Reply to Paper #1

The context in which comments can be made regarding the operating principles stated in section 38(1) of the Coastal Ferry Act is that BCF is a natural monopoly providing an essential service to the public. The theory and practise of a natural monopoly is that a single provider can offer the service at a lower cost than competition could provide, largely because of high fixed costs as, in this case, berths and ships. Competition would require duplicating both, resulting in a lower level of use than is now the case and therefore at a higher cost level. Ferry service on the coast is essential to the public in the sense that there are very limited real alternatives at an affordable price. The available air and barge service is either more expensive or more limited in service. These realities imply that the service either be provided by the government such as, typically, roads and transit, or by the private sector regulated to some level by the governments, in the case of the traditional communications and electrical power companies.

BCF is currently structured as a hybrid, theoretically intended to operate as a private concern although wholly owned by the public. This somewhat complicates commenting on the six principles as there are few comparable publicly owned natural monopolies providing an essential service and yet operating as a private concern (where the profit motive is normally present). Any comments need to be considered in light of the above.

(a) As the CFA is structured, with the service fee to the minor routes held constant, the only variables affecting financial sustainability are costs and fares. Thus, as costs, particularly fuel and regulatory costs, have risen far more than obviously envisioned in 2003, fares have risen far beyond the rates of inflation to the detriment of the coastal economy. As BCF is restrained from rationalizing service by the BFSC, there is no alternative to increasing fares. Ultimately the choice comes down to reducing the level of service or increasing the service fee as ridership drops and revenue declines. Obviously this ultimate choice was not provided for in the CFA as the province has kept the service fee constant while the CFSC has set a rigid service level. Financial sustainability, as a result is elusive under the CFA.

(b) It is difficult to relate the term “commercial approach” to a natural monopoly providing an essential service. A “commercial approach” is normally taken by a firm in a competitive market where failure and exit from the market is the result of an inadequate “commercial approach”. The services provided by BCF are essential, for economic and political reasons. Other than conducting its affairs in a businesslike and efficient manner within the constraints of the CFSC, there is little scope for a traditional “commercial approach”. It is noted that a similar “commercial approach” vision has not been adopted for other public transportation providers such as Translink and BC Transit.

(c) It should be remembered that when BCF was originally established there were a number of “alternative service providers” (ASPs), such as Black Ball and Gulf Island Ferries. In short order all their routes were absorbed by BCF for economic reasons. Recent attempts to attract ASPs have not been successful. Private operators are involved in Inland ferries and serve low volume passenger-only routes on the coast, either independently as to Lasqueti and Savary Islands or as in the case of Gambier/Keats under BCF contract. The very nature of the economic reality of coastal ferries appears to mitigate against the concept of ASPs operating auto ferries.

(d) This is a very nebulous principle. If it refers to expenses for a particular route, then obviously the BCF has an incentive to minimize expenses to improve the bottom line. If it refers to the system as a whole, then it may imply that BCF should consider whether the present route structure has minimized costs in providing ferry service to the coast. Any change in the route structure, even to minimize expenses, would require a change in the CFSC.

(e) Cross subsidization occurs in all aspects of life. The wealthy subsidize the less so with progressive income taxes, the have provinces subsidize the have-nots with transfer payments, profitable Ford cars subsidized unprofitable Lincolns for years. In the public domain cross-subsidization equalizes benefits among beneficiaries of a service, in the private sector it is often for branding or prestige reasons. BCF has a problem in that it is a “privatized” entity providing a public service. The “unprofitable” minor routes are operated for benefit- equalization reasons and a “private” operator would tend to drop them in the long run. As the CFSC prevents this, cross-subsidization should be considered as a normal part of providing a public service.

(f) It is doubtful that anyone realistically still believes that the service fee contributions by the government will be reduced. As the service fee has essentially been frozen and fares have dramatically escalated, the damage to the coastal society and economy has become apparent and three questions arise: (1) what is the commitment by the Province to ensure the “fair, stable rates” envisioned in the CFA, and (2) at what point does the economic and financial damage (caused by the high fares) to provincial tax revenues offset the savings generated by freezing the service fee? (3) why does the province adopt such a totally different attitude in the provision of essential transportation services to the coast compared to the interior ferries, roads and transit?

