Knapwynd,
School Lane,
Studland,
Dorset BH19 3AJ
Tel: 01929-450 222
Mobile: 07774-431 269
E-mail: – **Eric@TheStobarts.co.uk**

20th April, 2020

Secretary of State,

Department for Transport,

Tyneside House,
Skinnerburn Road,
Newcastle Business Park,
Newcastle upon Tyne,
NE4 7AR

By email to National Transport Casework team at: nationalcasework@dft.gov.uk
for the attention of Sandra Zamenzadeh.

and by First Class post

Dear Secretary of State,

The Bournemouth-Swanage Motor Road and Ferry Acts 1923 & 1986 and Transport Charges (Miscellaneous Provisions) Act 1954

Application for revision to the charges for use of the ferry between Sandbanks and South Haven Point

Introduction

1. I am writing to oppose the application by The Bournemouth-Swanage Motor Road and Ferry Company ('the Ferry Company') to increase toll charges pursuant to the Transport Charges (Miscellaneous Provisions) Act 1954 ('the Act') and to ask the Secretary of State to reject the application by the Ferry Company.

2. I do not consider that there is any justification for an increase in toll charges given the high levels of profitability and dividend distributions by the Ferry Company over recent years. The Ferry Company in its application, as in previous such applications over a number of years, again seeks to justify a toll increase on the basis of the need to prefund the cost of a new ferry, this time for entry into service in 2032.

3. I consider that the capital required for a new ferry should be provided by the Ferry Company, utilizing shareholder reserves from its retained profits, and from third party debt when the new ferry is commissioned. The costs of capital associated with a new ferry, when it eventually comes into service, should be borne by the users of the new ferry along with operating costs when it is in service and not by the current users of the existing ferry.

4. There is more than adequate time for the required equity capital to be accumulated out of the existing profitability of the Ferry Company or by its parent company, and for appropriate debt facilities to be put in place. If the current owners are not willing or able to provide the requisite capital in twelve years' time, then alternative owners of the Ferry Company, who would be prepared to do so, should be sought.

Background

5. The Ferry Company is a monopoly provider of the ferry service between Sandbanks and South Haven Point pursuant to Acts of Parliament. It is regulated by the Act. As such, the Ferry Company should be regulated with regards to its tariffs, service delivery and social responsibilities in the same way that other monopoly providers of essential services, such as water or electricity, are regulated.

6. Whilst shareholders should obtain a reasonable return on the capital necessarily deployed, this should be based upon an independent assessment of the value of the assets deployed based upon their economic value and a risk-based capital structure utilizing an optimal proportion of debt and equity. This should be in line with the basis upon which the capital structure and return on equity capital is assessed for other regulated monopoly providers.

Basis for any toll increase

7. The basis upon which any toll increase should be considered should be based upon a reasoned assessment of the overall operating costs of the Ferry Company and whether it is providing the requisite level of service. An allowance for the cost of capital should be included in costs but as indicated in paragraph 6 above, this should be based upon an appropriate determination of the capital deployed in the business and an optimal capital structure. No such case has been put forward as far as I'm aware.

Financing of a replacement ferry

8. The cost of financing a new ferry when it eventually enters service should be borne by the users of the new ferry. There is no rational reason why current users of the existing ferry now and for the next twelve years should be paying to use a new ferry the benefit of which they will not enjoy. This is in line with most regulated and commercial businesses. It is pertinent to note that the existing ferry may require

replacing at an earlier date if key spare parts become increasingly unavailable or environmental regulations change, restricting or prohibiting the use of fossil fuel powered ferries.

9. It is my understanding that under its Acts of Parliament, the Ferry Company can borrow up to £5 million. Given that the borrowing limit of the Ferry Company in the Acts of Parliament was set many years ago, there should be no inherent reason why the Acts of Parliament could not be amended to allow for a higher borrowing limit – they have been amended on several occasions in the past and there is plenty of time to do so before the proposed ferry replacement date as well as justification i.e. the increased cost of ferry replacement due to inflation.

