



February 25, 2020

Alana Gallagher  
Vice President, Finance & Chief Financial Officer  
British Columbia Ferry Services Inc.  
Suite 500, 1321 Blanshard Street  
Victoria, BC V8W 0B7

Dear Ms. Gallagher:

Re: Reset of Performance Term 5 Price Cap

This is in response to your letter of February 24, 2020 proposing factors for consideration in resetting the price cap indices for upcoming Performance Term Five (April 1, 2020 to March 31, 2024) ("PT5").

The commissioners feel it is warranted to continue with their policy of rebasing the price cap indices for every new performance term. This promotes transparency and ease of tracking compliance of the quarterly price compliance index with the quarterly price cap index.

In your letter you state that BC Ferries forecasts that the price compliance index will be below the price cap index (the "price cap position") by approximately \$62.4 million at the end of PT4 and that this underage arises from two factors:

1. The two-year fare initiatives agreement between the Province and BC Ferries which restored the senior's discount to 100% and committed to the fares on Routes 1, 2 and 30 being held flat, and the fares on Route 3, the minor routes and the northern routes being reduced 15 percent in Fiscal 2019 and held flat the following year.
2. The two-year agreement with the Province also prevented BC Ferries from using fare increases to recapture accumulated price cap underage at the end of Fiscal 2018 due to certain pricing initiatives undertaken by BC Ferries during the first 2 years of PT4.

For PT5 you are proposing that the PT4 underage amounts be carried forward for the PT5 price cap index and offer the following alternatives for determining the carry forward amounts:

1. The amount carried forward would recognize the amount of forgone revenue provided by the Company as a result of the fare initiatives agreement with the Province which you have estimated to be \$29.9 million.

2. The amount carried forward would recognize only the price cap underage position excluding the value of the two-year fare initiative agreement with the Province which you have estimated to be \$7.6 million.

The commissioners can not accept the first alternative of recognizing forgone revenues as a result of the agreement with the Province. The commissioners reflected the impact of this agreement in their determination of the price caps for PT5 and an argument can be made that the price caps could have been adjusted for the last two years of PT4. BC Ferries entered this agreement voluntarily without any assurance from the commissioners that foregone revenues would be recoverable in the future. Furthermore, by increasing the transportation service fees for PT5, it appears the Province intended the benefits of the fare initiatives to be extended into PT5.

The commissioners do agree with the recognition of the price cap underage position under the second alternative above. This recognition is consistent with past practice and the treatment of accumulated price cap underages and overages. To not recognize the underage would penalize BC Ferries unfairly for undertaking pricing initiatives to achieve certain business objectives during PT4.

Your letter also raises the proposed treatment of funding for the BC seniors' discount. The commissioners agree that the funding received from the Province for the BC seniors' discount should be treated in the same manner as funding received for social programs. That is, to be included as tariff revenue for the purposes of price cap calculations.

Finally, the commissioners agree with your proposal to have a qualified third party conduct a review of the calculations of the price cap indices reset and their alignment with the approach hereby approved by the commissioners.

Sincerely,

A handwritten signature in blue ink that reads "S. T. Stoilen". The signature is written in a cursive, slightly slanted style.

Sheldon Stoilen  
British Columbia Ferries Commissioner



VICE PRESIDENT & CHIEF FINANCIAL OFFICER

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February 24, 2020

Mr. Sheldon Stoilen  
British Columbia Ferries Commissioner  
BC Ferry Commission  
PO Box 9279 Stn Prov Gov  
Victoria, BC V8W 9J7

Dear Mr. Stoilen:

**Re: Reset of Performance Term 5 Price Cap**

We are writing to propose factors for consideration in resetting British Columbia Ferry Services, Inc.'s ("BC Ferries" or the "Company") price cap indices for upcoming Performance Term Five (April 1, 2020 to March 31, 2024) ("PT5").

The start of each performance term presents an opportunity to rebase the price cap index to 100 as the starting point for tracking this information during the performance term. Such resetting is not a requirement of price cap regulation but is often undertaken as it provides a more intuitive view of compliance.

During previous performance terms, when resetting the price cap to 100, the Commissioner has taken the opportunity to allow BC Ferries to carry forward price cap underage (i.e., the value of the difference between the price cap and a lower price compliance index). This was in recognition of the efforts that the Company had made to keep fares affordable through fare discounting and promotions and limitations on the Company's ability to recapture the underage. For example, at the end of Performance Term Three (April 1, 2012 to March 31, 2016), when BC Ferries was under the price cap index by \$6.8 million, the Commissioner approved this amount to be carried over to Performance Term Four (April 1, 2016 to March 31, 2020) ("PT4") through the reset of the price cap and price compliance indices.

The reset of the price cap indices also provides an opportunity to reset base fares to reflect any changes in the CFSC or in business practices. At the start of PT4 there were two such adjustments: the seniors' base fares were adjusted in recognition that only 50 percent of adult fares would be recognized as tariff revenue going forward, and the reservation fee was rolled into the vehicle fare instead of being treated as a separate item.

BC Ferries is recommending similar approaches be applied to the price cap indices reset for the start of PT5.

