

Submissions regarding BC Ferries' Drop Trailer Services

#	Date Received	Name
1.	January 15, 2016	Steve Roth, Seaspam Ferries
2.	January 15, 2016	Ken Slawson, Penta Transport Ltd.
3.	January 15, 2016	Cheryl Zmaeff, Penta Transport Ltd.
4.	January 15, 2016	Alex Dugan, Central Island Distributors
5.	January 15, 2016	Gord Putz, Penta Transport Ltd.
6.	January 15, 2016	Vicki Huntington's, MLA Delta South
7.	January 15, 2016	Greg Kolesniak, BC Trucking Association
8.	January 15, 2016	Dennis Dodo, BC Ferries
9.	February 4, 2016	Dennis Dodo, BC Ferries
10.	February 15, 2016	Commissioner Letter to BC Ferries
11.	February 17, 2016	Steve Roth, Seaspam Ferries
12.	February 26, 2016	Commissioner Letter to BC Ferries
13.	February 26, 2016	Commissioner Letter to Seaspam Ferries
14.	February 26, 2016	Louise Yako, BC Trucking Association
15.	March 11, 2016	Dennis Dodo, BC Ferries
16.	March 15, 2016	Steve Roth, Seaspam Ferries
17.	March 22, 2016	Commissioner Letter to Seaspam Ferries

January 15, 2016

Mr. Gord Macatee
BC Ferries Commissioner

Via e-mail: info@bcferrycommission.ca

Dear Commissioner:

I write further to your memorandum seeking comments from interested parties on BC Ferries' drop trailer services. We at Seaspan Ferries Corporation (from whom you received submissions in the process that led to Order 11-01, then known as Seaspan Coastal Intermodal Corporation) thank you for this opportunity to comment.

We wish to comment upon four subjects.

1. The need to include among BC Ferries' costs a return on equity.

Section 45.1 of the *Coastal Ferry Act* requires you to determine, among other things, whether BC Ferries' drop trailer service is priced below an appropriate allocation of the costs of that service. In making Order 11-01, your predecessor (Mr. Martin Crilly; hereafter, the "Commissioner") declined to include in the costs of the service a return on equity (see p. 34 of his reasons). We respectfully ask that you revisit that conclusion.

In 2010, in its submissions to the Commissioner, BC Ferries indicated that the direct costs of providing its drop trailer service were "easily identifiable". According to BC Ferries, these direct costs include a return on equity for each of the capital expenditures involved in providing the drop trailer service. The percentage used by BC Ferries at that time was 13.16%.

Seaspan agreed then with BC Ferries, and remains of the view that BC Ferries' submission was correct. The approach taken by BC Ferries then is consistent with generally accepted regulatory principles, as adopted by utilities boards across Canada. Your task in calculating the cost of BC Ferries' drop trailer service is not dissimilar to that performed by utilities boards when setting utility rates or tariffs. Utilities boards endeavour to determine an appropriate tariff or utility rate that will permit recovery of costs and the potential to earn a profit, in the context of a regulatory scheme. Given that s. 45.1 uses the language of "costs", it is significant that in utility rate and tariff determinations, return on equity is generally treated as part of the utility provider's cost of capital: see, e.g., *AltaLink Management Ltd. (Re)*, [2002] A.E.U.B.D. No. 111 (Alberta Energy and Utilities Board); and *Horizon Utilities Corp. (Re)*, 2011 LNONOEB 192 (Ontario Energy Board).

Building a return on equity into the price of a service reflects the economic reality of the cost of capital – usually, in the case of a private company, the cost of shareholder investment. If BC Ferries were a private company – like Seaspan, and other competitors of BC Ferries – BC Ferries

would invariably have to price its drop trailer service to produce a return on equity, which could then be the subject of a dividend. Conversely, no one would rationally invest in the shares of a company that was incapable of ever earning a return on the shareholder's equity. Thus, to say that BC Ferries need not deliver a return on equity in pricing its drop trailer service is to say that BC Ferries' net income from that service can be zero. But no private company would survive if its services produced zero net income.

When Minister Shirley Bond introduced what became s. 45.1 to the Legislature, she stated that the new law would require you "to look at anything that might be perceived or, in fact, in reality have the ability to give B.C. Ferry Services an unfair advantage" (see *Hansard*, No. 7 (June 2, 2010), p. 6128). If s. 45.1 is to achieve its objective of removing any and all unfair competitive advantages, and thereby creating a level playing field for BC Ferries' private competitors, the typical costs borne by those private competitors must be factored into the analysis of BC Ferries' costs. Return on equity is one such "cost".

Moreover, the context and scheme of the *Coastal Ferry Act* as a whole confirm that return on equity should be regarded as a species of "cost". Section 41 stipulates that the price cap determined by the Commissioner for core ferry services must permit recovery of operating expenses, administrative expenses and a "pre-tax return on equity" (see s. 41(2)(a) and (b)). If one species of service (i.e., core ferry service) warrants a return on equity, a harmonious interpretation of the *Coastal Ferry Act* requires that other species of regulated service (i.e., drop trailer service) be priced similarly.

While the Commissioner reached a contrary conclusion in making Order 11-01, he did so without the benefit of argument on this point, because the parties were in agreement that a return on equity should be included in the calculation of costs. We believe the reasons given above should be sufficient to resolve the concerns the Commissioner expressed on that occasion, and we respectfully ask you to reconsider this aspect of the analysis.

2. An approach based on a "horizon volume of traffic" is no longer necessary.

At the time Order 11-01 was made, BC Ferries projected that its drop trailer traffic level would reach its "mature volume" in five to seven years (see p. 34 of the reasons). However, the Commissioner chose instead to base the order on "expected costs at a [lesser] horizon volume of traffic". While the Commissioner declined BC Ferries' invitation to project unit costs based on "mature volume", nevertheless he accepted BC Ferries' underlying proposition that its "start-up volume" in 2010 was too low to allow for a reasonable calculation of the unit costs of drop trailer service. Hence the "horizon volume".

Given that we have now reached the period in which BC Ferries itself expected its traffic level to have "matured", there is no longer any need for unit costs to be assessed on a projected rather than actual basis. We respectfully submit that it is time to use actual traffic levels only.

3. Both the process and the outcome of your review should be transparent.

We maintain that Seaspan is entitled to a fair process, which includes at a minimum an opportunity to review, consider and comment upon BC Ferries' submissions to you, except those

aspects of the submissions that you are satisfied would, if disclosed to Seaspan, cause a real and substantial possibility of future harm to the financial or economic interests of BC Ferries. That is the approach the Commissioner took previously, in making Order 11-01.

On review of the Commissioner's decision-making, the Court of Appeal for British Columbia ruled that because of the potential for "financial repercussions" on competitors of BC Ferries such as Seaspan, before the Commissioner makes an order under s. 45.1, "[w]hat is required is that Seaspan have sufficient information to allow it to participate in a meaningful manner in the proceedings" (paras. 77, 82). This duty applies equally now.

As the Commissioner did in 2010, therefore, today you should (a) obtain from BC Ferries a submission with a non-confidential body and confidential appendices; (b) review on a line-by-line basis any purportedly confidential information to ensure that only information harmful to BC Ferries' financial or economic interests is withheld from Seaspan; (c) disclose to Seaspan everything properly producible, applying that test; and (d) afford Seaspan a reasonable period of time in which to provide its response. (See pp. 20-22 of the reasons for Order 11-01.)

In addition, the tariff you ultimately order (whether adjusted or not) should be disclosed publicly. The Court of Appeal expressed specific disapproval of the confidential order made last time, in these terms:

In dismissing this aspect of the appeal, I would note that principles of openness and public accountability are negatively affected by confidential orders. To some degree, such orders may also be seen as being contrary to the Rule of Law. While I recognize that it may sometimes be necessary for aspects of tribunal orders to remain confidential, I think it important to emphasize that the practice of making confidential orders is to be discouraged. [para. 91]

That is especially true here. BC Ferries publishes the tariff for its "live" trailer service. That service, too, competes with Seaspan's drop trailer service. There is no good reason why one tariff should be known publicly, and the other should remain secret.

4. BC Ferries' costs (fixed and variable) may have increased.

Seaspan has reason to believe that the fixed and variable costs to BC Ferries of providing its drop trailer service have recently increased, by way of the number of hostling units they have had to purchase, additional drivers, and increased allocation of terminal space to storage and handling of trailers. This belief is, admittedly, based on observation and anecdotal reports. In addition, Seaspan has concerns that the use of Four Square Logistics by BC Ferries is an attempt to circumvent the MAAT by bundling transportation services. These are the subjects upon which Seaspan is likely to focus its further commentary, after review of BC Ferries' submissions.

