

Seaspan Coastal Intermodal Company

**Response to
British Columbia Ferry Services Inc.'s
Submission to the BC Ferries Commissioner**

**Regarding
Section 45.1(1) of the *Coastal Ferry Act*
and Drop-Trailer Service**

November 26, 2010

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1 **Seaspan Coastal Intermodal Company**
2 **Submissions on BC Ferries' Drop-Trailer Service**
3

4 **1. INTRODUCTION AND OVERVIEW**

5 **1.1 Introduction**

6 BC Ferries has made it clear in its August 31, 2010 submission that it believes that it is
7 fair and appropriate for it to be free to price its new drop-trailer service down to any level
8 that recovers its direct incremental costs of providing this service. In its view, incremental
9 costs do not include the costs of terminals, ferries, fuel, crews and many other related
10 expenses, all of which will be paid for by the "core market."

11 Seaspan Coastal Intermodal Company ("SCIC") believes such aggressive pricing of
12 drop-trailer service by BC Ferries is inappropriate, unfair, and an abuse of BC Ferries'
13 mandate, and require action under section 45.1 of the *Coastal Ferry Act* (the "*CF Act*").
14 No private ferry operator can reasonably be expected to compete with a government-
15 owned ferry corporation that believes it does not have to include the full long-run cost of
16 terminals, ferries, fuel, crews, etc. in its ferry service rates because these costs are fully
17 carried by its captive "core" customers.

18 SCIC does not take issue with BC Ferries entering the drop-trailer market. However,
19 SCIC believes strongly that if BC Ferries is going to compete with the private sector
20 there must be a level playing field. SCIC takes issue with BC Ferries unfairly competing
21 in the commercial trailer market by utilizing advantages which are unique to BC Ferries
22 and which arise as a result of its, or its predecessor's, relationship with governments.
23 These advantages have put BC Ferries in a position where it feels justified in offering
24 rock bottom prices primarily to a select group of customers, customers who have
25 competitive options available elsewhere.

26 The Comptroller General recognized the risk the current situation poses for competitive
27 private carriers when she stated in her 2009 report:

28 *"To avoid the possibility that passenger fares could be allocated an unfair*
29 *portion of the costs, and to ensure there is no perception of undue*
30 *advantage, it is important that the allocation of costs between such*
31 *commercial services and passenger/vehicle services be transparent and*
32 *subject to independent oversight".¹*

33 The Legislature showed its clear concern about the risk to competitive markets when it
34 introduced s.45.1 of the *CF Act* which requires the Ferries Commissioner to review BC
35 Ferries' competitive offerings and "...*determine whether the ferry operator is pricing the*
36 *service below the direct costs and an appropriate proportion of the indirect costs*

¹ October 2009 Report on Review of Transportation Governance Models, p. 19

1 *associated with providing that ferry transportation service, ” or has “ an unfair*
 2 *competitive advantage ...”*

3 In similar markets, where a market participant has advantages through a privileged
 4 relationship with government, or has the ability to cross subsidize its competitive
 5 offerings by its monopoly service, legislated safeguards are often put in place to protect
 6 the private sector from these unfair competitive advantages. Indeed, this was clearly the
 7 intent of government when it introduced the changes to the *CF Act* set out above. It is
 8 SCIC’s belief that s.45.1 was introduced to protect private industry from BC Ferries
 9 leveraging its monopoly advantage and employing the very pricing strategy it attempts to
 10 justify in its August 31, 2010 submission.

11 The decision that the Ferries Commissioner will make in this matter will determine the
 12 future of private and public commercial trailer transport to and from Vancouver Island. If
 13 BC Ferries is permitted to continue to aggressively pursue commercial traffic to
 14 Vancouver Island through inappropriate and unfair price discounts to live and/or drop-
 15 trailer traffic, the impacts will not be limited to private ferry operators. BC Ferries’
 16 discounts have already set in play a series of destabilizing events that, if allowed to
 17 continue and grow, will detrimentally affect private operators, all commercial shippers
 18 and the passenger vehicle market for years to come.

19 **1.2 Seaspan Coastal Intermodal Company’s Interest**

20 Seaspan Coastal Intermodal Company, formerly The Canadian Pacific Railway’s
 21 Coastal Marine Operations, has been moving commercial trailers between the Mainland
 22 and Vancouver Island for well over 60 years. It currently employs over 150 people and
 23 last year paid taxes to all levels of government.

24 Prior to the entry of BC Ferries into the drop-trailer business, SCIC ran 6 vessels and a
 25 total of 11 daily mid-week return trips and nine weekend return trips to Vancouver Island
 26 over two routes – Tilbury, Delta to downtown Nanaimo and Tilbury, Delta to Swartz Bay.
 27 Today, SCIC operates a fleet of 5 vessels for an average total of 8 daily mid-week return
 28 trips and seven weekend return trips. If BC Ferries is allowed to continue to expand its
 29 commercial service with unfair pricing, SCIC’s service to Vancouver Island will inevitably
 30 be further curtailed.

31 **1.3 Background**

32 In reviewing this matter, SCIC would like the Ferries Commissioner to bear in mind the
 33 following key points:

34 (a) SCIC and Vancouver Island Barge (“VIB”) are private commercial operations that
 35 must recover their costs over the long run. If they cannot do this, they cannot
 36 continue to serve the commercial trailer needs of Vancouver Island.

37 (b) There is currently an active competitive market for commercial ferry traffic to and
 38 from Vancouver Island. While historically the live “mode” has made up

1 approximately 50% of the commercial traffic and the “drop-trailer” mode has
2 made up the other 50%, there is a significant percentage of customers that are
3 price sensitive and willing to shift between modes, based largely on rates and
4 total costs.

5 (c) BC Ferries is a government-owned corporation that has many advantages as a
6 result of its, or its predecessors, relationships with government. Among other
7 advantages and subsidies, it has access to terminals and ownership of a fleet of
8 ferries most of which were acquired by its predecessor during a period of lower
9 costs and high subsidies. As importantly, it has a contract, the Coastal Ferry
10 Services Contract (the “CFS Contract”), which requires it to provide a defined
11 number of sailings to Vancouver Island and which provides it with the opportunity
12 to recover the full cost of those sailings from the core market. This is not a
13 normal commercial context.

14 SCIC understands that the purposes of the CFS Contract include ensuring
15 frequent and predictable ferry sailings to both Swartz Bay and Nanaimo. SCIC
16 supports those goals, but does not believe that the destruction of the private ferry
17 market should be, or has to be, one of the unintended consequences of the CFS
18 Contract.

19 (d) Commencing in March 2009, BC Ferries entered the drop-trailer business
20 offering prices that are well below BC Ferries’ published tariff, for either live
21 service or drop-trailer service, prices that simply cannot be matched by private
22 commercial ferry providers who must take a long run view. Since March 2009,
23 BC Ferries appears to have taken approximately 8% – 12% of the drop-trailer
24 business from SCIC and VIB.

25 (e) Through its consultant, Gary Saleba of EES Consulting, BC Ferries argues that
26 as long as the drop-trailer prices recover anything more than the incremental
27 costs, the rates are reasonable. This is the same as arguing BC Ferries does not
28 have to take into account the cost of terminals, ferries, crews, fuel or overhead in
29 pricing its drop-trailer services. This is precisely the free rider approach the
30 Comptroller General warned against. This short term view fails to take into
31 account the full long run costs that these commercial customers impose on the
32 system. Joe Linxwiler’s (SCIC’s expert) report that forms part of this submission
33 shows BC Ferries’ position is not consistent with normal regulatory practice, nor
34 appropriate in this situation. He stresses the importance of including long term
35 costs in deriving rates.

36 (f) The inevitable long run results of unfair competition by BC Ferries in the drop-
37 trailer market will be (i) increased commercial traffic on BC Ferries with its
38 commensurate pressure on operating and capital costs, as new ferries are
39 required; (ii) reduced service options for commercial traffic during normal times
40 and particularly during storms, strikes or other service disruptions at BC Ferries;
41 and (iii) more difficult and expensive arrangements for dangerous goods
42 transport (including propane, gasoline, chemicals, including some household

1 goods like bleach and solvent based cleaning products, and munitions for the
 2 Canadian Armed Forces), as well as the safe and reliable carriage of specialty
 3 shipments such as rail car traffic.

4 (g) SCIC submits that an appropriate rate for a government-owned corporation is a
 5 rate that takes into account the full costs of drop-trailer service and the long term
 6 interests of BC Ferries, its customers, commercial shippers, and commercial
 7 ferry service providers. BC Ferries' current drop-trailer rates do not do this, to the
 8 inevitable detriment of all industry and public stakeholders.

9 **1.4 Requested Order**

10 (a) SCIC requests the BC Ferries Commissioner to rule that:

- 11 1. BC Ferries' drop-trailer service is priced below "the direct costs and an
 12 appropriate proportion of the indirect costs associated with providing that
 13 ferry transportation service";
- 14 2. BC Ferries has an "unfair competitive advantage"; and
- 15 3. The Ferries Commissioner will hold a further inquiry pursuant to s.45.1(2)
 16 to consider remedies. SCIC believes this request is consistent with
 17 BC Ferries' position set out at p. 41 of its August 31, 2010 submission.

18 (b) SCIC also requests that the Commissioner order BC Ferries to abide by the
 19 provisions of its own published tariffs², and charge its published rates to all drop-
 20 trailer and live commercial service customers, notwithstanding any existing long
 21 or short term contracts, until such time as the Ferries Commissioner conducts the
 22 second phase of this inquiry pursuant to s.45.1(2) and makes a final
 23 determination of the appropriate remedy. These published tariffs are rates that
 24 BC Ferries itself has determined to be reasonable³ and appropriate for offering to
 25 the commercial sector and will minimize the harm currently being done by BC
 26 Ferries' aggressive discount based entry into the drop-trailer market.

27 **2. SCIC EVIDENCE AND RELATED ISSUES**

28 **2.1 Access to Confidential Information**

29 This submission is filed in response to the submission of BC Ferries dated August 31,
 30 2010. It has been prepared without the benefit of seeing any of the detailed information
 31 contained within the confidential exhibits which are Exhibits B through Exhibit D1 and
 32 without receiving most of the key information requested pursuant to SCIC's information
 33 request of October 15, 2010. SCIC believes that this material contains vital information
 34 that should have been disclosed to participants in this proceeding. As a result of not

² BC Ferries' Submission, p.20

³ In response to SCIC Information Request 4.6(i), BC Ferries describes the published rates per foot for drop-trailer service as having been established "based on market research".

1 having access to this material, SCIC has had to proceed using its best estimates of
2 some key factual matters. SCIC asks that its estimates be respected as such, and taken
3 as illustrative, or reasonable assumptions.

4 **2.2 Evidence of Joe Linxwiler**

5 In addition to the submissions contained herein, SCIC is providing the supporting report
6 of J. Linxwiler, an expert consultant retained by SCIC, attached as Appendix "A", to this
7 submission.

8 His conclusions are important and to the point. After a careful review of the facts and
9 issues he found:

10 *"...it is my opinion that BC Ferries' proposed fees for drop trailer service are not*
11 *fairly or appropriately priced because BC Ferries does not include in its cost of*
12 *service analysis for that service any vessel-related costs or costs of associated*
13 *terminal facilities, including fuel or crew costs. "*⁴

14 -----

15 *"In particular, a zero allocation of ferry and terminal costs to drop trailer service is*
16 *not justified on the basis that the service is an off-peak service. To the contrary,*
17 *there are several reasons why it is appropriate to allocate a significant share of*
18 *vessel and terminal costs to drop trailer service:*

- 19 ● *Drop trailer customers should not be "free riders."*
- 20 ● *Costs and benefits should be appropriately aligned.*
- 21 ● *The price for a service like drop trailer service offered by a*
22 *monopoly supplier should not be less than prevailing market*
23 *prices (that is, prices offered by other suppliers and not distorted*
24 *by the supplier in question) or long-run incremental costs. "*⁵

25 -----

26 *"BC Ferries' proposed pricing is also not justified by the alleged "incremental"*
27 *nature of drop trailer services.*

28 *Thus, I do not disagree that the price or rate for drop trailer service should not be*
29 *below short-run incremental costs. However, that is too low a standard – the*
30 *price should not be below long-run incremental costs, which would include a*
31 *substantial contribution to fixed costs. "*⁶

32 -----

⁴ Linxwiler report, p. 2

⁵ Linxwiler report, p. 3

⁶ Linxwiler report, p. 3

1 *"FERC, a leading regulator in the US has adopted a so-called "or pricing" policy,*
2 *whereby the charges to a new transmission customer should be the higher of*
3 *average cost or incremental cost. In my opinion, BC Ferries' drop trailer service*
4 *should be similarly priced if it is to recover direct costs and an appropriate*
5 *proportion of indirect costs."*⁷

6

7 *"... it is my professional opinion that the fees or rates for drop trailer service*
8 *should satisfy the following criteria, which I explain below:*

9 (i) *The fees should not be less than long-run incremental costs of the*
10 *service;*

11 (ii) *The fees (normalized taking into account length, width and height*
12 *as well as weight), when expressed on a per-foot basis, should not be*
13 *less than the fees for other off-peak customers; and*

14 (iii) *The fees(normalized taking into account length, width and height*
15 *as well as weight), when expressed on a per-foot basis, should not be*
16 *less than what the average cost would be based on 100% utilization of*
17 *the ferries."*⁸

18 **2.3 Future Procedural Steps**

19 SCIC would welcome an opportunity to appear (with Mr. Linxwiler) before the BC Ferries
20 Commissioner to answer questions and make further submissions as appropriate.

