BC Ferry Commission
MEMORANDUM 24A

To: Mr. Bill Cottick Executive Vice President and General Counsel BC Ferries	Ms. Kathie Miller Assistant Deputy Minister Transportation Planning and Policy Government of British Columbia

From: Sheldon Stoilen
Deputy Commissioner

Date: July 22, 2008

Re: Amendment to Memorandum 24: Establishing a Baseline for Fuel Price Adjustments for Performance Term Two

By letter dated July 10, 2008, a copy of which is attached hereto, BC Ferries has requested a modification or clarification of Memorandum 24 to allow the early implementation of a fuel surcharge for the major, minor and route three (Horseshoe Bay-Langdale) route groups. The basis of this request is the dramatic rise in marine diesel fuel prices since the Commission fixed the set price for fuel for Performance Term Two (PT2) in the fall of 2007.

The purpose of this memorandum is to establish a baseline for fuel price adjustments during PT2 in accordance with the mechanism set out in Memorandum 24 which was issued as part of our preliminary decision on PT2 price caps. The effect of establishing a new baseline for fuel price adjustments will be the early implementation of a fuel surcharge as requested by BC Ferries but the result will be lower fuel surcharges which would otherwise come into effect at a later date pursuant to Memorandum 24.

This baseline adjustment applies only to the three route groups for which BC Ferries has requested authorization. The baseline for the northern route group is unchanged.

Status at end of First Quarter of Year 1 of Performance Term Two

During the first quarter of Year 1 of PT2 crude oil prices rose dramatically and BC Ferries has forecasted that for Year 1 they will pay, on average, $1.344 CDN/litre for fuel compared to the set price of $0.784 CDN/litre incorporated in the Price Cap for Year 1 of PT2. The difference, net of hedging gains or losses, and less the $0.025 CDN/litre which BC Ferries must absorb as explained in Memorandum 24, is being transferred to the fuel deferral accounts. The buildup of the fuel deferral accounts with no offsetting fuel surcharges for several months will trigger substantial fuel surcharges by December 2008/January2009 under the mechanism set out in Memorandum 24.

The Commission considers that it is in the best interest of customers and communities to implement lower fuel surcharges at an early date and that such surcharges be set at a level to eliminate the balance in the fuel deferral accounts, including the expected growth in those balances, over the remainder of PT2 as opposed to a 12 month period. The result of these modifications reduces surcharges on the Major Routes, Minor Routes and Route Three by an average of 30%.

Establishing a Baseline for Fuel Price Adjustment for Performance Term Two

Accordingly the Commission amends the mechanism for PT2 fuel price adjustments as follows:

- Adoption of PT2 Baseline Prices and Baseline Balances for the fuel deferral accounts based on forecast route group fuel prices as calculated using the WTI NYMEX futures curve as at June 30, 2008 and implementation of the following fuel surcharges effective August 1, 2008: Major route group 10.3%; Minor route group 17.6% and Route Three 9.2%.

- Continued 50/50 cost sharing of the first 5 cents/litre of the differential between the set price of fuel and the actual price of fuel with the fare payers' share charged/credited to the fuel deferral accounts.

- Continued use of the 2% threshold (month-end deferral account balances as a percentage of annual pre-surcharge tariff revenue by route group) as the "Surcharge/Rebate Trigger" for the determination of future adjustments to the fuel surcharge. Such adjustments are to be set at a level to eliminate any variance to Baseline Balances in the deferral accounts, including the expected growth in the balances, over the following 12 months or the remaining period of PT2, if that is shorter.

- Adjustments to the fuel surcharge may not be made more frequently than quarterly and BCFS must give at least 15 days public notice of the changes.

- Details of changes in fuel deferral balances by route group will be provided to the Commission on a quarterly basis.

- BCFS will provide to the Commission details of their fuel conservation initiatives for at least the first two years of PT2 and shall report progress with implementation of these to the Commission on an annual basis.

- An application under section 42 of the Coastal Ferry Act for an extraordinary increase in price caps will not be required to implement the Baseline Prices, Baseline Balances and initial fuel surcharges authorized hereunder in view of the fact that the Commission had previously provided for an adjustment mechanism under Memorandum 24 dated March 30, 2007 as a part of the price cap-setting process for PT2.

≈BCFerries

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July 10, 2008

Mr. Martin Crilly
British Columbia Ferry Commissioner
290 Longview Road
Comox, BC V9M 3T7

Dear Mr. Crilly:

RE: Fuel Surcharge

BC Ferries is writing to request that you modify or clarify your Memorandum #24 to authorize implementation of a fuel surcharge on the Major Routes, Minor Routes and Route 3 effective August 1, 2008.

