



**BACKGROUND TO THE BC FERRY COMMISSION'S
PRELIMINARY DECISION ON PRICE CAPS
FOR PERFORMANCE TERM TWO**

**Questions and Answers
Supplement A**

April 26, 2007

**This material is supplementary to the Questions and Answers dated March 30 2007
and responds to questions and comments raised by the public after that date.**

CONTENTS

Customer Reaction	3
1. Isn't your reported lack of public reaction on fuel surcharges just due to the lack of awareness of the opportunity to comment?	3
2. Surely you're wrong about customer satisfaction re: value for money?	3
3. Aren't you oversimplifying in stating traffic hasn't dropped with fare increases?	3
Service Fees	4
4. What is the re-distribution of service fees among the route groups for 2008-2012?	4
5. Does the service fee rebalancing among the non-major route groups mean the northern routes get more of the service fee than before?	5
6. Does the province's pay-down of the northern fuel deferral account affect just the north, or does the benefit spread across all the non-major route groups?	6
7. What is the effect upon fare cap increases of a change in the service fee?	6
8. What would be the effect upon fare cap increases of annual increases in Service Fee at the rate of anticipated CPI?	7
9. What dollar amount of service fees would be required for each year in PT2 to hold annual fare cap increases at the level of anticipated CPI?	8
10. What is each of the following's percentage contribution to revenue on the minor routes for each year in PT1 and for each year in PT2? a) the federal subsidy b) the provincial service fee c) the northern vessel & fuel adjustment d) the provincial social programs e) the fare-box	8
Fuel Surcharges	9
11. Fuel surcharges were supposed to end, so why are the new fares based on them?	9
12. Why have you changed your previous position that BC Ferries had to cover the first 5% of fuel price above the reference "set price", by moving to a formula where fare-paying customers share 50/50 with BC Ferries the variation of the first 5 cents/litre from the set price?	10
Other Questions	11
13. My route (Horseshoe Bay-Langdale, route 3) is near financially self-sufficiency already and should be treated separately. Won't lumping it with other routes at a 6.7% per year fare increase through 2012 put it far in excess of self-sufficiency?	11
14. Was the relationship between discounted prepaid fares and full fares part of your deliberations?	11
15. What are BC Ferries' projected operating and capital costs and corresponding revenue requirements for 2008-2012?	11
Comments from the Public	12
16. How can I give feedback and to whom? Is there a deadline?	12
17. Are you holding public meetings where people can ask questions and provide input?	12
18. Will you do anything with my feedback?	12

Customer Reaction

1. *Isn't your reported lack of public reaction on fuel surcharges just due to the lack of awareness of the opportunity to comment?*

You say "Before fuel surcharges... are put into effect the public has an opportunity to comment... we did receive comments from the public, but from only a fraction of one per cent of the traveling public." Actually the low response rate can be attributed to a lack of public awareness of the opportunity to comment, and to a lack of belief that commenting would do any good, rather than to a lack of public concern.

We did advertise widely, but recognize that the period for input coincided with local election campaigns which may have divided public attention.

If there were widespread dissatisfaction you would expect people to complain regardless of whether they thought the commission could/could not act on their complaints.

2. *Surely you're wrong about customer satisfaction re: value for money?*

You say BC Ferries' customer satisfaction survey shows a high degree of satisfaction, including value for money. Yet that survey at March 2006 states "satisfaction levels continue to be low with perceived value for money of the fares, with 28% reporting to be dissatisfied, an increase of four percentage points over the year". In fact "value for money" had the lowest rating of all the aspects of satisfaction addressed in the survey.

The overall satisfaction level in 2005 was 86% (p.35). On "value for money of fares" 72% were "very satisfied" "satisfied" or "neither satisfied/dissatisfied" with a total of 28% either "dissatisfied" (20%) or very dissatisfied (8%) (p.62). This level of dissatisfaction on value for money is up by 4% from 2004 but up only 1% from 2003. This is not a significant trend.

