Reprint

Island Tides

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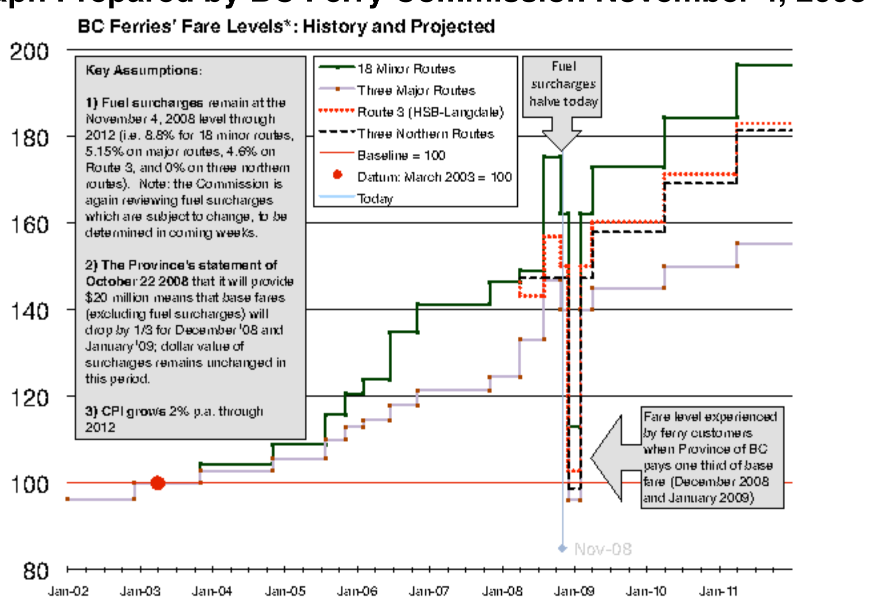
Reprint from Volume 20 Number 23 November 27, 2008

BC Cabinet did not hedge its bet about ferry finances ~ Patrick Brown

As all ferry users know, ferry fares have risen spectacularly since April 2003, the point at which BC Ferry Services (BCFS) was re-formed as a private corporation (albeit 100% owned by the Province) and took over the provision of coastal ferry services from the previous Crown corporation.

This November, the Ferry Commissioner published a graph showing the history of fare increases for major and minor routes since January 2002. The graph shows that the average fare levels on minor routes will nearly double by April 2011. (Note that these are the averages; some commuter fares show over 200% increases.)

Graph Prepared by BC Ferry Commission November 4, 2008



* ie: average fare level if BC Ferries charges the maximium alllowed by the commission. Typically BC Ferries has charged slightly less than the maximum, notable on minor routes.

The graph also shows that the Premier's announced cut of 33% in fares for December and January simply bring fares down closer to those of 2003, but only for those two months.

What Cabinet Was Told Would Happen

In 2003, when the provincial Cabinet spun-off BC's coastal ferry operation as a separate company, it based its decision on financial projections in the Premier's BC Ferries core services study which indicated that the organization would be viable with annual fare increases approximating the Consumer Price Index (CPI). The projections, assuming a 2% annual increase in the CPI, saw annual fare increases of 2.13% for the major routes, and 5.0% for minor routes.

The 2003 projections also assumed an annual provincial 'Fee for Service' of $105.5 million (partially offset by BCFS taxes of $4.5 million annually and dividend and interest payments of $33.3 million).

This 'fee' included an estimated $11.5 million which the Province was paying to the company to cover free transportation for seniors, students, and medical trips. (The net annual cost to the Province was estimated at $54.5 million.)

Public Interest Not Important

At the same time, the Province's annual contribution was to be capped at this $105.5 million and 'government interference' in BCFS's management was to end.

Cabinet had been told, in the core study's review of world-wide ferry services, that 'there is a move towards service delivery by private (commercial) ferry operators' and that 'with the exception of Washington State, little attention is paid to ensuring the public interest is served through government interventions.' Cabinet evidently took this as a rationale for avoiding any responsibility for BC's ferries.

The objective of privatization was to continue to provide the current service while ensuring that the company would be

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profitable enough to access private debt financing to support an anticipated capital program (ship building) estimated at $2 billion over 15 years.

What Actually Happened

However, far from original intentions, ferries' net earnings leveled out in 2006/7 and fell substantially in 2007/8—fare increases and soaring fuel surcharges resulted in a decrease in ridership.

In fact, when making its 2003 decision, the provincial cabinet was given warning that this might be the case:

> 'If several of the assumptions are over-stated, the cumulative impacts pose significant financial risk. For example, the traffic demand forecast estimated a 25% increase over the next 15 years. The plan also assumed fuel costs will not exceed 41¢/litre.
>
> 'If the traffic demand forecast fails to materialize, fuel costs rise beyond the rate of inflation, and the capital program proves one-third more expensive than currently estimated, then the taxpayers of British Columbia will incur additional public debt of approximately $1.0 billion.'

The first five years of operation by BCFS have seen less than a 1% increase in passengers and a 3.6% increase in vehicles carried. The vehicle increase is now less than half the original projection; passenger increase is far less than that.

No Help With Fare Increases

In 2003, it appears that cabinet approval was given to a fare scheme which would see an 11.1% cumulative fare increase over the first five years on the major routes, and a 27.3% increase on minor routes. The cumulative CPI increase over five years was assumed to be 9.5%. Since then, the CPI has turned out to be a minor factor in fare setting.

As the Commissioner's graph shows, average five-year cumulative fare increases to April 2008 were actually 33% on major routes, and 50% on minor routes. A further massive fare increase in July 2008 brought the figures to 46% on major routes, and 73% on minor routes.

These figures include fuel surcharges. Not only did the Province stubbornly refuse to increase its 'Fee for Service' to match or reduce the increased contribution by ferry patrons, but it also failed to share in the increased fuel costs.

Fuel Prices

The Commissioner's graph includes fuel surcharges, which were introduced as fuel costs rose along with world oil prices. Recognizing recent reductions in fuel prices, these surcharges were halved at the beginning of November, and may well disappear altogether in the new year.

However, BC Ferries has not revealed what it is currently paying for fuel. BCFS is known to undertake forward contracts to hedge against changes in fuel prices. The company may have been caught in the same trap as Air Canada, which now finds itself buying fuel at higher than current market prices as a result of these hedging contracts. ✐

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