

# **Coastal Ferry Act**

## **Responses to BC Ferry Commission Discussion Papers**

*prepared by Tony Law*

I have provided a submission to the BC Ferry Commission entitled: *Coastal Ferry Act: Objectives, outcomes, adjustments* (31 October 2011). The following responses to the discussion papers are supplementary to that submission.

### **Discussion Paper #1 – Principles**

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. If the operator is unduly squeezed to keep fares low, then inadequate investment will likely result, jeopardizing sustainability of the service.

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. It is worth noting that the Province took action to address two BC Ferry commercial initiatives: the drop trailer business and the proposed changes to Route 10.

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. It has also led to fares increasing at about twice the rate for ferry users on the minor routes compared with ferry users on the major routes.

**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).

**Conclusion and recommendation**

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, such as:

**38 (1) The commissioner must regulate each ferry operator in relation to the core ferry services that are to be provided by that ferry operator and the tariffs that may be charged for those core ferry services, 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.”**

## **Discussion Paper #2 – Consider the interests of ferry users**

### **1. Who are the ferry users?**

“Ferry users” is perhaps the wrong term to use when considering the beneficiaries of the ferry system as a transportation service. Transportation services are usually established not just with the interests of users in mind but in order to support provincial or regional economic and social objectives. For example, the development of the Comox Airport a few years ago was touted as an economic development driver. Many of the users of the airport are Albertans, but the affordability and accessibility of their transportation has benefits to the Comox Valley.

Ferries transport residents from their home community to places of employment, to clients and to services. But ferries also transport materials and products and bring clients and services to communities.

While “ferry users” may include everyone from a daily commuter to a once-in-a-lifetime visitor from another continent, those dependent on ferry service for economic and social well-being includes those who may not be regular users. Their interests need to be taken into account.

Because the direct and indirect interests in ferry services extend beyond the actual passengers, another term should be used rather than inferring an extended meaning to “ferry users” beyond its grammatical meaning. In fact, it is a broad spectrum of the public that is served including residents, businesses, communities and visitors. Perhaps something like “the public served by ferries” would be more appropriately encompassing than “ferry users”.

### **2. What are the interests of ferry users?**

Responses to the recent regime of steeply escalating fares has indicated that affordability is the key interest. Ferry fares affect every aspect of life in communities that depend on ferry service. It affects the cost of all goods and services coming into the community or being exported from the community, the level of tourism which is a key economic driver and the ability to access work and services outside the community.

While one could assume that no-one would want to see safety compromised for affordability, there may be willingness to sacrifice non-essentials such as appearance and comfort..

Reliability is perhaps the second most important issue.

A third key issue is consultation. Because ferries are such an essential service, affected communities expect to have a voice in all aspects of how the service is planned and delivered.

Although there is no provincial mandate for this, the role of ferries in emergency services is valued by communities.

With respect to “sustainability of the ferry operator”, from the perspective of the public served by ferries it is important that the service be provided affordably, safely and reliably on an on-going basis – which requires the capacity for adequate investment. However, the ferry operation should be sustained at a lean and efficient level.

### **3. What is meant by consider?**

“Consider” should involve taking into account the economic and social implications of ferry service and acting accordingly, including by making recommendations to the Province on appropriate levels of government contributions to address these.

#### **4. Balancing objectives?**

As previously noted, the ability of the ferry operator to safely and reliably sustain operations is an interest of those who depend on ferry service. Again, these operations should be sustained at a lean and efficient level. If the Commissioner determines that the legitimate returns needed by the operator to sustain a cost-efficient service cannot be achieved without increasing fares to a level that would have harmful economic and social consequences, then legislation should provide for the Commissioner making appropriate recommendations to the Province.

### **Discussion Paper #3 – Financial sustainability**

#### **1. Definition**

Financial sustainability, as defined, is an essential component if the transportation service is to be provided at the required level into the future – under the existing model.

#### **2. Return on equity**

Establishing return on equity is essentially a mathematical exercise if the assumed definition is to be acted upon in the existing model. However, as recent experience has shown, if the required RoE contributes to fares being set at a high level which contributes to declining traffic resulting in reduced revenue, then the RoE will not be achieved.

#### **3. Alternatives**

Because of the scenario referred to above, the process of setting an RoE that might not be achieved indicates problems with this model. Maybe the level of investment required (including to replace vessels and infrastructure that should have been addressed when the Province was running the system) cannot be achieved through non-government sources. This leads back to the suggestion that the Commissioner should be making recommendations to the Province on appropriate levels of contributions, including to address capital requirements. Ensuring that fares are at an accessible level will help generate the traffic and thus the revenue to support the sustainability of the operation.

### **Discussion Paper #4 – Regulatory approaches**

#### **1. Ensuring consumer protection**

The Commissioner should have the power to require, without micro-managing, that the service is provided as cost-effectively as possible within safety requirements and on a sustainable basis.

There should also be the authority to make recommendations to the Province on government contributions when the tariff revenue required to achieve this would result in economic or social harm.

