Response

to

BC Ferry Commission Discussion Paper #1

'The Six Guiding Principles'

from

the Southern Gulf Islands Ferry Advisory Committee

October 2011

SGIFAC Response
to
Discussion Paper #1, the Guiding Principles

Thank you for the opportunity to respond to this discussion paper.

In the words of Cheryl Wenezenki-Yolland, Comptroller General, in her October 2009 report to the ministers of Transportation and Infrastructure, and Finance . . .

> *While it may not have been the intention, this prioritization (*the sustainability of the ferry operator*) has resulted in the Commission taking a very narrow interpretation of the principles and the regulatory role. In particular, we would expect the Commission to focus as well on the sustainability of the coastal ferry system, balancing financial sustainability of the system with the needs of customers, the operators and the communities.*
>
> *The role fulfilled by the Ferry Commission should be broadened to include a number of additional responsibilities including the regulatory functions of protecting customers' interests . . .*

The report resulted in changes included in Bill 20. The recommendation was mentioned but with no tools to implement it. A task was implied but with no means of undertaking it or any expected outcome.

The purpose of a commission in a regulated monopoly or limited entry market is to balance the interests of the party providing the service with those of the party paying for those services. The service provider needs adequate income to remain viable. The customer needs protection from over-charging by the service provider in the protected market. This is seen with the CRTC (phone, cable, TV), the BC Utilities Commission (electricity and natural gas) and others. This works when there are just two parties – the service provider and the customer and the commission holds all the cards.

The BC Ferry Commission does not fit this model, in that there are three parties, the service provider on one hand, with the party paying the bills actually being two parties, the customer and the government. The service provider determines how much he needs to operate and the government unilaterally determines how much it's willing to contribute. The customer is left to pay the difference, tolerable or not. The commission has no authority over the government contribution. Thus, it is unable to 'consider the interests' of the customer. The customer is totally at mercy of the government. This is particularly the case with the BC Ferry Commission where the governing principles do not include any reference to, or means of, protection for the customer.

Considering each of the principles . . .

1. Financial sustainability – this principle is held to be paramount. But what does it mean?

   Does it mean avoiding bankruptcy, where the assets would be sold off and the business terminated, like NorTel or American Motors? Clearly, this would no more be allowed to happen than allowing BCTransit to suffer the same fate. BC Ferries (BCF) is an essential lifeline service, part of the transportation infrastructure of the province.

   Does it mean failing to meet its stated return on equity targets? BCF hasn't come close to meeting those for the past three years, and this year is going to be even worse. Yet the company seems to retain its credit rating, and business continues uninterrupted. Evidently, failure to meet ROE targets isn't related to sustainability. Further, there is nothing the Commissioner can do to alter this situation, priority or not.

   The Commissioner can set fare caps that, together with the Provincial contribution, should provide needed BCF funding. However, it's now apparent that when the fare caps, and resultant fares, exceed their respective tipping points, the law of diminishing returns kicks in. Traffic falls and revenue objectives are unmet. In the absence of additional funding from the Province, the Commissioner is powerless to alter this.

   At the end of the day, the Province has no choice but to assure that BCF, in one form or another, continues to operate. It's as vital to the province as the highway system. Financial sustainability, in this case, is a fictitious principle. Failure is not an option. Having it appear that financial sustainability is the responsibility of the Commissioner is misleading. If it was Rogers Cable, maybe. BC Ferries? No.

   Conclusion: This principle is a noble sounding collection of words, but without substance in this situation. The system *will be* sustained. Therefore, this principle should be deleted.

2. Adopt a commercial approach – Again, what does this mean, in this context?

   Does it mean, like Costco, drop the items that aren't profitable? Can't do that with committed core service.

   Does it mean, like Toyota, buy lots of advertising to win customers away from the competition, increase the market share? This is a monopoly; most of the customers are captive. A very few may opt for air travel. Discretionary customers seem to be more influenced by fare levels than by advertising as traffic continues to decline.

   Given that BCF is committed to a given core service level which is very close to the service levels that existed when the new structure was introduced, and

Given that BCF operates within a union environment with a long established collective agreement defining workers' rights, and

Given that BCF operates a fleet of vessels at various stages in their fifty year lives (long life assets), and

Given that BCF ventures into new revenue generating territory have been met with government reluctance to permit them, or with accusations that they are improperly competing, as a government-subsidized agency, with private, unsubsidized corporations, and

Given that if BCF undertakes a venture with some level of risk, and loses money, it comes out of the BCF bottom line. But if it makes money, BCF stands to have either fares reduced or the service fee reduced for the next performance term. Where's the incentive? And,

Given that BCF customers have built up businesses and life-styles based on existing service levels,

There isn't much room for BCF to adopt a 'commercial' approach. Better perhaps to adopt an 'efficient service delivery' approach, monitored by an appropriate audit program, and overseen by a board that cares about such things. Or by the Ministry. It's important to remember this is an essential lifeline service, operating in a regulated monopoly environment. While 'commercial' may imply greater efficiency to some, it's an almost empty word in this context.

Conclusion: It's a cliché that sounds good, but has little meaning in this circumstance or as a guiding principle for the Commissioner. It could be deleted without loss.

3. Alternative service providers – It appears, after several unsuccessful attempts to entice alternative service providers into the system, that BCF is a natural monopoly. There may be room for external service providers in unique situations, such as the passenger only service in Howe Sound or the cable ferry service to Denman Island. However, the car ferry business is fenced in by the high cost of vessels and terminals, and the need for back-up vessels in the case of refits or other reasons for vessels being unavailable for service.

   The pursuit of alternative service providers has been an expensive, time-consuming process for BCF, with nothing to show for it.

   Conclusion: The search for alternative service providers has been given a good shot. Time to accept it's not going to happen and take it off the list.

4. Encourage BCF to minimize expenses without adversely affecting core services – This assumes the Commissioner has the means to assess the appropriateness of all BCF's expenses. He doesn't. And the authority to deny them. It appears he may not have that authority. If BCF chooses, perhaps for good reasons, to reject his encouragement, what's left?

   Conclusion: With respect, this principle sounds like someone may have conjured it up believing it had a wholesome ring. However, it fails the 'why' test and the 'how' test.

5. Eliminate cross-subsidization from the major routes to the non-major routes – One has to ask why that is. Routes 1 and 2 subsidize Route 30. $24M last year and the year before. Route 3 subsidizes the Minor and North/Central Coast routes. The Major routes did, in fact, 'subsidize' the non-major routes for each of the last three years, and probably will again this year. This, despite the legislation saying it's to be eliminated within the first performance term (and presumably, thereafter).

   Within the performance term, there's nothing the Commissioner can do to prevent the cross-subsidization when it occurs as a result of traffic on the non-major routes falling below the break-even point.

   Going into a new performance term, the Commissioner can raise the fare cap on the non-majors, such that they should become self-sustaining. A reminder . . . the Commissioner has no authority over the Province's contribution, thus the only tool he has is the fare cap. The problem, which has been made clear up and down the coast, is that fares are already at barrier level. Raising them even faster will only increase the rate of traffic decline, creating a deadly inward spiral. While that's troubling for BCF, it's deadly for ferry users and ferry dependent communities.

   The bottom line is that ferry costs and revenues are dependent on geography and population distribution. The fact that one is financially stronger than another is a fact of life. For instance, Routes 5 and 9, serving the southern gulf islands, the lower mainland and southern Vancouver Island, receive substantial financial support. But consider that they serve five islands, with five staffed terminals; require one major vessel and two smaller ones; and carry a share of both Tsawwassen and Swartz Bay, expensive terminals from which to operate. They're expensive routes. Just like the road from Williams Lake to Bella Coola is expensive to maintain. If the SGI routes had to pay for themselves, the fares would be so high that they would collapse, as would the economies of the islands served. Same as would happen in Bella Coola if the true cost, including capital costs, of maintaining the road from Williams Lake fell solely on local residents.

   Conclusion: The 'no cross-subsidization' principle appears artificial and unenforceable. Given the rate of fare increases and the level of current fares on the non-major routes, this principle was doomed from the outset. More useful to set affordable fares on all the routes and subsidize where and as needed to restore at least some of the lost traffic, recognizing it won't all come back at once, and some will never return.

6. Greater user pay – This seems to have stemmed from the 2001 Wright Report that recommended substantial fare increases (without any reference to price elasticity). There appears to have been government perception of infinite capacity and willingness of customers to absorb higher, much higher, fares. Thus was enshrined in legislation the rather unique clause to encourage greater user pay so that the government contribution could be reduced.

   In fact, minor route fare revenue has increased 55% since 2003/04, while the provincial service fee has increase 4%. The 4% was the result of redistribution of service fee and federal grant money between the route groups, all within the fixed $92M basic service fee which has remained frozen since 2003/04.

   The ferry advisory committee chairs asked Ministry officials what was intended by 'greater user pay'. Did it mean 100%? Or was there some target percentage? They replied that they simply didn't know. As far as they knew, there was no target that they were aiming for.

   The chairs then asked by what means the Ministry would know that the greater user pay principle might have gone too far, to the detriment of British Columbians living on the coast and to the ferry dependent communities? Again, that appeared to not have been considered, as there was no mechanism suggested in the legislation. Specifically, the Commissioner had no direction to gauge, or to respond to, user or community distress arising from the greater user pay principle.

   As a result, Experience Card fares on Route 5 (Swartz Bay to the SGI) have increased 91% for passengers and 86% for vehicles since 2003. This route is predominantly used by island residents. It's their lifeline service. They commonly use the Experience Card. Route 9 (Tsawwassen to the SGI and Salt Spring) has seen fares increase 72% to 78%, depending on the day of the week. This service is predominantly used by visitors and part-time residents coming from the lower mainland.

   We believe the rate of fare increase, and the level to which fares have increased, have been the major causes of the consistent loss of traffic, year over year since 2005. The loss of traffic is a surrogate for the harm being suffered by the communities through loss of tourism, investment and employment.

   Conclusion: The vision of hiking fares in order to reduce the pressure on the government might have seemed reasonable at one time. Unfortunately there was no mechanism put in place to measure the impact of that vision. After eight years, with the last five of them showing consistent minor route traffic losses, it's time to take the temperature of the coastal communities and decide whether the principle has been taken far enough. We believe it's been taken too far. The initial promise of modest fare increases was abandoned at the starting gate, and has languished there ever since.

So, Question: What's missing?

Answer: Concern for, and protection of, the interests of ferry users and the coastal ferry-dependent communities.

How to balance that need with the financial interests of BCF?

Clearly, BCF needs assurance of adequate funding to safely and reliably provide the necessary service. They also need adequate committed funding to allow them to responsibly update and/or replace their vessels, terminal facilities and support systems as conditions dictate.

The users, and the government, need a means of assuring that BCF isn't operating inefficiently or pursuing inappropriate objectives (wasting money).

Both could fall within the domain of the Commissioner, but they aren't there now.

Finally, and critically, the users need to be able expect the modest and predictable fare increases that were promised in the beginning, and not delivered.

Our recommendation is that the six principles be replaced by one simple one:

Priority is to be placed on provision of safe, reliable and affordable ferry service.

