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Private Ferries

Submission to IPART in Support of

Claims for Fare Increases, 2004-2005

July 2004

Contents

Summary

Fare Increase Sought

The industry seeks an increase in fares for the 2004 – 2005 year of 11.34 percent, based on the analysis in Attachment I.

The Industry and the CVA

There are presently seven private ferry operators in New South Wales that the Association is aware of. All are members. All industry operators have agreed that the CVA will submit aggregate cost and other information to IPART, not individual operator information. Five of the seven have submitted information for this submission. The other two were unable to do so for reasons explained elsewhere.

In addition, it was further agreed that aggregate industry return on assets would be submitted.

The seven operators are:

Central Coast Ferries
Church Point Ferry Service
Clarence River Ferries
Cronulla and National Park Ferry Service
Dangar Island Ferry Service
Matilda Cruises
Palm Beach Ferries

This submission contains the information submitted by operators in the form of the amalgamated index and makes comments on issues. The industry looks forward to hearing the results of IPART's deliberations.

The Issues

IPART has sought comment on several issues. The comments sought on those relevant to private ferries appear here. In addition, we have commented on other issues.

IPART Issues

We understand from IPART that the issues to be addressed this time are exactly the same as those in last year's Issues Paper plus some new ones outlined in the Premier's letter to IPART dated May 18 2004. References to page numbers, etcetera are, therefore, are references to last year's Issues Paper.

Quality of Private Ferry Data

… the quality of private ferry data, individual cost components and the appropriateness of the present approach to fare-setting.

This is the third year that the industry has combined its data through the CVA. All companies' data is prepared by their accountants, all but one of these being accountants in private practice. The other is the financial controller employed by the substantial operator. The quality of data this year is better than last year and includes data from the Dangar Island Ferry Service for the first time. It does not include data from Central Coast Ferries as the operator of this business bought it about a year ago and has no data for comparison purposes for the year before, 2002-2003. It does not include data from Clarence River Ferries as this business is unable to separate out its ferry activity from its other activities.

The Association notes the comment in the issues paper on page 13 that no information was provided by operators as to industry revenue. This is because, in discussions with IPART, it was agreed that cost increase information only would be provided.

In addition, the operators have provided return on assets employed, not sought by IPART.

The industry is confident that the "… quality of private ferry data ..." is of a satisfactory standard for IPART's consideration.

"… the individual cost components …" are relevant to the industry's operations and were agreed to between the industry and IPART. The format in which the data is provided was supplied by IPART.

"… the appropriateness of the present approach to fare-setting." is not satisfactory, as discussed elsewhere.

Conclusion: the CVA is satisfied that the quality of the data provided by the industry is of a standard satisfactory for IPART's purposes.

Fare–setting Approaches

"… the application of various fare-setting approaches …"

Without debating each of the approaches mentioned in detail, the industry has these comments.

Generally:

The essential criterion for fare-setting is to ensure that the operator is able to achieve a reasonable return on investment, without which, he or she will choose to place their capital elsewhere and the business will cease to operate. The operators' contracts with the Director General recognise this to the extent that the Director General is obliged to compensate operators for cost increases incurred (see Section 19.2 of the PTA 1990).

This implies that the approach to fare setting should reflect the individual circumstances of each operation but this is not being sought by the industry

More specifically:

Outside cost increases, such as those measured in the CPI, are, for the most part, not relevant to the specifics of the industry. Where they are, they have been used, eg wage increases claimed are compared with award increases granted by the Commission, the award being the one that covers the industry specifically. Industry-wide increases clearly take no account of the particular operating circumstances of individual operators which should address length of route, manning requirements, relative number of concession passengers, etc

There should be no penalty for making efficiency gains. If there is to be such a penalty, why would operators make them? Other private companies retain the benefits of efficiency gains or pass them on in lower prices to maintain or gain market share. It should be noted that owners, in fact, have very little opportunity to increase the efficiency of their businesses. Crew numbers are determined by the Waterways Authority, wages are determined by the Industrial Relations Commission, service levels are determined by the contract and other big expenses are determined by the market place, eg fuel, insurance and interest. Passenger numbers are determined by the weather and school holidays. There is not much scope for efficiency gains in all this.

