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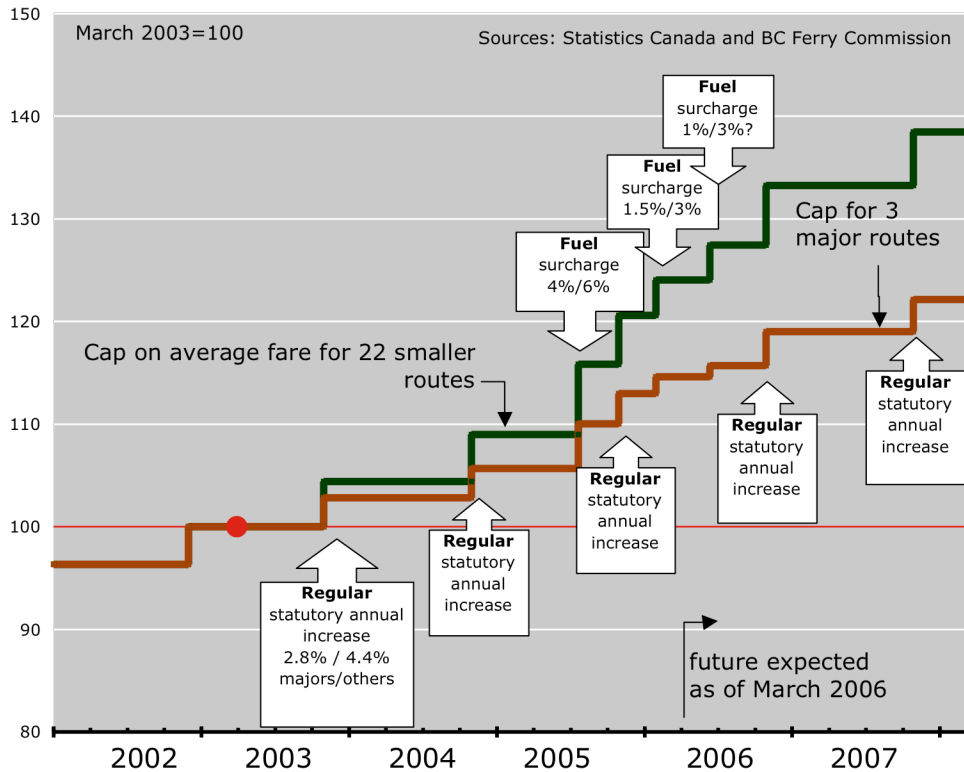
March, 2006

### FREQUENTLY ASKED QUESTIONS on fuel surcharges and related matters

#### Question 1: Why are the minor routes being hit with higher percentage increases than the major routes?

Fare caps have risen because of (a) statutory annual increases and (b) fuel surcharges. As shown in **Chart 1** below, increases are indeed lower for the major routes.