This could be achieved by establishing government policy that fares would rise no more than the consumer price index, while making sure that BCF expenditures were reasonable and prudent. That assurance could be provided by the Commissioner, with a means of oversight through audits or other processes. This would contemplate a still relatively light hand, not the expensive regulatory process that seems to prevail in the telecommunications world.

The bottom line is that adherence to the six principles has allowed, even contributed to, fares running amok over the past eight years, causing significant harm, much of it irreversible, to coastal communities.

The focus needs to change back to the customer and to the damaged communities.

Response

to

BC Ferry Commission Discussion Paper #2

'Consider the Interests of Ferry Users'

from

the Southern Gulf Islands Ferry Advisory Committee

November 2011

SGIFAC Response
to
Discussion Paper #2, Considering the Interests of Ferry Users

Thank you for the opportunity to respond to this discussion paper.

In the words of Cheryl Wenezenki-Yolland, Comptroller General, in her October 2009 report to the ministers of Transportation and Infrastructure, and Finance . . .

> *While it may not have been the intention, this prioritization (*the sustainability of the ferry operator*) has resulted in the Commission taking a very narrow interpretation of the principles and the regulatory role. In particular, we would expect the Commission to focus as well on the sustainability of the coastal ferry system, balancing financial sustainability of the system with the needs of customers, the operators and the communities.*

The Comptroller-General referred to the needs of three parties – the customers, the operators and the communities. It appears the 2010 amendment to the Coastal Ferry Act overlooked the third party, the communities.

The SGIFAC maintains that the impact on the customers, the users, is quite different from that on the communities. The customer, whether a resident, a business operator or a tourist, can make the decision to travel less. Or not at all. Or to pack it in and move to the mainland. The community, on the other hand, is left to die the death of a thousand cuts as young people move away, businesses curtail their hours, or close their doors for good, and tourism diminishes year after year. We believe the government missed this point in crafting the legislation.

The fact that the legislation provides no tools to address the plight of the customer, or user, is a separate issue.

To the Discussion Paper . . .

1. **The "ferry user':** While we applaud the Commission's effort to broaden the definition of 'ferry user', we believe it's pretty simple. The 'ferry user' is the person who travels from A to B on the ferry. While many businesses and people within the community depend upon ferries to transport goods, services, customers or family members to and from the communities, 'depend upon' isn't the same as 'use'. Rather than trying to expand the interpretation of 'ferry user', we'd suggest better to expand the area of concern to include 'communities' as a separate and parallel focus. That second focus would include all the interests included in the Commission's first question.
2. **Ferry user interests** include the noted items: safety, affordability, predictability, timeliness, service quality, emergency preparedness. A principle element of

service quality would include vessel capacity. Another would be convenience of scheduling. The level of user interest will be inversely proportional to the degree to which the service meets customer expectations. If some sailings consistently overload, and those left behind have a three-hour wait, or their day is lost, vessel capacity will be the top-of-mind user interest. If safety is being well managed, it will be near the bottom of the list as a concern, as it's taken for granted.

That said, the unanimous area of most interest to ferry users on our SGI routes is 'affordability'. This had to have been made clear to the Commissioner during his visits to Galiano, Mayne, Pender and Saturna islands. Customer expectations had been for 'modest' fare increases somewhat in relation to other cost of living increases, which would have amounted to fare increases between 12% and 15% over the last eight years. 'Modest' was the Minister's word in 2003. Instead, SGI daily commuters to Victoria (and all other regular users) have seen fare increases of 91% for passengers and 86% for their vehicles. Part time residents, a substantial element of, and source of income for, our islands have seen their fares to and from the mainland rise by 72% to 78%. For a couple coming to the islands for a weekend, the cost has increased from $84.25 to $144.75, enough to make the recreational home owner make fewer trips and the casual visitor opt for a less expensive excursion on the mainland. The operator of a 35' commercial vehicle has seen his fare increase from $231.50 to $408.15, all of which has to be passed on to customers, which isn't always possible. The increase has been a game-changer for many island businesses.

Clearly, in terms of pressure points, *lack of affordability of fares is by far the greatest 'interest' of SGI ferry customers* at this time.

Financial sustainability of the ferry system is no more an area of interest to users than financial sustainability of the highways, local transit service or municipal water or sewer service. It's part of the infrastructure. Its continuance is part of the contract between citizens and their government. Financial failure, presumably the opposite of sustainability, would be viewed as gross failure by abandonment on the part of government. While BCF is characterized as a private company, most people know that the government owns it and backs it. They view the private company characterization as little more than a convenient accounting artifice.

3. **"Consider**" in the context of "consider the interests of ferry users" when applied to the regulatory role has to mean "consider the interests of ferry users in setting the fare cap". That has to mean the amount of the fare cap has to be able to be influenced by the concerns of the ferry users. Nothing less. And we know that the Commission presently has no tools to respond to the interests of the ferry users.

   A FACC observation . . . In the first meeting of the ferry committee chairs with the new Commissioner and the Deputy Commissioner, one of the chairs asked what became of all the letters solicited and received by the Commission with respect to PT3 fares. The reply was that Commission members read all of them. When asked it that was all, the reply was that each of the letters was acknowledged. Nothing more. We were shocked, disappointed and finally, embarrassed for the Commission that the exercise had been of absolutely no influence in setting the fare cap. All those people had wasted their time.

The Commission has little if any authority to trim the proposed expenses of BC Ferries and no authority over the government contribution. Thus, the shortfall between ferry costs and the government contribution falls totally on the customer. Presently, the Commissioner has no means of altering the impact on the customer. Any 'consideration' is strictly spiritual, and of only token value to the affected users.

"Consider" has to have *real* meaning, or it shouldn't be used.

4. **Balance between "interests of the ferry user" and "financial sustainability of the operator":** In the absence of official definitions of "the interests of ferry users" and "financial sustainability of the ferry operator", permit us to suggest the following:

- *interests of ferry users:* affordable, safe, reliable, predictable, meeting or exceeding the broad service expectations of its customers.

- *financial sustainability:* having sufficient assured funding to efficiently operate and maintain the system and to upgrade or replace critical assets on a responsible timeline.

If we were considering BC Hydro or Fortis BC, the commission would examine for reasonableness the internal and external cost drivers presented in support of a rate hearing application. They would conduct public hearings related to the application. They would strip out any claimed elements that they believed to be unnecessary. This would protect the public from having to support inappropriate expenditures. They would then turn the crank and determine the rate increases, having attended to the *balance* between corporate and customer interests. If the costs to the corporation were determined to increase at 5%, then the rates across the system would increase at 5%. Same in the SGI as in suburban Vancouver.

It's a different situation with BC Ferries' non-major routes . . .

BC Ferries presents its expense forecasts including an expected net revenue (profit) to create a return on equity. Using data from 2003/04 when the experiment began, there are two principal funding sources for the system – tariffs, providing 63% of the revenue and the Provincial gov't service fee, providing 18% of the revenue. As well, the customer base is divided into two groups – the 'profitable' major routes, generating 58% of the revenue, and the gov't-dependent non-major routes, generating the remaining 42%, which includes the provincial and federal contributions.

Fare increases are calculated separately for the major and non-major routes. For the major routes, the expense increases are spread over the whole tariff base. Thus, a 5% increase in expenses would generate a 5% increase in fares.

For the non-major routes, the tariff contribution amounted to 40% of revenue, while the provincial gov't contribution accounted for 43% of the revenue. The Province has chosen to freeze its contribution, with the result that the needed increase in expenses has been drawn from just the tariff segment. Thus, the same 5% increase in expenses would generate a fare increase of 12.5% ie 5% divided by 0.4, for fare-paying customers on the non-major routes.

That's the way it's been happening on the non-major routes for the past eight years, and the Commission hasn't had any means to address the rate of increase of these fare hikes, which in some cases now exceed 100% (Bowen, Texada, Gabriola, Denman, Hornby, Quadra Islands, as well as Skidegate to Alliford Bay).

Thus, we would contend that there has been no balance between the interests of the ferry user and the financial sustainability of the ferry operator. There has been an effort to attend to the financial sustainability of the ferry operator, while the plight of the ferry user has been ignored by the government and out of reach of the Commissioner. Clearly, the interests of the financial sustainability of the ferry operator have taken precedence, in line with the expressed intent of the legislation.

Our recommendation is that it shouldn't be an 'either – or' situation.

There needs to be assured financial support for the operator to provide a safe, reliable, adequate 'no frills' service. Just as with any other critical lifeline element of the provincial infrastructure such as hydro or highways.

On the other hand, there needs to be government policy, that the Commissioner can rely upon, to maintain fare increases at a reasonable, affordable level. If that means increased government contribution to address extraordinary expense increases such as the examples following, then so be it.

The two interests shouldn't be placed in conflict.

Two examples of extraordinary expense increase and related fare impact with SGI connection . . .

1. **Intermediate vessel replacement:** The *Queen of Nanaimo*, serving route 9 between the lower mainland and the SGI, and the *Queen of Burnaby,* operating route 17 between Powell River and Comox, are 47 and 46 years old, respectively. They are both scheduled to be retired and presumably replaced within the next four or five years, at a cost in the area of $125M each, or $250M total. That capital cost would generate annual costs of about $25M, which would need to be recovered from minor route tariff revenue, presently about $77M. That $25M would require a 32% lift in fares across the whole minor route system, over and above normal increases, if it were to happen today. Allowing for anticipated tariff and revenue increases between now and then, purchase of those two vessels, on the backs of customers, would still add fare increases in excess of 20%.
2. **Smaller vessel, bad fit to route:** The *Queen of Cumberland* is a nineteen year-old, smaller vessel, serving route 5 between Swartz Bay and the SGI. It has two major problems on this particular route. The first is that it has insufficient power to keep on schedule while travelling through Active Pass, making it chronically late. The second is that it has ramps that need to be deployed at any of its various ports of call to accommodate heavier loads. Operating on a multi-port schedule, the ramps may be needed at any of the stops en route. Once the lower decks are loaded, the ramps cannot be deployed. Deploying the ramps, loading and unloading, adds approximately twenty minutes to a trip, again, making the vessel chronically late. Lacking insufficient power to make up lost time, a single late arrival or departure blows the schedule for the whole 8-hour shift. It also tends to cause the vessels with which it connects and/or shares terminals (the *Nanaimo* and the *Mayne Queen*) to also be late.

   The result? Route 5 had budgeted 2010/11 overtime of $737,000, or 18% of the total corporate overtime budget and the highest of any of the minor routes. Next highest was route 9 at $648,000, caused in part by the route 5 problems. There were only three minor routes that exceeded a $300,000 overtime budget. As well, route 5 consistently has the worst on-time performance of any route in the system, despite the fact that the *Mayne Queen,* which shares the route with the *Cumberland*, is generally on time.

   The *Cumberland* is clearly a costly misfit, providing hugely compromised service in its current application.

   So, what to do?

   Leave it in this service for the next forty or so years until it's eventually retired? As far as we can tell, that's the plan.

   Shift it to a less demanding route, replacing a smaller vessel, and replace it with a more suitable vessel? That's been proposed by the SGIFAC, but would carry a hefty price tag, raising fares substantially across the whole route group. Idea not well received by BC Ferries.