21 **3. FERRIES COMMISSIONER MANDATE**

22 **3.1 Comptroller Generals report**

23 In October 2009, the Comptroller General issued a Report on Review of Transportation
24 Governance Models, prepared for the Minister of Transportation and Infrastructure and
25 the Minister of Finance. In this report, the Comptroller General directly addressed the
26 problem of the lack of regulation of services provided by BC Ferries that compete with
27 private enterprise, stating the following:

28 *"The governance model provides no regulation of services BC Ferries*
29 *may provide that compete directly with private enterprise. For example,*
30 *BC Ferries recently entered into the "drop-trailer" market. Truck trailers*
31 *can be dropped off at a ferry terminal and BC Ferries will load and deliver*
32 *them to their destination ferry terminal. This presents direct competition to*
33 *private operations that provide similar services. While this is consistent*
34 *with the entrepreneurial behavior to be expected of a commercial*

⁷ Linxwiler report, p. 3

⁸ Linxwiler report, p. 4

1 enterprise, it could be perceived that BC Ferries has undue advantages
 2 such as having exclusive use of the ferry terminals, having a monopoly on
 3 ferry services and receiving funds from the provincial and federal
 4 governments. To avoid the possibility that passenger fares could be
 5 allocated an unfair portion of the costs, and to ensure there is no
 6 perception of undue advantage, it is important that the allocation of costs
 7 between such commercial services and passenger/vehicle services be
 8 transparent and subject to independent oversight. To this end, the
 9 Commission should regulate such competitive services separately from
 10 its regulation of the transportation of vehicles and passengers in order to
 11 avoid impacting regulated fares under the price cap model.”⁹ (underlining
 12 added)

13 The Legislature responded to the recommendation of the Comptroller General by
 14 amending the CF Act and adding s.45.1.

15 **3.2 Coastal Ferries Act**

16 Section 45.1 of the CF Act states:

17 Regulation of unfair competitive advantage

18 **45.1** (1) *If a ferry operator is providing a competitive service, the*
 19 *commissioner must determine whether the ferry operator is*
 20 *pricing the service below the direct costs and an appropriate*
 21 *proportion of the indirect costs associated with providing that*
 22 *ferry transportation service, or has an unfair competitive*
 23 *advantage, including, without limitation, an advantage resulting*
 24 *from the ferry operator having been provided with*

25 *(a) use of, access to or ownership of vessels or*
 26 *terminals that are or had been owned by the*
 27 *government or a government body within the*
 28 *meaning of the Financial Administration Act,*

29 *(b) any tax exemption, or*

30 *(c) any subsidy.*

31 (2) *If the commissioner makes the determination referred to in*
 32 *subsection (1), the commissioner must regulate the ferry*
 33 *transportation service in one of the following ways:*

34 *(a) make an order under section 69 (1) and, after an*
 35 *alternative service provider satisfactory to the*
 36 *commissioner has been located through a*
 37 *competitive process established in a plan approved*
 38 *under section 69 (4) (a) or created under section 69*
 39 *(4) (b) (i), order the ferry operator to arrange with*

⁹ Comptroller General Report on Review of Transportation Governance Models, October 2009, p. 19.

1 *that alternative service provider, under contract,*
 2 *franchise agreement or otherwise, for the alternative*
 3 *service provider to provide the ferry transportation*
 4 *service;*

5 *(b) calculate the amount that the commissioner*
 6 *considers would be charged as a tariff for that ferry*
 7 *transportation service to recover the direct costs and*
 8 *an appropriate proportion of the indirect costs*
 9 *attributable to providing the service were none of the*
 10 *factors referred to in subsection (1) of this section*
 11 *present, and order the ferry operator to charge at*
 12 *least that tariff when providing that ferry*
 13 *transportation service. (underlining added)*

14 The Legislature's specific concern with the behaviour of BC Ferries in the drop-trailer
 15 market is highlighted by the fact that the 2010 amendments to the *CF Act* added a new
 16 definition of "drop-trailer service" and included express reference to that service in the
 17 new definition of "competitive service" which is a prerequisite to action under the new
 18 s.45.1.

19 **3.3 Issue Before the Commissioner**

20 In Memorandum 37, the Ferries Commissioner determined that "BC Ferries' drop-trailer
 21 service on its major routes across Georgia Strait is a competitive service as defined in
 22 Section 1 of the Coastal Ferry Act" triggering this review under s.45.1 of the *CF Act*.

23 The issue now before the Ferries Commissioner is whether BC Ferries either:

24 *is "pricing the service below the direct costs and an appropriate proportion of the*
 25 *indirect costs associated with providing that ferry transportation service"*

26 or

27 *"has an unfair competitive advantage".*

28 It warrants emphasis that the Legislature's use of the word "or" in s.45.1(1) means that
 29 only one or the other of below-cost pricing or an unfair competitive advantage need be
 30 found before the Commissioner must exercise his authority under s-s. 45.1(2). To put it
 31 simply, "or" means "or", not "and" as seems to be implied by BC Ferries .

32 **3.4 Proper Interpretation of s. 45.1**

33 *(a) Appropriate proportion of the indirect costs*

34 The first test under s.45.1 is to determine whether the Ferry operator is pricing the
 35 service below the direct costs and "appropriate proportion of the indirect costs"
 36 associated with providing the Ferry transportation service. The choice of the word
 37 "appropriate" is very significant. The Legislature could have chosen "reasonable" which
 38 generally means in accordance with logic or reason, or it could have proposed a formula,

1 but it did neither. Instead the Legislature chose the word “appropriate” which commonly
2 means “suitable or proper”¹⁰.

3 In *Jodrey's Estate v. Province of Nova Scotia and the Attorneys General of*
4 *British Columbia*, Dickson J. of the Supreme Court of Canada wrote:

5 *The correct approach, applicable to statutory interpretation generally, is to*
6 *construe the legislation with reasonable regard to its object and purpose*
7 *and to give it such interpretation as best ensures the attainment of such*
8 *object and purpose.*¹¹

9 Principles of statutory interpretation require that “appropriate” or proper must be judged
10 in light of the purposes of the *CF Act* and a consideration of the types of competitive
11 action that are appropriate for a government-owned corporation to be carrying out.
12 Clearly the object and purpose of adding s.45.1 and a "drop-trailer service" definition to
13 the *CF Act* following the Comptroller General's report was to prevent the possibility of
14 abuse by BC Ferries of its monopoly power, including specifically, in the drop-trailer
15 market.

16 In this submission, SCIC will be arguing that the claim by the BC Ferries' expert that the
17 rate for its drop-trailer service need only recover the incremental costs of operation¹² is
18 just plain wrong. Such a rate clearly does not recover any indirect costs, let alone an
19 “appropriate” amount of the indirect costs. It ignores the contribution made by other
20 customers, such as live trailer service in similar circumstances; it ignores the fact that in
21 the long-run all capital related and operating costs must be recovered; and it ignores the
22 fact that BC Ferries is a government-owned corporation that should not be wreaking
23 havoc in the private commercial market for trailer service by under-pricing its services.

24 Furthermore, as Joe Linxwiler's evidence points out, BC Ferries' position does not have
25 a credible foundation in regulatory law or practice. An “appropriate” contribution to
26 indirect costs would be a contribution based on full long term cost including the costs of
27 terminals, ferries, fuel, crew and overheads. At a minimum, and until a closer
28 examination can be made, this contribution should reflect the contribution made by full
29 tariff trailers.

30 *(b) Unfair competitive advantage*

31 The second test to be considered by the BC Ferries Commissioner pursuant to s.45.1(1)
32 is whether BC Ferries

33 *“has an unfair competitive advantage, including without limitation, an*
34 *advantage resulting from the ferry operator having been provided with (a)*
35 *use of, access to or ownership of vessels or terminals that are or had*
36 *been owned by the government or a government body within the meaning*

¹⁰ Concise Oxford Dictionary 8th Edition, 1990

¹¹ [1980] 2 S.C.R. 774, at 807.

¹² EES report, p. 8

1 of the Financial Administration Act, (b) any tax exemption, or (c) any
2 subsidy”.

3 That this list is “*inclusive not exhaustive*” was recognized by BC Ferries in its
4 submission, unfortunately and inappropriately with qualifications.¹³ The words “including
5 without limitation” before the examples of situations that would amount to an unfair
6 competitive advantage mean exactly what they say, that the examples that follow are
7 just that, examples that should not be interpreted so as to limit the scope of the analysis.

8 In its submission, BC Ferries suggests that the Commissioner should impose restrictions
9 on what amounts to an unfair subsidy stating: “*While this list is inclusive, not exhaustive,*
10 *it is readily apparent that the factors identified relate to external benefits conferred upon*
11 *BC Ferries rather than advantage arising from the way in which BC Ferries operates.*”¹⁴
12 BC Ferries’ suggestion is wrong and amounts to reading into the *CF Act* words that are
13 not there. To emphasize this point it is worth noting that the words “*including without*
14 *limitation*” were not in the original Bill introduced in the Legislature, but were introduced
15 as amendments while the Bill was before the Legislature. The Legislature itself
16 specifically acted to prevent exactly the type of limitation that BC Ferries is now arguing
17 should be imposed on your interpretation of the Act. The Act was amended by the
18 Legislature to add “*including without limitation*” before the examples for the clear
19 purpose of allowing the Ferries Commissioner to determine what further behaviour or
20 circumstances amount to an “unfair competitive advantage”.

21 SCIC submits that the wording of s.45.1(1) is broad enough to include not just the listed
22 unfair competitive advantages but also to include the advantages conferred on BC
23 Ferries by the historical government ownership of BC Ferries, its predecessors and its
24 assets, the *CF Act*, and the CFS Contract as well as explicit and implicit subsidies. All
25 are competitive advantages conferred on BC Ferries by the government of British
26 Columbia and all are very similar to the listed advantages found in s.45.1(1). Together
27 they confer upon BC Ferries a preferred monopoly position that allows BC Ferries to
28 recover all its costs from the core market in return for accepting the obligation to
29 undertake a defined number of sailings, which in turn creates the surplus capacity and
30 the incentive to adopt marginal pricing of its competitive services. They are precisely the
31 sort of unfair competitive advantages contemplated by s.45.1(1). This combination of
32 benefits and obligations has created a situation where BC Ferries has seen fit to adopt a
33 business model that does not include the costs of terminals, ferries, crews, fuel, or
34 administrative and other overheads in setting its drop-trailer pricing.

35 **3.5 Other Competition Law**

36 BC Ferries refers to the provisions of the *Competition Act*¹⁵ suggesting that it does not
37 violate the provisions of the Act and accordingly must not be engaging in unfair
38 competition.¹⁶

¹³ BC Ferries’ Submission, p.6, l.14

¹⁴ BC Ferries’ Submission, p.6, l.14 - 17

¹⁵ RSC 1985 c. 19

1 Specifically BC Ferries states:

2 *“While the price cap creates an incentive to lower prices, BCF still cannot engage*
 3 *in predatory pricing. The simple fact remains that it is illegal in Canada to incur a*
 4 *loss on the sales of a product with the intent of gaining and exercising market*
 5 *power and dominance.”* (underlining added)

6 SCIC assumes BC Ferries is referring to the abuse of dominant position provisions of
 7 the *Competition Act* that prohibit “anti-competitive acts”, one of which is predatory pricing
 8 which is described in section 78(1)(i) of the *Competition Act* as the sale of articles at a
 9 price lower than the acquisition cost “...for the purpose of disciplining or eliminating a
 10 competitor”.

11 The courts and the Competition Tribunal have observed that in general the anti-
 12 competitive acts which can be subject to administrative orders and penalties under the
 13 *Competition Act* are acts whose purpose is an intended negative effect on a competitor
 14 that is predatory, exclusionary or disciplinary.¹⁷ Thus the *Competition Act* regulation of
 15 “anti-competitive acts” adds an important element of intention or purpose that is not part
 16 of the test for inappropriate pricing or unfair competition under s.45.1 of the *CF Act*.
 17 While SCIC does not concede here that such an intention or purpose does not exist at
 18 BC Ferries, our point is that it is unhelpful and misleading for BC Ferries to point to the
 19 prohibitions against predatory pricing in the *Competition Act* and argue that if BC Ferries
 20 is not violating that statute, then the Ferries Commissioner should not regulate “unfair
 21 competition” by BC Ferries in contravention of the *CF Act*.

