In the Matter of the *Coastal Ferry Act*
S.B.C. 2003, Chapter 14

And in the Matter of an Application by
British Columbia Ferry Services Inc.
pursuant to Section 42 of the *Coastal Ferry Act*

To: British Columbia Ferry Commissioner
P.O. Box 1497
Comox, British Columbia
V9M 8A2

APPLICATION

British Columbia Ferry Services Inc. ("BC Ferries") hereby applies pursuant to the provisions of the *Coastal Ferry Act*, S.B.C. 2003, c.14 (the "Act"), and in particular section 42, for extraordinary price cap increases in relation to six route groups (collectively, the "Route Groups") on the basis that an extraordinary situation exists, namely an extraordinary increase in the price of fuel. An extraordinary increase in the price of an uncontrollable input such as fuel is expressly identified in section 42(2)(b) of the Act to be a basis for an extraordinary price cap increase.

In respect of this Application BC Ferries submits:

1. BC Ferries is a ferry operator under the provisions of the Act with its head office at Fleet House, 1112 Fort Street, Victoria, B.C., V8V 4V2.

2. Pursuant to the Coastal Ferry Services Contract (the "Coastal Ferry Services Contract") dated April 1, 2003 with the Province of British Columbia BC Ferries operates the BC Ferry System as defined in the Services Contract.

3. Section 39 of the Act provides that for the first performance term of the Coastal Ferry Services Contract (which commenced April 1, 2003 and expires March 31, 2008) the price cap relating to a Route Group is the average of the tariffs payable as at April 1, 2003 on the designated ferry routes that are included in that Route Group, and that price

cap is increased on each November 1 in the performance term by 2.8% if the Route Group consists of Major Routes and 4.4% for all other Route Groups..

4. Pursuant to the Coastal Ferry Services Contract BC Ferries operates, or contracts for the operation of, ferries on seven Route Groups. By this Application BC Ferries seeks to increase the price cap applicable to six of those Route Groups: Route Group 1 (Major Routes); Route Group 2 (Horseshoe Bay/Langdale); Route Group 3 (Northern Routes); Route Group 4 (Discovery Coast); Route Group 5 (Brentwood Bay/Mill Bay); and Route Group 6 (Minor Routes). This Application does not seek to change the price cap applicable to Route Group 7 (Langdale/Gambier/Keats).

5. By Order 04-02 dated September 28, 2004 the Commissioner ordered that ferry operators were authorized to establish Deferral Accounts, to be operated as described in Schedule A to that Order. Schedule A provides that for the year commencing April 1, 2004 ferry operators shall charge to operating expenses, by Route Group, fuel oil costs calculated as the delivered price per litre budgeted for 2004/05 (the "set price") multiplied by the actual litres consumed to operate, redeploy, refit and maintain vessels, with the variance between the set price for fuel oil established for each Route Group and the actual delivered price per litre to be held, by Route Group, in the Deferral Accounts. Order 04-02 also ordered that "If an application is made by a ferry operator under Section 42 for an extraordinary price cap increase because of an increase in the price of fuel oil, and if such application is approved by the Commissioner to take effect before March 31, 2008, then the balance in the Deferral Accounts will be adjusted to reflect the extraordinary price cap increase."

6. Subsection (1) and (2) of Section 42 of the Act provide:

> (1) A ferry operator may apply to the commissioner for an extraordinary price cap increase, in relation to a route group, that exceeds any increase available under section 39 (b) or 41 (b), and the commissioner may authorize the extraordinary price cap increase.
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> (2) An extraordinary price cap increase must not be authorized under subsection (1) unless an extraordinary situation exists such as

(a) the deployment of a new capital asset such as a vessel on one or more designated ferry routes in that route group during the currency of the applicable performance term of the Coastal Ferry Services Contract,

(b) an extraordinary increase in the price of any uncontrollable input such as fuel,

(c) an unanticipated and extraordinary change in traffic levels on one or more designated ferry routes in that route group, or

(d) the introduction of new safety or other regulations that impose a new, unexpected and significant cost burden on ferry operator.

7. BC Ferries has experienced an extraordinary increase in the cost of an uncontrollable input, being an extraordinary increase in its fuel oil costs. As of the end of the 2004/05 fiscal year (March 31, 2005) the negative variances between the set prices and the actual delivered prices of fuel oil recorded by BC Ferries in the Deferral Accounts was approximately $8 million. That amount is substantially more that the $5.3 million negative balance that was forecast when the Deferral Accounts were established.

8. The material included with this Application provides information on the variances held in the Deferral Accounts, the actual delivered price of fuel that has been experienced by BC Ferries since April 1, 2004, the forecast price of fuel oil, the fuel price hedging strategy proposed by BC Ferries, the forecast balance in the Deferral Accounts, and the BC Ferries proposal for implementation of fuel surcharges if the price cap increases for which BC Ferries is applying are authorized by the Commissioner.

9. BC Ferries submits that the material filed with this Application establishes that an extraordinary situation exists and that the Commissioner should authorize extraordinary price cap increases for the six Route Groups.

10. Subsection 42(5) of the Act provides that the Commissioner must promptly, and in any event within one month after receiving the full information required by the Commissioner in relation to an application for an extraordinary price cap increase, issue to the ferry operator and the government the Commissioner's preliminary decision on the application.

BC Ferries applies for a preliminary decision of the Commissioner pursuant to subsection 42(5) of the Act, which becomes a final decision pursuant to subsection 42(6) of the Act, by which the Commissioner authorizes the following:

A. An extraordinary increase of 8% in the price cap for the Route Group 1 (Major Routes), which consists of the three major routes between Vancouver Island and the Mainland.

B. An extraordinary increase of 13% in the price cap for each of Route Groups 2 (Horseshoe Bay/Langdale), Route Group 3 (Northern Routes), Route Group 4 (Discovery Coast), Route Group 5 (Brentwood Bay/ Mill Bay) and Route Group 6 (Minor Routes).

BC Ferries also requests that the Commissioner review the hedging strategy proposed by BC Ferries, and acknowledge that the strategy is considered to be appropriate.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Dated at Victoria, British Columbia, this 10th day of June, 2005.

British Columbia Ferry Services Inc.

Robert P. Clarke

Executive Vice-President, Finance
and Chief Financial Officer

All communications in connection with this Application should be directed to:

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FILED BY BRITISH COLUMBIA FERRY SERVICES INC. IN SUPPORT OF APPLICATION FOR EXTRAORDINARY PRICE CAP INCREASES

1. This material is filed in support of the application by British Columbia Ferry Services Inc. ("BC Ferries" or "the Company") pursuant to section 42 of the *Coastal Ferry Act*, S.B.C. 2003, c.14 (the "Act") for extraordinary price cap increases in relation to its ferry operations in Route Group 1 through Route Group 6.

2. BC Ferries has experienced extraordinary increases in the cost of fuel and requires increases in the price caps relating to those six Route Groups.

3. By Order 04-02 the Commissioner authorized the establishment of Deferral Accounts in which to record the variance between the actual price of fuel (net of hedging gains and losses) and a set price for fuel for the six Route Groups. The increased fuel costs experienced by BC Ferries in its 2004/05 fiscal year has resulted in the aggregate balance in the Deferral Accounts reaching $8.0 million by March 31, 2005. It is forecast that if the price caps are not increased and fuel surcharges are not implemented, the aggregate balance in the Deferral Accounts will reach $29.5 million by March 31, 2006 and $53.9 million by March 31, 2008, the expiry of the first performance term under the Coastal Ferry Services Contract.

4. An extraordinary situation exists and increases in the price caps for the six Route Groups, which will allow the implementation of fuel surcharges, are required.

