The Corporate Structure of BC Ferries, its debt and credit ratings

Up and down the coast, BC Ferries provides service to 47 terminals, on 25 routes, using 35 vessels. In terms of both passengers and vehicles, it's one of the largest ferry operators in the world. Until 2003 it was a crown corporation overseen by the Minister of Transportation.

However, instead of a source of pride, the service has been a thorn in the province's side for a long time, especially since the "fast-cat ferries" scandal of the mid-1990's, which saddled it with a substantial debt.

In 2003, Gordon Campbell's Liberal government passed the Coastal Ferry Act and created the BC Ferry Authority, to put some distance between it and the government. The new BC Ferries was to operate more or less independently, under a contract with the Province that set minimum service levels and provided for subsidies on 22 marginal routes.

As part and parcel of this new arrangement, the government also:

(a) transferred the vessels to the new company in exchange for $75.447 million in 8% convertible preferred shares (representing the fleet's value less the debt assumed from the Province); and

(b) leased the terminal lands to it.

Corporate structure

The questions for anyone trying to understand BC Ferries, its shortcomings, and who or what is really responsible for it, are: "Who really owns BC Ferries, and why does that matter?"

The answers are complex to say the least. To all intents and purposes, it appears that *no one* owns it; but that's no answer, so let's take a closer look.

BC Ferries' correct legal name is British Columbia Ferry Services Inc., a company incorporated under the laws of British Columbia, having $1.9 billion of assets (mostly the fleet itself, as stated above).

Offsetting those assets are $1.5 billion of debt and equity of $400 million. Almost all of the equity is held by the BC Government – which certainly suggests ownership.

Examining the equity further, we find that it consists of two parts. The first is just one Class B voting common share held by the BC Ferry Authority, which has no issued shares; the second consists of 75,477 Class C shares held by the BC Government, worth $1,000 each, which pay the government an annual dividend of 8%, amounting to $6 million per annum – all of which would also suggest ownership.

But we must dig even deeper. It turns out that those Class C shares are non-voting, so it would appear that the government has no means of controlling the company, which raises the question, "If they can't control it, do they own it?"

Taking that a step further, if they can't control it, isn't that kind of dangerous? Couldn't someone buy that one controlling share from the ferry authority and walk away with the whole fleet?

Answer: Not quite. There are also a million Class A voting common shares, *although none have been issued, so technically, no one owns them.* However, in the event that the one Class B share was sold, guess what? Those government Class C preferred shares are *convertible into Class A voting shares*, so the BC Government *could* own BC Ferries in fairly short order.

But – and this is key -- *they don't own them yet* – and that is why the Government does not have to include BC Ferries and its pesky $1.5 billion debt, in its financial reporting.

From time to time, it's alleged that this helps BC maintain its high credit rating and low interest expense – and is put forward as the reason the coastal ferries are not brought back under the Transportation Ministry. Not surprisingly, this usually ends any conversation suggesting that should be done.

BC Ferry Authority

So now, what's this Ferry Authority about?

As stated above, the BC Ferry Authority was created by the Government, and it has a Board of Directors. One director is nominated by the BC Ferries & Marine Workers Union and four by the coastal regional districts; two are appointed by the Province and two more appointed from qualified Authority candidates in accordance with the Coastal Ferry Act

The Authority's main purpose is to hold the Class B voting share. It also appoints the Board of Directors of British Columbia Ferry Services Inc. (BC Ferries) and fixes senior executive compensation.

The BC Ferry Commission

Since the government doesn't control BC Ferries – and doesn't *want* to control it (allegedly for the reason cited – its $1.5 billion debt) – the BC Ferry Commission was created to balance the needs of the corporation with those of the public. The Commissioner's powers are limited by the legislation that created the position, but we note that he is seeking to broaden them.

Mr. Gordon Macatee is the commissioner and he has a deputy. Their expenses ($695,000 in fiscal 2015) are paid by BC Ferries.

The contract for the ferry service fee

As stated, BC Ferries has a contract with the BC Government to provide a specified minimum level of service to British Columbia. For doing so, BC Ferries receives a service fee. The contract is updated every four years. The current contract is for a performance term that will expire on March 31, 2020. It is the opinion of the Third Crossing Society that the BC Government should put BC Ferries on notice that the current contract is unsatisfactory and that changes will be required. There may be technical or legal difficulties with such a stance, but the parties have time to overcome them. Additionally, it is all-important to be sure that exercising control by using these negotiations does not void the objective of the current ownership structure.

The Board of Directors

The legal responsibilities of a Board of Directors are well understood at law. However, one cannot legislate a passion for excellence, and the results to date are inadequate.

