BC Ferries	1.3	Vehicles and Passengers Sailing Time: 1 hour 30 minutes between Tsawwassen and Swartz Bay (Victoria)

Route	Operator	Figure	Other information
Victoria/South Vancouver Island			
Swartz Bay Ferry Terminal, Victoria	BC Ferries	1.3	2 hours between Tsawwassen and Duke Point (Nanaimo) 55 minutes between Tsawwassen and Galiano Island 1 hour 35 minutes between Tsawwassen and Mayne (1 stop) 2 hours 15 minutes between Tsawwassen and Pender (2 stops) 3 hours between Tsawwassen and Saltspring Island (3 stops) Sailings: 9 to 14 daily roundtrip sailings between Tsawwassen and Swartz Bay 8 daily roundtrip sailings between Nanaimo and Tsawwassen 2 daily round trip sailings between Tsawwassen and the Gulf Island destinations
Victoria's Inner Harbour	Various operators	1.3	Vehicles and Passengers Sailing Time: 1 hour 30 minutes between Swartz Bay and Tsawwassen Sailings: 9 to 14 daily round trip sailings between Swartz Bay and Tsawwassen 1 daily round trip sailing between Swartz Bay and the Gulf Island destinations Operators: Black Ball Transport Inc Victoria Rapid Transit Inc Clipper Navigation Inc Passengers only Sailing time: 15 minutes Sailings: Daily sailings from 10am to s (May 15 to September 13) 4 daily sailings from 14 September to 15 October
Sidney to Sidney Spit	Private Operator	1.3	Vehicle and Passengers Sailing Time: 25 minutes Sailings: Minimum 9 daily round trip sailings
Gulf Islands			
Crofton to Vesuvius, Saltspring Island	BC Ferries	1.4	Vehicle and Passengers Sailing Time: 20 minutes

Route	Operator	Figure	Other information
Long Harbour, Saltspring Island	BC Ferries	1.4	<p>Sailings: 13 daily round trip sailings between Crofton and Salt Spring Island</p> <p>Vehicle and Passengers</p> <p>Sailing Time:</p> <p>1 hour 25 minutes Tsawwassen/ Long Harbour non-stop</p> <p>2 hours with 2 stops (Galiano Island and Mayne Island)</p> <p>3 hours with 3 stops (Galiano, Mayne and Pender Islands)</p> <p>Sailings:</p> <p>2 daily round trip sailings between Tsawwassen and Long Harbour</p>
Fulford Harbour, Saltspring Island	BC Ferries	1.4	<p>Vehicle and Passengers</p> <p>Sailing Time:</p> <p>35 minutes between Fulford Harbour and Swartz Bay</p> <p>20 minutes between Crofton and Vesuvius Bay</p> <p>1 hour 25 minutes Tsawwassen/ Long Harbour</p> <p>Sailings:</p> <p>8 daily round trip sailings between Swartz Bay and Fulford Harbour</p>
Sturdies Bay, Galiano Island	BC Ferries	1.4	<p>Vehicle and Passengers</p> <p>Sailing Time:</p> <p>55 minutes from Tsawwassen to Galiano Island</p> <p>1 hour 5 minutes non-stop between Swartz Bay and Galiano Island</p> <p>Check BC Ferries for Gulf Island sailings</p> <p>Sailings:</p> <p>4 daily round trip sailings between Galiano Island and Tsawwassen</p> <p>4 daily round trip sailings between Galiano Island and Swartz Bay</p> <p>Check BC Ferries for Gulf Island sailings</p>
Village Bay, Mayne Island	BC Ferries	1.4	<p>Vehicle and Passengers</p> <p>Sailing Time:</p> <p>1 hour 35 minutes between Tsawwassen and Mayne Island</p> <p>55 minutes between Swartz bay and Mayne Island</p> <p>Sailings:</p> <p>2 daily round trip sailings between Tsawwassen and Mayne Island</p> <p>6 daily round trip sailings between Swartz Bay and Mayne Island</p> <p>Check BC Ferries for Gulf Island sailings</p>

Route	Operator	Figure	Other information
Lyaall Harbour, Saturna Island	BC Ferries	1.4	Vehicle and Passengers Sailing Time: 2 hour 20 minutes between Saturna Island and Tsawwassen (transfer at Mayne) 1 hour 15 minutes between Saturna Island and Swartz Bay Sailings: 1 daily round trip sailing between Saturna Island and Tsawwassen 4 daily round trip sailings between Saturna Island and Swartz Bay Check BC Ferries for Gulf Island sailings
Otter Bay, Pender Island	BC Ferries	1.4	Vehicle and Passengers Sailing Time: 2 hour 15 minutes between Tsawwassen (Vancouver) and Pender Islands 40 minutes between Swartz Bay (Victoria) and Pender Islands. Sailings: 2 daily round trip sailings between Tsawwassen (Vancouver) and Pender Islands 5 daily round trip sailings between Swartz Bay (Victoria) and Pender Islands
Chemainus to Thetis and Kuper Islands	BC Ferries	1.4	Vehicle and Passengers Sailing Time: 15 minutes between Chemainus and Thetis Island 15 minutes between Thetis Island and Kuper Island 30 minutes between Kuper Island and Chemainus Sailings: Minimum 10 daily round trip circular sailings between Chemainus, Thetis Island and Kuper Island

Operators

- A1.7 Ferry operators who wish to operate in British Columbia can enter the market in three different ways:
- Entering into a contract with the BC Government;
 - Sub-contracting with the contracted operator; or
 - Operating on the unregulated routes.

- A1.8 To date, BC Ferries is the only operator with a contract with the British Columbia Government to operate the designated (loss-making) routes.

BC Ferries

- A1.9 Almost all the market is currently served by BC Ferries, a publicly owned independent operation. Historically, BC Ferries was a crown corporation under the name of British Columbia Ferry Corporation. The Government of British Columbia owned the preferred shares (non voting) of the company.
- A1.10 On 2, April 2003, after intense examination by the provincial government and the BC Ferries Board of Directors, the company was officially re-launched as a new, independent commercial company and was renamed British Columbia Ferry Services Inc.
- A1.11 The British Columbia Ferry Authority has ownership control of BC Ferries, owns the BC Ferries common shares (voting), and appoints its Board of Directors. BC Ferries is a self-financing company with a mandate to widen travel choices for users and to improve the quality of services. The company has to undertake major investments over the next years and this new form is supposed to attract new private investors.
- A1.12 Section 69 of the Coastal Ferry Act places specific requirements on BC Ferries. These include:
- BC Ferry must seek additional or alternative service providers to provide, under contract, franchise agreement or otherwise, ferry services on the designated ferry routes in an effort to reduce the costs of providing those services;
 - BC Ferries must prepare a plan for seeking such additional or alternative services.

A1.13 The Coastal Ferry Services Contract also designates BC Ferries to be the integrator of ferry services. In that capacity, BC Ferries is responsible for coordinating ferry transport activities in the BC ferry system.

Other ferry operators

A1.14 A ferry operator can operate without having a contract with the Province either by subcontracting with an operator that currently has a contract with the Province (BC Ferries) or by operating an unregulated route.

A1.15 BC Ferries can subcontract one of its routes with another operator via a franchise. This is encouraged by Section 69 of the Coastal Ferry Act. In each performance term, BC Ferries must seek such additional or alternative service providers in an effort to reduce the costs of providing those services.

A1.16 BC Ferries is responsible for negotiating and administering contracts-for-service (Operator Contracts) with independent operators on the eight unregulated routes. Under the Coastal Ferry Services Contract, the Province provides funding to BC Ferries (\$1.7 million per year) flow-through for private operators for the first performance term. BC Ferries channels the subsidy to the operator of unregulated routes to supplement revenue in return for guaranteed sailing pattern/schedules and possibly tariffs.

