Proceedings

Is Privatization of Our National Ports and Airports in Canadians' Best Interest?

Guest Speakers:

Dr. Michael Tretheway

Mr. Brad Eshleman

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Reporters' Note

This report relies on an audio recording, handwritten notes taken during remarks, copies of slide decks provided by the speakers, and a summary of Dr. Tretheway' s prepared remarks provided by him after the event. Dr. Tretheway has neither reviewed nor endorsed the report on the question-and-answer period. The report of Mr. Eshleman's prepared remarks and his answers in the question-and-answer period, which he has reviewed, closely paraphrase his words as delivered. The reporters have added: topic headings; explanatory words in the remarks [in square brackets] and footnotes. Errors and omissions remain the responsibility of the reporters and their supervisor.

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Biography of the Speakers: Dr. Michael Tretheway

Michael Tretheway is the Chief Economist and Chief Strategy Officer with the InterVISTAS Consulting Group. He is a co-founder of the InterVISTAS Consulting Group and has served as its Chief Operating Officer. Dr. Tretheway earned a Ph.D. in economics from the University of Wisconsin and served for 14 years as Associate Professor of Transportation and Logistics in the Sauder School of Business, University of British Columbia. He is frequently an expert witness on regulatory hearings, court cases, competition tribunal hearings, and in arbitrations. He was a member of the Board of Experts of the United Nations World Tourism Organization. Before co-founding InterVISTAS Consulting, he served as Vice President of the Vancouver International Airport Authority, on the Minister of Transport's Airport Transfer Task Force Advisory Board, and as Director of Research of the Ministerial Task Force on International Airline Policy. Dr. Tretheway has served on the editorial boards of the Journal of Air Transport Management, the Quarterly Journal of Finance and Accounting, and Logistics & Transportation Review. He is noted for his research on aviation costs and productivity, airport economics, aviation policy development and analysis, and antitrust issues in aviation.

Biography of the Speakers: Mr. Brad Eshleman

Brad Eshleman joined Western Stevedoring in 1986 and was appointed Vice President, Finance and Administration in 1992 and President in 2011.Mr. Eshleman is a Chartered Accountant and a business graduate of the University of British Columbia. Prior to joining the company in 1986, he worked for the accounting firm of KPMG. As President, he is responsible for the Western Group of Companies, including: Western Stevedoring Company Limited, Associated Stevedoring Company Ltd., Coast 2000 Terminals Ltd., Tidal Harmony Holdings, and CVS Cruise Victoria. The Western Group is the largest and most diversified stevedoring and terminal operator in British Columbia, providing professional stevedoring services to a worldwide customer base. Mr. Eshleman also serves on a number of industry associations and government relations groups, including: Chair, BC Terminal Operators Association; Vice Chair, Greater Vancouver Getaway Council; Director and Executive Committee, BC Maritime Employers Association; Director, Western Transportation Advisory Council; and Chair, BC Ports Competitiveness Committee.

Introduction by Mr. Martin Crilly FCILT, Moderator

Good morning. I'm a Fellow of the Chartered Institute of Logistics and Transport, and a member of its Pacific Chapter. I'd like to acknowledge our national President **Bob Armstrong** here in the audience and **Marian Robson** our Pacific Chapter Chair.

Today our large seaports and airports have two important similarities: how they are financed, and who controls them:

- You cannot buy a share in them—because both sea and airports are structured without shares: and
- The people on their boards of directors are nominated by stakeholder groups—not elected by shareholders.

The buzz about privatization now

The buzz began a year ago when the government published the Canada Transportation Act review chaired by the Honourable **David Emerson**. It moots changes in both finance and control.

On seaports, Dr Emerson recommends the government should "examine the feasibility of adopting a share-capital structure for ports, including receiving proposals from institutional investors or private equity investors". And he suggests new regulation of port changes by the Canada Transportation Agency, with a light touch.

On airports, Dr Emerson goes beyond "examining feasibility" to say "just do it". He calls explicitly for privatization of the large airports (within three years — that is two years from now) so that they can tap into equity financing from large institutional investors. And there is a related recommendation to scrap onerous lease payments by airports to Ottawa.