We note finally that in 2010 and 2011, the Commissioner had the benefit of assistance from PricewaterhouseCoopers in reviewing the cost data provided by BC Ferries. This was a major reason for his finding that he could resolve the cost allocation and pricing issues without full

disclosure to, and argument from, Seaspan on that subject. We assume for the present that your approach on this occasion will be the same, and would ask for your confirmation in that regard, at your convenience.

We thank you for the opportunity to make these submissions, and your consideration of them.

Yours truly,

A handwritten signature in cursive script, reading "Steve Roth".

Steve Roth
Vice President
Seaspan Ferries Corporation

From: Ken Slawson [mailto:ken@pentatransport.com]
Sent: Friday, January 15, 2016 1:13 PM
To: BC Ferry Commission, BC BCFC:EX
Subject: BC Ferries and Drop Trailer

To Whom it may concern:

Let me start by giving a little background about my business, I have been in the transportation industry for 40 plus years and Have relied on BC Ferries for the services that they provide. The last Number of years have been quite trying in a number of ways, but one of the Most trying is being able to use the BC Ferry drop trailer service as a Solution to the manpower shortage and by utilizing our equipment to Its fullest. To this date I have not been able to get a cost on this service Or any answers to questions about how exactly we can make this Work as a component of our business. I as a business person on Vancouver Island need the true costs involved in undertaking this as an alternative.

We use the Seaspan barge service on a regular basis and know exactly the costs. There seems to be a few select companies that have been given exclusive use To this service, I have always been with the understanding that BC Ferries is for the people, Not the chosen as the management of the drop trailer service has made the service into.

I have many questions and concerns, let's hope this commission can dig into this and Reassure business's like ours that there is no collusion among the players. But the old saying goes " If it quacks like a duck and walks like a duck it's probably a duck".

Regards

Ken Slawson
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Owner / General Manager
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From: Cheryl Zmaeff [mailto:cheryl@pentatransport.com]
Sent: Friday, January 15, 2016 2:56 PM
To: BC Ferry Commission, BC BCFC:EX
Subject: Opportunity to Comment on the BC Ferries' Drop Trailer Services

I would like to take the Opportunity to Comment on the BC Ferries' Drop Trailer Services. I work for an Island-Based Trucking Company and we originally protested the idea of BC Ferries providing a Drop Trailer Service. BC Ferries is a publicly funded entity and the drop trailer service that they provide competes directly with trucking companies. Eventually when we realized that our protests were falling on deaf ears, we then decided to give the service a try. We requested a rate and found that there was no basic rate table, nor could we simply reserve for a trailer to be on this service. We had to provide a multitude of information and guarantee usage even then it was doubtful that they would be able to accommodate us. The rates we were provided were more than using a Barge or transporting the trailers over live ourselves. This would have eased my mind if these rates were readily available to the public; however, because they are not posted rates for all I did wonder what others were paying. The lack of transparency is concerning BC Ferries receives public funding and has advantages that has been outlined previously by the commissioner. As an Island-Based Carrier, trucking is difficult enough to run a viable business without a publicly funded corporation that we spend hundreds of thousands of dollars in each year because they have a monopoly on live ferry travel, helping out our competitors. Therefore, we welcome the highest tariff you can impose on this service. Hopefully it will even the playing field and force BC Ferries to either open this service to all trucking companies with transparent rates posted on their website they do with their ferry rates.

Cheryl Zmaeff
Accounting & Administration



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From: Alex Dugan [mailto:alex@centralisland.ca]
Sent: Friday, January 15, 2016 3:11 PM
To: BC Ferry Commission, BC BCFC:EX
Subject: Comments Drop Trailer Service

Thankyou for inviting comments on the drop service portion of the BC Ferries business. I cannot comment on the service but instead have a number of questions about the service. For instance I would like to know if the BC Ferry Corporation is also in the trucking business or have plans to enter the trucking business as part of the Corporations plans? I ask because I know of at least one company that were told they could save a lot of money using the "drop service". The only catch was that this company had to stop using our trucking company for delivery and switch to "their" trucking/logistics company. That the savings for the drop service was ONLY available as a "package deal". Is the preferred trucking/logistics company that has been assigned by the BC Ferry drop service manager receiving payment from BC Ferries on a different line item that would make it appear that the "minimum" tariff is being met? Or is something else afoot here?

I would also like to ask if the rates for drop service are uniform and the same for all who want to use the service or are there special customers that receive better deals? If so, why? There are no rates posted for the drop service and the only person that is able to quote rates is the manager of the drop service. At the outset of the program, the public was told that the drop service trailers would only be placed on ferries that were not already full and that no pay as you go ferry traffic would be left behind and that the drop service would only be a value added part of the Ferries system to add revenue on deck space that would otherwise be vacant. That has not been the case in a lot of incidences as we are now told that the drop service trailers have a "reservation" on ferries and that reservations take precedence over non reserved vehicles.

I am available at any time if you would like to contact me directly.

Regards,
Alex Dugan
President
Central Island Distributors
250-716-8855

From: Gord Putz [mailto:gordy@pentatransport.com]
Sent: Friday, January 15, 2016 3:35 PM
To: BC Ferry Commission, BC BCFC:EX
Subject: Drop Trailers

Good Afternoon

I am taking this opportunity to voice my concerns with BC Ferries drop trailer service. BC Ferries has been & still is a vital link between the Mainland & Vancouver Island for many years & not a commercial carrier in competition with my business. When it started we tried to figure out it could be of service with our over-flow traffic but all I could get was that had to guarantee volume on specific sailing & days without being given any rates whatsoever. This response was of no use to us as we never know when we will be in an overflow situation so we made the decision to use Seaspam Coastal Intermodal as they do have set rates & a stand by service which has proven to be very useful for our business. I am hoping the commission will find that BC Ferries should offer a service closer to the Seaspam model so it is of more use to everybody & not just a select few

Thank You For the opportunity to voice my concerns

Gordy Putz
Dispatch/Owner



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January 15, 2016

Mr. Gord Macatee, BC Ferries Commissioner
BC Ferry Commission
PO Box 9279 Stn Prov Govt
Victoria, BC V8W 9J7

Dear Mr. Macatee:

RE: BC Ferries' Drop Trailer Services and MAAT adjustment

I am writing to express my support for the current review and reset of the BC Ferries Services Inc. (BCFS) drop trailer minimum allowed annual tariff (MAAT). The original determinations of Order 11-01, and Memorandum 42, published in early 2011, were welcome decisions that addressed an unfair competitive advantage assumed by BC Ferries.

I would also urge the Commissioner to consider stakeholder suggestions that data used to set the tariff rate be made available to the public. Similarly, as was the case in determining Order 11-01, I assume an independent audit firm will again assist your office in determining the new MAAT rate.

I thank you for this opportunity to comment.

Yours truly,

Vicki Huntington, MLA
Delta South

From: Greg Kolesniak (BCTA)
Sent: Friday, January 15, 2016 7:08 PM
To: 'info@bcferrycommission.ca'
Cc: Louise Yako
Subject: Opportunity to Comment on BC Ferries' Drop Trailer Services

To: BC Ferry Commission
RE: Opportunity to Comment on BC Ferries' Drop Trailer Services

Dear Commissioners,

Attached you will find a summary of the results from a survey of BCTA members about their views on the BC Ferries' drop-trailer service. We conducted the survey between December 17, 2015 and January 12, 2015.

Please note that the relatively low response rate to the survey makes it difficult to present a clear consensus, or majority view about the drop trailer service which is representative of BCTA's membership at large. Nevertheless, based on the small number of responses to the survey, despite concerns identified by some, the perception of the drop trailer service is generally positive among many of the respondents, particularly those that currently use the service.

Please do not hesitate to contact us if you have any questions.

Best wishes

Greg Kolesniak
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~ SUMMARY OF SURVEY RESULTS ~
BC Ferries Drop Trailer Service Survey
January 15, 2016

BACKGROUND

The British Columbia Ferry Commission (BCFC) released a notice in December 2015 inviting public comments on BC Ferries' (BCF) drop trailer service, which BCF has been providing on some of the major routes between the Lower Mainland and Vancouver Island since 2009.

BCTA surveyed motor carrier members about their views on the drop trailer service using an online questionnaire that was sent to 259 carriers on BCTA's BCF Distribution List or BCF Committee. There were 25 valid responses to the survey, yielding a 9.7% response rate.

SUMMARY OF RESULTS

Of the 25 respondents, 8 (32%) indicated that their company currently uses, or at one time used, BCF's drop trailer service.

- 6 of the 8 respondents indicated that their company on average drops 2 to 140 trailers per week, or 290 trailers per week collectively, while 2 indicated they do not currently drop any trailers (i.e., presumably used the service in the past).
- 5 of the 8 respondents (63%) rated the service as "excellent", 2 (25%) rated it "satisfactory", 1 (13%) gave it a rating of "very poor".