A1.17 The unregulated routes can sometimes be supplementary to the designated routes. In June 2003, a Request For Proposal was issued by BC Ferries to provide ferry service for the student population on Cormorant Island to attend school in Port McNeill. There were three bids, and an agreement was subsequently reached, where the unregulated service has been provided by a third-party operator.

A1.18 No ferry operator without a contract from the Province is constrained from providing ferry services. However, a major challenge for such an operator is to secure suitable terminals, especially if the operator intends to carry vehicles or freight which may require costly docks and ramps, back-up lands for parking and storage, and highway access. BC Ferries is not obliged to share its terminals, which are leased from the Province.

A1.19 BC Ferries is responsible for renewing or soliciting proposals from operators who are interested in providing services on the unregulated routes at the end of each performance term (five years in the first performance period, 4 years thereafter). At this time, BC Ferries will negotiate with the BC Ferry Commission on the funding arrangement for the unregulated routes, or whether the unregulated route should become regulated. If the latter were the case, the Coast Ferry Services Contract would be amended to include the former unregulated route, and a price cap and services requirements will be imposed.

Legislation

A1.20 The Coastal Ferry Act (2003)¹ is the coastal and island ferry legislation in British Columbia. Bill 18 of the Act, among other things:

¹ The main legislation, in terms of ferry services within the British Columbia, is the “Ferry and Coastal Act” (26th of March of 2003). (<http://www.legis.gov.bc.ca/37th4th/3rd%5Fread/gov18%2D3.htm>)

- Establishes and defines the corporate structure of the BC Ferry Authority;
- Defines the relationship between British Columbia Ferry Corporation and the Authority;
- Lays down the rules and structure of the ferry system in British Columbia, including ferry service contracts;
- Defines the responsibilities and rights of the ferry regulator, the Ferry Commissioner; and
- Specifies the obligations of ferry operators.

A1.21 The 60-year contract between the Government of British Columbia and BC Ferries can be considered legislation, as its contractual terms govern rules of engagement in the ferry market. Under the contract, BC Ferries provides passenger and freight services that would otherwise be loss-making, and in return the Government of British Columbia pays BC Ferries a service fee that is a subsidy paid on a per-sailing basis.

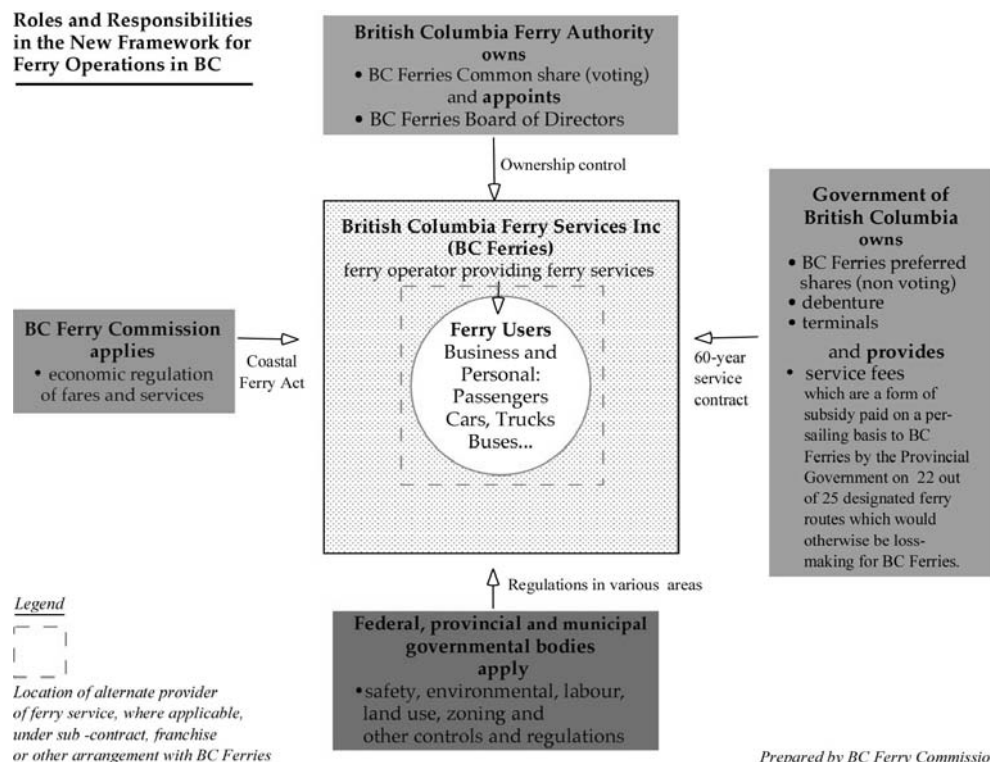
A1.22 The current contract was drafted in 2003². The contract details fares charged on services, schedules, vessels, and sub-contractual arrangements between BC Ferries and other operators along regulated and unregulated routes.

Regulator

Vessel Safety

A1.23 Vessel safety, as well as environmental, labour, land use, etc. is monitored by different federal, provincial and municipal governmental bodies. FIGURE A1.1 summarises the roles of each of the actors.

FIGURE A1.1 ROLES DIAGRAM



² The contract can be downloaded from the following website:
http://www.bcferrycommission.com/Coastal_Ferry_Services_Contract.pdf

Licensing

- A1.24 The British Columbia Ferry Commission is responsible for the economic regulation of fares and services.
- A1.25 The Coastal Ferry Act defines ferry operators as the entities that have been authorised to operate ferries on one or more routes under a contract with the Province. To date, the only operator regulated under the Coastal Ferry Act is BC Ferries.
- A1.26 There are two other ways in which a ferry operator can operate in this market and not be required to sign a contract with the Province. The first one is through subcontracting or obtaining a franchise from BC Ferries, as the Coastal Ferry Act recommends, on one of its 25 routes. The second way is to operate an unregulated route, which is not under the Ferry Commission's jurisdiction. In this case, BC Ferries is responsible for administering and negotiating these contracts.

A2. DESIGNATED SERVICES

Public Interest Services

- A2.1 The Coastal Ferry Act (Section 38 Article 1) sets out six principles which the regulator (Commission) has to follow in the course of its regulatory activities. These serve to define what is meant by the public interest in the provision of coastal ferry services:
- Priority is to be placed on the financial sustainability of the ferry operators;
 - Ferry operators are to be encouraged to adopt a commercial approach to ferry service delivery;
 - Ferry operators are to be encouraged to seek additional or alternative service providers on designated ferry routes through fair and open competitive processes;
 - Ferry operators are to be encouraged to minimise expenses without adversely affecting their safe compliance with core ferry services;
 - Cross subsidisation from major routes to other designated ferry routes is:
 - to be eliminated within the first performance term of the first Coastal Ferry Services Contract to be entered into under this Act, and
 - before its elimination, to be minimised.
 - The designated ferry routes are to move towards a greater reliance on a user pay system so as to reduce, over time, the service fee contributions by the government.
- A2.2 Currently, BC Ferries has the only 60-year Coastal Ferry Services Contract with the Government of British Columbia to provide the designated services.
- A2.3 The objective of the contract between BC Ferries and the Government of British Columbia is to ensure that the basic mobility needs are fulfilled. Each line is defined individually (not as a package) and therefore some routes are only for passengers, and others are for cars and passengers.

History of Government Intervention in the Ferry Market

- A2.4 The Union Steamship Company of British Columbia Ltd, incorporated in 1889, served the coast extensively until the mid 1950s. Together with the Black Ball Line, which dominated ferry operations in the U.S. Puget Sound directly south (with a BC

subsidiary) and the Canadian Pacific Railway's BC Coastal Steamship Service, Union served the needs of the province without major upset until the acceleration of post-war development. The main services to Vancouver Island relied on miniature ocean liners which became inadequate with swelling demand for transport of highway vehicles.

