

Response
to
the Wright Review
of
the BC Ferry Corporation

prepared by
the
Southern Gulf Islands Ferry Advisory Committee
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1 EXECUTIVE SUMMARY

The Wright Report has reviewed the well-documented history of the fast ferries and the process that led to their construction. We are basically in agreement with the conclusions regarding the fast ferries.

The report has assessed BC Ferries from a financial perspective. We have some areas of serious concern with the assessment, as well as a number of areas of agreement and some lesser areas of disagreement. These are as follow:

The report makes no reference to, and seems to attach no value to, the role of BC Ferries as part of the transportation infrastructure of the Province, not unlike the highways or the public transit system. The corporation plays a vital role in supporting coastal communities, one that transcends their own balance sheet. These communities don't expect four-lane, Cadillac service, but they do reasonably expect continuity of the basic service now in place. In fact, they are completely dependent upon their ferry service. They have no highway alternatives. While the report may overlook any obligation to the coastal communities, it would be unthinkable for the government to do so.

The report bases its whole assessment of system and route viability on the ability to recover the full cost of operations and capital renewal from revenue and the federal contribution. We believe this to be an arbitrary, unreachable expectation. The report cites no examples of domestic ferry service similar to ours where this is being achieved. Our research, in fact, shows BC Ferries has a much higher recovery rate than other roughly comparable systems, including neighbouring Washington State Ferries.

The report makes no reference to price elasticity. It appears to be presumed that fare increases can be accelerated and service cut without any impact on traffic. Common sense tells us that simply is not the way this or any other market works. Our concern is that if the corporation undertakes the suggested fare increases and service cuts, the traffic will decrease, reducing, and quite possibly reversing, the hoped for cost recovery improvements.

The report strongly advocates private sector involvement. We have no objection to private sector participation, provided that service and fare schedules are clearly specified. If the private sector can do it more efficiently, and still deliver the product safely, reliably and within the fare envelope anticipated by BC Ferries, we would not object. It should be remembered, though, that private companies also have unions.

The report advocates purchasing vessels offshore to take advantage of world market prices. We support the recommendation.

The report, by implication, casts BC Ferries in a darker light than we believe is appropriate. The negative comments, in our view, are gratuitous and/or without legitimate substantiation.

It is our view that the report raises some interesting issues but is flawed to the degree that it would be dangerous to base any substantial policy changes on its conclusions. The report can, and probably should, be used as a pointer to areas that would likely benefit from further investigation.

2 THE MAJOR ISSUES

There are three principal issues with which we take exception –

- ♦ failure of the report to acknowledge the role of BC Ferries in the transportation infrastructure of British Columbia
- ♦ presumption that operating the system on a break even basis is the preferred outcome without regard to collateral damage that may result
- ♦ failure to acknowledge price/demand elasticity, or the effect on traffic that would be caused by substantially raising fares and reducing service.

2.1 Ferries as Provincial Transportation Infrastructure

British Columbia is a beautiful province with a huge natural bounty and with its own specific challenges. It has rugged mountain ranges in the interior. It has a coastline dotted with a host of thriving communities on its many islands and inlets. And it has Vancouver Island just a ferry ride away off its west coast.

Mainland communities are linked by highways, many of them over high mountain passes or exposed to the deep cold of the north. These highways are expensive to build and to maintain. Coastal communities are linked by the ferry system, in a mature relationship that goes back generations. People count on the ferry service, just as they do upon the highway system, to provide safe, reliable and reasonably priced transportation. Aside from air travel, there are no alternative transportation means available.

We believe the Province has a fundamental obligation to respect the tacit bargain it made with the people who invested their savings and energy into the coastal communities, based on the expectation of sustained, reasonably priced ferry service. We would go further and suggest that if it turns its back on this bargain and obliges the ferry system to sharply raise fares and/or substantially cut service, it will have a crippling impact on the residents and businesses that are the heart of the coastal communities. Land values will drop, tourist-dependent businesses will lose their clientele and the cost of travel for essential purposes will become too expensive, too infrequent and possibly unreliable. In the case of the Gulf Islands, many of the residents are retired on fixed incomes. A sharp increase in the cost of the ferry service upon which they depend could have a devastating effect on them.

*Comment – it is entirely inappropriate to contemplate substantial changes to fares or service in the ferry system without reference to the role BC Ferries plays in the provincial transportation infrastructure. Safe, reliable and reasonably priced are the key words. Any contemplated change **must** take into consideration the collateral damage that could be caused to ferry-dependant communities, and their residents and businesses by precipitous changes.*

2.2 Financial Assumptions

The report refers to the terms of reference having as one of its principle (sic) objectives “Identifying the changes necessary to enable BC Ferries to provide an efficient, customer-focused ferry service at an acceptable cost to taxpayers”. This is a worthy objective, setting aside the issue of how well the organization presently meets each of the criteria.