Suggestions for improvement and general comments from 5 of the 8 respondents included adding more drop trailer sailings (late evening/late night or early morning), providing the service on more routes, providing auto tracking of trailers, and making improvements to the online reservation system. One of the 8 respondents suggested that BCF should cease providing the service.

Of the 17 respondents who indicated their companies do not use the service, 14 had general comments, categorized as follows:

- *5 of the 14 respondents (36%) were supportive of the service*, stating that it creates healthy competition (n=2), is very efficient and economical (n=1), should be expanded and made more accessible (n=1), and that it generally seems to work well (n=1).
- *5 (36%) were neutral*, stating that their companies do not use the service or that it does not fit within the scope or nature of their business operations.
- *3 (21%) were concerned*, stating that BCF must be able to prove the service is compensatory and not subsidized (n=1), that it gets priority and reduces available space in the reservation system for other commercial users (n=1), and because peak sailings get the most drop trailer traffic, while lightly used sailings do not, BCF should revert to using surplus space on vessels for the drop trailer service as originally intended (n=1).
- *1 (7%) posed a question* whether BCF will accept loaded or unloaded auto transport trailers.

Responses and Comments from BCTA Members that use (or used) BCF's Drop Trailer Service (n=8)

<i>Respondent</i>	<i>Trailers/Week (Average)</i>	<i>Service Rating</i>	<i>Additional Comments/Suggestions</i>
4405120186	140	Excellent	<u>Additional Comments in Relation to Service Rating:</u> If it wasn't for this service, we would not be able to satisfy our customers' needs, since [REDACTED] is not able to take on any more volume. In addition, the numerous sailings allow us quite often to maximize the turns per trailer, which isn't an option with [REDACTED] and their limited amount of barges. <u>General Comments/Suggestions for Improvement:</u> Possibly have a late night sailing dedicated to Commercial drop trailer traffic.
4412188531	120	Excellent	<u>Additional Comments in Relation to Service Rating:</u> BC Ferries are great to work with. They provide consistent service at a fair cost, are very professional, and handle our equipment and work with our staff and needs exceptionally well. <u>General Comments/Suggestions for Improvement:</u> A late evening, commercial sailing would be fantastic.
4421974643	15	Excellent	<u>Additional Comments in Relation to Service Rating:</u> Excellent Service - Staff are easy to deal with from their front line drivers/shunters all the way to management. Any issues are dealt with fairly and efficiently. <u>General Comments/Suggestions for Improvement:</u> It would be nice to have auto tracking of where trailers are, and what sailings they are on, with an auto email confirming loading, ETA, and off-loading. Also, website improvements for booking extra trailers or re-occurring trips would be helpful. The current system is sufficient but has limitations and is often bypassed with a phone call to our representative.
4407502651	8	Excellent	<u>No comments provided.</u>
4413796828	5	Satisfactory	<u>No comments provided.</u>
4412312227	2	Excellent	<u>Additional Comments in Relation to Service Rating:</u> We have never had a service failure or issue with BC Ferries drop trailer service. Prices are competitive to [REDACTED]. We appreciate the extra flexibility that BC Ferries Drop trailer service brings to the over water commercial service. <u>General Comments/Suggestions for Improvement:</u> We will always continue to use [REDACTED] for this service, too. We would be happy to use BC Ferries more, but our service model generally works better with the [REDACTED] schedule than the BC Ferries schedule. We need later sailing at night or very early in the morning to service our Customers.
4412228536	0	Satisfactory	<u>General Comments/Suggestions for Improvement:</u> Would like to see it on the Powell River to Little River route.
4423093207	0	Very Poor	<u>Additional Comments in Relation to Service Rating:</u> As a small carrier, (although we do over 20,000 feet annually to Vancouver Island via [REDACTED]), it is almost impossible to get reliable service from the ferries. We are told we are last in line and will likely get bumped, and have no ability to plan. As well, we know some carriers are given a preferential rate that leaves us no ability to compete. <u>General Comments/Suggestions for Improvement:</u> At best, they should get out of this business, and stop using government subsidies to compete against the commercial barge service provided by [REDACTED]. The playing field is not level. At worst, service should be provided on a first come first serve basis, based on economic activity generated, not preferential rates and loading privileges.

Note: In some cases, comments have been edited/paraphrased. Black = Redacted company name.

Responses and Comments from BCTA Members that do not use BCF's Drop Trailer Service (n=14)

<i>Respondent</i>	<i>Category</i>	<i>Comment/Suggestion</i>
4432592323	Supportive	I have no reason to object, if anything, I believe it creates healthy competition to prevent any one entity from monopolizing the lane/service.
4429167492	Supportive	I think it is OK. There was a similar service when the ferry system was started.
4439198443	Supportive	Very efficient and economical.
4431555136	Supportive	The service should be supported to provide some level of competition to [REDACTED]. It should be made more accessible, similar to BC Ferries' regular commercial traffic.
4429310675	Supportive	I have dropped off and picked up - it seemed like it worked well.
4435398359	Concerned	Must be able to prove it is a compensatory, not a subsidized service.
4423121720	Concerned	My concern is that the drop trailer service gets priority ferry space, thus reducing available space in the reservation system for over-height trailers. When our over-height (B trains) arrive, we require extra length due to the tractor. In summer months we are constantly competing with RV's for space, and now drop trailers. It all adds up to extra sailings missed, which effects our costing because of wages we pay for drivers riding ferries and wait times at terminals for another sailing.
4405344298	Concerned	I think BC Ferries should go back to the concept of using surplus space on the vessels. This was one of the original justifications for the service, but it seems that peak sailings get the most drop trailer traffic while lightly used sailings do not.
4430452643	Neutral	This isn't a service that we have used.
4430375223	Neutral	No comment - we do not use the service.
4430296630	Neutral	I have no history with this service, and am unable to give any real comments about it.
4430175117	Neutral	Due to the nature and scope of our operations, the service is not something we would likely ever use for our Vancouver Island trips.
4429182793	Neutral	We don't use the service as we are a coach company, so it would be unfair to comment.
4430410623	Question	Will BC Ferries accept loaded or unloaded auto transport trailers?

Note: In some cases, comments have been edited/paraphrased. Black = Redacted company name.



CHIEF FINANCIAL OFFICER

British Columbia Ferry Services Inc.
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January 15, 2016

Mr. Gordon Macatee
British Columbia Ferries Commissioner
BC Ferry Commission
PO Box 9279 Stn Prov Gov
Victoria BC V8W 9J7

Dear Mr. Macatee:

**Re: COMMENTS OF BRITISH COLUMBIA FERRY SERVICES INC. IN RESPONSE
TO COMMISSIONER'S DECEMBER 2, 2015 REQUEST REGARDING DROP
TRAILER SERVICES (THE "DROP TRAILER COMMENTS")**

Please find enclosed British Columbia Ferry Services Inc.'s Drop Trailer Comments.

Portions of Appendices B and C have been redacted to protect confidential information. Unredacted copies of these two appendices are being provided to you under separate cover on a confidential basis pursuant to section 54 of the *Coastal Ferry Act*. The basis for the request for confidentiality is addressed in section 1.4 of the enclosed Drop Trailer Comments, and further addressed in the cover letter enclosing the unredacted copies of the appendices.

Should you have any questions or require further information, please contact us.

Yours truly,

A handwritten signature in black ink, appearing to read "Dennis M. Dodo".

Dennis M. Dodo, MBA, CPA
Chief Financial Officer

British Columbia Ferry Services Inc.

Comments in Response to
British Columbia Ferries Commissioner's
December 2, 2015 Request
Regarding Drop Trailer Services

January 15, 2016



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- Appendix C: MAAT Calculation Summary Based on Proposed Approach (Redacted)
- Appendix D: Excerpt from Seaspan Website
- Appendix E: Seaspan Press Release
- Appendix F: British Columbia Ferry Services Inc. Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Drop Trailer Service – August 31, 2010 (without appendices)
- Appendix G: British Columbia Ferry Services Inc. Letter of September 30, 2011, Seeking to Vary Order 11-01

SECTION 1: INTRODUCTION AND OVERVIEW

1.1 Introduction

On August 31, 2010, British Columbia Ferry Services Inc. ("BCFS" or "BC Ferries") filed its *Filing Regarding Section 45.1(1) of the Coastal Ferry Act and Drop Trailer Service* ("August 2010 Filing"). On February 7, 2011, the Commissioner issued Order 11-01 and Memorandum 42 (together, "2011 Drop Trailer Decision"),¹ determining the Minimum Allowed Average Tariff ("MAAT") for drop trailer service. The MAAT was expressed in dollars per vessel-foot. Pursuant to the MAAT currently in place, BCFS must ensure that for a given quarter: *total revenue from drop trailers,² divided by the total number of drop trailer service feet carried,³ is greater than or equal to the MAAT.*⁴

In light of the fact that BC Ferries' drop trailer traffic has reached the volume specified in Order 11-01, on December 2, 2015, the Commissioner invited comments from interested parties on BCFS' drop trailer service. This Filing provides BCFS' comments on the appropriate regulatory approach to drop trailer service going forward. A fresh approach is required - one which reflects the new circumstances and information discussed below.