- A2.5 The early 1950s saw Union Steamship rapidly expand its cargo fleet, but it started losing long-haul passenger traffic. Expanding air services became serious competition securing, for example, almost all Queen Charlotte Islands passenger traffic. Indeed, passengers were forced to use the airlines when Union's entire coastal operations were strike-bound for two months. In 1956, Black Ball displaced Union to serve Bowen Island. Stiffer competition on main cargo routes, declining passenger revenues and lack of economical fleet replacements contributed to Union Steamship's downfall. Negotiations to increase federal subsidies on Union routes collapsed and the company decided to discontinue passenger services. Union's cargo services continued through 1959 when sold its assets to competitor Northland Navigation.
- A2.6 Black Ball and Canadian Pacific's ferry services were also in difficulty. A crisis occurred in 1958, when Canadian Pacific's employees struck for more pay and were joined in sympathy by Black Ball's workers. The BC Cabinet invoked the Civil Defence Act, which allowed the government to take possession of, and use the property and undertakings of, Black Ball for such periods as might appear necessary. (Note that Canadian Pacific's services were under the jurisdiction of the federal government, which elected not to intervene).
- A2.7 But Black Ball employees struck again in defiance of the Act and ignored an injunction to return to work. Simultaneously the Premier announced that the government would establish its own ferry service to Vancouver Island forthwith, declaring that the Government of British Columbia is determined that, in the future, ferry connections between Vancouver Island and the Mainland shall not be subject either to the whim of union policy nor to the indifference of federal agencies.
- A2.8 Further, in 1959 Canadian Pacific withdrew its night steamers from the Vancouver-Victoria run and reduced winter service. This may have precipitated action by the province which then declared that it was entering the ferry business only to provide a connection between lower Vancouver Island and the Mainland, because of the decline in Canadian Pacific's service.
- A2.9 The government scheduled its entry into the ferry business for the summer of 1960 with a service from Tsawwassen to Sidney (for Victoria). It constructed two roll-on-roll-off vessels in provincial shipyards and terminals were built. Initially, private competition continued in parallel, with Black Ball serving the Horseshoe Bay to Nanaimo and Horseshoe Bay to Langdale runs. The government bought out Black Ball in 1961, acquiring five of its vessels, and also acquired five small vessels of the Gulf Islands Ferry Company. Canadian Pacific continued but in 1962 cut back its services on the Vancouver-Nanaimo run, eventually retiring to freight only services.

A3. OPERATION OF THE PUBLIC INTEREST SERVICES

- A3.1 The Coast Ferry Services Contract specifies the routes, fares, and schedule of the designated routes.

Routes

- A3.2 The Government of British Columbia is responsible for defining the routes and therefore signing the one contract that covers the routes as a network. If a route within the network is self-financing, no money is given for that specific route.
- A3.3 BC Ferries receives public funds for 22 of the 25 routes it operates, under a single contract. Through this contract, the government pays BC Ferries a defined annual subsidy, or “service fee”, in return for making specified numbers of ferry sailings on specified routes, with a maximum total value of \$106 million per year. The terms of this long-term contract are to be reviewed next in 2008, and thereafter every four years.
- A3.4 The three major routes (the three routes between Vancouver Island and the BC Lower Mainland) are self-supporting and receive no service fee from the provincial taxpayer funds.
- A3.5 BC Ferries can subcontract one of its routes to another operator via a franchise. It could also negotiate a contract for one of the other unregulated routes. BC Ferries operates almost all the routes, both those that are financially supported by the government and the three that are not.

Fares

- A3.6 The BC Ferry Commission regulates ferry fare levels on the 25 routes operated by BC Ferries. These routes are divided into seven groups. The largest group has 16 routes in it, while the smallest groups have only one route. Generally, the routes in a given group have common characteristics. For instance, the “major route group” comprises the three busiest routes which connect the British Columbia Lower Mainland with Vancouver Island.
- A3.7 Every three months, BC Ferries must report to the Commission the actual average level of fares paid by its customers, reporting a single figure for each of the 7 route groups. The figure is a weighted average for all the routes in the group, combining all the different traffic types (passengers, autos, trucks, buses etc.), the different times of the week (weekend and midweek), the different peak/shoulder/off peak fares charged in that quarter, and other variables. This is a complex calculation and the Commission dictates the raw data, formulas and assumptions that BC Ferries must use.
- A3.8 BC Ferries has the freedom to restructure the fares within a route group (e.g. offering special discounts, charging premiums, making package offers). For the purposes of regulation, only the weighted average of all these fares (for a given route group) is taken into account.
- A3.9 In addition, the Commission computes a maximum permitted level of average ferry fares for each route group. The Coastal Ferry Act sets the initial cap at the level of the fares when the Act was passed, and it allows the price cap to rise annually by 2.8% for the major route group, and 4.4% for the other six route groups through the year 2007.

Starting in the fall of 2006, the Commission will begin a review process to establish the price caps for 2008 onwards³.

A3.10 BC Ferries must not allow the average level of ferry fares for a route group to rise above its price cap. If it does so, and after a short grace period, the Commissioner can order BC Ferries to reduce its fares. If BC Ferries fails to do so, the Commissioner can reduce the price cap as a penalty to BC Ferries. Since the start of this method of controlling ferry fares in April 2003, BC Ferries has in fact kept the average fares at or below the price caps, for all seven groups so the Commission has not had to take any enforcement action.

A3.11 The Commission can make adjustments to the price cap under extenuating circumstances (e.g. if fuel prices take an extraordinary jump and BC Ferries applies to the Commissioner for relief). To date, BC Ferries has not made such an application.

Service Levels

A3.12 Minimum service requirements are set by the Government of British Columbia in the 60-year service contract⁴. The contract defines for each route the core service requirements, which consist of the hours of operation, number of round trips per day, during peak and off peak periods, total number of round trips to be delivered, etc.

A3.13 The Coastal Ferry Act says that BC Ferries must not reduce service on a route unless it first obtains the authorisation of the Commissioner.

A3.14 BC Ferry Commission regulates the service provided on a ferry route in a number of ways:

- It monitors BC Ferries' adherence to its contract with the Province, which commits BC Ferries to provide a specific number of sailings per day on each of its 25 routes. There is an allowance of 20 consecutive days and/or a cumulative total of 30 days each calendar year for Temporary Service Disruptions which fall within the following categories:
 - Vessel or dock breakdown or mechanical failure
 - Situations that compromise safety
 - Tasking of vessels for emergency response
 - Bad weather
 - Maintenance to vessels or docks
 - Sinking or grounding of vessels
 - Fire
 - Labour disputes, except lock-outs initiated by BC Ferries
- It requires BC Ferries to report quarterly on its on-time performance for each route, and on the number of overloaded sailings.

³ According to the BC Ferry Commissioner, the calculation of the average fare is complicated for several reasons. One is the way the legislation is framed (seven separate route groups, a price cap that lifts part way through a quarter, and the offside determination which allows the operator some leeway before coming back onside). Another factor is the heterogeneity of traffic types and absolute fare values, and significant seasonal variation. Accordingly and with expert advice, the Ferry Commissioner chose to produce an index of yield which uses revenue-weighted yield growth smoothed by using four-quarter totals of revenue and volume as inputs.

⁴The contract can be downloaded from the BC Ferry Commission website: http://www.bcferrycommission.com/Coastal_Ferry_Services_Contract.pdf.

