Coastal Ferry Act: Objectives, outcomes, adjustments

Submission to the BC Ferry Commission

prepared by Tony Law

<u>Objectives and outcomes of the *Coastal Ferry Act*</u>

This submission is from the perspective of a) the minor routes and b) ferry users. The three route groups that make up the coastal ferry services – the major routes (now to include Route 3), the northern routes and the minor routes – each have different characteristics and considerations. The *Coastal Ferry Act* distinguishes the major routes in that no cross-subsidization to other routes is permitted. The *Coastal Ferry Services Contract* distinguishes the northern routes in that a "northern strategy" has been incorporated with additional contributions to the northern transportation fee. The remaining routes, the minor routes, are distinct in that they generally serve smaller coastal communities that depend on ferries as the principal or only transportation service and have not been subject to special attention by either the *CFA* or the *CFSC.*

Ferry users are primarily concerned with service and fares rather than the governance structure that delivers them. However, in the face of current challenges, some call for a return of the service to direct operation by the government with the hope that this will bring improvements. The reality is that there were significant problems when this was the case. Debt was incurred as a result of ongoing losses. There was inadequate investment in vessels, terminals and IT and limited long-term planning. Ad hoc decisions created an irrational tariff structure. There were conflicts with ferry users and union. And of course, the expensive procurement of the Fast Cats.

The *Coastal Ferry Act* was enacted to avoid such problems by establishing a sustainable operation at arms length from short-term political considerations. Legislation requires a commercial approach and the minimization of expenses with the oversight of an independent commissioner. The legislation is intended achieve the objectives of a reduced burden on tax payers while maintaining "guaranteed service levels" and "fair, stable rates" for ferry users.

While ferry users are focused upon the key elements of service and fares, there are two other key elements involved: the cost of service delivery and government contributions. The *CFA* establishes a process for these four elements. Required **service** (A) is determined by the Province, **cost of service delivery** (B) is then determined by BC Ferries (with review by the BC Ferry Commissioner). Level of **government contributions** (C) is determined by the Province. Finally, f**ares** (D) are determined by the Commissioner who is required to ensure an appropriate return on equity for the ferry operator. Essentially, fares (D) are predetermined by A, B and C. If expenses (B) are successfully minimized as required by legislation, this means that the decisions on A and C – which are being made by the Province - essentially determine fare levels.

If one assumes that "fair, stable rates" are fares that increase in keeping with CPI, this model would have met its objectives if the increased cost of delivering service had been less than increases in CPI. This would have enabled government contributions to decrease while price caps could have increased with CPI. The reality is that costs (mostly non discretionary) have escalated since the CFA came into force.

From the tax payers' perspective, government contributions in the form of transportation fees for the minor routes have remained at the 2003 level. (However, as fares have increased so have the reimbursements paid by the government in conjunction with the social programs).

From the ferry users' perspective, rates have been far from fair and stable. Fares have increased at multiples of the increase in CPI. The impact is acute on the minor routes because of the high level of dependence on ferry service. (However, the service provided has remained essentially the same during this period.)

Key Elements of the Coastal Ferry Services Model (Minor Routes perspective)

	Key elements	Responsibility under CFA	2003 Policy objectives (in legislation) *(in News Releases)*	2003-2011 Outcomes
A	**Service**	Province is responsible for determining core service: - routes to be serviced - frequency of service - capacity of service BC Ferry Commissioner is responsible for authorizing reductions or discontinuation of core services	*Improved service and customer choice* *Guaranteed service levels* *Long term service commitments*	No significant changes to service levels General improvement in service delivery No additional choices
B	**Cost of service delivery**	BC Ferries is responsible for implementing required service and determining: - capital costs - operating costs - administration costs (less ancillary revenue) BC Ferry Commissioner is responsible for determining that costs are reasonable	Commercial approach Minimization of expenses No cross-subsidization from major routes Seeking ASPs	Significant increases in costs due to: - capital expenditures (investment catch-up) - accelerating fuel costs - higher procurement costs - regulatory requirements - collective agreement - discretionary costs? One ASP established on passenger only-route
C	**Government contributions**	Province is responsible for: - determining transportation fees - providing social program reimbursements - passing on the Federal subsidy	Reduced service fee contributions by government	Transportation fee is essentially unchanged Increase in social program reimbursements as a result of fare increases
D	**Fares**	BC Ferry Commissioner is responsible for determining ceiling (price cap) for fares once A, B and C are determined (in accordance with requirement to ensure appropriate returns for operator)	Priority on financial sustainability of ferry operator Movement towards user pay *Fair, stable rates* *Modest and predictable increases* *Tourism growth and enhanced economic development and jobs*	Appropriate provision for returns to operator (but recent net earnings less than forecast) Significant movement towards user pay Fare increases at much higher rate than CPI Traffic decline following fare increases (reducing anticipated fare revenue) Negative impacts on tourism, economic development and jobs