The Commissioner's determination in 2011 that BCFS should be allocating additional vessel and terminal costs to drop trailer service was the most significant driver of the MAAT. This finding was the basis for the Commissioner's conclusion that BCFS was pricing drop trailer service "below the direct costs and an appropriate proportion of the indirect costs associated with providing that ferry transportation service". It also formed the basis for a finding of "unfair competitive advantage" associated with the price cap regulation of core ferry services. The only other MAAT adjustment related to BCFS' tax free status, and it was relatively small.

Section 45.1 of the *Coastal Ferry Act* (the "Act") does not define the "appropriate" proportion of indirect costs. In order to assist the Commissioner's assessment of the "appropriate" proportion in the present context, BCFS has included with these comments a report prepared by Dr. Roger Ware.⁵ Dr. Ware is a pre-eminent expert in competition and regulatory economics. His report demonstrates that an average avoidable cost approach⁶ to pricing drop trailer service is appropriate, fair and efficient. He explains that a MAAT set above average avoidable cost inevitably harms core ferry users, drop trailer users and market segments reliant on drop trailer service. In Dr. Ware's expert opinion:

¹ Order 11-01 (non-confidential version), dated February 7, 2011: http://www.bcferrycommission.ca/wp-content/uploads/2011/04/BCFCOrder1101_non_confidential_copy.pdf

² Including all charges, e.g. terminal fees.

³ Including hostlers.

⁴ Memorandum 42, dated February 7, 2011, p. 6: http://www.bcferrycommission.ca/wp-content/uploads/2011/05/s43-69/BCFCMemo042_Drop_Trailers_copy.pdf

⁵ Appendix A.

⁶ In this case, synonymous with an "incremental cost" approach.

- an “appropriate” proportion of indirect costs in the circumstances is zero because BCFS’ indirect costs are not avoidable, i.e. they would be incurred even if BCFS were to exit drop trailer service; and
- price cap regulation does not confer an “unfair competitive advantage” where drop trailer service recovers average avoidable costs, which, in this case, equates to direct costs.

Developments since 2011 should also inform what is an “appropriate” allocation of indirect costs. BCFS believes that an allocation of indirect costs is no longer “appropriate” given the increasing importance of drop trailer revenue for offsetting core ferry fares, and the potential economic harm to the drop trailer market and consumers associated with maintaining a high MAAT when there is now only one other option for drop trailer service. In the present circumstances, the current MAAT can be expected to yield the perverse result of becoming increasingly detrimental to core ferry users, drop trailer users and the public generally. The current MAAT is unnecessarily limiting BCFS’ ability to generate additional revenue that would contribute directly to lower fares for all other ferry users. The MAAT is insulating the dominant (and now the only other) market player – Seaspan Ferries Corporation (“Seaspan”) - from healthy competition from BCFS, potentially leading to drop trailer fares being set artificially high. This translates into upward pressure on goods and services pricing and negative effects on disposable income of consumers on Vancouver Island. At the same time, the shareholders of the dominant market player, Seaspan, obtain benefits that should flow to BCFS’ core ferry users, the drop trailer users of both companies, and consumers of the products carried by drop trailer services including on Vancouver Island.

Under the present fiscal framework of BCFS, which has changed since the 2011 Drop Trailer Decision, BCFS’ tax free status has a much smaller impact on the drop trailer business. The financial impact is now negligible - too small to have any practical effect on BCFS’ pricing decisions or to confer a realizable advantage in the drop trailer market.

BCFS submits that section 45.1(2) is not triggered in the present circumstances where BCFS is pricing above avoidable costs and the tax exemption no longer confers any practical advantage on BCFS’ drop trailer business. No MAAT is required, as BCFS has every intention of pricing drop trailer service above its direct costs so as to generate incremental revenues for the benefit of other ferry users.

BCFS submits that to the extent a MAAT is currently required at all, it should be set based on the direct costs of drop trailer service and possibly reflecting a minimal adjustment for BCFS’ tax exempt status. The evidence in this Filing also justifies moving away from assessing MAAT compliance on a quarter-by-quarter basis in favour of a four-quarter rolling average, so as to provide BCFS with a more reasonable and fair level of flexibility.

1.2 Overview of Filing

This Filing is organized as follows:

- Section 2 provides background information relating to drop trailer service.
- Section 3 describes several developments that have materially changed the circumstances in which the Commissioner made his original 2011 Decision. The most significant developments during the past five years, each of which is discussed in Section 3, are:
 - o **Seaspan's increasingly dominant market position:** With Seaspan's December 2011 acquisition of Vancouver Island Barge Services Inc. ("VIBS"), there are now only two providers of drop-trailer service, namely Seaspan and BCFS. Seaspan, a non-regulated drop trailer service provider, has captured the majority of the drop trailer business in part through its acquisition of VIBS. The absence of VIBS as a third provider means that Seaspan no longer faces any price competition below the MAAT.
 - o **Seaspan's acquisition of new vessels to serve drop-trailer market:** Seaspan has announced its acquisition of new vessels to serve the drop-trailer market. In a competitive environment, drop-trailer users would see a benefit from Seaspan's reduced cost structure. With the MAAT, Seaspan has the ability to lower its cost structure free from concern that BCFS (Seaspan's only remaining competitor) can lower its rates to maintain a competitive position. The market protection accorded to Seaspan positions Seaspan to retain a larger portion of the benefits that would otherwise flow to drop-trailer users and end consumers.
 - o **Consolidation of drop-trailer users:** The drop-trailer customer base has consolidated since the recession that coincided with the introduction of drop-trailer service. The MAAT, based on the existing inputs, is not equipped to accommodate the expectations of high-volume users demanding volume based discounts. The MAAT is increasingly constraining BCFS' ability to compete in this new market reality.
 - o **The growing importance of drop-trailer revenue to ferry users:** There has been an increased recognition of the impact of rising ferry fares and the growing importance of drop-trailer revenue to mitigate pressure on fares for core ferry users. Drop-trailer revenues have the ability to provide important benefits to ferry users in the face of rising costs and fares.
 - o **New financial framework reduces ROE:** The changes to BCFS' financial framework introduced by statute after the 2011 Drop Trailer Decision have had the effect of limiting BCFS' pre-tax return on equity. This, in turn, further limits the implications of BCFS' tax exemption for the drop trailer business.
- Section 4 provides an overview of the new expert evidence of Dr. Roger Ware. Dr. Ware is a recognized expert in competition matters and has opined that an average avoidable cost approach for BCFS' drop trailer service is appropriate where drop trailer service reflects the

efficient use of a system designed to serve peak demand for ferry services. Dr. Ware's report is attached to this filing as **Appendix A**.

- Section 5 addresses the Commissioner's task under section 45.1, and how it should be applied in light of Dr. Ware's expert evidence and the changed circumstances outlined in Section 3.
- In Section 6, BCFS explains why, if a MAAT is deemed necessary, compliance with the MAAT should be based on a four-quarter rolling average, rather than on a quarter-by-quarter basis.

1.3 Confidential Information in Appendices

Appendix B is a one page summary sheet of the MAAT under the approach approved in Order 11-01 as at fiscal 2010 and updated for fiscal 2015. **Appendix C** is a one page summary of the MAAT for fiscal 2010 and fiscal 2015 as calculated using an incremental costing approach, with an adjustment for the tax exemption. As Appendices B and C contain confidential and commercially-sensitive information, they have been partially redacted. Unredacted versions are being provided to the Commissioner under separate cover.

The redacted information in Appendices B and C is highly confidential and commercially-sensitive, and accordingly BCFS requests that the Commissioner and its advisors maintain confidentiality over the unredacted versions of these documents pursuant to section 54 of the Act. The reason for this request is that BC Ferries is competing with other providers of drop trailer service (at present only Seaspan). Seaspan would benefit from the information in the unredacted appendices because the information would put Seaspan in a position to price its services lower than BCFS' average unit costs without BCFS being able to compete based on price. BCFS' request is consistent with the decision of the Commissioner in the previous drop trailer proceeding to keep similar information from the August 2010 Filing confidential. In particular, in Order 10-01, dated November 15, 2010, following detailed submissions on the issue, the Commissioner ordered as follows:

As was determined in the Commissioner's October 26, 2010 decision, access to the cost data in the Confidential Exhibits would likely allow a competitor such as Seaspan to target easily identifiable high volume drop trailer customers of BCFS with potentially predatory pricing incentives which would likely erode BCFS' customer base. Disclosure of the data in the Confidential Exhibits to Seaspan would be harmful to the business interests of BCFS.