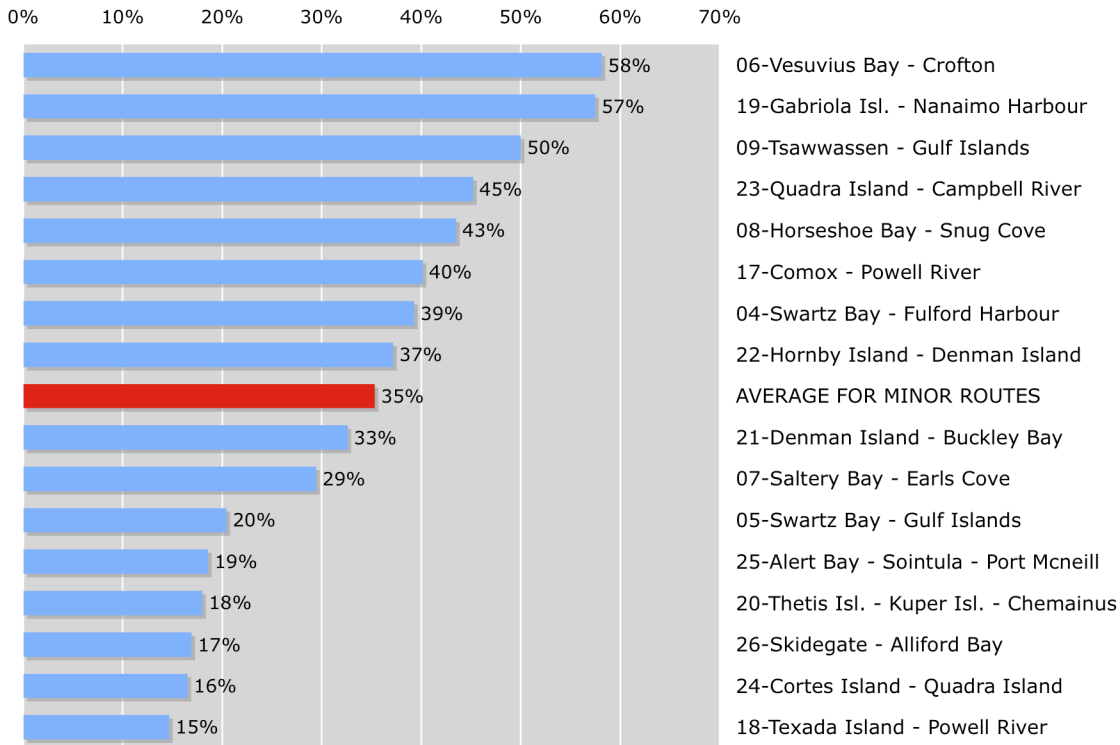
**Chart 1: Fare cap escalation**  
**Major routes versus the other 22, smaller BC Ferries routes**



For the smaller routes, fares cover only a part of the cost of operating the route. This is illustrated for the minor route group below in **Chart 2**.

**Chart 2: BC Ferries' 16 Minor Routes: User Pay**

Percent of BC Ferries route costs met by customer revenue on the route  
(average of two years FY 2003/4 and FY 2004/5)

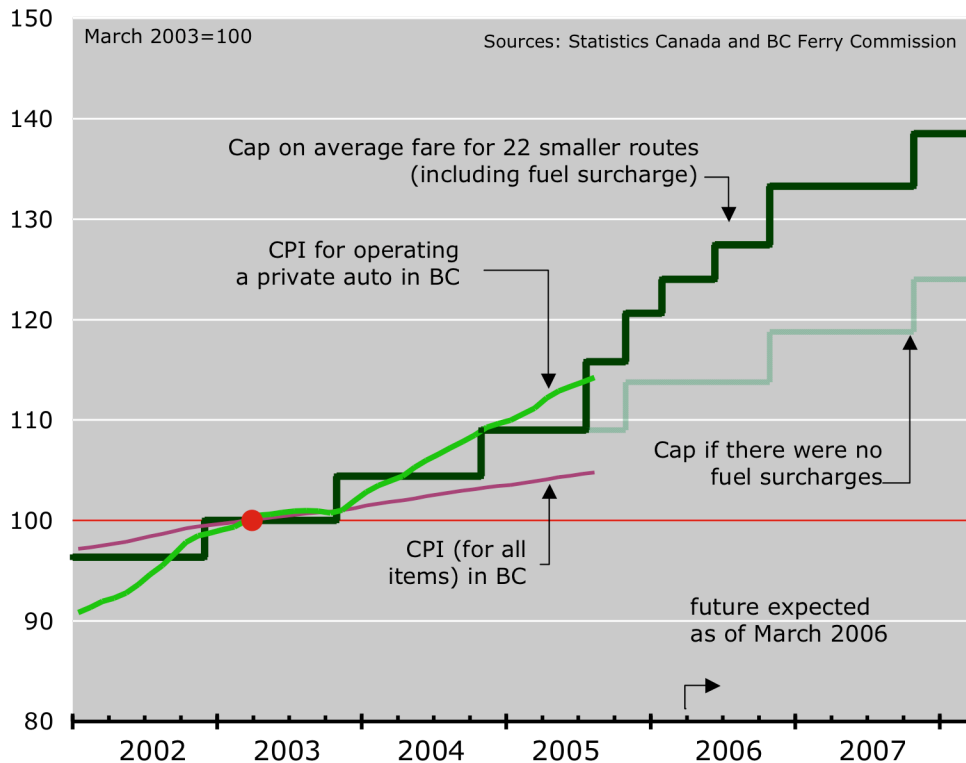


As shown above, the average minor route is roughly 1/3 user-pay. So if the cost of operating the route increases 10%, *and if all that extra cost has to be borne by ferry customers*, fares would have to go up by 30%.