3. *Aren't you oversimplifying in stating traffic hasn't dropped with fare increases?*

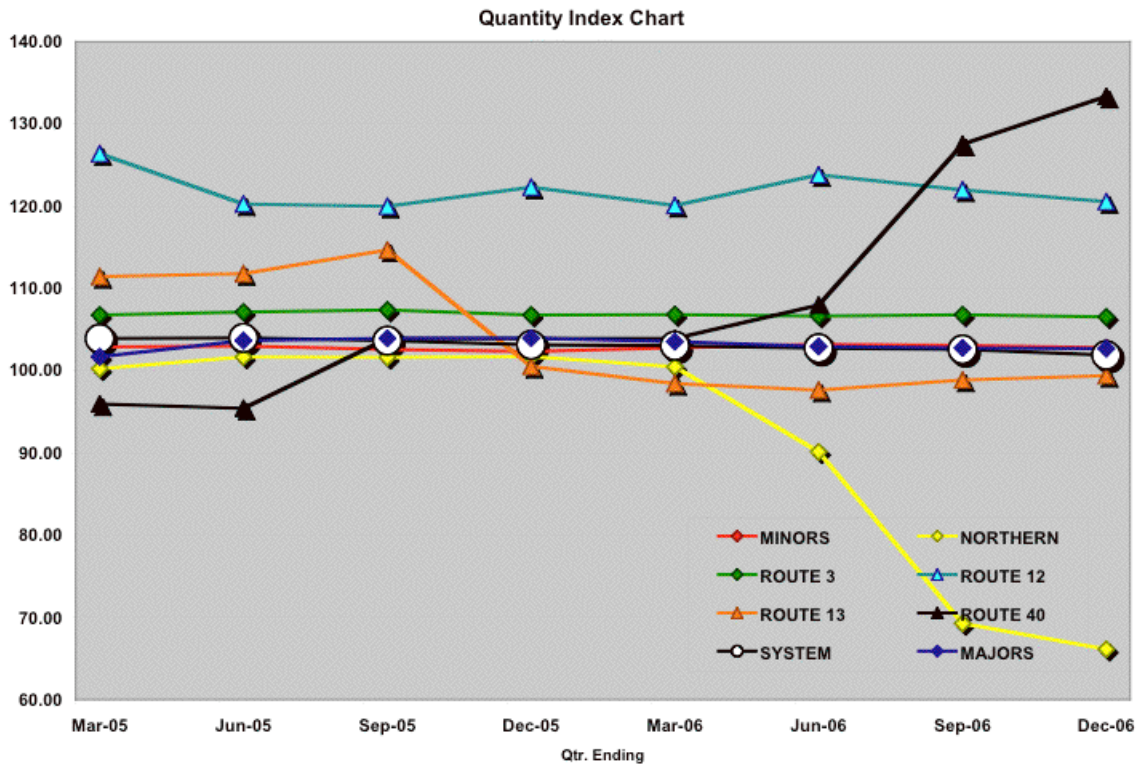
You say "If there were significant public objection to the level of fares we would expect to see a reduction in the numbers of people traveling. This has not occurred. Although there has been a significant increase in fares since 2003, mainly due to much higher fuel prices, there has not been a reduction in the number of people using the ferry system." This is a very simplistic and somewhat misleading statement on a complex and crucial issue.

There has been low growth in traffic numbers for over 10 years so the impact of recent higher fares is unclear. Also with higher gasoline prices there is less automobile traffic on the roads and with other factors affecting tourism (fewer US visitors, higher Canadian dollar vs. U.S.) it is not clear what role is played by higher fares.

There is a general trend for urban (wealthier) residents to buy property on the Islands; whether this is a good or bad trend for local services and businesses depends on the

business. For instance, Salt Spring Island has seen considerable growth in island businesses in recent years as wealthier residents have moved there.

It is true that broad averages conceal finer and sometimes meaningful detail. Certain traffic components have declined, others increased, though recent traffic growth has been quite flat. Below is a chart of the history of traffic volumes in the last two years, when fuel surcharges had their strongest bite. Note that the traffic volumes are measured quarterly. By using the total traffic for the previous twelve months, we obtain a traffic quantity index which eliminates the considerable seasonal variation in traffic through the year.



Service Fees

4. What is the re-distribution of service fees among the route groups for 2008-2012?

The six non-major route groups receive taxpayer contributions. As noted in our preliminary ruling, the province and BC Ferries informed us that they intend to re-distribute taxpayer funding in such a way as to produce a uniform rate of fare cap growth among the non-major route groups in the second performance term. This would be accomplished through an amendment to the Coastal Ferry Services Contract.

