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**British Columbia Ferry Services Inc.**

**Opportunities for Enhanced Efficiency in  
Performance Term Three**

**October 2010**

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### FORWARD LOOKING STATEMENTS

This report contains certain “forward looking statements”. These statements relate to future events or future performance and reflect management’s expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management’s current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, the Canadian Dollar relative to the US Dollar, fuel costs, construction costs, the state of the local economy, turbulent financial markets, demographics, import duties remission, tax changes, and the requirements of the Coastal Ferry Services Contract.

Forward looking statements included in this report include statements with respect to our:

- short and long-range business plans,
- estimates of future customer demand and capital expenditures,
- asset renewal programs for vessels and terminals,
- expectations of funding under the Infrastructure Stimulus Fund program, and
- expectations regarding the impacts of the bargaining unit exclusions award, the head office relocation, the harmonized sales and carbon taxes, and the efficiency opportunities requiring service level changes by the British Columbia Government.

In some cases, forward looking statements can be identified by terminology such as “may”, “will”, “should”, “expect”, “plan”, “anticipate”, “believe”, “estimate”, “predict”, “potential”, “continue” or the negative of these terms or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with traffic volume and tariff revenue risk, safety and security, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land claims.

Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this report are based upon reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this report, and British Columbia Ferry Services Inc. assumes no obligation to update or revise them to reflect new events or circumstances except as may be required by applicable law.

# OPPORTUNITIES FOR ENHANCED EFFICIENCY IN PERFORMANCE TERM THREE

## 1.0 INTRODUCTION

Section 40 (1.1) of the *Coastal Ferry Act* (the "Act") contemplates that British Columbia Ferry Services Inc. ("BC Ferries" or the "Company") will prepare a plan identifying opportunities for efficiency in the delivery of coastal ferry services in the upcoming performance term (the "Plan"). This is a new section of the Act and the timing of its being brought into force is such that a Plan for performance term four ("PT4") (April 1, 2016 - March 31, 2020) is the first that is statutorily required to be prepared. BC Ferries, however, continuously seeks opportunities to enhance efficiency and productivity in the delivery of coastal ferry services. With that as its continued objective, BC Ferries has prepared this Plan for performance term three ("PT3") (April 1, 2012 – March 31, 2016).

Customers, coastal communities, the Province and BC Ferries all share an interest in finding opportunities to realize efficiencies in the delivery of coastal ferry services. BC Ferries' on-going dialogue with stakeholders, the British Columbia Ferry Commission, the Province and Ferry Advisory Committees, has helped shape many of the initiatives included in this Plan. BC Ferries is pleased to present this Plan in response to the call by the Province, the Commission and other stakeholders to find innovative ways to deliver services more productively and efficiently.

## 2.0 OVERVIEW OF EFFICIENCIES REALIZED IN PERFORMANCE TERM TWO

Performance term two ("PT2"), which commenced April 1, 2008, has been particularly challenging for BC Ferries, as it has for many businesses in Canada and abroad. Uncertain economic conditions, exchange rate volatility and uncertain gasoline prices have caused people to think twice about travel. BC Ferries' passenger and vehicle traffic declined in fiscal 2009 compared to the previous year and this resulted in lower than expected revenues. Although some recovery of traffic was experienced in fiscal 2010, BC Ferries has yet to see a full recovery of passenger and vehicle traffic. Recognizing that difficult market conditions, such as these, are a fact of life, the Company has responded by becoming more efficient, while remaining focused on key business priorities, including safety and customer satisfaction. Last year, BC Ferries' customer satisfaction rating was the highest ever at 91%.

Safety has and continues to be BC Ferries' number one priority. The SailSafe program, a partnership initiative with the BC Ferry & Marine Workers' Union to realize world class safety performance, has made substantial progress and generated significant results in improved safety and efficiency. In fiscal 2010 alone, BC Ferries experienced an 8% reduction in overall

employee injuries, a 20% reduction in time-loss injuries and a 27% reduction in days lost. Also in fiscal 2010, BC Ferries integrated incident management and service recovery into its new Operations & Security Centre, completed lifesaving appliance upgrades and entered into an agreement with British Columbia Institute of Technology ("BCIT") Marine Campus to participate in its simulator renewal initiative, an important step towards a new partnership with BCIT for regulatory and BC Ferries specific training.

