Review of Independent Authorities – TransLink and BC Ferries

Requested by Transportation and Infrastructure Minister Shirley Bond
Reporting to Finance Minister Colin Hansen
Conducted by Comptroller General Cheryl Wenezenki-Yolland

On behalf of the Ferry Advisory Committee chairs, please accept this submission to the BC Ferries component of your review of BC's independent transportation authorities. The FACC is composed of chairs, or their delegates, of BCF's twelve Ferry Advisory Committees.

Collectively we represent more than one hundred volunteer members of the twelve FACs, which in turn represent the thousands of residents of and travellers to the coastal communities served by the 22-non-major ferry routes.

We provide advice to BC Ferries, and liaise with the BC Ferry Commission, the Ministry of Transportation, local governments and the public. Our current focus is on the extraordinary growth of fares for the non-major routes. We also are active in service and operational issues that span the non-major routes.

This submission provides our perspective on aspects of governance and objectives, related to the goal articulated by Finance Minister Colin Hansen when the review was announced. Specifically:

> "we must ensure the governance arrangements are operating as efficiently as possible and the authorities are meeting their service objectives."

The submission includes these components:

Preamble: Under-examined dynamics of the ferry system

- Route groups
- Governance
- Objectives
- Limits to viability

Response to relevant terms of the review

FACC recommendations

Other documents (attached): Previously submitted to then-Transportation Minister Kevin Falcon. On issues of greatest relevance to BC Ferries' non-major routes:

- **Stratminor-June08** – capital needs for BC Ferries' non-major routes
- **Stratminor-Sept08** – Minor Route Strategy position paper
- **Twenty Million Dollars** – results of provincial government's pilot stimulus program
- **RET-Mar08** – other ferry systems' responses to common ferry system challenges

You also have received submissions from several individual Ferry Advisory Committees, each of which addresses aspects of collective concerns about the current ferry system.

Acronyms in this submission

AG – Auditor General
BCF – BC Ferries Services Inc
BCFA – BC Ferry Authority
BCFC – BC Ferry Commission
CFA – Coastal Ferry Act
CFSC – Coastal Ferry Services Contract
FAC – Ferry Advisory Committee
FACC – Ferry Advisory Committee Chairs
TRAN – Ministry of Transportation

Preamble

An understanding of the restructured coastal ferry system requires consideration of these factors:

- route groups – heterogeneity in the system
- role of provincial government in governance
- government objectives – inherent assumptions and conflicts
- limits to viability of non-major routes, and role of public policy.

Route groups – the 'mini-companies' within BCF

Analysis of the system must address the interaction of four mandated aspects of the system:

- division of routes into route groups
  [CFA: Definitions, CFSC: Schedule A, CFSC-Amend.3: 2.10]
- elimination of cross-subsidization of major routes to non-major routes
  [CFA 38 (1)(e)]
- increasing reliance on user pay, to reduce government contributions
  [CFA 38 (1)(f)]
- government service fees tied to service levels, with remaining revenue needs from ferry users
  [CFSC-Amend.4: Appendix 1, Schedule B].

The combination of the above factors creates in effect four 'mini-companies' within BCF, the four route groups, each with different characteristics. Any summary that is system-wide, or that focusses largely on the Major Route Group, obscures important dynamics within the system.

The FACC believes that this heterogeneous aspect of the restructured ferry system has been under-examined in previous assessments of the coastal ferry system, before and after the restructuring ***[eg. Wright 2001, AG 2006.]*** We believe the results of your review will have greatest value if they consider this heterogeneity within BCF.

The Ferry Advisory Committees, by necessity, have examined closely the characteristics of the three route groups we serve, and how they differ from the Major Route Group. We have been able to offer insight to the parties involved in ferry service, and we hope to offer the same to your office.

Role of the provincial government in governance

We take a broad approach to defining ferries governance. Using this broad sense, governance is taken as the factors that direct BCF mandate and operations.

While direction comes from the BCFA, the system is also subject to legislative, regulatory and contractual direction. These include the CFA, BCFC, CFSC, as well as federal security, safety and environmental legislation and regulation (which have had a major impact recently), and the terms of the BCF labour agreement, including the Ready process. All these are relevant to the ferry system, in that they affect BCF's three major cost centres: capital, fuel and labour.