Accordingly we computed the required re-distribution of federal and provincial taxpayer contributions among the non-major route groups which produces a uniform average compound growth rate in the fare cap index, which works out to be 6.7% per year.

The amount of federal subsidy changes by year with inflation, so the table below refers to a particular year of the second performance term (in this case the first year). We assume that the basic provincial service fee total (\$91.8 million) and amount allocated to each route group is the same for all years of the second performance term, as it was in the first term.

How Tax Payer Funds Would be Reallocated to Achieve the Same Growth Rate of 6.7% per year in the Price Cap Index for Non-Major Route Groups in the Second Performance Term Amounts in C\$Millions for the Year 2008/9							
Item	BCFS Total for Non-Major Route Groups*	Group 2 Route 3	Group 3 North'n	Group 4 Route 40	Group 5 Route 12	Group 6 Minors	Group 7 Route 13
Federal Contract , new allocation after redistribution	\$ 26.4	\$ 1.4	\$ 7.2	\$ 0.2	\$ -	\$ 17.4	\$ 0.07
Federal Contract, old allocation	\$ 26.4	\$ 1.5	\$ 3.9	\$ 0.6	\$ -	\$ 20.3	\$ 0.15
Change in Federal Contract Subsidy	\$ -	\$ (0.0)	\$ 3.3	\$ (0.3)	\$ -	\$ (2.9)	\$ (0.09)
Provincial Service Fee new allocation after redistribution	\$ 91.8	\$ 3.3	\$ 11.2	\$ 1.4	\$ 1.4	\$ 74.0	\$ 0.46
Service Fee old as in Coastal Ferry Services Contract (excl. northern adjustment)	\$ 91.8	\$ 5.0	\$ 13.4	\$ 1.9	\$ 1.4	\$ 69.5	\$ 0.53
Change in Service Fee	\$ -	\$ (1.7)	\$ (2.3)	\$ (0.5)	\$ 0.0	\$ 4.6	\$ (0.07)
Total federal subsidy and service fee (new)	\$ 118.2	\$ 4.7	\$ 18.4	\$ 1.6	\$ 1.4	\$ 91.5	\$ 0.53
Less: total federal contract old and Service fee (old)	\$ 118.2	\$ 6.5	\$ 17.4	\$ 2.4	\$ 1.4	\$ 89.8	\$ 0.68
Net change in total taxpayer funding (fed+prov) to the route group	\$ -	\$ (1.8)	\$ 1.0	\$ (0.8)	\$ 0.0	\$ 1.7	\$ (0.16)
Percent change in total taxpayer funding support	0%	-27%	6%	-34%	1%	2%	-23%

*The Major route group receives no federal subsidy or service fee and is not shown in this table

5. Does the service fee rebalancing among the non-major route groups mean the northern routes get more of the service fee than before?

As shown in the table above, the rebalancing of taxpayer funding (federal subsidy and basic provincial service fee) results in a 6% increase for Route Group 3 (Northern Routes 10 and 11) and a decline of 34% for Group 4 (Route 40 Discovery Coast). Taking these two groups together as “northern”, the total dollar change is \$1.0 minus \$0.8 million, equaling plus \$0.2 million, out of a total of \$118.2 million in taxpayer funding (\$26.4 federal plus \$91.8 provincial funds).

Note, however, that the northern routes are the beneficiaries of a separate, special adjustment in the service fee, affecting mainly performance term two. This effectively covers the amortization and cost of capital for newly acquired ships for the north, after recognizing insurance proceeds from the loss of the Queen of the North. To distinguish

this “special” adjustment in the north from the service fees applying to all the non-major routes in PT1, in this Q&A paper we call the latter “basic”.

6. Does the province’s pay-down of the northern fuel deferral account affect just the north, or does the benefit spread across all the non-major route groups?

The provincial pay-down of the northern fuel deferral account effectively benefits all non-major route groups through the calculation which produces a uniform fare cap growth rate of 6.7% for all the non-major groups.

7. What is the effect upon fare cap increases of a change in the service fee?

To get the most straightforward indication of how service fees affect fare caps in the second performance term, we use a single measure of the fare cap growth.