Reply to Paper #2

1) Re the definition of ferry users

The members of the SSIFAC unanimously agree that the broadest definition of “ferry users” should apply - one that recognizes the interests of whole communities, residents, tourists and all those who depend on the services provided by the ferry system.
There are two categories of usage of the ferry service - those who use it directly by travelling on the ship and those who depend on the ferries to provide them with goods, services and customers. To an extent they are the same people but there are those who rarely travel on the ferry but are still very dependent on it. Therefore: ferry users and ferry dependents, both, in current jargon: stakeholders..

The entire coastal society and economy are ferry dependents. When BCF was first established, it was promoted and seen as an engine of economic development on the coast. As the traditional industries of fishing and forestry declined in relative importance, tertiary economic activity, particularly tourism, expanded. Tourism is , if anything, even more dependent on the ferry service than the resource sectors are. Relevant businesses and communities have developed, dependent on the ferry service available. If that service is now priced out of affordability, then the entire coastal economy declines. Thus, whether directly or indirectly, both users and dependents are concerned with the maintenance of the ferry system. As BCF is a monopoly and as all routes but one are to destinations inaccessible by road, there are no real options.

2) Affordability and dependability tend to be the major interests expressed by SSI residents and visitors. A current issue regarding dependability has arisen in connection with the construction work being conducted on berths 4 and 5 at SWB. When the 7:50 Skeena sailing is held back from docking on time in SWB, schedules, whether connecting to route 1 or getting to work, have been disrupted.
As the impact of rising fares has been well reported, it can only be reiterated how critically fares are considered an interest. Most other interests mentioned such as safety are taken for granted. Ancillary service levels on the minor routes are of lesser concern. , other than the recent “branding” exercise , than on the majors, where there is more controversy.
Some users seem to prefer not much more than a barge service while others fully appreciate the Pacific Buffet. As the ancillary services are profitable, they are best maintained.

3) Within the context of the CFA and the expanded role of the Commissioner, the word “consider” is inadequate. Considering a situation or a result implies reaching a conclusion. A conclusion without an order or directive is a sterile exercise and a simple recommendation does not imply action. The CFA makes clear the independence of the Commissioner, but this is of little value if the Commissioner does not have the authority to act in the interests of the ferry user. It would seem that the Commissioner would have the power to issue an order or directive. The use of the word “consider” is appropriate only when the authority of the Commissioner to issue directives has been established.

(4) The members of the SSIFAC are divided on the question of "financial sustainability," especially as put in the Commissioner's question "the financial sustainability of the ferry operator". The SSIFAC recognizes that the ferry system is an integral part of British Columbia's highway system. No one seriously argues that the highway system is "financially sustainable" in and off itself - that is, it does not rely on user fees. Rather, it depends on the contribution of the taxpayer as a benefit shared by all residents and visitors to British Columbia. The ferry system provides a similar benefit and should be funded in part by those who make direct use of the ferries as well as those who do not - much the same as every resident of British Columbia contributes to the cost of building and maintaining the highway into places where they never travel.

Financial sustainability is obviously critical to the ferry users and dependents insofar as the system needs to be sustainable in order to continue to exist. But as BCF is a provincial government owned entity, the assumption is made that it will always be there in some form. Sustainability is viewed in the CFA as reducing the draw on provincial revenues and increasing the direct charge to the user/dependent. As this view has led to the current crisis, and, in fact, to this Review of the Act, it becomes obvious a different concept of sustainability is needed. As there are only three players here, BCF, the government/taxpayer and the user/dependent, and *as BCFs costs rise and the fares to the users are hitting a wall, it falls to the government to either contribute more or allow a reduction in the level of service mandated by the CFSC*. It may be interesting to compare the concept of sustainability of the ferry service to that applied to transit and roads.

Reply to Paper 3.