Where would the money raised by selling shares go? To build new infrastructure in those same ports and airports? Or into the treasury? Or somewhere else? The buzz got louder when the government spoke of a Canada Infrastructure Bank and the notion of cycling of infrastructure assets. Does this mean selling one asset to buy or build another elsewhere?

Just Exploring Possibilities

Late last year the government seemed to move to follow Dr Emerson's recommendations when it hired advisors — Credit Suisse on airports and Morgan Stanley on seaports — on privatization. Then late last month, here in Vancouver, Minister Garneau went out of his way to calm the buzz, stating: "The examination of privatization and asset recycling is only something we are looking at... you should not in any way assume it is policy. We are exploring options. The decision factors—overriding factors—are what is best for passengers and how it will affect the efficiency of ports. Please do not assume it is a done deal. It's new government exploring possibilities in the context of the above priorities."

So what better time could there be for us to explore this hot topic too! Please welcome our panelists.

Remarks of Dr. Michael Tretheway

Toll Booth or Spark Plug?

A 2012 Senate Report, "The Future of Canadian Air Travel: Toll Booth or Spark Plug" raised a number of issues for Canadian air travel, focusing especially on the high taxation and rents on Canadian travel relative to that in the U.S. The 2016 Emerson report on Canada's transportation policies also raised the issue of aviation charges, and other issues. One issue is that current airport leases are not viable in that they require return of airport assets after 60-80 years, but with no compensation from the federal government and a requirement that all airport debt be retired at no cost to the taxpayer. These conditions are not tenable. While this could be fixed by revising lease terms to pay airport authorities for the ending net book value of assets, allowing debt to be extinguished, two of seven options proposed by Emerson include privatization of airports. His subsequent testimony to the Senate suggested that a primary motivation is to enhance management discipline questioning whether he intended privatization to generate funds for the government. Privatization paradoxically would be inconsistent with the travel cost reducing recommendations of the Senate and (parts of) the Emerson report.

Monetization vs. Privatization

It is important to understand that the current privatization discussion should be termed "monetization". Airports are already run by private corporations (the airport authorities), albeit not-for-profit corporations, and there is no provision in current legislation or the airport ground leases for the government to seize the leases from the airport authorities against their will. The government policy currently being considered seems to be one of expropriating assets already leased and selling them again, but at their new higher values. This will generate one-time cash for the federal government and continuing cash from income taxes as for-profit entities. Airport monetization will work in the sense that there are investors willing to pay significant EBIDTA multiples for Canada's airport assets. But this will be at the cost of higher fees and charges. Current EBIDTA seems sufficient, after paying off current airport debt, to cover the debt and equity servicing costs of fully private investors. But current EBIDTA is earmarked for new capital. Thus after monetization, airports will need a second equity and debt round for construction, and this will increase airport fees and likely decrease air travel by about 12-17%. This is not catastrophic but it will reduce the national welfare derived from air travel.

The issue then focuses on whether the benefits of airport privatization outweigh the risks. The current regime works well, and there is risk as to whether a fully private regime will work better. As air travel from Canadian airports will inevitably be reduced, and cross border driving will increase to reach less expensive US air travel options, this seems dubious and significant risks are present. If the monetization proceeds are used for other purposes, and if those uses of government funds produce extremely high benefits, then there could be a net gain. This leaves a question for Canada, the same one posed by the Senate: Are airports a spark plug for economic growth and social connectivity, or are they a toll booth for government coffers and other uses of funds?

Remarks of Mr. Brad Eshleman

Introduction

You'll see some similarities and some differences between our two presentations, because my focus is on the ports as opposed to airports.

First, I will give you an overview of the **Marine Terminal Operator's Association**, and then talk about the possible privatization and its consequences. We are currently preparing a report on this subject to submit to the federal government. What I want to do today is pose a number of questions. Then I want to talk about the current Canada Ports Act model, and some other concerns about that.