Whether to endure the situation, or to fix it, entails extraordinary costs that one way or the other are carried on the backs of the ferry users.

Under existing legislation and established government policy up until May of this year, there is no relief in sight, no consideration for the interests of the ferry user.

This needs to be corrected, and now.

Response

to

BC Ferry Commission Discussion Paper #3

'Financial Sustainability'

from

the Southern Gulf Islands Ferry Advisory Committee

November 2011

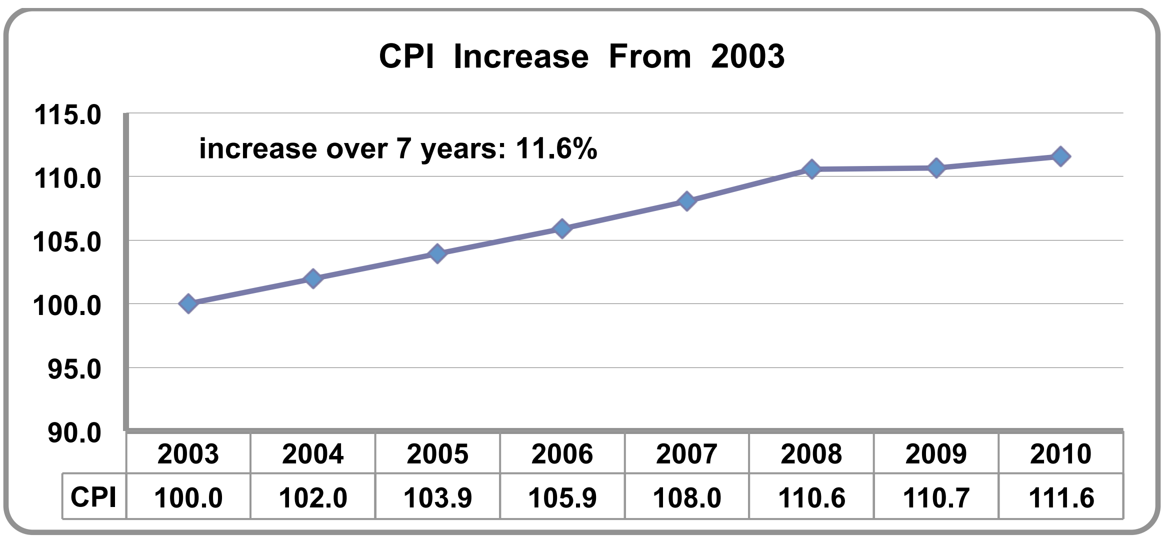
SGIFAC Response
to
Discussion Paper #3, Financial Sustainability

Thank you for the opportunity to respond to this discussion paper.

We would be delighted to endorse BCF sustainability according to the generally accepted definition:

> *Sustainability is achieved when service and infrastructure levels are delivered and maintained according to a long-term plan without the need to increase rates other than for inflation.*

Unfortunately, the BCF situation includes a major wrinkle. The legislation decrees that the minor route user shall pay an increasing share of the ferry expenses so that the Province may pay less. Accordingly, the Province has frozen its basic service fee at $92M since 2003, while the minor route (including SGI) customers have seen average fare increases over 70%, with several fare increases in excess of 100%. Meanwhile, the Vancouver CPI has increased just 11.6% from 2003 to 2010.



	2003	2004	2005	2006	2007	2008	2009	2010
CPI	100.0	102.0	103.9	105.9	108.0	110.6	110.7	111.6

The minor route customer fares have been burdened with astronomical increases in fuel costs, added crewing costs (updated Transport Canada requirements), unexpected and unbudgeted HST costs, unexpected fuel carbon taxes and substantial capital cost increases, all in addition to the normal inflationary increases. The Province has declined to absorb any of these unanticipated expenses, or to waive the need for BCF to pay those imposed by the Province.

To be clear, the SGIFAC supports BCF being assured of necessary funding to provide safe, reliable service, including updating and replacement of critical assets on a timely basis. The caveat is that the company should be required to demonstrate that it is making the most efficient use of available funding. That's our view of financial sustainability of the operator, without reference to the source of that funding.

To the specific points . . .

1. *Is the generally accepted definition of financial sustainability appropriate for BC Ferries?* It should be, but it clearly hasn't been applied. If the generally accepted definition had been the test of sustainability, the model would have failed miserably to meet it. As we understand it, there have been major delays in the ministry-BCF decision making process, forcing expensive life-extension expenditures on ferries that should more properly have been replaced as they reached the end of their economic lives. BCF has not come even close to meeting its ROE targets any year in PT2, and is expected to show a negative ROE this year.

   The critical, and hugely more important failure, however, has been the relentless astronomical fare increases imposed on minor route customers.

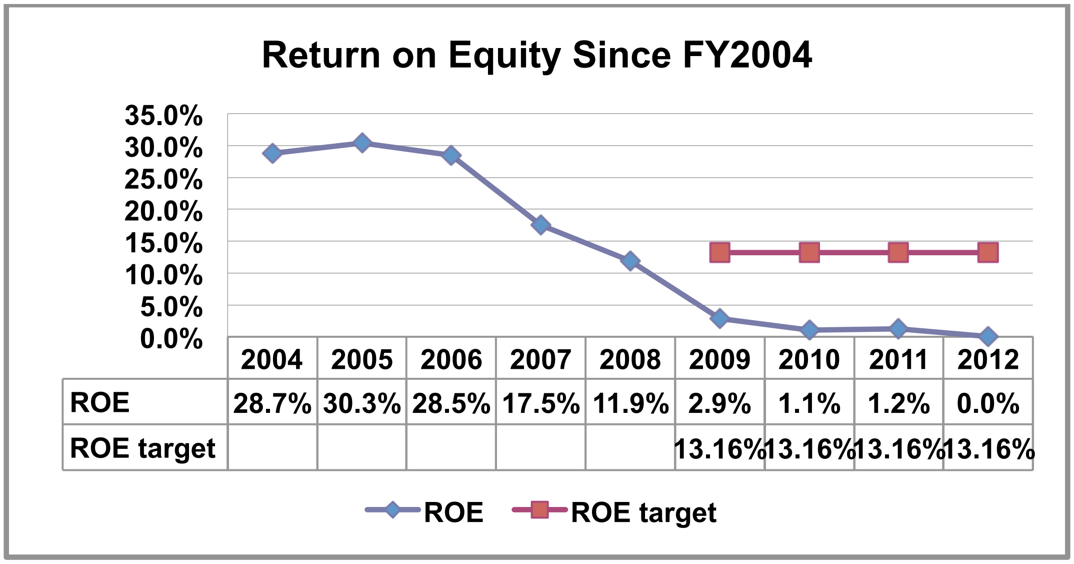
   Despite the Ministry assurances at the outset that fare increases would be 'modest and predictable', the real intent was defined in the legislation that set priority on increasing 'user pay' so the government could pay less. That intent has been amply satisfied, establishing the value that could be placed on the early Ministry statements.

   As the generally accepted definition includes 'without the need to increase rates other than for inflation', it is clear the Province never intended the model to meet that generally accepted definition for sustainability. As minor route fares have leapt skyward to their present barrier levels, traffic on these routes, including the SGI routes, has consistently diminished since 2005. Traffic levels have proven to be unsustainable given the rate of fare increases over the past six years. At the current level of fares, traffic is doomed to continue its downward slide, even if fares were frozen today.

   Is the generally accepted definition of financial sustainability appropriate for BCF? It should have been, should be. However, the reality is light-years away from it.

2. *Appropriateness of regulated ROE in establishing fares:* We can appreciate it may be necessary for BCF to show a respectable rate of return as they go to the bond market to borrow money. We're not in a position to comment on what constitutes an appropriate ROE. We note however that the actual ROE has fallen well below expectations for the past three years, and will likely be negative this year. Yet BCF has retained it stellar bond rating. It might be worth looking into the actual connection between ROE and the cost of borrowing.

   It's of interest that the Commissioner is without means, other than increasing the fare cap, to do anything about BCF failing to meet its 'regulated' ROE.



3. *Alternatives to address financial sustainability of BCF while providing affordable service for ferry users:* The objective as stated is inconsistent with existing legislation that sets no priority on affordable service. However . . .

   Some suggestions:

   1. Have the government refocus its attention on the interests of the user and the ferry dependent communities as one of two primary objectives, along with the second, financial sustainability of BCF in the cost-efficient provision of *basic*, safe, reliable service.
   2. In the short term, recover some of the traffic and credibility that's been squandered over the eight years, through a substantial government-funded fare roll-back in the order of 30%.
   3. In the longer term, establish as government social policy that ferry fare increases will be monitored for affordability and will not exceed CPI increases. That would include whatever means necessary to assure that BCF is making efficient use of available funding, sticking to their core business – transport of people and vehicles. The ferry system is the backbone of our coastal communities. They prosper or perish depending on service and fare decisions taken in Victoria.
   4. Have a look at the CalMac system in Scotland where the government has provided sufficient funding to keep fare increases within CPI. As well, the government recognized that steep ferry fares had been choking the financial and social life of the ferry dependent communities. As a result, the government introduced and financed a road equivalent tariff (RET) trial on selected routes in 2008. The program has generated dramatic traffic increases, with corresponding new hope injected into the communities. *The key is the Scottish government recognized there was a problem and addressed it. That's what's needed in British Columbia. The rest is detail.*

Response

to

BC Ferry Commission Discussion Paper #4

‘Regulatory Balance;
BCF and Ferry Users’

from

the Southern Gulf Islands Ferry Advisory Committee

November 2011

SGIFAC Response
to
Discussion Paper #4, Regulatory Balance; BCF and Ferry Users

Thank you for the opportunity to respond to this discussion paper.

This response will include some repetition of opinions previously expressed.

The SGIFAC believes there should be two primary objectives around BCF.

- financial sustainability of the service provider and
- affordable fares for the users in support of financial and social sustainability for coastal ferry dependent communities.

Both must be treated with equal importance.

Presently, there is only one objective: financial sustainability of the service provider. Concerns for the users, and the communities in which they live, aren't identified objectives of any stature – primary or secondary.

Again, the Commission is hobbled by this unusual three-party format. BCF delivers the service and spends the money. The provincial government contributes as much or as little as it chooses to support the operation of BCF. The system customers pay whatever is needed to make up the shortfall between the approved expenses and the government contribution. In the absence of any material control of BCF expense projections and any control at all of the provincial government contribution, the commission is powerless to influence the affordability of fares for the customer. By extension, that includes the viability of our coastal communities.

It's unfortunate, but it's the way it is.

The Province has been able to dump excessive cost burdens on ferry users, and they've been doing so for the last eight years. The ferry users, the coastal communities and the province as a whole have paid a steep price for the government indifference to steeply rising fares.

To the questions . . .

1. *What can the commissioner do to ensure consumer protection?* Realistically, nothing! At least, not under the present legislation.

   Theoretically, he could reduce the approved expenses of BCF, but that would shortly lead to BCF inability to provide service and/or to undertake a responsible capital program. Gone, their sustainability, and that can't be allowed to happen. Even then, the government could claw back any reduced expenses (or increased revenues) of BCF. The user wouldn't necessarily be the beneficiary.
   Or he could direct major service cuts on the minor routes, which would save some money, but not in equal measure to the loss of service. Again, this is not a viable

option, as communities have built their lives and businesses around existing service levels. Substantial service cuts would not be consistent with consumer protection.