The report then goes on to state “The Province should expect BC Ferries to operate on a break-even basis and provide for the renewal of its decidedly aging vessels.” From that point on, the report equates “acceptable cost to the taxpayers” with “operating on a break-even basis”. There is no indication how that conclusion was reached, nor is there any evidence provided to legitimize it. If some routes have the traffic and capacity to operate at a profit, why would they not do so? By the same token, if some routes need assistance to provide basic service, we believe that assistance should be forthcoming.

In reviewing other systems, it was found that the Washington State Ferry (WSF) system recovered 59.3% of their operating costs from the fare box in fiscal year 2001. All of their capital costs, as well as the shortfall in their operating revenues, were funded by the state and federal governments.

By comparison, in 2001 BC Ferries fareboxes produced over 80% of the required operating and capital funds, according to the report’s projections. Using WSF criteria, BC Ferries’ operating funds recovery from the fare box was 114%. BC Ferries are not necessarily better – they may or may not be. The BC system is different than the Washington one. The point is that a roughly comparable ferry service, accepted as part of the highway system, operates with proportionately far more subsidy than BC Ferries receives. The subsidy is seen as part of the cost of maintaining critical infrastructure.

Another comparison is Marine Atlantic, the federal crown corporation providing ferry service between Nova Scotia and Newfoundland. For the year 2000, their commercial revenue was \$54.1M and their operating subsidy was \$25.4M. They recovered 68% of their operating expenses from the farebox. Their capital expenditures were fully funded by the federal government. Again, not a direct comparison, but one that shows ferry subsidies are in order when routes, traffic and the community good warrant them.

The report provides no evidence that taxpayers are presently dissatisfied with the level of funding provided to BC Ferries, compared to other transportation links – BC Transit, highways maintenance, TransLink.

There is nothing in the report to support the notion that 100% cost recovery from the fare box is the optimum, or even a reasonable, expectation.

Comment – the opinion that taxpayers feel the provincial funding for BC Ferries is unacceptably high is unsupported. The notion that the acceptable level, and thus the object of the report, is 100% operating and capital recovery from the farebox is also completely unsupported. In fact, industry evidence with similar ferry services indicates that government funding support is the norm, and usually to a greater extent than found in BC. If the province were to undertake the report's recommendations to reach this arbitrary goal, there would be severe damage to the coastal communities as well as to the residents and businesses therein. Even then, it is unlikely the goal would ever be reached as the traffic, and revenue, would fall in reaction to accelerated fare increases and cuts in service.

2.3 Price Elasticity

The report makes no reference to price elasticity. Astonishingly, it seems to take the position that traffic would not be affected by fare increases and service cuts. The report states “. . . revenue on the Horseshoe Bay to Bowen Island run could be increased by over 50% if commuter discounts were removed”. It asks you to believe that if passenger fares were increased by 86% and vehicle fares by 30%, that every single trip now taken would continue to be taken. Charitably, this might be described as naïve.

The report views the discounted fares as “commuter” fares, suggesting people are using them to travel back and forth every day. That may be the case in

some instances, but in most, the discounted fares are used by regular users of the system, traveling to attend the host of concerns that cannot be addressed on their island – doctors, building supplies, provincial services, grocery shopping, visiting friends in hospital. If the discount were removed, there would be fewer trips made and the anticipated revenue gains would evaporate, while compromising the health and happiness of the communities and people involved. This could hardly be viewed as customer-focused service, one of the stated objectives.

Had the report considered the elasticity factor, it would have first had to identify who the customers were, and then assess how accelerated fare increases and service cuts would likely be received by the various market segments. The report appears to not have taken into account who the customers actually are. For instance, it refers to “These routes (southern Gulf Islands) require six vessels and ten terminals to serve five island communities with a combined population of 15,000 and lose over \$20 million (\$1,333 per capita) per year before overhead.” The report fails to recognize that the residents are only a part of the traffic. The ferries also serve off-island residents, tourists and business people. It is a fact that half of the 10,000 residential properties on the islands are owned by people living off-island. Most of these are weekenders, heavy though discretionary users of the system. While the weekenders are sensitive to fare and service adjustments, the tourists who flock to the islands in the summer are even more discriminating how they spend their vacation dollars. They have many choices and have no particular equity in going to the Gulf Islands, or Vancouver Island for that matter, to spend their money.