The Marine Terminal Operator's Association

By way of introduction, we are the container, break-bulk, grain, and bulk terminals, and cruise operators in Vancouver and Victoria. We also operate the grain, bulk, and container operators in Prince Rupert and container and forestry operators in Nanaimo.

"Pretty well everything you see in stores is imported though our facilities." Canada, and our standard of living, is built on trade with the world.

As marine terminal operators we are the tenants to the port authorities. We rent the land from the Port, and we operate the import and export terminals. The terminal operators are the ones who make improvements to infrastructure and equipment. The Port rents the land to us, and we provide the infrastructure, develop the terminals, and buy the equipment required to operate the ports.

Why the Interest in Privatization?

In this portion, you will see some similarities with what Mike Tretheway said.

First, we want to understand some reasons for privatization.

From the private sector, pension fund managers are looking to put their money somewhere that will provide both security and reasonable returns in the long run. These managers are looking at the Port's earnings (before interest, taxes, depreciation and amortization or EBITDA) of approximately $180M per year as a stable cash flow that can be used as an investment tool. They are some of the parties that would be interested in privatization.

On the public side, funding is needed to replenish infrastructure and to deliver on promises made during the election period – the government is looking at where they can generate some money.

However, would the current government use these funds to reinvest in transportation, or would it be used elsewhere?

Concerns about Privatization

Once the port has been monetized, that revenue stream is gone, and it is no longer available for trade or infrastructure. In this case, how will we pay for future port development and infrastructure? The funding would likely come from users, with the fees likely to increase.

This higher cost would have several potential effects: reduced competitiveness of Canadian exports, increased domestic prices, and potential diversion of traffic to other international ports.

There are several other questions I want to pose that will need to be addressed before the government decides about privatization.

- A private system would likely be commercially focused, but would this be in the national interest?
- What about environment stewardship programs – who will provide funding for the initiatives that are currently being done by the Port?
- Who will be responsible for regulating this newly-privatized business?
- What would happen to the Port's involvement in local community?
- Who will champion the Asia Pacific Gateway in Vancouver or Prince Rupert? To attract investment in a container port in the north, [Prince Rupert Port CEO] **Don Krusel** had a road show going on for a long long time to try to attract people to do it. Would that have happened under a privatized system?"
- Would there be increased politicization of Port and airport expansions?
- How would the governance structure change because of privatization?
- Would this create a monopoly, and how would that affect the competitiveness of the Ports?
- Are there other alternative arrangements that would serve Canada better?
- How will First Nation land claims be addressed in a privatized system?

The Current Model

We've attracted cargo away from the US, and they're looking at us as a model. The current model has encouraged forward-thinking government policies such as the Asia Pacific Gateway and Corridor Initiative. Private investment has also been encouraged through a safe and stable framework that has funneled billions of dollars in. It has also seen exponential growth in cargo, jobs, and trade in the last 10 years. This is a model that we know, even if there are still areas for improvement, but there are many question marks associated with privatization.

Wrap Up

As a final thought, when selling an asset, you want to sell it for as close to the peak of its value as possible. Over the next 5-10 years, we are forecasting for the Asia Pacific Gateway and Ports increased demand for resources and growth potential for the ports. In addition there's the impact of the new US President's policies: this change may result in even more growth potential for Canada's resources.

By analogy, the Vancouver housing market has been a growth market; how would you feel if you sold your house 5-10 years ago versus now? Returning to the Ports, is now the time to sell? I'm not so sure.

Discussion, Questions and Answers

Discussion with Martin Crilly
FCILT, *moderator.*

Won't Private Share Ownership Mean Better Efficiency?

Q*: Dr. Emerson isn't concerned with where the money goes; he doesn't say very much about that. Rather, he says that the airport and port systems have only moved half-way towards privatization, and he holds out greater efficiency (relating to reduced cost) as well as improvements to the capital program through greater financial discipline, if we moved to a fully private system. The question is: is there value in this claim that those improvements can only come with fully transitioning to the private sector?*

A: (Brad Eshleman) Ports don't operate any terminals – they don't handle any of the trade corridors or cargo. The Ports currently lease land to the terminal operators and provide regulation. I have a hard time understanding how a private landlord would improve our efficiency, our terminal's efficiency, and the trade corridor efficiency. However, taking money out of the system by monetizing the ports does **not** help with improving port infrastructure.