22 The *CF Act* has a very different purpose than the *Competition Act*. The *Competition*
 23 *Act’s* prohibitions against abuse of dominant position were enacted in 1986 to replace
 24 the previous criminal offence of being a party to the formation of a monopoly. They have
 25 the potential for very large administrative penalties (up to \$10 million for the first order
 26 and \$15 million for subsequent orders) and the intention or purpose of the impugned
 27 business is relevant to the commission of the act. In contrast, the *CF Act* is designed to
 28 regulate the appropriate pricing of a provincial government-owned corporation providing
 29 both monopoly and competitive services. Under the *CF Act* the intention of the ferry
 30 operator is irrelevant.

31 The recent amendments to the *CF Act* would be redundant if the behaviour the
 32 amendments are designed to control were already prohibited by the *Competition Act*. It
 33 must be assumed the Legislature did not intend to be redundant but had a meaningful
 34 purpose in introducing s.45.1 of the *CF Act*. This can easily be seen to be the case.
 35 There are no criminal or quasi-criminal sanctions pursuant to the *CF Act*. It only requires
 36 a finding that there is pricing of the service below the “direct costs and an appropriate

¹⁶ BC Ferries’ Submission p. 6, 33

¹⁷ See for example, *Canada (Commissioner of Competition) v. Canada Pipe Co.* 2006 FCA 233, Federal Court of Appeal at para 66: “Two aspects of this definition should be noted. First, an anti-competitive act is identified by reference to its purpose. Second, the requisite purpose is an intended predatory, exclusionary or disciplinary negative effect on a competitor....”

1 proportion of the indirect costs” or an unfair competitive advantage. These are less
 2 stringent tests than those found in the *Competition Act*, particularly in that there is no
 3 requirement to show intent to gain or exercise market power.

4 **3.6 Other Examples of Similar Concerns with Monopoly Suppliers**

5 Other government-owned corporations have run into similar issues when they started to
 6 engage in businesses outside their monopoly mandate in competition with the private
 7 sector. In many cases the government has moved, as it has here, to limit the abuse of
 8 their monopoly power.

9 **The Insurance Corporation of British Columbia (“ICBC”)**

10 In the case of ICBC, problems emerged when private insurers alleged that ICBC was
 11 using its dominant position in compulsory automobile insurance to obtain an unfair
 12 advantage in the supply of optional insurance. It was also alleged that ICBC withheld
 13 actuarial information from competitors. To deal with this situation, in 2003 ICBC came
 14 under the regulatory authority of the British Columbia Utilities Commission.

15 The Commission is explicitly directed by legislation to ensure that revenues from the
 16 compulsory insurance business are not used to subsidize the optional insurance
 17 business, and it is given the power to ensure that cross-subsidization does not take
 18 place. The relevant legislation is as follows:

19 *49 (1) The commission must ensure that the universal compulsory vehicle*
 20 *insurance business and the revenue of the corporation, other than*
 21 *revenue from the corporation’s optional vehicle insurance business, are*
 22 *not used to subsidize the corporation’s optional vehicle insurance*
 23 *business;*

24 *(2) For the purpose of subsection (1), the commission may issue any*
 25 *orders it considers necessary to ensure that the corporation’s optional*
 26 *vehicle insurance business and activities are segregated from the*
 27 *corporation’s other businesses and activities for accounting purposes and*
 28 *that, in addition, any other businesses and activities of the corporation*
 29 *that the commission considers appropriate are segregated from the*
 30 *remaining businesses and activities of the corporation for accounting*
 31 *purposes, including, without limitation, orders*

32 *(a) requiring reports from auditors,*

33 *(b) requiring reports from actuaries,*

34 *(c) specifying cost allocation practices and other accounting*
 35 *practices that the corporation is to follow.*

36 The ICBC situation is very similar to the BC Ferries situation. Both are provincial
 37 government-owned corporations, both have a substantial monopoly mandate, and if left

1 unregulated both could use that mandate to take advantage of what they see as
 2 opportunities in a competitive market. In the same manner that the competitors of ICBC
 3 required legislative and regulatory protection from unfair competition by a government-
 4 owned corporation, SCIC requires action by the Ferries Commissioner under s.45.1 of
 5 the *CF Act* to provide it and others with similar regulatory protection.

6 **Canada Post Corporation**

7 Similar concerns were expressed to the Federal government about the activities of
 8 Canada Post Corporation after it acquired 75% of Purolator in 1993. A review of
 9 Canada Post's activities was conducted in 1996 for the responsible Federal minister.
 10 The review investigated allegations that Canada Post used revenues from its letter mail
 11 monopoly to cross-subsidize its commercial competitive businesses and concluded:

12 *"In its competitive activities with regard to unaddressed admail, courier*
 13 *services, and mailing centres, Canada Post Corporation is an unfair*
 14 *competitor in ways detrimental to private sector companies. Further, the*
 15 *corporation's misallocation of costs constitutes a form of cross-*
 16 *subsidization, whether intentional or otherwise. And its ability to leverage*
 17 *a network built up with public funds on the strength of a government-*
 18 *granted monopoly gives it a pricing advantage over competitors that is*
 19 *seriously unfair."*¹⁸

20 Clearly BC Ferries, like Canada Post, possesses "the ability to leverage a network built
 21 up with public funds on the strength of a government-granted monopoly", which gives it
 22 "a pricing advantage over its competitors that is seriously unfair".

23 **4. THE MARINE FERRY TRAILER BUSINESS IN BRITISH COLUMBIA**

24 **4.1 The Trailer Market**

25 In order to understand the effect which BC Ferries' conduct is having on the commercial
 26 trailer business between Vancouver and Vancouver Island, one needs a basic
 27 understanding of that market.

28 **Live and Drop Service**

29 Until March 2009, the commercial trucking market to and from Vancouver Island was
 30 served by two ferry systems, "live" and "drop" service. Although there are similarities,
 31 including the fact that both drop-trailer and live service traffic consist of primarily, but not
 32 exclusively mid-week traffic, each system appeals to its own market with significant price
 33 sensitive crossover. For these price sensitive customers the two markets are seen as
 34 substitute services.

¹⁸ *The Future of Canada Post Corporation : Report of the Canada Post Mandate Review*, Finding #2 at p. 122.

1 The highest “profile” or best known ferry market is the “live” system. In the live system,
2 both the tractor and the driver accompany the trailer during transit. This market is served
3 by BC Ferries. It appeals to customers who require same-day delivery or to owner-
4 operators who own their equipment and wish to stay with the load as it is delivered.
5 Frequently, owner-operators do not have access to tractors and labour either on the
6 Island or on the Mainland which is required in the drop-trailer model. The live ferry
7 market, served by BC Ferries alone, with a few minor permitted exceptions, is made up
8 of about one-half of the commercial trucking industry to and from Vancouver Island or
9 about 150,000 units per year.

10 The remaining one-half is served by the “drop” trailer ferry system. In the drop-trailer
11 market, commercial truckers drop their trailers at the ferry terminal throughout the day.
12 Unlike the live system, the tractor and driver do not accompany the load during marine
13 transit; instead tractors and drivers are free to continue working elsewhere. The private
14 sector ferry operators use yard tractors with hydraulic 5th wheels to lift the trailers just
15 enough to pick them up from the support of their landing legs, then back the trailers on to
16 the vessels and park them on the decks by lowering them onto the vessel’s deck where
17 they remain supported on a combination of the trailers’ landing legs, support jacks, cross
18 braces, and dollies when necessary. BC Ferries’ drop-trailer service is similar except
19 that the trailers remain on the tractor units for the crossing. The drop-trailer market
20 appeals to customers that require overnight delivery and who are not willing to pay the
21 costs of their tractor and driver to transit Georgia Straight. Until March 2009, this market
22 was served by SCIC and VIB, and not by BC Ferries.

23 **Market observations**

24 In its comments on the trailer market, BC Ferries made a number of observations that
25 SCIC believes are wrong and misleading including those below.

26 • **Private Ferry Operator Service Quality**

27 (i) At page 15 table 1 of its submission, BC Ferries suggests that existing commercial
28 drop-trailer service is low frequency and that service for drop-trailers was not
29 available at convenient times of the day.

30 Neither of these statements is valid. Prior to BC Ferries’ entry into the market, SCIC
31 completed 11 trips per day from 0830- 0330 the next day from its Tilbury Terminal for
32 arrival on Vancouver Island between 16:00 the same day and 11:00 the next day. This
33 depth of service more than adequately covers customer demand for drop-trailer service
34 to and from the Island. None of the customers who have migrated to BC Ferries have
35 advised SCIC that they did so because of SCIC scheduling issues. To the best of
36 SCIC’s knowledge all shifts were due to BC Ferries offering low discounted prices which
37 SCIC could not match.

1 (ii) In its submission, BC Ferries states *“By 2004, commercial customers were seeking*
 2 *to extract more efficiency from their trailer assets. The terminals of SCIC were*
 3 *nearing capacity which was causing delays and inefficiency in the supply chain.”*¹⁹

4 This statement is incorrect. SCIC has always maintained some excess capacity to allow
 5 growth. SCIC has significant expansion lands, immediately adjacent to its Tilbury
 6 terminal as well as the necessary ramp infrastructure to expand if and when demand
 7 warranted such expansion. It has approximately 50 acres at Duke Point ready to
 8 expand when demand warrants such investment. SCIC has also tank tested and
 9 designed a new vessel, however, these expansion plans are on hold until SCIC is
 10 confident that competition from BCFS will come only on a level playing field.

11 • Demand Creation

12 When commenting on market demand in its submission, BC Ferries stated:

13 *“Prior to BCF entering the drop trailer market, there was unmet demand*
 14 *for service. The BCF drop trailer service responds to that gap and*
 15 *introduces healthy competition in the market for drop trailer service.”*²⁰

16 In a similar vein, in a BC Ferries’ memo issued on March 9^t, 2009 announcing the
 17 expansion and the establishment of its Commercial Services Division, BC Ferries
 18 wrongly claims that this *“initiative will create productive growth and with it, increased*
 19 *employment opportunities.”*

20 There is not now, and in the time period being considered, has not been "excess"
 21 demand. The economics of Vancouver Island trailer traffic are such that price reductions
 22 by one ferry service provider do nothing to increase the total number of trucks that move
 23 between the Mainland and the Island. Price reductions simply shift the portion of the
 24 existing load between service providers. Therefore, all growth and employment
 25 opportunities that BC Ferries realizes will come at the expense of private industry.

26 BC Ferries has set pricing that is unsustainably low for private industry or itself in the
 27 long run. All of the new drop-trailer traffic that BC Ferries has attracted since entering
 28 the drop-trailer service has come from private ferry services and possibly from their own
 29 “live” customer base. SCIC has canceled three regular sailings. There has been no
 30 upward shift in the industry demand function. BC Ferries has increased its traffic only by
 31 undercutting prices.

32 SCIC

33 SCIC has been moving trailers between the Mainland and the Island for well over 60
 34 years. It currently employs over 150 people and last year paid taxes to all levels of
 35 government. SCIC has terminals that cover large tracts of land because the SCIC
 36 model is to supply ample storage area and “dwell” time. SCIC’s Tilbury site occupies

¹⁹ BC Ferries’ Submission, p. 11, l. 43-45

²⁰ BC Ferries submission, p. 28, l.18-20

1 approximately 18 acres, Swartz Bay occupies approximately 5 acres, and Nanaimo
2 occupies approximately 14 acres.

3 Prior to the entry of BC Ferries into the drop-trailer business, SCIC ran 6 vessels and a
4 total of 11 daily mid-week return trips and nine weekend return trips to Vancouver Island
5 over two routes – Tilbury, Delta to downtown Nanaimo and Tilbury, Delta to Swartz Bay
6 with a total capacity just around 225,000 units per year. Importantly, approximately 15 -
7 20% of SCIC's business is dangerous goods including propane, gasoline, chemicals
8 (including caustic soda, chlorine, and oxygen), dynamite, and Department of National
9 Defence shipments (including munitions and explosives). This traffic generally cannot
10 be carried on passenger-certified vessels.

11 Today, SCIC operates a fleet of 5 vessels for an average total of 8 daily mid week return
12 trips and seven weekend return trips. Each sailing takes anywhere from 2.5 to 3.75
13 hours to complete depending on the ship employed. SCIC operates its schedule at a
14 68% utilization rate which translates to approximately 135,000 trailers shipped while
15 offering a total capacity of just under 200,000 trailer trips a year. This 14% reduction in
16 volume hurts the bottom line. The drop-trailer service supplied by BC Ferries is also
17 putting downward pressure on rates, which further exasperates SCIC's profitability and
18 its ability to re-capitalize appropriately. If BC Ferries is allowed to continue to offer and
19 expand its drop-trailer service with unfair pricing, SCIC's service to Vancouver Island will
20 inevitably drop further.