## Price Cap Indices Forecast

BC Ferries forecasts that the price compliance index will be below the price cap index (the "price cap position") by approximately \$62.4 million at the end of PT4. This underage arises from two factors:

1. The two year fare initiatives agreement between BC Ferries and the Province effective Fiscal 2019 that:
  - Returned the BC senior's discount from 50 to 100 percent. The Province offset BC Ferries' loss of the BC senior's tariff revenue with a fixed amount based on a forecast for seniors' travel over the last two years of PT4; and
  - Committed to the fares on Routes 1, 2 and 30 being held flat, and the fares on Route 3, the minor routes and the northern routes being reduced 15 percent in Fiscal 2019 and held flat the following year. This initiative was funded 50 percent each by the Province and BC Ferries, and resulted in forgone revenue by the Company that would otherwise have been available if it had raised fares as allowed by the price cap regulation.

The table below outlines the estimates of the value of the two year agreement with Province, showing the provincial funding amounts and BC Ferries' anticipated foregone revenue:

		Province	BC Ferries
Fiscal 2019	Fare Freeze	\$ 3.7	\$ 3.7
	15% Fare Roll Back	\$ 13.0	\$ 13.0
	Seniors	\$ 9.8	\$ -
	<b>Total</b>	<b>\$ 26.5</b>	<b>\$ 16.7</b>
Fiscal 2020	Fare Freeze	\$ 7.7	\$ 7.7
	15% Fare Roll Back	\$ 14.6	\$ 14.6
	Seniors	\$ 10.2	\$ -
	<b>Total</b>	<b>\$ 32.5</b>	<b>\$ 22.3</b>

The Province's funding was recognized as ferry transportation fees and was not incorporated into the price cap compliance reporting for PT4. If it had been included, the price compliance index would be \$32.5 million closer to the price cap at the end of PT4.

2. The two year agreement with the Province also prevented BC Ferries from using fare increases to recapture \$11.2 million of price cap underage accumulated by the end of Fiscal 2018.

During Fiscal 2017 and Fiscal 2018, BC Ferries conducted various fare discount programs throughout the system, and in Fiscal 2018, it also limited fare increases to a 1.9 percent fare increase only on vehicles on Routes 1, 2 and 30.

The fares that were then in place became the base for the fare initiatives undertaken with the Province in Fiscal 2019 and Fiscal 2020. Because the initiative resulted in frozen fares during this two-year period, it was not possible for BC Ferries to use fare increases to recapture any of the previous price cap room.

In summary, these two factors represent BC Ferries' PT4 contribution to fare affordability through foregone revenue.

## **Proposals for the PT5 Price Cap Indices**

### *1. PT5 Price Cap Carry Forward*

The Company proposes that the PT4 underage amounts be carried forward for the PT5 price cap index. The following are alternatives for determining the carry forward amounts:

- i. The amount carried forward would recognize the amount of forgone revenue provided by the Company over PT4. This would be calculated as:

*March 31, 2020 price cap position (currently forecast to be \$62.4 million) minus \$32.5 million of provincial funding. Estimated to equal \$29.9 million.*

- ii. The amount carried forward would recognize only the price cap underage position excluding the value of the two year fare initiative agreement with the Province. This would be calculated as:

*March 31, 2020 price cap position (currently forecast to be \$62.4 million) minus \$32.5 million of provincial funding minus \$22.3 million of BC Ferries foregone revenue. Estimated to equal \$7.6 million.*

This \$7.6 million estimate is lower than the Fiscal 2018 year-end amount of \$11.2 million noted above, due to the Company's efforts to provide more access to higher valued fare products (e.g. reservations on major routes) which had a positive but limited impact on the price compliance index.

### *2. PT5 Price Caps and Senior Fare Funding Treatment*

BC Ferries and the Province typically amend the CFSC in advance of each performance term. Under the amending agreement for PT5, up to \$30 million of the Ferry Transportation Fee that the Province pays BC Ferries for the provision of ferry services is to be used to fund the 100 percent senior's discount. In effect, this means this tariff revenue is funded by the Province in much the same way as social programs (such as disabled discounts and BC students discounts). As such, BC Ferries is proposing to treat this 'shadow fare' revenue as tariff revenue in the PT5 price cap calculation.

Price cap calculations for BC seniors would be as follows:

- For all routes, BC Ferries would calculate the amount of the senior's 'revenue' to be recognized in the price cap calculation by using the number of seniors who travelled, by route, multiplied by the posted adult fare on the route of travel.
- If the amount of the BC senior's discount 'revenue' to be recognized in the price cap calculations exceeds the \$30 million received from the Province, the

maximum funding will be allocated amongst the routes based on their proportion of the total BC senior's discount.

### **Summary**

BC Ferries is proposing:

- A. That the price cap indices rebasing process provide for the carry forward of a portion of the price cap underage experienced at the end of PT4 through recognition of either:
  - i. The full amount of forgone revenue that BC Ferries provided over PT4; or
  - ii. The partial amount of forgone PT4 revenue that BC Ferries provided, excluding its contribution to the two year fare initiative agreement with the Province.
- B. To treat the funding received for the BC senior's discount in the same manner as funding received for social programs. That is, to include as tariff revenue for the purposes of price cap calculations.

### **Validation**

As with the PT4 price cap indices rebasing, BC Ferries is proposing to have a qualified third party conduct a review of the calculations of the price cap indices reset and their alignment with the approach approved by the Commissioner.

Thank you for considering our proposal. Should you wish to discuss this further, please feel free to contact me.

Sincerely,



Alana Gallagher  
Vice President, Finance & Chief Financial Officer