Wouldn't Equity Investors from Elsewhere in the Supply Chain Make Better Decisions?

Q*: For capital projects like the new proposed Terminal 2 at Roberts Bank, does it make sense for some entity within the supply chain… that might want to have an equity participation in that terminal to build the infrastructure improvement?*

A: **(Brad Eshleman)**: Yes I think that the private investor should build that improvement. In the current system, there are no rules against having private investors fund capital projects. The Port can do that right now; that's done that all over the world to build terminals and develop them.

A: (Michael Tretheway): Regardless of whether you are funding projects through the public or private sector, the projects themselves would go ahead. Academic research does suggest that private airports invest less, create more congestion, and have lower traffic.

I think we should have made the transition to a privatized system 25 years ago, and that doing it now has significant negative consequences. My company works with airports from around the world – both private and otherwise – and Canada's airports are relatively efficiently operated.

With the Ports, however, they are limited in the current system in their access to financing. Airports can borrow money at will, and the market determines how much money they can borrow. However, the Ports Minister is the one who sets limits on debt for the ports. Why do we have to limit the debt of the ports but not the airports, especially is the airports cannot pledge the land in borrowing. Why do we have to have this process where they need approval to then eventually request funding from the financial markets; with Terminal 2, the value of the improvement will go well beyond this funding limit?

Is There No Meeting of Minds Among Professional Analysts and Advisors?

Q: Mike, you questioned the professional analysis by the CD Howe institute and also that of Dr. Emerson's own team. You're essentially saying that they did it wrong; is that correct? How can a difference in opinions be resolved among professionals to get the right answer?

A (Michael Tretheway): I think that they did get it wrong. CD Howe looked at the problem from a financial perspective, asking "financially, can you do this, and the answer is yes."

The Emerson report does not provide background material that allows you to see what led to his conclusions.

The CD Howe report does have that background information and you can reverse engineer it. The Howe report did no analysis on what things will look like in 15 years. The Vancouver Airport Authority's analysis differs, because they say "this is what we need in years 5, 10, 15, and with a privatization/monetization option, this is what our fees and charges will look like." They acknowledged that there could be some efficiency gains, though with benchmarking it's hard to say how much. There is a public forum for moving toward a consistent answer, and the Airports have responded already (though not with one voice, which is why this mess has developed).

Two questions *from* ***Mark*** **Szakonyi**
Executive Editor, Journal of Commerce

Loss of Cargo to US Ports?

Q: *Can you expand on the risk of losing some of that US-bound cargo currently flowing through our ports,*

A (Brad Eshleman): To answer the first question, Prince Rupert has roughly 50-60% of their traffic go to the US, while Vancouver has roughly 20%. Under a system with increased costs per container, for price sensitive products that can go through the US or Canada. Presently, it is more cost competitive to go through a Canadian port before being transported to its final US destination. If that changes, where the costs go up substantially, the cargo can go through ports in the US instead.

Other Countries' Experience with Privatized Ports?

Q: *second, has there been any other experiences where the port authority has been privatized completely in other countries.*

A (Michael Tretheway): privatizations are difficult because they're not all the same; sometimes it is the operation that is privatized, or certain terminals that are privatized while the runways or other parts stay controlled.

Santiago Chile broke the airport into pieces and then had to reassemble the pieces. Australia has done this recently, but there isn't enough data yet. UK case was very complicated, where it was mixed up with terminals. There is no clear record of port privatizations that we can learn from other countries.

Q: *Follow-up, was the land privatized in Australia?*

A (Michael Tretheway): That's a very astute question because one of the things we don't know about is whether airport and port privatization [in Canada] will be a prepaid lease of the land, or buying the land itself. In the case of Australia, there's been no clear answer given; they use prepaid leases, but it's not clear what the lease gives you.