10. The current borrowing limit would represent some 40% of the projected cost of a new ferry in 2032, or around 60% of the cost if it was replaced over the next couple of years. This borrowing should be capable of being provided by bank or lease company finance. Some twelve months ago the Ferry Company's bankers, who it is understood are also bankers to the Ferry Company's parent company, indicated in a letter to the Ferry Company, now made public, that their initial observations were that neither the assets of the Ferry Company nor the equity interest in the Ferry Company would provide sufficient security to enable that particular bank to '*proffer the funding facilities requested at this time'*

11. It is unclear what the funding facilities requested were from the bank concerned or the case presented to the bank. There are, I consider a number of specialist wholesale banks and asset finance companies that with a well-presented proposal would be prepared to give consideration to providing an appropriate level of finance to this monopoly, cash generative, relatively low risk and highly profitable operator. I recognize that such lending organisations may require some form of support from the Ferry Company's parent company in order to enable the optimal level of debt to be provided. The cost of such support should be rewarded appropriately in the cost of capital model.

12. If the current capital or borrowing structure of the Ferry Company's parent company does not support third party debt financing of a new ferry for some reason, then it should be reconfigured to make sure that it does – again there is plenty of time to do this in advance of the proposed ferry replacement date. There is no reason why current or future users of the ferry should pay for an inefficient capital structure or provide cross subsidies for other businesses within the Ferry Company's parent company group. The equity required for a new ferry should be provided by the equity holders, who should be rewarded appropriately when they have invested the capital but not before.

13. Should the Ferry Company's parent company be unable or unwilling to provide such support, there are a number of alternative owners of the business who would I'm sure be interested in acquiring the business, including institutional infrastructure funds who already operate local ferry companies in Southern England.

14. I would also note that in its proposals for a toll increase the Ferry Company has said '*The Ferry Company owners have committed voluntarily to ensuring the Ferry Company is loaned the required funds when required and to acquire and bring into operation a suitable, newly built replacement vessel for the current ferry, Bramble Bush Bay, by the time it reaches the end of its useful life'*. It is thus unclear why any pre-funding is required now or immediately before the new ferry is ordered

<u>Return on capital to shareholders</u>

15. The return on equity to capital providers of the Ferry Company should be based upon a properly assessed and independent determination of the value of the assets and capital deployed in the business and an appropriate risk related return calculation. Shareholders have received strong returns over recent years up until the current operating difficulties. In particular, the assets should be assessed based upon their economic value reflecting replacement cost, alternative use value or third-party sale value. The value of the land, roads and slipways of the Ferry Company, for instance, is shown in its 2019 accounts at £11.5 million compared with a cost figure of £140,000. At the public inquiry in 2018, a construction engineer opined that the cost of re-building the access road to the ferry to be in the order of £3 million. It is difficult to see how the balance of the assets can possibly equate to £8.5 million.

16. In assessing the return that the shareholders in the Ferry Company should be earning, as with other regulated monopoly providers, a weighted average cost of capital basis should be used reflecting the risk adjusted cost of both debt and equity based upon an optimal capital structure.

<u>Conclusion</u>

17. It is difficult to see any justification for an increase in tolls. The justification for such an increase could be if costs of operating the ferry had increased materially and resulted in the shareholders in the Ferry Company receiving an inadequate return. The latter would be determined based upon medium term returns that they have earned on capital reflecting a properly assessed valuation of the assets in the business, an optimal capital structure and a risk adjusted return on equity capital.

18. Given the relatively stable level of operating profits of the Ferry Company, other than in years when major maintenance has been undertaken on the ferry and the ferry has been out of service for an extended period (and no doubt in 2020), and the questionable value of the assets in the balance sheet, it is difficult to see how an inadequate return in recent years can be demonstrated and that a toll increase can be justified on grounds of inadequate returns.

19. In terms of raising tolls in order to pre-finance a new ferry that would come into service in 12 years' time, there is no reason why users of the ferry today should be

paying for this. The cost of the new ferry, including its financing costs, should be paid by the users at the time. There should be several ways in which the finance can be provided through a combination of equity and debt financing and there is plenty of time to put this in place.

20. Before the Secretary of State reaches a conclusion on whether the Ferry Company's application for an increase in tolls should be granted, there should be a full public inquiry and consultation in front of an appointed Inspector as there has been on previous occasions when the Ferry Company has applied for toll increases.

21. It is recognised that in the current environment a public inquiry is unlikely to be practicable in the short term but there is no reason why it couldn't be held in due course. Failure to do so, could result in an application for a Judicial Review of the decision-making process, which would clearly be time consuming and expensive.

22. I would be pleased to discuss the contents of this letter with you or your Departmental colleagues.

Yours sincerely

<u>Eric Stobart</u>
<u>M.Sc (Econ), FCA</u>