21 **VIB**

22 VIB operates a fleet of Articulating Tugs and Barges ("ATB"), which are designed for the
23 ocean carriage of roll-on and roll-off ("RORO") traffic, including semi-trailers,
24 automobiles, off road industrial equipment and other self-propelled vehicles. ATB
25 vessels transit further up the Fraser River than any other daily shipping service linking
26 Vancouver Island with the Lower Mainland. SCIC estimates that VIB has an annual
27 volume of between 40,000 – 80,000 trailers.

28 BC Ferries has suggested that "...they [VIBS] are only limited to the Nanaimo market"²¹.
29 This is not correct. Given the low cost of trucking and the fact that much of the
30 commercial and industrial locations in the Greater Victoria area are moving out towards
31 the Langford area, the trucking differential between Duke Point in Nanaimo and Langford
32 compared to Swartz Bay and Langford is minor. VIB, with its trucking partner, is
33 certainly very competitive in serving the Victoria area as they run considerable freight
34 from Duke Point to the South Island.

35 **BC Ferries**

36 BC Ferries is a provincial government-owned corporation that has operated largely as an
37 unregulated monopoly in its drop-trailer function and only subject to review of rate caps

²¹ BC Ferries' Submission, p. 12 I. 40

1 in its live trailer service. SCIC believes that BC Ferries has close to 100%²² of the “live”
2 commercial traffic, which amounts to somewhere around 150,000 units/year, and has
3 secured well over another 10,000 units/year in drop-trailer business in the last year-and-
4 a-half.

5 **4.2 The History of Commercial Trailer Service to Vancouver Island**

6 Section 2.1 of the BC Ferries’ submission, The History of Services to Vancouver Island,
7 omits very important parts of that history, parts that must be acknowledged if one is
8 going to learn from the past.

9 In the early 1960s, when government ferry operations were undergoing rapid growth,
10 private investment in facilities was discouraged by the government’s presence. By the
11 summer of 1966, at the peak of tourist season, demand began to exceed ferry capacity,
12 and by 1967, the situation was sufficiently critical that the Province severely restricted
13 the drop-trailer service on government ferries to make space available for more cars. By
14 May 1973, drop-trailers were totally banned on the major routes between the Mainland
15 and Vancouver Island. At the time, the C.P.R.’s Coastal Marine Operations (now SCIC)
16 was seen as an important supplement to government services. C.P.R. began to take the
17 drop-trailers that government ferries could no longer accommodate, and the direction of
18 truck traffic to C.P.R. was encouraged by government authorities. Such encouragement
19 has been SCIC’s operating assumption since that time.

20 If BC Ferries is now allowed to force other service providers out of the market, by
21 unfairly and inappropriately under pricing them, and passenger demand grows again, the
22 result will not be as benign as it was in the late 1960s and early 1970s. This is because
23 there is a crucial difference between then and now. In 1967, C.P.R. was a significant
24 participant in the British Columbia rail freight market and had some ancillary capacity to
25 handle drop-trailer traffic as well, and thus, was able to rescue the Province from its
26 predicament. Rail service to Vancouver Island has since dwindled dramatically and
27 SCIC has retooled and recapitalized its infrastructure to support drop-trailers as its core
28 business. If SCIC and VIB are forced to downsize or are forced out of business, when
29 BC Ferries can no longer carry all commercial traffic (as inevitably will be the case) there
30 will not be sufficient capacity to take this traffic as there was in the early 1970’s.

31 BC Ferries has also omitted to describe the critical role that private ferry operators have
32 played in getting commercial trailers and vital goods to and from Vancouver Island when
33 BC Ferries was unable to do so due to weather or strikes. For example, during the last
34 BC Ferries’ strike, SCIC transported a record number of trailers to Vancouver Island
35 ensuring critical supplies were available to the various Island communities that depend
36 on them.

²² SCIC has a very limited amount of special purpose “live” traffic.

1 4.3 BC Ferries' Monopoly

2 BC Ferries has an effective monopoly on passenger vehicle and live commercial traffic
3 to Vancouver Island. This long standing monopoly is secured by the CFS Contract, the
4 key assets it was provided by its predecessor and by the natural physical and financial
5 barriers to entry to this market by others.

6 The CFS Contract is the only contract for the provision of ferry services into which the
7 government has entered. It is not available to private commercial ferry operators. In
8 addition to its unique relationship with the government, BC Ferries enjoys control of its
9 terminal sites provided to it by its government-owned predecessor. The scarcity and cost
10 of potential new terminal sites, together with the high cost of acquiring vessels, creates
11 significant barriers to the entry of other ferry operators. As a result, BC Ferries has an
12 effective monopoly on passenger ferry service, and has for many years provided all of
13 the "live" ferry service for commercial trucks between the Lower Mainland and
14 Vancouver Island.

15 The Ferries Commissioner noted both this near-monopoly position and the barriers to
16 entry in his 2009/10 Annual Report where he stated:

17 *"Although BC Ferries has weighty service obligations, it also enjoys*
18 ***privileges as a near-monopoly**. It has exclusive use of terminals, which*
19 *are facilities of major strategic and competitive importance to an operator.*
20 *On 22 of its routes (those other than the three major routes), BC Ferries*
21 *is the sole recipient of taxpayer support. The company is also income-tax*
22 *exempt. It has the advantages of a large, incumbent operator with*
23 *flexibility in vessel deployment, able to take advantage of economies of*
24 *scale and network coverage. These give the company a low risk profile*
25 *from the investors' perspective and result in a comparatively low cost of*
26 *borrowing.*

27 *These advantages are intended by the legal and contractual framework,*
28 *but they largely **protect BC Ferries from meaningful competition**.*
29 *There are few existing competitors against whom to benchmark BC*
30 *Ferries. The market and regulatory structure does not foster the*
31 *emergence of such competitors in future".²³ (emphasis in the original)*

32 4.4 The Rapid Expansion in BC Ferries' Drop-Trailer Service

33 BC Ferries has purchased or leased 44 new tractor units designed for drop-trailer use at
34 a cost that SCIC understands to be in the range of \$4.5 million.²⁴ Since March 2009, BC
35 Ferries has taken steps to expand its commercial truck transportation services, both live
36 and drop-trailer service and has aggressively marketed and priced both those services.

²³ Page 11- 12

²⁴ Described in a November 10-16, 2009 Business In Vancouver article as "...the largest single purchase of terminal tractors in Canada from Ontario-based TICO..."

1 As recently as October 2010, and in spite of the introduction of s.45.1 of the *CF Act*, and
2 the commencement of your investigation, BC Ferries has confirmed and expanded on its
3 aggressive position publicly stating:

4 *BC Ferries will continue to explore opportunities to expand the drop trailer*
5 *service on the major routes to utilize spare vessel capacity, increasing*
6 *competition in a marketplace otherwise dominated by a large, unregulated*
7 *private sector company. Expansion of the service into transportation of*
8 *dangerous goods on dedicated (overnight) sailings will be one such opportunity*
9 *considered.*²⁵

10 If BC Ferries reaches its stated goal of 80 trailers per day from Monday to Friday one
11 way (160 return), plus a total of 50 on weekends, BC Ferries will have approximately
12 45,000 units annually. SCIC estimates that 75% of those trailers will come from SCIC
13 service while the remaining 25% will come from VIB. This represents approximately
14 33% of SCIC's business and SCIC estimates 20% of VIB's business. What is more
15 troubling is that SCIC estimates that the 44 new tractors acquired by BC Ferries will
16 provide it with the capacity to deliver an extra 250 to 280 trailers per day on its
17 Vancouver Island routes, representing almost 50% of SCIC's current trailer business.

18 Both the number of terminal tractors ordered (or leased) and the size of the holding
19 compound leased at Duke Point and set aside at Tsawwassen and Swartz Bay suggests
20 that BC Ferries' drop-trailer ambitions greatly exceed the amount disclosed in the BC
21 Ferries' submission or in public forums such as before the Delta Council. The threat that
22 BC Ferries' new offering poses has been confirmed by the loss of long term SCIC
23 customers to BC Ferries' new drop-trailer service in response to deeply discounted rates
24 and other incentives. Coupled with the resulting financial strain of downward rate
25 pressure and the immediate need for capital investment in the private enterprises, it is
26 easy to see how the viability of those operating in the private sector will come into
27 question. The seriousness, and unfairness, of a major threat to one's business by a
28 competitor who feels that it can offer ferry service at a price that does not include the
29 cost of terminals, ferries, crews, fuel, administration and other overheads cannot be
30 overestimated.

31 **5. BC FERRIES' COST ALLOCATION AND PRICING JUSTIFICATION**

32 **5.1 The Facts About Excess Capacity**

33 BC Ferries alleges that drop-trailer traffic is carried in excess capacity. SCIC does not
34 accept this and knows that it is not uncommon for drop-trailer traffic to be carried when
35 full fare core traffic is left behind, at the expense and inconvenience of that traffic. This
36 was confirmed in the Commission's Responses to SCIC's Disclosure Request²⁶ "SCIC
37 IR Response", SCIC question 2.1 which stated:

²⁵ Opportunities for Enhanced Efficiency in Performance Term Three, British Columbia Ferry Services Inc. October 2010, Page 12

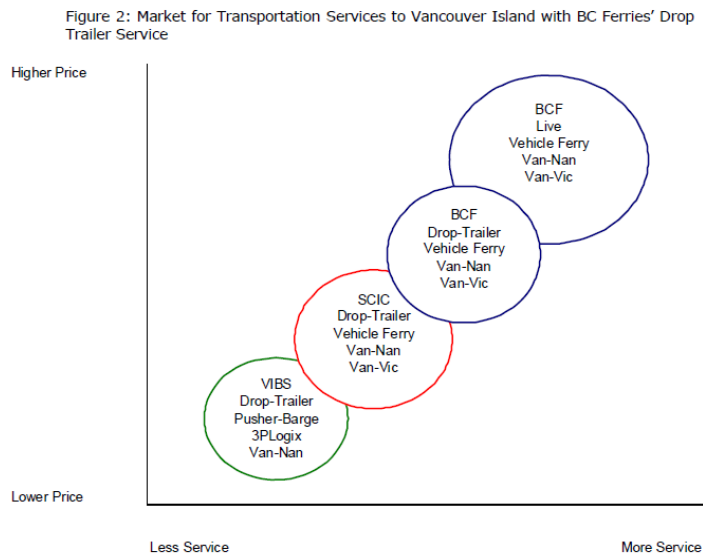
²⁶ Attached to SCIC's cover letter dated October 15, 2010

1 “BCFS has provided 19,906 sailings since March 16, 2009 through to
 2 August 31, 2010 on routes 1 and 30. Of these sailings, 6446 carried drop
 3 trailers. There were 1632 sailings when drop trailers were carries [sic.] on
 4 a sailing when one or more passenger vehicles were left in the terminal
 5 after the vessel finished loading.”

6 This response confirms that drop-trailers, which are loaded first before all other traffic,
 7 are carried on about one third of all sailings. Furthermore, on about 25% of all drop-
 8 trailer sailings, passenger vehicles, which were paying their own way and contributing to
 9 BC Ferries’ profit, were being left behind while drop-trailer traffic (that the passenger
 10 traffic was subsidizing) was being carried. Undoubtedly, this percent will increase if
 11 BC Ferries expands its drop-trailer service, and as its core traffic grows. BC Ferries
 12 suggests that there are a variety of factors besides insufficient room that could lead to
 13 cars being left behind, including people who failed to return to their cars in time for
 14 loading. SCIC submits this is not a credible explanation for such a significant number of
 15 sailings and that BC Ferries is grasping at straws. The most likely explanation for the
 16 majority of these occasions when drop-trailers "bumped" the full fare core traffic would
 17 be the service guarantees that BC Ferries provides its drop-trailer customers and the
 18 fact that it loads these trailers first, before it knows with finality, how many core
 19 passengers will require service on that sailing. But regardless of the explanation, the
 20 evidence clearly is that a significant number of drop-trailers are not traveling during times
 21 of "excess" capacity.

22 5.2 BC Ferries’ Theoretical Explanation is Badly Flawed

23 BC Ferries has portrayed drop-trailer service as providing less service than live. This is
 24 illustrated in the self-serving and very inaccurate graphic contained at page 16 - figure 2
 25 of BC Ferries’ submission, where the schematic reproduced below originates.



