



# **Report on the Final Price Cap Decision For the Fourth Performance Term**

*Prepared and submitted in accordance with  
Sections 40 and 41 of the Coastal Ferry Act  
of the Province of British Columbia*

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## **Introduction**

The BC Ferries Commissioners (the “commissioners”) issued Order 15-02 on March 18, 2015, to establish a preliminary decision on price caps for the fourth performance term (“PT4”). An accompanying document entitled “Report on the Preliminary Price Cap Decision for the Fourth Performance Term” was posted to the commissioners’ website the same day, setting out reasons for the preliminary decision. In accordance with Section 40 of the Coastal Ferry Act (the “Act”), the commissioners have issued a final decision for price caps in PT4, and this document sets out the reasons thereto.

### **1. Governing Legislation under the *Coastal Ferry Act***

The process for establishing price caps is set out in Section 40 of the Act as follows:

40 (1) For the purposes of section 38 (2) (c), each ferry operator must, at least 18 months before the beginning of a performance term for which a price cap is to be set, provide to the commissioner, the Authority and the Minister of Transportation and Infrastructure information, satisfactory to the commissioner, respecting the following in relation to each designated ferry route that is included within a route group for which a price cap is to be set:

(a) the core ferry services that the ferry operator has provided, and reasonably expects to provide, in the current performance term;

(b) the tariffs for core ferry services, including, without limitation, reservation fees, that the ferry operator has charged, and reasonably expects to charge, in the current performance term;

(c) the service fees that have been paid, and that the ferry operator reasonably expects will be paid, by the government in the current performance term;

(d) the revenues from all sources that the ferry operator has earned, and reasonably expects to earn, in the current performance term;

(e) the following expenses that the ferry operator has incurred, and that the ferry operator reasonably expects will be incurred, in the current performance term:

(i) the operating expenses, including amortization of capital costs, that the ferry operator has reasonably allocated to the designated ferry route;

(ii) the portion of the ferry operator's administrative expenses that the ferry operator has reasonably allocated to the designated ferry route;

(iii) the portion of the expenses applicable to the terminals serving the applicable designated ferry route that the ferry operator has reasonably allocated to the designated ferry route, and the methodology by which those amounts have been allocated among its routes;

(f) the requests for proposal issued, or other actions taken, in the performance term by the ferry operator in accordance with section 69, the responses received by the ferry operator to those requests or actions, any unsolicited proposals received in the performance term by the ferry operator for the provision of ferry services by additional or alternative service providers on the designated ferry route and the results of those requests, actions, responses and proposals;

(g) any other records considered by the ferry operator to be relevant to the setting of the price cap.

(1.1) Each ferry operator must provide to the commissioner, with the information submitted under subsection (1),

(a) a plan as to how the ferry operator intends to provide services more efficiently in the upcoming performance term, and

(b) the most recent capital plan prepared under section 64.1.

(1.2) Promptly after receiving the information referred to in subsections (1) and (1.1), the commissioner must, subject to subsection (1.3), publish that material on the commissioner's website.

(1.3) The commissioner need not, under subsection (1.2), publish information that, under section 17 or 21 of the *Freedom of Information and Protection of Privacy Act*, the commissioner may or must refuse to disclose in response to a request made under that Act.

(2) The commissioner must, at least 12 months before the beginning of a performance term for which a price cap is to be set,

(a) review the information and plans provided to the commissioner under this section,

(a.1) make public a request for public comment in relation to the following:

- (i) the reports maintained under section 68 (3);
- (ii) the information and plans provided to the commissioner under this section;
- (iii) any other information on the commissioner's website that relates to the commissioner's powers and duties under this section, and review the comments received in response;

(b) make the determinations referred to in section 41 (3),

(c) prepare a report that describes the findings of the review under paragraph (a) of this subsection and the determinations made under paragraph (b), the findings of the review under paragraph (a) of this subsection and the determinations made under paragraph (b), and indicate in that report the commissioner's preliminary decision about what the price cap for each route group will be for the next performance term,

(d) issue the report referred to in paragraph (c) to the ferry operator and the government, and

(e) publish the report referred to in paragraph (c) in a manner that the commissioner is satisfied will bring it to the attention of the public.

(3) At least 9 months before the beginning of the performance term for which the price cap is to be set, a ferry operator referred to in subsection (1)

must submit to the commissioner the most current version of the Coastal Ferry Services Contract that is to apply in respect of that upcoming performance term to indicate the changes, if any, to be made to

- (a) the core ferry services, and
- (b) the service fees to be provided to the ferry operator by the government.

(4) After receiving the Coastal Ferry Services Contract referred to in subsection (3), and at least 6 months before the beginning of the performance term for which the price cap is to be set, the commissioner must

- (a) reconsider the preliminary decision included in the report referred to in subsection (2) (c) in the light of
  - (i) the Coastal Ferry Services Contract,
  - (ii) any additional information received by the commissioner from the ferry operator or from the government, and
  - (iii) any public comment received on the report, and
- (b) issue the commissioner's final decision on the application to the ferry operator and the government.

## **2. Commissioners' Determinations**

In accordance with Section 40 (3), on June 30, 2015 the ferry operator ("BC Ferries") filed with the commissioners the amending agreement to the Coastal Ferry Services Contract ("CFSC") which constitutes the latest version of the CFSC. A copy of the amending agreement is posted on the commissioner's website.

Since receiving the amending agreement, the commissioners have addressed the requirements of Section 40 (4) (a). The preliminary decision has been reconsidered in light of the amended CFSC, any additional information received from the ferry operator or from government and the public comments received by the commissioners since the preliminary price cap decision was released on March 18, 2015.