The report makes a number of recommendations for substantial fare increases and service cuts, calculating the increased revenue and reduced expenses without once acknowledging that there would be customer reaction to those cuts, offsetting the financial benefits, or even negating them. Other ferry service reviews that have contemplated fare increases and service cuts have included reference to the public’s reaction to them. They have urged cautious introduction of the changes, so that no great damage would be done if the adjustments were to backfire.

A clear example of price elasticity cause and effect can be found in this report although it is not identified as such. On p 20, the report contains a graph depicting traffic growth on the main routes charted against population growth in the areas served by them. The report states “Actual traffic patterns

have been erratic over short periods but in line with the population growth over long periods.” At first glance, the graph would appear to support that conclusion, as a result of careful selection of scales on the vertical axes. However, looking more closely at the numbers on the graph, one sees that it breaks into three discrete sections. The first is 1976 to 1992, the ‘growth period’. The second is 1992 to 2001, the ‘flat period’ and the third is 1992 to 2020, the ‘optimistic future’. In the first period, the traffic increased at 4.0% while the population grew at 1.9%. In the second period, the traffic increased at 0.7%, while the population grew at 2.2%. From growing at twice the rate of the population, ferry traffic leveled off to grow at less than half the rate of the population. The flat period can also be defined as the period during which the NDP government imposed a series of steep fare increases, with the declared intent of recovering all the operating and capital costs from the farebox. In the third period, the report predicts that traffic will increase at 1.4%, more than double what has been happening for the past decade, while the population is expected to grow at 1.9%.

The report, on page 18, states “From 1992 to 1999, total revenues increased at 5.5% per annum substantially as a result of increased tariffs . . . while passenger traffic grew at less than 1% per annum and vehicle traffic remained flat.” It fails, however, to connect the decrease in traffic growth to the increase in fares. The question is not asked what the revenues might have been had the ideologically motivated fare increases been less ambitious. Nor is there any reference to the lost business opportunities as ferry-related tourist traffic leveled out or decreased.

Contemplating the results of the previous government’s fare policies, it is inconceivable that the financial projections of the report will have any chance of materializing if the fare increases and service cuts recommended in the report are imposed. It would be a stretch even with the modest fare increases and limited service adjustments contemplated by BC Ferries. This is a matter of common sense.

Comment – The lack of reference to price elasticity, and the probable effects that sharp fare increases and service cuts will have on traffic volumes, is an incredible oversight. The resulting analyses are thus grossly optimistic as to the financial benefits expected to result from the recommendations and cannot be relied upon. The concept is an elementary one; its absence, a fatal flaw.

3 GENERAL OBSERVATIONS

These points of interest generally follow the flow of the report.

3.1 Executive Summary

3.1.1 Efficient, customer-focused service – *comment – we applaud these two objectives. We trust the Ministry will want to perform a legitimate assessment of how well BC Ferries presently meets these goals. We are comforted that the report includes customer concerns among its fundamental objectives.*

3.1.2 Fast Ferries – *comment - without access to information beyond this report, we would agree that continuing with the sales process for a fixed period is prudent. There should, however, be some motivation for the agent to work toward an early sale, without seriously discounting the sale price to get it. There should be a Plan B in the event the vessels cannot be sold for anything approaching the hoped for price. Given the asking price and the many speed, range, weight and capacity compromises, the fast ferries will not be seen as bargains. The biggest detriment will likely be their limited wave tolerance capacity, which prohibits them from sailing in the open sea where most fast ferries operate. There is a high likelihood that BC Ferries will own these vessels when the two year search, now a year and a half old, is over.*

3.1.3 Governance – *comment – as long as the ferry service in BC is either owned or regulated by the government, the government will have a legitimate interest in fares, routes and major capital expenditures. Having said that, most of the legislation already exists to allow the appointed Board to govern the system. It would probably be useful to provide them with the authority to approve fare increases up to CPI without having to seek permission to do so. Beyond the Board, the Minister's office and Treasury Board provide a legitimate oversight function. The Crown Corporations Secretariat could probably be taken out of the loop with no great loss.*

3.1.4 Service Improvement Alternatives –

The report states “Such a model (ferry service that offers consumers choice and provides efficient, customer-focused service) would clearly require greater private sector involvement.” The report seems convinced from the outset that “. . . the private sector can do it better.”