A. Background

5. BC Ferries entered into the Coastal Ferry Services Contract with the Province of British Columbia as of April 1, 2003. The term of the Coastal Ferry Services Contract is 60 years and may be renewed by agreement of the parties for another 60 years. The first performance term under the Coastal Ferry Services Contract is the five year period of April 1, 2003 through March 31, 2008. Pursuant to the Coastal Ferry Services Contract, BC Ferries operates, or contracts for the operation of, ferries on seven Route Groups. The Route Groups are: Route Group 1 (Major Routes); Route Group 2 (Horseshoe Bay/Langdale); Route Group 3 (Northern Routes); Route Group 4 (Discovery Coast); Route Group 5 (Brentwood Bay/Mill Bay); Route Group 6 (Minor Routes) and Route Group 7 (Langdale/Gambier/Keats).

6. Pursuant to section 39 of the Act the price cap relating to each Route Group effective April 1, 2003 was the average of the tariffs payable as at April 1, 2003 on the designated ferry routes that are included in that Route Group. Section 39 of the Act also provides that the price cap for each Route Group increases on November 1 in each year of the first performance term by 2.8% over the previous year's price cap for Route Group 1 (Major Routes) and by 4.4% over the previous year's price cap for all other Route Groups.

7. In September 2004 BC Ferries proposed that the Commissioner approve the establishment of a deferral account mechanism in order to reduce the volatility of fuel oil prices. That filing with the Commissioner noted:

> A number of significant cost pressures have been identified which are negatively impacting the Company's ability to meet the 2004/05 budget, most notably the current extraordinary increase in the price of fuel oil.
>
> The 2004/05 fuel budget was based on world energy markets forward contracts. At that time, the world markets were forecasting fuel oil price per barrel at US $30 (CDN $40). In August, 2004 spot prices of WTI crude fluctuated between US $ 42 and US $ 49. On a per litre basis, the average delivered price of fuel oil (net of hedging gains) [for the 2004/05 fiscal year ending March 31, 2005] is forecast to be greater than $0.44 compared to the $0.40 budgeted which creates a negative variance of $5.3 million [referring to the impact during the 2004/05 fiscal year].[1]

8. At the time of its proposal to the Commissioner respecting a deferral account mechanism the primary concerns of BC Ferries were volatility in fuel costs and the possibility of a prolonged period of extraordinarily high prices.

9. At the time of its proposal to the Commissioner respecting deferral accounts BC Ferries did not apply for extraordinary price cap increases as oil prices were expected to be volatile and BC Ferries was not seeking to have its fares move up and down with the volatile world oil prices. In the Fall of 2005 energy markets were forecasting that world oil prices would begin to decline over the course of the 2005 calendar year, and the Order establishing the Deferral Accounts provided that the Accounts would be credited with the savings (variances from actual delivered prices below the set prices) when oil prices returned to lower levels. The Deferral Accounts

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[1] The BC Ferries' forecast of world crude oil prices at the time was $42 per barrel. The BC Ferries' forecast of delivered fuel oil prices as provided to the Commissioner was $0.444 per litre

were implemented by BC Ferries with the expectation that the deferral account mechanism would deal with fuel price volatility without impacting fares in an extraordinary way.

10. By Order 04-02 dated September 28, 2004 the Commissioner ordered:

1. Ferry operators are authorized to establish Deferral Accounts, to be operated as described in the attached Schedule A.

2. The Deferral Accounts will be maintained until March 31, 2008 at which time the Commissioner will decide on their continuation.

3. The balance in the Deferral Accounts, at a date prior to March 31, 2008, to be determined at the time of the price cap review required under Section 40, will be taken into account in setting the allowable price cap increase, by Route Group, for the performance term commencing April 1, 2008.

4. If an application is made by a ferry operator under Section 42 for an extraordinary price cap increase because of an increase in the price of fuel oil, and if such application is approved by the Commissioner to take effect before March 31, 2008, then the balance in the Deferral Accounts will be adjusted to reflect the extraordinary price cap increase.

5. Any balance remaining in the Deferral Accounts at March 31, 2008, not taken into account in setting the price cap for the term commencing April 1, 2008, will be taken into account in a subsequent price cap review.

11. Order 04-02 provides that for the year commencing April 1, 2004 ferry operators shall charge to operating expenses, by Route Group, fuel oil costs calculated as the delivered price per litre budgeted for 2004/05 (the "set price") multiplied by the actual litres consumed to operate, re-deploy, refit and maintain vessels. Any variance between the set price for fuel oil established for each Route Group and the actual delivered price per litre is to be held, by Route Group, in the Deferral Accounts. Schedule A of the Order establishes set prices for fuel oil for each Route Group, calculated as the delivered price per litre budgeted for the 2004/05 year, and for years subsequent to 2004/05 the set price for each Route Group is increased by the percentage increase reported by Statistics Canada in the Consumer Price Index (Vancouver) for the previous calendar year. Any gains or losses on fuel oil futures contracts ("hedging" gains or losses) are to be charged or credited to the Deferral Accounts, proportionate to fuel oil use by Route Group.

12. As discussed in greater detail below, BC Ferries has experienced extraordinary increases in the costs of the fuel oil used in its operations. World oil price forecasts have changed, and

current forecasts of world oil prices indicate that the extraordinary high price of fuel oil will continue. Action beyond the Deferral Accounts is required to address the high fuel prices being experienced by BC Ferries.

13. Over the past several years, BC Ferries has implemented significant changes to its operations in order to reduce the volume of fuel consumed. In 2001, BC Ferries' annual consumption was 127.6 million litres of fuel. In the last fiscal year, ending March 31, 2005, BC Ferries' annual consumption had dropped to 122.2 million litres while providing the same or better levels of service. This reduction is the result of the changes to the operating profile, the commitment of the company to on-time performance, and improvements in technology. BC Ferries remains committed to improvements in efficiency; however, consumption reductions are not capable of solving the current problem of extraordinarily high fuel costs. BC Ferries submits that the appropriate response to the recent and forecast extraordinary increase in the price of fuel is this Application pursuant to section 42 of the Act for extraordinary price cap increases.

14. Section 42 of the Act allows a ferry operator to apply to the Commissioner for, and the Commissioner to authorize, extraordinary price cap increases if an extraordinary situation exists such as an extraordinary increase in the price of a non-controllable input such as fuel.

15. In this Application, BC Ferries applies for extraordinary price cap increases relating to six Route Groups, being Route Groups 1 though 6, based on the extraordinary increase in the cost of fuel. In this Application, BC Ferries is not seeking an increase in the price cap for Route Group 7 (Langdale/Gambier/Keats).

16. This Application distinguishes between the extraordinary price cap increase sought for Route Group 1 (Major Routes), which consists of route 1 (Swartz Bay to Tsawwassen), route 2 (Horseshoe Bay to Nanaimo), and route 30 (Tsawwassen to Duke Point); and extraordinary price cap increases sought for the other five Route Groups collectively, which consist of non-major routes. BC Ferries seeks an extraordinary increase of 8% in the price cap for Route Group 1, and a separate and common extraordinary increase of 13% in the price caps for Route Groups 2 through 6. The rationale for taking this approach is twofold.

(a) First, section 38(1) of the Act stipulates that cross-subsidization from the Major Routes to other ferry routes is be to eliminated by the end of the first performance term (March 2008) and, in the interim, is to be minimized. Route Group 1, therefore, must recover only those fuel costs incurred on the Major Routes. There is no similar provision in the Act respecting the relationship among the non-major routes.

(b) Second, the Province pays Service Fees to BC Ferries pursuant to the Coastal Ferry Services Contract in respect of Designated Ferry Routes, which are all the routes other than those in Route Group 1. As only a portion of the costs of BC Ferries for the ferry services provided on Route Groups 2 through 6 is recovered through fares (with the Provincial Service Fees covering the other portion of the costs), the percentage increase in the price caps for Route Groups 2 through 6 must be greater than the percentage increase for Route Group 1 since the fuel surcharges that BC Ferries intends to implement relate only to the fares paid by customers, and not to the Service Fees from the Province.