- If the route had been 100% user-pay, the fare increase would be the same as the cost increase (i.e. 10%). This is the case for the major routes. This mathematical relationship is the main reason for the majors having lower percentage increases.
- Note the dollar fare increase can be the same for the two types of route, yet the percentage fare increase is higher because it is calculated on a smaller base.
- Another factor is that the price of fuel delivered to the ship is higher for the smaller routes (8% higher than for the major routes on average in FY 2004/5).

Coincidentally, so far the increase in fare caps for the 22 smaller routes has paralleled the inflation rate for operating a private automobile in BC, as measured by Statistics Canada and shown on **Chart 3 overleaf**, though this may not continue into the future. We have required BC Ferries to accumulate a backlog of extra fuel costs, that is the fuel costs not yet recovered through fuel surcharge revenue. This backlog, called the “deferral account”, stood at over \$20 million in December 2005.

**Chart 3: BC Ferries' 22 smaller routes: fare cap escalation compared to consumer price indices (CPIs)**



**Question 2: To what extent has BC Ferries been required to look at revenues and potential savings in other areas of its operation to absorb all or part of increased fuel costs?**

We made two rulings requiring BC Ferries to absorb part of the increased fuel cost:-

- *First, BC Ferries is absorbing part of the increase in fuel prices, without compensation, as a normal part of doing business*

Our ruling for the July 2005 fuel surcharge finds a one-time 5% increase in the price of fuel (above general inflation, and relative to a fuel price level established when the Coastal Ferry Act was passed) to be an “ordinary” increase for BC Ferries to absorb. We estimate that the effect will be to reduce BC Ferries retained earnings for the first performance term (i.e. through March 2008) by some \$7 to \$8 million below what it would otherwise have been. The rest of the increase in the price of fuel we recognized as meeting the test of “extraordinary” as defined in the Act. This additional fuel cost is tracked through a “deferral account” and if not recovered through fuel surcharge is eventually recoverable through fares (and/or higher service fees at the discretion of the province).

- *Second, to encourage fuel efficiency, we gave BC Ferries a target volume for fuel burned each year, with the extra cost of any fuel used in excess of the target volume being uncompensated.*

BC Ferries is expected, for the two fiscal years FY 06/07 and 07/08, to reduce the volume of fuel burned by 1% per cent cumulatively for each year from the volume in FY 05/06. The cost of fuel used in excess of these targets will not be transferred to the accumulated backlog of fuel costs (i.e. the deferral account) but must be charged to BC Ferries' operating costs.

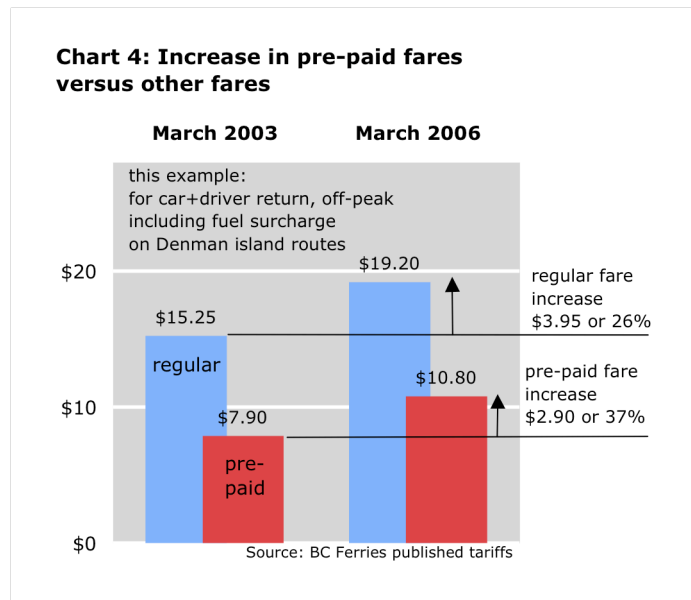
**Question 3: What consideration has been given to potential decreases in ferry use resulting from tariff increases?**

We took no account of the fact that fewer people will travel because of higher fares. This will cut into the company's revenues. In particular, we have not increased fuel surcharges to compensate for this effect.