- BC Ferries must submit its annual Customer Satisfaction Tracking Survey to the Commission.
 - BC Ferries cannot stop serving a route or cut back service on a route without the Commission's permission.
- A3.15 The Coastal Ferry Services Contract permits BC Ferries to apply to the Commission for authorisation to discontinue a route after April 1, 2006, but not before. To date, BC Ferries has not applied for permission to stop serving any of its 25 routes.
- A3.16 According to the Coastal Ferry Act, in assessing an application for authorisation to discontinue service, the British Columbia Ferry Commission must consider whether any of the following applies:
- Another form of affordable transportation exists or is likely to be established to link the locations served by the designated ferry route;
 - It is possible to operate the designated ferry route economically at an affordable tariff level;
 - The Province is willing to reduce the core ferry services required on, or increase its service fee contribution for, the designated ferry route;
 - An extraordinary drop in traffic has occurred because of a change in the local economy or some other unanticipated factor.
- A3.17 The Commissioner must not authorise the discontinuance of a designated route unless:
- BC Ferries has made a suitable economic case for the route's discontinuance
 - The Commissioner is satisfied that increasing tariffs on the route would not, because of a reduction in user demand or otherwise, result in revenues on the route increasing to the extent necessary to enable economic operation of the route.
- A3.18 In some situations, BC Ferries may temporarily cut back on the number of sailings it has agreed to make in its contract with the province. The Commissioner may authorise a reduction in service if the Commissioner is of the opinion that it is for a temporary period and for an extraordinary situation.
- A3.19 So far, the Commission has given such authorisation once, on the Tsawwassen-Nanaimo route.

Carrying statistics

- A3.20 The Government of British Columbia provides in the contract with BC Ferries very detailed statistic of each of the routes regulated under the contract⁵.

Vessels

- A3.21 BC Ferries' fleet is made up of 35 vessels, representing a wide range of sizes and classes. Some these vessels can accommodate up to 2,100 people and 470 vehicles, some smaller ones carry 133 people and 16 vehicles. In addition, BC Ferries also own fast ferries.

⁵ This can be found in the "Schedule A" of the contract. This statistics cover the historical traffic from 1987 up to 2001, traffic, service and schedule levels, trip purpose, residence, profit and loss account, etc.

- A3.22 Fast ferries, however, are believed to add pressure on the financial viability of BC Ferries' operations on the high-traffic routes, e.g. the Departure Bay- Horseshoe Bay route.

A4. FINANCIAL AND COMMERCIAL SUPPORT

Financial Support

- A4.1 The financial support given by the Government of British Columbia to BC Ferries is referred in the contract as "Service Fee". This service fee has three components.
- A4.2 The first component is the "Ferry Transport Fees", not exceeding \$91.9 million in total, for ferry transportation services on the routes defined in the contract (Designated Ferry Routes). Each of the routes has a different subsidy amount, adding up to the contracted lump sum.
- A4.3 Secondly, the service fee includes a reimbursement to the operator (BC Ferries) in whole for any forgone revenue with respect to provincial social program discounts, e.g. students, disabled people, senior and medical travel assistance program discounts.
- A4.4 There is also an "unregulated route fee", which is financial support for the unregulated routes up to \$1.7 million per year for the first performance term (first 5 years). This amount has to be paid by BC Ferries to the companies which operate the ferry unregulated routes. In the event that aggregate costs payable by BC Ferries to those operators exceeds \$1.8 million per year, the Province will pay an additional fee equal to the excess costs above \$1.8 million to a maximum of \$200,000.
- A4.5 In addition, the 22 subsidised routes also receive provincial taxpayer support.

Ferry Transport Fees

- A4.1 A "Ferry Transportation Fee" is applicable to the 22 regulated (loss-making) routes, amounting to \$91,9 million. These amounts are defined in the contract.
- A4.6 This fee is paid monthly to BC Ferries. There is a quarterly reconciliation between the operator and the government according to the service provided in that period.

Reimbursement of Social Program Discounts

- A4.7 Reimbursements for the "Social Programs" are made to BC Ferries 30 days after receiving the invoice.

Competition

- A4.8 Regulated services do not overlap with unregulated ones.
- A4.9 BC Ferries has an exclusive contract for the subsidised services to these off-shore islands, and face no competition in that market. The contract itself is a barrier to market entry, hence competition, by other operators.
- A4.10 However, the Coastal Ferry Act (Bill 18, Part Three Division One) does stipulate that the Minister may, with the approval of the Lieutenant Governor in Council, enter into one or more contracts with one or more persons under which the Minister agrees, on behalf of the government, to authorise the other contracting party to operate one or more ferries on one or more specified ferry routes.

- A4.11 BC Ferries also face little competition in the unregulated market, because they have advantage over other operators in the use of ports and harbour facilities. A major challenge for other operators to enter the unregulated market is to secure suitable terminals, especially if the operator intends to carry vehicles or freight which may require costly docks and ramps, back-up lands for parking and storage, and highway access. BC Ferries is not obliged to share its terminals, which are leased from the Province, with other ferry operators.
- A4.12 During 2003/04, BC Ferries received a number of inquiries from interested parties who wanted to operate on the Designated Ferry Routes. However, no unsolicited proposal was received.
- A4.13 BC Ferries did have a request for a proposal in December 2002 for its passenger-only service from Langdale to Gambier and Keat Islands. The results of the RFP demonstrated that another operator could deliver the service at 5% to 10% cheaper than BC Ferries.
- A4.14 In June 2003, an RFP was issued to provide a ferry service for the student population residing on Cormorant Island to attend school in Port McNeill. Three bids were received in response to the RFP, of which two proposals offered vessels which met the vessel capacity requirement. An agreement was reached with the successful proponent and service has been provided by this third party operator since August 22, 2003.

Cost Risks

- A4.15 Under Section 42 of the Coastal Ferry Act , BC Ferries can apply to the Commission for a fuel surcharge on fares.
- A4.16 Instead of doing so in times of highly volatile fuel prices, BC Ferries has asked for a change in their accounting procedure to keep track of variations in fuel costs above and below a “set price” in a temporary “deferral account”. Only the “set price” will be used in reporting expenses appearing on the company’s income statement, so its reported earnings will be smoothed from the effects of fuel price changes. If in future fuel prices fluctuate back to earlier levels, the balance in the deferral account may disappear. If the balance does not, a fuel surcharge (or, in theory, a discount) or other adjustments (e.g. at the time of the next general price cap review effective 2008) would be applied to eliminate it. This application was approved by the BC Ferry Commission⁶.

A5. THE CONTRACT

Structure of the contract

- A5.1 The contract for the bundle of 25 routes is a net-cost service contract with the Province of British Columbia (the government) and BC Ferries. Through this contract, the government pays BC Ferries a defined annual subsidy (service fee) in return for making specified numbers of ferry sailings on specified routes, with a maximum total value of some \$106 million per year.

⁶ More detail about this change in accounting procedure is available from: <http://www.bcferrycommission.com/Order0402.pdf>

- A5.2 The terms of this long-term contract are to be reviewed next in 2008, and every 4 years thereafter.
- A5.3 BC Ferries takes the risks from the operation. However, the subsidy amount (service fee) could be reviewed if any extraordinary circumstances arise. The Ferry Commission is responsible for evaluating whether this review is necessary and in what quantity.

Tendering

- A5.4 No tender competition was held for the current, 60-year contract that was signed in April 2003. BC Ferries were awarded the contract as a result of historical circumstances.
- A5.5 Other operators, however, can get into the market either as subcontractors to BC along one or more of the designated routes, or on one of the unregulated routes.
- A5.6 An RFP in 2002 for the passenger-only regulated Route 13 (Langdale to Gambier and Keats Islands) resulted in a contract between BC Ferries and the successful proponent.
- A5.7 In June 2003, an RFP was issued to provide ferry service for the student population on Cormorant Island to attend school in Port McNeill (unregulated route). Three bids were received, and two of which met vessel and capacity requirements. An agreement was reached with the successful proponent and the third-party operator has been providing the service since August 2003.

Anticipated Changes

- A5.8 Future activities are planned for the BC Ferry Commission. These include the review of price caps, service level changes, and policies on asset deployment⁷.
- A5.9 In addition, the Commission will be making a determination on the removal of a route designation for a route upon which sufficient competition exists so that regulation of that route is no longer necessary.

⁷ The future plans of the BC Ferry Commission are available at: <http://www.bcferrycommission.com/FerryCommBudgetTo2006.pdf>

APPENDIX B
NORWAY CASE STUDY

B1. FERRY LEGISLATION AND LICENSING

Domestic Ferry Services

B1.1 As Norway has a long coast lined with fjords, islands and straits, ferries are considered to be a part of the national road system and have been treated as such in national transport planning.