Use of CPI does not meet the criteria of being industry specific and is certainly not operator specific. The bundle of costs in the CPI does not closely reflect the bundle of costs in a private ferry operation.

The "building block approach" has some merit in that it addresses the most important thing, viz return on investment. However, it seems very complex for this industry and also requires operators to detail information which, for reasons noted below, they are not willing to.

Importantly, the industry and IPART have had informal discussions about no fare regulation at all. The reason for this is that all operators face competition from other transport modes and, therefore, do not operate monopoly services. "Why cannot private operators set their own fares, taking into account their local circumstances of passenger mix and competition, water taxis, buses, etc?" (IPART). The industry's cautious answer is that it does not trust the government to continue to provide a contract for the exclusive right to operate the service if it, the industry, yields the government's right to set the fares in exchange for this exclusive right. "Why don't they trust the government?" (IPART). There are two

reasons principally. A few years ago, the government sought to reduce the cost to it of the SSTS. It did so by deciding to reduce the "participation factor" in the payments formula from 92 percent to 77 percent, with no recompense for revenue forgone – none. The deal was, "if you agree to this, we shall extend the automatic renewal of your existing contract by another five years; if you do not, your contract will not be renewed at the end of the current period". In addition, when one operator, two years ago asked a then DOT officer a question, the answer was supplied to both him and every other operator in the form of the department's confidential ferry fare report on the whole industry, containing confidential information supplied by operators.

Conclusion: the approach to setting fares should remain as in PTA 1990 but with the additional check that return on capital is adequate, say 15 percent. The industry and IPART should use the time between the end of September this year and the start of next year's round to improve the fare-setting process.

Private ferry fare structure

… comments on the existing fare structure for private ferries, including the range of tickets on offer and relativities with Government-owned operations

In 2003 IPART addressed and rectified industry's concerns in relation to this Issue.

Service quality – private ferries

… … comments on the quality of service offered by private ferries

Service quality is covered by the terms of individual operator contracts with the government and vary from one private service to another. At present, these contracts specify only the frequency of services to be provided.

The industry is of the view that these items are the main ones that determine the level of service:

- frequency and adequacy of the timetabled trips

- achievement of a certain standard of on-time running
- provision on board of adequate shelter from adverse weather, including rain, wind and sun
- adequate standards of maintenance, other than just safety, such as lights that work and toilets that are not blocked (safety issues are the province of the Waterways authority)
- provision of a suitably vessel for the task

<u>Conclusion</u>: service quality should be limited to these items with specific targets (frequency, etcetera) to be negotiated between the operator and the Director General at the time contracts are signed or renewed.

Environmental issues

… comments on environmental issues and how these should be considered in the fare-setting process …

New South Wales has comprehensive environmental law that covers the operation of ferries and charter vessels in particular. This includes the POEO Act that prohibits the discharge of any foreign material, such as sewage, "grey" water(1) or vessel wash water into State waters; the Waterways Authority has been delegated responsibility, by the EPA, for policing this Act on State waters; in addition to water pollution requirements, there are others governing noise levels (such as from loud music); the industry is of the view that, if operators meet all these and other legal requirements, they are doing all that can reasonably be required of them with regard to the environment.

(1) this is on board water other than from toilets, such as washing up water

<u>Conclusion</u>: present law and regulation is sufficient to ensure private ferries meet community acceptable environmental standards and that, because environmental issues are covered by specific legislation, there is no place for environmental considerations in fare-setting.

Social impact

IPART does not explain what it means by the words "social impacts of fare increases".

If it means the impact on individuals and families of a change in their life styles because of a shift in their disposable income to commuter costs through a fare increase, then the industry has these comments:

- services provided by private enterprise to the public will only continue to be provided if the prices charged are sufficient to cover costs and produce a return on investment that is at least as good as an alterative of equivalent risk
- to the extent that government is concerned about this shift (above), it will have to compensate private service providers in order that they can provide the service at a price that does not disproportionately shift disposable income to commuter costs (which means, of course, that all members of the community will subsidise private ferry commuters) or
- provide the service themselves, also at a further cost to everyone

<u>Conclusion</u>: the industry believes that, in the context of the points above, social responsibility is that of the government.

