

# **Ferry Governance: A Matter of Ideology**

**Presented**

**to**

**the BC Ferry Commissioner**

**by**

**the Ferry Advisory Committee Chairs**

**October 20, 2011**

## **Ferry Governance: A Matter of Ideology**

**In the beginning . . .** BC Ferries was born July 18, 1958 in response to critical service disruptions in the ferry service between the lower mainland and Vancouver Island. WAC Bennett created the organization to provide reliable, safe, affordable transportation to Vancouver Island and to the many coastal communities that depended on lifeline ferry service.

It was a matter of ideology.

**In 2003 . . .** British Columbia Ferry Services, Inc. (BC Ferries), a quasi-private company was born April 1, 2003, a creature of Bill 18, the *Coastal Ferry Act*. The March 12, 2003 press release, under the heading “**Guaranteed Fair Rates**” proclaimed “. . . annual rate increases will be modest and predictable.”

The position of Commissioner was created as part of the *Act* with six guiding principles (attach 1), beginning with placing priority on the financial sustainability of ferry operators and concluding with the legislation’s bottom line, moving toward greater user pay so that the government could reduce its contribution.

Not one of the six principles made any reference to the interests of ferry users or the communities dependent on the service.

The new and current ideology.

### **Since 2003 . . .**

1. Ferry fares have increased on average over 70% on the 18 minor routes, 80% on the north/central coast routes and 40% on the three major routes (attach 2). Fares have increased over 100% on several minor routes.
2. Ferry passenger traffic, system-wide, has declined 2.9%, or 6.0% from its peak in 2008. Vehicle traffic has declined 2.1%, or 5.6% from its 2008 peak. Minor route passenger traffic has declined 6.6%, or 8.4% from its 2005 peak. Minor route vehicle traffic has declined 5.7%, or 8.4% from its 2005 peak. (attach 3).
3. As a result of traffic losses on the non-major routes, caused largely by the devastating fare increases, the non-major routes have lost money in each year of Performance Term 2, resulting in their being cross-subsidized by the major routes (attach 4).
4. BC Ferries’ Return on Equity has fallen to 1.2% and is expected to be negative this year (FY2012) (attach 5).

## The Principles, a closer look . . .

- (f) **financial sustainability** – As long as the Commissioner has no authority over the transportation service fee, he's not in a position to manage the financial sustainability of the operator. The customer is unable to carry the whole load of increasing costs. Current situation is a case in point; all the cost increases have been loaded on the fare-paying customer, with the result traffic has dropped, collapsing net revenues. With one of the two financial levers out of his reach, the Commissioner has been and remains unable to materially influence the sustainability of the operator.
- (b) **commercial approach** – This is an undefined term but suggests something like what Chrysler or Pepsi-Cola might employ to win market share while improving profit for the share-holders. Or to keep from going bankrupt and closing their doors. Commercial, in the sense of a free-enterprise, non-subsidized company refers to a competitive, unregulated, non-essential market. BC Ferries is a government-supported, essential service operating in a regulated, natural monopoly environment. It shares neither the challenges nor the potential rewards of Chrysler or Pepsi-Cola. An approach reflecting consistent high value for money would be more appropriate than a so-called 'commercial' approach. The principle sounds nice but is without practical meaning in this situation.
- (c) **alternate service providers** – This has been repeatedly attempted and borne no fruit for the past eight years. The only service that's been devolved is a passenger ferry - essentially a scheduled water taxi service. The coastal ferry system is a natural monopoly that doesn't lend itself to fragmentation. Rather than trying to bring in competition to keep costs down, it would be more productive to conduct value for money audits from time to time on the operator. While alternate service providers might work out in stand-alone situations, such as the passenger ferry noted or the possible cable ferry, the program has been an expensive exercise in futility, and should be dropped.
- (d) **minimize expenses** – This is a self-evident motherhood statement. In fact, the Commissioner does not have the resources, and possibly the authority, to examine and challenge the legitimacy or reasonableness of BC Ferries expenditures. His attempt to do so in the PT3 preliminary fare cap decision was met with a legal challenge by BC Ferries. Either the Commissioner or the Province, or both, need to have comprehensive audit information to assure BC Ferries are minimizing their expenses, while providing 'safe compliance with core ferry services'. In the absence of such information and authority, this principle is without meaning.
- (e) **cross-subsidization** – In fact, the major routes have 'cross-subsidized' the non-major routes for the past three years. It's been the inevitable outcome of the non-major routes losing money, as they lost traffic due to their fares reaching and exceeding the barrier level for many travelers. There is nothing the Commissioner was, or is, able to do to prevent it. The issue of subsidization between routes is a red herring. Routes 1 and 2 have historically 'subsidized' Route 30. The minor routes and Route 3 have