B1.2 There are three types of ferries operating in the Norwegian domestic market:

- A large Coastal Voyage (Hurtigruten) which runs once a day from Bergen in the south to Kirkenes in the north;
- Fast ferries which operate along the coast; and
- Services across fjords and to off-shore islands without connection by bridges.

The Coastal Voyage

B1.3 The Coastal Voyage takes 11 days (round-trip). These ferries carry passengers, vehicles and freight.

B1.4 Under the Hurtigrute-agreement (2002-2004), the Norwegian central government purchased NOK 170 millions of ferry services per year. Under such a net-cost agreement, the operators bore a high financial risk.

TABLE A5.1 CARRYING STATISTICS OF THE NORWEGIAN COASTAL VOYAGE

Year	Number of journeys ('000)	Person-km ('000)	Average travelling distance (km)	Traffic revenue ('000 NOK)
1998	441	298.9	678	842,630
1999	431	305.3	708	906,372
2000	420	289.3	689	967,466
2001	446	314.1	704	1,040,217
2002	547	362.6	663	1,221,719
2003	529	383.0	724	1,365,336

Source: Annual Report from Hurtigruten 2003

Fast ferries

B1.5 Fast ferries take passengers and light freight, but not vehicles.

Car ferries

B1.6 Car ferries that are used for shorter journeys are considered to be a part of the road network. These are used to cross fjords or give access to islands not connected to the mainland with bridges. They might also carry freight.

B1.7 The county municipalities decide on the compensation and operator for regular services on regular routes in the counties.

B1.8 The Ministry of Transport and Communications is responsible for paying compensation to operators of ferry links in the national highway system. The Ministry stipulates the type of contract and guidelines, which shall apply to the allocation of compensation.

Operators

B1.9 There are about 20 ferry operators in the market, some of which are:

- Det Stavangerske Dampskipselskap (DSD)
- Hardanger/Sunnhordlandske Dampskipselskap (HSD)
- Fylkesbaatane I Sogn og Fjordane (FSF)
- More and Romsdal Fylkesbatar (MRF)
- Fosen Traffikklag (FTL)
- Torghatten Traffikkselskap (TTS)
- Helgeland Traffikkselskap (HTS)
- Namsos Traffikkselskap (NTS)
- Troms Fylkes Dampskipselskap (TFDS)
- Ofoten og Vesterdalens Dampskipselskap (OVOS)
- Finnmark Fylkesrederi (FFR)

B1.10 All of the ferry operators are joint-stock companies. However, two of the companies are 100% owned by county councils, and would therefore be considered as government - owned companies. The other companies are privately owned but the county council might own some shares.

Regulation

B1.11 The services are strictly regulated by the Public Roads Administration with respect to prices, level of service etc., under a variety of contractual forms. Recently, various forms of competitive tendering processes were introduced at regional level for the car ferry contracts.

B1.12 The Norwegian Public Roads Administration is responsible for the planning, construction and operation of the national and county road networks, vehicle inspection and requirements, driver training and licensing. The Public Roads Administration is under the leadership of the Directorate of Roads, which is an autonomous agency subordinate to the Ministry of Transport and Communication. The Public Roads Administration encompasses five regional offices. The Public Roads Administration was reorganised 1st January 2003.

B1.13 On matters pertaining to national roads, the Public Road Administration is under the direction of the Ministry of Transport and Communications. On those related to county roads, the Regional Director is subordinated by the county legislature. The Public Roads Administration is also authorised to grant subsidies for ferry operations through procuring services from the ferry operators.

- B1.14 Ferries which are a part of the main road network are administrated directly by central government through the Public Roads Administration. The Coastal Voyage is under the regulation of the Ministry of Transport and Communication.
- B1.15 The county councils are primarily responsible for regulating and operating contracts for ferries and for buying services from ferry operators. They issue licenses and enforce license conditions.

Safety

- B1.16 The Norwegian Costal Administration (Kystverket) is the Norwegian national agency for costal management, marine safety and communication. The Costal Administration is responsible for the following areas:
- Piloting services;
 - Vessel Traffic Services (VTS);
 - Maintaining lighthouses and buoys and issue navigational warnings;
 - Improving coastal channels and construct and maintain fishing ports;
 - Taking care of the State's preparedness against acute pollution;
 - Managing legislation (e.g. the Norwegian Pilotage Act, the Harbour Act and parts of the Pollution Control Act); and
 - Reporting and planning (also taking part in the national planning such as the maritime sections of the National Transport Plan), as well as co-operating with other authorities responsible for safety, transport and preparedness.

Planning

- B1.17 The national policy regarding ferry services is set out in the National Transport Plan (NTP), which covers a period of 10 years (2002 to 2011). The NTP sets out the policies for all modes of transport in the period.
- B1.18 The aim for the Government in the NTP (2002-2011) is to increase the frequency and standard of the services on the main roads. This means having a ferry every half hour for 18 hours of the day and then an hourly service in the remaining hours of the day.
- B1.19 The NTP guides the contracts the county councils set out. In areas where it is not viable to keep the frequency stated in the NTP, the historical norm that has been followed over the years dominates. Currently, most of the contracts (non-tendered contracts) are negotiated every year, with themes that are up for discussion. The contracts specify minimum level of service and ticket price, determined by historical practices.

B2. SUBSIDISED CAR FERRY SERVICES

- B2.1 In the past few years, there has been a significant increase in people moving to the central areas around Oslo and the cities in the south. One objective of the government is to keep the population and businesses in the more remote areas of the country. To achieve this, all parts of the country ought to have good links with the central areas as well as Europe. The Government recognises that in order to achieve these goals, subsidies will have to be provided to ferry routes that are not profitable enough to attract supply in the free market.

- B2.2 None of the ferry services, which are part of the road network, are formally regarded as lifeline services or with defined Public Service Obligations (PSOs).

Minimum Service Requirement

- B2.3 In order to get a license to run a service, however, the operator needs to sign a one-year contract with the county council or Public Road Administration. In the contract, the frequency of services and ticket prices are defined. This is to ensure a satisfactory level of service for people depending on it.
- B2.4 The specifications for the minimum service requirements are often based on historical service levels.

Market Entry

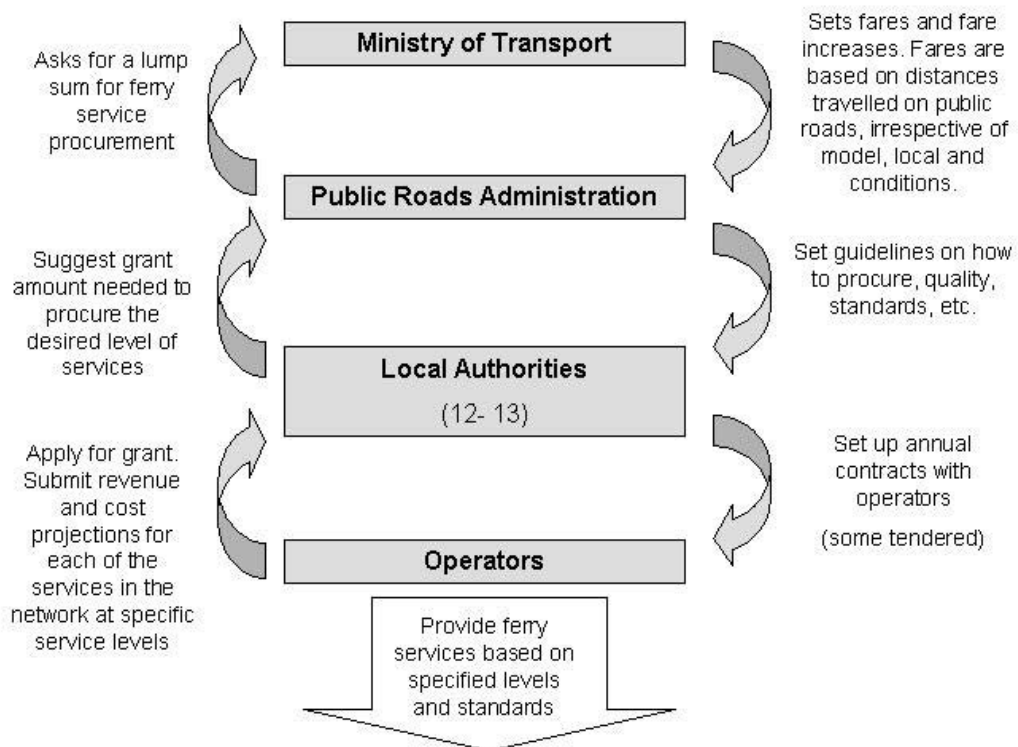
- B2.5 The ferry operators need contracts to be able to run a service, and this is granted by the local authorities/Public Road Authority. The contracts are given for specific routes and therefore there is no competition. In the new legislation that came into force this year (2005), tendering processes for the routes will be in place in lieu of the current concessions or licenses that are given to local operators.
- B2.6 Historically, local/regional island ferry service markets are monopolised by local operators. These operators have often served the routes for a long time, having been granted rights and licenses to do so by the government.
- B2.7 During the trial tender period (as discussed later), the contracting periods have been set at between 5 to 8 years.