Article 5 of the Coastal Ferry Services Contract provides that if BC Ferries applies for an extraordinary price cap increase in relation to a Designated Ferry Route or Route Group and the Commissioner issues a preliminary decision, then within 10 days BC Ferries and the Province are to meet to review the preliminary decision and discuss whether the Province is willing to increase the Service Fees in relation to the Designated Ferry Route or Route Group that is the subject of the Commissioner's preliminary decision. If the Province agrees to increase the Service Fee the parties to the Coastal Ferry Services Contract will amend the agreement to incorporate the agreed Service Fee and will notify the Commissioner of the amendment. The Commissioner can then consider whether or not the extraordinary price cap increase for the Route Groups for which the Service Fees have been increased should be revised. The parties will also inform the Commissioner if the Province chooses not to increase the Service Fees. Subsections (5) and (6) of section 42 of the Act provide for the Commissioner to issue a preliminary decision on an application pursuant to section 42 and for the preliminary decision to be amended. Article 5 of the Coastal Ferry Services Contract is quoted and addressed in more detail later in this Filing.

17. BC Ferries considers it appropriate that for the reasons above, non-major Route Groups 2 through 6 be distinguished from Route Group 1. BC Ferries also considers it appropriate that Route Groups 2 through 6 be treated in a similar manner and that the percentage increase in the extraordinary price caps be the same for those five Route Groups.

18. BC Ferries intends to impose fuel surcharges to passenger and vehicle fares upon the Commissioner authorizing extraordinary price cap increases. Details of the fuel surcharges and BC Ferries' implementation strategy are set out later in this filing.

B. Extraordinary Fuel Cost Increases from April 1, 2004 to March 31, 2005

19. Schedule A of Commissioner Order 04-02 establishes a "set price" in Canadian dollars per litre for fuel oil to be used for purposes of the Deferral Accounts. The set price, by Route Group, for the 2004/05 year (commencing April 1, 2004) is displayed in column three of Table 1 below. The average actual delivered price per litre of fuel oil experienced by BC Ferries during the 2004/05 year for each of Route Groups 1 though 6 is set out in column four of Table 1 below.[2] The volume of fuel consumed in 2004/05 is set out in column five.

20. The variance between the set price (i.e. from Order 04-02) for each Route Group and the actual delivered price experienced by BC Ferries, multiplied by the actual litres consumed to operate, redeploy, refit and maintain vessels, has been recorded in the appropriate Deferral Account.

21. Schedule A of the Commissioner's Order provided that any hedging gains or losses were to be charged or debited to the Deferral Accounts. For 2004/05 hedges, the total gains were $4.3 million, which were credited as follows: $2.71 million to Route Group 1 (Major Routes) and $1.63 million to Route Groups 2 to 6 collectively.[3] The balance as of March 31, 2005 as

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[2] Actual prices can fluctuate, in some cases on a daily basis.
[3] No new hedging was done in 2004/05; the gains are attributable to hedging contracts put in place in 2003/04.

recorded in the Deferral Accounts for each Route Group, after taking into account hedging gains, is set out in column six of Table 1 below.

Table 1

Route Group	Routes	Set price (C$ per litre) for 2004/05	Average delivered price per litre during 2004/05	Volume of fuel consumed (million litres) in 2004/05	Deferral Account (debit) balance as of March 31, 2005 ($000)
1	Major Routes	0.3978	$0.4528	76.3	$4,173
2	Horseshoe Bay/Langdale	0.4011	$0.5221	8	$965
3	Northern Routes	0.4029	$0.4688	9.8	$796
4	Discovery Coast	0.4030	$0.5727	0.8	$131
5	Brentwood Bay/Mill Bay	0.4058	$0.4864	0.1	$5
6	Minor Routes	0.4117	$0.6040	27.3	$1,930
					$7,999,700

22. Thus, the aggregate balance in the Deferral Accounts as of March 31, 2005 was $8.0 million, as compared to a forecast balance of $5.3 million when a deferral account mechanism was first proposed to the Commissioner. This represents a $2.7 million difference, or an increase of approximately 50% in the Deferral Accounts above the amount forecast when the Accounts were established.

23. As discussed above, BC Ferries proposes, for the purposes of this Application, to consider Route Groups 2 to 6 together, and Route Group 1 on its own. The balance in the Deferral Account for Route Group 1 (Major Routes) as of March 31, 2005 was approximately $4.2 million and aggregate balance in the Deferral Account for Route Groups 2 to 6 as of March 31, 2005 was approximately $3.8 million.

C. Extraordinary Fuel Cost Increases since March 31, 2005

24. For the 2005/06 year (April 1, 2005 through March 31, 2006) the fuel price for each Route Group set by Commissioner Order 04-02 increased on April 1, 2005 based on the increase in the Consumer Price Index (Vancouver) for calendar year 2004. The set prices for fuel in this filing are based on an estimated 2% Consumer Price Index increase . It is understood that the actual Consumer Price Index increase will be 1.98%.

25. World fuel prices were at extraordinarily high levels during the 2004/05 fiscal year and have continued at extraordinary high levels since the start of the current fiscal year. The impact on the Deferral Accounts has been to increase the balance of the extraordinary fuel costs recorded in the Deferral Accounts. As of April 30, 2005 the approximate balance in the Deferral Accounts was $9.65 million, with approximately $5.25 million in the Deferral Account for Route Group 1 (Major Routes) and approximately $4.4 million in the Deferral Accounts for the five other Route Groups.

D. Forecast Extraordinary Fuel Cost

26. World fuel prices are now forecast to remain high in the long-term. Specifically, the forecast average of the economic groups of the five major Canadian banks with which BC Ferries deals indicates that over the next 3 years the price of WTI crude will fluctuate between US$55 and US$40 per barrel, with the forecasts averaging $US55 for 2005 and then decreasing toward the $40 level over 2006 and 2007.[4] Since the cost of fuel to BC Ferries is primarily driven by world oil prices, the cost of fuel to BC Ferries will remain at extraordinarily high levels for an extended period of time.

E. Forecast Impact of Extraordinary Fuel Costs on the Deferral Accounts

27. If, as currently forecast, world fuel prices continue to be significantly higher than the set prices established by Order 04-02, the balances in the Deferral Accounts will increase to levels far beyond those contemplated when the Deferral Accounts were established. BC Ferries needs to be able to implement fuel surcharges to keep the Deferral Accounts within reasonable levels.

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[4] Figures are based on the average, after removing the high and low, of forecasts received from CIBC World Markets, RBC Capital Markets, BMO Nesbitt Burns, Scotia Bank Group and TD Securities Inc.

28. The forecast Deferral Account balances over the next three years are a function of forecast delivered fuel prices[5], forecast consumption and the set prices in Order 04-02 (as adjusted for CPI increases).

29. Without an increase in the price caps, the forecast increase in the Deferral Account balances for each of the current and next two fiscal years, and the forecast cumulative balances at the end of each fiscal year, is set out in Table 2 below.[6] The forecast debit cumulative balances in the Deferral Accounts as of March 31, 2006 is $29.5 million and it is forecast that by March 31, 2008 the balances will reach $53.9 million.

Table 2
Forecast in $C

	2005/06	2006/07	2007/08
Yearly Increase in Deferral Accounts	$21.5M	$15.3M	$9.1M
Cumulative Balance	$29.5M	$44.8M	$53.9M

30. The forecast balances in the Deferral Accounts of $29.5 million as of March 31, 2006 represents approximately $17.9 million for Route Group 1 (Major Routes) and $11.6 million for Route Groups 2 to 6 collectively.

[5] The factors that go into the conversion of world crude oil prices to actual delivered fuel prices for BC Ferries include: US exchange rate, delivery fee, discounts, federal and provincial taxes, federal taxes (including fuel tax and GST), tax recoveries, and input tax credits.

[6] Calculations of the future Deferral Account balances are based on: (i) a fuel delivery price of $0.583 cents per litre across all routes which in turn is based on an 80-cent dollar and world WTI oil prices of US$55 bbl for 2005/06. For future years, WTI oil prices used are US$50/bbl for 2006/07 and US$45/bbl for 2007/08; (ii) 2005/05 budgeted fuel consumption at 123.98 million litres for Route Groups 1-6 collectively, or 77.3 million litres for Route Group 1 and 46.6 million litres for Route Groups 2 to 6 collectively; and (iii) the stipulated inflationary increase of the set price, as per the Order 04-02. The deferral amounts are net of annual reductions of $1.7M for fuel discounts, tax recoveries, and Input Tax Credits. The deferral amounts do not take into account any future changes in pricing (such as delivery charges, margins, excise tax, and B.C. fuel tax) which may increase with a new fuel contract in 2006. No hedges have been assumed.