1 While this graphic is interesting, it is not an accurate depiction of the relationship
 2 between price and service in the trailer market to Vancouver Island. BC Ferries' Figure
 3 2 shows "live" ferry traffic at the top in terms of service provided and price. This is not
 4 supported by the facts which show a very different picture.

5 The BC Ferries' published tariff shows drop-trailer service as more expensive than live
 6 ferry rates.²⁷ At the same time, SCIC customers report that BC Ferries has offered
 7 substantial discounts or lower rates to drop-trailer service, and that accordingly BC
 8 Ferries' drop-trailer service is priced significantly lower than SCIC's drop-trailer vehicle
 9 ferry from Vancouver to Nanaimo. Thus, for the illustration to be accurate in respect of
 10 price, the BC Ferries' drop-trailer balloon should be low on the chart, but it is not.

11 Equally importantly, is the underestimation of the level of service provided by BC Ferries'
 12 drop-trailer service. At page 21 of its submissions, BC Ferries describes the attributes of
 13 its drop-trailer service compared to that of VIB and SCIC, stating in part:

14 *"Third, the crossing time between the Mainland and the Island is between*
 15 *90 and 120 minutes depending on the route. This enables BCF to*
 16 *process a customers' trailer and have it at the designated terminal ready*
 17 *for pick up in just over 2½ hours. This is a significant improvement*
 18 *versus the traditional drop-trailer providers where it can take 5 – 12*
 19 *hours."*

20 SCIC believes this is a significant exaggeration of the benefits of BC Ferries' drop-trailer
 21 service and not consistent with BC Ferries' description of "By" and "At" service.²⁸
 22 However, if one accepts it at its face value, the drop-trailer service that BC Ferries
 23 provides is better than live service. One cannot get on and off the ferry any faster with
 24 live service. More importantly, with live ferry service, the trucking company provides the
 25 driver, the tractor and the trailer, paying full fare²⁹ for each and BC Ferries does nothing
 26 but provide the ferry service. Clearly BC Ferries' drop-trailer service provides more
 27 service than its live service.

28 In fact, if properly costed, BC Ferries' model for its "drop-trailer" service is a high cost
 29 model with higher cost than its "live" service model. In addition to a proportional cost of
 30 the terminals, the ferry, fuel, and crews which should be allocated to drop-trailer traffic,
 31 but are not, the out-of-pocket costs of transporting a drop-trailer using the BC Ferries'
 32 drop-trailer model is much higher than live traffic. BC Ferries' entry into the drop-trailer
 33 market required BC Ferries to acquire tractors worth an estimated \$4.5 million. These
 34 tractors must stay hooked up to the trailers for the crossing.³⁰ This requires BC Ferries to

²⁷ BC Ferries' Submission p. 20

²⁸ BC Ferries' Submission, p. 19

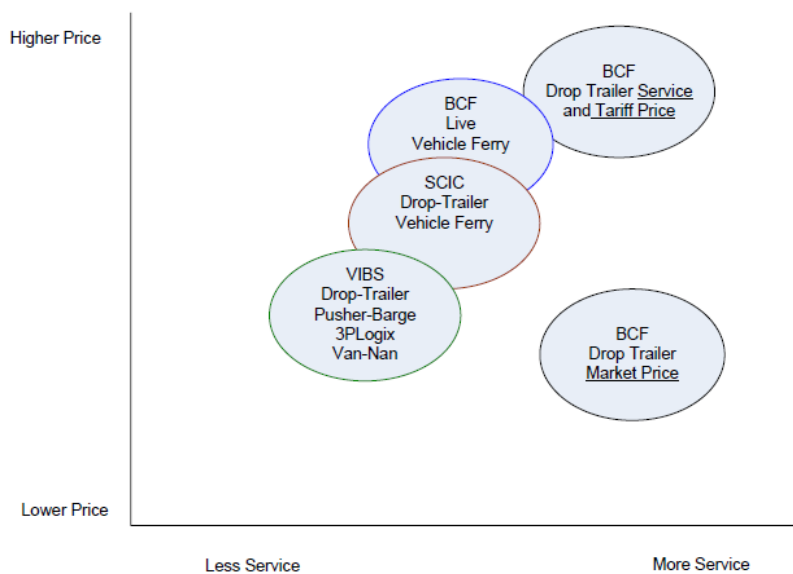
²⁹ Subject to the possibility of any customer specific discounts or rebates which are, if they exist,
 are outside the knowledge of SCIC

³⁰ This is stated by BC Ferries to assist with rapid loading and unloading, but SCIC believes is
 more likely due in large part to the fact that, unlike SCIC's vessels, the decks on BC Ferries'

1 have a much higher ratio of tractors to trailers than a private service provider would have
 2 and results in very inefficient utilization of a very expensive capital asset. In addition, BC
 3 Ferries needs many more drivers to move the same number of trailers than a private
 4 carrier requires. The tractor also occupies the equivalent space and revenue of
 5 approximately 1 car for which no one pays. In sum, the BC Ferries' drop-trailer service is
 6 a much higher cost model than that offered by private industry or its own live trailer
 7 service. Thus, the balloon for BC Ferries' drop-trailer service in the figure should be
 8 further to the right on the service continuum than live service, but it is not.

9 A more accurate depiction of the relationship between BC Ferries' drop-trailer service
 10 and the competitive services in the market would show BC Ferries' drop-trailer service
 11 high on the service scale (and price, if sold at tariff rates) and low on the market price
 12 scale as shown below.

Figure 2: Market for Transportation Services to Vancouver Island with BC Ferries' Drop Trailer Service



13

14 This altered graphic demonstrates the contradictions in BC Ferries position. In reality
 15 BC Ferries' drop-trailer service is a premium service, offering more service than "live"
 16 service, but at significantly discounted prices.

17 5.3 Published BC Ferries' Commercial Rates Don't Reflect Reality

18 SCIC does not have access to BC Ferries' pricing information. However, SCIC does
 19 know that BC Ferries is not charging many, if any, of its drop-trailer customers the rates
 20 set out on page 20, table 2 of BC Ferries' commercial fee schedule.

vessels are not strong enough to support the concentrated weight (called "point loading") of a loaded trailer on only the landing legs.

1 BC Ferries says that “BC Ferries will consider altering the fee schedule for a specific
2 drop-trailer customer based on a variety of circumstances”.³¹ It then lists factors that it
3 will generally consider including:

- 4 • What level of service is required – expedited service or a slower service?
- 5 • What is the scale of their volume commitment?
- 6 • How predictable is their volume?
- 7 • How flexible is their schedule?
- 8 • Is the business complementary to our core segments in terms of seasonality?
- 9 • What types of goods is the customer carrying?

10 Based on reports given to SCIC, competitor’s rates should also be on the list of factors
11 BC Ferries considers in offering discounts, rebates and other incentives to drop-trailer
12 customers.

13 It is now also admitted that BC Ferries negotiates “live” commercial rates.³²

14 **5.4 BC Ferries’ Excess Capacity is Not Without a Cost**

15 BC Ferries suggests that its ferries were acquired solely to serve the core service. This
16 is simply not correct, as is reflected in BC Ferries’ quarterly report (3Q, ending
17 December 31, 2008 Financial Report):

18 *To increase our capacity in the commercial sector, we have assigned one*
19 *new Super C Class vessel to each major route between the Lower*
20 *Mainland and Vancouver Island.*

21 Having stated that it increased its capacity in the commercial sector, by investing a major
22 new ships just months before the commencement of its drop-trailer service, BC Ferries’
23 suggestion that this traffic is being carried using “no cost” surplus capacity is simply not
24 credible.

25 In addition, SCIC observes that since the delivery of the 3 Super C Class vessels, there
26 has been a significant decline in overall passenger and commercial freight to Vancouver
27 Island, largely in response to difficult economic circumstances prevailing since late 2008.
28 SCIC believes that BC Ferries failed to anticipate this drop in demand when they
29 ordered these massive vessels and that it is now seeking to expand its commercial
30 traffic at the expense of existing competing carriers.

31 **5.5 Alleged Benefits**

32 BC Ferries alleges a number of benefits in supporting its actions in this matter. SCIC
33 submits that when carefully examined these benefits are illusory and short term at best.
34 The following are some examples:

³¹ BC Ferries’ Submission p. 20 , l. 36

³² SCIC IR Response 4.1

1 (a) “...BC Ferries is benefiting the truck transportation sector (which now has another
2 option for drop-trailer service) and all other ferry users (who benefit from the more
3 efficient use of BC Ferries existing infrastructure).”³³

4 The truck transportation sector may experience some price benefits in the short run due
5 to BC Ferries pricing well below its average costs. However, this will not likely be
6 considered a benefit to, or by, the trucking industry in the long run if the private ferry
7 operators are forced to exit the market and BC Ferries ends up with a monopoly on all
8 commercial trailer traffic to Vancouver Island. Contrary to BC Ferries’ suggestion, in that
9 case it will not have created more options but will have taken away options.
10 Furthermore, BC Ferries’ commercial rates will probably have to immediately escalate to
11 sustainable levels in order to allow BC Ferries to service the additional traffic it will have
12 taken over.

13 (b) “BC Ferries’ drop-trailer service is complementary to its existing business and
14 benefits the transport industry and other ferry users.”³⁴

15 BC Ferries’ drop-trailer is not complementary to its existing “live” trailer business – it is a
16 substitute service and therefore competes with its existing business in a similar manner
17 to how it competes with private drop-trailer service providers. The only circumstances
18 under which BC Ferries’ drop-trailer service discounts might be considered
19 complementary is if they are only offered to shippers using the private carriers and are
20 not offered to BC Ferries’ existing live trailer customers. If this is the case, and it may
21 well be, it is also blatant and unfair discrimination.

22 (c) “It is advantageous to all ferry users for BC Ferries to make efficient use of
23 underutilized non-peak capacity.”³⁵

24 This statement is true only in the short run if the manner in which BC Ferries makes
25 “efficient use of underutilized nonpeak capacity” does not create long term problems
26 itself, if the benefits are in fact shared by all ferry users, and if such use does not “bump”
27 core service customers off the vessel. SCIC submits that none of these conditions is
28 present here. Clearly, BC Ferries has not properly considered the short or long term
29 ramifications of its actions.

30 **5.6 BC Ferries’ Alleged Benefits are Not Worth the Damage**

31 BC Ferries suggests drop-trailer revenues provide benefits to its core market when the
32 prices are compared to the short run incremental cost of drop-trailer service.
33 Unfortunately, the details are confidential and SCIC has not been able to view the
34 relevant information or test those details.

35 Notwithstanding the lack of available information to SCIC, it would appear that the
36 approximate short term incremental or direct costs of BC Ferries’ drop-trailer service are

³³ BC Ferries’ Submission, p. 2, l. 38-41

³⁴ BC Ferries’ Submission, p. 8. l. 3-4

³⁵ BC Ferries’ Submission, p. 8. l. 10-11

1 likely to be in the \$1.50 - \$2.00 per foot range. This is well below BC Ferries' published
2 basic "live" tariff of \$5.25 and the published "drop-trailer" tariff rate of \$6.75 per foot. For
3 illustrative purposes, we have used an average drop-trailer price of \$3.00 per foot, being
4 a level between the "live" tariff and our estimate of the incremental or direct cost. At a
5 rate of \$3.00, the average trailer pays its incremental costs plus about \$50 - \$80 per
6 crossing.

7 SCIC estimates that at current volume levels BC Ferries has taken approximately 12,500
8 trailers annually, or about 125 round trips per week per 50 week year, from the
9 competitive market. This represents a net return of about \$625,000 - \$1,000,000 per
10 year to partially offset the cost of the terminals, ferries, crews and fuel. Clearly this is a
11 minimal contribution on the major routes which have tariff revenues in the range of \$350
12 million per year, and definitely not worth the risk to BC Ferries or the associated damage
13 to the private ferry industry in British Columbia.

14 The impact of BC Ferries' actions may not be limited to 12,500 trailers. BC Ferries was
15 quoted at a Delta Council meeting on September 22, 2009 as stating that it is planning to
16 maximize the business at 75 to 80 trailers one way per day. If this happens it is
17 equivalent to 880 trailers round trip per week, or assuming a 50 week year, 44,000 trips
18 per year. At this level, the destruction of the commercial ferry service to Vancouver
19 Island as we know it today is virtually assured. In this case the contribution of trailer
20 traffic to BC Ferries' cost of the terminals, ferries and fuel amounts to \$2 to \$4 million.
21 This is a small portion of BC Ferries' net route losses of around \$24 million on Route 30
22 portion and represents an even smaller portion of BC Ferries' total tariff revenue of \$360
23 million.

24 This extra revenue is not worth the risk to BC Ferries and commercial damage to the
25 private ferry industry in British Columbia. Nor is it sustainable, because once those
26 levels of traffic are reached the tipping point will have been passed and BC Ferries will
27 need to carry all commercial traffic. As discussed elsewhere, this will necessitate
28 increased capacity and increased rates for commercial and passenger vehicle traffic.