In addition, after a possible future determination by the Commission on an appropriate methodology for allocating indirect costs, a competitor such as Seaspan, if also in possession of all of the data in the Confidential Exhibits, would likely be able to estimate a minimum tariff set by the Commission under s. 45.1(2)(b). While the Commission has not yet determined that a potential future minimum tariff should be kept confidential, the Commission is mindful that it may do so in future. To disclose all the data in the Confidential Exhibits could render ineffective a potential future determination that a minimum tariff be kept confidential.

The Commissioner therefore has decided to grant the Reconsideration Request in part, but affirms his decision not to disclose the numerical data in the Confidential Exhibits.⁷

BCFS submits that the same considerations are applicable for this filing. BCFS has taken the approach used by the Commissioner in Order 10-01, redacting out only the numeric portions of **Appendices B and C** in the public version while leaving all line items visible.

BCFS further submits that the Commissioner will be in a position to undertake a meaningful review of the information in this filing, and arrive at a decision, while still maintaining confidentiality over commercially-sensitive data. Protecting the commercial interests of BCFS, its customers and all ferry users pursuant to section 54 of the Act is appropriate in the circumstances. In the event that the Commissioner decides to release any of the information, BCFS respectfully requests that the determination be provided to BCFS with sufficient advance notice so as to permit BCFS to take any additional steps it considers are required to protect the confidentiality of the information.

⁷ Order 10-01, dated November 15, 2010, page 9 of 10: http://www.bcferrycommission.ca/wp-content/uploads/2011/05/s43-69/Order1001_copy.pdf

SECTION 2: COMMERCIAL AND REGULATORY BACKGROUND

Much of the background information regarding drop trailer service was provided in the August 2010 Filing, the body of which has been included as **Appendix F**. This section highlights some key elements of the background information from the August 2010 Filing.

2.1 Overview of Commercial Background Regarding Drop Trailer Service

BCFS entered the drop trailer market in 2009. At that time, there were two other providers of drop trailer service to Vancouver Island, VIBS and Seaspan. The following is a summary of the providers of drop trailer services to Vancouver Island as of 2010:

- VIBS used a pusher barge vessel for its drop-trailer service mid-island. The pusher barge took over 5.5 hours to cross Georgia Strait but required less fuel to do so than a self-propelled vessel. As a result, VIBS offered the market lower prices for drop trailer service but could not provide frequency or speed of service.⁸
- Seaspan provided drop-trailer marine transportation service in the southern corridor between Vancouver and Victoria and the mid-island corridor between Vancouver and Nanaimo. Seaspan provided barged marine transportation using an intermodal business model. Seaspan partnered with other companies to provide some of their customers a third party logistics service.⁹
- BCFS provided a 365 days a year operation that utilized many of the scheduled sailings on Route #1 (Swartz Bay to Tsawwassen) and Route #30 (Tsawwassen to Nanaimo), and catered to different customer delivery needs through the use of two different drop trailer products: an “at” service that is attractive to customers that have predictable and price supply-chains and are less flexible with delivery times; and a “by” service for customers that have less predictable and time sensitive supply-chains and are more flexible with delivery times. BCFS provided service to and from two locations on Vancouver Island: Victoria and mid-island. The services were available on a large number of scheduled sailings, with crossing times between the Mainland and the Island of between 90 and 120 minutes depending on the route.¹⁰

In the August 2010 Filing, BCFS provided a more detailed history of the movements of freight on and off of Vancouver Island.¹¹

In the August 2010 Filing, BCFS explained why BCFS chose to enter that market. As BCFS stated in the August 2010 Filing:

⁸ See August 2010 Filing, pp. 12-13, attached Appendix F.

⁹ Such as repackaging goods for final delivery, warehousing and final distribution. See Appendix F, August 2010 Filing, p. 12-13.

¹⁰ See Appendix F, August 2010 Filing, p. 16-21.

¹¹ See Appendix F, pages 9-12 of the August 2010 Filing for a review of that history.

Recent changes to legislation now require truck drivers to record their time at a ferry terminal as hours of work. This change has increased the cost of using the “live” service and changed the nature of the value equation between the drop-trailer and “live” services. Higher fuel costs, just-in-time inventories, changes in hours of work rules and a recession have put increasing pressure on freight companies. In response, freight companies have placed greater priority on cost rather than service.

...

BC Ferries has seen significant share erosion in its “live” service over the past decade. The BC Ferries “live” offering has a disadvantage due to the increased value placed on a driver’s work hours by requiring a driver to be present during marine transportation, thus increasing a customer’s cost to serve.

...

At the same time, the mid-island began to experience urban growth, but BC Ferries had a disadvantage servicing that growth. One driver cannot make several stops and deliver loads originating from the Mainland or further points such as Calgary and return in the same day back to the Mainland. The driver’s hours would run out on the Island and the driver would have to stay in a hotel, thus adding to the customer’s overall cost of transportation.

Prior to BC Ferries’ entry into the drop trailer service, the options for customers were limited. In an effort to better service the changing marketplace, BC Ferries worked closely with the customers of the Vancouver Island market to understand and identify their needs. These discussions confirmed that customers place a great deal of emphasis on a lower cost-to-serve model and greater service and that market participants still were not meeting these needs. Customers wanted greater access to markets and efficient utilization of assets...

...

The BC Ferries solution was to provide a drop-trailer service that optimizes the existing assets by offering the service in non-peak sailing times, but still produces greater sailing frequency and access than the existing providers of drop-trailer service. The introduction of BC Ferries drop trailer service fills a market gap created by new truck driver hours of work rules...

The result is a healthy market for commercial marine transportation services. Section 2.4 of this Filing discusses some of the benefits flowing from the addition of BC Ferries’ drop trailer service to the market.¹²

It was in this context that the Commissioner reached the 2011 Drop Trailer Decision. The changes in the drop trailer market since 2010, which are material, are described in Section 3 below.

2.2 Drop Trailer as Competitive Service

Section 45.1 of the Act provides as follows:

(1) If a ferry operator is providing a competitive service, the commissioner must determine whether the ferry operator is pricing the service below the direct costs and an appropriate proportion of the indirect costs associated with providing that ferry transportation service, or has an unfair competitive advantage... [Emphasis added.]

The Act defines a “competitive service” as follows:

¹² Appendix F, August 2010 Filing, pp. 13-16.

"competitive service" means a ferry transportation service, including, without limitation, a drop trailer service, that is the same as or substantially similar to a service being provided

(a) by a person other than a ferry operator, and

(b) in a geographical area that is sufficiently near to where the ferry transportation service is or may be provided that the 2 services could reasonably be in competition;

In Memorandum 37, issued by the Commissioner on July 19, 2010, the Commissioner made the following finding:

The drop trailer service offered by BC Ferries on its major route group is substantially similar to services being provided by Seaspam Coastal Intermodal Company and Van Isle Barge Services Limited. Those companies provide drop trailer services across Georgia Strait between terminals near to those of BC Ferries. They are sufficiently near that the Commission considers that BC Ferries' drop trailer service to be in competition with Seaspam and Van Isle.

Accordingly the Commission finds that BC Ferries' drop trailer service on its major routes across Georgia Strait is a competitive service as defined in Section 1 of the Coastal Ferry Act.¹³

As a result, the Commissioner commenced the process that culminated in Memorandum 42 and Order 11-01, which are described in the following section. BCFS' drop trailer service is still a competitive service, but there are some fundamental changes to the market and new evidence addressed in this Filing that affects the application of section 45.1 going forward.

2.3 2011 Drop Trailer Decision

In the original Drop Trailer Filing proceeding, the Commissioner considered whether BCFS was pricing drop trailer service below direct costs and an "appropriate proportion" of the indirect costs, as well as whether there was any "unfair competitive advantage". Relevant excerpts from Memorandum 42, which accompanied Order 11-01, include:

The commissioner finds that BCFS exemption from income tax affords it an unfair competitive advantage.¹⁴

...