Discussion

Reduction of fares (or, at the very least, of future fare increases) is the major concern of ferry users at this point. As noted above, fare increases in accordance with CPI could be considered as meeting the objective of the CFA for “fair, stable rates”.

However, this can only be achieved through changes in one or all of service (A), cost of service delivery (B) or government contributions (C). The following is a discussion of how each of these elements could be addressed.

A. Service

The Province determines through *CFSC* the designated routes that must served and the core service level that must be provided for each route. These requirements have remained essentially unchanged over the life of the *CFA* (though there is now more flexibility in the contract with respect to the delivery of the required number of sailings).

Two proposals for route-specific service changes were rejected by the Province following expressions of concern from interested parties.

BCF has presented a list of nine suggested service changes which could provide opportunities for cost savings and has suggested that increased flexibility in service delivery would enable BCF to more effectively and efficiency tie service to demand. There has been no follow-up to these suggestions.

Ferry users are naturally reluctant to see changes to services which for them appear to be working well – particularly during a time when they are already being faced with escalating ferry fares.

The Province seems reluctant to consider changes when there is public resistance. An objective of the CFA is a long term commitment to service levels.

However, are current service levels realistically expected to continue in perpetuity? Probably not, given a changing context of escalating fuel and other costs, demographics, economic conditions, lifestyle choices and the imperative to address greenhouse gas emissions. This means that a process needs to be in place for long-term ferry service planning – especially as decisions on the acquisition of vessels that will be in service for many decades have major cost consequences. The transportation system provided by ferries on the minor routes moves people, goods and vehicles – with people and goods generally carried in vehicles on most routes. A migration from the low-occupancy use of vehicles to car-pooling, foot-passenger travel, delivery of on-line orders by freight etc, has significant impact on a business plan based on making deck space available for private vehicles.

As noted above, a bottom-up impetus for service review is unlikely to happen because of a general attachment to the status quo. A top-down approach is likely to meet with resistance. What could work best is a collective approach involving all parties, namely: the Province (ultimately responsible for decisions), BC Ferries (able to bring operational perspectives and information to the table), Ferry Advisory Committee representatives (bringing perspectives of users and affected communities) and the BC Ferry Commission (which has responsibility for considering reductions or discontinuations of core services and could facilitate the process and provide a report on outcomes).

A pilot of this kind of process has already occurred with the “innovation” workshop facilitated by the Commission. It should be noted that FACs are not formally constituted. To be effective, they should include representatives of key user groups for each route and of local governments.

Provision for this on-going long-term planning process could be included in the *Coastal Ferry Act.*

B. Cost of service delivery

BC Ferries acts as a contractor to carry out the required service with minimal costs. Key cost areas are capital, operations and administration. ASPs have not so far emerged as a factor to reduce costs and may only be viable for a particular service that is outside BC Ferries' core service (such as passenger-only ferries). While net costs can be reduced through ancillary revenue, there are fewer opportunities to derive such revenue on the minor routes compared to other routes..

Capital costs are incurred to provide the vessels, infrastructure and support systems to address service and safety requirements and to reduce maintenance costs associated with aging assets. The aging assets are largely a result of inadequate investment when the Province was operating the ferry system. A case can be made for the Province to pay directly for vessels and terminals as these are part of the Province's essential transportation infrastructure (as are highways, bridges and inland ferries). However, direct responsibility for such expenditures may open the door to the kind of political decisions that plagued prudent capital planning and acquisition in the past. It may be more appropriate for the Province to provide a "minor route adjustment transportation fee", over and above the basic transportation fee" in each performance term to address capital acquisition.

