



**ADDITIONAL OR ALTERNATIVE
SERVICE PROVIDERS PLAN**

Second Performance Term

March 2008

PREFACE

In accordance with section 69 of the *Coastal Ferry Act* (“Act”), British Columbia Ferry Services, Inc. (“BC Ferries” or the “Company”) submits its Second Performance Term Additional or Alternative Service Providers Plan (“PT2 ASP Plan”).

Consistent with the *Act*, the PT2 ASP Plan addresses alternative service delivery (“ASD”) options for “*ferry services on the designated ferry routes*” only. ASD options for other services may be pursued by BC Ferries, but are not discussed herein.

This PT2 ASP Plan sets out the ferry routes for which BC Ferries will seek ASD options in the Second Performance Term, the general approach used to identify routes as candidates for ASD, the process that BC Ferries will use to explore and implement ASD initiatives, and the lessons learned during the First Performance Term.

BC Ferries has designed its PT2 ASP Plan based on best practices from other jurisdictions and from experience gained over the First Performance Term. It has been structured to be fair to third parties and sufficiently flexible to accommodate evolving circumstances, yet achievable within existing resource constraints.

The ultimate objective of seeking additional or alternative service providers (“ASPs”) is to ensure that safe, reliable and quality service is provided at the most attractive financial terms. The determination of who should provide the service is based on value rather than price alone, with a strong emphasis on safety, reliability and quality of service. Nonetheless, savings from contracting with third-party service providers is a key consideration. BC Ferries will use a business case as the central decision making tool throughout the assessment process.

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INTRODUCTION

Regulatory Context

The *Act* transformed BC Ferries from a Crown Corporation into a regulated, independent commercial company and created the office of the British Columbia Ferries Commissioner (“Commissioner”) to regulate the core ferry services that BC Ferries provides under the Coastal Ferry Service Contract (“CFSC”), a long term fee for service contract with the government of British Columbia (the “Province”).

Under Section 69 of the *Act* (see [Appendix 1](#)), BC Ferries is required to provide to the Commissioner a plan for each performance term, as defined under the CFSC, in which it sets forth the manner by which it intends to seek ASPs for ferry services on designated ferry routes¹ during that term.

ASP Plan Objectives

Section 69 mandates BC Ferries to seek ASPs, “...in an effort to reduce costs of providing those services...”. The fundamental objective that must guide BC Ferries in developing and implementing its ASP plans is, therefore, to determine if, through third party service providers, BC Ferries can provide safe, reliable, quality service that fully meets the requirements of the CFSC at lower cost.

Ensuring cost effective service is, however, just one objective which must guide BC Ferries in identifying and considering ASD opportunities. It is important to note that under the CFSC, BC Ferries remains fully responsible for the service on all designated routes regardless of whether that service is provided by an ASP under subcontract or directly by BC Ferries. If BC Ferries’ obligations under the CFSC are not satisfied, even with respect to an individual route, BC Ferries is at risk of being in default under the CFSC, which potentially could result in early termination of the CFSC. In considering an ASP’s proposal, BC Ferries must, therefore, consider carefully all elements of a potential sub-contracting arrangement. The determination of who should provide the service will be based on consideration of value and risk, rather than price alone. Nonetheless, potential savings from contracting with third-party service providers is a key consideration.

Approach to Seeking ASPs

The *Act* also provides guidance in respect of the approach BC Ferries should follow in seeking ASPs. In the context of setting the principles by which the Commissioner must perform his regulatory role, including his responsibilities in respect of Section 69, the *Act* (Section 38) sets out that “fair and open competitive processes” should be followed by BC Ferries in seeking ASPs. The procurement approach BC Ferries has adopted in respect of its

¹ Designated ferry routes are identified in the CFSC and are subject to price-cap regulation by the Commissioner. Additionally, the CFSC requires BC Ferries to administer eight ‘unregulated routes’, which are presently all operated by independent operators under contract.

ASD initiatives fully responds to this principle through its reliance on the use of competitive tendering processes that reflect industry best practices, and through the engagement of independent third party experts at various stages in the ASD process.

First Performance Term

In March 2004, BC Ferries submitted its First Performance Term ASP Plan². In July 2005 and February 2006, BC Ferries submitted supplements to this plan. The plan and associated supplements (collectively the "PT1 ASP Plan") identified specific route groups for which ASD options were to be assessed during the First Performance Term, and set out a proposed procurement model to support this process. A summary of the ASD initiatives undertaken during the First Performance Term is provided below in the section entitled 'ASD in the First Performance Term'.

The loss of the *Queen of the North* during the First Performance Term significantly impacted the implementation of the PT1 ASP Plan. The actions required by BC Ferries to respond to this extraordinary event, including the restoration of service on the northern routes and the acquisition of replacement vessels for the northern service, necessitated a refocusing of all Company resources, and resulted in the deferment of certain ASD initiatives planned for the First Performance Term.

An ASD process for the Northern Routes was initiated in the First Performance Term but was ultimately deferred as a result of the need to respond to the loss of the *Queen of the North* and the fact that service levels and associated vessel requirements for the Discovery Coast service (Route 40), which may also impact Route 10 (Port Hardy – Prince Rupert) and Route 11 (Queen Charlotte Islands – Prince Rupert) service levels, have not been finalized, despite extensive negotiations with the Province in that regard.