The report provides no comment on the service that predated BCFC on the main routes. It was provided by Black Ball and CPR to Nanaimo and CPR to Victoria. Black Ball provided simple direct service, but was shut down for at least one lengthy labour dispute. CPR provided harbour to harbour service, with painfully slow automobile loading and unloading. BC Ferries took over the *Chinook* and *Kahloke* from Black Ball and basically replicated the Horseshoe Bay to Nanaimo service, but without the exposure to labour problems (strikes in the public service were illegal at the time). The ‘new’ BC Ferries service chose a much shorter route to Victoria with new vessels with dramatically reduced loading and unloading times. The customers loved it.

The report refers to “the majority of maritime jurisdictions around the world have discovered that . . . the private sector can do it better.” On p 13, the report states that the move to privatization is “. . . particularly evident in Europe . . . and in New Zealand but minimally in North America.” No examples are given of specific ferry systems or results achieved. One wonders if the European ferry systems referred to are the ocean going vessels plying the heavy international traffic routes of the North Sea, the English Channel and the Mediterranean Sea. If so, those systems are a world apart from our local service circumstances. They use large vessels, as big as and bigger than our Spirit class ferries, travelling between major ports carrying heavy passenger and vehicle loads. The profit potential is substantial. In New Zealand, the principal ferry service is the one across the Cook Strait between Wellington and Picton, a three hour and twenty minute crossing using vessels larger than our Spirits. As the only ferry service connecting the North and South islands, it enjoys heavy traffic and substantial profit potential.

It may well be that some types of private service could do a better job than BC Ferries in some or all applications. It should be noted that private operators will likely have union influence in their work place – quite possibly the ferry workers union. In the interests of customer focus, we would want to know that the service provided would meet defined specifications for service and fares. This has worked for BC Transit in their municipal transit systems

around the province and conceivably could work for BC Ferries. On the other side of the coin, privatization of some transit services in New Zealand turned into a huge embarrassment when the standards were not defined. Service fell apart and financial expectations were not met. We support the initiative to explore the market to find out what might work here. However, starting with a basic assumption that the private operator will do a better job, without any supporting evidence, is dangerous. The fact that it has not been embraced in North America could be a warning flag.

comment – we have no objection to private ferry service. It may or may not provide a preferred solution. We believe, however, that it is dangerous to start with the fundamental assumption that the private service will, by definition, ‘do it better’.

3.1.5 Financial Framework – *comment – as discussed previously, we believe the assumption that the system must operate on a break even basis, and will get there by raising fares and cutting service without regard to customer backlash, is unsupported and inappropriate. Without linking traffic volume changes that would result from the fare increases and service cuts, the conclusions are meaningless.*

3.2 Request for Public Input

3.2.1 Public awareness - *comment – the study was well publicized among interested parties. There was no shortage of time or opportunity to comment. However, there seems to have been no attempt to survey the silent majority, those with no axe to grind. On-board passenger surveys would have provided much more credible evidence of the level of customer satisfaction, or dissatisfaction, with the system. In the absence of such input, the report is left to rely upon anecdotal information coming from a non-representative sample of respondents generally preloaded with a negative bias. Most people will not be motivated to write in that they think the service is just fine. 195 people is a microscopic, non-random, sample of the total ferry-travelling public. In our collective observation, the conclusion of general ‘deep disenchantment’ is not valid. We believe it to be a gross overstatement and unwarranted. In any event, there is no credible evidence presented to support the description as applying to the broad customer base. The conclusion is without credence.*

- 3.2.2 *Gulf Islander complaints – comment – the advisory committee also hears complaints from Gulf Islanders who believe the ferries should run like a Swiss watch, providing service for them when and where they want it, with no intermediate stops. They fail to accept that there are five islands with similar wants, and three vessels serving the most complicated routes in the system (9 and 5). As Gulf Islanders, we must compromise to realize the greatest overall good. That is a fact of life. We know the system is operating under tight fiscal restraint. It does not, and will not, have the resources to add extra vessels or overtime to the service. The management and staff do a good job with the resources at hand. Unfortunately, there are some Gulf Islanders who feel entitled to Cadillac service on a Chevrolet budget and won't be satisfied until they get it. They expect crown corporations to have an infinite capacity to serve their needs. They may speak loudly, but they do not for the majority.*
- 3.2.3 *While written contributions were solicited, there seems to have been no attempt to engage ferry advisory groups or ferry dependant communities in dialogue with respect to service and fares. It is hoped that if system changes are contemplated, there will be more interaction with the affected communities. Such discussions could offer guidance as to how service might be altered with the least possible loss of traffic and the least damage to the communities. There would be strong resistance to accelerated fare increases. However there may be selected service reductions that would be more tolerable and would not likely seriously impact traffic levels.*
- 3.3 **Alternative uses for the Fast Ferries** - *comment – as earlier, we accept the recommendation to continue the sales process, with the caveat that there should be a drop dead date when the Province accepts that the search for a buyer as conducted thus far is futile, and goes to Plan B. With the vessel limitations and history, and apparent lack of buyer interest after a year and a half, that outcome is more than a mere possibility.*
- 3.4 **Morfitt and Gordon** - *comment – The Gordon and Morfitt reports speak for themselves. It must be taken into account that the fast ferries were a political creation, undertaken against the advice of BC Ferries, and in a fashion totally at odds with the management and control processes of any other project the corporation has been involved with.*