In fiscal 2009, BC Ferries restructured its business to align expenses with reduced revenues. This restructuring was in addition to other cost savings measures that included deferral of filling staff vacancies and reduced travel, consulting, marketing, advertising and other discretionary expenditures. Approximately 77 positions were eliminated and exempt wages were frozen. BC Ferries continued cost containment efforts in fiscal 2010 and fiscal 2011. Initiatives included: the realignment of call centre hours to better match customer's needs; training optimization and crew familiarization efficiencies; removal of under-utilized sailings on the major routes during the off-peak season; substituting vessels, where appropriate, to realize fuel and labour savings; further optimizing fuel consumption; managing overtime thereby achieving reductions of 8% in overtime versus fiscal 2009; as well as workforce management initiatives, which have resulted in employee absenteeism (i.e. paid absence hours) decreasing from 5.2% of compensatory hours at the start of PT2 to 3.7% presently. These proactive measures, along with other initiatives, reduced operating expenditures by approximately \$14 million from previously planned levels in fiscal 2010. These initiatives continue in fiscal 2011.

Cost pressures due, for example, to heightened security requirements, Transport Canada's decision to reset crew levels for BC Ferries' vessels based on the new safe manning initiative, increased pressure on benefit costs due to health program cost increases and, the introduction of the harmonized sales tax (HST) and carbon tax, have challenged BC Ferries in its efforts to enhance efficiency and contain costs. Cost items, such as these, will have long-term impacts.

An efficient marine transportation system requires efficient and reliable vessels and infrastructure. Fiscal years 2009 and 2010 have been active years for BC Ferries in terms of its capital program. BC Ferries is one of the largest marine transportation companies in the world and strives to keep its 36 ships and 47 terminals operating smoothly at all times. PT2 saw the introduction into service of five new major vessels: the *Coastal Renaissance*, *Coastal Inspiration* and *Coastal Celebration* on the major routes, and the *Northern Expedition* and *Northern Adventure* on the northern routes; and an intermediate vessel, the *Island Sky*, on the Sunshine Coast. With the arrival of these ships, the Company completed the first phase of its major vessel replacement program that added seven new vessels to the fleet over a period of 30 months. The Company also introduced the *Kuper* into service and completed significant

upgrades of the *Queen of New Westminster* and *Quinsam* in PT2, which will enable them to continue to provide safe, reliable service for many more years.

Thus far in PT2, BC Ferries has also made significant improvements in terminal infrastructure, including work at Swartz Bay, Departure Bay and a number of minor terminal upgrades, maintained the fleet to high standards, and invested in customer service and financial systems and technology. To help offset the cost of certain of its infrastructure projects, BC Ferries pursued and was successful in receiving funding commitments from the federal government of up to \$9.5 million under the Infrastructure Stimulus Fund program, \$9.1 under the Marine Security Contribution program, and \$2.8 million under the Structured Financing Facility Program. BC Ferries has also been successful in receiving duty remission on four vessels it has built offshore. The \$119.4 million import tax and GST that will be returned to the Company will go towards fare reductions of approximately 2% on all routes effective October 18, 2010. In addition, BC Ferries is investing \$20 million to upgrade key assets in the ship repair and maintenance business in British Columbia.

Management presence on-board the vessels is considered necessary by BC Ferries to manage the assets in an effective, efficient and accountable manner and to ensure high standards of customer service. In February 2008, BC Ferries initiated a process to seek the exclusion from the bargaining unit of certain senior positions on board its vessels. The matter was referred to binding arbitration. In September 2010, Arbitrator Vince Ready issued his award, concluding that in the order of approximately 155 senior positions in the fleet should be excluded from the bargaining unit. A structured plan will be developed by BC Ferries to implement the award over the next three to five years. BC Ferries believes that the outcome in terms of increased management presence in the fleet will bring positive results including decreased costs in such areas as overtime, and increased efficiency and customer service.

BC Ferries has also pursued efficiencies with respect to its head office in Victoria. BC Ferries sold its existing head office building in August 2008, and entered into a 15-year lease with renewal options for up to an additional 20 years, allowing for the relocation of its corporate centre to a new building in downtown Victoria. This relocation will provide approximately the same space as BC Ferries currently occupies in several locations and will allow for operating efficiencies by combining all departments under one roof. The relocation is scheduled to be complete in 2010.

BC Ferries' Commercial Services Division was established ahead of schedule in PT2 and, with the introduction of a new innovative drop trailer service on two of the major routes, has delivered incremental revenue growth. Planning and implementation was also finalized in PT2 for the BC Ferries Vacation Centre that officially opened on May 11, 2010 in downtown Vancouver. Through this and other initiatives, relationships within the tourism industry in

British Columbia and abroad have continued to be enhanced, resulting in further opportunities for incremental revenue growth.