BC Ferries did conduct an ASD process for Route 12 (Mill Bay – Brentwood Bay) during the First Performance Term, which, as of this report date, is in the final stages of assessment. The Company also worked with a proponent on an unsolicited proposal outside of the PT1 ASP Plan for a pilot project for Routes 21 and 22 (Buckley Bay - Denman Island and Hornby Island - Denman Island).

The PT1 ASP Plan also envisaged an ASD process for Routes 17 (Comox - Powell River) and 18 (Powell River - Texada Island). However, action on this initiative was, and still is, dependent on a response from the Province regarding the *Vessel and Service Strategy* proposed by the Company in September 2005.

Second Performance Term

BC Ferries submits its PT2 ASP Plan in accordance with its obligations under Section 69 of the *Act*. As required, the PT2 ASP Plan addresses ASD options for "ferry services on the

² The First Performance Term is defined under the Coastal Ferry Services Contract as April 1, 2003 to March 31, 2008. The Second Performance Term is defined as April 1, 2008 to March 31, 2012. Subsequent Performance Terms are defined as the four-year periods thereafter. The Coastal Ferry Services Contract can be found on the BC Ferries website (www.bcferrries.com).

designated ferry routes" only. ASD options for other services may be pursued by BC Ferries, but are not discussed herein.

The PT2 ASP Plan sets out the designated ferry routes for which BC Ferries will seek ASD options in the Second Performance Term, the methodology used to select the routes, the process that BC Ferries will use to explore and implement ASD options, and the lessons learned during the First Performance Term.

The PT2 ASP Plan embodies BC Ferries' approach to ASD whereby proposals are solicited to undertake the full spectrum of operational services associated with a route, or group of routes, rather than specific components of a ferry service operation. This subcontracting model approach is very flexible, and still allows for the possibility that proponents may wish to contract back to BC Ferries certain components of the ferry services.

BC Ferries has designed its approach based on best practices from other jurisdictions and from the experience it has attained over the First Performance Term. The PT2 ASD Plan has been developed to ensure a fair, transparent and open competitive process, and to offer opportunities which the Company believes will be well received by potential ASD proponents. Also, the PT2 ASP Plan is sufficiently flexible to accommodate evolving circumstances, yet is achievable within the Company's existing resource constraints.

ASD IN THE FIRST PERFORMANCE TERM

Below is a summary of ASD initiatives undertaken during the First Performance Term. This includes only outsourcing initiatives related to the designated ferry routes, and excludes other subcontracting initiatives that were successfully completed by the Company, such as those involving the eight unregulated routes specified in the CFSC. These other ASD initiatives are summarized in [Appendix 2](#).

In its PT1 ASP Plan, BC Ferries identified three specific groups of designated routes where it planned to test the market for ASD options during the First Performance Term. They were the Northern Routes, Route 12 and Routes 17 and 18. ASD activity in respect of these three offerings, as well as other routes, during the First Performance Term is summarized below.

Northern Routes

Route 10 – Port Hardy - Prince Rupert

Route 11 – Queen Charlotte Islands - Prince Rupert

Route 40 – Discovery Coast Passage (Port Hardy - Mid Coast)

Route 26 – Skidegate - Alliford Bay

The Northern Routes were chosen as ASD candidates in part because the three existing vessels, *Queen of Prince Rupert*, *Queen of the North* and the *Queen of Chilliwack*, were nearing the end of their useful lives, and faced potential compliance issues in respect of future Transport Canada regulations. In addition, the CFSC required BC Ferries to provide a number of deliverables for the Northern Routes in the First Performance Term, including the development of a long term strategy to improve customer service and enhance operational efficiencies. BC Ferries believed that an ASD initiative would help to respond to these imperatives.

A Request for Expressions of Interest ("RFEOI") was issued by the Company on August 2, 2005 to identify ASPs interested in delivering ferry services on the Northern Routes, including ticketing, vessel provision, on-board services, terminal operations and maintenance. The RFEOI closed September 30, 2005 and resulted in two existing ferry operators and one financial institution coming forward with expressions of interest. The financial institution and one of the ferry operators subsequently withdrew from the process, leaving one ferry operator as the sole proponent. Plans to implement the next phase of the procurement, a combined Request for Qualifications ("RFQ") /Request for Proposals ("RFP"), was deferred as a result of the loss of the *Queen of the North* on March 22, 2006. Instead, BC Ferries elected to devote its limited resources to restoring service to the Northern Routes and ensuring timely acquisition of replacement vessels for the northern service.

The original RFP for the Northern Routes contemplated the ASP providing new vessels. However, since the loss of the *Queen of the North*, BC Ferries has secured one used vessel and has commissioned construction of a second vessel to service the Northern Routes. In addition discussions are ongoing with the Province regarding potential changes in the service levels and associated vessel requirements for Route 40. As the service levels and

vessel requirements for Route 40 may impact service levels and vessel deployment on Routes 10 and 11, these discussions will need to be finalized before the ASD process can be restarted for the Northern Routes.

Route 12 (Mill Bay - Brentwood Bay)

Route 12 connects Brentwood Bay on the Saanich Peninsula with Mill Bay on Vancouver Island. Route 12 is used by local commuters and tourists who use the route as an alternative to the Malahat section of the Island Highway. The vessel presently serving on the route is the *Mill Bay*.

Given that Route 12, with its highway alternative, is unique in comparison with the balance of the BC Ferries network, and that a replacement vessel will be required in the near term, it was chosen as an ASD candidate.