Subsidies and Remuneration

- B2.8 The subsidies are set out by central government in their annual spending plans. The state pays an annual block grant to cover part of the county municipalities' expenses. The grant is distributed via the local government revenue system in accordance with rules laid down by the King. Each county council is given a budget which they can spend on buying services from the ferry operators.
- B2.9 The subsidies are given to an operator based on its concession area. Currently, most operators operate in concession areas with both profitable and loss-making routes. This makes it possible for an operator to transfer money from a profitable service to a loss-making service. The new tendering process precludes the possibility of cross subsidies as the contracts would be for individual routes and not areas.
- B2.10 The contracts which are negotiated every year stipulates a minimum level of service and ticket prices.
- B2.11 The government ensures that ticket prices are at a reasonable level. The price of the tickets are adjusted to the level of inflation, consumer index and interest rate levels.
- B2.12 In the event that an operator does not fulfil its contractual obligations, it is issued with a written warning. The warning gives the operator a period of 14 days to present measures to improve the situation.

- B2.13 For minor breaches that are not corrected after a written warning, the operator can incur day penalty fines until the situation improves. Day penalty fines will be equivalent to one- thousandth (0.1%) of the annual purchase sum.
- B2.14 In the event of repeated breaches of a serious nature that are not improved following a written warning, the contracting authority has the right to revoke both the contract and the concession rights. The same applies if the operator no longer holds the necessary guarantees, certification or other formal approvals as specified for implementing the contract.
- B2.15 The following diagram illustrates the relationships amongst the Ministry of Transport, the Public Roads Administration, Local Authorities, and Operators *vis-a-vis* ferry services in Norway.

FIGURE A5.1 ILLUSTRATED RELATIONSHIPS AMONGST STAKEHOLDER IN THE NORWEGIAN FERRY MARKET



B3. TENDERING OF SUBSIDISED SERVICES CONTRACTS

Tendering Process

- B3.1 The Norwegian Public Roads Directorate (NPRD) decided in 1990 that it would tender all the ferry services in the country. The objectives of tendering the services were to lower ferry transport subsidies and to improve service performance.
- B3.2 The responsibility of tendering ferry services has fallen on subsidiary road authorities at the local and regional level. This has resulted in different designs of the tendering

process and contractual arrangements. There is a combination of net-cost and gross-cost contracts currently in place in Norway.

- B3.3 The first ferry services to be tendered in the Norwegian market are those that have historically required the least amounts of subsidy. These are high-traffic, relatively urban routes.
- B3.4 In the period from 1996 to now, 10% to 15% of the routes have been tendered on a trial basis. From 2005 onwards, this will be permanent arrangement. Within the next 7 to 10 years the remaining 100 routes will be up for tender, when between 10 to 14 routes will be contracted each year. The tender will take place according to a schedule, so that bidding operators will know a year in advance the routes that are up for tender.
- B3.5 Contracts where there is not a need for any new material will last for about 5 years; contracts requiring new material or specialist material can be as long as 10 years.
- B3.6 The invitation to tender is put on the EU TED database as well as in the DUFF (Norwegian database)⁸. Contracts are usually awarded to the lowest bidder, and tender documents are required to be in Norwegian.
- B3.7 Routes that have already been tendered each generated about 3 to 5 competing bids. Some of the operators submitted several bids taking into account different scenarios. The maximum numbers of bids for a tender is set at 5.
- B3.8 All of the bidding operators were Norwegian.
- B3.9 Several of the successful bidders were new entrants to the routes for which they won the contracts.

Implications of Tendering

- B3.10 A study by More Forsking (2004) reported the effect the tenders have had on the services, compared to those that are not tendered. One of the main concerns highlighted by the authors is that in the long run, a tendering process could facilitate collusion. Companies already operating in same areas would get together to bid for contracts and create monopolies to keep out other competitors. No measure is designed to prevent this from happening. The authors of the report estimate that the tendering process can lead to an oligopolistic ferry market with only 4 to 5 companies (grouped by smaller companies).
- B3.11 A paper by Olav Hauge from Molde College suggests that tendering the contracts marginally reduces ferry subsidies and lowers transport costs for all involved partners. For the local authorities, there is a reduced administration needs and subsequently, administrative costs. The contracts give local authorities an extra parameter for controlling the ferry transport system, and put pressure on companies in negotiations

⁸ An invitation to tender document (in English) can be found at:
http://ted.publications.eu.int/official/Exec?DataFlow=result_details.dfl&Template=TED/result_details_curr.xml&Page=1&StatLang=EN

over subsidies for the non-tendered services. It is believed that such pressure will improve internal efficiency of the ferry operators. Overall, tendering has resulted in:

- Lower subsidies for ferry transport;
- More efficient and better structured ferry transport organising;
- Lower operational costs and more flexible shift systems; and
- More ferry capacity with better supply quality and frequency.

B3.12 The Hauge paper also suggests that strong competition for the tendered contracts results in incumbent operators reducing bidding prices to even below the no-profit level to prevent market entry by outside operators. There may also be the need for ferry operators to cross-subsidise between the tendered and subsidised (not tendered) services. The existing contracts have a tendency to underestimate the cost of extra capacity, and restrict the operators' flexibilities with respect to ferry fleets. Overall, Hauge suggests that moving towards a tendered contracts can increase transaction costs related to contract negotiations.

Contracts

B3.13 Up until now, there are three types of tendered ferry contracts in Norway:

- Net subsidy contracts
- Minimum subsidy contracts
- Gross cost contracts. These are a mixture of cost subsidy and minimum subsidy contracts. These contracts build in an opening for revenue transfer (above expected revenue level) to the ferry company as an incentive.

B4. SUBSIDISED COASTAL VOYAGE

B4.1 The route between Bergen and Kirkenes, also known as "Hurtigruten" (Coastal Voyage), serves important transport and tourism functions. The sheer transport function of the route is especially pronounced in the north, and between Bodo and Lofoten.

B4.2 Some of the services, e.g. Tromso-Harstad and Rorvik - Sandnessjoen, would not be viable without government subsidies.

B4.3 Before being put out to tender in 2004, operator Coastal Express received 120 million NOK (in 2001). To purchase the services north of Tromso alone was estimated to cost around 88 million NOK.

Tendering Process

B4.4 In 2004, following the Norwegian Parliament's deliberations on a Government White Paper entitled "About transport Standards and Procurement of Transport Services for the Coastal Route between Bergen and Kirkenes", the Coastal Voyage was put out to an open tender competition for a contract with the central government.