These are just some of the many initiatives BC Ferries has pursued in PT2 to enhance efficiency and productivity. A more expansive list is contained in BC Ferries' PT3 submission to the British Columbia Ferries Commissioner (the "Commissioner").

### **3.0 EFFICIENCY OPPORTUNITIES IN PERFORMANCE TERM THREE**

#### **3.1 Setting the Context**

The beginning of each new performance term triggers a resetting by the Commissioner of the price caps for the route groups that are served by BC Ferries. In setting the price caps, the Commissioner must, among other things, ensure that the Company is afforded sufficient revenue to ensure its continued financial sustainability. In simple terms, BC Ferries generates revenue from three sources: fares; ancillary services such as parking, catering and travel packages; and, service fees paid by the Province for the delivery of service on all but the major routes. The more efficient the service provided by BC Ferries, the lower the revenue the Company requires to be sustainable. The efficiencies that BC Ferries achieves during a performance term help the Company build equity, which is re-invested in vessels, terminals and other initiatives to improve customer service. In the subsequent performance term, those efficiencies are "captured" by either or both of the customers through lower price caps, and/or the Province through lower service fees. Accordingly, all three parties - customers (and the communities that derive economic benefits from the service offered by BC Ferries), the Province and BC Ferries itself - share an interest in finding opportunities to realize efficiencies in the delivery of coastal ferry services.

#### **3.2 Defining Efficiency**

The term "efficiency" is defined as *"the ability to produce a desired effect, product or service, etc. with a minimum of effort, expense, or waste"*. Put another way, it is *"the extent to which time and resources are well used for the intended task."* Within this definition, the 'desired product or service' or 'intended task' is critical. Efficiency opportunities for BC Ferries must be identified within the context of what the desired or intended service levels are.

The Province sets the core service levels BC Ferries must provide for each of the 25 designated ferry routes. As the ferry operator, BC Ferries' role is to supply the service that the Province asks and pays for under the Coastal Ferry Services Contract (the "CFSC") in the most efficient manner possible. For each of the designated routes, the CFSC defines the core service levels to include the number of round trips that must be

delivered, the home ports, the hours of operation and the capacity that must be provided. The core service levels in the CFSC are subject to review in advance of each performance term. While BC Ferries has operational experience that it can and does share with the Province in the context of these reviews, the decision on service levels is a matter of public policy. The views of stakeholders, including customers and coastal communities, will be important considerations to the Province in making its decisions in respect of the service levels.

The foregoing is important in the identification of efficiency opportunities through PT3. It suggests two categories of options to consider in regard to enhancing efficiency. The first relates to initiatives that BC Ferries can pursue within the constraints of the status quo or existing CFSC service levels, and the second relates to opportunities for cost savings and efficiency gains that could be brought about through changes to and/or rationalization of the CFSC service levels. Opportunities through PT3 arising under these categories are described below in sections 3.4 and 3.5, respectively. The Commissioner will reflect the efficiency and productivity enhancements that BC Ferries expects to realize in PT3 in setting the PT3 price caps. By far, the greatest potential to realize cost reductions and efficiency gains that could be directed to off-set potential price cap increases in PT3 arise from the initiatives within the second category. Recognizing that decisions on service levels are a matter of public policy, which fall within the sole purview of the Province, BC Ferries presents this second category of initiatives as options for the government's consideration. As well, BC Ferries will review these options with the Commissioner, in the context of the price cap setting process and the Commission's new regulatory requirement to consider the interests of ferry users. Many of these initiatives have been presented to the Province in the past and are here included for possible further reconsideration in light of the significant challenges PT3 brings, in terms of potential impacts on fares.

### **3.3 The Challenge**

As described in BC Ferries' PT3 Submission, higher costs will be experienced in PT3 in supplying status quo ferry service on all routes. Contributing to the higher costs that will be experienced on the minor routes, is the capital investment required for vessels and terminals. Investment in the fleet was deferred over decades when BC Ferries was a crown corporation. Replacement or refurbishment of some minor vessels cannot be deferred beyond PT3. Investment in vessels required in PT4 is also substantial. While the cost of supplying service in the north will not materially change, the cost per passenger will rise due to declining ridership, assuming status quo service fees from the Province. BC Ferries submits that price caps in PT3 for the minor and northern routes will need to increase significantly to offset higher costs unless:

- (a) Further efficiency gains can be made within the status quo or existing service level framework;
- (b) The package of services delivered by BC Ferries under contract to the Province can be rationalized to reduce costs; and/or
- (c) The Province increases ferry service fees.