An RFEOI was issued October 21, 2005 to identify ASPs who were interested in delivering ferry services on the route, including ticketing, vessel provision, on-board services, terminal operations and maintenance. The RFEOI closed November 18, 2005 and resulted in two existing ferry operators coming forward with expressions of interest. The next phase of the procurement, a combined RFQ/RFP, was temporarily deferred as the Company refocused its internal resources to respond to the loss of the *Queen of the North*. The RFQ/RFP was ultimately issued on February 5, 2007, with responses due by June 15, 2007. BC Ferries is evaluating the responses received and expects to make a decision on whether to contract with a third party for the provision of service on this route shortly.

Route 17 (Powell River - Comox)

Route 18 (Powell River - Texada Island)

Route 17 connects Powell River with the Comox/Courtenay area on Vancouver Island. The route is serviced by the *Queen of Burnaby*.

Route 18 connects Texada Island with Powell River. Route 18 is used by Texada residents to access employment and services in Powell River, including students who commute to high school. The route is serviced by the *North Island Princess*.

As required by the CFSC, BC Ferries has developed a Vessel and Service Strategy with respect to these two designated routes. This strategy was developed after extensive consultation with the community and was submitted to the Ministry of Transportation in September 2005. As provided in the PT1 ASP Plan, BC Ferries anticipated proceeding with its evaluation of a potential ASD offering for these routes once the Vessel and Service Strategy, now with the Province, was finalized. However the Company continues to await a response from the Province, and consequently has been unable to proceed with its ASD strategy for these routes. When BC Ferries receives a response from the Province to its strategy, it will then explore an ASD offering.

Route 13 (Langdale - Gambier Island - Keats Island)

Route 13 is a passenger-only service from Langdale on the Sunshine Coast to Gambier and Keats Islands. This is BC Ferries' only designated route that is a passenger-only service (i.e., no vehicles carried). Faced with a need to replace its aged vessel, BC Ferries assessed the route against alternative means of providing the service in 2003. Following a competitive RFP process, operation of the route was awarded to a third party operator in April 2003, who has demonstrated that it could deliver the service on a more cost-effective basis than BC Ferries. Customer service feedback has been positive, and during the First Performance Term, BC Ferries renegotiated and extended the term of the contract with the operator to the end of the Second Performance Term.

ASD Activities Outside the PT1 ASD Plan

Route 21 (Buckley Bay – Denman Island)

Route 22 (Hornby Island – Denman Island)

During the last portion of the First Performance Term, with the active encouragement of the Commissioner, BC Ferries worked with a potential ASP, who approached BC Ferries on an unsolicited basis, regarding a possible pilot project for the Buckley Bay to Denman Island and Hornby Island to Denman Island routes (Routes 21 and 22). The arrangement to consider the viability of the pilot project on an exclusive basis with this company has been terminated.

LESSONS LEARNED

From the initiatives undertaken during the First Performance Term, the Company gained certain insights into the ASD process. These are summarized below.

Market Response

The breadth of the response to BC Ferries' ASD offerings in the First Performance Term was limited. Relatively few proponents responded to initial RFEOs and for both the Northern Route ASD and the Route 12 ASD. The limited response is consistent with the experience in other jurisdictions looking to outsource ferry operations. For example, Erik Ostergaard, CEO of the Danish Transport & Logistics Association, said at an Interferry conference in Stockholm in 2007 that only two routes had changed hands out of 27 tendered in Denmark, and the situation was similar in other European countries.

As part of its ASD program, BC Ferries interviewed proponents that withdrew at any stage in the procurement process. In general, proponents reported that their withdrawal had to do with internal issues and other opportunities and did not identify the procurement process as a key reason why they withdrew. At this point, BC Ferries can only speculate as to the reason for the limited participation. Possible explanations include:

- a limited number of potential providers,
- perceived economic or technical difficulties in providing proposals that are competitive with the incumbent provider,
- inadequate upside given the risks involved, and/or
- resources required to respond to ASD requests coupled with the uncertainties regarding the ultimate outcome.

During the First Performance Term, BC Ferries met with European organizations involved in outsourcing ferry services in an effort to structure an effective ASD program. The Company also had similar discussions with domestic organizations involved in outsourcing ferry services during the First Performance Term. Best practices employed by these parties were then incorporated into the Company's procurement model. In the Second Performance Term, BC Ferries will continue to consult with other ferry organizations engaged in outsourcing initiatives, in an effort to learn from their experiences and continue to strengthen the ASD process.

Internal Resource Requirements

The resources required from BC Ferries to run an ASD process are considerable. In addition to composing and evaluating the RFEOI, RFQ and RFP, BC Ferries must calculate its own benchmark cost and service offering. This requires a wide variety of expertise and a significant time commitment by the Company and its personnel, and has led to the position that the Company should carefully define the scope of the ASD process for the Second Performance Term, and limit its commitment to evaluate unsolicited proposals.

Unsolicited Proposals

The PT1 ASP Plan was prepared with the view that its implementation would fully commit BC Ferries' available resources. Unsolicited ASD proposals outside the PT1 ASP Plan would be considered only in the event that BC Ferries' resources did become available. The PT1 ASP Plan set out a proposed procedure BC Ferries would follow in the event an unsolicited proposal was accepted for consideration³. This procedure included an initial review of the proposal by the Company followed, if warranted, by a competitive procurement process.