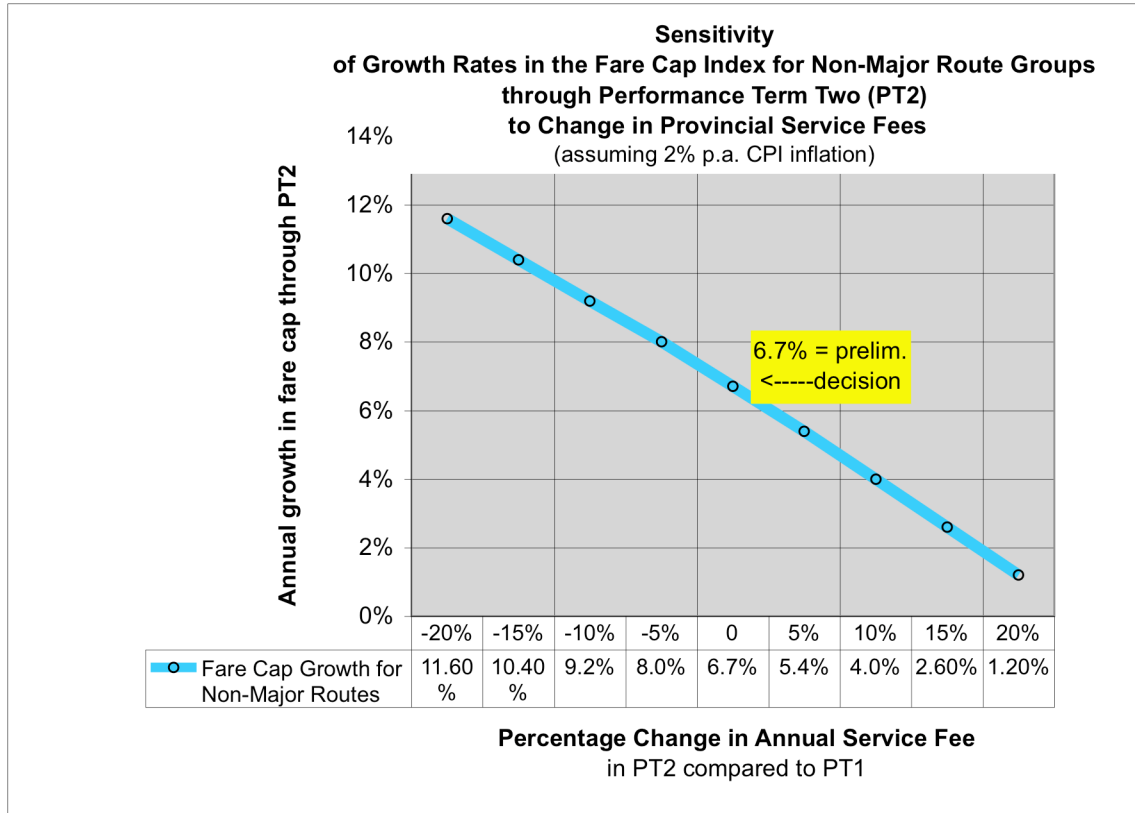
We use the **average compound growth rate in the fare cap index through the second performance term** as this measure.

If inflation is at 2% through the second performance term, our preliminary ruling is equivalent to an average compound rate of growth of the fare of 6.7% for the non-major route groups¹. Our preliminary ruling assumes no change in the “basic” annual service fee. By basic, we mean the service fees as agreed in 2003 between BC Ferries and the Province, before adding subsequent adjustments made for the service fee in the north.

The chart and table below show how the Commission’s ruling for non-major route groups is sensitive to provincial service fees (the ruling for the major route group is not, as this group does not receive service fees).

A rule-of-thumb for the relationship between taxpayer contributions on the non-major routes is as follows: *a one-time +/- \$1 million taxpayer funding change, made this year (2007/8), changes the rate of fare cap increase by roughly +/- 0.1%*. For instance, if a one-time additional taxpayer contribution of \$2 million were made today, this would reduce the above 6.7% figure to 6.5%.

¹ The preliminary ruling sets the first year increase at 3.6% on April 1, 2008. This is lower than the 6.7% to recognize that only five months earlier there will have been the last of the statutory 4.4% increases in the first performance term. The “reduction” from 6.7% to 3.6% in the first year can be thought of as a timing correction. The figure of 6.7% per year remains the best measurement of the rate of the fare cap increase in the second performance term.