This Plan presents proposals in respect of the efficiency opportunities available under points (a) and (b), above. The opportunity for service fee enhancements, as set out in point (c), is not a matter for discussion in this Plan.

### **3.4 Efficiency Opportunities within Status Quo Service Levels**

BC Ferries has made significant gains in efficiency and innovation since its transition from a crown corporation in 2003. These gains have been made despite the significant regulatory and structural constraints within which BC Ferries operates. These constraints include:

- A largely fixed cost base – labour & benefits and fuel comprising 58% and 18% of total operating, maintenance and administrative expenses, respectively;
- A restrictive collective agreement (for example, with respect to hours of work, job description flexibility);
- Crew levels set by Transport Canada with limited to no opportunity for reductions through traditional means, such as capital investments;
- Rigidity in core service levels in the CFSC – daily number of round trips and hours of operation, home ports, and vessel capacity are specified in the CFSC; inability to optimize/rationalize vessel utilization and demand; and,
- Point of assembly and familiarization clearance restrictions for various vessels.

While these represent significant challenges, BC Ferries is committed to pursuing further opportunities to enhance efficiency and innovation. The following summarizes key initiatives BC Ferries expects to pursue through PT3 within the Company's five key goals of safety, operational reliability, continuous improvement, value for money and financial integrity.

#### **3.4.1 Safety**

A safe operation is an efficient operation. BC Ferries' top priority is the safety of its customers and employees. Through PT3, BC Ferries will:

- Implement subsequent phases of the SailSafe program and continue towards the shared goal of safety improvement.

- Continue to maintain high safety standards and deliver quality safety training programs to new hires and existing staff.
- Build on the Company's success in reducing time-loss injuries and days lost through better awareness and early intervention when injuries occur.
- Reduce controllable passenger injuries and maintain high standards for food safety throughout the fleet.
- Improve learning event reporting through the ALERT (All Learning Events Reported Today) handbook and through continued training and awareness programs.
- Further embed the principles of Hazard Identification and Risk Management into BC Ferries' operations.
- Continue proactive service recovery planning through the Operations & Security Centre.

### **3.4.2 Operational Reliability**

Investing in assets serves to enhance overall system reliability and efficient use of operational resources. BC Ferries will continue its program of renewing and expanding its asset base through PT3.

- The Company's total capital investment budget in PT3 is approximately \$545 million. This includes planned vessel and terminal capital expenditures of \$460 million and systems and other capital expenditures of approximately \$85 million to support business requirements and improve infrastructure reliability and service delivery.
- A vessel replacement strategy for PT3 and PT4 will be developed, which will consider in all cases, options for rebuilding rather than replacing a vessel and acquiring versus building new, where it is cost-effective to do so.
  - Round trip cancellations, due to engineering incidents, will be reduced to 0.3% or less.
  - Call management and employee scheduling in the Customer Service Centre will be enhanced.
  - Enhancements to the new Operations & Security Centre will be completed to improve incident tracking and data reporting capabilities. Opportunities to generate revenue through selling similar services as are provided by the centre to other companies will be considered.
  - Opportunities will be pursued to increase utilization of BC Ferries' shipyard as a means of reducing overall costs and increasing productivity in ship repair work.
  - Implementation of a new electronic point of sale / reservation system will enhance efficiency. Revenue generating opportunities through marketing and possible sale of the system to other companies will be considered.

- The feasibility of a cable ferry alternative for the Denman Island - Buckley Bay route will continue to be explored, as a means of serving those islands in a more cost-effective manner.

### **3.4.3 Continuous Improvement**

BC Ferries will pursue productivity initiatives in PT3 to realize efficiencies and serve its customers better:

- Initiatives to reduce employee absenteeism and increase workforce flexibility adaptability will be pursued.
- Work will continue to be guided by clear business objectives and performance planning.
- Employee improvement goals will be supported through efficient training programs, including the new partnership with the BCIT Marine Campus; education cost reimbursement and career planning.
- Work will continue to develop and roll out a bridge team simulation program, including simulator training areas for bridge crews, at three major terminals.