As you know, as part of the decision on performance term two ("PT2") price caps, and as established in Memorandum #24, it was recognized that the price of fuel would likely continue to be volatile throughout PT2. To address this volatility, a fuel adjustment mechanism (for either a fuel surcharge or fuel rebate) was established by the Commission that would be implemented automatically in the event that fuel prices significantly increased or decreased from the set price for fuel established for PT2.

BC Ferries believes that the framework for the automatic fuel adjustment mechanism as set out in Memorandum #24 is sound and supports its continued application through PT2. However, for the reasons set out below, BC Ferries believes that it would be in the best interest of our customers and the communities we serve if, on a one-time basis, the early implementation of a fuel surcharge for the Major Routes, Minor Routes and Route 3 were to be approved through modification or clarification of Memorandum #24.

As you know, consistent with Memorandum #24, a set price of approximately $0.784 CDN/litre for fuel for was established for year 1 of PT2 (increasing annually by CPI). As at June 30, 2008, BC Ferries is forecast to pay for year 1, on average, $1.344 CDN/litre for fuel. The resulting $0.56 CDN/litre is therefore being transferred to the deferral accounts.

BC Ferries has undertaken sensitivity analysis, based on actual first quarter of fiscal 2008/09 results, fuel price forecasts and the WTI NYMEX futures curve as at June 30, to determine the timing and magnitude of the fuel surcharges that will need to be implemented, consistent with the automatic fuel adjustment mechanism set out in Memorandum #24. Based on the WTI NYMEX futures curve at June 30, 2008, BC Ferries expects that initial fuel surcharges as set out in Table 1 below, will be required to eliminate the expected fuel deferral account balances, including the growth in those balances, over the following 12 month period. Based on the WTI NYMEX futures curve at June 30, 2008, BC Ferries expects that surcharges will continue to be required subsequent to the 12 month period and throughout PT2.

TABLE 1
INITIAL FUEL SURCHARGES
WITH FUEL PRICE BASED ON WTI NYMEX FUTURES CURVE (AT JUNE 30, 2008)

Majors		Minors		Route 3	
Surcharge Date	Surcharge	Surcharge Date	Surcharge	Surcharge Date	Surcharge
Nov 1, 2008	14.1%	Dec 1, 2008	25.4%	Dec 1, 2008	13.5%

As can be noted in Table 1, BC Ferries anticipates that fuel surcharges of a significant magnitude will be required for the Major Routes by November 1, 2008 and for the Minor Routes and Route 3 by December 1, 2008. Earlier implementation of the fuel surcharges would diminish the expected magnitude of the fuel surcharges in PT2 and help mitigate the potential negative impact to our customers and coastal communities.

Given the unforeseeable aberration in fuel prices which has occurred, and the significant variance in current and expected fuel prices from the set price, BC Ferries is requesting approval to implement fuel surcharges August 1, 2008. BC Ferries is not proposing that the set price for fuel be adjusted or that the automatic fuel adjustment mechanism as set out in Memorandum #24 be rescinded for PT2. Rather, it is proposed that, on a one-time basis, BC Ferries be granted approval to implement such fuel surcharges as are forecast to be required to reduce the fuel deferral account balances to zero by the end of PT2, consistent with what would have been the case, had current world fuel prices been anticipated and reflected in the final determination of PT2 price caps.

Table 2 below, sets out the specific fuel surcharges proposed for implementation by BC Ferries effective August 1, 2008.

TABLE 2
FUEL SURCHARGES WITH
FUEL PRICE BASED ON WTI NYMEX FUTURES CURVE (AT JUNE 30, 2008)
AND IMPLEMENTED EFFECTIVE AUGUST 1, 2008

Majors		Minors		Route 3	
Surcharge Date	Surcharge	Surcharge Date	Surcharge	Surcharge Date	Surcharge
Aug 1, 2008	10.3%	Aug 1, 2008	17.6%	Aug 1, 2008	9.2%

As can be noted in Table 2, by proceeding with fuel surcharges in the summer, when traffic levels are much higher than in the fall, and setting the surcharges at a level that eliminates the balances in the fuel deferral accounts, including the expected growth in those balances, over the performance term as opposed to a 12 month period, the overall magnitude of the surcharges required in PT2 is significantly reduced.

Finally, BC Ferries believes implementing a fuel surcharge now would be consistent and understandable in the marketplace, given the current world price of fuel and the actions taken to introduce fuel surcharges by other companies affected by the recent dramatic increases in fuel prices.

BC Ferries requests that you modify or clarify your Memorandum #24 to authorize BC Ferries to implement the fuel surcharges as set out in Table 2 effective August 1, 2008 and to adopt the revisions to the automatic fuel adjustment mechanism occasioned by the early implementation of the fuel surcharges as set out in Attachment A.