2. *Is a tiered approach the most appropriate for BCF regulation?* Probably, but it would require two primary objectives, financial sustainability of BCF and the interests of the consumers. The commissioner cannot attend to the interests of the consumers as long as the government has the means (adjusting the service fee) to over ride any action he might take.

   As to secondary objectives, those are served at the pleasure of the government (tourism, investment, environment) or of the operator (labour relations, public image, quality of service). They are largely out of reach of the regulator, or regulator involvement would unduly impinge on the operator's opportunity to manage the affairs of the company. The commissioner should not be engaged in micro-managing operational issues.

3. *What should the primary and secondary duties of the regulator be?* Under the current legislation, the commissioner can try to ensure the financial sustainability of BCF. He can encourage BCF to operate efficiently. He can, if he chooses, recommend that the government adjust the service fee. He can monitor the 'average fare' vs the fare cap, making sure that it doesn't exceed, on a sustained basis, what's been permitted. He can ensure BCF delivers the core service stipulated in the contract.

   Thus, the commissioner has a single primary objective – financial sustainability of BCF. Protection of the interests of the users is so minimal that, at best, it might be regarded a tertiary objective, if it could be considered an objective at all.

   There is a wild card, not yet played, in the mix. BCF points to the legislation and tells us they have no obligation to commit to what they believe the traffic will be for a performance term. That appears to be the case. Then, if the traffic, and with it, the revenue, fails to materialize, they can apply under Section **42** (2) (c) for an extraordinary fare cap increase arising from an 'unanticipated and extraordinary change in traffic levels'. The commissioner would be under substantial obligation to grant such an application, given his primary objective is the financial sustainability of the operator. If the government chooses to not participate, as it has with all the other minor route fare cap increases, then the added costs will fall once again entirely on the user. BCF hasn't played this card (yet) but it's within their rights to do so.

   Further with regard to government control of fare outcomes . . . If BCF undertakes to improve their bottom line through an investment or change in service that involves some risk, they have no assurance they will get to keep the rewards if the venture succeeds, but they will surely get to keep the losses if the venture fails. The Province has the authority to claim any benefits, reducing the service fee accordingly, for the next performance term. Whether they would or would not do it is unknown. What *is* known is that they hold all the cards and *can* do it.

A similar situation applies to reduction or alteration of service to reduce costs. This would almost certainly involve pushback from customers and employees.

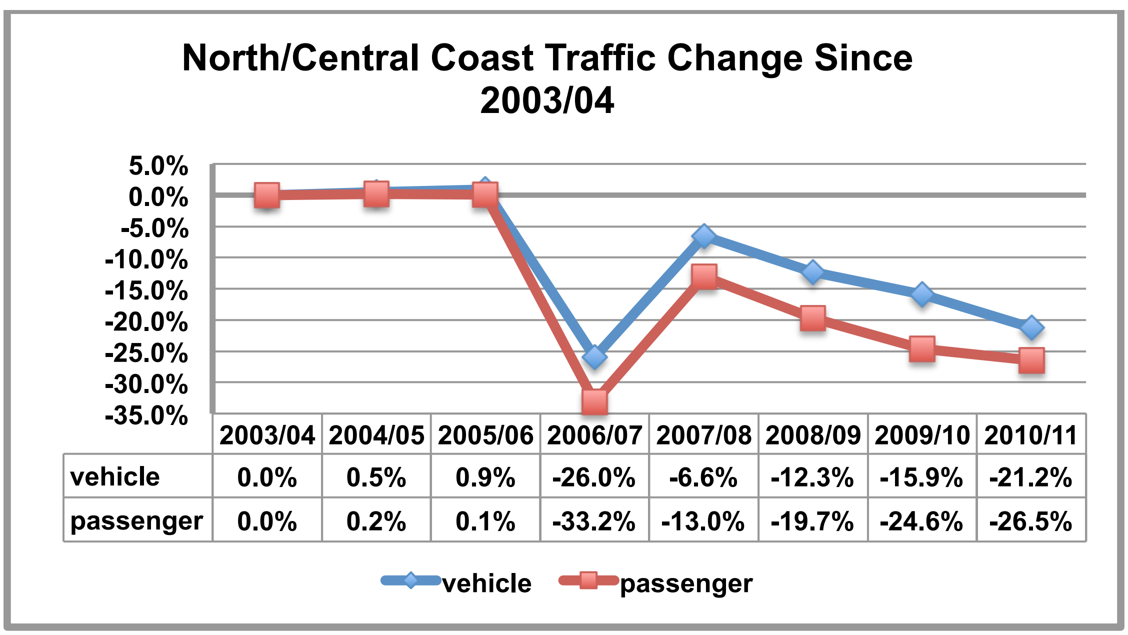
Would the customers get to keep the benefits of the lower costs ie lower fares? Maybe.

Would BCF get to keep the benefits? Maybe.

Is there any assurance the government wouldn't claw back the savings at the next performance term? No.

The result is that there is little motivation for the company to take any risk or venture into unpopular areas to improve their bottom line. By the same token, there is little motivation for customers to give up service in hopes of seeing lower fares. This is all due to the government having carte blanche control over its contribution level, beyond the influence of the commissioner.

As well as holding the contribution card, the government also holds the approval card. The Coastal Ferry Services Contract between the Province and BCF is tightly prescriptive. Any changes, even on a trial basis, such as the BCF proposal to extend the Port Hardy to Prince Rupert trip into Tsawwassen once every two weeks in the summer required an amendment to the contract. The Province, reacting to political pressure, denied BCF the opportunity to make the change. Meanwhile, the northern route continues to hemorrhage traffic and revenue.



	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
vehicle	0.0%	0.5%	0.9%	-26.0%	-6.6%	-12.3%	-15.9%	-21.2%
passenger	0.0%	0.2%	0.1%	-33.2%	-13.0%	-19.7%	-24.6%	-26.5%

4. *What alternative approaches are appropriate?* This regulatory arrangement is unlike any under the control of the BC Utilities Commission, in that the government is one of the funding parties and reserves the right to contribute as much or as little as it chooses. As long as that situation prevails, the commissioner will have no ability to

‘protect the interests of the user’ or, by extension, ‘those of the coastal communities’. It is the view of the SGIFAC that the Coastal Ferry Act was created to give the illusion of the government no longer being involved in ferry matters, while in fact providing a means for it to pass all future increases, including the cost of replacing an aged fleet, on to the customers. In creating the commission, the government attempted to create the appearance of an independent party that would be protecting the users with respect to fares and service.

In fact, it has become apparent to all that the government has everything to do with fare levels, with the commission handling the arithmetic and making sure the average fare doesn’t exceed the cap. The commission may have the ability to make recommendations regarding service fee levels. But that’s advisory – what we do, but from a higher perch – not regulatory.

The bottom line is that the government controls fare levels. At the end of the day, the government is, and will remain, in control of, and accountable for, affordability of ferry travel regardless of what the commission tries to do.

Response

to

BC Ferry Commission Discussion Paper #5

'Price Caps'

from

the Southern Gulf Islands Ferry Advisory Committee

November 2011

SGIFAC Response
to
Discussion Paper #5, Price Caps

Thank you for the opportunity to respond to this discussion paper.

We apologize for some unavoidable repetition of points offered in our previous responses. We'll try to keep the repetition to a minimum.

The distortion induced by the provincial influence will be left aside for the moment.

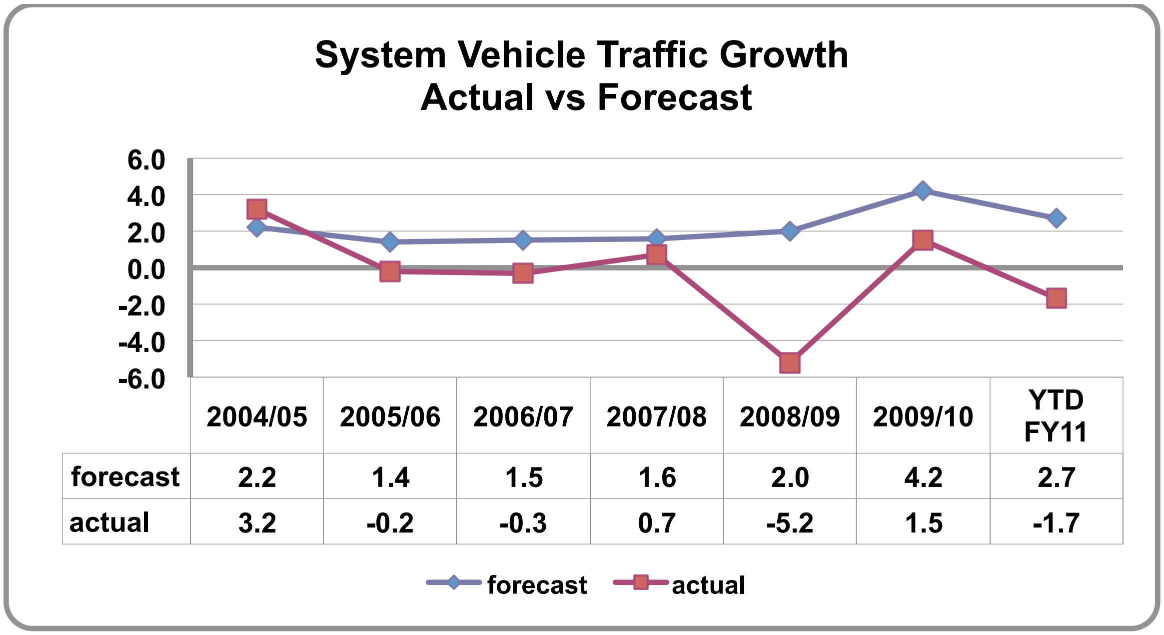
We understand the idea behind the price cap approach. Among its benefits, it gives the customer some certainty as well as protection with respect to anticipated fares. It's not complete certainty, as there needs to be room to accommodate exceptional circumstances.

In the ferry model, it's a matter of BCF forecasting as well as they can what their expenses will be, with the price cap then established to deliver sufficient revenue to meet those expenses. By its nature, the process will incent BCF to generate as much revenue as they possibly can within the price cap. The cap becomes the target, not just the maximum.

The process that has evolved for managing fuel prices works well. In the absence of any flex, BCF would reasonably budget for the highest possible fuel prices, building them into the fare cap. If fuel prices turned out to be lower than expected, then BCF would profit at the expense of the over-charged customer. However, the way it works, BCF budgets for reasonable fuel price growth. If fuel prices exceed the budgeted unit cost, the customer pays for the excess. If prices are lower, then the customer gets a rebate. The deferral account is targeted to be zero by the end of the performance term. If it isn't, then the adjustment is made in the next performance term. It all works.