In addition, the provincial government, though setting up much of this framework to operate independently, continues to have a direct role in a significant part of BCF governance.

The government intended to create BCF along the lines of a private sector company. Yet, only one of the four groups (Major Route Group) functions in this way. It is self-supporting, and the provincial government has little role in its ongoing operations.

The other three groups (Minor Route Group, Northern Route Group and Route 3) are not self-supporting. Government policy plays a large role in the governance and objectives for these groups. This is becoming increasingly apparent as we approach the limits of user pay. ***[See attached: Twenty Million Dollars.]***

Under the current system, the single biggest decision defining fares and service for the non-major routes comes from the provincial government, in its setting of service fees and mandated service levels. The government decides this unilaterally for each four-year performance term of the CFSC. The BCFC and BCF respond to that decision in setting and implementing financial and operational parameters.

Government objectives – inherent assumptions and conflicts

Government objectives for the ferry system are not clearly articulated ***[AG 2006 p.19]***, and we submit that neither are they sufficiently defined ***[See also AG 2006 pp.38-39]***.

By examining several sources, the Auditor General identified five main objectives:

- separating public policy from financing decisions
- system transparency
- increasing user pay
- protecting the system in the long-term
- improving customer service.

To this list we add an objective stated in the government's announcement of the new system ***[TRAN News release 12 Mar 03, preamble to CFSC]***.Then-Transportation Minister Judith Reid announced that the new system would be "protecting consumers." More specifically:

> "This new contemporary structure ensures long-term service commitments, modest and predictable average fare increases, and a major investment in vessels and terminals to support tourism growth in British Columbia."

The Auditor General notes that the objectives will come into conflict from time to time ***[AG 2006 p.19]***. We now face a compelling and urgent example of this.

The government wishes to improve and protect the system and ensure capital investment, while at the same time decreasing its service fee contributions. The onus is on users to make up the gap in revenue needs. Users' capacity to do this appears based on several assumptions:

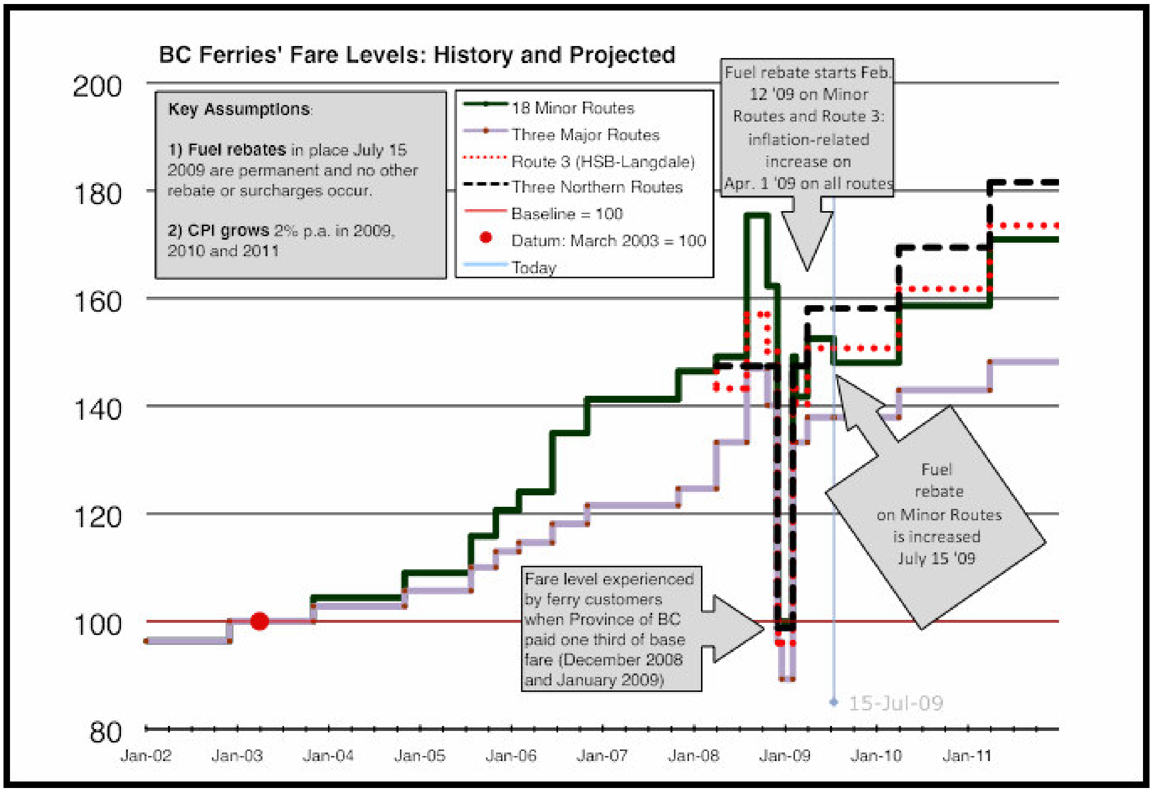
- Operational costs will not increase unduly.
- Users can pay fares no matter how high they must be to fill the gap.
- Traffic meets projections, and remains high enough to spread costs sufficiently widely.
- Users can support service costs (operational needs) and completely fund capital needs.