While there can always be improvement in project approval and management processes, the fast ferries were not the creation of BC Ferries Corporation. It might be useful to examine the role of the Crown Corporations Secretariat in this unhappy tale.

3.5 Service Improvement Alternatives –

The report refers to the “many jurisdictions through the world (which) have developed approaches to service delivery that incorporate competition, private sector operations and private sector finance”. Yet no examples are offered to provide the reader with a sense of applicability to the BC situation. The recommendation to take as an objective “commercializing, to the greatest extent possible, the provision of ferry services” asks the reader to accept the unsupported assumption that private is better. It needs to be remembered that once services are privatized, it would be very difficult to ever bring them back into a consolidated government operation.

The report floats the idea of using fixed links to replace some of the routes. The idea may have merit and should probably be explored. There would likely be mixed reaction to any bridge proposal. However, if bridges appear to offer a viable option, they could, and should, reasonably be considered.

comment – The private sector may offer some benefits not presently available. However, it is not a panacea guaranteed to resolve all the perceived problems of the system. Any forays into privatization should be well researched beforehand and executed with sufficient care that the customer focus will not be sacrificed. If privatization is used as a mechanism to impose abrupt fare increases and service reductions, there will still be an impact on traffic volume and the hoped for financial results will not be realized. Fixed links may have potential; more information would be needed in order to comment.

3.6 Review of BC Ferry Corporation

3.6.1 Management –

The report attributes BC Ferries with “ . . . a reputation for being unapproachable, unbending and bureaucratic”. The same would be said to greater or lesser degree for most government departments and agencies. It would also be said about CPR, Telus, insurance companies, Air Canada,

Rogers Cable and a host of other large, private organizations, particularly those with monopolies or positions of near absolute power over their customers. In fact, it is the view of our advisory committee that BC Ferries has worked very hard to hear and respond to the concerns of our constituents. The ferry advisory committee works directly with the ships' captains to set schedules; there is no intermediate 'bureaucracy'. In the absence of credible evidence to the contrary, we submit that the reputation attributed by the report is inaccurate and undeserved.

Reference is made to the "considerable progress" achieved under the current management team. We agree with and endorse the observation. We suggest that the noted progress is a clear indication that BC Ferries is capable of successfully addressing the issues under examination in the report.

The key assumptions in the strategic plan are sensible and take into consideration the fragile nature of price elasticity. They are applicable whether the service is provided by BC Ferries or private operators.

comment – the reputation ascribed to BC Ferries is unsupported by any credible evidence and flies in the face of general opinion and the opinion of this ferry advisory committee. The report acknowledges that the current management team is doing a good job in all the important areas; they would seem to have earned the right to proceed with their plan. The strategic plan is a conservative one, recognizing the realities of the transportation market in coastal BC. It responds to the current financial constraints under which the provincial economy is labouring, while accepting BC Ferries' obligations to the people and communities it serves.

3.6.2 Proforma Historical Financial Results

This analysis reflects the impact of the fare increases on traffic over the past decade. The summary of 10-year proforma historical financial performance indicates revenue increased 4.1% per annum while passenger volume grew at 0.5%. As the fare increases outstripped inflation, residents, tourists and weekenders traveled less. People travelling on business, including the business of governing the province, turned increasingly to the helicopter and fixed wing alternatives at least in part due to the increasing ferry fares. One wonders how the traffic and resulting revenue would have responded to more modest fare increases. A significant difference between the last ten years and the strategic plan is that the plan contemplates holding fare increases within

CPI levels. That is fundamental to achieving the anticipated traffic increase, the component suppressed for the past decade.

comment – the proforma financial performance figures are based on the arbitrary assumption that the corporation can and should be able to fund its operating expenses and capital needs from revenues. This arbitrary assumption is unsupported by any business based rationale at this time. Any conclusions drawn from the exercise are thus of limited value.