Assuming that a 10% increase in fares produces a loss of 5% of traffic volume on the major routes<sup>1</sup>, 3% on minor routes (assumed less elastic), the loss of revenue to BC Ferries from the date of the first fuel surcharge (July 2005) to the end of March 2008, through loss of traffic due to fuel surcharges, could be \$25 to \$35 million. For comparison, BC Ferries net earnings for FY 2004/5 were \$40 million.

**Question 4: What consideration is given to recommending that increases be structured in order to diminish impacts upon the costs of goods and services coming to islands?**

BC Ferries has freedom to structure the tariff within the cap on the weighted average fare. We have not given direction to BC Ferries on this matter.



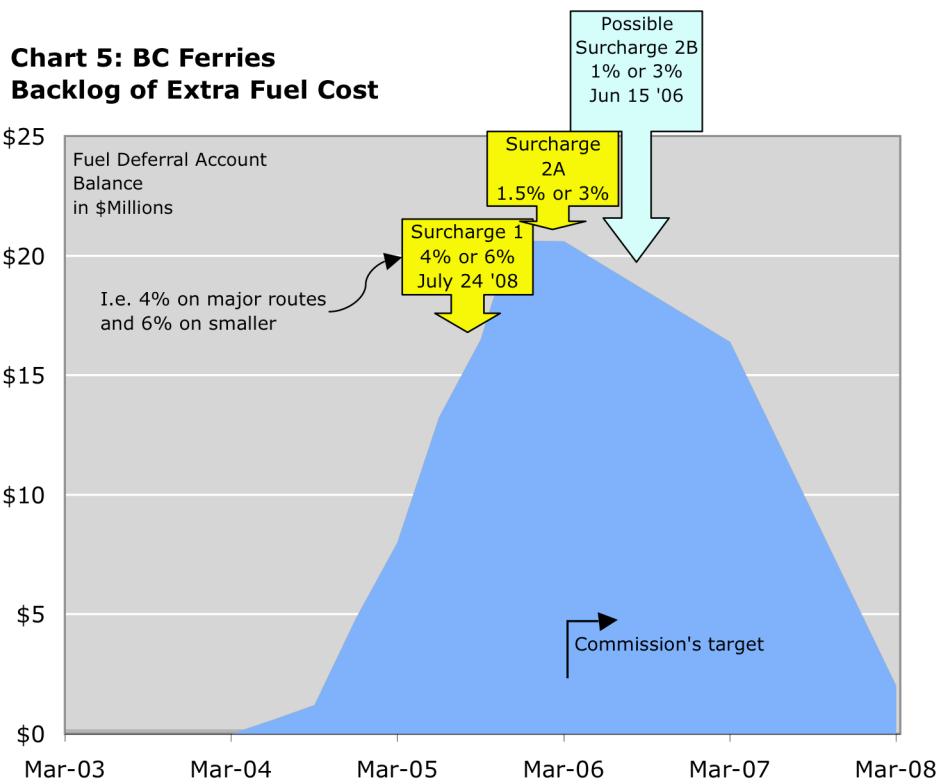
<sup>1</sup> Source: BC Ferry Corporation, Price Elasticity Study, Technical Report May 29, 1997, page 39.

BC Ferries has used its freedom to make adjustments in its tariff, of one fare relative to another, while keeping the average within the cap which the commission enforces. Because of this, and the seasonal variations overlaying fares and revenues, one can find individual items—like the prepaid tickets used by most island residents—which BC Ferries has increased faster than the average fare (see **Chart 4** on the previous page). Where this is the case, there are other fares in the tariff which BC Ferries has increased more slowly, to keep the average within the cap, such as for single-purchase travel for passengers, cars and trucks used for goods and services.