Premier's Issues

In his letter of May 18 last, the Premier raised some issues relevant to the industry. Here are our comments.

"the making of a determination based on a five-year price path"

The CVA is not sure what this means but if it means fares being set five years in advance, rising each year or not for the five year period, then it would not adequately address the fare setting criteria in Section 19 of PTA 1990 nor the obligations of the Director General in operator contracts.

Two references to fares, the CPI, efficiency gains and service quality

The Premier is implying here that fare increases, less than, equal to or greater than CPI increases, should only be granted if operators make efficiency gains and service quality improvements.

If efficiency gains mean lower operating costs, then these are largely outside the control of the operator (see page 6).

Improving service quality can only be done with added costs, if service quality is defined as on pages 7 and 8. Increasing trip frequency or total hours of operation per day can only be done by incurring higher costs of fuel, wages and wear and tear, for example.

The Premier needs to be reminded of the fact that if operators are insufficiently profitable because they are required to provide more or because their cost increases are not re-imbursed, they will cease to provide the service.

"single fare increase figure for both private and public operators"

While the CVA has indicated that the industry would accept, on this occasion, the same percentage fare increase as for Sydney Ferries, provided this increase was adequate to re-imburse operators for cost increases, it does not think this approach is logical as it assumes the cost base of both industry segments is identical which it is not.

Industry Issues

Approach to fare regulation

For private companies, those operating private ferries, for example, the single most important criterion for their continuation in the industry is their return on investment. Clearly, if a point is reached where this return can be bettered by investing elsewhere, they will withdraw their investment from private ferries and the ferry service will cease (unless they can sell it to someone satisfied with a lower return or who has reason to believe that he or she can improve the return to a satisfactory level).

The present method of increasing fares each year, based on the increases in operating costs during the preceding year, is unsatisfactory.

- money lost, between the time of the rise in a cost item and the next fare increase, is never recovered (see example below)
- differences between the operating conditions peculiar to individual operators, such as the length of the routes serviced, are not addressed
- return on investment is not addressed

Here is an example of the money lost.

Year	**1**	**2**
Labour cost (fixed number of staff)	Jul-Sep @ $16,000 pm $48,000 Oct-Jun @ $16,500 pm $148,500 Total $196,500	Jul-Sep @ $16,500 pm $49,500 Oct-Jun @ $17,000 pm $153,000 Total $202,500

Here, an award increase of about three percent is awarded in the month of October in both of the years shown. At the beginning of Year 2, the owner is awarded a cost increase of three percent to match the award increase in October in Year 1. From October in Year 2, however, he bears the monthly increase in costs from October to June of nine months by $500, or $4,500, without recompense, which he also bore in Year 1, of course. This kind of analysis applies to all cost increases he incurs throughout the year in any year.

Labour is, in fact, an example of a cost increase that can be precisely known in advance and provided for at the time of fare-setting, as opposed to more volatile items, such as fuel cost increases. The national wage case outcome is know early in the calendar year. The State wage case outcome, which invariably mirrors it precisely, is known by the middle of the year and the flow-on to individual wards takes place in October, approximately. Thus the amount to be carried by operators for nearly nine months (October to June) is known before the fare-setting process even begins, let alone at next year's round.
Whilst the present method of fare-setting continues, industry is of the view that mid-period cost increases, above a certain percentage of total operating costs, should trigger an automatic right for the operator to increase his fares to recover the increase. He would receive a commensurably small increase at the next review. The industry proposes that this "certain percentage" should be three percent.

Apart from the fact that increases are, in fact, usually awarded, correctly based or not, the present system is about as unsatisfactory as it could be.

<u>Conclusion</u>: whilst the present method of fare-setting continues, operators should be allowed to increase their fares mid-term if their total costs rise by three percent or more.

Regular Review of Fares

<u>Conclusion:</u> fares need to be reviewed at regular intervals so that operators do not have to carry cost increases for a longer period than is absolutely necessary and so that they can plan for the rise.