'subsidized' the north/central coast routes. Whether routes make or lose money is, and will ever be, the result of geography and population distribution. There will always be some routes stronger financially than others. What they share is that they're all part of the British Columbia coast, populated by British Columbians with an expectation of safe, reliable, affordable transportation access. Elimination of 'cross-subsidization' has no place in determining how the system is to be configured. Rather, appropriate, affordable fares need to be determined for each route, and the support funding needs to be available accordingly.

(f) **user pay** – this presumes the user contribution was artificially low. Yet no evidence to support that conclusion has been presented. As well, no reply has been forthcoming to the question of 'how much user pay is intended?' Tariff revenue on the 18 minor routes has increased by 54.6% while the transportation service fee has increased 4.0% since 2003. On Rte 3, tariff revenue has increased 59.4% while the transportation service fee has *dropped* 26.3%. On the north/central coast routes, tariff revenue has increased only 19.5% due to collapsing traffic. Their transportation service fee has increased by 207.1% due to an infusion to offset the capital costs associated with replacement of two major vessels and related terminal upgrades, and transfer of funding from Rte 3. Briefly, the user has been paying through the nose while the basic service fee has remained frozen for eight years, with the exception of the northern adjustment. The principle has been carried to a costly extreme. Until provincial highways and public transit bear the obligation to increase user pay so that the Province may pay less for their operation, this principle is inappropriately applied to BC Ferries.

### **Conclusions . . .**

- 1. Fare increases have NOT been “modest” or “predictable”.** They have outstripped inflation by a factor of 500% to 600%.
- 2. Traffic has fallen to its lowest level in decades** primarily in response to barrier level fares, particularly on the non-major routes.
- 3. The major routes have been obliged to subsidize the non-major routes each year of PT2** as a result of loss of traffic on the non-major routes, primarily as a result of crushing fares.
- 4. BC Ferries have not come anywhere near meeting their target return on equity in any year in PT2** as a result of diminished revenue resulting from traffic declines on both the major and non-major routes.
- 5. Communities have suffered economically and socially as substantial declines in minor route traffic have led to businesses shrinking or closing, families being isolated, schools losing enrollment, young people leaving and tourism plummeting.**

## Recommendations . . .

### 1. Go back to basics . . .

**Q. Why do we have a ferry system?**

**A. For the same reason we have a highway system, to tie British Columbia communities together, by providing transportation for people and necessary goods and services.**

2. Then, consider the appropriate ideology. We suggest it needs to be focused on serving British Columbians and British Columbia coastal communities, not trying to make BC Ferries operate as if it were a non-essential service in a competitive, unregulated market.
3. To apply an appropriate focus, one that recalls the original ideology, the existing guiding principles should be withdrawn and be replaced with just one . . .

***To provide a safe, reliable, affordable ferry service***

The issue of sustainability of the ferry system is a red herring. It's as relevant as discussing the sustainability of the highway system. The ferry system is part of the provincial transportation infrastructure and needs to be operated, maintained and renewed as necessary with appropriate provincial funding as required.

4. In order to achieve that 'safe, reliable and affordable service', and to restore some of the lost traffic, it is recommended that the Provincial contribution be sufficiently increased in April 2012 to support a major roll-back in fares on the non-major routes, such as occurred in 1997. At the very least, the contribution should be increased sufficiently to permit non-major route fares to be frozen at current levels for the next four years.