A (Brad Eshleman): There's a lot of differing discussions and opinions about the potential options – can you sell off a terminal, part of a terminal, what is the range of opportunities that can be found?

Question *from* ***David Brett****,*
Operations Management student, BCIT

Most Important Thing In A Privatization?

Q: *Supposing that the privatization does go ahead, what are decision makers most likely to get wrong? Put another way, what's the absolute most important thing for decision makers to get correct?*

A (Michael Tretheway): What you want to get out of it – sparkplug or tollbooth. Do you see the role of the ports and airports as sparking growth in other areas of the economy, or is it just a source of revenue. "Most of the rest of the world views transport as so critical to the economy that they provide access to land at zero" because transport changes everything – it changes social connectivity, etc. The biggest risk is that they focus on the financial aspect of the decision and not balance it against the broader social and economic benefits of the decision. We can only monetize these assets once – what are we going to do 20 years from now?

A (Brad Eshleman): As someone from within the industry, you're selling a section of the Asia Pacific Gateway, and a lot of work has gone into developing the Gateway. Will a private equity investor put the same effort into developing the trade corridors and that gateway in Canada's best interest?

Two questions *from* ***David Egan***
PriceWaterhouse Coopers

Effect on Inland Ports?

Q: *If the ports are privatized, would there be any difference in how inland ports are developed.*

A (Brad Eshleman): Inland ports we're not sure because they are related to the container aspect. If it gets too costly (user fees) to deal with it at the terminals, that would help with inland ports. If you sell at a high multiple, and they have to increase user fees, that may help inland ports.

Impact on Airport Improvement Fees?

Q: *Will there be a shift of the airport improvement fee (to "budget improvement fee"?). At the moment, the airports have some say in how AIF funds are spent. If the model changes, how the capital decisions change for those airport improvement fees?*

A (Michael Tretheway): Emerson's recommendation is that AIFs need to be federally approved – it goes to a body that approves the fee for a certain amount for a certain period of time. For the private sector, they don't need to go to an improvement fee, they can go raise equity capital. During the project, there is no increase in fees, and after the project is completed "fees get incorporated into the cost structure and that's when the fess will go up." Although Emerson provides a structure for administering fees, a private sector airport would not need to use AIF's and instead force users to pay higher landing fees.

Comment *from* ***Dr. David Fung***
Chancellor, Capilano University

Avoid Political Bias

Comment*: I am surprised that both of you are not in favour of privatization. Instead you are leaving it in the hands of the government, which is a highly politicized body, where funding can be given based on political reasons rather than need. If we let the market decide what needs to be built in terms of infrastructure, either private ownership or forcing them to go to financial markets for financing, we avoid political bias. If it is privatized, government still has the ability to provide incentives for private operators to act in the best interest of Canadians, through independent funding of projects, etc.*

A (Brad Eshleman): we're posing a lot of questions, and it relates to concerns about governance. For the Gateway, you're monetizing portions of it and potentially moving those funds to something else; is that in the best interest of the Gateway? There are issues of governance of the current CPA model; if you take the money out of the system that also needs help.

A (Michael Tretheway): Under the current airport-model we have had no history of failing to do projects either through AIF's or debt financing. The current model maintains strong improvement and customer service, higher than US airports. The monetization is extracting from the airport system and taking it somewhere else.

Question *from* **Joe Sulmona**,
Sky Blue Sea Enterprises.

Revert to Government Management?

Question: Another model that hasn't been talked about is a management model, back to the government. We're competing against tax-financed projects in the US; a management model where debt is under the books of the Government of Canada, and they continue to operate.

A (Michael Tretheway): The government model of operating airports failed. Government wanted to build a YVR runway but no terminal, when what was needed was a terminal. Toronto Terminal 1 was falling down, and parkade had to be closed, with no move to make the required improvements. We went to a good model. If we want to go to private sector, that's fine, just recognize that we will have 10% less air travel, and 10% smaller carriers, freight forwarders, and it will reduce national connectivity.

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