The major components of operating costs are labour, fuel and maintenance. Labour costs are largely tied by regulatory requirements and collective agreement provisions (though recently-acquired vessels generally have lower crewing levels reducing the impact of labour costs). Fuel costs can only be mitigated to a limited extent through purchasing strategies and efficiency measures. Maintenance costs can be reduced through replacing aging capital assets, but that requires investment costs to be incurred. Ferry users tend to question some discretionary expenditures as unnecessary frills and wonder whether current marketing efforts bring benefits to the minor routes (BC Ferries collaboration in destination marketing plus pricing strategies might be more effective).

With respect to administration costs, BC Ferries points to a relative decline in these costs, with a steep drop after the 2003 restructuring. However, the Comptroller-General noted that BCF's administration costs as a percentage of revenue are much higher than those of Translink and suggests that there are further opportunities for reductions. There are frequently-stated assertions by ferry workers and others that BC Ferries is top heavy.

In over-seeing these costs the Commissioner is limited by a small staff and the legislated framework. BC Ferries has challenged the Commission's jurisdiction with respect to proposed reductions of allowable expenses in the *PT3* Preliminary Decision. While one can expect disagreement between regulator and the regulated entity, in this case it is based on legal arguments. This may point to the need for more clarity in the CFA.

As noted above, the return of ferry operations to government administration can re-open the door to the problems that occurred in the past. However, operating at arms-length does require sufficient over-sight to ensure that costs are minimized. The BC Ferry Commission provides such over-sight, but could become more effective with increased powers and resources. However, micro-supervision should be avoided as this would incur significant costs for a Commission bureaucracy and for BC Ferries to provide a large quantity of information for monitoring.

C. Government contributions

Once service requirements and service delivery costs have been determined, the Province's decision on its contributions essentially determines the revenue required from the fare box. The government's decisions are no doubt shaped by the policy objective of moving towards user pay and reducing government contributions. The major routes have been cut loose from government subsidy but also freed from cross-subsidizing other routes. The northern routes have required significant additional contributions, although this has not kept fares from continuing to rise steeply on the routes.

The transportation fee contributed to the minor routes has remained essentially unchanged, resulting in substantial increases in fares to meet revenue requirements. (The increase in fares has resulted in an increase in social program reimbursements).

As predicted by the Ferry Advisory Committee chairs, escalating fares have been accompanied by significant declines in traffic – a particular persistent pattern on the minor routes. This down-ward spiral cannot continue without jeopardizing the objective of ensuring the financial stability of the operator and its ability to make the investments required to maintain existing service, let alone improved service. As it is, there has been complete failure to achieve the policy objectives for fair, stable rates, modest and predictable increases, tourism growth and enhanced economic development and jobs – objectives that are fundamental for an essential transportation system.

Government contributions are determined without any involvement of the Commission. The Commissioner makes the preliminary price cap with the existing government contributions as a given and makes the final decision with the government contributions specified in the *CFSC* as a given.

While it would not be appropriate for the Commission to require the government to make particular levels of contributions, the Commissioner could make recommendations on the level of contribution needed to meet the objectives for ferry service.

D. Fares

In determining the price caps that put a ceiling on fares, the Commissioner is limited by the terms of the *CFSC* and by the guidance of the six principles stated in Section 38 of the *CFA*:

a) Priority is to be placed on the financial sustainability of the ferry operators.

This principal is presumably in place to a) ensure that the operator has sufficient earnings to secure the required capital investments to maintain service and b) prevent a "rogue" commissioner from driving the operator into the ground by keeping fares so low that debts are incurred.

The reality is that the sustainability of the operator and the sustainability of the customer base are intrinsically connected. If fares are allowed to rise astronomically to address the short-term sustainability of the operator, long-term sustainability can be threatened by reductions in traffic.

As with other principles, this one does not provide helpful guidance as stated.

However Section 41 of the *CFA* does spell out particular principles with respect to the financial sustainability of the operator making this particular principal redundant.

b)Ferry operators are to be encouraged to adopt a commercial approach to ferry service delivery;

Again, there is a lack of clarity about what this means in practical terms – and it seems an inappropriate principal for a basic transportation service.

c) Ferry operators are to be encouraged to seek additional of alternative service providers on designated ferry routes through fair and open competitive processes;

This principal is presumably put in place to remove the complacency that might be associated with a monopoly and to provide an opportunity to secure a cheaper alternative to service provision where this is possible. In reality there are very limited potential opportunities, and this requirement can lead to uncertainty on the part of all parties plus a significant focus of BCF resources on pursuing unlikely options. It seems that ASPs only make sense where a particular route is a stand-alone service outside BC Ferries core operations – as is the case with