Approach to industry regulation

The industry agrees with IPART's expressed view that fares should not be regulated but, instead, set by operators in the light of their passenger mix and their competition. However, before proposing such a reform, the operators wish to enter into discussion with IPART, and perhaps the Ministry, between this fare round and the next, to discuss this and other reforms and their consequences. The operators are concerned, for example, that the government might withdraw exclusive rights to operate on their routes if it does not have the right also to set fares.

In addition, operators want to point out the expense of buying new boats and the expense of maintaining old ones. In this context, operators need certainty in order to risk the investments needed to upgrade services on their routes. As a consequence, contracts need to be reasonably long and with some certainty of renewal provided their contractual obligations have been met. In this period between fare setting rounds, this is one of the reforms that operators would like to discuss with IPART.

<u>Conclusion</u>: the industry proposes no changes to the regulatory framework now, other than the way fares are set, but has some ideas it would like to discuss with IPART between fare setting rounds.

Industry Operators

There are seven operators in the industry in New South Wales. Five have responded to this submission process. The operators are

Operator	Contact Name	Phone
Church Point Ferry Service	Jack Kirkpatrick	0409 223 879
Central Coast Ferries*	Jon Kirk	0418 641 133
Clarence River Ferry Service*	Lawry Duff	6646 6423
Matilda Cruises	Kate Morresey	9373 6832
Palm Beach Ferry Service	Peter Verrills	0414 555 522
Cronulla and National Park Ferry Cruises	Carl Rogan	9523 2990
Dangar Island Ferry Service	Gordon Davey	9985 7566

* did not make responses

The two operators who have not made submissions are

Central Coast Ferries; this business changed hands last calendar year; the present proprietor has insufficient financial records to complete the proforma

Clarence River Ferries; this operator is unable to separate his costs into ferry and other so declines to make a submission

Attachment I

Operators' Cost Index for 2004

Percentage increase in cost items, total dollar spend, on previous period

Operator	Dangar Island	Church Point	Matilda	Palm Beach	Cronulla & Nat P	Total
Costs						
Labour	6.35	2.87	-11.10	2.93	11.11	2.43
Fuel	9.68	13.41	0.60	29.92	1.21	10.77
Repairs and Maintenance	417.26	3.06	11.60	-30.65	18.07	83.87
Insurance	15.70	9.54	10.00	57.19	74.70	33.43
Depreciation	44.27	33.33	105.70	-0.83	-9.09	34.68
Interest	9.25	17.05	0.00	0.00	14.87	8.23
Licensing Fees						
Berthing/Mooring Fees	0.00	7.44	36.00	153.86	4.99	40.46
Advertising	-37.07	-80.05	11.00	101.91	7.99	0.76
Motor Vehicle Expenses	75.06	25.77	0.00	18.11	-19.26	19.94
Other	42.26	-0.82	-28.40	4.75	81.57	19.87
Total	20.61	6.88	3.60	6.96	18.63	11.34
Revenue	-17.19	2.14	-13.50	-22.20	19.54	-5.71
Return on '04 Assets %	6.00	-5.92	-16.90	4.79	-11.43	-4.69

Comments

The information above is based on the period from July '03 to April'04 for all but Matilda who have used the full 12 months to June.

Overall revenue declined for three of the five operators, despite last year's fare increases. Church Point's revenue went up by only 2 percent. Whilst Cronulla's went up by nearly 20 percent, this amount includes some concession income claims attributable to previous years.

Dangar Island's large increase in Maintenance is because of a considerable amount of work that had to be done on a new, second hand boat, acquired as a back-up.

Matilda reduced their labour consumption because of their revenue decline.

In general, insurance expenses increased significantly. This will probably not be repeated next time.

The Industrial Relations Commission made an award increase of a flat $17 per week, effective on December 3, 2003. This amounts to 3.49 percent for a General Purpose Hand, 3.13 percent for a Master, less than 18.5 m, and 3.11 for a Master, 18.5 m or more, vessel length.

Percentage each cost item is of the total, all operators combined, except Matilda (info not available)

Operator	%
Costs	
Labour	45.03
Fuel	7.64
Repairs and Maintenance	12.35
Insurance	8.27
Depreciation	9.91
Interest	3.09
Licensing Fees	0.00
Berthing/Mooring Fees	1.10
Advertising	2.16
Motor Vehicle Expenses	2.16
Other	8.30
Total	100.00