F. The Importance of Increasing the Price Caps at this Time

31. As discussed above, the current balances in the Deferral Accounts are significant, and are growing very quickly. The forecast Deferral Account balances are far more significant than BC Ferries had anticipated when the deferral account mechanism was first proposed. BC Ferries believes that it is not a viable option to wait until March 2008, the end of the first performance term, to address the rapidly growing balances in the Deferral Accounts.

32. An undesirable situation for customers and for BC Ferries will be created if there is delay in increasing the price caps, and implementing fuel surcharges on fares. For instance:

(a) Those customers currently travelling, even when adding the Provincial Service Fees and the monies from the Federal Subsidy Agreement, are not covering the full cost of the service. Future customers, therefore, will be subsidizing current customers.

(b) This additional subsidy has downstream disincentives as customers travelling in the future will be penalized for the deferred costs incurred today. This issue is exacerbated the longer the Deferral Account is allowed to grow.

33. BC Ferries believes that a proactive approach in addressing the extraordinary cost of fuel is consistent with section 38(1)(b) of the Act, which provides that regulation of BC Ferries must be undertaken in accordance with the principle that "ferry operators are to be encouraged to adopt a commercial approach to ferry service delivery." Moreover, recital "G" of the Coastal Ferry Services Contract acknowledges that "For the travelling public, fares…should be predictable…when financially viable."

G. Calculation of the Required Extraordinary Price Cap Increases

34. BC Ferries has calculated that the extraordinary price cap increase required for Route Group 1 is 8% and that the extraordinary price cap increase required for Route Group 2 though Route Group 6 is 13%. This section of the filing sets out the means by which it was determined that those extraordinary price cap increases are required to address the extraordinary increase in the cost of fuel being experienced by BC Ferries.

35. The explanation for the differing percentage increases between Route Group 1 and the other five Route Groups relates to the Service Fees that the Province provides in respect of the routes other than those in Route Group 1. Under the Coastal Ferry Services Contract BC Ferries receives Service Fees from the Province in respect of the Route Groups other than Route Group 1. Since Route Groups 2 through 6 recover a smaller percentage of their costs from fares, the fuel surcharge must be higher (when calculated as a percentage of the fares paid by customers) to recover the extraordinary increase in fuel costs. The price cap for Route Groups 2 through 5 must be increased accordingly. Other reasons for the difference between the percentage increase in the price cap that is required for the Major Routes and that required for the other routes include:

- the delivered price of fuel which is generally higher for non-major routes,
- the traffic levels: the Major Routes carry more passengers and vehicles than the non-major routes
- the higher fares on the Major Routes: so that a percentage increase equates to a value that is generally higher than a similar percentage increase on the non-major routes.

36. As discussed in more detail below, the fuel surcharges that BC Ferries intends to implement upon the extraordinary price cap increases being authorized by the Commissioner are forecast to recover approximately $25 million by March 31, 2006 (based on an assumed July 1, 2005 implementation of the fuel surcharges), with approximately $16 million being recovered on Route Group 1 and the balance of approximately $9 million being recovered on the other five Route Groups. All amounts recovered by way of fuel surcharges will be credited to the Deferral Accounts established by Order 04-02.

37. The rationale for seeking to recover these monies in the current fiscal year is the need to address the immediate fuel price problem. BC Ferries believes it would be inappropriate to plan to recover funds over a longer period due to volatility in fuel price and the inability to forecast with any certainty what fuel prices will be over the next three years. There is a concern that the current price levels represent a structural change in the world oil market and that the problem of high oil prices may worsen. If the fuel surcharges are not implemented at an early date, and in

the amounts proposed by BC Ferries, and if world oil prices increase beyond the forecast level, the under-recovery of fuel costs will be exacerbated, with the result that there will be even a larger problem in the future.

38. The extraordinary price cap increases for which BC Ferries is applying, and the implementation of fuel surcharges, were determined by reference to the following principles:

(a) *The extraordinary fuel costs that BC Ferries will incur in 2005/06 should be covered by the fuel surcharges, and an additional amount recovered to reduce the balances currently in the Deferral Accounts. All revenues from the fuel surcharges will be recorded in the applicable Deferral Account.*

As set out in Table 1 above, it is forecast that during fiscal 2005/06 the balances in the Deferral Accounts will increase by $21.5 million without extraordinary increases in the price caps and the implementation of fuel surcharges.

The balance in the Deferral Accounts as of March 31, 2005 was $8.0 million. Therefore, without extraordinary price cap increases and the implementation of fuel surcharges the balances in the Deferral Accounts as of March 31, 2006 are forecast to increase to $29.5 million.

Authorization of the extraordinary price cap increases for which BC Ferries is applying and implementation of the fuel surcharges that BC Ferries intends to implement is forecast to recover approximately $25 million in the current fiscal year through the fuel surcharges. Appendix A provides details of the ferry traffic assumed in the calculation of the fuel surcharge recovery.

The forecast effect of the fuel surcharges is a reduction in the aggregate balance that existed in the Deferral Accounts at the commencement of this fiscal year (April 1, 2005) from $8.0 million to approximately $4.5 million by the end of the fiscal year (March 31, 2006). That is a reduction in the aggregate balance of approximately one half.

BC Ferries considers that a reduction in the Deferral Account balances by one half is a reasonable objective in the circumstances of high and volatile fuel oil prices. A supporting rationale for the target of reducing the Deferral Account balances by about one half is that if fuel prices increase beyond the forecast price levels, the Deferral Accounts should not deteriorate beyond the current levels. Further, since all revenue from the fuel surcharges will be credited to the Deferral Accounts, if fuel prices decrease, the effect will only be to reduce the actual balance of the Deferral Accounts below the target level of $4.5 million at the end of the current fiscal year.

It should be noted that the forecast recovery of approximately $25 million through fuel surcharges by March 31, 2006 was calculated with an assumed implementation date of July 1, 2005. The actual implementation date will be later, which will reduce the amount recovered by March 31, 2006.

The forecast recovery of $25 million also assumes that there is no price elasticity between the number of persons using ferry services and the price of those ferry services; that is, the implementation of fuel surcharges will have no impact on ridership. BC Ferries has assumed that the implementation of fuel surcharges will not impact traffic, based on findings from fuel companies that, even though gasoline prices have risen to approximately $1.00 per litre, motorists are not altering their driving patterns in a significant manner. To the extent that the assumption of no price elasticity is incorrect, and customers decide to reduce their use of BC Ferries services because of the fuel surcharges, the forecast recovery of approximately $25 million from fuel surcharges will decrease and the balances in the Deferral Accounts as of March 31, 2006 will be greater than the target $4.5 million.

(b) *All users of the system should pay a fuel surcharge. The distribution of the fuel surcharge recovery between Route Group 1 and the other five Route Groups is based on the principle that there should be no cross subsidy between Route Group 1 and the other five Route Groups, that customers on both Route Group 1 and the other five Route Groups should pay the current fuel oil costs being incurred by BC Ferries, and that customers on Route Group 1 and the other five Route Groups should contribute proportionately to the reduction of the Deferral Accounts associated with Route Group 1 and the other five Route Groups, respectively.*

Appendix B and Table 1 above provide the Deferral Account balances for Route Group 1 and Route Groups 2 through 6, as of March 31, 2005. Appendix B also provides details of the fuel costs forecast for the 2005/06 fiscal year for Route Group 1, and the Route Groups 2 through 5, using a BC Ferries' forecast corporate average delivered fuel price for fiscal 2005/06 of $C 0.583 per litre. The calculation of the corporate average delivered price of $C 0.583 per litre (derived from the forecast oil price of $US 55 per barrel) is set out in Appendix C. Appendix A provides details of the ferry traffic assumed in the calculation of the fuel surcharge recovery.

