Studland Parish Council:

Closing Statement

Introduction

1. **Objectives**: The objectives of the inquiry are to decide if the tolls and revenue are sufficient to provide for:
    a. The working, management and maintenance of the ferry;
    b. Charges to revenue for the provision of contingencies / capital sums; and
    c. To provide an adequate rate of return.

2. **Existing toll levels already achieve these objectives**: the analyses submitted by parties, and discussed during this Inquiry, indicate that the existing toll levels are already sufficient for the Ferry Company to meet all these objectives in the short term, with only minor adjustments possibly needed – depending on levels of inflation – in the future. (please see the table submitted by Malcolm Tice: MT3 table).

Supporting comments

3. **Peak fares have already been reached**:

    a. The very helpful analyses provided by Mr Thomas showed that the peak year for car usage – which provides approximately 90% of all revenues – was 2011/12, since when numbers of users are declining; this is over a period when DfT data shows road traffic growth of 17%;
    b. The Ferry Tolls have already achieved a "peak" price, and price elasticity has kicked in;
    c. This high pricing is causing distress to local businesses (see the submissions from The Pig Hotel, the Bankes Arms, and the National Trust) as well as residents (see survey conducted by Studland Parish Council, and objections from residents;
    d. It is already forcing more people to drive around through Corfe Castle, Wareham, Sandford, causing greater congestion and pollution for the residents there. Commercial vehicles largely boycott the ferry due to the high tolls.
    e. Instead of being an essential, everyday service, the Ferry is becoming a luxury, mainly used by visitors / holiday makers – hence the high seasonality of traffic.
    f. Of significance to this Inquiry, higher fares will lead to further lower usage and lower revenues, meaning that the budgets / forecasts provided – which are based on constant numbers of users – will not be achieved.
    g. We consider that there is a lot of merit to the National Trust proposal. We also consider it would merit the Ferry Company to commission market research on user patterns and needs, and to develop a new fare structure that takes into

account better the needs of users, environmental considerations as well as the financial requirements of the Ferry Company.

4. **The increases proposed are well ahead of inflation**:

    a. The Ferry Company has opted to use the out-dated RPI, which provides for higher levels of inflation than CPIH: CPIH has been the Bank of England's main inflation measure since 2003, and Rishi Sunak has now switched from RPI to CPIH for calculating the indexation of gilts from 2030 – which have a major impact on pensions.
    b. The Ferry Company also have adopted a level of inflation – 3.0% - which is well above the Bank of England central forecast of 2%. Whilst this may sound like a small difference, over 12 years, a 2% p.a. increase gives an overall increase of 26.8%, whilst 3% gives 42.6%: the difference would mean increasing fares from £4.50 to £5.70 rather than to £6.41 (which is still below the £6.75 sought by the Ferry Company (please see Studland Parish Council submission, section 3).

5. **Operating forecasts and dividends will be excessive:** if the toll application is allowed profitability after tax will average 39.2% over the 12-year period, and dividends will average 23.6% pa over the 12-year period. (See Studland Parish Council submission, section 7). We regard these as excessive.

6. **Returns will be much higher than for comparable companies:** data submitted by both the Ferry Company and Studland shows that for comparable companies' profitability / return on sales to be much higher in the Ferry Company than in comparator companies. The company admits – 3.3.10 – that "the Company's Profit Before Tax as a Percentage of Sales" is much more favourable than other companies in similar industries". The Company justifies this by saying it "is more effective at controlling its costs". We feel a more likely explanation is that the company has been more effective at putting up tolls: from 2003 to Feb 2020 RPI increased by 61%, but tolls increased by over 100% (from £2.20 to 4.50). Mr South's analyses supported this, showing that – for the distance covered – tolls at the Ferry Company were higher than in other operators.

7. **Productivity**: all businesses today build in productivity improvement targets to their budgeting: the old business model – outdated at least since the 1980's – was for cost plus inflation to justify prices. Today the market sets the price, and companies must reduce costs to maintain profitability. And yet, in questioning, Mr Thomas, the accountant, said that no productivity assumptions had been built in. As stated in point 3 above, peak prices have already been achieved, and passenger numbers are declining: to derive extra profits the Ferry Company should be seeking productivity improvements, not price rises: further price rises will only decrease future usage and be counter-productive to revenue generation: price rises without productivity improvements is a failed and outdated business model.

8. **The rate of return sought is excessive**:

    a. The Ferry Company wants a return on investment – defined as "Profit before tax as a percentage of shareholders' funds" – of at least 6.1% (Mr Thomas, page 10 of 3.3.2). Mr Thomas – page 166 – also argues that a return of only 5% would be very low. But these targets come from historic analyses and are not based on today's reality.
    b. The economy and markets are changing. As reported in the "Investors Chronicle" (17 – 23 July, 2020), Ofgem says it intends to halve the rate of return previously allowed: "the Regulator is proposing that the allowed rate of return on equity – based on the CPIH – be set at 3.7% for electricity transmission and 3.95% for gas transmission and distribution, down from the current 7 – 8% level". The Regulator justified this saying "so that less of consumers' money goes towards network companies profits and more towards driving network improvements". We quote this to show that the market and returns available have changed, and that the Ferry Company's goals of 6% plus are no longer reasonable.

9. **Valuation of the company's assets is a blackhole**: the valuer refused to explain the methodology in the DRC method, so we have no idea of the assumptions; also, the method takes no account of business performance. We must assume that the reluctance to share this data indicates an over-valuation of the company's assets, which mean that the returns sought by the Ferry Company are even more excessive. The submission from Mark Street, of the National Trust, throws further doubts on the soundness of the valuation: he said that the 2015 valuation should be treated with caution.