The yet-to-be-tested process for adjusting for traffic variances is less defined. The legislation, Section **42,** allows for a fare cap increase in the event of "unanticipated and extraordinary changes in traffic levels". It appears that if BCF underestimates traffic levels when the fare cap is set, they can come back and ask for a fare cap increase to capture the revenue lost with the lost traffic. We'd want to see a definition of "unanticipated and extraordinary" prior to such a request being made. The point is that BCF has chronically overestimated traffic while they've consistently denied the magnitude of the impact of fares on traffic (see the graph below). We, along with other members of the public, would see as "readily predictable" the traffic losses to date that BCF would likely call "unanticipated".

One solution to deal with the traffic forecasting challenge would be something like the fuel price adjustment process. BCF would make their best assessment of future traffic and the fare cap would be set accordingly. If traffic was less than anticipated, there could be a formula providing for a surcharge to make up for lost revenue. Conversely if there was more traffic than anticipated, passengers would receive a rebate. There is, however, a major problem with this approach. We contend that the high fares are the dominant factor in the traffic losses. If the response to lost traffic is even higher fares, then it becomes a vicious circle at the expense of the fare-paying customer and the ferry-dependent communities already dying the death of a thousand cuts. We are not recommending this type of adjustment process. That said, something *does* need to be done about the traffic variable that's fundamental to setting the fare cap.



	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	YTD FY11
forecast	2.2	1.4	1.5	1.6	2.0	4.2	2.7
actual	3.2	-0.2	-0.3	0.7	-5.2	1.5	-1.7

Fare caps and fare increases: One of the little understood elements of the fare cap process is that the fare cap doesn't necessarily mean the increases that people might actually see. *Any or all of the fare increases can legally exceed the fare cap*. The fare cap sets the limit for the 'average' fare, which is all the fares combined in a route group. That presumes a given mix of pedestrian, bicycle, car, truck and commercial traffic. If that mix changes, the average fare can drop below the fare cap. For instance, if there is a migration from vehicle to passenger traffic (as there has been), then the average fare will drop. If there is a migration from cash fares to experience card fares (as there has been), then the average fare will drop. The result is that BCF is then allowed to increase fares at any time to close the gap. While they typically don't increase fares between first of Apr adjustment dates, they've made it clear that they can if they so wish. The most recent data available (Dec 2010) indicates a minor route trend to a widening gap between the fare cap and the average fare, making the minor routes vulnerable to either an interim fare increase, or a fare increase in excess of the notional 4.15% in April. All quite legal.

We recommend that the published fare cap be the real cap for fares, and not necessarily for the 'average' fare cap. This would place the responsibility on BCF for getting the mix right, and acceptable to the Commission, going into the fare cap process each term. Too high a proportion of foot passengers and experience–card fares in the fare cap calculation could result in the cap being too high, and passengers being over-charged. Assumptions of too high a proportion of high paying traffic could leave BCF short-changed.

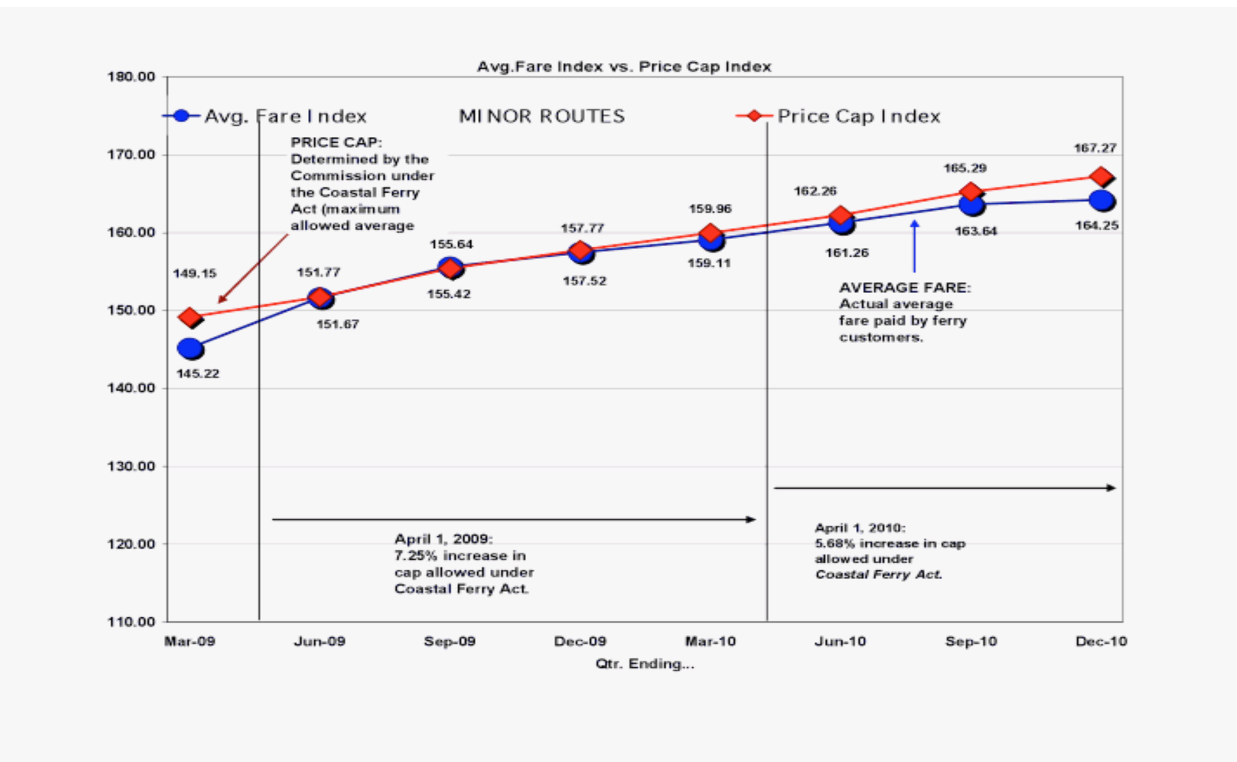
Our major concern, however, is exposure to fare hikes in excess of those that are expected. This is, we believe, is a result of the barrier level fares.

The move to a higher proportion of passengers is the result, in part, of more people using the parking lots or public transit and travelling on foot onto the ferries. This shift is clearly pronounced on the majors, the minors and the system totals. The FY2012 YTD minor route numbers to September show a 2.86% decline in passenger traffic and a 3.35% decline in vehicle traffic.

The trend to a higher proportion of experience-card fares is the result of the cash customers, usually the discretionary travellers, staying away, while the experience card customers are usually island residents, with less discretion about when to travel.

We see both trends continuing as long as fares stay at or above present levels.

The twelve-month shroud:



Each of the data points represents a rolling 12-month period, in order that there shall be no seasonal peaks and valleys. Makes sense. However, if there is some substantial short term or single point external input into the data – usually an accounting adjustment

– the average fare is out of whack for the four quarters, not one. Essentially, the regulatory tool is blind for the year. This has happened on a number of occasions and is subject to happening again.

Two recommendations:

1. *The average fare data should be limited to what the actual fares really are, and external accounting adjustments should not be allowed into this regulatory tool. Their propriety under GAAP rules does not legitimize their disabling of the regulatory tool, and*
2. *There should be, in addition to the rolling 12-month results, quarterly results so that any anomalies that do occur aren't allowed to disable the tool for a whole year.*

Audits and reviews: The SGIFAC would recommend that value for money audits be done more regularly as part of a regular audit program rather than just once every four years. We would like to think that such expenditures as the $900,000 recently spent on cosmetic upgrades on the 46-year old *Mayne Queen* in the name of 'product branding' could be challenged before they were undertaken. A recent similar $2.6M cosmetic 'branding' expenditure on the *Queen of Cumberland* amazed local travelers who viewed the work as totally unnecessary, especially in these days of draconian fares and failing traffic.

We agree with the 'regulatory light' approach as financially appropriate given the cost of the commission is paid for by BCF out of our fares, on top of the BCF costs of responding to whatever regulatory system is in place. That said, the commission needs the authority to assess BCF expenses in the broad picture, with the accompanying authority to rule expenses deemed inappropriate, unacceptable for inclusion in setting the fare cap. We have read the BCF challenge to the Mar 31 preliminary fare cap decision. It's clear the commission authority needs to be clarified and probably strengthened.

The elephant in the room, however, is the same pachyderm that dominated the previous responses. The government's complete freedom to unilaterally set the service fee, and their track record of freezing their basic contribution at $92M for the past eight years have made any other discussions of secondary importance. Crippling fares, as you know from your tour, is the top-of-mind issue in all the coastal communities, including in our SGI.

Discussion paper #5 refers to "In some price cap systems, the cap is set at inflation, less a provision for efficiency gains expected to be achieved by the firm." SGI residents can only dream of such a system. The Commission's current fare step chart indicates an 80% average fare hike for minor route customers since 2003/04. Inflation in that period is under 12%. Therein lies the elephant.

Ironically, the problem is not with the structure, but with the government's iron resolve to leave all the heaped cost burdens, including some of their making (HST, carbon tax), on the fare-paying customer. Had the government adjusted the service fee to help with the unforeseen ferry costs, it's likely we wouldn't be having these discussions today.

Capital costs and the fare cap: As you note, some fare caps are adjusted to accommodate the costs of capital investment. The BCF cap is one of those. We believe the government should increase the fare cap to cover capital costs, as they did with the northern routes, when BCF purchased the *Northern Adventure* and the *Northern Expedition* and upgraded their terminals. This would go beyond just new vessels and would include terminal upgrades, refits and support systems (information technology, maintenance), whose costs are presently attached to the route groups and included in the fare cap. These peripheral capital costs have been largely responsible for driving the annual capital costs applied to the minor routes since 2003/04 from $18.3M to $34.6M, with only one and a half new, smaller vessels introduced to the routes.

Bottom line: the fare cap process makes sense but in the case of BCF, it is terminally distorted due to the governments' commitment to making the user pay more, a whole lot more, without regard to the consequences.

Response

to

BC Ferry Commission Discussion Paper #6

‘Price Caps:
One or Multiple?’

from

the Southern Gulf Islands Ferry Advisory Committee

November 2011

SGIFAC Response
to
Discussion Paper #6, Price Caps: One or Multiple?

Thank you for the opportunity to respond to this discussion paper.

This is an interesting question. Thank you for asking it.

It is our understanding that in the beginning, the crafters of the legislation wanted to have every route stand independently. Zero cross-subsidization.

BCF management argued that twenty-five freestanding financial entities would be an administrative and public relations nightmare. Allocation of the service fee and adjustments of the price cap would be dependent on vessel replacements, major refits and terminal upgrades as well as the normal variables. The argument for route groups prevailed. Cross-subsidization within route groups was now acceptable.

The Coastal Ferry Act, Section **40** (2) (c) refers to ". . . what the price cap will be for each route group . . .". However, in the initial performance term, the legislation specified that all six non-major route groups would have a common fare cap. No separate caps for each route group. This common grouping was continued at the direction of the Province into PT2 and PT3. Thus the notion of separate fare caps for each route group appears to have been no more than a notion. Cross-subsidization between the non-major route groups is now the norm.

So, it comes to two price caps, one for the majors and one for the non-majors, the routes that rely upon government contribution. The results are illustrated in Attachment 1, with average major route fare increases since 2003/04 about 45% and average non-major route fare increases between 75% and 80%. The non-major route averages hide the fact that several fares on the non-major routes have increased over 100%.