FACC 20 October 2011

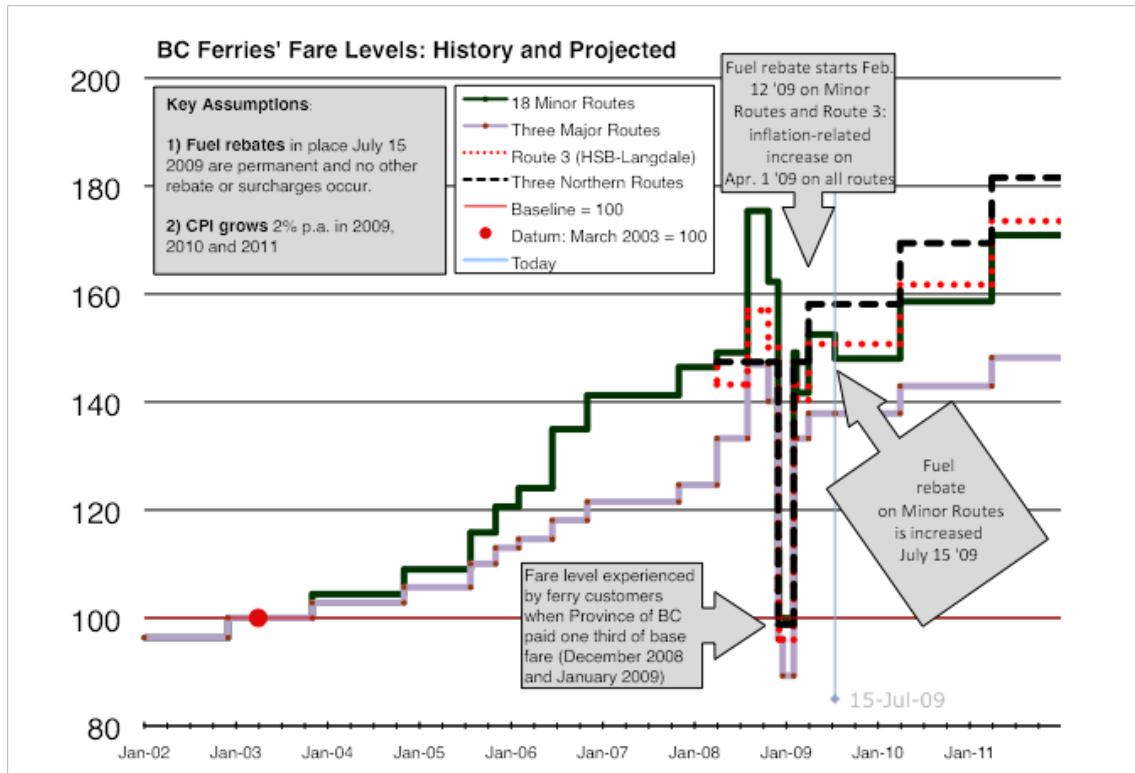
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## **Attachment 1**

The Six Guiding Principles, from section **38** (1) of *The Coastal Ferry Act*

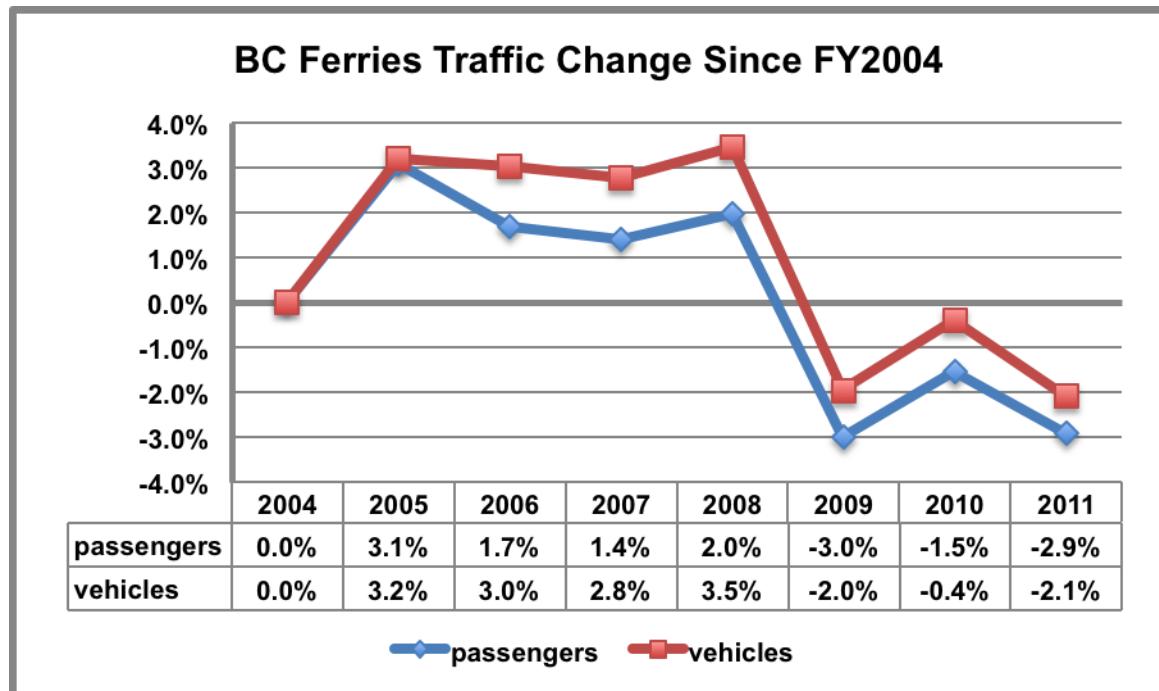
- (a) priority is to be placed on the financial sustainability of the ferry operators;
- (b) ferry operators are to be encouraged to adopt a commercial approach to ferry service delivery;
- (c) ferry operators are to be encouraged to seek additional of alternative service providers on designated ferry routes through fair and open competitive processes;
- (d) ferry operators are to be encouraged to minimize expenses without adversely affecting their safe compliance with core ferry services;
- (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;
- (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.