During the First Performance Term, with the active encouragement of the Commissioner, BC Ferries worked on an exclusive basis with a potential ASP who approached the Company on an unsolicited basis, regarding a possible pilot project on two of the designated routes. BC Ferries' experience in pursuing an unsolicited ASD project in the First Performance Term that was outside its PT1 ASP Plan has proven that such initiatives can be very demanding on the Company from a resource perspective, and can detract the Company from executing its planned ASD program in a timely manner. While unsolicited proposals are one means of potentially bringing forward innovative service delivery concepts, consideration of them in the absence of a competitive tendering process, however, means they are difficult to assess in terms of whether they represent best value.

Structural Considerations

During the First Performance Term, BC Ferries gained insight into issues that impact the design of the ASD process, including the following:

Contractual Framework

The CFSC is a binding, 60-year agreement between the Province and BC Ferries, and defines routes served by BC Ferries, the minimum service levels required on each route, and the maximum price cap⁴ for each route group. As provided under the CFSC, the first service review was completed in 2008, and subsequent reviews will occur every four years, at which time service levels and/or price caps may be changed. Hence any agreement between BC Ferries and an ASP needs to accommodate the possibility that the ferry services and/or tariffs charged may change every four years. This can add complexity to the terms of any arrangement with an ASP that extends beyond the current 4-year Performance Term.

Also, under the CFSC BC Ferries is required to deliver safe, reliable and quality ferry services on the designated routes. Delivery is provided directly or through contracts with third parties. In all cases, BC Ferries carries the ultimate responsibility to ensure the ferry services are delivered, and there are clear penalties, including possible contract termination, if BC Ferries does not meet its obligations. Hence any agreement with an ASP must incorporate mechanisms that enable BC Ferries to continue to provide uninterrupted ferry services should the contract with that ASP be terminated. For example under an arrangement where the ASP supplies its own vessel, BC Ferries typically will require an option to lease or purchase the vessel so that it can continue to service the route upon

3 Additional or Alternative Service Providers Plan Supplement, July 2005, pp 21, 30-36.

4 Price caps determine the maximum average tariff that may be charged on a given route group.

termination of its contract with the ASP. If this is not obtained, BC Ferries could find itself in a position where it might face difficulty meeting its obligations under the CFSC if the operator chose to remove the vessel from service on contract termination. This requirement adds complexity to a contract with an ASP.

In addition to the CFSC there are other contracts that BC Ferries is party to that constrain the types of transactions it can enter into with ASPs. These include the 'Master Trust Indenture' and the 'Acknowledgement Agreement'⁵. The restrictions under these and other agreements must be considered when entering into any contract with an ASP.

Asset Finance

To the extent that asset financing is included in the scope of an ASD opportunity, an ASP's lenders will typically look for protection for their outstanding capital investment if the contract with BC Ferries is terminated. This is particularly important if the asset is a dedicated and somewhat unique asset with no clear buyer or value in the secondary market⁶. This protection for lenders can be similar to the protection provided to BC Ferries in the CFSC where, if service on a route is terminated for any reason, BC Ferries has an option to either:

- Sell the vessel and associated assets in the open market; or
- 'Put' the vessel and associated assets back to the Province at Net Book Value.

At the same time, regardless of the term of the ASD contract, BC Ferries will normally require the option to maintain control of critical asset(s) to ensure its ability to meet its contractual obligations with the Province, potentially including review of the design and maintenance of the asset.

The potential mismatch between the concession term and the time required to recover a capital investment is also a challenging issue in other jurisdictions seeking to outsource ferry services. The following comments summarize the views expressed during the Interferry conference held in Stockholm in 2007 on public tendering of ferry services from case studies from Canada, Denmark, France and Scotland⁷.

*"While confirming that competition promised user benefits in terms of price and quality, the presentations also pointed to major problems – notably because the typical concession term of around five years created operator uncertainty about making large investments with a short depreciation horizon. **Erik Ostergaard**, CEO of the **Danish Transport & Logistics Association**, said that only two routes had changed hands out of 27 tendered in Denmark and the situation was similar in other European countries."*

BC Ferries identified concession term as a potential issue early in the ASD process, and has subsequently agreed to consider proposals that contemplate long-term contracts so that proponents can more readily obtain asset financing. In addition, the Company has

5 These financing agreements govern the terms under which BC Ferries may incur certain borrowings. Both documents are available at www.sedar.com.

6 In this case, the lender may be unable to sell the asset and repay its financing.

7 www.interferry.com

expressed a willingness to consider other contract terms that will mitigate this “capital risk”, including agreeing to buy an operator’s vessel upon contract termination in certain circumstances. As part of its ASD process BC Ferries envisages continuing to work with the proponents, as appropriate, to negotiate terms that are mutually acceptable and that allow the proponents to obtain the necessary financing.

Constraints on Proposals

Marine transportation services in British Columbia are provided within a highly regulated environment. Many elements of an operation, including crewing levels and safety practices, are subject to stringent regulations. This, combined with limited flexibility in the service levels that must be delivered under the CFSC, and the possibility for union successorship to apply to a ASP’s operation, may limit the extent to which opportunities exist for a proponent to develop innovative, cost saving approaches to service delivery. Nonetheless, given the benefits which are potentially achievable when new creative ideas are applied, innovation will be a factor in evaluating ASP proposals as the Company conducts ASD initiatives in the Second Performance Term.