The SGIFAC believes, without reservation, that three things need to happen:

1. *that existing minor route fares should be assessed for reasonableness after eight years of crippling increases and adjustments made where necessary, and*
2. *that future increases should be no more than the rate inflation, and*
3. *those increases, as well as any fare surcharges or rebates, should be common across the whole system.*

Consider:

1. Fortis BC has just this week applied for rate revisions that would result in 'common rates across BC for its various customer classes'. It states that presently "Annual average gas bills for customers on the Island, Sunshine Coast and Whistler are about 45% higher than what a comparable customer in the Lower Mainland pays – economies of scale make it cheaper to deliver gas to

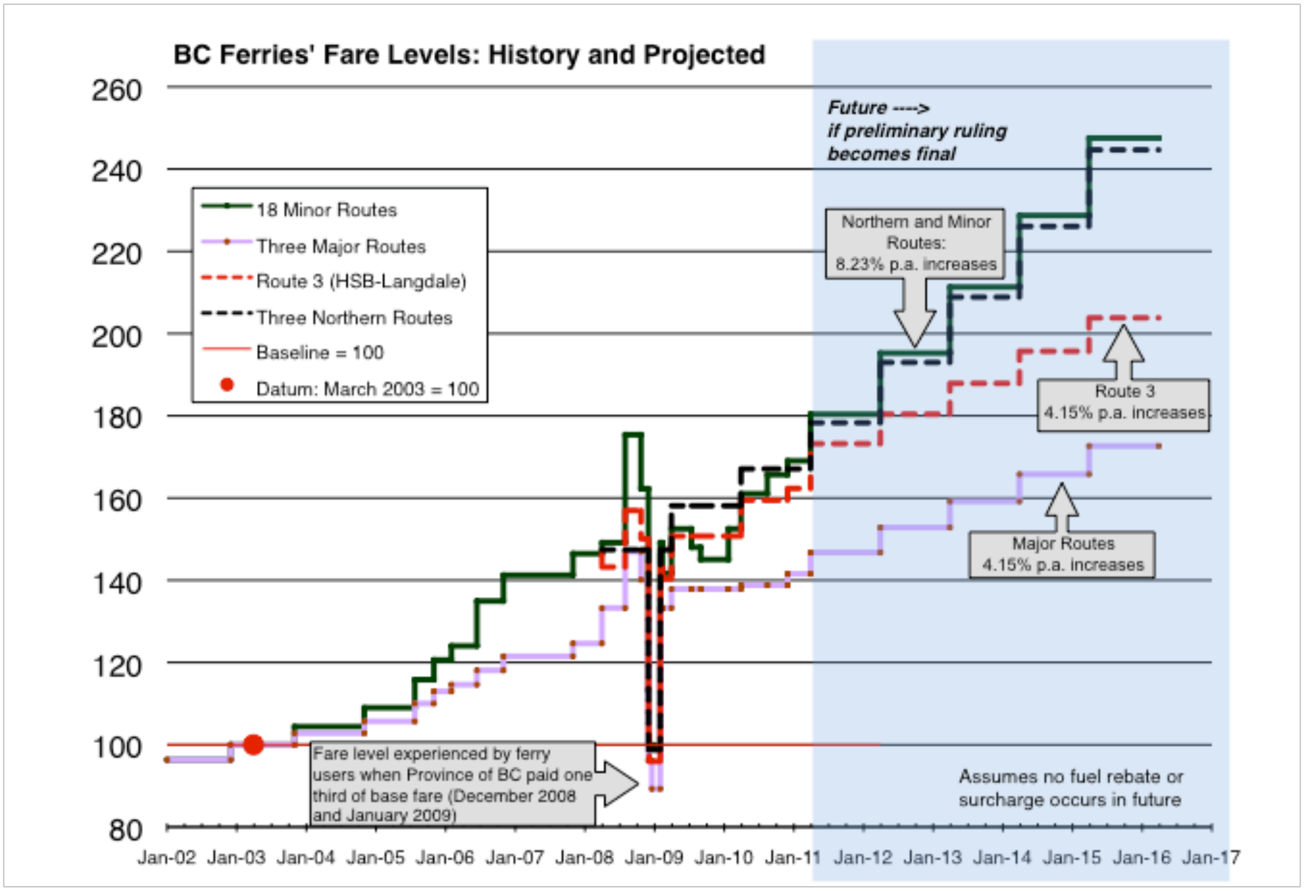
most other delivery areas." To achieve this, 'bills in the Lower Mainland would go up less than $3 a month' while substantially reducing costs in the less populated areas. As an essential service monopoly, Fortis sees the obvious moral imperative to provide equitable treatment to all their customers. We are not seeking common fares across the system, but we *are* seeking common percentage fare increases across the system. We don't accept the argument that the higher density, more profitable routes should receive preferential treatment on a route group basis any more than more profitable routes should receive preferential treatment across the non-major route groups or within the major route group.

2. When BC Transit and TransLink increase their fares, they don't have smaller increases on the major routes and larger increases on the suburban and owl routes. They all receive the same percentage increase. Otherwise, the higher cost, lower volume routes would quickly fall into disuse, and the losses would be even greater until the route would be abandoned, at great loss to the traveling public.
3. There is a sense that the provincial gas tax, which is the same throughout the province, is the major funding component for the maintenance and repair of the provincial highway system. Following the BCF model, the citizens of the Peace River Area and the Kootenays would pay substantially higher fuel taxes than residents of the Lower Mainland and southern Vancouver Island (higher density, no mountains, mild winters, no lake crossings, shorter distances). Such a proposal would die an instant death. It's one province, one highway system and one common funding source. Like the ferries, it's a lifeline connection between communities and needs to be treated as such.
4. When BC Hydro applies for rate adjustments, it's our understanding that those adjustments are applied uniformly across the province, despite the fact that the margin per customer is many time higher in Vancouver than it is in Vanderhoof. Again, it's a lifeline service providing equitable treatment to all its customers.
5. The SGI shares terminals with Rte 1 (a major route) in Tsawwassen (Rte 9) and Swartz Bay (Rte 5). The capital costs of those terminals and any capital projects on them are shared between the minor and major routes on the basis of vehicle throughput. The major costs result from the double deck, two lane approaches and loading equipment for Rte 1, while Rte 5 uses ground level, single lane ramps, and Rte 9 uses ground level, two lane loading. So, the big expenses are for the embedded and new facilities for the major routes, which derive the major revenue, while the costs are shared strictly on a vehicle count basis. With the disparate fare caps, it feels to gulf islanders that they are subsidizing the major routes, as they carry much more than their share of the capital costs. This is an issue as the fare caps are based on the perceived capital and operating costs for each route group.
6. The SGI connects via Swartz Bay to Tsawwassen using through fares. There is an overarching question about equitable distribution of the fare revenue and fuel surcharge revenue between the major and minor route groups. At the very least, this has to be a complex accounting process, with the results frustrating both the major and the minor route groups.

It boils down to this . . .

Ferry route profitability is a product of geography and population distribution. Once the Province committed to providing affordable ferry service to the coastal communities, allowing them to grow and prosper, they'd entered into a moral contract to sustain that service, not changing the rules as it pleased them. This is one province, one ferry system and one coastal community. The punishing separation into 'have' and 'have-not' routes has had a crippling effect on the small communities up and down the coast and needs to be fixed. That means the provincial government providing even-handed funding to make the whole system affordable and reliable. One fare cap.

Attachment 1.



Response

to

BC Ferry Commission Discussion Paper #7

‘Alternate Service Providers’

from

the Southern Gulf Islands Ferry Advisory Committee

November 2011

SGIFAC Response
to
Discussion Paper #7, Alternate Service Providers

Thank you for the opportunity to respond to this discussion paper.

We see the issue of alternative service providers from two perspectives, the local SGI service viewpoint and the broader corporate one.

First, the local situation . . .

The SGI area is served by two vessels out of Swartz Bay on Rte 5, and one out of Long Harbour on Rte 9. A second vessel out of Tsawwassen is added to Rte 9 to accommodate additional summer demand. As well, replacement vessels are required when any of the three vessels are out of service for refit. The three, and sometimes four, vessels have interconnecting schedules, as well as having to coordinate use of the same berths on the four islands they serve. As well, the terminals on all four islands need to be staffed to sell tickets to Tsawwassen or for inter-island travel, as well as to manage traffic bound for multiple destinations. Rte 9 offers free reservations, as demand exceeds capacity on busy weekends, and waiting for the next ferry isn't an option. Finally, due to the infrequent Rte 9 service, BCF provides the option of connecting through Swartz Bay via Rte 1 and Rte 5 at the cost of the same trip on Rte 9. It's hard to imagine a local ferry service being much more complicated and interwoven with various BCF resources (vessels, sea- and land-based staff, local and major terminals, reservation system).

If an alternate service provider were to take over the SGI service with his own vessels, the first question to arise would relate to backup vessels to cover for refit absences. Presently, BCF uses the *Bowen Queen* as the refit replacement for the two vessels on Rte 5 as well as for vessels on several other routes. Additionally, the *Bowen Queen* provides the supplementary service on Rte 9. The Rte 9 refit replacement has been the *Queen of Burnaby,* borrowed from Rte 17, and replaced there by the *Queen of Chilliwack* in its off-season from the Discovery Coast service. Short of trying to charter vessels as needed from BCF, it would be difficult for an alternate service provider to access such short-term capacity on either route.

Beyond the vessel issue, it would seem to be a formidable challenge hooking into BCF resources – terminals, reservation system, revenue sharing and such. *The SGIFAC cannot see even considering an ASP for either or both of the SGI routes.*

To the bigger picture . . .

We find it surprising, your comment that "There is currently no established methodology or criteria for the selection of an ASP . . .". BCF has been canvassing for ASPs for the past several years. One would reasonably assume that there was an established methodology, and criteria for the selection of an ASP. One would further assume that that methodology and criteria would have been known to the Commission.

There seems to be an implicit assumption that the idea of an ASP strategy comes with built-in legitimacy. This assumption appears to have been based on the premise that anything a government body can do, a private company can do better, faster and cheaper. The ASP concept was part of the 'privatization' of BCFerries, which emerged along with plans for privatizing the Coquihalla and instituting fares and shorter hours on the inland ferries.

The SGIFAC suggests the assumption is open to question. BCF has undertaken several attempts to find ASPs for various routes and has found none forthcoming that were willing and able to provide the service expected at competitive rates. The passenger-only service on Rte 13, Langdale-Keats-Gambier, seems to have been reasonably successful. However, its success isn't proof of concept, in that it is an isolated service with a relatively low capital requirement and labour component. It's more like a water taxi than the rest of the fleet. There are many water taxi operators on the BC coast but no other vehicle ferry operators.

Our observation is that service on any route is bound by fixed schedules, capacity requirements, Transport Canada crewing and other safety requirements, and embedded customer expectations. Those requirements largely define the cost of operating the route, with administration being the outstanding element where a contractor might be able to save some money. While lower labour costs might be the dream, it is likely employees of any contractor would belong to a union, if not initially, then shortly after being employed. Enter the collective agreement. Thus we would question any presumption that engaging an ASP would automatically lead to lower fares or a lesser government contribution (we resist calling it a subsidy until such time as we hear of 'subsidies' being granted to the highway system).