With regard to Section 40 (4) (a) (i) and (ii) the commissioners have determined the following:

1. The latest version of the CFSC is consistent with the assumptions used by the commissioners in setting the preliminary price cap. Minimum annual service levels are unchanged and the service fees provided by government to the ferry operator remain at the levels assumed in that decision. The amending agreement also:

- Sets ferry transportation fees for PT4;
- Maintains annual service levels in effect at the end of the third performance term (“PT3”);
- Defines the funding arrangement for the senior’s discount;
- Revises timelines for the publication of sailing schedules;
- Specifies that the consolidated route group will revert to majors, minors and northern route groups at the commencement of the performance term five, unless otherwise agreed to in writing by the parties;
- Allows for a temporary service disruption for the herring roe fishery on route 21;
- Revises the minimum number of daily peak round trips on route 1 from 13 – 15, to 10 – 15 (while maintaining the same annual minimums), to give more scheduling flexibility such as in the transition from shoulder to peak seasons; and
- Permits dangerous goods round trips to be run only ‘on demand’, based on customer notice ten minutes prior to the scheduled departure of the initial leg of the round trip sailing (currently only route 26 runs round trip dangerous goods sailings).

2. Financial Targets

The financial modeling continues to indicate that targets for “debt service coverage ratio” and “equity as a percentage of total capitalization” are achievable.

3. Operating and Other Costs

The commissioners have received no information from the ferry operator to suggest any significant change in operating, amortization or financing cost assumptions for PT4.

4. Efficiency Targets

The efficiency target for PT4 was set at \$27.6 million, and no information has been received from the ferry operator to indicate that the target is not reasonable or achievable.

5. Long Term Capital and Efficiency Plans

The commissioners have received no information from the ferry operator which would necessitate a change to the long term capital or efficiency plans which were used to set the preliminary price caps.

6. Fuel Set Price

The preliminary price cap was based on a price per litre of marine diesel which assumed the West Texas Intermediate (“WTI”) barrel price would remain at or below \$65 USD and a Canadian to US dollar exchange rate of 1.25 plus an allowance for annual inflation. The exchange rate has fluctuated between 1.20 and 1.33 and the WTI price has fluctuated between \$38 and \$62 since the preliminary decision, and to date has not exceeded the \$65 threshold.

Accordingly, the commissioners believe the fuel set price included in the preliminary decision remains reasonable for purposes of setting the final price caps.

7. Fuel Deferral Mechanism

The commissioners have received no information from the operator or comments from the public which would require a reconsideration of fuel deferral accounting in PT4. The fuel deferral mechanism is working as intended and therefore will continue in PT4 with certain modifications.

8. Traffic Forecasts

The preliminary price cap reflected a traffic growth projection of 5% by the end of PT4. In the 6 months since the preliminary decision there has been traffic growth on many routes. There are numerous factors which may explain this growth, including a low Canadian dollar and increased tourism. It is too early to assume a growth trend will be sustained throughout the full performance term, and some growth is required to achieve the goal of price caps at or below the rate of inflation. Accordingly, the commissioners have not adjusted traffic projections in setting the final price caps.

9. Ancillary Revenues

The annual report from the ferry operator shows continued growth in ancillary

revenues in keeping with assumptions used by the commissioners, which continue to be considered reasonable.

#### 10. Price Cap Index

The price cap index is used by the commissioners to oversee compliance with the price caps during the performance term. At the beginning of PT3 the index was reset to 100. The index will again be reset to 100 at the beginning of PT4.

### 3. Public Comments

In keeping with the Coastal Ferry Act (s. 40 [4] [a] [iii]), the commissioners reviewed and considered all public comments they received about the preliminary price cap decision. For transparency, the commission has posted a summary of the comments on its website. Our related findings and determinations are as follows:

#### 1. Rollback of ferry fares

Several submissions called for a general rollback in ferry fares in the order of 20 to 25% over PT4 on some routes or on all routes. We have considered these proposals in the context of the role of the commissioner as set out in the Act, and have concluded that the proposals exceed the commissioner's authority. The commissioner is required to balance the interests of the ferry operator, ferry users and taxpayers. Putting the ferry operator at risk of financial failure is not in any of those interests. A 25% fare reduction system wide would create a revenue shortfall for the ferry operator in excess of \$500 million during the term. If only applied to the minor routes the rollback of this magnitude would create a \$60 million shortfall. The proponents have not identified any new sources of revenue or service reductions to offset a rollback. The commissioners have noted that the recently approved application for new IT systems to support reservations, and possible time of day pricing may result in fare reductions on some sailings. It is too early to know the magnitude of such opportunities, but it seems possible that fare reductions on some routes at certain times could be significant.

#### 2. Affordable fares generally

Many comments were received about fare affordability and the effect on residents and communities. People have stated that a 1.9% price cap increase was a welcome relief from much higher price caps in previous years, but are coming on top of fares which are considered by many to be too high to start with. Fare affordability was the most common issue raised when the commissioners

conducted their review of the Act. Prior to that review there was concern that fares could rise by as much as 81% on the northern routes, 43% on the minor routes and 16% on the major routes. In the interest of ferry users a great deal of work has gone into addressing fare affordability over the past four years, and the result is price caps for the next four years below the notional inflation rate target set by the Bank of Canada. In the face of a \$3 billion program to replace aging vessels and terminal, and recognizing that 80% of operating costs are attributed to labour and fuel, holding fares at or below the rate of inflation will be an ongoing challenge.

#### **4. Final Decision on Price Caps for PT4**

In conclusion, the commissioners have ordered that the increase in the price cap for PT4 be set at 1.9% in each year.