Competitive Environment & Structural Issues

When ferry operations are conducted by BC Ferries directly, customers enjoy certain benefits from having service provided by a large, integrated ferry company. Offering services that are competitive with those of the incumbent service provider poses certain challenges. Potential ASD proponents need to assess their competitive position relative to BC Ferries and be aware of various structural and statutory issues, including the following:

Vessel Regulations and Refit Relief

Typically, BC Ferries removes its vessels from operation to perform maintenance that cannot be performed while the vessel is in service. This is referred to as ‘refit’. If an ASP performs a similar maintenance regime, it will likely require a supplementary backup vessel in order to meet the contractual service level requirements. In addition, there are specific Transport Canada requirements for dry-docking of vessels on a routine basis in order to meet certification. Unlike BC Ferries, not all ASPs will have access to a fleet of vessels that can potentially provide relief during a refit process.

Integration with BC Ferries’ systems and assets

To a large extent, BC Ferries’ assets have been designed to work together in an efficient and cost effective manner. A proposal by an ASP may need to ensure that its assets are properly integrated with existing BC Ferries assets. For example, a vessel may need to be modified in order to be compatible with BC Ferries’ existing marine structures. The additional cost of these modifications could make it more difficult for a proponent to submit a competitive proposal. In addition, BC Ferries has the advantage of scale in its operations.

Taxes

BC Ferries is exempt from paying income taxes - most third party providers are not. Additionally, the service fee BC Ferries pays to a sub-contracted operator may be subject to GST on a non-recoverable basis, whereas BC Ferries' direct costs are largely free of GST.

Local ASPs

For more than 40 years BC Ferries has served the coastal communities of British Columbia as the primary operator for the provision of ferry services. BC Ferries has experience contracting for minor ferry services in the local market and understands the market of available local ASPs. The number of local ASPs is relatively limited, and largely consists of smaller operators with limited resources. This observation is consistent with the modest response received to the ASD initiatives in the First Performance Term.

PROCUREMENT MODEL

The procurement model employed by BC Ferries for seeking ASPs is described below.

The Process

Request for Expressions of Interest

The process for seeking ASPs is initiated with an RFEOI to assess the market's willingness to enter into a transaction and any issues that proponents may wish to highlight. This stage is analogous to a market sounding, with the objective to obtain information from and about the market. This information is subsequently used to structure the RFQ and RFP. The RFEOI will often require information about a proponent such as an "Organizational Overview", "Project Understanding", and a "Capabilities Overview". All parties who wish to receive a copy of the RFQ must complete the RFEOI.

Request for Qualifications

The next stage in the process is the RFQ. The purpose of the RFQ is to determine which parties are capable of meeting the required standards. This stage will usually require information such as a proponent's "Qualifications and Experience" and "Financial Characteristics".

Request for Proposals

The next stage in the process is the RFP. Only bidders who pass the RFQ stage will be invited to respond to the RFP. The RFP is typically a very detailed document, and requires considerable input from a proponent in defining its bid.

Where appropriate, BC Ferries may combine the RFQ and RFP stages of the procurement process if there are benefits (e.g. efficiency and/or cost reduction) in doing so.

Benchmark

BC Ferries will compare a proponent's bid to its own 'benchmark' cost, service offering and risk profile in order to determine if proceeding to the negotiation phase with the proponent is warranted. In order to provide transparency to the process and assurance to proponents and the Commissioner, the benchmark will be completed in advance of the closing date of the RFP. The evaluation of proposals against the benchmark is undertaken by BC Ferries staff, together with external resources as required.

Prior to the release of the RFP, BC Ferries will consult with the BC Ferry & Marine Workers' Union in accordance with the requirements under the Collective Agreement. As input to and prior to the completion of the Company's benchmark, the BCFMWU will be invited to identify opportunities for enhancing the efficiency and effectiveness of BC Ferries' delivery of service on the route(s) subject to the RFP. Cost effective measures identified, where viable, will augment the competitiveness of the service delivered by BC Ferries and will be incorporated in the Company's benchmark.

Evaluation

BC Ferries' final decision on an ASD proposal will be made on the basis of a business case analysis. Ultimately, this analysis will compare the ASD proposals to the benchmark cost, service offering and risk profile of BC Ferries continuing to provide the service. The business case will consider such things as cost, financing, service delivery, safety, human resources, regulatory compliance and risk mitigation. The purpose of the business case is to determine which opportunity represents the best 'value for money' all things considered.

In an effort to streamline the process, BC Ferries will evaluate bids using two steps.

Step one focuses on economics. It involves comparing the all-in cost of a proponent providing the service with BC Ferries itself continuing to provide the service. If the ASD cost is higher than the benchmark cost, the bid will be rejected. An exception to this process will be made for cases where the service offered by the proponent is distinctly and materially better than that provided by BC Ferries.

If the evaluation conducted in step one demonstrates that the cost of a proponent providing the service is materially less than BC Ferries' cost or is distinctly and materially better than that provided by BC Ferries, then the evaluation process will proceed to step two. This second step involves a full evaluation of the proponent's proposal and comparison against the benchmark. Potential measures that may be evaluated include safety, human resources, operational plan, financing, vessel, regulatory compliance, risk mitigation, and contractual terms. Innovation will also be a factor in evaluating the proponent's proposal.