29 **6. S.45.1 REQUIREMENT THAT DROP-TRAILER PRICING MUST BEAR AN** 30 **APPROPRIATE PROPORTION OF INDIRECT COSTS**

31 **6.1 Overview**

32 The Ferries Commissioner is required by s.45.1 of the *CF Act* to determine if BC Ferries
33 is pricing its drop-trailer service below the direct costs and an appropriate proportion of
34 the indirect costs associated with providing that ferry transportation service. SCIC is not
35 privy to the details of the cost allocations made by BC Ferries and our requests for such
36 information have been denied. As such we can only speculate that the cost allocation
37 proffered by BC Ferries is consistent with their consultant's position that any recovery
38 above incremental cost will be sufficient to meet the test of the *CF Act*.

1 It is intuitively wrong to think that one group of ferry customers should not be allocated
 2 any of the costs of the ferries, terminals or operating cost of either. Mr. Linxwiler looks at
 3 BC Ferries' submissions and explains in more detail why BC Ferries' approach is wrong

4 **6.2 Proper Cost Allocations**

5 BC Ferries argues "*efficiency is the source of BC Ferries' competitive advantage*".³⁶
 6 This is not correct. BC Ferries' justification for competitive rates is based on allocations
 7 of costs, not efficiencies. Mr Linxwiler examines the approach taken by BC Ferries with
 8 respect its cost allocations, analyzes them and sets out what other regulatory authorities
 9 have done in reviewing the appropriateness of similar allocations.

10 His conclusions are clear and reflect a great deal of common sense. He found:

11 *"Based on my review of only the narrative description of the allocated cost of*
 12 *service study (which was the only information made available to me), I have*
 13 *concluded that the study is seriously flawed in a major respect – no portion of the*
 14 *costs of owning and operating BC Ferries' ferry vessels have been allocated to*
 15 *the costs of providing drop trailer service. As a result, the costs attributed to the*
 16 *service, and the resulting rates, do not reasonably or fairly reflect the actual costs*
 17 *of providing the service. Moreover, with the proposed pricing, BC Ferries' other*
 18 *customers will subsidize the costs of providing that service, which represents an*
 19 *unfair competitive advantage of BC Ferries over SCIC, which has no other*
 20 *customers from which it can obtain similar subsidies."*³⁷

21

22 *"It is quite remarkable that a transportation service – drop trailer service – is not*
 23 *assigned any of the costs of the vessels that actually perform the transporting.*
 24 *For the reasons that I will explain, it is also wrong and highly inappropriate."*³⁸

25

26 *"... Fairness requires that the benefits of diversity (which are the avoidance of*
 27 *some new capacity) should be shared among all customers that contribute to that*
 28 *diversity. Here, BC Ferries would unfairly allocate all of the benefits of time*
 29 *diversity to drop trailer service (by allocating no ferry capacity costs to that*
 30 *service) and none of the benefits to its other, "core" customers.*

31 *Next, BC Ferries' proffered cost allocation study improperly presumes that all of*
 32 *the costs of the ferry vessels (and, possibly, related facilities) are demand or*
 33 *capacity-related and that, therefore, all such costs arise solely from on-peak*

³⁶ BC Ferries' Submission section 3.1

³⁷ Linxwiler report, p. 10

³⁸ Linxwiler report, p. 11

1 demands and reservations. But today, this is a rare and largely discredited
2 notion in ratemaking, and for good reason.”³⁹

3 -----
4 “At least one authoritative government agency has promulgated a definitive rule
5 regarding the recovery of incremental costs for monopoly service. The Federal
6 Energy Regulatory Commission (“FERC”) is one of the most important and
7 influential regulatory agencies in the United States. ...

8 ... FERC is required by law to ensure that the electric and natural gas rates that
9 it regulates are “just and reasonable and not unduly discriminatory.”⁴⁰ With
10 respect to electric transmission service (which is a transportation service rather
11 than an energy generation or supply service), FERC in 1994 adopted its so-
12 called “Or Pricing” policy, whereby the charges to each new transmission
13 customer should be the higher of average cost or incremental cost.⁴¹ Under this
14 policy, if the incremental cost of serving a new customer is higher than the
15 average cost for all customers (after adjustment to include the new costs), then it
16 is permissible to charge the incremental cost to the customer. Otherwise (i.e., if
17 the incremental cost is less than the average), the new customer must pay the
18 same as all existing customers.”⁴²

19 -----
20 Mr. Linxwiler concludes, or summarizes his views with his recommendations on how
21 cost should be allocated stating:

22 “In my opinion, BC Ferries’ fees for drop trailer services, if they are to be fair and
23 nondiscriminatory and otherwise appropriate, should satisfy three criteria:

24 (i) First, for the reasons I have described above, BC Ferries’ fees for
25 drop trailer service should not be less than the long-run incremental costs
26 of providing the service, including a share of the costs of eventually
27 replacing the ferry vessels and associated terminal facilities. For this
28 purpose, a reasonable (and much higher than zero) share of fixed costs
29 should be allocated on the basis of total through-put for all types of
30 vehicles.

31 (ii) Second, also for reasons I explain above, in order to be non-
32 discriminatory and to provide a reasonable benefit to other ferry
33 customers, the normalized rate per foot of transported trailer (taking into
34 account length, width, and height, as well as weight) should not be less

³⁹ Linxwiler report, p. 13

⁴⁰ See U.S. Federal Power Act and Natural Gas Act.

⁴¹ FERC’s Order on Transmission Pricing Policy, issued December 1, 1994, in Docket No. RM93-19-000.

⁴² Linxwiler report, p. 16

1 *than the price charged for transporting other vehicles at the same time.*
 2 *That is, the normalized rate per foot (for vehicle-related ferry costs)*
 3 *should be the same for all customers traveling at the same time.*

4 *(iii) Third, in order to provide proper price signals, and also determine*
 5 *a minimum reasonable share of costs reasonably allocated to off-peak*
 6 *customers, the normalized rate or average cost per foot (for vehicle-*
 7 *related ferry costs) should not be less than the average cost per foot that*
 8 *would be obtained if the ferry vessels were to be fully utilized. I will*
 9 *explain the basis for this calculation below.”⁴³*

10 **6.3 Summary**

11 Cost allocations are central to any determination as to whether BC Ferries is pricing its
 12 drop-trailer service below the direct costs and an appropriate proportion of the indirect
 13 costs associated with providing that ferry transportation service. As such it is vital that
 14 they be transparent and reasonable. BC Ferries’ allocations are neither. It simply defies
 15 common sense that a major group of ferry customers would not be allocated any costs
 16 for ferries, terminals or their operation. Joe Linxwiler’s report sets out why BC Ferries’
 17 approach is wrong and describes the appropriate regulatory practices and principles to
 18 be applied to the BC Ferries Commissioner’s determinations in this matter.

19 There is simply no evidence to support BC Ferries approach and accordingly, the Ferries
 20 Commissioner should now proceed to review and determine the appropriate remedies
 21 pursuant to s.45.1(2).

22 **7. S.45.1 UNFAIR COMPETITIVE ADVANTAGE**

23 **7.1 Overview**

24 BC Ferries has a major unfair competitive advantage as a result of its effective monopoly
 25 on passenger service, the assets provided to it by its government-owned predecessor
 26 (particularly terminals and ferries), and the requirements for more sailings than would
 27 normally be economic due to obligations pursuant to the CFS Contract. Because BC
 28 Ferries knows that all of its costs will be paid by the core traffic, it feels it can price the
 29 drop-trailer service at unfairly low prices.

30 BC Ferries acknowledged as much when it stated at page 33 of its submission:

31 *“ At an individual price level, the price cap actually creates an incentive*
 32 *for BCF to price competitive services as low as necessary to generate*
 33 *more business.”*

34 It should also be pointed out that the converse of this is also true; at an individual price
 35 level on the other end of the spectrum the price cap actually creates the flexibility to
 36 price monopoly services higher to generate more revenue. The price cap mechanism

⁴³ Linxwiler report, p. 24,25

1 affords BC Ferries the luxury to price its most inelastic markets (consumer) high
 2 provided its elastic market (commercial) is proportionately lower, while still maintaining
 3 the average rate for all traffic at or just below the price cap.

4 BC Ferries also possesses all three of the unfair competitive advantages listed in
 5 s.45.1(1). First, it uses vessels and terminals that were formerly owned by the
 6 government, or by BC Ferries when it was itself a government body, and which BC
 7 Ferries obtained on advantageous terms when it was restructured in 2003. These
 8 ferries and facilities were all built at a time when costs were lower and government
 9 subsidies were higher. The pre-paid 80-year terminal leases are of particular interest in
 10 this regard. Second, unlike SCIC and VIB, BC Ferries is exempt from income tax which
 11 it argues, is offset by an increased return requirement. Even if this is true, which is not
 12 clear, it would result in a benefit in terms of greatly increased cash flow, an important
 13 benefit to any company. Third, BC Ferries is subsidized by, among other things, by
 14 direct cash payments from British Columbia under the CFS Contract and by the pass-
 15 through of the \$27 million/year plus of ferry subsidy from the federal government.

16 These advantages together give BC Ferries an unfair competitive advantage in the
 17 provision of its drop-trailer service. In essence, what has occurred here is that BC
 18 Ferries has been supplied with large amounts of cash and infrastructure that permitted it
 19 to overbuild its capacity, and a mandate that required it to over build its capacity (by
 20 commercial market standards). The public purpose for which this was done was to
 21 ensure the existence of adequate, timely and affordable passenger service to and from
 22 Vancouver Island, a public purpose understood and supported by SCIC. The effect,
 23 however, was to provide BC Ferries with enough capacity to give an incentive to price its
 24 drop-trailer service at rates below that of the competition, who must price their services
 25 at a level sufficient to cover all of their costs, fixed and variable, short and long-term.

26 **7.2 Coastal Ferry Services Contract**

27 The Comptroller General's 2009 report stated as follows:

28 *"... it could be perceived that BCFS has undue advantages such as*
 29 *having exclusive use of the ferry terminals, having a monopoly on ferry*
 30 *services and receiving funds from the provincial and federal*
 31 *governments."*⁴⁴

32 The Comptroller General has accurately described what is happening, and it is not just a
 33 possible perception.

34 Notwithstanding the Comptroller General's observations, BC Ferries suggests
 35 throughout its submission that *"efficiency is the source of the BCF competitive*
 36 *advantage"*.⁴⁵ As we have previously submitted, the excess capacity was not created by
 37 efficiency, the excess capacity is created by the CFS Contract between British Columbia

⁴⁴ October 2009 Report on Review of Transportation Governance Models, p. 19

⁴⁵ BC Ferries' Submission Section 3.1.

1 Ferry Corporation and the Province of British Columbia. Specifically, the contract has
 2 three effects: First, it assures BC Ferries that it will be paid by the core customers, all
 3 terminal, ferry, fuel and operation costs. Second, it bundles routes 1 and 30 together
 4 assuring that there is a sufficient body of core traffic on route 1 to subsidize the lesser
 5 used route 30 where substantially all of the excess capacity is present. Third, it creates
 6 excess capacity on routes 1 and 30, by requiring more sailings than would normally be
 7 economic, particularly on route 30.

8 This becomes very clear when one examines the traffic and earnings forecasts for
 9 routes 1 and 30.

10 **BC Ferries Route 30 Losses**

11

Route	Passenger Vehicles ⁴⁶	PV as % of Route Traffic	Route % of PV Traffic	Commercial Vehicles ⁴⁷	CV as % of Route Traffic	Route % of CV Traffic	Route % of Total Traffic	Net Earnings (000's)
1	1,796,790	94%	76%	116,906	6%	59%	75%	24,269 ⁴⁸
30	559,849	87%	24%	80,753	13%	41%	25%	(24,454 ⁴⁹)
Total	2,356,639		100%	197,659		100%	100%	(185)

12

13 The table shows the following:

- 14 • The bulk of excess capacity is almost certainly on the very unprofitable
 15 "commercial" Route 30.
- 16 • The Route 30 losses would clearly be unsustainable, even in the short run, on
 17 their own.⁵⁰
- 18 • BC Ferries continues to take major losses on Route 30, due to the contractual
 19 requirement for a minimum number of sailings.
- 20 • BC Ferries can do this because the CFS Contract allows it to cross-subsidize any
 21 shortfall on Route 30 from core monopoly revenues earned on Route 1.

22 This is not a normal commercial situation. SCIC understands that one purpose of the
 23 CFS Contract is to ensure frequent and predictable ferry sailings to Vancouver Island.
 24 SCIC supports that goal in terms of offering the travelling public more flexibility and

⁴⁶ *BCFS Performance Term Three Submission to BC Ferries Commissioner; September 30, 2010, Appendix D, at 141, Fiscal 2010/11 Forecast [Performance].*

⁴⁷ *Ibid.*

⁴⁸ *Ibid* Appendix B, at 109.