As discussed above, the recovery of $25 million from fuel surcharges is required to reduce the balances in the Deferral Accounts to $4.5 million by March 31, 2006 (the $4.5 million being somewhat more than one half the balances in the Deferral Accounts as of March 31, 2005). The appropriateness of recovering approximately $16 million of that $25 million from Route Group 1 and the balance of approximately $9 million from Route Group 2 through Route Group 6 was determined as follows:

> As set out in Appendix B and Table 1, the Deferral Account for Route Group 1 had a debit balance of $4.173 million as of March 31, 2005. The balance in that Deferral Account is forecast to increase by $13.699 million by March 31, 2006 if fuel surcharges are not implemented. In order for the fuel surcharges to recover (i) the $13.699 million of fuel costs resulting from variance between the set price of $0.4058 per litre and the forecast corporate average delivered price of $0.583 per litre, and (ii) approximately one half the balance of the Route Group 1 Deferral Account as of March 31, 2005 (half of $4.173 million, or $2.1 million), approximately $16 million must be recovered by way of fuel surcharges from Route Group 1 customers.
>
> Similarly, as set out in Appendix B and Table 1, the Deferral Accounts for Route Groups 2 through 6 had a debit balance of $3.827 million as of March 31, 2005. The balances in those Deferral Accounts are forecast to increase by $7.928 million by March 31, 2006 if fuel surcharges are not implemented. In order for the fuel surcharges to recover (i) the $7.928 million of fuel costs resulting from

variance between the average set price of $0.4130 per litre and the forecast corporate average delivered price of $0.583 per litre, and (ii) approximately one half the balance of the Route Group 1 Deferral Account as of March 31, 2005 (half of $3.827 million, or $1.9 million), approximately $9 million must be recovered by way of fuel surcharges from customers on Route Group 2 through Route Group 6.

Appendix A provides details of the ferry traffic assumed in the calculation of the fuel surcharge recovery. Based on the forecast ferry traffic as set out in that Appendix, and based on the average fuel surcharges that are also set out in that Appendix, the forecast recovery from fuel surcharges by March 31, 2006 is $25 million. As noted earlier, the recovery from fuel surcharges assumed a July 1 implementation of the fuel surcharges and assumes no decline in ferry traffic as a result of the fuel surcharges. As can be seen in Appendix A, the amount forecast to be recovered from fuel surcharges on Route Group 1 is approximately $16 million ($6.010 million from passenger traffic and $10.386 million from vehicle traffic) with the balance of the $25 million being recovered from fuel surcharges on passenger traffic and vehicle traffic on the other five Route Groups.

Based on the current fuel price forecast, and with the assumptions that ferry ridership does not decrease and a July 1 implementation date, the fuel surcharges that BC Ferries intends to implement will reduce the balances in the Deferral Accounts to approximately $4.5 million by March 31, 2006, when the balance in the Deferral Account for Route Group 1 is forecast to be reduced to $1.9 million and the aggregate balance in the other Deferral Accounts is forecast to be reduced to $2.59 million.

The extraordinary increase in the price cap for Route Group 1 that is required to enable BC Ferries to implement fuel charges that recover approximately $16 million by March 31, 2005 (using the assumptions noted above) is 8%. The extraordinary increase in the price caps for each of Route Group 2 through Route Group 6 that is required to enable BC Ferries to implement fuel charges that recover approximately $9 million by March 31, 2005 (using the assumptions noted above) is 13%. The percentage by which the average fare for passengers and for vehicles on each of Route Groups 1 through 6 will increase as a result of the implementation of the fuel surcharges that BC Ferries proposes to implement is also set out in Appendix A.

As indicated earlier, all amounts recovered by way of fuel surcharges will be credited to the Deferral Accounts established by Order 04-02.

(c) *BC Ferries will place the fuel surcharge as a separate line item on the fare ticket. This will ensure that each customer understands the extent of the additional fare (fuel surcharge) that is being collected in respect of the extraordinary fuel costs being experienced by BC Ferries.*

(d) When the balance in the Route Group 1 Deferral Account, or the aggregate balance in Deferral Accounts for Route Groups 2 through 6, reaches zero, BC Ferries will reduce the fuel surcharge for Route Group 1, or for the other five Route Groups, respectively, so that the balance in that Deferral Account, or those Deferral Accounts, based on the then prevailing forecasts of oil prices, is forecast to remain at zero.

39. BC Ferries believes that addressing the extraordinary increases in fuel costs requires the adoption of a fuel cost hedging strategy. Commissioner Order 04-02 requires that any gains or losses on fuel oil futures contracts (“hedging” gains and losses) be charged or credited, as the case may be, to the Deferral Accounts, proportionate to fuel oil use by Route Group. Since the Order requires that hedging gains or losses be charged or credited to the Deferral Accounts established by the Commissioner’s Order, it is appropriate that the Commissioner review the hedging strategy that BC Ferries intends to implement. BC Ferries has selected a fuel cost hedging strategy that will coincide with the implementation of fuel surcharges.

40. BC Ferries intends to launch a new fuel hedging program by averaging in on a monthly basis with a hedging range between 30% and 90% and targeting 70% fixed price. Gains or losses from hedging will continue to be charged or credited to the Deferral Accounts in accordance with Order 04-02. Inherent in authorizing the extraordinary price cap increases is an

endorsement of the hedging strategy, as the results of the hedging strategy will affect the balances in the Deferral Accounts and therefore the amounts to be recovered over time through the fuel surcharges. BC Ferries requests that the Commissioner review the hedging strategy proposed by BC Ferries and acknowledge that the strategy is considered to be appropriate. There is further discussion of hedging strategy in Appendix E.

H. Implementation Strategy Upon Authorization of Extraordinary Price Cap Increases

41. In this section, BC Ferries addresses how it proposes to deal with the potential for increased Service Fees from the Province, and also sets out its intentions respecting the implementation of fuel surcharges upon the Commissioner authorizing the extraordinary price cap increases sought by BC Ferries.

42. Subsection (5) of section 42 of the Act provides that the Commissioner must promptly, and in any event within one month after receiving the full information required by the Commissioner in relation to an application for an extraordinary price cap increase, issue to the ferry operator and the government the Commissioner's preliminary decision on the application. Subsection (6)(b) provides that the preliminary decision may be amended by the Commissioner.

43. Article 5 of the Coast Ferry Services Contract sets out a process to be followed on an application by BC Ferries for an extraordinary price cap increase and a preliminary decision by the Commissioner, in order to provide the Province with the opportunity to consider increasing its Service Fees. Article 5 provides in part:

> 5.02 If BC Ferries applies to the Commissioner under the Act for an extraordinary price cap increase in relation to a Designated Ferry Route or Route Group and the Commissioner issues a preliminary decision in respect of that application, then, within 10 days after receiving the preliminary decision, the parties will meet to review the preliminary decision and to discuss whether the Province is willing to increase the Service Fees in relation to the Designated Ferry Route or Route Group that is the subject of the preliminary decision for the remainder of the Performance Term.
>
> 5.03 If the Province agrees to increase the Service Fee in relation to the Designated Ferry Route or Route Group, the parties will promptly, and in no event later than 20 days after receiving the preliminary decision

(a) amend the Agreement to incorporate the agreed Service Fee in relation to that Designated Ferry Route or Route Group for the remainder of the Performance Term; and

(b) notify the Commissioner of the amendment.

5.04 If the Province chooses not to increase the Service Fee in relation to the Designated Ferry Route or Route Group, the parties will promptly, and in no event later than 20 days after receiving the preliminary decision, so inform the Commissioner.

44. Pursuant to Article 5 of the Coastal Ferry Services Contract, upon the Commissioner authorizing extraordinary price cap increases for Route Groups 2 though 6, BC Ferries will meet with the Province to review the preliminary decision and to discuss whether the Province is willing to increase the Service Fees. If the Province agrees to increase the Service Fees in relation to any of Route Groups 2 though 6 the Coastal Ferry Service Contract will be amended and the Commissioner notified. The Commissioner will then have the opportunity to consider whether the preliminary decision should be amended.