B4.5 The route structure of the Voyage would remain unchanged, involving daily, year-round journeys.

- B4.6 The contract was for regular transport services in the period 1 January 2005 to 31 December 2012. In the case of tenderers needing to procure new vessels, deferment of start-up for up to one year was considered⁹.
- B4.7 The contract allows for readjustments of the subsidy amount according to oil-price fluctuations, wage rate increases, and interest rates based on negotiations.
- B4.8 The invitation to tender was advertised openly, following ESA tendering procedures. It was advertised in DOFFIN, in Norsk Lysingblad and in the Official Journal of the European Union and the European Economic Area under the reference 2004-12085. The last day to tender was March 2004 for a contract that commenced on 1 January 2005. The tender process was open to Norwegian as well as non-Norwegian operators.
- B4.9 The contract was eventually awarded to Ofoten and Vesteraalens Dampskibsselskab ASA (OVDS) and Troms Fylkes Dampskipsselskap (TFDS), which handed in a combined bid. They are the current operators of the route and were the only bidders for the tender. The new contract was signed in November 2004 and is for the period 2005-2012. The value of the contract is NOK 1.9 billion (2005 value), paid by the government.
- B4.10 The new tendering procedure is fully compatible with the EFTA Surveillance Authority (ESA), which demands an open, transparent and non-discriminatory procurement process. The EU Regulation (EEC 3255/92) that came into force in 1992 was incorporated from that point. Norway was included in the EEA agreement.
- B4.11 In 1997, four new acts were added to the EEA Agreement in the field of maritime transport during the reporting period. These were the 1997 Amending Directive to the Ship Inspection and Survey Directive (97/58/EC), the Regulation (EC) No 179/98 on the Safety Management of Ro-Ro Ferries and the Marine Equipment Directive (96/98/EC) and the Maritime Cabotage Regulation (EEC) No 3577/92.
- B4.12 In 1998, The EFTA Authority sent a Pre-Article 31 letter to Norway reminding it of its obligation to incorporate the Regulation into its legal order.
- B4.13 The process of deregulating the whole ferry market is a difficult process both in economic and legal terms. The most difficult process is to comply with the maritime cabotage rules set out by the EU and to interpret this into practical solutions. This lessens the degree of flexibility by the government to provide subsidies and determine fares.
- B4.14 It is also difficult to control the real capital in the liberalised market, where the ferry companies own the vessels. Some areas require specially constructed vessels, such as for the Coastal Voyage, which needs to be able to run a service in all weather conditions – some of which can be very harsh. The high sunk cost of operator-owned vessels, make it harder for operators to enter new markets. In addition, if an operator does not win any contracts, it would not be able to use its vessels.

⁹ The invitation to tender document can be downloaded from: http://odin.dep.no/filarkiv/215202/Tender_document.pdf

APPENDIX C
JAPAN CASE STUDY

C1. LICENSING AND LEGISLATION

Domestic Ferry Services

- C1.1 The four main islands of Japan are collectively known as the mainland (Honshu, Kyushu, Shikoku and Hokkaido). The other 6,848 islands are known as isolated or remote islands. Less than 1% of Japan's total population live on the 433 inhabited remote islands.
- C1.2 There are, in total, 619 ferry routes in Japan. This includes services that carry passenger and freight, freight, and just passengers. Over half of these routes are services to remote islands.
- C1.3 199 of these routes have passenger and vehicles services.
- C1.4 Fast ferry services are especially attractive for remote island access.

Statistics

- C1.5 110 of the routes, operated by 106 different operators, received subsidies from the central government in 1998.
- C1.6 The following table summarises the ferry services and carrying statistics in Japan in 2002.

TABLE C1.1 FERRY TRANSPORT SUMMARY, 2002

Total Number of Ferry Routes	619 routes
Of which, Connecting Remote Islands	335 routes
Total Number of Passengers	99.6 million
Of which, To and From Remote Islands	50.2 million
Number of Vehicles Carried	16.8 million

Source: Public Planning and Policy Studies, Inc

Operators

- C1.7 Ferry operators in Japan are predominantly private. They are either joint-stock corporations or private limited companies.

C2. LEGISLATION AND REGULATION

Legislation

- C2.1 The Maritime Bureau, under the Ministry of Land, Infrastructure and Transport, is the central regulating body in Japan.
- C2.2 There are three national laws that cover the domestic ferry services:
- "Maritime Transport Act" 1949. Last revised in 2004.
 - "Domestic Shipping Act" 1952. Last revised in 2004.
 - "Improvement of Sea Routes at Remote Islands Act" 1952. Last revised in 2002.

C2.3 Legislative changes took place in order to further liberalise the maritime market. The objective of the revision of the Maritime Transport Act was to “increase the convenience of the passengers in the transport areas by promoting a free competitive market” and to “abolish the supply-demand adjustments that have been the basis of it as a rule”.

C2.4 The revised acts also abolished government subsidies to ferry shipments of cargo.

Safety

C2.5 The Japanese Coast Guard, an extra-ministerial bureau of the Ministry of Land, Infrastructure and Transport, is responsible for monitoring vessel safety.

Licensing

C2.6 With the revision of the Maritime Transport Act, the Licensing System for passenger ferry services was replaced by a Permission System. Under Article 3 of the Maritime Transport Act, ferry operators have to obtain permission from the Minister of Land, Infrastructure and Transport in before operating a service.

C2.7 According to article 4 of “Maritime Transport Act”, a body who wishes operate ferry routes is required to meet 6 requirements in order to obtain a permission. These requirements are, namely:

- Vessels and berthing facilities are adequate for transport demand and nature of the route.
- The transport plan is adequate for securing the safety of the route.
- The plan is adequate for providing ferry services above and beyond meeting demand and safety standards.
- The body is able enough to perform the business.
- Starting the ferry route(s) will not affect safety of existing vessel traffic.
- The route will secure the daily and social lives of residents around the route (such as remote island), when a body wishes to operate a “designated sea routes”.

C2.8 With respect to fares, the revised Maritime Transport Act changed the Authorisation System to the Registration System. In the past, fare changes and levels had to be authorised by the MoT. Currently, while the Minister of Land, Infrastructure and Transport will impose a price cap, operators can charge the fares they want as long as they stay within the upper limit and register with the MoT.

C3. DEFINITION OF DESIGNATED SEA ROUTES/ LIFE ROUTES

C3.1 A “Designated Sea Route” is a sea route where there are no other transport modes other than vessels, such as a route connecting remote islands. The objective is to maintain proper and secure ferry transport to maintain the daily and social life of residents on or around the designated routes.

C3.2 “Designated Sea Routes” are determined by the Minister of Land, Infrastructure and Transport (MoT) after consulting with related prefecture governor(s), as defined in Number 11 of Article 2 of “Maritime Transport Act”. The ways “Designated Sea

Routes” are defined in Number 11 of Article 2 of “Maritime Transport Act” would qualify them as lifeline services.

- C3.3 Not all “Designated Sea Routes” are subsidised. In 1998, there were 335 “designated sea routes”, but only 107 of which receive government subsidies. According to Article 4 of the “Improvement of Sea Routes at Remote Islands Act”, the Minister of Land, Infrastructure and Transport determines which of the designated sea routes would receive subsidies. The basis for subsidies are:
- The subsidy is necessary in order to maintain and operate the route;
 - The applied number of services and time schedule match a desired level of demand.
- C3.4 The Remote Island Liner Services Development Law of 1952 allows for government to subsidise part of the loss incurred by remote island liner businesses, and to subsidise the cost of modernising vessels. The subsidy is known as the “Remote Islands Sea Routes Grant”.
- C3.5 To qualify for the “Remote Islands Sea Routes Grant”, the government considers the following 6 criteria:
- The route must involve a ferry service to an isolated/ remote island;
 - The service provided must be regular;
 - The service incurs a financial operating loss;
 - The route services island people and carries essential goods and mail;
 - The prefecture government recommends the route for subsidy; and
 - The Government applies an income/expenditure scale to establish expected loss and gauge the level of subsidy required.