Route 13.

d) Ferry operators are to be encouraged to minimize expenses without adversely affecting their safe compliance with core ferry services;

This is a key principal, though somewhat understated in that it merely involves "encouraging" rather than "requiring".

e) Cross subsidization from major routes to other designated ferry routes is i)to be eliminated within the first performance term of the first Coastal Ferry Services Contract to be entered into under this Act, and ii) before its elimination, to be minimized;

This principle was presumably put in place with the understanding that the major routes could be self-financing and could stand alone without government support. However, the limited levels of government support for the remaining routes have resulted in fares on those rising at twice the level as for the major routes.

The reality is that major and minor routes share the same passengers, the same administration services and in some cases the same terminals. This leads to a complex cost-allocation exercise with inevitable bleeding of costs between the route groups. It creates an artificial division in what is essentially one transportation system.

f)**The designated ferry routes are to move towards a greater reliance on a user pay system so as to reduce, over time, the service fee contribution by the government.**

The Commissioner is not in a position to exercise this principle because the Commission has no role in determining the service fee which is set by the Province and thus determines the portions of revenue to be derived from government and from fares. There is a lack of clarity with respect to how much "movement" is required and thus when this principal has been achieved.

In practice, the government quickly realized that it had to increase its contributions in order to sustain the northern routes. While transportation fees have remained unchanged for the minor routes this has been at the expense of an unsustainable escalation in fares (which has increased the social program reimbursements paid by the government).

Collectively, these principles as stated are unclear, unworkable or both. They fail to articulate any public service principle (unlike the preamble to the *CFSC* which states that "coastal ferry service is integral to economic growth and development in British Columbia").

The present set of principles could be replaced by one over-arching objective that provides general direction without uncertainty of interpretation.

Conclusions

The *Coastal Ferry Act* spells out the division of responsibility with respect to the key elements of to be addressed in meeting policy objectives: ie service, cost of delivering service, government contributions and fares. However, it has failed to deliver on critical policy objectives to the extent that the sustainability of the communities served and of the operator itself is jeopardized.

One option is to scrap the *CFA* and to have ferry services carried out as a government operation. However, such a move, in and of itself, will not make the inherent challenges go away and – as noted above – significant problems existed when this was the case in the past.

Another option is to make adjustments to the *CFA* so that it is better able to deliver on the original objectives.

Recommendations

1. Service

The legislation should provide for the Commissioner to facilitate an on-going long-term service planning process involving participation of the Ministry of Transportation and Infrastructure, BC Ferries and Ferry Advisory Committees. This process could lead to recommendations being made to the Province on service requirements that would be stated in the Coastal Ferry Services Contract. *(Ferry Advisory Committees have established themselves as providing a vital contribution to addressing ferry service issues, bringing representation from ferry users and local governments to the table. Perhaps these entities could be specified in legislation.)*

2. Cost of operations

The legislation should expand the capacity of the Commission to oversee BC Ferries operations and capital procurement to better ensure efficiencies without getting into micro-management.

3. Government contributions

The legislation should require the Commissioner to a) set preliminary price caps at a level that would keep fare increases in line with anticipated increases in CPI while ensuring sufficient return for the operator to meet operational and capital financing costs and b) state the required government contributions for this to be achieved. It will then be up to the government to decide whether to act upon the Commissioner's recommendation with respect to the service fees. When extraordinary increases are considered, the Commissioner should also make recommendations on appropriate government contributions.

4. Fares

The present principles used to guide the setting of price caps should be replaced with one general over-arching principle such as

"...and must undertake that regulation in order to achieve the objective of providing sustainable, safe, reliable, efficient and affordable ferry service to meet the needs of British Columbians and coastal communities that depend upon that service."

As an immediate measure, fares should be rolled back – or at least frozen – to allow for recovery from the impact of excessive fare increases during the initial years of the *Coastal Ferry Act.*

prepared by Tony Law – 31 October 2011

[Tony Law is a local trustee for Hornby Island, Chair of the Denman-Hornby Ferry Advisory Committee and Chair of the Coastal Communities Ferry advisory Committee. However, this submission is a personal one and is not intended to represent the views of any of the entities with which the writer is associated.]