⁴⁹ *Ibid* at 111.

⁵⁰ A review of recent BC Ferries' financial statements shows the Fiscal 2010/2011 situation is not unusual.

1 options, but does not believe unfair competition with private ferry operators, should be,
2 or has to be, an unintended consequence of the CFS Contract.

3 In sum, the capacity to take drop-trailer traffic from private sector ferries does not come
4 from efficiency; it comes directly from the government and is similar to an asset, tax or
5 subsidy advantage, the very advantages listed in s.45.1 of the *CF Act*.

6 **7.3 Subsidies**

7 BC Ferries also claims in its submission:

8
9 *“BC Ferries receives no service fees or subsidies from the Province for serving*
10 *Routes #1 and #30, on which BC Ferries offers drop-trailer service.”⁵¹*

11 In SCIC’s submission, BC Ferries must be using an extremely narrow definition of
12 subsidies to make such a statement. The Ferries Commissioner should use a broad and
13 normal meaning for the term “subsidies”. The Oxford Dictionary defines subsidy as; a
14 *“sum of money granted by the state or a public body to help an industry or business*
15 *keep the price of a commodity or service.”⁵²* Although cash payments and tax reductions
16 are common forms of subsidy, benefits can take other forms as well.⁵³

17 (a) Direct Cash Payments by Governments

18 SCIC understands that BC Ferries receives direct cash payments from the Province,
19 totalling approximately 17 - 20% its total revenues. While the service fees paid under
20 the CFS Contract are not intended to subsidize the “major routes” to Vancouver Island
21 (Routes 1, 2 and 30), they support the larger overhead and other fixed costs of the entire
22 business thereby allowing for economies of scale that would not otherwise be available
23 to the major routes on a “stand alone” basis.

24 In addition to the cross subsidization of the major routes which occurs as a result of the
25 payment of service fees noted above, on occasion direct subsidies have also been
26 granted by the Province to support BC Ferries’ commercial service. Some examples
27 follow:

28 **Fall 2008 Government Support**

29 BC Ferries received a \$20.8 million dollar direct subsidy in 2008⁵⁴ from the provincial
30 government in exchange for reinstating cancelled sailings and reducing all fares by 33%
31 specifically on the major routes. The 33% reduction in fares was arranged pursuant to a
32 December 19, 2008 fare reduction agreement between BC Ferries and the Province,
33 and was implemented as a means of stimulating traffic during a period of poor economic
34 conditions. This is clearly a subsidy and was also cleverly directed to both its monopoly

⁵¹ BC Ferries’ Submission p.7, l 4-6

⁵² www.oxforddictionaries.com

⁵³ www.investopedia.com

⁵⁴ October 23rd, 2008 media release and fare advisory posted on the BC Ferries’ website

1 and competitive markets. SCIC was forwarded a November 6th 2008 BC Ferries' memo
 2 issued specifically to commercial customers – including several of SCIC's customers –
 3 advising of this rate reduction. The memo further encouraged commercial reservations
 4 as they anticipated a *“peak in demand especially for peak periods”*. The availability to
 5 BC Ferries of such grants during times of economic hardship is a subsidy that is clearly
 6 not available to private operators or their investors.

7 **Interest Relief**

8 It appears from BC Ferries financial statements⁵⁵ that it receives millions of dollars in
 9 government interest rate support for major refurbishment of its vessels. While full
 10 particulars are not known, SCIC understands that such support is not available to private
 11 carriers.

12 **Deferred Fuel Costs**

13 BC Ferries has a significant advantage over private carriers in its ability to defer
 14 differences between actual fuel costs and the approved fuel costs which were used to
 15 develop the regulated price caps. Private carriers cannot go back to their customers for
 16 additional money associated with costs which arose after prices were set or contracts
 17 entered into. This ability to defer, then later recover costs is our submission unique to
 18 utilities and other regulated monopolies. It is a substantial benefit and can have
 19 significant affects on profitability and the cost of raising debt.

20 Furthermore, in BC Ferries Annual Report 2008/09 there is the following reference to BC
 21 Ferries receiving direct and substantial amounts from the Province with respect to
 22 deferred fuel costs.

23 *“During December 2008 the Province entered into an agreement with the*
 24 *company to pay \$1.7 million to be applied against the balance of deferred*
 25 *fuel costs”⁵⁶*

26 This appears to be a subsidy from the provincial government to BC Ferries that is not
 27 available to private carriers.

28 **Duty Remission**

29 On September 23, 2010 the Government of Canada issued the Certain Ships Remission
 30 Order 2010, SOR/2010-203, remitting \$119 million in customs duty to BC Ferries, in
 31 respect of the vessels Coastal Renaissance, Coastal Inspiration, Coastal Celebration
 32 and Northern Expedition. BC Ferries announced that “the funds will go towards an
 33 across the board ferry fare reduction of about two per cent.”⁵⁷ At least two of these
 34 vessels are the same vessels used for drop trailer traffic.

⁵⁵ For example see BC Ferries 2009/10 Annual Report - Notes to Consolidated Financial Statements, note 17 p. 74

⁵⁶ BC Ferries Annual Report 2008/09, p. 63

⁵⁷ BC Ferries News Release dated October 1, 2010

1 (b) 1977 Coastal Ferry Subsidy Agreement

2 Pursuant to the terms of the Canada/British Columbia Coastal Ferry Subsidy Agreement
3 dated April 18, 1977, Canada pays to the Province additional sums for assuring
4 reasonable and adequate ferry service in British Columbia and appropriate supervision
5 thereof. The subsidy is adjusted annually based on the Vancouver Consumer Price
6 Index, and in 2010, totalled \$26,924,000.

7 It appears from the BC Ferries' Performance Term Three Submission to the British
8 Columbia Ferries Commissioner, September 30, 2010, that this subsidy, like the service
9 fees paid under the CFS Contract is not allocated to the "major routes". It is not clear
10 whether this is due to a decision of the federal government, the provincial government or
11 BC Ferries. However, like the previously discussed service fees, this subsidy also
12 supports the larger overhead and other fixed costs of the entire business thereby
13 allowing for economies of scale that would otherwise not be available to the major routes
14 on a stand alone basis.

15 (c) Income Tax Exempt Status

16 BC Ferries is income tax exempt. BC Ferries argues that the fact that it is non taxable is
17 not a benefit because it has a high return on equity requirement. SCIC does not accept
18 this argument. At the very least, the permitted 13.16% pre-tax return requirement
19 provides BC Ferries the prospect of a high tax free cash flow. This is clearly something
20 of value that is not available to private sector operators. Since 2003, BC Ferries has
21 been profitable, showing retained earnings of \$235 million as of March 31, 2010. If it
22 was taxable, it would have paid tax on that income at a rate of at least 30% and
23 accordingly it benefits by having more cash flow than would a similar, but taxable, entity.

24 (d) Use of Terminal Lands and Water Lots under Long Term Prepaid Leases

25 The properties making up BC Ferries' terminals – land, buildings, and water lot leases –
26 were previously held by several government agencies, including the pre-2003, Crown-
27 controlled incarnation of BC Ferries itself. These properties, including those held by BC
28 Ferries' direct predecessor, were acquired at a time when the ferry operation was
29 heavily subsidized and accordingly paid for to a significant degree by government. They
30 were all transferred to the BC Transportation Financing Authority. Subsequently, the new
31 BC Ferries signed agreements with the Financing Authority that transferred ownership of
32 the buildings and improvements to BC Ferries and gave it exclusive use of the ferry
33 terminal lands and water lots through a 60-year lease (with a renewal option for 20
34 years) on each of 43 terminals. The consideration for the properties transferred from the
35 former BC Ferries was made equal to the present value of the payments on the leases,
36 with the result that the leases are prepaid for the full 60 years. In other words, the new
37 BC Ferries enjoys the use of the terminal lands and water lots through the disposition of
38 the assets its predecessor had previously obtained from or with the assistance of the
39 Province. This is a benefit not enjoyed by private competitors.

1 (e) Cost of Capital

2 BC Ferries' privileged relationship with government (as both "owner" and major long-
3 term financial supporter under the CF contract and as the beneficiary of a state-
4 sponsored monopoly) gives it an artificially low cost of debt with interest rates well below
5 the risk premium that would be assigned to a standalone company with similar financial
6 statements.⁵⁸

7 **7.4 Summary**

8 BC Ferries has a large number of significant unfair competitive advantages as a result
9 of:

- 10 (a) its effective monopoly on passenger service;
- 11 (b) the assets provided to it by its predecessor;
- 12 (c) the requirements for more sailings than would be normal pursuant to the CF
13 Contract;
- 14 (d) the ability to recover costs from the core market; and
- 15 (e) a multitude of subsidies including direct cash payments by government,
16 preferential arrangements and associations that lead to lower interest rates,
17 interest rate rebates, deferred fuel costs and duty remissions, and it's income
18 tax exempt status.

19 These are not advantages that are available to all. When they are used by a monopoly
20 entering into a competitive market to reduce costs and prices, they are without doubt
21 unfair competitive advantages. Accordingly, the Ferries Commissioner should now
22 proceed to review and determine the appropriate remedies pursuant to s.45.1(2).

23 **8. LONG TERM RAMIFICATIONS**

24 If BC Ferries is permitted to continue to grossly under-price its commercial services
25 there will be a number of long-term ramifications for its competitors. The damages to BC
26 Ferries' core market is less obvious but equally inevitable.

27 The damage to BC Ferries' competitors is clear. Left unfettered, BC Ferries will clearly
28 continue to price the commercial service below market rates and draw volume and
29 margins from the private sector. In its own submission, BC Ferries not only fails to show
30 remorse, but defends the reasonableness of pricing drop-trailer services right down to
31 the incremental cost alone:

⁵⁸ For example see the BC Ferries Media release on January 20 2009 where they announced securing a 108 million loan from the KfW IPEX Bank at an interest rate of 2.95%

1 *“Based on the type of service provided to the drop-trailer class, this class*
 2 *should at a minimum pay for any incremental (direct and indirect) costs*
 3 *incurred by BC Ferries due to providing the service. This minimum rate*
 4 *will result in keeping all other ratepayers harmless and not increase rates*
 5 *to other service classes.”*⁵⁹

6 By resisting any change to its pricing model, BC Ferries is demonstrating that it will
 7 continue to carry on its business plan until all the other drop-trailer service providers
 8 have left the market. No one can be expected to operate a commercial ferry service in
 9 the face of competition from an operator who does not have to recover the cost of its
 10 terminals, ferries, or fuel as part of its rates. Inevitably, if private sector margins drop
 11 below an acceptable rate of return the private service providers will naturally look to
 12 deploy their assets and utilize terminal lands in other more profitable ventures. Some of
 13 the likely repercussions are:

14 1. *BC Ferries will no longer be able to take commercial traffic at its option, it will*
 15 *become mandatory.*

16 While BC Ferries may like to think that it can attract additional commercial traffic
 17 for a short period of time to fill temporary and convenient slices of over capacity,
 18 over time this traffic will become part of the traffic BC Ferries is obligated to carry.
 19 For example, if SCIC were to cease its current operations, up to 700 units per
 20 day (Monday to Friday) and up to 200 per day on weekends would still need to
 21 move to Vancouver Island. BC Ferries, even with the help of VIB, would not be
 22 able to manage all this volume in the short run or long run without additional ferry
 23 and terminal capacity. The basic needs of the residents and businesses of
 24 Vancouver Island to deliver and receive goods and services to and from the
 25 mainland will require a substantial expansion of BC Ferries, complete with a
 26 greater burden on the core market, commercial market and probably the
 27 taxpayer.

28 If existing suppliers sell off some capacity in response to a loss of business to BC
 29 Ferries, it will be expensive and financially risky for BC Ferries, or others, to
 30 restore that capacity. For example, private terminal capacity that is sold off will
 31 most likely be converted to other uses which would oblige new suppliers to
 32 undertake relatively large sunk cost investments in order to purchase new sites
 33 or convert the properties involved back to terminal capacity.

34 One also needs to keep in mind that when BC Ferries no longer needs its
 35 subsidized commercial traffic, it will not be able to unload it back onto its
 36 competitors as its predecessor did in the late 60s and early 70s. The competitors,
 37 who in the late 60s and early 70s were sustained by rail traffic, will not likely be
 38 there and others will not be able to replace them quickly, easily or at the same
 39 costs presently in place.

⁵⁹ BC Ferries' Submission, Appendix C –EES Consulting Report, p. 8

1 In the process of describing its competitors, or the lack thereof, BC Ferries has
 2 described, for prospective lenders, a number of the hurdles new market entrants
 3 would face.