During this second step, evaluation of each measure will be performed by a team of subject specialists from BC Ferries, and external third party experts where appropriate. These teams will analyze and evaluate how a proponent's bid compares with the benchmark for their specified measure. The results of the teams' analysis will be documented in separate reports. A steering committee will then review these reports. These reports principally will form the basis for the business case determination.

External Reviews

Like any other private sector company, BC Ferries has an interest in determining the best and most cost effective approach to delivering the services it provides. Unlike most other companies, however, BC Ferries is mandated by statute to conduct such assessments. The Commissioner plays an important role in this regard. Implementation of BC Ferries' PT2 ASP Plan is subject to oversight by the Commissioner.

BC Ferries engages external naval architects, lawyers, financial consultants and other expert resources, as required, to provide independent assessments of the service standards and requirements the Company believes are necessary for an ASP to meet. These reviews require technical and subject matter expertise and are conducted with a view to determining whether the specifications BC Ferries establishes are fair, reasonable and appropriate.

BC Ferries' final decision regarding an ASP's proposal will be made on the basis of a business case analysis. An independent third party may be engaged by BC Ferries to assess

the fairness and reasonableness of the recommendations presented in the business case. The final report of such a review is provided to the BC Ferries' Board of Directors and the Commissioner.

Project Selection and Comprehensive Agreement

If the best ASD proposal meets BC Ferries' qualifications and is deemed to provide superior 'value for money' as compared to BC Ferries' benchmark, the final authorization to contract with the proponent will be contingent on successful negotiation and execution of a comprehensive agreement between the ASP candidate and BC Ferries. BC Ferries' Board of Directors will be required to approve any agreement before execution.

Exit Interviews with Proponents

BC Ferries will continue to interview proponents that withdraw at any stage in the procurement process. Input from these interviews will be used to structure future ASD initiatives that are attractive to potential proponents while continuing to meet BC Ferries' objectives.

Community Involvement

BC Ferries recognizes that the public would like to know as many details about the ASD process as possible and endeavors to keep communities informed. Typically, the primary channel for communications is the local Ferry Advisory Committee (FAC)⁸.

One of the principal messages BC Ferries provides in its communications on the ASD process is that it is not a tool to reduce or eliminate service on any route, but rather is a search to determine how ferry services can be provided most efficiently. Regardless of who provides the ferry service on a designated ferry route, BC Ferries has an ongoing responsibility to ensure that core ferry services continue to be delivered in accordance with the requirements of the CFSC.

⁸ An FAC is the designated community organization with which BC Ferries conducts public consultation on issues relating to ferry service. There are currently twelve such organizations in BC.

ASD INITIATIVES FOR THE SECOND PERFORMANCE TERM

Route Selection Methodology

In preparing its PT2 ASP Plan, BC Ferries considered all designated routes as possible candidates for ASD activities. The route selection methodology adopted by the Company centered on identifying routes where the Company believes that during the Second Performance Term proponents will have the greatest potential to add value. To this end, BC Ferries considered key attributes of each route, including the following:

- Pending major vessel and/or terminal capital expenditures required (which could potentially be avoided if route operations are outsourced to a third party).
- Attributes which may indicate that a different, perhaps more flexible, operator could service the route more efficiently, such as highly seasonal traffic flow, high intraday traffic volatility, small size, low average load factor, poor on-time performance by BC Ferries, and low forecasted growth for the route.

Additional considerations with respect to each route also factored into the selection process. These included:

- The possible bundling of routes to make them more attractive to proponents. Several routes outsourced as a single offering also offers the potential to enable BC Ferries to explore ASD for more routes on a more resource efficient basis.
- The potential application of unfolding technology to a given route that may enhance ferry services.
- The remoteness of a route relative to the rest of the BC Ferries network. Routes, or groups of routes, that are geographically separate from the Company's other operations tend to have less synergistic advantages for BC Ferries, and are therefore more likely to have cost savings potential from ASD.
- Whether a route's terminals are shared with other routes. Routes with dedicated terminals do not require terminal sharing arrangements and/or coordination between two separate labour forces, and are therefore potentially more attractive ASD candidates for both BC Ferries and potential ASPs, all else held constant.

The route specific analysis, as described above, provided baseline information from which BC Ferries developed its PT2 ASP Plan. It served as the basis upon which routes were prioritized in terms of their potential attractiveness as ASD candidates in the Second Performance Term.

ASD Initiatives

With input from its analysis of the individual routes as potential ASD candidates and the lessons learned during the First Performance Term, the Company identified the designated routes for which ASD may be pursued in the Second Performance Term and developed a plan for how to sequence the ASD activities in respect of these routes. The PT2 ASP Plan is

considered aggressive in terms of its scope, but achievable within the Company's existing resource constraints.

The PT2 ASP Plan involves a phased approach to pursuing the specified ASD initiatives. For Phase One, the Company has included the initiatives that it will pursue on a priority basis. After completing all of Phase One (to the extent possible), BC Ferries will then execute as many Phase Two initiatives as time permits.

The outcomes of the ASD processes undertaken in this first phase of the PT2 ASP Plan will dictate, in large part, how much time and what resources are available for the Company to pursue Phase Two ASD activities in the Second Performance Term. An ASD process that concludes, for example, with contract negotiation and transition of service to an ASP will take more time and resources of the Company than a process that concludes with BC Ferries continuing as the service provider. The size and complexity of any service being transitioned to an ASP will also be a factor. Progress will need to be assessed as Phase One initiatives proceed. BC Ferries will keep the Commissioner apprised of the status of implementation of its PT2 ASP Plan.