Organisation

- C3.6 In addition to the MoT, the following bodies are concerned with remote islands:
- National Land Agency: Responsible for remote islands development;
 - Governor’s Association for Island Development: Consisting of governors of public bodies (by prefecture);
 - The National Association for the Development of Japanese Remote Islands: Consisting of governors of local public bodies, e.g. cities, towns, and villages;
 - National Institute for Japanese Islands: Consisting of governors of local public bodies, e.g. cities, towns, and villages;
 - Isolated Island Council (IAC): Consisting of island towns and villages; and
 - The Japan Passenger-boat Association (JPA) represents ferry operators and is concerned with securing stable marine transport services for islanders.

Operator

- C3.7 “Designated Sea Routes” are mostly operated by private companies who have received permission to operate by the Minister of Land, Infrastructure and Transport. Some are publicly operated by the relevant municipal or local authority, while others are operated by joint ventures between the public and private sectors.

- C3.8 Operators of “designated sea routes” often have mail contracts with the Ministry of Postal Communications to carry mail to the remote islands.

Service Requirements

- C3.9 The operation of ferry services is not on a contractual basis. Instead, it is based on a notification system.
- C3.10 A minimum level of service for subsidised services is implied during the subsidy application process. When applying for a subsidy, the operator must submit to the MoT the route’s starting point, ports of call, details of the passenger vessels (including reserve vessels), and service schedule. The subsidy is then granted if the MoT deems that the service frequency is at a desirable level.
- C3.11 To prevent fare hikes on life route services, the Maritime Transport Act requires an authorisation on the upper limit on fares.
- C3.12 Ferry services are monitored by the local branches of the MoT. Should the Minister realise that the operator is damaging consumers’ convenience and welfare, Number 1 of Article 19 of the Maritime Transport Act can be invoked whereby the MoT can:
- Change the upper limit of the fare;
 - Change the operating stipulation
 - Change the business plan;
 - Change the vessel operating plan.

Competition and Risks

- C3.13 The concept of risk and return is not prevalent in the ferry business in Japan. Compared to other modes of transport, the profitability of operating ferries is low. Little competition exists in this market.
- C3.14 Revisions to the Maritime Transport Act abolished subsidies for non-regular passenger ferry businesses. In addition, the operation of non-regular passenger ships are prohibited. However, plying boats and pleasure crafts are allowed to sail on the same routes as regular ferry services.
- C3.15 In theory, any operator that wishes to operate a loss-making route can apply for and receive subsidies from the government. However, when an operator is currently receiving subsidies on a “designated sea route”, the government would in practice deny the subsidy application by a new company. Hence, in practice, almost no competition exists on subsidised routes.
- C3.16 There are currently about 100 ferry operators operating subsidised sea routes (or networks of routes). The ferry business, especially along remote island routes, does not attract many new market entrants.
- C3.17 Most of these routes are served by conventional passenger ferries, with a small number of fast ferries.

C4. FINANCIAL/COMMERCIAL SUPPORT

Legislative Changes

C4.1 The revisions of the Maritime Transport Act abolished the "supply-demand adjustments" on passenger ferry services.

Types of Subsidy

C4.2 Subsidies in the Japanese ferry business are a form of top-up to meet losses of the operating companies. The government subsidises part of the loss incurred by the ferry operators, as well as the costs of modernising vessels.

C4.3 Factors such as the relative remoteness of a particular island, access, journey time, cancellation rate, availability of alternative transport, etc., are also taken into account when calculating the subsidy amounts.

C4.4 The annual subsidies cover the period from October 1 of the previous fiscal year to September 30 of the current fiscal year.

C4.5 There are two types of subsidies from the National Government to ferry operators:

- Remote Islands Sea Routes Grants; and
- Vessels of Remote Islands Modernisation Grant

C4.6 The amounts of these grants are summarised in the following table:

TABLE C4.1 FERRY GRANT SUMMARY (1998)

Remote Islands Sea Routes Grant		
Number of Operators subsidised	103	operators
Number of Routes subsidised	107	routes
Total Amount of Grant (in Japanese Yen)	4,083	million yen
Total Amount of Grant (in UK Pounds)	20	million pounds
Average Grant per operator (in UK Pounds)	198	thousand pounds
Vessels of Remote Islands Modernisation Grant		
Number of Operators subsidised	3	operators
Number of Routes subsidised	3	routes
Total Amount of Grant (in Japanese Yen)	128	million yen
Total Amount of Grant (in UK Pounds)	0.6	million pounds
Average Grant per operator (in UK Pounds)	214	thousand pounds

Source: Public Planning & Policy Studies, Inc

C4.6 The "Remote Islands Sea Routes Grant" gives ferry operators the amount of grant equalling the amount of deficit. This is based on the standardised wage rate and unit operating costs, etc.

- C4.7 Over 100 operators have been operating the designated sea routes with the “Remote Islands Sea Routes Grant” for a long time.
- C4.8 The “Vessels of Remote Islands Modernisation Grant” subsidises 50% of construction cost to make vessels “barrier free”, and an additional 10% of tonnage value of the vessels.
- C4.9 In addition to these national grants, each prefecture has its own means of subsidising “designated sea routes”, as the national subsidies do not cover all loss-making sea routes. The types and conditions of such subsidies differ widely across prefectures.

Subsidy Application

- C4.10 To apply for a subsidy, the operator has to submit the following items to the Minister of Land, Infrastructure and Transport, as defined in Article 3 of the “Improvement of Sea Routes at Remote Islands Act”:
- An Operation Plan;
 - Route Profit/ Loss Estimate; and
 - Other documents prescribed by the Ministerial Ordinance concerning the route’s starting point, ports of call, details of the passenger vessels (including reserve vessels), and service schedule.
- C4.11 Once the operator is a recipient of subsidies, it is subject to the following government controls:
- The Minister can instruct the operator to improve the service;
 - The Minister needs to approve modifications to the operator’s operational plan;
 - Ferry subsidies cannot be used for purposes other than the ones for which they were intended;
 - Failure to comply with these conditions can result in the Minister ordering repayment of all subsidies.
- C4.12 Ferry operators have to show operating losses in their accounts in order to receive the annual subsidy. Since subsidies only apply for a year at a time, re-applications for subsidies must be submitted on an annual basis.

Fares

- C4.13 With the revision of Article 8 of the Maritime Transport Act in 2000, fare regulation was changed from an “approval basis” to a “notification basis”. The regulation of fares is clearly defined in Article 8 of the Maritime Transport Act.
- C4.14 Ferry operators are no longer required to receive approvals from the Minister when they change fares. They just have to notify the Minister in advance that they intend to change fares.
- C4.15 Should the Minister of Land, Infrastructure and Transport recognise any inconvenience incurred as a result of the fare change, such discriminatory pricing amongst users, he can order the ferry operator to change the fare.

C5. CONTRACTING AND TENDERING

- C5.1 Ferry services are run on a notification basis as opposed to a contractual one. As such, there is no tendering process.
- C5.2 Operations are subsidised on an annual basis.
- C5.3 The current “Designated Sea Routes” system has a long history, and there is little indication that things will change in the near future.
- C5.4 According to an analysis by Dr. A.J. Baird, the current set-up of state-subsidised ferry services in Japan has several drawbacks:
- First, existing subsidies offer no incentive for operators to modernise services. The 1-year concession period does not allow operators to plan future investment with any degree of assurance. A competitive tendering process could generate a degree of competition and innovation in the industry, and create best value for money.
 - The many small operators operating in a fragmented industry make economies of scale hard to achieve. Bundling of routes into networks, or merging companies in each geographic area could potentially improve economies of scale.
 - Subsidy decisions are made centrally, whereas prefectural governments usually have a better understanding of the demands and operation of services.

References:

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