Admirable as the generally accepted definition of financial sustainability may be it seems to have had little relevance to BCF for two reasons. Although starting with a cleared balance sheet under the CFA, BCF had to spend massively in a catch-up mode to replace ageing ships and berths. Infrastructure spending had to be at a level higher than it would have been if capital assets had been kept up to date. As well, as the provincial government made the ideological decision to freeze the service fee at a time of excessive cost increases, it meant that rates on the minor routes had to increase, not only at a rate much higher than the rate of inflation but also at a rate much higher than on the major routes. It is thus impossible to reconcile the generally accepted definition of financial sustainability with the realities of the CFA presumption of the government shifting the burden of its historic level of financial support to the user. In no way can BCF not need to increase rates beyond the rate of inflation under these terms.

To determine an alternative which can address the financial sustainability of the ferry operator and still provide “affordable” service for ferry users will require a change in approach by the owner of the ferry service. The ideological decision to reduce the owner’s contribution to a natural monopoly providing an essential service has led to the current situation. “Privatizing” BCF is not the issue: note the financial problems of Washington State Ferries, which is a branch of of the Department of Transportation similar to the Highways branch. Recognition of the ferry service as an essential component of the transportation system would require a financial contribution by the province more comparable to that awarded to other forms of monopoly transportation such as transit and roads. At the same time, BCF should be given the latitude to adjust service levels as needed rather than be constrained by the CFSC.

Reply to paper #4

As stated earlier, members of the SSIFAC consider the ferry system part of British Columbia’s integrated highway system. All British Columbians therefore have an interest in the sustainability of the ferry system. Additionally, we argue that the Commissioner should understand the term “user” in the broadest possible sense, reflecting the interests of communities and not merely “riders” or “consumers”.

However, if by “consumer”,the Commissioner means only those making direct use of the ferry system, then the consumer needs to be protected in three ways: with the assurance that the ferry system will continue to operate, that fares are reasonable, and that the provincial service fee will be adequate to maintain the financial sustainability of the ferry system.The user is, theoretically, protected from the elimination of the service by the fare cap set by the Commissioner: however, consumers hardly feel protected when fares have reason astronomically. It brings to mind the Viet Nam war quote “we had to destroy the village to save it”.

As the Comptroller- General’s report recommended, the impact of fares on the coastal community should be considered. If this to mean anything, the Commissioner requires more authority. However, as outlined before, the sustainable balance between the needs of the user and the financial requirements of BCF depends on an adequate service fee and a flexibility by BCF to rationalize the level of service where needed. As the ferry service is provincially owned, the negative fall-out of any service reductions would also fall politically on the provincial government. The province may think itself in a no-win situation: if it increases the service fee it will have financial difficulties; if it forces service cuts it will have political difficulties.

It is doubtful that a tiered approach would be any more effective in establishing regulatory duties than the single level approach now taken, unless there is a major change in the mandated duties of the Commissioner. As long as those duties lie essentially in the financial sector; i.e. pricing, an integrated approach would seem more useful. If the mandate changes, a different approach may be required.

Alternatives to the current approach by the Commissioner to ensure consumer protection are limited given the current legislation. Subject to legislative change, however, a direct solicitation of consumer input similar to the current consultations would ensure a better understanding of the impacts of his decisions. Something similar to this approach is taken at Washington State Ferries.

Reply to paper #5

While the concept of a “regulatory light” approach to price regulation with the use of a “price cap” generally works well, there are some issues.

a) It is becoming increasingly difficult to estimate usage rates of the ferry service. Economic, demographic and social conditions change but the simple law of supply and demand has become a major factor. The impact of rising fares has both depressed usage rates and shifted the mix somewhat from auto to foot passenger traffic.

b) While the flexibility of the price cap theoretically provides an incentive for innovation and efficiency, the rigidity of the CFSC is a disincentive, as seen in the case of the proposed Route 10A.

c) At the end of PT1, the increased price of fuel covered under the fuel surcharge mechanism was incorporated into a new base price for PT2, which would have meant an artificially higher PT2 fare if fuel prices had dropped.

d) As the principle driver of increased minor route fares has been the increased cost of fuel and as the province has not increased the service fee in reaction to this increase, the burden of the increase has fallen entirely on the ferry user. To add insult to injury, then building this higher cost into the cap of the next performance term, institutionalizes this increase for the future. Over time this reality will lead to continual higher escalation of minor route fares as compared to the majors.