8. What would be the effect upon fare cap increases of annual increases in Service Fee at the rate of anticipated CPI?

For the major routes, which receive no service fee, there would be no change in our ruling. For the other route groups, to all of which provincial service fees apply, the effect would be as follows.

Annual Percent Change in basic Annual Service Fee during each of the four years of performance term two, starting from a base equal to the annual service fee in Term One	Compound Annual Average Increase in the Price Cap Index in the Second Performance Term assuming CPI inflation of 2% per year for the six non-major route groups
Zero per cent per year (as assumed in Preliminary Fare Cap Ruling of March 30 2007)	6.7% (i.e. our ruling)
Two per cent per year (i.e. same as rate of CPI inflation assumed in the row above)	5.4%

9. What dollar amount of service fees would be required for each year in PT2 to hold annual fare cap increases at the level of anticipated CPI?

Suppose that CPI inflation is 2% through performance term two (PT2). As can be seen from the chart under question #7, an approximate 17% increase in “basic” service fees occurring at the start of PT2, not increasing further during PT2, corresponds to a 2% increase in the fare caps for the non-major routes through PT2. The 17% increase is equivalent to an increase of \$15.6 million per year (= 17% of \$91.8 million) for each of the four years of PT2.

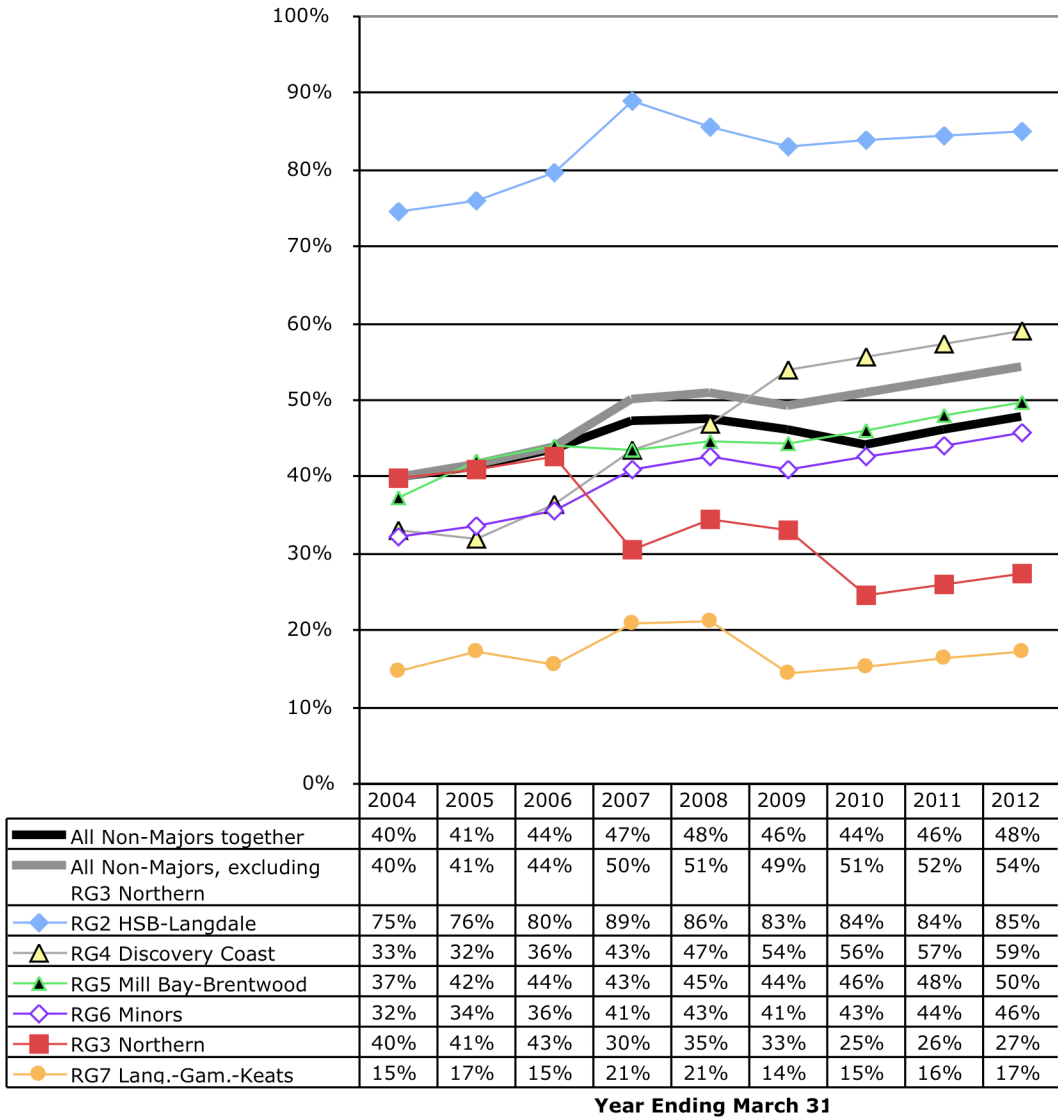
10. What is each of the following's percentage contribution to revenue on the minor routes for each year in PT1 and for each year in PT2? a) the federal subsidy b) the provincial service fee c) the northern vessel & fuel adjustment d) the provincial social programs e) the fare-box