3.6.3 Strategic Plan - *comment – BC Ferries' strategic plan is a conservative one that recognizes the realities of the coastal transportation market in BC. The traffic increase seems ambitious but is no doubt predicated on maintenance of existing service levels with only nominal fare increases. The plan seems to acknowledge the fiscal reality of the times (no new routes or service expansions). Whether this will be adequate to service the new southern Gulf Islands National Park and the other anticipated growth remains to be seen.*

3.6.3.1 Strategic Plan – Revenue, Expense and Capital Expenditure Assumptions

3.6.3.1.1 Vehicle and passenger forecasts

The main route section is discussed earlier in Section II C, Price Elasticity. If the minor route growth is based on population as implied, it will not have considered the impact of recreational property owners or tourists. Their service needs account for a substantial part of Gulf Islands traffic. With the opening of the Pacific Marine Heritage Legacy National Park in the southern Gulf Islands, the service demand will increase. There is, to our knowledge, no provision in the planned service to accommodate this increased demand.

comment – We agree there is likely a medium risk attached to achieving the projected traffic growth. The most serious hazards for the projected growth patterns, however, will be fares and service levels. If fares are raised sharply or service is severely reduced, traffic will decrease, quite possibly to the point where revenue will decrease more rapidly than operating costs.

3.6.3.1.2 Tariff - *comment – the possible tariff growth rate of 75% of the CPI is deemed by the report to be a conservative assumption, posing little risk. It is conservative in that it would likely be found*

tolerable my most travelers, but it would be pushing the limit. Fare increases at or above the CPI growth rate could be expected to result in constrained or negative traffic growth.

3.6.3.1.3 Capital Plan - Vessels - *comment – we concur with the recommendation to purchase standard vessels, with proven performance in BC waters, in the world marketplace. If it is deemed necessary by government to pay a premium to employ BC workers or to utilize BC shipyards, then that premium should be borne by the recommending agency, not by BC Ferries.*

3.6.3.1.4 Capital Plan – Terminals and Information Technology – *comment – we agree with the recommendation regarding the need to improve informatoin technology systems. We look forward to the time when route scheduling software is in place for the southern Gulf Islands and the reservation system is updated to track reservations requests that are denied for lack of vessel capacity. We also accept that the most critical system shortcomings should be addressed first, with the rest to follow.*

3.6.3.1.5 Labour Costs

3.6.3.1.5.1 Vessel Operations– *comment – we concur with the observations regarding wage increases possibly exceeding the CPI growth and changes in regulations possibly requiring larger crew complements. However, the directions now being established for wage and contract price controls would suggest that wages may reasonably be expected to remain within the CPI envelope. As well, the direction in transportation staffing requirements is toward fewer, not more, as evidenced by reduced size of train and aircraft crews. If current directions are sustained, we see this as a low risk element as opposed to the medium risk shown in the report,*

3.6.3.1.5.2 Vessel Repairs and Maintenance – *comment – in the absence of any expert opinion countering BC Ferries maintenance expectations, we believe the report’s assessment of vessel repair and maintenance costs to be high risk to be overstated. Low risk would be more appropriate.*

- 3.6.3.1.5.3 Terminal Operations and Maintenance – *comment – it should be noted that the 20% vehicle traffic increase over fifteen years is only 1.22% per year. That increase is predicated on fare increases within the CPI and sustained service levels. If fares increase more rapidly or service is cut substantially, then the traffic increases will not likely occur and may well turn out to be traffic decreases. In any event, with the management controls now in place, there is little likelihood of the future workforce growth reflecting the growth of the past ten years. Low risk would be more appropriate.*
- 3.6.3.1.5.4 Regional and Corporate Overhead – *comment – the report sees the anticipated future cost of regional and corporate overhead presenting a low risk of exceeding expectations. We concur with the report's observations.*
- 3.6.3.1.5.5 Collective Bargaining Agreement – *comment – we agree with the report's assessment of the significant issues inhibiting efficient operations. It might be noted that these impediments are found to some degree in most collective agreements, including those of private contractors, such as the highways maintenance companies. They tend to occur more in monopoly situations (where customers have no other choice). Apart from the counter-productive union issues, we would point out that most front line customer contact ferry employees work hard to provide a positive experience for the travelling public. It is the exceptional few who create the indelible negative impressions.*
- 3.6.3.1.5 Fuel – *comment – while fuel prices are beyond the control of BC Ferries, there are historic market ceilings. Market forces have generally kept prices beneath these ceiling and may reasonably be expected to do so in the future. In that the assumptions were conservative to begin with, the risk of their being exceeded is likely medium at the highest and not high as stated.*
- 3.6.3.1.6 Repairs, Maintenance, Materials and Supplies – *comment – repairs and maintenance for familiar assets is reasonably predictable. We believe the risk is overstated at high, and more appropriately viewed as low.*