The commissioner finds there is a competitive advantage for BC Ferries inherent in the price cap regulatory framework under which it operates. Every four years the commissioner must set maximum allowed fares for other (i.e. non-drop trailer) monopoly traffic, to meet BCFS' cost of providing contracted capacity on each route. This capacity cannot be changed without the consent of the Province through amendments to the contract. This means that, once price caps for a performance term have been set, BC Ferries may take the view that any vessel/terminal capacity used by incremental drop trailer traffic has already been paid for by monopoly base traffic. Because this framework is available to BC Ferries, and to no other operator for

¹³ Memorandum 37: http://www.bcferrycommission.ca/wp-content/uploads/2011/05/s43-69/BCFCMemo037CompetitiveService_copy.pdf

¹⁴ Memorandum 42, p. 3 of 6.

reasons of government policy, this advantage is unfair with respect to competitive services.¹⁵

...

b) For costs indirectly attributable to the drop trailer service, the commissioner finds it appropriate to apply a "route overhead charge" to the costs of drop trailer service to recognize the provision of terminal and deck space, and marine transport. In this respect the commissioner disagrees with BCFS' approach to costing the drop trailer service, whereby the cost of providing terminal and vessel capacity, and the cost of moving the vessel across the water, are excluded.¹⁶

c) The commissioner considers that an after-tax return to equity is not a cost: it should not be included in the calculation of costs, direct or indirect, of the drop trailer service. In this the commissioner disagrees with BCFS' submission which made such an inclusion.¹⁷

The Commissioner stated on page 4-5 of Memorandum 42:

Included in the calculation are allowances for the two sources of unfair competitive advantage as found above:

(a) to account for BCFS' income-tax exempt status, which is a relatively small adjustment, the cost calculation includes an amount each year equal to the equity directly and indirectly associated with the drop trailer service, multiplied by the difference between a pre- and post-tax percentage annual return; and

(b) to account for the advantage inherent in the price cap regulatory framework, the commissioner's allocation of a portion of "route overhead charge" makes the appropriate adjustment, which is a significant one. The commissioner accepts a method used by BCFS to allocate certain costs between passengers and vehicles onboard vessels, which is to use deck area exclusively used by passengers and vehicles as the basis for allocation.

The allocation of a portion of the "route overhead charge" also addresses the factor of the service being priced below cost, by requiring that an appropriate proportion of indirect costs are associated with the drop trailer service.

The Commissioner derived the MAAT accounting for all of these factors. The MAAT was described in Memorandum 42 at page 6 of 6 as follows:

The Minimum Allowed Average Tariff (MAAT) is expressed in dollars per vessel-foot. To be in compliance, BCFS must show the commissioner that for a given period

total revenue from drop trailers (including all charges, e.g. terminal fees)
~divided by~
the total number of drop trailer service feet (including hostlers) carried

is greater than or equal to the MAAT.

The minimum tariff regulation will begin April 1, 2011. The initial dollars per vessel-foot figure for the MAAT will be inflated over time. Fuel surcharges and rebates applied to other traffic types carried by BCFS on the major routes shall apply in the same proportion to the MAAT. When the drop trailer traffic reaches a threshold volume n [sic.] vessel feet set by the commissioner, or at the discretion of the commissioner,

¹⁵ Memorandum 42, p. 3 of 6.

¹⁶ Memorandum 42, p. 2 of 6.

¹⁷ Memorandum 42, p. 2 of 6.

the MAAT will be recalibrated against BC Ferries' current actual cost and traffic data by a method similar to that used for the initial figure.

2.4 Commissioner's Decision Regarding Four Quarter Rolling Average

On September 30, 2011, BCFS filed a request for the Commissioner to vary the aspect of his initial 2011 Drop Trailer Decision that had, in effect, required the MAAT to be met in each quarter. A copy of the September 30 letter is attached as **Appendix G**. In Order 11-01B, issued on October 31, 2011¹⁸, the Commissioner declined to reconsider the original Order "at this time". However, the Commissioner also made it clear that BCFS was at liberty to re-apply once the Seaspan appeal of the original Drop Trailer Decision had concluded.¹⁹ The Commissioner's October 31, 2011 decision on the four quarter rolling average stated in part:

On September 30, 2011 BCFS filed with the Commissioner a request for reconsideration of the methodology for calculating the quarterly report. BCFS submits that the Order should be varied to reflect a quarterly calculation based on a four-quarter trailing average. BCFS also proposed transitional implementation that would allow for compliance to be assessed based on data as it is accumulated throughout 2012.

BCFS argued that a reconsideration should be granted because the approach to evaluating compliance with the MAAT had not been the subject of submissions by the participants to the drop trailer proceedings, and that the proper implementation of the MAAT is a new principle that has arisen as a result of the Commissioner's decision to adopt the MAAT.

On the merits of the reconsideration request, BCFS' main argument is that the practical result of using a single quarter's experience to assess compliance with the MAAT is that BCFS cannot set its annual service prices to achieve the MAAT without running the risk that changes in traffic and customer mix within a particular quarter could cause non-compliance in that quarter. It must therefore leave a significant margin on its annual fixed prices to account for fluctuations in volume and mix within the year.

....

The Commissioner has determined that he will not reconsider the Order, at this time, for the following reasons:

1. The Commissioner has discretion to reconsider the MAAT formula to deal with errors, oversights, changes in circumstances, and in light of experience over time with actual costs and drop trailer traffic volumes.
2. BCFS' request for reconsideration is not based on an error or oversight. The only alleged change in circumstances is that BCFS' experience with the MAAT has revealed a shortcoming. However, there has been only limited experience with applying the formula. Therefore, the conditions do not presently exist to warrant a reconsideration.
3. The pending appeal is another factor which the Commissioner has considered. It is premature for a reconsideration to take place on only one

¹⁸ Order 11-01B, dated October 31, 2011: http://www.bcferrycommission.ca/wp-content/uploads/2011/04/BCFCOrder11-01B_BCFRegforReconsideration.pdf

¹⁹ At the time Seaspan had commenced an appeal of the 2011 Drop Trailer Decision. Seaspan's appeal was heard in May of 2012, and reasons for decision dismissing Seaspan's appeal were issued on February 6, 2013: *Seaspan Ferries Corporation v. British Columbia Ferry Services Inc.*, 2013 BCCA 55.

aspect of the MAAT while the appeal is pending. Depending on the outcome of the appeal, the reconsideration may be futile.

The Commissioner therefore declines to hear the BCFS reconsideration request at this time. BCFS may renew its request once Seaspan's appeal of the Order has been concluded.²⁰ [Emphasis added.]

The Seaspan appeal was dismissed on February 6, 2013, and another 12 quarters have passed since then. As discussed in Section 6 below, additional experience has confirmed the challenges identified in the original request to adopt a four quarter rolling average. The adoption of a four quarter rolling average is now warranted. BCFS has remained in compliance with the MAAT since 2011.

²⁰ Order 11-01B, pp. 2-3.

SECTION 3: CIRCUMSTANCES HAVE CHANGED

There have been significant changes to the drop trailer market in the last five years, most notably:

- Seaspan's increasingly dominant market position, in part due to its acquisition of VIBS.
- Seaspan's acquisition of new dual fuel vessels to serve the drop-trailer market, which lowers the cost structure of Seaspan's service.
- The consolidation of drop-trailer users, which places some customers in a position to demand volume-based discounts.
- Increased recognition of the impact of rising ferry fares and the growing importance of drop trailer revenue to mitigate pressure on fares for core ferry users.
- Changes to BCFS' fiscal framework have reduced its pre-tax ROE, which in turn further reduces the already limited implications of the tax exemption for drop trailer service.

In Section 5, BCFS describes why these changes in circumstances, along with new expert evidence (described in Section 4), call into question the current allocation of indirect costs to drop trailer service.

3.1 Seaspan's Increasingly Dominant Market Position

At the time of the original Drop Trailer Filing, there were two incumbent unregulated drop trailer service providers: VIBS and Seaspan. As noted on the "History" section of Seaspan's website, in "2011 Seaspan Ferries acquired the business of Van Isle Barge Services Ltd."²¹ With Seaspan's 2011 acquisition of the VIBS business, there are now only two providers of drop-trailer service: Seaspan and BCFS. Seaspan, a non-regulated drop trailer service provider, has captured the majority of the drop trailer business.