During Performance Term One, ending March 31 2008, BC Ferries’ projections show that fares on the taxpayer supported routes (i.e. those other than the three major routes forming the major route group) will rise relative to other sources of funding, from 40% of the total of fare revenue-plus-taxpayer-funding in 2004 to 45% in 2008. The Commission’s projections, based on its preliminary fare cap ruling of March 30, 2007, indicate that this percentage will continue to climb to 48% by 2012, assuming taxpayer contributions change as shown.

BC Ferries Revenues from the Six Taxpayer-supported Route Groups (the "non-majors")									
(in \$millions excluding ancillary revenues)									
For Six Non-Major Route Groups	Performance Term One					Performance Term Two			
	2004	2005	2006	2007	2008	2009	2010	2011	2012
Yr ending March 31									
Fares Including Fuel Surcharges	80	86	93	103	115	124	133	144	155
Social Program Reimbursement	6	6	7	7	8	11	11	12	13
Adjustments for the North*	0	0	0	5	17	16	38	38	37
Federal Subsidy	24	24	25	25	26	26	27	27	28
Provincial Service Fee (basic)	92	92	92	92	92	92	92	92	92
Total	202	209	216	232	256	269	302	313	325
<i>Percentages</i>									
Fares Including Fuel Surcharges	40%	41%	43%	44%	45%	46%	44%	46%	48%
Social Program Reimbursement	3%	3%	3%	3%	3%	4%	4%	4%	4%
Adjustments for the North*	0%	0%	0%	2%	6%	6%	13%	12%	11%
Federal Subsidy	12%	12%	12%	11%	10%	10%	9%	9%	9%
Provincial Service Fee (basic)	46%	44%	42%	40%	36%	34%	30%	29%	28%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%
<i>*Prov. Service Fee Adjustment, paydown of N. Fuel Deferral Account, insurance proceeds from Q. of the North</i>									
<i>Sources:</i>									
<i>Performance Term One: BC Ferries.</i>									
<i>Performance Term Two: Commission projections based on Preliminary Ruling of March 30, 2007</i>									

This overall percentage does not reveal the variation among route groups, which is shown on the following chart (sources are as above).

**Fare Revenues as a Percentage
 Fare Revenues Plus Taxpayer Funding**



Fuel Surcharges

11. Fuel surcharges were supposed to end, so why are the new fares based on them?

As the starting point for the percentage increases in the second performance term, you've taken the fare level reached by March 31, 2008, including fuel surcharges. Yet you ordered the fuel surcharges eliminated by March 31 2008. How do you square this?

We consider that the current level of fuel prices is no longer extraordinary and, therefore the base fare should now include fuel at, or close to current price levels. The percentage

fare cap increase in 2008 would be larger if the March, 2008 base fare (excluding fuel surcharge) were used as a starting point, but the dollar amount of the post-March, 2008 fare would be the same, irrespective of whether the starting point included or excluded the fuel surcharge..

Note the new mechanism starting April 1 2008 which will provide a fuel surcharge/rebate when fuel costs deviate by more than a certain amount as a result of fuel price changes (see http://www.bcferrycommission.com/BCFCMemo024_copy.pdf)

12. Why have you changed your previous position that BC Ferries had to cover the first 5% of fuel price above the reference "set price", by moving to a formula where fare-paying customers share 50/50 with BC Ferries the variation of the first 5 cents/litre from the set price?