As revenue needs have increased and effective government contribution decreased, it has become apparent that the above assumptions are not realistic.

The government has recognized this conflict for the Northern Route Group; it cannot reduce its contributions and at the same time sustain the system. In response, the government has developed a Northern Strategy, and increased its contribution to the group accordingly.

Service challenges remain. Fares on northern routes are still exceedingly high, and traffic is dropping alarmingly. The existence of a Northern Strategy, however, provides a mechanism by which government can examine its objectives, and modify its policy and contributions accordingly.

The above user-pay assumptions are also unrealistic for the remaining two route groups, Route 3 and the Minor Routes. Users of these routes also have experienced successive, substantial fare increases, far above the rate of inflation, as indicated in the following graph.



Source: BCFC Annual Report, July 2009
Note: This graph represents fare caps only. The prepaid fares, used by a very large majority of coastal residents, have risen more steeply.

This highlights a second significant conflict among government objectives. In this instance, the objective of ensuring modest and predictable fare increases has been completely sacrificed in the move toward user pay.

Surcharges, intended as a response to extraordinary circumstances, were a fixture for half of the first performance term, and in the second term disappeared only because first-term surcharges had been rolled into baseline fares.

In the six years since the system was restructured, it has moved toward user pay. Now we are approaching its limits, as evidenced by the drop in traffic across the system. In response to FACC questions, senior TRAN staff have indicated that government has no specified goal for user pay increase or provincial contribution reduction, nor a mechanism to assess the effects of their progression.

On top of these service cost issues, capital investment is about to begin in earnest for the minor routes. Up to now, the bulk of capital costs have occurred in the Major and the Northern route groups.

In the next four-year performance term, the two remaining groups will face vessel replacements within their aging fleet, along with terminal upgrades. This will add an unsupportable burden on user fares. Surcharges again may become an option in addressing these capital costs. Regardless of mechanism, the fare burden will further depress traffic, which in turn will force fares still higher, which creates a very real potential to spiral into crisis.

The Minor Route Group and Route 3 are in urgent need of a Minor Routes Strategy to address these elements: capital costs soon to face users of these routes, strains already in the system, and assessment of the effects of increasing user pay. ***[See attached: Stratminor-June08 and Stratminor-Sept08.]***

Limits to viability of the non-major routes, and the role of public policy

The conflicts among government objectives – that is, protecting customers and protecting the system, while moving toward user pay – has placed a burden on ferry users that is a threat both to the ferry system and to communities along the coast.

The non-major routes have moved substantially toward user pay, but at a cost – to BCF in traffic, and to coastal communities in exacerbating economic and population declines.

In 2006 the FACC became alarmed about potential traffic elasticity related to fare increases, and began to raise this with BCF, BCFC and TRAN. Evidence now is clear that traffic has been dropping for some time on the non-major routes, and is now system-wide. Other parties continue to understate or disregard fares as a factor. Traffic decrease is a direct threat to BCF revenue projections as well as to user fares, and there is merit in understanding the underlying dynamics.