BC Ferries will continue to work with community, stakeholder and First Nations groups on issues that are important to them and that create efficiencies in delivering service. BC Ferries will:

- Continue long-term master planning for improvements at our terminals and ensure that all stakeholders are involved in the process and that stakeholder needs are efficiently met.
- Continue to work with Ferry Advisory Committees and the provincial government to evaluate whether service alternatives exist that may reduce fares for customers.

Through PT3, BC Ferries will continue to look for ways to minimize its impact on the environment while improving operational efficiency:

- Fuel consumption will continue to be optimized through fully utilizing newer vessel capabilities, matching vessel capacity to utilization, improved on-time performance and reducing in-port turnaround inefficiencies.
- BC Ferries introduced the use of B5 biodiesel on the *Queen of Alberni* as a pilot project in September 2009. Now all vessels burn a B5 fuel blend in service areas where the product is available. Opportunities for using natural gas as an alternative to diesel will be considered for new vessels.

- Sewage pump ashore and waste water treatment projects will be implemented this year at eight terminals and will enable BC Ferries to reduce sewage discharge from its fleet in future performance terms.
- BC Ferries has introduced the Watt Now! Program to identify and reduce hydro consumption in its offices, at its terminals and onboard its vessels. BC Ferries will continue to identify opportunities for improving energy conservation.

#### **3.4.4 Value for Money**

BC Ferries will continue to find ways to provide better value and service to its customers. Through PT3, BC Ferries will:

- Align ticket agent staffing with anticipated high volume periods to reduce customer wait times.
- Expand availability of self-serve kiosks to provide customers with ticketing options.
- Increase menu innovation and expand new product introduction, stimulating revenue growth.
- Expand popular customer services like sailing reservations to additional routes.
- Use the Company's ongoing fuel hedging program, when appropriate, to help stabilize fuel costs and the cost of travel.
- Introduce more cost-effective vessel maintenance approaches, including aligning annual refits with periodic dry-docking to reduce out-of-service time.
- Introduce more cost-effective call handling methods at the Company's terminals and Customer Call Centre.

BC Ferries will access funding through provincial and federal government programs wherever possible to offset costs. Examples of the Company's success to date in accessing such funding include:

- BC Ferries was successful in its request to the federal government for duty remission on four vessels it has built offshore. \$119.4 million import tax and GST will be returned to BC Ferries. These funds will go towards reducing fares on all routes by approximately 2% effective October 18, 2010. BC Ferries is also investing \$20 million to upgrade key assets in the ship repair and maintenance business in British Columbia. A substantial amount of effort has been expended by BC Ferries to realize this duty remission and it will benefit everyone in British Columbia.
- Under the federal Marine Security Contribution program, BC Ferries received approval for up to \$9.1 million to help offset costs of perimeter security, access control measures and training.

- Under the federal Infrastructure Stimulus Fund program, BC Ferries will qualify for partial reimbursements of eligible costs for eight sewage pump-ashore and waste water treatment projects, as well as other terminal projects. The net funding expected is \$9.5 million.
- Under the federal Structured Financing Facility program, BC Ferries received approval for funding of up to \$1.0 million for the *Quinsam* upgrade project. In addition, an application under this program has recently been approved for the *Quadra Queen II* life extension project amounting to funding of up to \$1.8 million.

### **3.4.5 Financial Integrity**

Management will ensure the Company's continued financial integrity, while providing safe, efficient service for customers. Through PT3 BC Ferries will:

- Actively manage long-term capital and operating plans.
- Use best practices in supply chain management and risk/insurance coverage to manage costs.
- Maintain strong relationships with the Commissioner and Ministry of Transportation and Infrastructure.
- Continue to pursue business initiatives that may enable the Company to reduce fares – for example:
  - When possible, marketing programs, such as CoastSavers, will continue to be used to encourage ridership and generate non-fare revenues that will ultimately offset ferry fares. The successful "CoastSaver" program is a promotional fare incentive initiative providing mid-week price discounts on passenger and passenger-vehicle fares on the major routes. The discounts provide an incentive for customers to travel at less busy times, which can translate into operational savings for BC Ferries.
  - The BC Ferries Vacations Centre opened in May providing a strong presence in downtown Vancouver and an effective platform to launch BC Ferries Vacations products. Further expansion of the product lines will increase ferry utilization and revenues. The viability of opening an additional centre in another geographic area will also be considered.
  - BC Ferries will continue to explore opportunities to expand the drop trailer service on the major routes to utilize spare vessel capacity, increasing competition in a marketplace otherwise dominated by a large, unregulated private sector company. Expansion of the service into transportation of dangerous goods on dedicated (overnight) sailings will be one such opportunity considered.