BCF has been described as a natural monopoly, in that it is an integrated system with the critical mass to have vessel flexibility, common system-wide safety and operating standards and the financial wherewithal to commit to long-term investment in major capital assets. BCF was able to relocate the *Tenaka* and *Tachek* from the SGI to routes more suited to their capacity when the move became appropriate, demonstrating the value of system-wide flexibility. As well, BCF is able to juggle vessels to accommodate scheduled refits.

Could the system operate in separate fragments? Of course. Some of us remember when CPR provided service from Vancouver to Victoria and Nanaimo, and Black Ball provided service from Horseshoe Bay to Nanaimo (different terminal than CPR) and the Sunshine Coast. In 1958, the CPR lines were shut down behind picket lines, and Black Ball employees had issued 72-hour strike notice. Vancouver Island was about to lose its transportation connection to the lower mainland. Black Ball was placed under government trusteeship, and CPR eventually worked out their problems. But the realization of how fragile the ferry links were drove the creation of BC Ferries. Over time, the several smaller coastal ferry routes operated by the highways ministry were folded into BCF. So, going back to operating a system with a few or several fragments isn't out of the question.

Would other service providers want to operate existing BCF routes? Possibly. Let's consider the challenges for a potential service provider:

- *capital*: having to provide your own vessels would require a capital outlay of a minimum of $20M for a small ferry, to something in the order of $120M for a replacement for the *Burnaby* or *Nanaimo.* More for vessels on the major routes, though it's likely a contractor would purchase existing vessels already in service. Interest and amortization costs would be in the order of 10% of the capital cost, with interest rate based on the likelihood of the operator turning a profit. The capital costs would need to be factored into the cost of operation, and thus the fares.

- *length of contract*: with a major capital investment in equipment, the operator would need a long term contract to have some hope of recovering his investment.
- *staffing*: while not likely a problem in urban centers, it would be a challenge to find and retain sufficient qualified officers, engineering staff and maintenance technicians to staff three watches in some of the smaller coastal communities.
- *future profitability*: In committing to a long term contract, any operator is going to want protection against cost impacts he can't control, such as runaway fuel prices, unexpected taxes, unforeseen new safety/security regulations and, most of all, unanticipated traffic losses. In the absence of that protection, he's going to have to build in his own safety factors or risk operating at a loss. For the inland ferries, there is government protection shelter for unanticipated cost escalation, such as for fuel. Traffic isn't an issue as the ferries are free; there is no operator dependence on tariff revenue. The ferries could run dead empty and the operator wouldn't care.
- *contract rigidities*: any contract would spell out required service levels, while leaving the matter of fares up to BCF, which would still be dependent on government set contribution levels on any of the non-major routes. Fare levels are thought by some to be, at most, a minor factor in traffic levels. An operator might see it differently. With no control over service levels or fares, he would be effectively straight-jacketed.

If there is to be any consideration for engaging ASPs to provide service, we would recommend it be restricted to unique situations that are separate from the main system, and not part of the core operation. Rte 13 is an example, much like the passenger ferry to Lasqueti Island. A cable ferry to Denman Island *could,* not necessarily *would,* be a candidate for an ASP. ASPs could also be considered for specific isolated applications augmenting existing service. It must be remembered, however, that such service additions would still have to make sense under financial cost-benefit analysis, regardless of who provides the service.

Parceling out the core ferry service to independent operators could also be described as fracturing the system. Considering the downside risk against what we expect the possible gains might be, *the SGIFAC cannot support proceeding further with the ASP strategy in any but the most limited peripheral applications. Seeking ASPs been tried and found to not provide any silver bullets as originally hoped. It's time to set the practice aside and use other more direct means to manage corporate efficiency.*

Response

to

BC Ferry Commission Discussion Paper #8

‘Cost Efficiency’

from

the Southern Gulf Islands Ferry Advisory Committee

November 2011

SGIFAC Response
to
Discussion Paper #8, Cost Efficiency

Thank you for the opportunity to respond to this discussion paper.

The SGIFAC absolutely agrees that ferry users expect the ferry service to be cost-efficient. We see ensuring cost efficiency to be a critical element of the commissioner's role. As BCF has a monopoly and is more or less guaranteed a profit, the user needs to know that BCF's cost of operation will be subject to meaningful oversight and containment.

We realize there is a conscious balance between 'regulatory light' and 'regulatory HD' that needs to be appropriate for the circumstances. The current 'light' model seems to have limited intrusion into the affairs of BCF, and is relatively inexpensive. The 'HD' model, exemplified by CRTC regulation of communication and broadcast operators, is highly intrusive and expensive for both the operators and the regulator. Given that the ferry customer covers the cost of both the commission and BCF regulatory activities, 'less expensive' is a worthy goal.

Certainly, it shouldn't be the role of the commissioner to micro-manage the business of operating the ferry system. On the other hand, the commissioner needs sufficient depth of information to determine that certain expenses are inappropriate and cannot be included in the fare cap calculations. He needs the authority to make such decisions stick.

While cost containment is an obvious role of the commissioner, generation of 'new' revenue serves the same fare-affecting purpose and needs to be encouraged when possible.

We don't know what financial information is available to the Commission. Thus we can't comment on its adequacy. That said, the information available to the public falls far short of providing a basis to offer meaningful comment. Most of the good stuff is routinely severed.

A 'for instance', we have asked on various occasions for the administration costs assigned to each route, or even to each route group. The information was deemed to be commercially sensitive and thus not available. We hear from people who should know, that BCF is top-heavy in senior and middle management. We have no way of validating that, or denying it. The commissioner needs to be able to address such issues.

We read that the BCF vacation center customer count is 78% for the major routes, 19% for the north/central coast routes and 3% for the minor and sunshine coast routes.

Looking at the packages sold by the vacation center, similar thing: 79% majors, 16% north coast, 1.8% southern gulf islands, 1.3% sunshine coast, 0.6% northern gulf islands.

The SGIFAC would like to be assured that the marketing and advertising costs are distributed proportionately, that the minor routes aren't subsidizing the major routes. We may not need to have the information ourselves. We would, however, expect to be protected by the commissioner from inappropriate costs being loaded into our fares.

As the commissioner heard on most if not all the SGIs, residents were shocked at the amount of money – millions of dollars - spent on cosmetic branding exercises on the two Rte 5 vessels last year. This was exacerbated by the selection, with no community consultation, of new seating that was worse than anything that had existed, on one of the vessels. We would like to think that the commissioner would have sufficient insight into capital expenditure plans to address and, if necessary, intercept this type of spending. At a time of skyrocketing fares, there is little if any public support for marketing initiatives of this sort.

The setting of productivity gains must be accompanied by a sense of how realistic the objectives are. Again, this goes to having sufficient knowledge of the structure and practices of the organization. The commissioner needs to know how the distinction between admin and operational expenses is defined. It's a time-honoured practice in regulated companies to claim a maximum number of people in the more defensible operations category. Not saying it happens in BCF, but . . .

In addition to properly determining the portion of operating and capital expenses being applied to each route group, the commissioner needs to make the same determination for admin expenses. The minor routes are looking for fair distribution, not a free ride. Presently, the annual BCF report to the commissioner lumps admin costs in as part of operations expenses. The public doesn't know and can't find out how much those costs are or how they're distributed.

Regarding the BCF submitted ideas for efficiency improvements; the sixth one, *elimination or restructuring of Rte 9 was of greatest interest to SGI residents and visitors.*

Elimination of the route was seen by the SGIFAC as a non-starter. Some reasons:

- it would be an economic catastrophe for the SGI, especially Galiano which would go from a 70 minute crossing to a 4 to 5 hour trip
- Rte 9 is busiest on Fri evenings, Saturday mornings and Sunday evenings, particularly in the shoulder and summer seasons. If that traffic is shifted to Rte 1, backtracking on Rte 5, there may or may not be adequate capacity on Rte 1 to handle the additional volume. There won't be on Rte 5, which is typically already near capacity on Friday evenings.
- Due to the high weekend demand and infrequent sailings, BCF has found it operationally practical to provide free reservations on Rte 9. This assures maximum utilization of the vessel while providing certainty for travelers. While it would be vital to have reservations on a Rte 1/Rte 5 trip, it is unlikely they would be free, unless a more efficient means is found of rebating the fee upon transferring to the Rte 5 leg. As well, there is no reservation system on Rte 5. Implementing one would be expensive to set up and complex to administer as it would need to include all traffic, coming from both Victoria and Tsawwassen, and destined for all four islands on the two vessels. *Basic customer issues: need for certainty and increased travel cost.*
- There is no connectivity assurance between Rte 1 and Rte 5, opening up the possibility of travelers being stranded in Sidney. This isn't a matter of waiting for the

next ferry as in many cases there is no next ferry until the next day. Or the next ferry adds three to five hours to the trip. Hardly encouraging for visitors or part-time residents trying to spend weekends in the SGI.

- We wouldn't presume to speak for SSI, but can see the same problems arising for them. As well, Fulford Harbour has been a chronic choke point (and a safety hazard) with inadequate parking space for existing traffic. Trying to move all the Rte 9 traffic through there as well would seem to be the height of optimism.

As a BCF manager told us some time ago*, "Rte 9 is a milk run, meshing with the complex inter-island network; there will always be challenges. Live with it. "* He was right. The same advice applies to BCF.

It is guaranteed, without reservation, that eliminating Rte 9 would kill traffic to the SGI and destroy businesses and property values. It would we seen as a gross betrayal of the SGI community.

Restructuring Rte 9 looks like it might have potential, from an SGI perspective. As we understand the proposal, it would include two vessels, one in Swartz Bay, the other in Tsawwassen, which would be crisscrossing the strait, stopping at Otter Bay, Village Bay and Sturdies Bay enroute. Saturna traffic would connect through a transfer at Village Bay (as presently) or a bridge connecting to Mayne Island. The two-vessel idea would permit service to be reduced to one vessel during the low traffic periods.

It's recognized that the subject of bridges is a sensitive one in the gulf islands. That said, it may well be worth pricing out the option and presenting it to islanders with the full cost-benefit analysis, including improved service for all of Rte 5. While it would be more complicated, and much more expensive, than joining South Pender and North Pender, the end result would be about the same. It would take a cooperative effort between BCF and Highways. All challenging, but not impossible. Worth at least a preliminary look.

The major hitch, as we see it, would be servicing SSI, especially on weekends. The suggestion acknowledges that it would require substantial increase in capacity at Fulford Harbour. That would be a start. It would also require a much-improved process for handling traffic to and from SSI at Swartz Bay. Presently, vehicles transferring to or from Rte 1 to Rte 4 or 5 need to exit the terminal and re-enter it as 'new' traffic. To receive any consideration from SSI, this would need to be fixed such that traffic going either way would be treated as 'in-transit' going through Swartz Bay with assurance of boarding the next sailing in the desired direction. It's presumed the SSI traffic would be connecting with Rte 1, as there'd be no point hooking into a three-stop Rte 9 sailing. Again, we don't speak for SSI, but we believe Fulford capacity and Swartz Bay procedures need to be fixed before they'd even consider such a plan.