45. The fuel surcharges that BC Ferries intends to implement, in the absence of any increase in the Service Fees that BC Ferries receives from the Province, for most of its fares on each of the routes in Route Groups 1 through 6 are set out in Appendix D. The fuel surcharges for passenger and underheight passenger vehicles, as set out in Appendix D, will be applicable to both full fare payments and to prepaid discount tickets. In addition to the fuel surcharges set out in Appendix D, fuel surcharges will also be implemented with respect to the other existing fares, such as the fares for motorcycle and bicycle traffic, on an equivalent basis.

46. When the balance in the Route Group 1 Deferral Account reaches zero, BC Ferries will reduce fuel surcharges on Route Group 1 to the level at which the balance in that Deferral Account is forecast, based on the then prevailing forecasts of world oil prices, to remain at approximately zero. Similarly, when the aggregate balance in the Deferral Accounts for Route Group 2 through Route Group 6 reaches zero, BC Ferries will reduce fuel surcharges on Route Groups 2 through 6 to the level at which the aggregate balance in those Deferral Accounts is forecast, based on the then prevailing forecasts of world oil prices, to remain at approximately zero.

47. An extraordinary increase in the price caps is required to address the extraordinary situation that has arisen due to the extraordinary increase in the fuel that is being experienced by BC Ferries. BC Ferries regrets that fuel surcharges must be imposed, but believes that because of the extraordinarily high fuel prices it is experiencing, and the forecasts of extraordinarily high world oil prices continuing, an increase if the price caps and the implementation of fuel surcharges is necessary.

APPENDIX A
TRAFFIC FOR FUEL SURCHARGE CALCULATION

July 1 2005 to March 31, 2006

Total Passengers	16.7 million
Total Vehicles	6.5 million

	Passenger Traffic 000's	Average Fare	Passenger Fuel Surcharge Revenue 000's	Average Surcharge	% of Ave. Fare
Route Group 1	8,585	$8.78	$6,010	$0.70	8%
Route Group 2	2,051	$3.38	$821	$0.40	12%
Route Group 3	82	$55.54	$571	$6.96	13%
Route Group 4	8	$68.34	$70	$9.00	13%
Route Group 5	113	$2.27	$28	$0.25	11%
Route Group 6	5,892	$2.46	$1,822	$0.31	13%
Totals	16,732		$9,322		

	Vehicle Traffic 000's	Average Fare	Vehicle Fuel Surcharge Revenue 000's	Average Surcharge	% of Ave. Fare
Route Group 1	2,883	$44.57	$10,386	$3.60	8%
Route Group 2	857	$14.92	$1,483	$1.73	12%
Route Group 3	26	$194.14	$635	$24.45	13%
Route Group 4	2	$209.52	$60	$26.76	13%
Route Group 5	55	$9.96	$69	$1.26	13%
Route Group 6	2,669	$8.75	$3,046	$1.14	13%
Totals	6,493		$15,679		
Total Revenue			$25,001		

APPENDIX B
FORECAST DEFERRAL ACCOUNTS CONTINUITY

	Route Group 1 ($000's)	All Other Routes ($000's)	Total ($000's)
Year ended Mar 31/05 - Actual			
Fuel costs	34,513	22,569	57,082
Volume (thousand litres)	76,269	45,957	122,226
Unit set price	0.3978	0.4078	
Total approved	30,340	18,742	49,082
Mar 31/05 Deferral Account Balances	4,173	3,827	8,000
Year ended Mar 31/06 - Forecast			
Fuel costs (@ $0.583 per litre)	45,059	27,191	72,250
Volume (thousand litres)	77,287	46,641	123,928
Unit set price	0.4058	0.4130	
Total approved	31,360	19,263	50,623
Mar 31/06 Forecast Deferral Account Balances	13,699	7,928	21,627
Mar 31/06 Cumulative Deferral Account Balances	17,872	11,890	29,762

APPENDIX C
CALCULATION OF FORECAST FUEL COST PER LITRE

1	Market Forecast of West Texas Intermediate (in US$) per Barrel		$ 55.00
2	Multiply by the exchange rate to convert to CAD$	1.25	$ 68.75
3	Apply GST	7%	$ 73.56
4	Calculate cost per litre (159 litres = 1 barrel)	159	$ 0.463
5	Add average incremental costs includes margins, Excise tax, BC Fuel tax, and delivery costs	$ 0.1345	$ 0.597
6	Add back forecast input tax credit per litre	$ 0.0137	$ 0.583

APPENDIX D
FUEL SURCHARGES

In addition to the fuel surcharges set out in this Appendix, fuel surcharges will also be implemented with respect to the other existing fares, such as the fares for motorcycle and bicycle traffic, on an equivalent basis.

	Passsenger Fares One Way			Proposed Fuel Surcharges	Child Fares One Way			Proposed Fuel Surcharges
	Low	Shoulder	Peak		Low	Shoulder	Peak	
Tsawwassen - Swartz Bay	$8.75	$10.00	$10.50	$0.70	$4.50	$5.00	$5.25	$0.70
Horseshoe Bay - Departure Bay	$8.75	$10.00	$10.50	$0.70	$4.50	$5.00	$5.25	$0.70
Tsawwassen - Duke Point	$8.75	$10.00	$10.50	$0.70	$4.50	$5.00	$5.25	$0.70
Horseshoe Bay - Langdale	$4.25	$4.25	$4.38	$0.40	$2.13	$2.13	$2.25	$0.40
Swartz Bay - Fulford Harbour	$3.25	$3.25	$3.38	$0.25	$1.63	$1.63	$1.75	$0.25
Swartz Bay - Gulf Islands	$3.38	$3.38	$3.50	$0.25	$1.75	$1.75	$1.75	$0.25
Vesuvius Bay - Crofton	$3.25	$3.25	$3.38	$0.25	$1.63	$1.63	$1.75	$0.25
Saltery Bay - Earls Cove	$4.25	$4.25	$4.38	$0.40	$2.13	$2.13	$2.25	$0.40
Horseshoe Bay - Snug Cove	$3.13	$3.13	$3.25	$0.25	$1.63	$1.63	$1.63	$0.25
Tsawwassen - Gulf Islands	$7.63	$7.63	$7.88	$0.70	$3.75	$3.75	$4.00	$0.70
Comox - Powell River	$8.00	$8.00	$8.25	$0.70	$4.00	$4.00	$4.25	$0.70
Texada Island - Powell River	$2.88	$2.88	$3.00	$0.25	$1.50	$1.50	$1.50	$0.25
Gabriola Island - Nanaimo	$2.88	$2.88	$3.00	$0.25	$1.50	$1.50	$1.50	$0.25
Thetis Island - Kuper Island - Chemainus	$2.88	$2.88	$3.00	$0.25	$1.50	$1.50	$1.50	$0.25
Denman Island - Buckley Bay	$2.63	$2.63	$2.75	$0.25	$1.38	$1.38	$1.38	$0.25
Hornby Island - Denman Island	$2.63	$2.63	$2.75	$0.25	$1.38	$1.38	$1.38	$0.25
Quadra Island - Campbell River	$2.63	$2.63	$2.75	$0.25	$1.38	$1.38	$1.38	$0.25
Cortes Island - Quadra Island	$3.13	$3.13	$3.25	$0.25	$1.63	$1.63	$1.63	$0.25
Alert Bay - Sointula - Port McNeill	$3.13	$3.13	$3.25	$0.25	$1.63	$1.63	$1.63	$0.25
Skidegate - Alliford Bay	$2.63	$2.63	$2.75	$0.25	$1.38	$1.38	$1.38	$0.25
Bear Cove - Bella Bella - Prince Rupert	$59.00	$79.00	$107.00	$10.00	$29.75	$39.50	$53.50	$10.00
Prince Rupert - Skidegate	$21.50	$21.50	$25.25	$3.00	$10.25	$10.25	$12.75	$3.00
Port Hardy - Bella Coola	N/A	N/A	$111.00	$9.00	N/A	N/A	$55.50	$9.00
Port Hardy - Mid Coast	$37.75	$47.50	$66.50	$5.00	$18.75	$23.75	$33.25	$5.00
Bella Coola - Mid Coast	N/A	N/A	$41.25	$5.00	N/A	N/A	$20.75	$5.00
Inter - Mid Coast	N/A	N/A	$22.25	$2.50	N/A	N/A	$11.25	$2.75
Mill Bay - Brentwood Bay	$4.50	$4.50	$5.00	$0.25	$2.25	$2.25	$2.50	$0.25