**Question 5: What adjustments will be made to tariffs if fuel costs decrease?**

Fuel surcharges and BC Ferries’ extra fuel costs are tracked through a deferral account, the balance of which represents the backlog of extra fuel costs which for which BC Ferries is to be compensated.

The fuel surcharge is authorized until March 2008, and is calculated to pay down the accumulated backlog of extra fuel costs by then, based on fuel price projections, which are uncertain, made last fall, as illustrated in Chart 5 below.



If fuel prices are lower than expected and the deferral account is paid off earlier than expected, the fuel surcharges will be removed before March 2008.

**Question 6: Can the public apply for removal of the surcharges?**

There is no appeal mechanism in the Coastal Ferry Act. Should a political decision be taken to increase public funding to the ferry system, then the Commission would lower the price cap, causing a fare reduction as provided for in the Act.

**Question 7: How can be people be heard and have faith that the impacts on communities are being considered?**

The decision making framework for the regulated ferry system can be condensed as follows:

The <b>PROVINCIAL GOVERNMENT</b> decides....	The <b>FERRY COMMISSION</b> decides....
<p style="text-align: center;">(A)</p> <ul style="list-style-type: none"> <li>• <b>what communities</b> will get government-supported ferry service (by designating routes), and</li> <li>• <b>how much service</b> (by defining core service on them);</li> </ul>	<p style="text-align: center;">(B)</p> <ul style="list-style-type: none"> <li>• the <b>(preliminary) level of ferry fare caps</b> that BC Ferries reasonably requires to operate the services defined by the government</li> </ul>
<p style="text-align: center;">(C)</p> <ul style="list-style-type: none"> <li>• <b>how much public money</b> to inject in order to “buy down” the commission’s preliminary fares to a level it considers in the public interest, i.e. the degree of user-pay.</li> </ul>	<p style="text-align: center;">(D)</p> <ul style="list-style-type: none"> <li>• the <b>(final) fare cap level</b> to reflect the government’s commitment of public money.</li> </ul> <p><i>The commission also:</i></p> <ul style="list-style-type: none"> <li>• <b>monitors</b> BC Ferries to ensure they do not overcharge or compromise service quality</li> <li>• <b>incentivizes</b> BC Ferries to be efficient in delivering service.</li> </ul>

The commission cannot speak for the government's decisions, i.e. (A) and (C) above and any associated public processes. For its own decisions (B) and (D), the commission's job is essentially a technical one. It is open to public comments, ideas and questions and aims to explain its decisions clearly.

***Comment: a process is required to answer these and other questions. People who will be impacted need an opportunity to understand and respond to proposals for surcharges. Information needs to be conveyed in a form that is more readily understandable to the lay person than the draft decision of the Commission.***

We endeavour to provide opportunity for input within the statutory limits, to answer questions and explain our decisions clearly, through public appearances, the media, direct correspondence and on-line. This paper is part of that effort.

***Requests: our Ferry Advisory Committee is therefore asking three things: Request 1: that any further decisions on fuel surcharges (including on possible second-step increases) not be made without effective consultation with affected communities;***

The law requires a one-month period for public comment and gives the Commission a two-month deadline for a ruling. We have met those requirements, for both of BC Ferries' fuel surcharge applications. The Commissioners have also met interest groups when invited during the month for public input.

***Request 2: that the Commission hold public meetings on both our islands at which people can ask questions and provide input;***

The Commission will not be hosting public meetings but we look forward to invitations from representative groups.

***Request 3: that all Ferry Advisory Committees be informed early and directly when the Commission is considering issues that will impact island communities.***

We have informed the public through advertising in newspapers, radio and TV interviews, BC Ferries' news releases, and (for the first surcharge) a toll-free phone line, and on-line. We think these occasions have been well publicized so far, but are open to specific suggestions for improvement and to special notification to FACs.

BC Ferry Commission  
March 8, 2006