Yet, dropping traffic is only one effect of high fares. The cost burden for coastal residents has many dimensions: direct outlay to travel, costs of goods and services to communities, barrier to new business activity, and decrease in tourism and other economic activity. People are moving from our communities, citing in part fares increase.

As fares continue to increase, we fear that depopulation will reach a critical point below which our communities lose the essential components that make them viable. This in turn may make some of BCF's routes unviable as currently conceived.

It is not within the scope of this review to discuss the value of supporting coastal communities. We simply raise it to indicate that the provincial government role in governance, and the importance of its public policy on ferries, did not end with the establishment of the framework for the new system. The parameters of such a policy must be transparent.

In developing the Northern Strategy, government acknowledged its role. We call on government to extend its acknowledgement, by examining the state of the remaining two route groups that it supports, and to develop a Minor Routes Strategy, to ensure their viability.

Response to relevant terms of the review

1. The division of responsibility between the Province, the respective entities, commissions and authorities.

We note in the Preamble the Province's role in the three non-major route groups, particularly as it relates to its decision on service fees and service levels for each four-year contract performance term.

Given the centrality of this decision, its placement within the timeline mandated for setting performance term conditions leaves very little time for response by BCF or the BCFC. ***[AG 2006, p.25, http://www.bcferrycommission.com/TimeLinePT3PriceCapReview.pdf]*** This inhibits the ability of either body to respond with creative solutions for meeting revenue needs and service levels once the provincial decision is set. This in turn adds greater pressure on the limits to user pay, as the currently available solutions to the challenges are through increasing fares or cutting service.

2. The size, composition, appointment process and compensation for the board of directors of the BC Ferry Authority, BC Ferry Services Inc as well as the South Coast British Columbia Transportation Authority.

The FACC does not have a position on the directors' and executive compensation. That said, we note these points:

- The extensive framework governing BCF mandate and operations, noted above, suggests that the scope of work of BCFA directors is less than might be expected normally of a private-sector board.
- The compensation of directors and executives, while of an order of magnitude that adds in a small way to the fare burden on the non-major routes, is nonetheless of an insignificant order of magnitude compared to BCF's three major costs centres: capital, fuel and labour.

3. The regulatory environment, including responsibilities, authorities and powers of the Ferry Commission as well as the regional transportation commissioner and Mayors' Council on Regional Transportation.

We support the work of the Ferry Commission. We believe it serves a valuable role by successfully fulfilling its mandate and offering valuable oversight. Additionally, the BCFC has taken initiative to highlight shortcomings in the system, such as the limits of provisions for alternative service providers, and to initiate probes. The Commission also has expressed willingness to host an innovations workshop, to explore potential new solutions to the service challenges in the system.

Currently, no body is charged with protecting consumer interests and assessing the impacts of fare changes on users and communities. Regulatory commissions in other sectors typically have this mandate. Given the resources to do so, we believe the BCFC could fulfil this role.

4. The operating costs and service delivery models of the entities including the company's efforts to reduce costs using alternate service providers, and actions to increase productivity and quality customer service.

Alternative service providers

The BCFC has documented the shortcomings of the alternative service provider model, as has the Auditor General. ***[AG 2006 p.45, BCFC Annual Report 2009 pp.8-9]*** We concur. It is apparent that the same three major cost centres that constrain BCF operations and flexibility are also barriers to entry for potential alternative service providers: capital, fuel and labour. A potential provider also must meet the cost of meeting federal security, safety and environmental standards. Transport Canada's marine safety regulations have been revised recently, and costs associated with these and other regulations have escalated rapidly in recent years.

The mandated process for soliciting alternative service providers is expensive and time consuming. Its lack of success over the past five years suggests there is merit in reconsidering this legislated requirement. The desired controls on BCF's costs and monopoly position may be addressed through other mechanisms, perhaps within the BCFC's purview. The other alternative is to address the systemic constraints that affect both BCF and potential alternative providers.