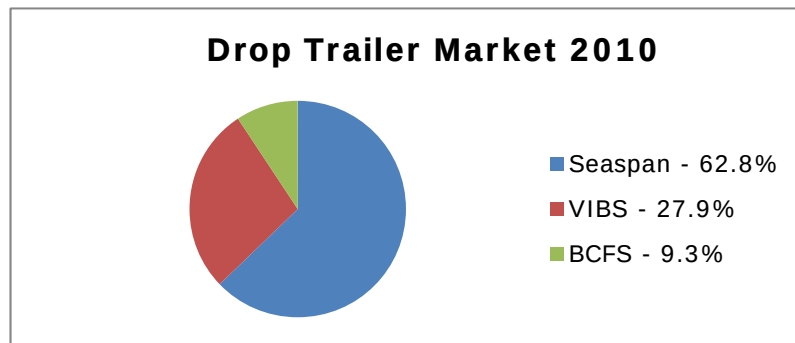
In its November 26, 2010 submission to the Commissioner in the previous drop trailer proceeding (the "2010 Seaspan Filing"), Seaspan provided annual volume estimates for its drop trailer business. Seaspan stated that it shipped approximately 135,000 trailers annually, and claimed a 14% reduction in volume since BCFS had entered into the drop trailer market between the period of 2009-2010.²² In its 2010 Seaspan Filing, Seaspan estimated that VIBS had an annual volume of between 40,000 – 80,000 trailers.²³ Assigning a value of approximately 20,000 annual units to BCFS (based on the 14% volume reduction provided by Seaspan in 2010), and using the middle-point of Seaspan's estimate for

²¹ <http://www.seaspan.com/history>; a printout of this webpage is attached as Exhibit D.

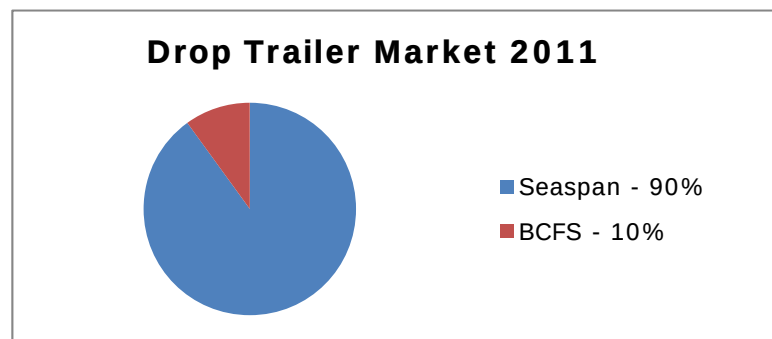
²² Seaspan's November 26, 2010, "Response to British Columbia Ferry Services Inc.'s Submission to the BC Ferries Commissioner – Regarding Section 45.1(1) of the *Coastal Ferry Act* and Drop-Trailer Service", p. 19, lines 13-16: http://www.bcferrycommission.ca/wp-content/uploads/2011/05/s43-69/s45-SCIC_Submission_to_BCFC_2010-11-26.pdf

²³ See p. 16, lines 26-27.

VIBS (i.e. 60,000 units), the following market share picture of the drop trailer market emerges for the year 2010:



In the following year (2011), Seaspanspan acquired VIBS, and using the 2010 numbers set out above increased its market share to over 90% of the market.



The Seaspanspan-VIBS transaction involved the acquisition of 3 barges, the operating rights to two terminals in Surrey and Duke Point, as well as a charter party agreement with Sea-Link Marine Services Ltd. to provide pusher tug service. In acquiring its main rival VIBS, Seaspanspan confirmed its position as the dominant player in the drop trailer market.

BCFS does not have access to Seaspanspan's volumes and is therefore unable to determine the current market share as between Seaspanspan and BCFS. However, it is reasonable to assume that Seaspanspan remains the dominant player in the market. Based on BCFS' own volumes today relative to BCFS' volumes in 2010, the drop trailer market would have had to contract significantly since 2010 for the relative market shares of BCFS and Seaspanspan to reverse. The implausibility of this scenario is reinforced by Seaspanspan's recent vessel acquisitions and the frequency of Seaspanspan's sailings today.

In a market characterized by high barriers to entry, such as control over limited terminal access points and vessels with high capital requirements, Seaspanspan is in a position to sustain and exert its influence over the market.

3.2 Seaspan's Acquisition of New Vessels

Seaspan recently announced an acquisition of new vessels to serve the drop-trailer market. In a competitive environment, drop-trailer users would see a benefit from Seaspan's reduced cost structure. With the MAAT, Seaspan has the ability to lower its cost structure free from concern that BCFS can lower its rates. The market protection accorded to Seaspan positions it to retain a larger portion of the benefits that would otherwise flow to drop-trailer users.

As noted in a press release on November 19, 2014, Seaspan is ordering two new dual-fuelled ferries (LNG and diesel).²⁴ At 148.9 metres long, the new vessels can accommodate up to 59 trailers, which is an increase of 11 trailers over the Coastal Spirit which carries 48 units. The press release gives no indication if the new vessels will be replacing existing ones or if they will be added into the existing sailing compliment.

The new vessels provide Seaspan with the ability to lower its cost structure, realizing efficiencies through an increased load capacity, more efficient ship technologies and the ability to choose the cheaper fuel source. In a competitive marketplace, efficiencies of this nature can be used in several ways depending on the strategic goals of the company. Such strategies could include, but are not limited to, lowering the cost to serve existing users of the service, pursuing new customers through aggressive pricing, or increasing the profit margin which allows investment back into the operation. These options are not unique to Seaspan's situation but would be available to most businesses in similar situations. Given that BCFS' ability to compete in a price-competitive market is limited by the MAAT, Seaspan does not need to lower the cost to serve drop trailer customers, thus freeing Seaspan to realize a larger profit margin.

The existence of the MAAT prevents BCFS from immediately flowing benefits of its own realized cost efficiencies to drop trailer users because the MAAT remains unchanged until the Commissioner reviews actual costs. This lag in resetting the MAAT acts as a barrier to BCFS attracting and retaining customers despite pricing above its cost structure.

The introduction of Seaspan's two new vessels comes at a time where the growth of the market has been limited. As a result, there is a strong likelihood that to the extent Seaspan can fill this additional capacity, it will be based on price competition with BCFS. The MAAT framework prevents BCFS from competing fairly in response despite having priced its service above its cost structure.

Under these circumstances, the MAAT framework is reducing competitive forces and artificially sustaining Seaspan's dominant market position to the detriment of drop trailer users and end consumers.

²⁴ <http://www.seaspan.com/seaspan-ferries-corporation-awards-contract-build-two-new-liquefied-natural-gas-fuelled-vessels>) attached as Appendix E.

3.3 Consolidation of Drop-Trailer Users

Since 2010, drop trailer customers have consolidated in an effort to reduce costs, becoming more efficient through economies of scale and increasing their bargaining power. Prior to a merger/purchase/consolidation, the separate companies would typically pay more for drop trailer service than the new entity would. The trend of consolidation is forcing a downward pressure on drop trailer rates. Given that larger customers traditionally have more flexible supply chains, with more drivers, tractors, trucks and depots in their supply chain, these customers have more options available to them to bring their goods to market. These larger customers are looking for pricing concessions reflecting the efficiencies found in the supply-chain. The MAAT limits BCFS' ability to provide these pricing concessions, which the market is demanding. As the consolidation trend continues, the current MAAT framework increasingly places BCFS at a competitive disadvantage in the drop trailer market.

3.4 Importance of Additional Revenue for Core Ferry Users

Since 2010, the pressure on fares has only increased. The ferry system is facing challenges. Significant periods of declining ridership, together with significant capital investment requirements for fleet renewal and terminal upgrades, has put a strain on the financial sustainability of BC Ferries and has increased fare pressure. Ferry users have expressed concerns that large fare increases are undesirable and can impact the ability of some ferry users to make use of the coastal ferry system. BCFS has looked for innovative ways to increase efficiency and generate new revenue to offset rising costs. In that context, drop-trailer revenue has taken on heightened importance for ferry users.

The Commissioner has recognized the challenges facing BCFS in his regulation of core ferry services. For instance, the Commissioner implemented several initiatives during performance term three (PT3) to reduce operating costs to minimize pressure on required fares. These included:

- Service level adjustments effective April 2014 to reduce annual operating costs by approximately \$7.0 million.
- In establishing the price caps for PT3, BC Ferries was required to reduce operating costs by \$54.2 million over the four years. It is currently forecasted that this target will be achieved.

BC Ferries is also required to deliver a further productivity gain of \$27.6 million over performance term four to aid in the ability to establish predictable fare increases of 1.9% for the corresponding four years (fiscal 2016 – fiscal 2020). In addition, BC Ferries was “directed to revisit its capital plan with a view to reducing the long term capital plan by \$100 million” in order “to have a positive effect on fares in PT5 and beyond”.²⁵ Further efforts to minimize fares include the pursuit of several efficiency opportunities, including a shift to LNG fuel and the ability to provide fare flexibility to its customers.