3.6.3.1.7 Other expenses – *comment - we concur with the observation regarding the results of current management's cost controls. They appear to have effective control of costs. Results from the previous decade do not generally apply to the new regime.*

3.6.3.1.8 Insurance, Taxes and Utilities – *comment – we concur there is medium risk of these costs exceeding plan, particularly in the wake of the Sept 11 terrorist attacks.*

3.6.3.1.9 Catering and other Retail Services – *comment – we concur with the comments regarding BC Ferries' success in increasing these ancillary revenues.*

3.6.3.2 Strategic Plan – Sensitivity Analysis

This is an unusual analysis in that sensitivity analyses typically adjust the key factors in both favourable and unfavourable directions if best case and worst case scenarios are to be illustrated. If worst case only is being tested, then the factors will all be adjusted in the unfavourable direction. The exception to this would be if one factor was a function of another ie moving one unfavourably meant another would move in the favourable direction. The report increases the tariff growth 33% higher than basic plan (favourable) while adjusting the rest of the factors in an unfavourable direction. It may be that the traffic adjustment (25% less than plan) was seen as a consequence of the tariff growth increase, but no narrative is provided to support this linkage.

3.6.3.2.1 Tariff – *comment – as noted elsewhere, tariffs can be increased over a fairly wide range, but traffic will respond to those adjustments. As long as CPI growth remains low, adjusting the tariff increases to match the CPI will likely slow traffic growth but not reverse it.*

3.6.3.2.2 Traffic – *comment – considering the interest expressed in accelerating fare increases and cutting service, it would be prudent to consider much larger negative adjustments in traffic growth, such as zero and –1%. Both are entirely possible. The report only tests traffic growth dropping from 1.4% to 1.05%.*

- 3.6.3.2.3 Interest Rates – *comment – validity of this assumption is a technical issue based upon how conservative the 6.6% used in the plan is.*
- 3.6.3.2.4 Vessel Acquisition Costs – *comment – given the report’s observation on p 23 “ prices for nearly all types have vessels have declined in recent years”, it is puzzling to see an increase of 36% in acquisition costs as the test factor. That is a huge increase and, on the face of it, totally unlikely, provided the corporation is allowed to seek the best value in the marketplace. If they are forced to purchase locally, then the premium cannot reasonably be charged to BC Ferries, other than by political decree. A more reasonable test factor would be in the range of 5% to 10%.*
- 3.6.3.2.5 Expense Compound Annual Growth Rate – *comment – probably a reasonable high end test factor.*
- 3.6.3.2.6 Strategic Plan Summary and Assessment

The report states “it is clear from the sensitivity analysis that small unfavourable changes in the forecast assumptions could have large negative impacts on the financial position of BC Ferries.” A 36% increase in vessel acquisition costs, which in itself is a major component of the financial picture, could hardly be described as “small”. Traffic growth is a much more important factor to worry about. If it falls significantly below plan, then the financial results will be in serious trouble. That risk is high, if fares and service are adjusted unfavourably beyond that contemplated in the plan. That concern is valid whether the service is operated by BC Ferries or a private operator.

It is puzzling to note in the second para, section h on p 31, that long term debt will increase by approximately \$1.2 billion if *just two* of the sensitivity adjustments (vessel costs and expenses) are realized. In the last para of section g, same page, the report indicates that long term debt will increase by the same \$1.2 billion if *all five* factors are taken into account.

The assessment includes concludes that BC Ferries will not achieve its Strategic Plan and thus fail to meet its financial objectives. The assessment is based on the ten-year historical performance, notwithstanding earlier

observations that the current management is effectively controlling costs, a project management plan is in place and BCFC is now free to consider purchasing vessels at world market prices.

comment – the conclusion is based on dubious assumptions and an analysis that includes an unreasonably high cost of vessels adjustment. The one major element that could cause BC Ferries to fail to meet their financial objective is if they fail to attract the traffic growth they anticipate. This will surely occur if fares are raised too quickly or critical service is cut, and will occur regardless of who the service provider is.