Phase One Initiatives

The first priority of the PT2 ASP Plan is to complete, where possible, the processes for those ASD initiatives commenced, but not finalized, in the First Performance Term. The following two ASD initiatives comprise this phase:

Route 12 (Mill Bay - Brentwood Bay)

BC Ferries is evaluating the responses received to the RFP issued for Route 12. Should a proponent's proposal be determined to represent superior value for money to the BC Ferries' benchmark, the next step would involve the proponent and BC Ferries negotiating and, if successful, executing a service contract. Should this occur, the next step would be to transition the Route 12 service to the ASP. BC Ferries expects to make a decision on whether to contract with a third party for the provision of service on this route shortly.

Northern Routes

BC Ferries initiated an ASD process for the Northern Routes in the First Performance Term and is committed to proceeding with this initiative on a priority basis as part of its PT2 ASP Plan. BC Ferries will consider ASD for the provision of ferry services for the Northern Routes, including ticketing, provision of a third vessel (if needed), on-board services, terminal operations and maintenance.

BC Ferries will recommence the ASD process for the Northern Routes once discussions with the Province regarding the Route 40 service levels and vessel requirements have been finalized. This is expected by the late spring of 2008. If completion of these discussions becomes significantly delayed, then the Company will restructure the timing of the ASD initiatives planned for the Second Performance Term and, specifically, will bring forward for earlier implementation one or more of the initiatives identified in Phase Two of the ASP Plan.

The process to complete the ASD process for the Northern Routes will involve the issuance of a combined RFQ/RFP to the single respondent remaining in the process. A Northern Routes RFQ/RFP will be a major undertaking, and has the potential to limit the Company's ability to conduct an ASD process for other routes in the Second Performance Term. This is particularly true if an ASP proposal is determined to represent superior value as compared to the BC Ferries' benchmark, and BC Ferries needs to devote considerable resources to negotiating and executing a contract and implementing the transition of the Northern Route operations to the proponent.

It is anticipated that the time required to issue the RFP and receive a response from the proponent would be approximately 10-12 months, following which an additional 2-4 months would be required to negotiate and execute a contract, should the proponent's proposal represent superior value to the BC Ferries benchmark. The time required to transition route operations would be approximately a year, during which time Company resources would be fully engaged and, with the exception of continuing its other Phase One activities, would be unable to conduct an ASD initiative for any other route(s).

The timeline currently envisaged by BC Ferries to undertake the ASD process for the Northern Routes is set out in Table 1. BC Ferries will make best efforts to proceed as expeditiously as possible; however, not all activities are within the direct control of BC Ferries. It is predicated on the assumption that discussions with the Province on Route 40 service levels and vessel requirements are completed by June 1, 2008, and that the proponent's successful proposal is based on using vessels already, or nearly already, built, which may or may not be the case.

Table 1: Northern Routes ASD Timeline (tentative)

Date	Action
June, 2008	Route 40 service levels finalized
November, 2008	Issue RFQ/RFP to proponent
May, 2009	Response due from proponent
October, 2009	Evaluate response to RFQ/RFP
<i>If proposal is superior to benchmark, then:</i>	
February, 2010	Complete contract negotiations
February, 2011	Operations transition complete

Phase Two Initiatives

BC Ferries' first priority in the Second Performance Term will be to complete the Phase One ASD initiatives. Depending on the outcome of those initiatives, BC Ferries may or may not be in a position to undertake further ASD initiatives in the Second Performance Term. In particular, the execution of an agreement and the transition of services for the Northern Routes would be a major undertaking, and would dramatically limit the ability of the Company to outsource other routes in the Second Performance Term.

The Company will keep the Commissioner apprised of the status of the Phase One ASD program and its capacity to initiate additional ASD initiatives in Second Performance Term. The additional ASD offerings that the Company would pursue in the Second Performance Term, as time and resources permit, would include one or both of the following initiatives:

Routes 23 (Campbell River – Quadra Island)

Route 24 (Quadra Island – Cortes Island)

Route 25 (Port McNeil – Sointula – Alert Bay)

Routes 23 and 24 operate in close proximity to each other and both serve Quadra Island. The two routes form a natural route “bundle” and should present an attractive route offering to potential proponents. Route 25 connects Alert Bay on Cormorant Island and Sointula on Malcolm Island with Port McNeil on Vancouver Island. BC Ferries would bundle all three routes in a single ASD offering. It is expected that it would take approximately one year to issue and receive responses to the RFEOI, RFQ and RFP phases of this ASD initiative.

Route 17 (Comox – Powell River)

Route 18 (Powell River – Texada Island)

Routes 17 and 18 operate in close proximity to each other and both serve Powell River. Route 17 is a large route, and Route 18 is small relative to BC Ferries’ other routes. They form a natural route “bundle” and should present an attractive route offering to potential proponents. Proponents will be given an opportunity to bid on these routes on a combined basis.

A complication with this offering is the uncertainty surrounding the future service requirements for these routes. As required under the CFSC in the First Performance Term, BC Ferries, in consultation with the residents and other stakeholders, developed a Vessel and Service Strategy with respect to these two designated routes. The Province is considering the strategy and possible adjustments to the service for Routes 17 and 18. The service offering will need to be finalized with the Province, and BC Ferries will need to confirm that any new service offering will benefit from an ASD initiative, before the ASD process for these routes is initiated.