A secondary concern would be the presumption that there would be sufficient capacity surplus to the needs of Rte 5 to permit using it to augment service to Fulford on busy weekends. We would be surprised if such were the case.

We asked BCF for some detail on what they had in mind regarding traffic levels on a reconfigured Rte 5 and an expanded Rte 4. We asked about anticipated vessel capacities and sizes, mindful of the need to have vessels large and stable enough to safely handle winter seas crossing the strait. At that point, they had no answers, as the suggestions were very preliminary. It was still in a 'connect the dots' phase.

It would appear the reconfigured Rte 9, with related terminal work, could improve service for both SGI and SSI. It might save money; that remains to be seen. There would be pushback from SSI, with respect to employee dislocation and community payroll. That's a social policy issue outside SGI consideration, one we'll leave for others.

Extending Rte 10 to Tsawwassen twice a month, the fourth efficiency suggestion: The SGIFAC was disappointed when the proposal to extend the Prince Rupert to Port Hardy trip to Tsawwassen twice a month in the summer was quashed by the Ministry without ever having even been trialed. Given that the fares paid in the SGI are related to the profitability of the northern routes, we are concerned at the ongoing loss of traffic and revenue on Rte 10. Depending on the pricing, it seemed highly likely that sailing from Tsawwassen twice a month would have gone a long way toward improving traffic and revenue on the route. As well, it would have been attractive to SGI residents as it would have been an easy connection for them at Tsawwassen. Much easier than driving to Port Hardy. It appeared local politics prevailed over sustainability of the operator.

To the specific questions . . .

1. It's not clear from outside the process what the cost determinations are that the commissioner must make in setting the price caps. Thus it's not possible to comment with any authority on their sufficiency to hold BCF accountable for cost efficiency.

2. With reference to the first point, there is the appearance – perhaps not a valid one – that the administrative part of BCF is generally beyond the reach of the commissioner. It's the SGIFAC sense that *all* expenses and revenues need to be on the table and subject to inclusion in setting the fare cap. Those would include, among others, catering, gift shops, parking and reservations. In expanding the net, there needs to be incentive for BCF to manage those costs and revenues to improve the bottom line.

   The wild card that needs to be taken into account is traffic projections.

   The PT3 submission forecast 2010/11 traffic at 21.036M passengers and 8.255M vehicles, this in the middle of FY2011. In fact, it turned out to be 20.746M passengers, 1% under forecast, and 8.120M vehicles, 3% under forecast. The same submission forecast traffic levels for 2011/12 at the same level as forecast for 2010/11. If traffic continues on its present trajectory, passengers will come in around 20.123M, 4% under forecast, and vehicles, 7.876M, 6% under forecast.

   Accurate traffic forecasts are fundamental to financial results and, in a broad sense, to cost efficiency. It appears at this point that nobody is responsible for forecasting traffic to set the fare cap, and there is no means at hand for adjusting projections as the terms unfold. Given our view that the current barrier level fares are driving discretionary traffic away, and are surely going to continue to do so, this is now a critical issue. *It needs to be addressed.*

3. The starting point in determining productivity is recognizing that every route is a product of geography and population distribution. Every route is different. Comparing one route to another in terms of cost and revenue generation is of minimal, if any, value. The basic comparison needs to be based on how well, and how cost effectively, the service meets the *reasonable* requirements (not the *wouldn't-it-be-nice* requirements) of the people using the route. In larger terms, it's a matter of value for money of the various administrative expenditures. That's not to discount the value of appropriate staff resources; they're vital. But each of those resources needs to have a demonstrable financial connection to the cost and/or quality of service.

4. Presently, the Coastal Ferry Services Contract is tightly prescriptive. If BCF wants to make any adjustments to service levels, they need to get the permission of the Ministry in order to alter the contract. That's before the commissioner even sees the proposed change. *The SGIFAC recommends that the contract terms be relaxed to give BCF more flexibility, with changes subject to approval of the commissioner, not the government*. That is, BCF would propose a change to the commissioner. The public and the government would have an opportunity to comment. Then the commissioner would make the decision to accept or reject the proposal. The commissioner would be able to assess community impact without being influenced by the politics of a situation.

In summary:

1. ***The commissioner needs to have eyes into the whole of BCF in order to determine what should and should not be acceptable in setting the fare cap.***

2. ***The commissioner needs sufficient authority to have his decisions stick.***

3. ***Eliminating Rte 9 needs to be stricken from the list of possible 'efficiency' suggestions.***

4. ***Restructuring Rte 9 may have potential for cost reduction and service improvement and should be investigated further.***

5. ***BCF needs to have more flexibility within the contract with potential changes subject to commissioner approval, not that of the Province.***

Response

to

BC Ferry Commission Discussion Paper #9

'Unfair Competitive Advantage'

from

the Southern Gulf Islands Ferry Advisory Committee

November 2011

SGIFAC Response
to
Discussion Paper #9, Unfair Competitive Advantage

Thank you for the opportunity to respond to this discussion paper.

The SGIFAC realizes the drop trailer landscape is a complex one, populated by dueling consultants and lawyers. Since we are neither, we are restricting our comments to how the process to date is viewed by observers somewhat more informed than the average lay person, but without the expertise to enter the legal or accounting debates.

We also realize that this appears to be a major routes issue, and none of our business. However, upon closer inspection, it does affect the minor routes' fare caps.

Some background as we understand it . . .

BCF and Seaspan have been the main providers of commercial transportation service between the lower mainland and Vancouver Island for the past several years. BCF has provided live tractor-trailer service, while Seaspan has provided drop trailer transport.

In 2009, BCF expanded their offerings to include a modified drop trailer service to utilize some of the unused capacity on their existing sailings. The BCF 'modification' was that the yard tractor would stay attached to its trailer from the pick-up point to the drop point on the other side, facilitating faster loading and unloading, within existing schedules. It is our understanding that the pricing was based upon advice received from consultants, specialists in the business, in order to properly cover direct and appropriate indirect costs.

In October 2009, the Comptroller General issued a report on BCF and TransLink, wherein she recommended that the commission's mandate should be expanded to include, among other additions, regulation of 'competitive services such as drop trailer transportation'. It's understood this recommendation was a result of Seaspan submissions regarding what they perceived as unfair competition from BCF. It is further understood they were ably assisted in their representations by a then recently retired deputy minister to the Premier and publicly supported by at least one Liberal MLA.

Following the CG recommendation, the Coastal Ferry Act was expanded to have the commission attend to issues of 'competitive fairness'.

In July 2010, the commission determined that the BCF drop trailer service was a competitive service as now defined in the just revised Coastal Ferry Act.

Accordingly, the commission received information from the interested parties to determine if BCF fares were creating unfair competition, that is, set so low they didn't recover the direct costs and an appropriate portion of the indirect costs associated with the service. There was not a question whether or not BCF should be allowed to participate in the business.

The commission, with the assistance of PricewaterhouseCoopers, subsequently determined that BCF was recovering all the direct costs, but less than the appropriate portion of the indirect costs. It's noted that *the government contribution to the non-major routes was not a factor in the commission decision*. The outcome of the hearings was that the commission set a minimum allowed average tariff that permitted BCF to continue their drop trailer business on what was now deemed to be a fair competitive basis.

BCF appealed process-related portions of the decision, though apparently not the actual tariff.

Seaspan also appealed the decision, taking the matter to the BC Court of Appeal. The commission will now be going to court to defend its ruling.

That's where drop trailer regulation seems to stand at this time.

The cost of regulation and SGI fares . . .

We are reminded that the full cost of the commission is paid for by BCF or, more accurately, out of customer-paid fares (and a fixed government contribution). As well, the cost to BCF to manage their regulatory process is paid for out of the same pockets. In the beginning, the regulatory structure was designed to be 'regulation light'. That is, involving minimal complexity and cost. The notion of the commission becoming a competition regulator was not part of the plan. Competition regulation was recently attached to the Act as a no-big-deal addendum. In fact, it has become a costly exercise for the commission and for BCF. Both parties have had to engage consultants that then arrived at conflicting conclusions. Now that the process is before the courts, the consultants will be recalled and their bills will be added to those of the lawyers. All on the customers' dime.

Why should we care? We care because all these costs, as well as the ongoing reporting and monitoring costs, will be added to the BCF administration load that will be parceled out over the whole system. For every dollar spent by BCF and the commission on this process, there will be between thirty and forty cents charged to the minor routes. In the absence of any data on admin cost distribution, that's our best guess. We estimate the combined cost to BCF and the commission is now in the thousands of dollars, maybe even tens of thousands. And destined to increase dramatically over the next year and beyond.

The SGIFAC finds this troubling.

We believe this assignment was inappropriately dumped onto the commission, without regard to the costs involved or the distraction it would present, taking time and energy away from its intended role.

We recommend that the whole matter of fair or unfair competition should be dealt with in an arena designed and resourced to handle such matters, such as the Federal Competition Bureau. Not loaded as an ad hoc cost onto the backs of ferry customers.

Rigid walls . . .

The first two governing principles for the commission refer to prioritizing financial sustainability of the operator and encouraging the operator to apply a commercial approach to the business. Our preferred single principle would be to provide a safe, affordable, reliable service. Either approach would encourage BCF to creatively seek new revenue sources within the limited opportunities available to them. A free market business needs to adapt to changing times if it's to survive. In the case of a regulated monopoly, failure to adapt means higher and higher rates passed on to customers.

In the drop trailer situation, it's our understanding that the BCF tariff structure, established in consultation with industry experts, was compliant with the Federal Competition Bureau requirements. Then, as a result of representations by a local concern, a new set of rules was created overnight and the commission became a competition bureau. Rightly or wrongly, this process appears to have political fingerprints all over it. It would be interesting to know if the drop trailer venture, as it was conceived, was in contravention of any provincial or federal regulations prior to the 2010 amendment to the *Coastal Ferry Act.*

This situation is similar to that in which BCF proposed bringing the *Northern Expedition* to Tsawwassen twice a month in the summer in an attempt to boost traffic and revenue on Rte 10, and the Ministry denied them the opportunity to do so.

We recommend that it's vital that BCF not be straightjacketed into situations where they have no ability to respond to changes in their markets, or where they can't explore creative opportunities to expand their revenue base.

Unanticipated costs, the government and SGI fares . . .

Performance Term Two has seen the emergence of several BCF expenses that were unanticipated when the PT2 fare cap was set. The surprise costs include, but are not limited to, overheated fuel prices, Transport Canada directed additional crewing costs and security requirements, HST in place of GST+PST, fuel carbon taxes, FOI compliance costs and now, the added commission costs to act as a competition bureau (and the BCF costs of responding to the new requirements). We believe these unanticipated costs add up to several million dollars.

The government turned a deaf ear to requests for assistance with the first two. Those costs were external and beyond provincial control. Customers absorbed the fuel price hikes through surcharges. BCF absorbed the safety and security costs. Unlike the first two unbudgeted factors, government *created* the remaining ones, providing no relief for BCF. Those costs, along with the expected inflationary costs, will be embedded in PT3 fares.

While government taxation and regulatory matters, like government contribution to ferries, are matters of social policy, we point out that they are directly responsible for some of the heavy added costs being heaped onto fare-paying customers.

The competition legislation is but the most recent example.