3.6.4 Service Level, Tariff and Financial Framework

3.6.4.1 Maintaining Existing Service Levels

While accepting the numbers at face value, we take exception to the characterization of the gap between revenue on one hand, and operating costs and sustaining capital expenditures on the other, as losses. This amount is part of the cost of maintaining a vital segment of the provincial transportation infrastructure. Some of it is covered by the surplus from Routes 1 and 2, and the remainder comes from provincial funds. Until the cost of building and maintaining highways is characterized as a loss, that term is inappropriate when applied to the ferry system infrastructure.

It might be noted that the system recovered over 80% of its total operating and capital funding requirements, an achievement that would be envied by most ferry systems in North America.

comment – the report is predicated on the objective of the system recovering its complete operating and capital funding requirements from revenues. In the absence of any evidence to the contrary, that appears to be an arbitrary assumption and not one supported by industry practice, nor accepted by this committee.

3.6.4.2 Commuter Routes and Discounts

In the southern Gulf Islands, the ferries serve some daily commuters and many regular users who are not daily commuters. The discounted rate is seen as ‘the’ tariff by those regular users. Reducing or eliminating it will be seen as a fare increase, and traffic levels will respond accordingly. Providing

service in only the “rush hours” in the southern Gulf Islands would not be an option simply for the lack of vessels to meet the requirement and the time required for the trips. While it may or may not be the case on other routes, the later morning trips and the afternoon trips on Routes 5 and 5A are generally well utilized.

The example of Bowen Island increasing its revenue by 50% by eliminating the discounts on the route presumes that everyone is now taking advantage of the discount, and everyone would continue to make as many trips as they do now in the face of an 86% increase in passenger fares and a 30% increase in vehicle fares. Those presumptions strain the limits of credibility.

comment – as stated elsewhere, we believe the objective that each route must cover all its operating and capital costs is arbitrary and inappropriate. It is highly unlikely that short of selling the vessels and real estate, and dismissing the crews, sufficient revenue will ever be collected to cover the full costs of many of the routes.

3.6.4.3 Southern Gulf Islands

The report cites the southern Gulf Islands requiring “. . . six vessels and ten terminals to serve five island communities with a combined population of 15,000 and lose over \$20 million (\$1,333) per capita per year before overhead” while noting the islands receive “. . . service from Swartz Bay and Tsawwassen.”

A little clarification of this image of six ferries buzzing around the southern Gulf Islands:

- ♦ two of these vessels service Salt Spring exclusively, connecting Fulford Harbour to Swartz Bay and Vesuvius to Crofton.
- ♦ one of these vessels is a standby and replacement unit for eight months of the year and provides supplementary summer service. In the summer it serves Salt Spring primarily but is of benefit to all the islands in relieving the pressure on the mainland service.
- ♦ one vessel is used as the backbone of service to and from Tsawwassen
- ♦ two vessels connect Galiano, Mayne, Saturna and Pender Islands with Swartz Bay, and to a lesser degree, with each other.
- ♦ there are, as stated, about 15,000 residents on the islands. There are, however, a great many off-island property owners who constitute the bulk of the traffic to and from Tsawwassen, particularly during and around the

weekends. There are 10,163 residential land titles registered in the southern Gulf Islands, with 10,450 owners. Of these owners, 5,175 are non-residents, having ‘off-island’ addresses. There are also many tourists from across North America who are drawn to the islands every summer. This will increase as the new southern Gulf Islands National Park comes on stream. Implying that the ferries serve only the residents is incorrect and misleading.

The report also notes dissatisfaction from the ‘residents’ with the current level of service. If every one of the 195 individual responses received was from a dissatisfied southern Gulf Island resident, that would be a sample of 1.3% of the community. It would be considerably less if the number of residents was expanded to include the off-islanders and tourists. The point is that the southern Gulf Island ferry traffic undoubtedly includes a few people who are dissatisfied with the service and who are outspoken on the subject. On the other hand, the vast majority of people who enjoy the southern Gulf Islands are ordinary citizens, who appreciate the service they receive and are content to arrange their lives around the schedules and fare structures of the system. Had the measure of satisfaction or dissatisfaction been sampled on board the vessels, it is very likely the outcome would have been much different to that cited in the report.

comment – the observations and assessment are based on incomplete and skewed information. The conclusions are thus not only without meaning, they are misleading, as they misrepresent the situation. With regard to the reports’ premise that full cost recovery should be the criteria for route viability, it is viewed as an arbitrarily selected goal and not practical or achievable in these circumstances.

3.6.4.4 Alternatives to Existing Routes – *comment – the fixed link alternative has been discussed in the past. If a properly prepared case can be made for fixed link connections, most islanders would be open to discussion on the subject. With respect to the suggestion of elimination of routes, it would be regarded in the same light as closure of highways between communities.*