Reply to Paper #6

The multiple price cap system has been the major reason for the increase in fares for the minor routes; increasing at a rate roughly double that of the majors. It can be argued that this reality simply reflects the less efficient, more costly minor route service, where the economies of scale of the major routes don't exist. It can also be noted that postage costs for first class mail delivered from Ganges to Iqaluit are the same as for mail delivered locally. In the private sector, the auto companies have had a history of producing non-profitable models from time to time for prestige reasons, whose losses were covered by the profits elsewhere in the firm.

Some realities:

a) The multiple cap allows BCF to more accurately track the costs and revenues of each route group. As a result, the construction of the Coastals could be financed based on the performance of the major route group.

b) If the service fee had been increased at the rate of cost increases, the multiple cap format would have been more equitable.

c) Provision of other regulated or publicly owned services such as transit do not depend on variable price increases for the same service. Islanders are penalized by geography while, on the other hand, for instance, residents of the Prince George area pay no more to have considerable snow plowed on their provincial highways than the residents of the Fraser Valley pay for minimal snow removal.
Therefore, we tend to prefer one price cap, If the multiple price cap model is to remain, it would require an ongoing adjustment of the service fee to make the multiple price cap more equitable.

Reply to Paper #7

There appear to be two possible levels of ASP service; one where the operator provides the ship and operates under contract as a relatively independent contractor and one where the operator only provides the operational service on a ship owned, whether directly or indirectly, by the government, as in the case of the inland ferries. Given the nature of the coastal ferry service and the capital cost of the required ships, it would seem that only the second model would apply here. Currently only one passenger-only service is provided by an ASP on a regulated route and it is interesting to note that although the private sector provides passenger-only service to several small islands, no private operator has attempted to provide regular auto ferry service and a number of islands such as Valdez, Sonora, and the Redondas have no regular service of any kind. It is interesting to speculate how these islands may have developed if there had been regular auto ferry service. Given the realities of the market, unless very generous terms are offered, the scope for ASPs looks bleak. Even in the straightforward point-to-point routes there has been little interest and in the more complex routes such as 9, 9a, 5 and 5a, it would be an administrative challenge.

Reply to Paper #8

Note: As the Discussion Papers deal with closely related issues, some repetition in these responses is setting in.

The multiple price cap mechanism and the need to apportion costs to route groups adds considerably to the workload of the Commissioner. In addition, the difficulty in accurately forecasting fuel costs and travel rates complicates matters further. The rigidity of the CFSC and BCFs interpretation of the contract further inhibits possible measures to enhance efficiency. A crystal ball may be useful. Given predictable conditions, the process by which price caps are set should be sufficient. If they are not, either the Commissioner's authority should be enhanced or the rigidities in the CFSC reduced. That still leaves the need for a better crystal ball.

The measurement of productivity gain in the case of a regulated monopoly essential service provider is an extremely difficult task, not the least of which is the fact that an achievable gain may result in an unacceptable social and political cost. For instance, if the population of a community were to decrease, a reactive reduction in service may cause a further decrease in population. However, amongst the factors that can be measured are:

- Are operating costs lowered or at least the rate of increase lowered?
- Are usage rates increased? (Several years ago a late Friday evening sailing on Route 6 was replaced by and early Saturday sailing and usage rates increased while the total number of sailings remained the same.)
- Has BCF achieved the highest level of efficiency within the rigidities of the CFSC? The experience of the proposed Route 10a and the current controversy over the proposed cable ferry for Denman Island are instructive as to the challenges of enacting major efficiency improvements within the CFSC or without.
- Does BCF follow an ongoing procedure to control the traditional "culture of excess" so often endemic in large corporate entities?

Reply to Paper #9

The subject of this discussion paper lies well beyond the terms of reference of the FACs but it can be said that this issue again arises from the very private/public nature of BCF. As the berths and ships are essentially “public property” and used mostly for purposes in which there is a public interest; is there an unfair competitive advantage? Does the BCF Vacations have an unfair advantage when offering travel packages? Would a drop-trailer service on the minor routes be different from the service on the majors, where no service fee is involved? Does the inherent fact that BCF controls the berths inhibit the interest of a possible ASP? This may be ground where even the Federal Competition Bureau may fear to tread.