Cost reduction

We believe the BCFC provides adequate oversight of BCF cost control. Yet, both the BCFC and BCF are seriously constrained by the big three cost centres – again, capital, fuel and labour. Many ideas with potential to reduce these costs and improve efficiency and flexibility must grapple with existing infrastructure, terms of the labour agreement, and federal regulations.

Our fear is that without a mechanism and adequate time to explore innovative solutions within each performance term negotiation, increasing costs will remain treatable only with yet more fare increases or with service cuts. We wish to have the opportunity to work with other parties to explore innovative proposals to minimize fare increases, and if service cuts are necessary, to have input into choosing those that make most sense for our routes.

Quality customer service

Customer satisfaction evaluation is aimed primarily at users of the major routes, particularly vacationers and other discretionary travellers. The role of fares in determining customer satisfaction and service is underestimated for all ferry users, but especially so for coastal residents and other non-discretionary ferry users.

5. A review of options available to the Province that are consistent with the entities' independence under generally accepted accounting principles (GAAP) and which would ensure that existing and future independent, regulated, publicly created authorities such as BC Ferries and the South Coast British Columbia Transportation Authority are effectively structured to:

- **Protect ratepayers' interests with minimal administration costs, including hard caps on compensation levels for senior executives and board members.**

  BCFA and BCF are independent of this level of government control. Yet, to the extent that BCF's central costs are allocated among route groups, there may be a mechanism to limit the portion of compensation for directors and executives allocated to non-major route groups, by setting those limits as a condition of service fee contributions.

- **Protect clearly mandated customer service levels.**

  For the non-major route groups, this is in the realm of public policy, and within the responsibilities of the provincial government, as noted in the Preamble.

- **Improve transparency and public accountability for decisions and performance levels.**

  The Coastal Ferry Act has led to increased transparency within the ferry system. The BCFC provides transparency into performance. Additional improvement could be achieved by increasing transparency in the allocations among route groups of shared or multi-group costs.

Consult with the commissions, authorities, and operating entities, as well as any other stakeholder deemed appropriate.

As noted in the introductory paragraphs, the FACC represents key stakeholders in the non-major groups within the ferry system. The communities we represent cover a large region of British Columbia. We hope the provincial government gives weight to the concerns of its residents.

We urge you to review the attached documents with a view to understanding the importance we attach to the provincial role in the non-major ferry routes, as well as the requirements necessary to ensure that those routes become sustainable.

Other jurisdictions and their ferry systems

Other ferry systems face similar challenges to those outlined in this submission. They too must reconcile the need for affordable, reasonable ferry service with support for users and small communities. We examined actions by two governments, Scotland and Newfoundland. Each government accepts the centrality of public policy, and each has taken actions to address the challenges comparable to those faced here. ***[See attached: RET-Mar08.]***

The ferry system in Washington State is undergoing a similar exercise, and offers another instructive example. The state's ferry system is different in many ways to the one in British Columbia, and the state's approach different to that of the provincial government. Yet, there is a significant commonality, and a relevant point to be drawn from a comparison.

Like BC, Washington began a move toward user pay. It hit the limit of user pay, which BC is approaching rapidly. Washington's progression through this pattern began earlier than in BC (1999) and for different reasons (repeal of its Motor Vehicle Excise Tax, which removed funds from the ferry system). The state's response to funding constraints was to mandate a user pay level of 80% of operational costs (a limit not defined in BC), and to defer capital costs (which in BC users are expected to pay). The user-pay experiment culminated in four of the system's very old vessels being condemned and withdrawn from service for safety reasons. In response, the governor and the head of the ferry system acknowledged the system had indeed hit the limit of user pay. The governor and the legislature chose to recognize the importance of sustaining the system and allocated the funding necessary to rejuvenate it. The exercise continues.

The Washington State response is identical to those of Scotland and Newfoundland, in that they all recognize that essential, affordable, functional ferry service requires government public policy and adequate government support. We urge the BC government to clearly define its own public policy and role in non-major routes by developing a Minor Route Strategy, and examining the potential consequences of not doing so.

Apples and oranges – government contributions to BCF and to ferry users

The provincial government cites $170 M as its contribution to BCF, noting this is an increase over its contribution at restructuring in 2003. The figure includes elements that are not part of basic support of the system. An instructive picture of government contributions is shown here (p.9).