### **3.5 Efficiency Opportunities Requiring Service Level Changes by Government**

BC Ferries believes that opportunities exist to realize significant efficiency gains and cost savings through changes in and/or rationalization of the service levels prescribed in the CFSC. Set out below are a number of options, many of which have been discussed with the Province, the Commissioner and stakeholders in the past. BC Ferries recognizes that the Province must consider many public policy factors as it makes decisions and that BC Ferries, in turn, implements those policy decisions related to marine transportation service. The following options offer opportunities for cost savings and efficiency gains and may be worthy of reconsideration. It should be noted that these are not recommendations of BC Ferries, but highlight matters of public policy for consideration.

#### **3.5.1 Elimination of Route 12 – Mill Bay to Brentwood Bay**

Route 12 connects Mill Bay to Brentwood Bay with nine round trips each day from 7:30 am to 6:30 pm. Passengers and vehicles carried on Route 12 averaged approximately 140,000 and 72,000, respectively per year over the last three years. Service fees paid by the Province are \$1.1 million annually.

Highway service is available as an alternative to Route 12. Transit time by highway is approximately the same as transit time (including waiting times) by ferry. It is estimated that vehicle traffic on the Malahat Highway (Victoria to Mill Bay) is approximately 25,000 vehicles per day (or 9,125,000 per year).

Route 12 is currently served using the *Mill Bay*. The vessel is 53 years old and is approaching the end of its economic life. The *Klitsa* will be the replacement vessel and will commence operations in the spring of 2011 when the *Mill Bay* will be retired. The capital costs to ready this vessel for operations will be \$2.3 million. In addition, terminal upgrades of \$2.8 million are required at both Brentwood Bay and Mill Bay to accommodate this replacement vessel. The larger size of the *Klitsa* and increased carrying capacity will also increase fuel operating costs and crew costs due to regulatory requirements.

Route 12 can be considered a redundant transportation link between the Saanich Peninsula and Mill Bay that serves less than 1% of vehicular traffic needs. The CFSC could be revised to eliminate Route 12 service and the transportation fees redirected to the remaining minor routes. This would help offset fare increases on the minor routes in PT3.

### **3.5.2 Alternatives for Route 40 – Discovery Coast**

Route 40 was started in 1996 to serve the ports of Shearwater, Ocean Falls, Klemtu and Bella Coola. Route 40 is a peak season only service running each year from approximately mid-June through Labour Day (13 weeks per year). The 31 year old *Queen of Chilliwack* provides service on this route. Passengers and vehicles carried on Route 40 averaged approximately 8,600 and 2,700, respectively per year over the last three years.

Alternatives exist to meet the transportation requirements of the communities served by Route 40:

- Bella Coola is served by Provincial Highway 20 from Williams Lake.
- As a result of the Province's recent decision to invest \$25 million into terminal structures at Klemtu, service to that port will be provided via Route 10 (Port Hardy – Prince Rupert) on a year round basis.
- The communities of Shearwater and Ocean Falls are served in the off-peak season by a connecting service to Route 10 at Bella Bella. Total traffic each year (peak and off-peak) for these two ports combined is in the order of 400-500 passengers and 200 vehicles, while annual fare revenue to BC Ferries is approximately \$32,000. Other local service providers in the area exist and could be expected to meet the marine transportation needs of these communities in the peak (and off-peak) season.

Annual service fees paid by the Province are currently approximately \$1.0 million. The Federal-Provincial Subsidy Agreement contributes an additional \$0.3 million per year for this service. Service fees will rise to an average of \$5.1 million per year in PT3 to fund the \$15 million investment to refit the *Queen of Chilliwack*. In view of the significant capital expenditures that will be required to replace the vessel after its planned retirement date of 2017, the Province may wish to consider if the alternatives that exist to meet the transportation requirements of the communities served by Route 40 are sufficient to enable the elimination of this route. In this regard, BC Ferries notes the recent road closures in the Bella Coola area and suggests that the options for Route 40 will need to be considered within the context of ensuring adequate emergency response services to the local communities continue to be available.