The first 5% of higher fuel surcharges are not for BC Ferries account as in PT1 because we have decided that the current higher prices for fuel are not "extraordinary" and should be built into the ordinary fare base. With respect to the customer/BCFS share of the band of 5 cents/litre, both above and below the set price, we have decided to share this portion of additional (or lower) costs equally between BCFS and customers. Costs resulting from prices above or below the band are for the customer's cost (or credit) and transferred to the deferral account by route group.

Other Questions

13. My route (Horseshoe Bay-Langdale, route 3) is near financially self-sufficiency already and should be treated separately. Won't lumping it with other routes at a 6.7% per year fare increase through 2012 put it far in excess of self-sufficiency?

Setting aside the major route group, which is 100% user pay, the user pay percentage of the Horseshoe-Bay – Langdale route is the highest of the other route groups.

Given that a newer vessel will be assigned to this route, and other cost increases, we project that by 2012 the net effect of the higher fares will be to put the route closer to 100% user pay, but not beyond it.

One of the principles of the Coastal Ferry Act calls for a move towards user pay. Our projection is consistent with that principle. While our projections do not go beyond the end of performance term two in 2012, after 2012 the Horseshoe Bay-Langdale route may be in the same position as the major routes, no longer requiring taxpayer support and seeing relatively lower rates of fare increase through performance term three which ends in 2016.

14. Was the relationship between discounted prepaid fares and full fares part of your deliberations?

No, it wasn't. Setting the tariff structure in such a way that the weighted average fare does not exceed the price cap is the responsibility of BC Ferries.

It's worth noting that the weighted averaging of the two types of fare means that the more that prepaid fares are used, in general the more gap between full fares and discounted fares will shrink. In other words, the "break" that users of the prepaid fares enjoy depends on restricting the use of those fares to target customer groups.

15. What are BC Ferries' projected operating and capital costs and corresponding revenue requirements for 2008-2012?

You must have had a profile of what operating costs and costs of capital would be between 2008 and 2012 for the non-major routes. What are they?

We made our own calculations of BC Ferries' operating costs and costs of capital for both the major and non-major routes for the 4-year period from 2008. As a starting point we used BC Ferries' projection of costs for fiscal year 2007/08, AFTER we and our consultants confirmed, following a review, that those cost projections were reasonable. We have not released BC Ferries' projections for the same period due to concern over the release of information that could have an impact on BC Ferries' ability to obtain competitive quotations, especially for vessels to be acquired in the 4-year period.

Comments from the Public

16. How can I give feedback and to whom? Is there a deadline?

We shall be pleased to receive comments on our preliminary decision from the public by e-mail, fax or Canada Post by June 30 2007.

Please contact us by email at the [BC Ferry Commission](#), by fax at (250) 285-3740 or by regular mail at BC Ferry Commission, P.O. Box 1497, Comox, B.C.

To comment on any aspect of Provincial government policy, please contact Minister Kevin Falcon at the address below.

To provide comments on taxpayer funding, the frequency and capacity of sailings on any route, and any other aspect of the Coastal Ferry Services Contract, please contact:

BC Ferries via	Minister Kevin Falcon via
Email: www.bcferrys.com/contact_us or Phone: 1-888-223-3779	Email: Minister.Transportation@gov.bc.ca or Mail: PO Box 9055, Stn Prov Govt Victoria, BC V8W 9E2

17. Are you holding public meetings where people can ask questions and provide input?

The Act requires us to make the preliminary decision on price caps by March 31, 2007 (for the second performance term) and to issue a report, which includes the decision, to the “ferry operator and the government”. We are also required to publish the report to bring it to the attention of the public and that is why it is on the website. We have met with representatives of the ferry advisory committees to inform them of the process and expect to have further meetings over the next few months before our final decision is made.

We shall be pleased to receive comments from the public by e-mail, fax or Canada Post within the next three months through e-mail, fax or Canada Post (see above).

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

18. Will you do anything with my feedback?

All responses from the public will be carefully reviewed and, if we consider that the final decision will benefit from adopting any proposals, we shall adjust our decision to reflect them.