The Advisory Boards

The volunteers appointed to these boards are exactly that: advisory. While they may provide the corporation with quality input, they have no legal authority.

The reporting system

The ferries corporation and the BC Ferry Authority together issue an annual report. The corporation also produces quarterly and annual reports to the BC Ferry Commission.

So, why the elaborate corporate structure

There appears to be two main reasons: dissatisfaction of the public (inconvenience, high fares, etc.) and the very high capital costs of the ferries and the related debt. Public dissatisfaction reaches the frenzy level when overloaded ferries are unable to take all the passengers and they are left behind waiting for the next ferry or even the ferry after that! BC Ferries has never taken effective steps to solve that problem. On top of that, the whole operation is very expensive – with the result that subsidies are now more than $150 million per year and fares are still rising.

There's a general belief that BC Ferries itself is the problem. It's often characterized as bureaucratic, wasteful and uncaring. Consequently, there are regular calls that it should be taken "back into the government."

Government's normal response is that the debt that it would have to assume would damage the Province's AAA credit rating, and that typically ends the conversation.

The facts are:

As of March 31, 2015, the Province had debt of $63 billion. Of that, $20 billion is "self supported", meaning that the likes of BC Hydro and others can and do service their own debt. The rest – almost $43 billion – is serviced by the taxpayers. In fiscal 2015 this debt actually increased by almost a billion ($932 million).

This $43 billion of debt includes promissory notes, bonds, debentures and capital leases maturing over many years up to 2063. The largest maturity period is 2021 when $12.8 billion matures.

The weighted average interest rate on this taxpayer supported debt in fiscal 2015 was 3.76%, down from 3.98% the year earlier. It is this reasonably low interest rate that the government refers to when making reference to its AAA credit rating.

What is this AAA credit rating?

The market for government bonds is huge: almost $1.2 *trillion* of direct federal and provincial debt, not to mention for the debts of crown corporations like BC Hydro. To evaluate risk and determine interest rates, investors use countless metrics, credit rating for one.

There are three main rating agencies that score provincial debt in Canada: Standard & Poors (S&P), Dominion Bond Rating Service (DBRS) and Moody's Investors Service. These firms have their own rating scales and definitions. As you can see they disagree from time to time, and ratings do change. Here's an example provided by the Government of Alberta:

Province	S&P	DBRS	Moody's
Alberta	AA+	AAA	Aaa
BC	AAA	AA (high)	Aaa
Sask	AAA	AA	Aaa
Man	AA	A (High)	Aa2
Ontario	A+	A (low)	Aa2
Quebec	A+	A (high)	Aa2
New Brunswick	A+	A (high)	Aa2
Nova Scotia	A+	A (high)	Aa2
Newfoundland	A+	A	Aa2
PEI	A	A	Aa2

When S&P downgraded Alberta from AAA with the fall in oil prices, Alberta's Minister of Finance opined that the downgrade would have little or no effect. Naturally, the opposition disagreed.

Many factors influence the interest rate or yield. Longer term bonds have higher yields than shorter term bonds. The 25-year bond is often a benchmark for rating purposes. The Atlantic provinces approach interest of 3.5%, Manitoba pays 3.35%, Ontario with only an A+ rating pays 3.2% while Saskatchewan and Alberta pay 3.25%. BC leads the pack at 3.1%.

Still, the variances are modest – a few basis points. The difference between the Atlantic provinces and BC is only 0.4%. The main variance between provinces seems to be size. This makes sense. Larger provinces have more debt outstanding making it easier for investors to buy and sell them. This is a 'liquidity premium".

Moody's recently noted that BC's "large and diverse economy provides the province with a large base on which to apply a productive tax base, ensuring that provincial revenues are not strongly impacted by a decline in one particular sector."

However, they noted that BC Hydro's debt "increased from $8.1 billion in 2008 to $18.1 billion and there is a further $20 billion expected in the future and that ultimately a province is responsible for the debt of its crown corporations.

Conclusion

Given the numbers involved:

Direct debt (taxpayer supported)	$43 billion
Crown corporations, etc.	20 billion
Future expectations (infrastructure)	20 billion
	$83 billion

It is extremely unlikely that adding BC Ferries' $1.5 billion debt to the provincial balance sheet would unfavourably impact the Province's credit rating – and if it did, the impact would be modest; more importantly, it would soon be offset by the elimination of the corporation's expensive structure that exists today.

We conclude that there is no good reason to separate BC Ferries from Government.

Electorally speaking, the Government cannot escape responsibility for BC Ferries.