### **3.5.3 Alternative Service Delivery for Shearwater and Ocean Falls**

As described above, service to the mid-coast ports of Shearwater and Ocean Falls is provided by Route 40 in the peak session (13 weeks from approximately mid-June through Labour Day) using the *Queen of Chilliwack* and, in the off-peak season (39

weeks from Labour Day through mid-June) by connecting service to Route 10 at Bella Bella, using the *Nimpkish*. Traffic to these ports is modest, with approximately 400-500 passengers and 200 vehicles in total per year.

In fiscal 2010, BC Ferries sought prospective alternative service providers (“ASP”) to deliver service to Shearwater and Ocean Falls. At that time, BC Ferries concluded that having an ASP deliver the service on a year-round basis would generate significant savings. However, the Province was not in a position to confirm that the service levels proposed under the initiative would meet CFSC requirements and, consequently, BC Ferries cancelled the initiative.

BC Ferries continues to believe that alternative service delivery (“ASD”) for the ports of Shearwater and Ocean Falls holds promise in terms of cost savings, which would enable lower fares on the northern routes. It is understood that the Commissioner is supportive of further exploration of an ASD opportunity.

As indicated above, the CFSC could be revised to eliminate service by BC Ferries to these ports. Other local service providers in the area exist and could be expected to meet the marine transportation needs of these communities.

Alternatively, BC Ferries could further pursue an ASP to deliver service under contract to BC Ferries either for the off-peak season only or for year-round service. It is expected that some modest changes by the Province to existing service levels would be required to realize the savings that such an initiative could be expected to generate.

#### **3.5.4 Extension of Northern Service to Tsawwassen**

BC Ferries has developed a proposal to extend the northern service to Tsawwassen terminal over the summer season using the new *Northern Expedition*. The new service is expected to generate \$2 million in annual incremental revenue for the Company. Following community consultation in fiscal 2010, BC Ferries was not able to receive unanimous support from the various northern communities. The Province indicated it was not, therefore, in a position to agree to the change in service and BC Ferries suspended efforts to launch this enhanced service. BC Ferries continues to believe this service offers tremendous potential to create additional ridership and revenue, at the same time generating additional economic benefits to the north coast.

### **3.5.5 Change in Terminal Location for Route 19 – Gabriola to Nanaimo Harbour**

Cost savings and better utilization of the *Quinsam* in the form of additional sailings, could be realized from moving the Route 19 terminal on Vancouver Island from Nanaimo Harbour to BC Ferries' Duke Point Terminal. Please note this option was rejected by local residents in a recent survey.

### **3.5.6 Elimination or Restructuring of Route 9 - Tsawwassen to Southern Gulf Islands (SGI)**

There are numerous challenges and constraints facing Route 9 services at present. These include the following:

- Transfer risk – arising from late sailings on shared routes;
- Berth conflicts - arising from late sailings on shared berths;
- Long round trip logistics – resulting in difficulties in maintaining schedule;
- Multi-port loading and discharging logistics due to the number of stops required by each of the three vessels on the SGI routes;
- Point of Assembly constraints – resulting in reduced vessel crewing opportunities from Salt Spring Island versus the Mainland; and,
- Size of vessel – creating excess capacity apart from the peak Friday and Sunday night sailings.

The option of eliminating Route 9 service would increase traffic pressure through Fulford Harbour on Salt Spring Island as well as Swartz Bay. In addition, transit times from some of the SGIs (particularly Saturna, Gailano and Mayne Islands) to the Mainland would be considerably increased (e.g. 3 to 4 times current passage time). Elimination of this route would result in cost saving opportunities from the closure of Long Harbour terminal on Salt Spring Island, the elimination of vessel replacement costs for the *Queen of Nanaimo* (estimated at \$109 million), and on-going operating costs for the route (crew and fuel). Annual service fees paid by the Province for Route 9 are currently \$8 million, while further funding of \$2.1 million per year is provided under the Federal-Provincial Subsidy Agreement. The annual service fees will increase substantially when the replacement vessel for the *Queen of Nanaimo* is put into service. Elimination of this route would enable this funding to be redirected to the other minor routes thereby helping to offset fare increases in PT3.

The option of restructuring Route 9 service would include changing the service delivery model for SGI services and continuing to provide connectivity and timely passage through a "transit style" terminus to terminus operation. The model would home port two intermediate sized vessels running parallel - but opposite - routing between

Swartz Bay and Tsawwassen. Sailing from Swartz Bay, it would take Vancouver Island traffic outbound and pick up SGI traffic heading to the Mainland enroute to the port of Tsawwassen. The same sailing service would be done from Tsawwassen to Swartz Bay, with the vessels then reversing the routing providing the same service and home porting at the end of the operating shift.