Future Unsolicited Proposals

Because of resource constraints, BC Ferries may consider unsolicited proposals only if BC Ferries has the necessary resources available to appropriately address the proposals, and if evaluation of the proposals does not detract from execution of the PT2 ASP Plan.

CONCLUSION

BC Ferries advanced several ASD initiatives during the First Performance Term and gained valuable experience in the ASD process. It has built on these experiences in formulating its PT2 ASP Plan.

The PT2 ASD Plan involves a phased approach to pursuing ASD initiatives. Phase One will focus on completing those ASD initiatives commenced, but not finalized, in the First Performance Term. Phase Two will include two additional initiatives. After completing all of Phase One (to the extent possible), BC Ferries will then execute as many Phase Two initiatives as time permits. However, given the resources available and the time required to conduct ASD processes, BC Ferries can only bring a limited number of offerings to market in the Second Performance Term. The number will also depend on whether any proponent is awarded the service under an ASD initiative, in which case the Company will need to execute a contract with the proponent and transition the ferry services. In particular, the execution of an agreement and the transition of services for the Northern Routes in Phase One would be a major undertaking, and would dramatically limit the ability of the Company to outsource other routes in the Second Performance Term.

It is important to recognize that the service levels and other circumstances surrounding some routes may change over time. BC Ferries commits to remaining flexible and making the necessary adjustments to the ASP Plan as circumstances warrant.

Finally, BC Ferries believes that its ASP Plan is aggressive, but achievable within existing resources constraints and is fully committed to ensuring its successful implementation.

APPENDICES

Appendix 1:

Section 69 of the Coastal Ferry Act

- 69 (1) In each performance term of the Coastal Ferry Services Contract, the ferry operator must, in accordance with the plan prepared by it under subsection (2) in relation to that performance term, seek additional or alternative service providers to provide, under contract, franchise agreement or otherwise, ferry services on the designated ferry routes serviced by the ferry operator in an effort to reduce the costs of providing those services on those designated ferry routes.
- (2) A ferry operator must, for each performance term, prepare a plan in which the ferry operator sets out the manner in which it intends to seek additional or alternative service providers to provide ferry services on the designated ferry routes serviced by the ferry operator and must provide that plan to the commissioner,
- (a) in the case of a plan prepared in relation to the first performance term, within 12 months after the effective date of the Coastal Ferry Services Contract, and
 - (b) for each subsequent performance term, on or before the beginning of that performance term.
- (3) If the commissioner considers that a ferry operator has failed to comply with this section, the commissioner may, in addition to any power the commissioner may exercise under section 48, do any or all of the following:
- (a) adjust any productivity factor the commissioner is to establish under section 41 (6) to reflect that failure;
 - (b) order the ferry operator to prepare and provide to the commissioner, a plan, in form and content satisfactory to the commissioner, setting out the manner in which the ferry operator intends, over the period specified by the commissioner, to seek additional or alternative service providers to provide ferry services on the designated ferry routes serviced by the ferry operator;
 - (c) order the ferry operator to comply with the plan provided under paragraph (b).

Appendix 2:

Other Performance Term One ASD Initiatives

Unregulated Routes

For eight routes under the CFSC, BC Ferries administers contracts with independent operators who provide ferry services to coastal communities. During the First Performance Term, agreements with all of these independent operators were renegotiated and/or extended.

Parking Automation/Management Contract

In the First Performance Term, BC Ferries undertook an assessment of parking facilities at its major terminals. An outside consultant concluded that parking services were antiquated. It was recommended that BC Ferries should assess alternative service schemes to maximize the overall profitability. Based on this recommendation, an RFP was issued to the market.

In November 2003, BC Ferries introduced a new pre-paid automated parking system and entered into a management contract with two professional parking management companies. This initiative has improved the bottom-line performance of the Company.

Terminal Asset Management

In the First Performance Term, BC Ferries entered into a strategic partnership with SNC-Lavalin, one of the world's leading engineering companies, to implement the Terminal Asset Management business unit. The new business unit is responsible for the overall management of maintenance and new construction for all terminal facilities. This new Business Unit has improved overall efficiency and productivity.

The Terminal Asset Management business unit includes representatives from both BC Ferries and SNC-Lavalin. A key contribution to the partnership by SNC-Lavalin is their broad project management expertise, especially in the area of new construction. In addition, SNC-Lavalin provides the management expertise to oversee the new unit. In effect, BC Ferries has "contracted in" with SNC-Lavalin to provide necessary management personnel to jointly oversee employees within BC Ferries' business unit.

Tsawwassen Quay

Management of the new Tsawwassen quay was outsourced to Lonsdale Quay Market Corp. under a ten year concession agreement which includes management of tenants, maintenance of the facility, and other duties. The facility offers a total of 18 food, beverage, service and retail outlets.

Food Services

BC Ferries has entered into partnering arrangements with third parties to provide branded food service programs on several vessels. These initiatives have been very successful, and have led to higher sales and improved food quality.

Automated Ticketing

BC Ferries has installed self-ticketing machines (kiosks) for foot passenger use at two of its major terminals. The focus of this initiative is to improve customer service by offering alternative points of sale and reduced line-ups.