10. **The Ferry Replacement Reserve is a flawed concept**: the FRR is an anachronistic bookkeeping methodology that was discontinued by most companies many years ago. The need is for the cash funds for the ferry replacement to be ring fenced into an Escrow account or Trust fund. Despite various Applications where toll increases were justified by the need to increase the FRR, the FRR stood at £1.145m in 2003, and at £2.495m in 2008. This stood at only £2.6m in 2020. Where has the money gone that was given in previous settlements? The Accountant, Mr Thomas, was unable to explain why this was, or where the extra toll income had gone. Mr Thomas was also unable to understand why dedicated funds for the FRR should be created – as with an Escrow account, or Trust Fund. The reason for the company's opposition to an Escrow or Trust Fund is nothing to do with their technical feasibility: it is because they would lose control over use of the funds to cover other expenses – which may be for emergency operational or maintenance reasons, but also because such funds would remove the company's flexibility to move the money to where they want: i.e. to dividends, or

other parts of the Fairacres Group. Cash is king and can only be properly ring fenced through a dedicated Escrow account or Trust Fund.

11. **The finances of the Ferry Company should be treated entirely separate from that of its parent company, the Fairacres Group**. Ideally, as hypothesised by Mr Tice, the Ferry Company would be a totally separate business. However, as part of the Fairacres Group it is one component: analyses from year 2008 to year 2019 (see submission) show that the Ferry Company provided 77% of all Fairacres Group net profits before tax. In the years 2014 – 2019 the Fairacres Group would have been loss making in five of the six years without the Ferry Company contribution. We can only surmise, but the current pandemic will have hit the loss-making hotel businesses hard. The Fairacres Group relies heavily on the cash from the Ferry Company: it is, effectively, the cash cow of the Group business. We can understand that the Fairacres Group is in need of greater income; however, the Ferry Company – which is the subject of this Inquiry - does not.

12. **No fare increases are necessary**: We do not see why a new ferry, due to enter service in 2034, should be financed by ferry users in the intervening period. It should be financed by the users of the new ferry once it is in service. In addition, a capital and tax efficient structure should be used utilising as far as possible cheaper, tax efficient debt. In the meantime, the current cash holdings of some £3.2 million (as at 31st March, 2020) should be easily capable of being built up to meet from such resources the non-debt financed element of the capital cost of the new ferry. There needs to be a firm commitment in the meantime to keep set levels of cash in the Company. The existing limit on the borrowing capacity of the Ferry Company should be increased to a realistic, current day limit through amendment to the Act of Parliament, for which there is plenty of time. This structure would also remove the need for the Ferry Replacement Reserve bookkeeping and potentially enable a higher level of dividends to be paid the shareholders. Please see the paper / objection from Eric Stobart.

13. **Replacement ferry**: given that new diesel and petrol cars are being banned from 2030, there is no justification for a new diesel ferry in 2034: it must be electric / hydrogen or similar. Mr Stobart suggested that, given the importance of the environmental agenda to the Government, that grants, or subsidies, may well become available to meet a significant share of the cost. This should be taken into account in future fare increase applications.

14. **Local residents, businesses and employees have been ignored by both the Ferry Company and the Consortium**: as outlined in the Inquiry (submissions of John Smith and Peter Bowyer) local residents in Studland in particular, and Purbeck more widely, tend to be lower income earners, and more aged. These local residents and employees will face above inflation increases when they are already struggling: even the discounted fares will rise by 35%, way ahead of the government's inflation forecasts. They will avoid the ferry and drive the long way around. Please see also the objections

from The Pig Hotel and the Bankes Arms. John South has outlined at least seven examples where comparable ferries offer much greater discounts for local residents and employees who need to use the ferry regularly rather than as a "treat". The Ferry Company should come forward with new proposals to assist residents and employees in Studland and Purbeck. This would-be part of their Corporate Social Responsibility, as stated by Mr Bowyer.

15. **The period sought in the toll application – 12 years – is far too long**: the forecasts are simply unreliable; this is a pure spreadsheet exercise with no credibility. Mr Thomas was unable to quote how many other companies use such a long period: the reason is because there are none, because budgeting over such a long period is meaningless. Mr Thomas argues that the business is a steady one: in reality it should be, but it was shut for 5 months in 2019 due to an "unforeseen" mechanical failure, and Year 1 of it's 12 year forecasts have been blown apart by Covid : even steady businesses become unsteady in a turbulent market. If for no other reason, we suggest the Inspector should reject this Application because the 12-year budgeting / forecasts are totally unreliable. In addition, such a period also removes all opportunity for scrutiny of the company's accounts – for example: is it indeed achieving its objectives e.g. of building a FRR – and removes all accountability and redress.

16. **Consortium**: our objections were set out in our opening statement.

17. For the record, as "objectors" – although we prefer to see ourselves as residents and consumers or users of the Ferry services – we do want to see a viable and reliable ferry service and are open to toll increases that are reasonable. Sadly, those presented by the Ferry Company are not reasonable. We are also quite content for the Ferry Company to earn an acceptable, risk adjusted return on an efficiently structured capital base

Conclusions

18. In conclusion, the current Toll levels are more than adequate to meet the Ferry Company's current requirements, as set out in section 1 above. For this and all the reasons above, we call on the Inspector to reject the Toll Applications from both the Ferry Company and the Consortium, and suggest the Inspector invite them to return – after a year – with more credible proposals.