The basic Provincial transportation fee has not increased since 2003. The federal subsidy has increased, indexed to inflation. The apparent increase to the non-Northern non-Major route fees in FY 2009 is offset by reallocation of federal subsidy from those routes to the Northern routes, for a small net loss to Rte 3/Minors. The provincial fee increase to Northern routes arises from needs identified in the Northern Strategy: a recognition of new vessel costs, fuel costs and loss of traffic.

Provincial and Federal Contributions	**FY 2004 start PT1 ($M)**	**FY 2008 end PT1 ($M)**	**FY 2009 start PT2 ($M)**
Provincial transportation fees			
Basic transportation fee (Rte 3 and Minors)	76.47	76.45	78.01
Basic transportation fee (Northern)	15.35	15.37	13.81
Total basic transportation fee	91.82	91.82	91.82
Northern adjustment transportation fee		11.98	11.48
Total Provincial transportation fees	**91.82**	**103.80**	**103.29**
Other Provincial payments			
33 % fare reduction stimulus program ($15M to Majors, $4.6M to non-Majors)			19.60
Service restoration agreement (Majors and Rte 3)			1.20
Contribution to fuel deferral accounts (Federal duty remission on Northern Adventure)			1.70
Contribution to Northern fuel deferral account (surcharge protection)			2.40
Total 'Other' Provincial payments			**24.90**
Total Provincial contributions to BCF operations	**91.82**	**103.80**	**128.19**
Federal contributions			
Federal contribution (Rte 3 and Minors)	19.90	21.47	19.79
Federal contribution (Northern)	4.07	4.39	6.51
Total Federal contributions to BCF	**23.97**	**25.86**	**26.29**
Total Provincial and Federal contributions to BCF	**115.79**	**129.66**	**154.49**
Pass-through funding to third parties through BCF			
Social program reimbursement (seniors, students, medical)			
. . . . Fares for travellers on major routes	6.67	8.79	9.91
. . . . Fares for travellers on non-major routes	5.64	8.46	9.35
Total social program reimbursements	**12.32**	**17.25**	**19.25**
Contracted route fees (Passed through to third-party carriers on Unregulated routes)	1.75	1.70	1.90
Nicola refit costs reimbursements (for BCF vessel leased to Lax Kw'alaams)		0.50	1.10
Total Pass-through funding	**14.06**	**19.45**	**22.25**
Total Provincial and Federal Ferry-Related Contributions	**129.85**	**149.11**	**176.74**
Dividend paid by BCF to Province	-6.04	-6.04	-6.04

Sources:
BCF reports to BCFC. (Dividend: BCF annual reports)

Recommendations

1. Update the Auditor General's 2006 review with a follow-up review, using the same parameters for comparison. Distinguish different findings among different route groups.

In the 2006 report, the Auditor General noted that the real test of the restructured system would be in negotiating new performance terms, which had not yet occurred at that time.

We concur. The process of setting the second performance term was instructively revealing of aspects of the system for all parties. Yet another term-setting process has begun, for the third performance term, which makes this a good time to update the Auditor General's 2006 findings.

2. Set measures to evaluate progression and effects of increased user pay, and of decreased provincial contribution, on the system and users.

Some of the six system objectives noted in this submission have been clearly defined and studied, others not:

1. separating public policy from financing decisions ***[AG 2006]***
2. system transparency ***[this review]***
3. increasing user pay
4. protecting the system in the long-term
5. improving customer service ***[BCFC ongoing, but missing a fare component]***
6. protecting the customer by ensuring modest and predictable fare increases

An evaluation as recommended here will complete the assessment of objectives for the restructured system.

3. Modify the process for setting each new performance term with a discussion of cost saving options and alternatives as the need arises. Include input of ferry users and ferry-dependent communities in the process, to capture their knowledge of the system.

In addition, we recommend that this include increased transparency of BCF costs that are shared and allocated among more than one route group.

4. Develop a Minor Routes / Route 3 Strategy to sustain and protect this component of the coastal ferry system and its users.

Respectfully submitted 24 August 2009, by the FACC (Ferry Advisory Committee Chairs)