Thank you for your consideration of this request and, should you have any questions, I would be pleased to discuss this matter further.

Yours truly,

WR Cottick

William R. Cottick
Executive Vice President, Corporate Affairs & General Counsel

Attachment

cc: Sheldon Stoilen, Deputy Commissioner

ATTACHMENT A

FUEL SURCHARGE/REBATE IMPLEMENTATION PROCESS CLARIFICATION

This document provides the technical description of the fuel surcharge/rebate implementation process as per Memorandum #24. In addition, it provides the technical description of the implementation process that would be followed based on an earlier implementation date for the first fuel surcharge in Performance Term Two ("PT2").

Fuel Surcharge/Rebate Process Overview:

The fuel surcharge/rebate implementation process as set out in Memorandum #24 can be divided into three components as follows:

1. When a surcharge/rebate is implemented
2. When the surcharge/rebate is adjusted; and
3. The amount of the surcharge/rebate.

Process as described in Memorandum #24:

1. A fuel surcharge/rebate will be implemented when the absolute month-end balance in a route group fuel deferral account exceeds 2% of the *Annual Pre-Surcharge Tariff Revenue* for the route group.
2. The fuel surcharge/rebate would be adjusted no more frequently than once a quarter, whenever the actual month-end balance for a route group is greater or less than the 2% *Surcharge/Rebate Trigger* as described in step 1.
3. The *Surcharge/Rebate Amount* is to be adequate to eliminate the *Expected Deferral Balance*, including the expected growth in the balance, over the following 12 months or the remaining period of PT2, if that is shorter.

Early Implementation Date Process (August 1, 2008):

It is proposed that initial fuel surcharges, based on forecast route group fuel prices as calculated using the WTI NYMEX futures curve as at June 30, 2008 ("*PT2 Baseline Prices*"), be implemented as of August 1, 2008. The surcharges will be at levels adequate to reduce the fuel deferral account balances to zero by the end of PT2.

This calculation will produce forecast monthly balances for deferral accounts until the end of PT2. These forecast balances ("*Baseline Balances*") will become the basis for the calculation of the *Surcharge/Rebate Trigger*.

These initial surcharges would replace Step 1 of the process described in Memorandum #24. The remaining two steps would mirror those outlined in Memorandum #24 with changes to address the *Baseline Balances* and the ensuing impact on the *Surcharge/Rebate Trigger*. These steps are revised as follows.

1. A fuel surcharge will be implemented effective August 1, 2008 at a level forecast to reduce the forecast balance in a route group fuel deferral account to zero by the end of PT2.

2. The fuel surcharge/rebate would be adjusted no more frequently than once a quarter, whenever the actual month-end balance in the deferral account for a route group varies from the *Baseline Balance* for that month, by 2% of the *annual Pre-Surcharge Tariff Revenue* for that route group.
3. The *Surcharge/Rebate Amount* is to be adequate to eliminate any variance to the *Baseline Balance*, including the expected growth in the balance, over the following 12 months or the remaining period of PT2, if that is shorter.

Table 1. Glossary of Terms

Annual Pre-Surcharge Tariff Revenue	*The annual pre-surcharge tariff revenue will be calculated as a rolling total of the actual tariff revenue by Route Group for the previous 12 months.*
Baseline Prices	*The forecast prices by Route Group based on the WTI NYMEX futures curve as of June 30, 2008.*
Baseline Balance	*The deferral account balances as calculated using the Baseline Prices. Note that the actual balances will equal these balances if the actual prices are equal to the Baseline Prices as forecast.*
Expected Deferral Account Balance	*The calculation of the Expected Deferral Balance is dependent upon the use of fuel price forecasts for each route group. It is proposed that the forecasts be based on the WTI NYMEX futures curve. In order to address market anomalies this would be calculated as an average rather than use the curve at a single point in time. The average of the futures curve would be calculated based on the Wednesday close over a four week period prior to any forecast updates of the deferral account balances.*
Surcharge/Rebate Amount	*The surcharge/rebate will be calculated as a percentage over the 12 months looking forward by Route Group. Most likely the 12 month period will span two fiscal years and will be applied to multi tariffs. Consequently, the percentage although the same through out will produce a higher surcharge/rebate yield in the latter part of the forecast period.*
Surcharge/Rebate Trigger *- Memorandum #24.*	*When the absolute Fuel Deferral Account Balances are greater than 2% of the Pre-Surcharge Tariff Revenue for the associated Route Group.*
Surcharge/Rebate Trigger *- Early Implementation Process*	*When the absolute Fuel Deferral Account Balances are greater than the Baseline Balances by 2% of the Pre-Surcharge Tariff Revenue for the associated Route Group.*