	Underheight Vehicle Fares One Way			Proposed Fuel Surcharges	Overheight Vehicle Fares One Way			Proposed Fuel Surcharges
	Low	Shoulder	Peak		Low	Shoulder	Peak	
Tsawwassen - Swartz Bay	$26.50	$31.25	$34.75	$2.50	$45.25	$51.50	$57.00	$5.50
Horseshoe Bay - Departure Bay	$26.50	$31.25	$34.75	$2.50	$45.25	$51.50	$57.00	$5.50
Tsawwassen - Duke Point	$26.50	$31.25	$34.75	$2.50	$45.25	$51.50	$57.00	$5.50
Horseshoe Bay - Langdale	$12.75	$14.38	$15.63	$1.25	$22.25	$25.38	$26.88	$2.75
Swartz Bay - Fulford Harbour	$9.38	$9.38	$11.00	$0.60	$15.00	$15.00	$16.88	$1.50
Swartz Bay - Gulf Islands	$10.63	$10.63	$12.13	$0.60	$16.88	$16.88	$18.75	$1.50
Vesuvius Bay - Crofton	$9.38	$9.38	$11.00	$0.60	$15.00	$15.00	$16.88	$1.50
Saltery Bay - Earls Cove	$12.75	$14.38	$15.63	$1.25	$22.25	$25.38	$26.88	$2.75
Horseshoe Bay - Snug Cove	$9.00	$9.00	$10.25	$0.60	$14.25	$14.25	$15.88	$1.50
Tsawwassen - Gulf Islands	$23.00	$23.00	$30.13	$2.50	$44.00	$44.00	$51.63	$5.50
Comox - Powell River	$24.50	$24.50	$28.25	$2.50	$40.25	$40.25	$44.50	$5.50
Texada Island - Powell River	$6.75	$6.75	$7.63	$0.60	$11.25	$11.25	$12.50	$1.50
Gabriola Island - Nanaimo	$6.75	$6.75	$7.63	$0.60	$11.25	$11.25	$12.50	$1.50
Thetis Island - Kuper Island - Chemainus	$6.75	$6.75	$7.63	$0.60	$11.25	$11.25	$12.50	$1.50
Denman Island - Buckley Bay	$5.63	$5.63	$6.75	$0.60	$8.50	$8.50	$9.50	$1.50
Hornby Island - Denman Island	$5.63	$5.63	$6.75	$0.60	$8.50	$8.50	$9.50	$1.50
Quadra Island - Campbell River	$6.00	$6.00	$6.75	$0.60	$9.25	$9.25	$10.13	$1.50
Cortes Island - Quadra Island	$7.13	$7.13	$8.25	$0.60	$13.25	$13.25	$14.50	$1.50
Alert Bay - Sointula - Port McNeill	$7.13	$7.13	$8.25	$0.60	$13.25	$13.25	$14.50	$1.50
Skidegate - Alliford Bay	$6.00	$6.00	$6.75	$0.60	$9.63	$9.63	$10.63	$1.50
Bear Cove - Bella Bella - Prince Rupert	$139.00	$185.00	$252.00	$23.00	$283.00	$337.75	$418.50	$40.00
Prince Rupert - Skidegate	$79.75	$79.75	$93.50	$8.00	$137.25	$137.25	$153.00	$15.00
Port Hardy - Bella Coola	N/A	N/A	$221.75	$20.00	N/A	N/A	$282.25	$40.00
Port Hardy - Mid Coast	$88.50	$117.50	$141.75	$12.50	$148.75	$194.50	$186.25	$20.00
Bella Coola - Mid Coast	N/A	N/A	$80.75	$12.50	N/A	N/A	$101.00	$10.00
Inter - Mid Coast	N/A	N/A	$45.50	$6.25	N/A	N/A	$60.50	$5.00
Mill Bay - Brentwood Bay	$10.75	$10.75	$12.50	$1.25	$16.50	$16.50	$18.75	$1.50

	Underheight Vehicle Weekend Fares One Way			Proposed Fuel Surcharges	Overheight Vehicle Weekend Fares One Way			Proposed Fuel Surcharges
	Low	Shoulder	Peak		Low	Shoulder	Peak	
Tsawwassen - Swartz Bay	$28.25	$33.25	$36.75	$2.50	$48.00	$55.25	$60.00	$5.50
Horseshoe Bay - Departure Bay	$28.25	$33.25	$36.75	$2.50	$48.00	$55.25	$60.00	$5.50
Tsawwassen - Duke Point	$28.25	$33.25	$36.75	$2.50	$48.00	$55.25	$60.00	$5.50

	Bus per Foot Fares One Way			Proposed Fuel Surcharges	Commercial Vehicle per Foot Fares One Way	Proposed Fuel Surcharges
	Low	Shoulder	Peak			
Tsawwassen - Swartz Bay	$2.40	$2.70	$3.00	$0.20	$3.85	$0.30
Horseshoe Bay - Departure Bay	$2.40	$2.70	$3.00	$0.20	$3.85	$0.30
Tsawwassen - Duke Point	$2.40	$2.70	$3.00	$0.20	$3.85	$0.30
Horseshoe Bay - Langdale	$1.20	$1.35	$1.43	$0.15	$1.83	$0.20
Swartz Bay - Fulford Harbour	$0.80	$0.80	$0.93	$0.05	$1.05	$0.10
Swartz Bay - Gulf Islands	$0.88	$0.88	$0.98	$0.05	$1.18	$0.10
Vesuvius Bay - Crofton	$0.80	$0.80	$0.93	$0.05	$1.05	$0.10
Saltery Bay - Earls Cove	$1.20	$1.35	$1.43	$0.15	$1.83	$0.20
Horseshoe Bay - Snug Cove	$0.75	$0.75	$0.80	$0.05	$0.98	$0.10
Tsawwassen - Gulf Islands	$4.80	$4.80	$5.60	$0.20	$3.40	$0.30
Comox - Powell River	$1.75	$1.75	$2.00	$0.15	$2.60	$0.30
Texada Island - Powell River	$0.65	$0.65	$0.73	$0.05	$0.85	$0.10
Gabriola Island - Nanaimo	$0.65	$0.65	$0.73	$0.05	$0.85	$0.10
Thetis Island - Kuper Island - Chemainus	$0.65	$0.65	$0.73	$0.05	$0.85	$0.10
Denman Island - Buckley Bay	$0.50	$0.50	$0.53	$0.05	$0.55	$0.10
Hornby Island - Denman Island	$0.50	$0.50	$0.53	$0.05	$0.55	$0.10
Quadra Island - Campbell River	$0.55	$0.55	$0.60	$0.05	$0.68	$0.10
Cortes Island - Quadra Island	$0.85	$0.85	$0.98	$0.05	$1.20	$0.10
Alert Bay - Sointula - Port McNeill	$0.85	$0.85	$0.98	$0.05	$1.20	$0.10
Skidegate - Alliford Bay	$0.65	$0.65	$0.70	$0.05	$0.78	$0.10
Bear Cove - Bella Bella - Prince Rupert	$15.05	$15.05	$15.05	$1.50	$22.00	$2.50
Prince Rupert - Skidegate	$7.35	$7.35	$7.80	$0.75	$10.20	$1.25
Port Hardy - Bella Coola	N/A	N/A	$14.85	$1.50	$21.25	$2.50
Port Hardy - Mid Coast	$9.70	$9.70	$9.60	$0.75	$13.80	$1.25
Bella Coola - Mid Coast	N/A	N/A	$7.55	$0.75	$11.40	$1.25
Inter - Mid Coast	N/A	N/A	$5.00	$0.50	$5.00	$0.60
Mill Bay - Brentwood Bay	$0.95	$0.95	$1.00	$0.05	$1.20	$0.10