## Attachment 2

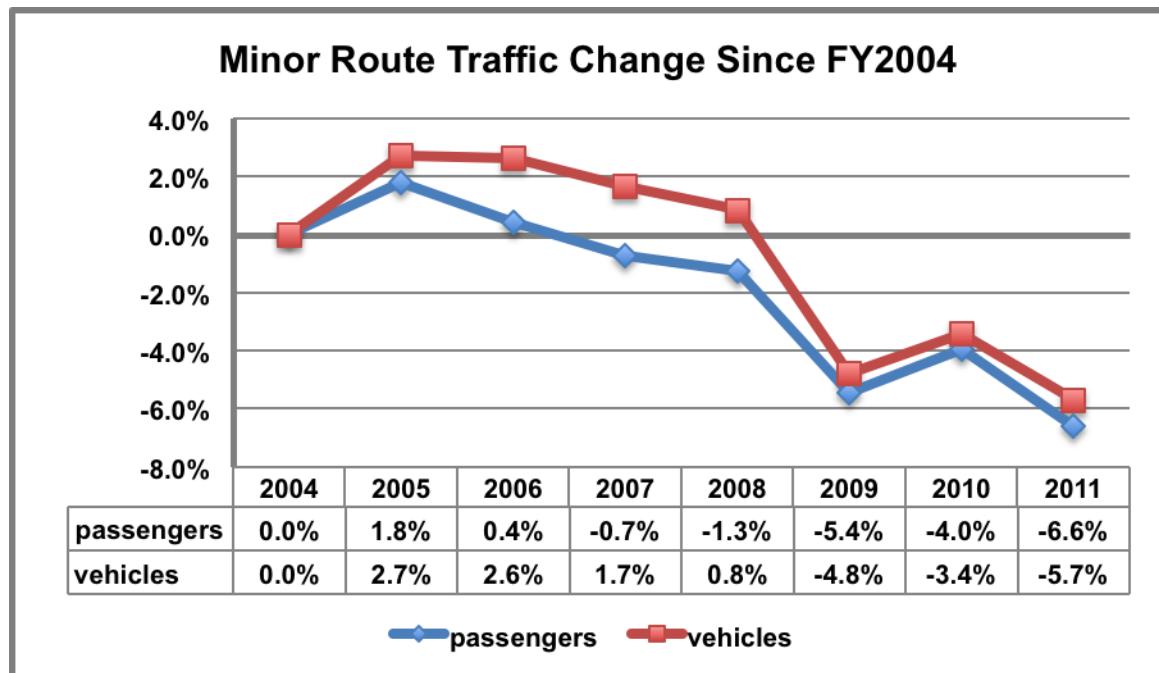


source: BC Ferry Commissioner

### Attachment 3

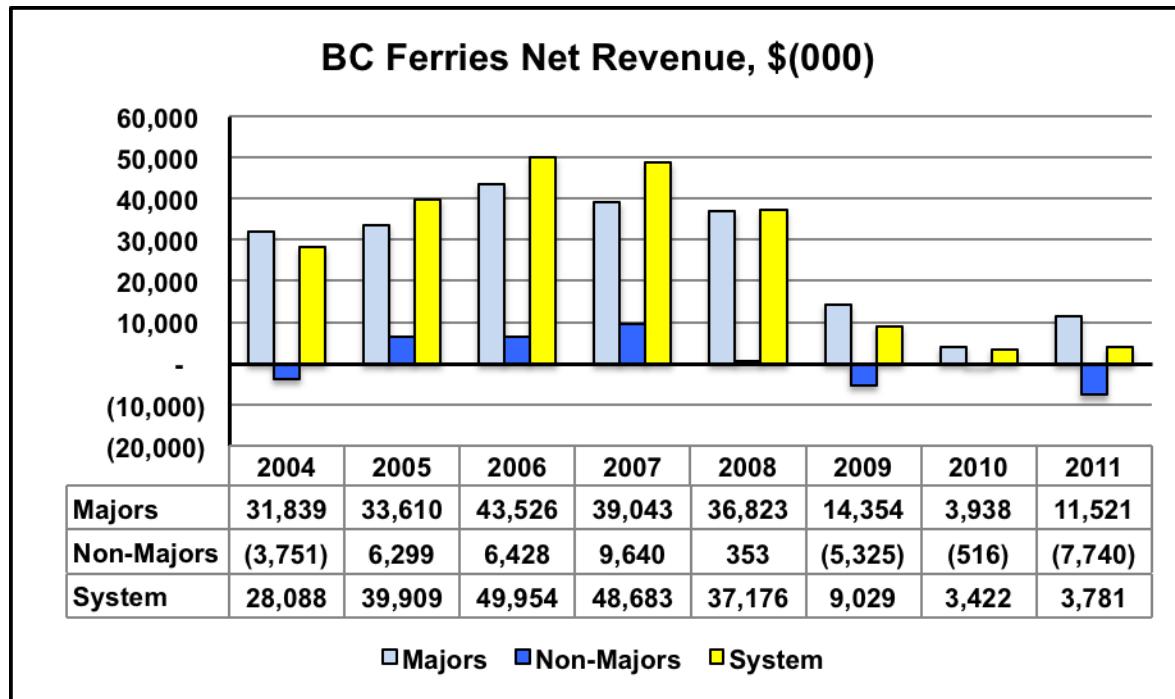


source: BC Ferries Annual Reports