The Commissioner should also have the authority to convene an on-going long-term service planning process as required service levels are a primary driver of costs along with the expenses of sustainably providing that service.

## **2. Tiered approach?**

As noted previously, the interests of those who depend on ferry service include the continuing sustainability of ferry service so these two factors are inextricably linked as the primary consideration.

## **3. Primary and secondary duties**

As noted above, I see the following as primary linked duties:

- a) Facilitating on on-going long term consultative planning approach for service requirements and making recommendations to the Province
- b) Ensuring the service is delivered sustainably and as efficiently as possible.
- c) Making recommendations to the Province on government contributions required to provide the required service efficiently and without economic and social harm (a trigger with respect to the latter could be increases that exceed CPI).
- d) Setting price caps once a), b) and c) have been addressed.

## **4. Alternatives**

Comments above suggest an alternative approach to that provided for in current legislation.

## **Discussion Paper #5 – Price cap system**

### **What improvements are possible within the existing price cap system?**

The present system only specifies price-caps for average fares, which can result in some individual fares increasing at a much higher rate. Perhaps a maximum price cap should also be set for any individual tariffs with the provision that the operator can make a case for specific exemptions. Any further adjustments to the system could result in too much complexity.

## **Discussion Paper #6 – One or multiple price caps**

### **1. Is the multiple price cap system the most appropriate model for the BC ferry system?**

A multiple price cap system would work better if government contributions had ensured that fares on the non-major routes had increased at about same level as those on the major routes. As it is, this system has resulted in non-major fares increasing at about double the rate of major fares which is not sustainable. The “no-cross-subsidization” principle would be more supportable if the Province had made up the difference.

### **2. What are the perceived benefits and challenges associated with the multiple price cap system?**

Multiple price caps benefit the major groups but lead to serious discrepancies in fares across the system. They provide more flexibility in pricing for the operator but significant challenges in cost allocation.

### **3. Is a one price cap model preferred over the existing model and why?**

A one price cap model is more straightforward and equitable. A one price cap on average fares still allows flexibility in setting individual tariffs, which could be restricted from getting too extreme through a maximum price cap on individual tariff increases as suggested above.

## **Discussion Paper #7 – Alternative Service Providers**

### **1. How should an ASP strategy be managed?**

Rather than ASPs being pursued on an ad hoc basis, which creates a great deal of uncertainty for all parties, there should be pre-identification of routes, with distinct characteristics where an ASP may be desirable and feasible.

### **2. Which routes or routes groups are most likely to successfully be operated by an ASP?**

Routes should be pre-identified through a consultative long-term service planning process facilitated by the Commissioner.

### **3. Are there transportation solutions that could work in tandem with an ASP strategy that would reduce costs of the ferry system?**

There may well be and these could be identified through the service planning process which would look at the most appropriate ways to transport goods, people and vehicles – which may include options other than the existing range of vessels.

## **Discussion Paper #8 – Cost efficiencies**

### **1. Are the determinations the commissioner is required to make in setting the price caps sufficient authority to hold BC Ferries accountable for cost efficiency?**

There is a sense among ferry workers and regular ferry users that there are excessive costs that need to be addressed. Regularly-identified areas that might need attention are: top-heavy management, inefficiencies resulting from centralized decision-making not utilizing on-the-spot knowledge, marketing, cosmetic changes and costly “improvements” that are not experienced as such.

### **2. If not, what additional tools are required to ensure such oversight and accountability?**

While the danger of getting into expensive micro-management should be avoided, there seems to be a need to more effectively evaluate administration and marketing costs and capital improvements

### **3. What factors should the Commissioner take into account in determining the productivity gain that the ferry operator should achieve?**

Ensuring that safety and reliability are not compromised while addressing all discretionary costs over and above fundamental operations.

**4. What role should the commissioner have in a process for pursuing the opportunities to enhance efficiencies as identified by BC Ferries?**

I believe these items should be more appropriately identified as adjustments to required service levels rather than efficiencies, which should refer to how the required service is delivered. As suggested elsewhere, these should be addressed through a statutory planning process facilitated by the Commissioner and involving BCF, FAC (with local government reps) and TRAN and resulting in recommendations being made by the Commissioner to the Province.

**Discussion Paper #9 – Unfair competitive advantage**

**1. Are provisions in the Act covering unfair competitive advantage appropriate or should such issues be dealt with in some other manner?**

It seems appropriate for BC Ferries to use under-utilized capacity as one of the few options to derive revenue other than through increased fares or increased government contributions – especially as the original rationale behind the *Coastal Ferry Act* included modest fare increases and reduced government contributions. Any issues that might arise around competitive practices should be addressed through other mechanisms and not through the *Act*.

**2. Should the commissioner have more discretion in determining what constitutes an unfair competitive advantage? What improvements are possible with the current administrative review process?**

*Not relevant in the light of response to question 1.*

**3. Should additional tools be available to the commissioner such as imposing a mediation process to determine if the parties can come to an agreement?**

*Not relevant in the light of response to question 1.*

*prepared by Tony Law – 24 November 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.]*