Salt Spring Island traffic bound for the Mainland would be routed from Fulford Harbour through Swartz Bay to Tsawwassen.

Additional weekly sailings required to provide access to Swartz Bay/Victoria would be met by a reconfigured Route 5A service model that would include stops at Fulford Harbour to alleviate congestion and take traffic to Swartz Bay or traffic to the Mainland. Saturna Island could be served by either a bridge to Mayne Island or the reconfigured Route 5A model.

This model would eliminate transfers, berth conflicts and resulting services degradation to all routes whenever one route/ship is under performing.

This service model would replace the major vessel replacement capital expenditure with an intermediate vessel replacement capital expenditure. It would increase the terminal development requirements at Fulford Harbour, but would afford the closure of Long Harbour terminal. These costs would need to be developed if this service model is to be further considered by the Province.

The remaining option is the status quo, which requires major vessel replacement; Long Harbour and Fulford Harbour terminal upgrades; continued upgrade of outer island terminals to accommodate a major vessel; higher crew levels and under utilized capacity. The increased costs associated with the status quo will result in price cap and/or service fee increases.

### **3.5.7 Inclusion of Route 3 in the Major Route Group**

Route 3 could be amalgamated in the CFSC with the major routes and the service fees and contribution from the Federal-Provincial Subsidy Agreement for that route (collectively \$4.7 million per year in PT2) could be redirected to the minor and/or northern routes. In addition, this would afford greater flexibility in managing the CFSC round trip requirements across four routes in the major route group versus three routes currently, and would also mitigate the impact on Route 3 of future investments at Horseshoe Bay terminal.

### **3.5.8 Off-peak Saturday Service for Route 30 – Duke Point to Tsawwassen**

Adjustments to the off-peak service on Saturday evenings and Sunday mornings on the Duke Point to Tsawwassen route, as set out in the CFSC, to respond to low vessel capacity utilization could be further considered. To realize efficiencies from these adjustments, modest changes to service levels for the major route group would be required. BC Ferries supports this proposal and has received an indication from the Commissioner of his support as well.

In addition, an opportunity exists to replace Saturday evening Route 2 service via Duke Point through Horseshoe Bay allowing cost savings through the early closure of Departure Bay.

### **3.5.9 Alternatives to the Charter Agreement for the *Nicola***

As specified in the CFSC, a vessel charter agreement is in place between BC Ferries and the Lax Kw'alaams Band. Under the agreement, BC Ferries provides the vessel, the *Nicola*, for a nominal amount, and the Band, in turn, operates a passenger and freight ferry service between Prince Rupert and Tuck Inlet. The charter agreement expires March 31, 2012. In order for the *Nicola* to continue operating beyond May 2012, it will require a regulatory refit. The last refit of the vessel was undertaken in 2008, with costs of \$1.6 million fully funded by the Province. It is difficult to estimate the extent and, therefore, the costs of the work required in 2012 until the vessel is in dry dock. However, it is expected that the costs to the Province of the refit in 2012 could be triple or more than that of the 2008 refit. The refit will ensure the vessel meets safety and regulatory requirements and will include an upgrade the sewage treatment system to enable raw sewage to be pumped ashore. The Province may wish to consider more cost-effective alternatives to having the charter agreement renewed (and thereby incurring the cost of the refit) to meet the ferry transportation needs of the communities currently served by the *Nicola*.

### **3.5.10 All Routes – Increased Flexibility**

BC Ferries has previously sought contractual amendments that provide increased flexibility to enable BC Ferries to tailor its service more closely to demand, including reducing mid-day and late night sailings on all routes, to increase capacity utilization. Increased flexibility would be afforded by the ability to manage the CFSC round trip requirements for each route or route group within a range versus an absolute minimum. Such changes would enhance efficiency and generate cost savings.

#### **4.0 CONCLUSION**

BC Ferries continues to actively explore and pursue initiatives to enhance the efficiency and effectiveness of its operation. BC Ferries believes that the most significant efficiency gains and cost savings can be realized through changes in and/or rationalization of the service levels prescribed in the CFSC. Section 3.5 of this Plan contains examples of such initiatives. BC Ferries stands ready to explore these initiatives further, should there be interest by the Province and the Commissioner in their being pursued in order to realize additional efficiency gains in the delivery of coastal ferry services. BC Ferries is not recommending any service cuts, but is providing options for possible further exploration.