4 *“There are significant barriers to entry into the market served by BC
 5 Ferries for other ferry operators, including:*

- 6 • *acquiring locations for terminals in prime service areas;*
- 7 • *making the capital commitment necessary to establish the*
 8 *required infrastructure;*
- 9 • *obtaining financial support comparable to the service fees and*
 10 *federal subsidy BC Ferries receives from the Province;*
- 11 • *obtaining environmental approvals to construct terminal facilities;*
 12 *and*
- 13 • *obtaining approvals to connect roads and highways to terminal*
 14 *facilities.”⁶⁰*

15 In short, relatively rapid entry and expansion by competitors in response to future
 16 needs is unlikely. As a result, the long-run inefficiencies associated with BC
 17 Ferries’ production of commercial services at higher stand-alone costs than
 18 would be incurred by competitors may persist for a relatively long period of time.

19 2. *BC Ferries will have an expanded monopoly.*

20 Without viable alternatives, BC Ferries would have a monopoly on commercial
 21 traffic as well as in the passenger traffic to the Island. At that time it will become
 22 obvious to all, if it is not already, that the costs of carrying commercial traffic are
 23 not limited to the direct costs, but rather clearly includes the total costs. Core
 24 market users will recognize that they are subsidizing this traffic and BC Ferries
 25 will either have to get rid of the commercial traffic (which will not be possible due
 26 to barriers to entry discussed elsewhere) or charge its full costs, or more likely
 27 charge something in between, where the core market subsidizes commercial
 28 traffic and commercial traffic pays greatly higher costs with reduced service from
 29 that which exists today.

30 3. *The threat of BC Ferries as a sustained subsidized competitor also effects*
 31 *private industry’s desire to recapitalize and invest in other related business*
 32 *ventures.*

33 SCIC is unable to make further investments in its present ferry operation until the
 34 current uncertainty surrounding BC Ferries’ aggressive market entry is removed.
 35 For example, SCIC was planning to build terminals further along the Fraser
 36 River. It would then be able to move trailers further up or down river, connecting

⁶⁰ “Prospectus, British Columbia Ferry Services Inc., Senior Secured Bonds Series 04-1,” May 19, 2004, available at <http://www.llbc.leg.bc.ca/public/PubDocs/bcdocs/369465/ProspectusClean.pdf>

1 the deep sea terminals to many shippers and customers. This would take trucks
 2 off heavily congested arteries as well as leave a considerably smaller carbon
 3 footprint throughout the GVRD. The social benefits of such a venture are
 4 obvious, and have been recognized in the Province's Gateway strategy.
 5 However, these plans depend on SCIC's basic ferry business being viable. Until
 6 SCIC can regain confidence that competition in the commercial ferry business is
 7 fair and equitable, these projects will remain on hold.

8 4 *There will be fewer options for dangerous goods or hazardous cargo.*

9 A significant portion of the cargo transported by the commercial ferry operators is
 10 not suitable for carriage on passenger ferries. For example, propane, gasoline,
 11 chemicals (including caustic soda, chlorine, and oxygen), dynamite, and
 12 Department of National Defence shipments (including munitions and explosives)
 13 all now travel with private commercial services. If in the future these services are
 14 reduced or eliminated, BC Ferries will have to meet the demand with dangerous
 15 cargo sailings or the shippers will be forced to use much more expensive barging
 16 alternatives.

17 5. *Destruction or reduction of a valuable backup service when BC Ferries cannot*
 18 *sail due to strike or weather.*

19 Commercial ferry operators provide valuable backup service during those periods
 20 when BC Ferries is not able to provide service to Vancouver Island due to
 21 extreme weather or strike action by BC Ferries' employees. In general, SCIC's
 22 service is not as weather dependent as BC Ferries due to the absence of
 23 passengers on SCIC's vessels and the ability to adjust schedules to capture
 24 sailing opportunities during inclement weather. During the December 2003 strike
 25 at BC Ferries, SCIC handled a record number of trailers. This backup service is
 26 particularly important to grocers and others who maintain minimal inventory and
 27 are reliant on the ferry system generally to deliver goods on a regular basis.
 28 SCIC was only able to provide responsive backup in 2003 because it was
 29 running an existing operation with the capability to quickly ramp up its capacity in
 30 the face of an urgent and important need.

31 9. OTHER MATTERS

32 9.1 Preferred shipping Arrangements

33
 34 There is a final matter that ought to be an element of the Ferries Commissioner's
 35 investigation. SCIC has learned that a former employee of BC Ferries has set up a new
 36 company⁶¹, which SCIC understands has purchased substantial blocks of drop-trailer
 37 space from BC Ferries, possibly on long term contracts. SCIC understands the

⁶¹ SCIC does not believe there is a useful public purpose in naming this company at this time but is prepared to disclose it to the Ferries Commissioner and BC Ferries on a confidential basis at the request of the Ferries Commissioner.

1 company resells the space to companies shipping trailers, again possibly on long term
 2 contracts, and thereby acts essentially as a freight forwarder. The nature and purpose
 3 of the relationship between BC Ferries and this company is not clear to SCIC. If it is not
 4 at arm's-length from BC Ferries, or it has negotiated a deal that was not available to the
 5 public generally, it could well be of significant relevance to the Commissioner's
 6 determinations in this matter under s.45.1.

7 **9.2 Live Traffic**

8
 9 SCIC is still waiting on a ruling from the Commissioner on SCIC's request⁶² *"that the*
 10 *Commissioner make a finding that BCFS's "live" commercial service is a competitive*
 11 *service"*.

12 While it is not clear that BC Ferries discounts "live" service to the same extent it
 13 discounts drop-trailer service, it is now clear BC Ferries does discount live service in a
 14 similar manner. In its information responses, BC Ferries confirmed that it does negotiate
 15 discounts with its customers on "live" service making it just as real a threat to the future
 16 of private ferry operators as drop-trailer service.⁶³ As drop-trailer and live service both
 17 serve the same purpose, that is getting trailer units to and from Vancouver Island, and
 18 are substitutes for each other, it is clear that the principles that govern drop-trailer
 19 service, as determined by the BC Ferries Commissioner in this proceeding, must also
 20 cover live service.

21 **10. REMEDIES SOUGHT**

22 **10.1 Factual Summary**

23 SCIC submits that the evidence in this matter is overwhelming.

24 Specifically it is clear that:

- 25 (a) BC Ferries is providing a competitive service with respect to drop-trailers;
- 26 (b) The published tariff rates for its drop-trailer service are \$6.75 per foot;
- 27 (c) BC Ferries is providing drop-trailer service at rates lower than the published tariff
 28 found on page 20 of its August 31, 2010 submission, and lower than the rates of
 29 its competitors.;
- 30 (d) BC Ferries has argued that it is transporting the drop-trailers using "excess
 31 capacity" when in fact BC Ferries has bumped core passenger traffic to carry
 32 drop trailer customers on up to 25% of the sailings that carry drop-trailers, a
 33 percentage that will increase if BC Ferries expands its drop-trailer service, and as
 34 its core traffic grows;

⁶² SCIC Letters to the BC Ferries Commissioner dated July 30, 2010 and August 17, 2010.

⁶³ Response to SCIC Question 4.1

- 1 (e) BC Ferries omitted any mention or consideration of a reduction or withdrawal of
 2 meaningful competition in the commercial ferry transportation market and the
 3 serious implications of such a reduction on other customers, the residents and
 4 businesses of Vancouver Island, and the Province as a whole;;
- 5 (f) BC Ferries feels that as long as it recovers the *"incremental direct and indirect*
 6 *costs incurred by BC Ferries due to providing the service"* that the result will keep
 7 *"all other ratepayers harmless and not increase rates to other service classes."*
 8 At a practical level SCIC estimates this means that BC Ferries could price drop-
 9 trailer service as low as \$1.50 to \$2.00/foot. If this principle is accepted, BC
 10 Ferries will be effectively authorized to destroy the competitive commercial drop-
 11 trailer business in British Columbia for little or no benefit to the core ferry market.
 12 This cannot be "appropriate";
- 13 (g) BC Ferries submitted a cost allocation study to support and justify its approach
 14 that is seriously flawed. Intuitively, it does not make sense that a cost of service
 15 study should not allocate any costs of the ferries, the terminals or their operating
 16 costs to a significant class of ferry service customers. Furthermore, Joe
 17 Linxwiler's report shows that BC Ferries model does not make sense in terms of
 18 well established regulatory principles and practices;
- 19 (h) Private competitive ferry services cannot compete, and should not have to
 20 compete, with a government-owned service which provides service to their
 21 clients priced without regard to the cost or value of the terminals, ferries, fuel and
 22 crew involved in providing that very service;
- 23 (i) Contrary to the suggestions of BC Ferries, it is the recipient of substantial
 24 monetary transfers and other direct and indirect benefits as a result of its close
 25 association with the Province, and in particular, as a result of the CF Contract.
 26 These advantages amount to an unfair competitive advantage which it is using to
 27 advance its position to the detriment of private ferry operators; and
- 28 (j) There can be no question that BC Ferries' drop-trailer service is priced below
 29 *"the direct costs and an appropriate proportion of the indirect costs associated*
 30 *with providing that very service"* and that BC Ferries has an *"unfair competitive*
 31 *advantage"* arising from its monopoly, the CFS Contract as well as other forms of
 32 assistance, which leads to the excess capacity being offered in the competitive
 33 market at unfair aggressive prices.

34 **10.2 Section 45.1(1)**

35 SCIC requests the Ferries Commissioner issue a ruling pursuant to s.45.1(1) that:

- 36 1. BC Ferries' drop-trailer service is priced below "the direct costs and an
 37 appropriate proportion of the indirect costs associated with providing that
 38 ferry transportation service"; and
- 39 2. BC Ferries has an "unfair competitive advantage".

1 **10.3 Section 45.1(2)**

2 S.45.1(2) states:

3 *(2) If the commissioner makes the determination referred to in subsection (1), the*
 4 *commissioner must regulate the ferry transportation service in one of the*
 5 *following ways:*

6 *(a) make an order under section 69 (1) and, after an alternative*
 7 *service provider satisfactory to the commissioner has been located*
 8 *through a competitive process established in a plan approved under*
 9 *section 69 (4) (a) or created under section 69 (4) (b) (i), order the*
 10 *ferry operator to arrange with that alternative service provider, under*
 11 *contract, franchise agreement or otherwise, for the alternative*
 12 *service provider to provide the ferry transportation service;*

13 *(b) calculate the amount that the commissioner considers would be*
 14 *charged as a tariff for that ferry transportation service to recover the*
 15 *direct costs and an appropriate proportion of the indirect costs*
 16 *attributable to providing the service were none of the factors referred*
 17 *to in subsection (1) of this section present, and order the ferry*
 18 *operator to charge at least that tariff when providing that ferry*
 19 *transportation service.*

20 SCIC accepts BC Ferries' suggestion⁶⁴ that the final decision on the s.45.1(2) remedies
 21 is appropriately dealt with in a second phase of this proceeding, hopefully one in which
 22 much more information is made available to the public.

23 SCIC believes that once the Ferries Commissioner has determined that BC Ferries has
 24 violated s.45.1(1), then BC Ferries' position that, if its prices were disclosed it would not
 25 be in a position to compete based on price,⁶⁵ will no longer be relevant. This will mean
 26 that clearly there will be no justification for less than full disclosure. Full disclosure will
 27 be necessary in order for SCIC and others to make meaningful submissions on: "... *the*
 28 *amount that the commissioner considers would be charged as a tariff for that ferry*
 29 *transportation service to recover the direct costs and an appropriate proportion of the*
 30 *indirect costs attributable to providing the service...*" pursuant to s.45.1(2).

31 Accordingly, SCIC requests the Ferries Commissioner issue a ruling pursuant to
 32 s.45.1(2) that the Ferries Commissioner will hold a further enquiry to consider remedies
 33 under s.45.1(2).

34 **10.4 Interim Order on BC Ferry Rates**

35 SCIC requests that in order to minimize the harm being done by BC Ferries' aggressive
 36 entry into the drop-trailer market, the Ferries Commissioner order BC Ferries to abide by
 37 the provisions of its own published tariffs⁶⁶, and charge its published rates to all drop-

⁶⁴ BC Ferries' Submission, p. 41, l. 4 - 7

⁶⁵ BC Ferries' Submission, p. 40, l. 38

⁶⁶ BC Ferries' Submission, p.20

1 trailer and live commercial service customers, notwithstanding any existing long or short
2 term contracts, until such time as the Ferries Commissioner conducts the second phase
3 of this inquiry pursuant to s.45.1(2) and makes a final determination of the appropriate
4 remedy. These published tariffs are rates that BC Ferries itself has determined to be
5 reasonable and appropriate for offering to the commercial sector and will minimize the
6 harm currently being done by BC Ferries' aggressive entry into the drop-trailer market.