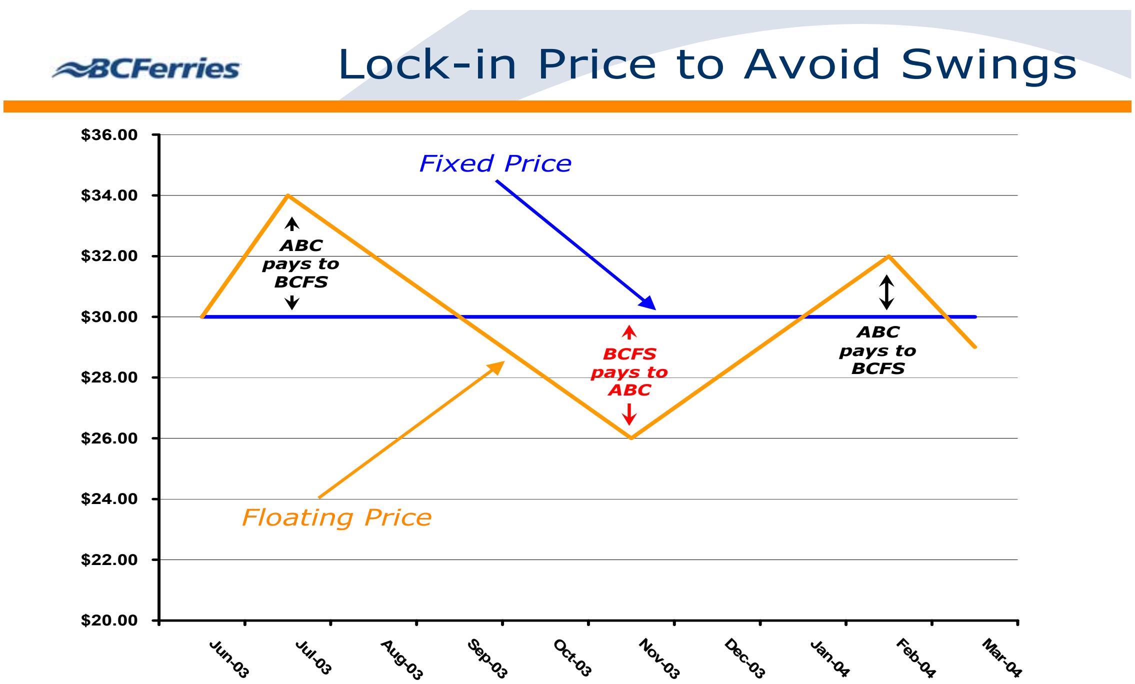
	Bus per Foot Fares Weekend Fares One Way			Proposed Fuel Surcharges
	Low	Shoulder	Peak	
Tsawwassen - Swartz Bay	$2.55	$2.95	$3.15	$0.20
Horseshoe Bay - Departure Bay	$2.55	$2.95	$3.15	$0.20
Tsawwassen - Duke Point	$2.55	$2.95	$3.15	$0.20

APPENDIX E
FUEL HEDGING STRATEGY

1. As indicated in the body of this filing, the calculation of the proposed extraordinary price cap increases assumes the adoption of a particular fuel cost hedging strategy. In this Appendix, BC Ferries first explains its prior hedging strategy and its overall impact on alleviating fluctuations in BC Ferries' fuel costs due to price volatility. BC Ferries then outlines the basis for its selection of a fuel hedging program going forward.

A. Background

2. The goal of a fuel-hedging program is to reduce the volatility of fuel expenditures. Effectively, hedging is establishing a future fuel price. As illustrated in the chart below, hedging smooths the highs and lows of the swings in the energy markets.



B. BC Ferries' Prior Hedging Strategy

3. BC Ferries began a hedging program in June 2001 and since that time, the Company has entered into forward contracts, hedging between 30% and 90% of its annual fuel purchases. Hedging has provided some predictability and has enabled the Company to generally remain within its fuel budget requirement.

4. For 2004/05, fuel hedging contributed $4.3 million towards reducing fuel oil costs. However, due to the recent highs in the price of WTI and the creation of the Deferral Accounts, new hedging activity was deferred. BC Ferries did not enter into any new hedging contracts during the 2004/05 fiscal year. Approximately 33% of 2004/05 annual consumption was hedged from existing contracts that had been entered into during the 2003/04 fiscal year.

5. At the present time there are no hedges in place for fuel consumption in the 2005/06 fiscal year.

C. Prospective Hedging Strategy

6. BC Ferries is proposing to re-institute a fuel hedging program because hedging can be used to decrease the potential volatility in the Deferral Account balances. BC Ferries' cost of fuel can be impacted by either (i) adjusting the hedged amount (the decision to hedge anywhere between 100% to 0% of the fuel price) and (ii) the timelines for hedging (i.e. whether to hedge, for example, 1, 2 or 3 years).

7. When hedging is being considered, conditions in the fuel market will influence the hedging strategy. Ideally, the best time to hedge is while the markets are in *backwardation,* i.e. where the near-term spot price trades at a premium to the same commodity traded further forward. Generally, BC Ferries hedges when the fuel markets are in backwardation so that future fuel prices are less expensive than the current spot price.

8. However, currently the market is in *contango,* which means that the future spot price is higher than the current spot price. In these circumstances, the price paid for fuel on a hedged contract will be higher than the current market price. While this is not ideal, generally if the energy markets are in *contango*, this indicates that the markets expect the spot price to increase.

9. As discussed below, BC Ferries has had to consider the hedging strategy that it should undertake in current market conditions.

D. Options for Prospective Hedging Strategy and Recommended Strategy

10. As indicated earlier, inherent in the granting of the extraordinary price cap increase is an endorsement of the BC Ferries' hedging strategy since the results of the strategy will affect the

balances in the Deferral Accounts. In this part of the Appendix, BC Ferries first discusses the hedging strategy options and then explains the strategy selected.

11. One strategy, although not the preferred approach, would be to hedge 100% of the Deferral Account over three years. By hedging 100% of the 2005/06 to 2007/08 fuel requirements until the end of this performance term, BC Ferries would be locked into a set price for all fuel purchases for the next three years.

12. This strategy would provide a fixed cost to BC Ferries and therefore eliminate the risk associated with the volatile fuel markets. The extraordinary price cap increases, and fuel surcharge, would be certain for the duration of the hedging contracts. The only remaining variables would be ridership and fuel consumption rates.

13. The risk associated with this strategy would be that the fuel price could decline during the hedging period. The opportunity to take advantage of reductions in the fuel price would be eliminated. Also, there would be a requirement to maintain the fuel surcharge over the three-year period. While it may be reasonable to completely eliminate the fuel price risk, if BC Ferries were to commit to this hedging strategy, and the price of fuel subsequently declined, the Company could be placed in the unenviable position of trying to justify why customers must still continue to pay the fuel surcharge. For the above reason, BC Ferries rejected this option.

14. A second strategy, although not the preferred strategy, would be to remain 100% unhedged over three years. Under this strategy, BC Ferries would pay the spot price until the end of this performance term and not hedge any fuel.

15. Over time this could be the cheapest option as hedging includes transaction costs. However, BC Ferries would be subject to the full world oil price volatility. For this reason, BC Ferries rejected this option.

16. BC Ferries has selected a hedging strategy that employs an ’averaging-in’ (buying future hedges on a regular basis), with a hedging range between 30% and 90%, and targeting 70% fixed price. This rollout strategy will involve entering into hedging transactions, with expiration dates no longer than 6 months forward. BC Ferries’ selection of this strategy was based on the concept

that it will allow BC Ferries to retain flexibility in its planning, while taking advantage of some potential reductions in fuel prices by maintaining a core amount of hedged fuel.