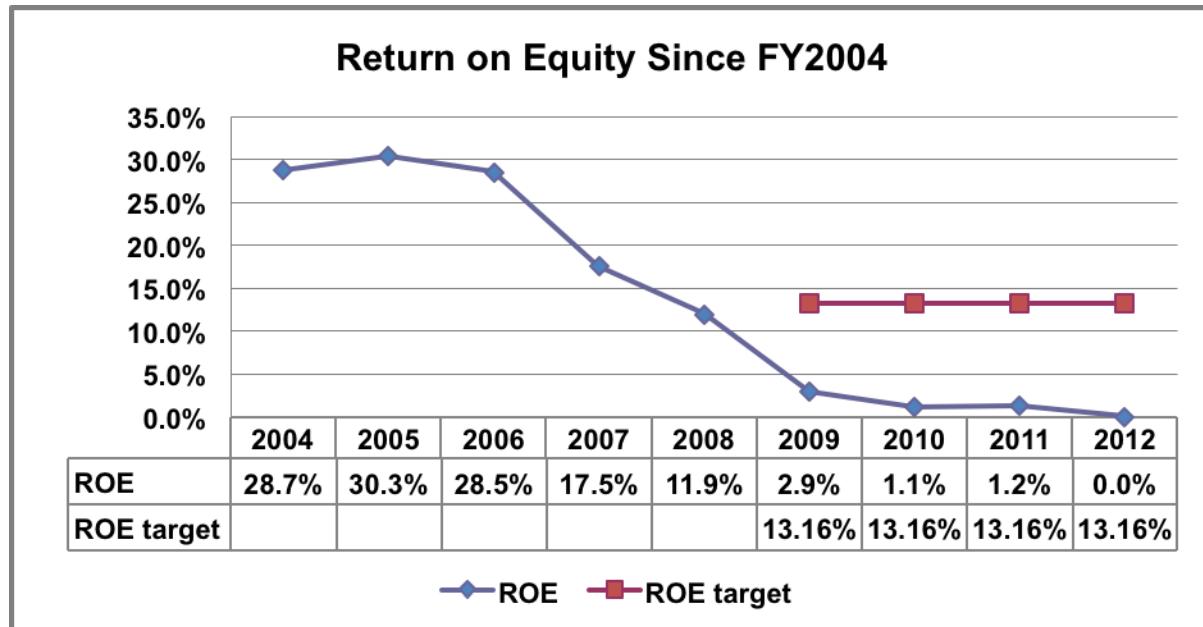
source: BC Ferries Annual Reports to the Commissioner

#### Attachment 4



Source: BC Ferries Annual Reports to the Commissioner

#### Attachment 5



source: BC Ferries Annual Reports