BCFS' ability to minimize fares is also influenced by its ability to generate incremental non-fare revenues. These include ancillary services, such as food services, retail goods and parking. BCFS has

²⁵ BC Ferry Commissioner, PT4 Preliminary Price Cap Report, p. 14: <http://www.bcferrycommission.ca/wp-content/uploads/2011/04/PT4-Decision-Documents.pdf>

pursued these avenues, and will continue to do so. The Commissioner stated in his Preliminary Price Cap Report, for instance:

i) Ancillary revenues

Ancillary revenues from non-regulated business activities are a key contributor to keeping fares lower than would otherwise be the case. Revenue from food service, parking, gift shops, terminal services, BC Ferries Vacations and others contribute to the company's bottom line. The commissioners do not regulate these activities, but consider them essential to keeping fares low. The price caps are based on the assumption that BC Ferries will continue its efforts to maximize ancillary revenues from existing and new sources over time. The projections provided in the submission have been accepted for price cap setting purposes.²⁶

...

Ancillary Revenue

The revenues that BC Ferries generates from non-regulated ancillary goods and services, such as catering and retail sales both on and off the vessels, as well as its commercial drop trailer service, the sale of vacation and travel packages, staterooms, parking and other services, has also help [sic] reduce pressure on fares.²⁷ [Emphasis added.]

The Commissioner's PT4 Preliminary Price Cap Report, quoted above, expressly recognizes that drop trailer service provides another means of generating revenues that will contribute towards offsetting inflationary pressure on fares.

3.5 Changes in Fiscal Framework Affecting Tax "Advantage"

In the 2011 Drop Trailer Decision, the Commissioner identified BCFS' tax exempt status as being a relatively small advantage that should be accounted for in the MAAT. Changes in BCFS' fiscal framework since the 2011 Drop Trailer Decision have reduced the potential impact of the tax exemption on the drop trailer business.

The *Coastal Ferry Act* was amended in 2012 by, among other things, removing the principle from Section 41 requiring the Commissioner to establish a pre-tax ROE consistent with other similar regulated entities and replacing it with a requirement for the Commissioner to set:

41...(b) the price cap, when combined with all other price caps applicable to all route groups serviced by the ferry operator, must allow for a return sufficient to enable the ferry operator to

(i) meet its debt obligations, and

(ii) maintain access to borrowing rates that, in the opinion of the commissioner, are reasonable in all of the circumstances;

²⁶ BC Ferry Commissioner, PT4 Preliminary Price Cap Report, p. 17.

²⁷ BC Ferry Commissioner, PT4 Preliminary Price Cap Report, Appendix B, p. 13. Recently, the Province explored the ability to allow on-board gaming in an effort to generate incremental revenues. However, analysis demonstrated the potential revenues would not cover the estimated costs of staffing, IT and equipment.

The practical effect of this change has been to reduce BCFS' pre-tax return on equity from the 13.16% provided for in performance term two price caps to the resulting average earned over the first three years of performance term three of 7.83%. BCFS is earning well below a normal return on equity. This, in turn, reduces the impact of the tax exemption on BCFS' drop trailer business.

3.6 Summary

Since the August 2010 Filing, the circumstances of the drop trailer market have changed considerably. There are no longer three competitors in the market. Seaspac has acquired VIBS and as a result, the market is now a competition between a service provider that is subject to a price floor (BCFS), and a single unregulated service provider (Seaspac). As a result, Seaspac has the ability to lower its cost structure and increase its profit margins, free from the concern that BCFS can lower its rates to maintain competition due to the current MAAT. Seaspac has recently acquired new vessels to serve the market. The drop-trailer customer base has evolved since the recession that coincided with the introduction of the drop trailer service by BCFS. Customers are now demanding volume-based discounts, which BCFS is constrained in providing under the existing MAAT. Finally, since the August 2010 Filing, other revenue streams have taken on greater importance in mitigating fare increases.

As further explained in the following section, the aggregate effect of these changes in the drop trailer market means that Seaspac has a competitive advantage over BCFS by virtue of the MAAT, because the MAAT constrains BCFS' ability to adapt to, and compete within, the new market reality for drop trailer services. This change is detrimental to ferry users and consumers alike.

SECTION 4: NEW ANALYSIS BY EXPERT

A significant differentiating feature between the August 2010 Filing and the resulting proceeding, and the current request for comments process, is that the Commissioner now has the benefit of commentary from Dr. Roger Ware, a professor of Economics at Queen's University. Dr. Ware is a distinguished Canadian expert in the area of competition policy and economics, who (among other things) has served as an advisor to the Canadian Competition Board. His report is found at **Appendix A**.

The three questions that BCFS asked Dr. Ware to address, and his responses (in summary and italicized), are as follows:

- How would competition and antitrust principles define the appropriate costs to be allocated to BC Ferries' drop trailer service to ensure that BC Ferries is not engaging in anticompetitive or predatory pricing?

The appropriate cost concept from competition and antitrust principles for pricing in drop trailer service is that of average avoidable cost. Because of the design and operation of BC Ferries' passenger and vehicle services, only the direct costs of operating the drop trailer service should be considered to be avoidable.

- If BC Ferries adheres to the principles articulated in the response to the first question, and appropriately allocates costs to the drop trailer service so that it is not engaging in anticompetitive or predatory pricing, then to what extent does the price cap regulation of BC Ferries' passenger and vehicle ferry services provide a competitive advantage to BC Ferries?

The drop trailer service operated by BC Ferries is designed to optimize the use of capacity on ferry sailings and imposes no additional costs on the passenger and vehicle ferry services. To the extent that BC Ferries is using this excess capacity for its drop trailer service, there is no cross-subsidy from the passenger and vehicle ferry services to the drop trailer service. A corollary is that the price cap calculated for all ferry services is an appropriate one and confers no unfair competitive advantage on the drop trailer service in the freight service market to and from Vancouver Island.

- What economic harm, if any, flows from a regulator setting a price floor for BC Ferries' drop trailer service that is higher than what is necessary for BC Ferries to cover an appropriate allocation of costs as reflected in the response to the first question?

To the extent that the price floor incorporates costs that are over and above avoidable costs, the price floor imposed by the BC Ferries Commissioner is currently set a level that is too high to allow effective competition in the freight services market between BC Ferries and its dominant rival, Seaspan Ferries Corporation ("Seaspan"). As a result, freight customers will be exposed to higher rates for freight shipping services both with BC Ferries and with Seaspan.

The high price floor allows Seaspan to exercise market power without the competitive check that would otherwise be imposed by effective competition from BC Ferries. In addition, because less income is earned by the drop trailer service than could potentially be the case, the passenger and vehicle customers of BC Ferries are also harmed, in that they are required to pay higher fares (and shipping rates for on demand truck customers) than would be the case with a price floor either removed or set at a lower and more appropriate level.²⁸

Dr. Ware's overall conclusion regarding the current MAAT, and BCFS' drop trailer service is that:

56. The price floor currently imposed on the drop trailer services offered by BC Ferries restricts competition and artificially distorts the market for freight services. Although the regulatory framework implies that the regulator is merely constraining the income that BC Ferries could earn from its drop trailer services, this reduction in income implies that, other things being equal, passenger and vehicle ferry services customers would have to pay more than they should have, and that price caps for passenger and vehicle ferry services may need to be set higher. A price floor set at a level that reflects the appropriate avoidable / incremental costs of providing drop trailer services will allow BC Ferries to effectively compete, providing benefits to all customers of BC Ferries as well as the customers of competing service providers. The use by BC Ferries of the drop trailer services to optimize the use of its assets is not unfair competition; rather it represents a globally efficient use of its resources.²⁹

Dr. Ware's expert report supports BCFS' position that, if a MAAT is required at all, the existing MAAT is too high. Dr. Ware's expert report, and the implications of his evidence, is discussed further in Section 5.

²⁸ Appendix A, Roger Ware Report, paras. 2 and 5.

²⁹ Appendix A, Roger Ware Report, para. 56.

SECTION 5: APPLICATION OF SECTION 45.1 IN PRESENT CONTEXT

In this section, BCFS addresses the appropriate application of section 45.1 in light of the new expert report of Dr. Roger Ware and the changed circumstances described in Section 3. BCFS is not pricing drop trailer service “below the direct costs and an appropriate proportion of the indirect costs”. Price cap regulation does not confer an “unfair competitive advantage”. BCFS’ tax exempt status no longer confers any material competitive advantage on drop trailer service. For these reasons, BCFS submits that if the MAAT is retained at all, it should be reduced significantly.

5.1 The Two “Branches” of the Test Under Section 45.1(1)

The Commissioner’s ability to implement a MAAT under section 45.1(2) is only triggered in the event the Commissioner makes certain findings under section 45.1(1). Section 45.1(1) provides as follows:

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

- (a) use of, access to or ownership of vessels or terminals that are or had been owned by the government or a government body within the meaning of the Financial Administration Act,
- (b) any tax exemption, or
- (c) any subsidy.

Thus, the only two potential triggers for implementing a MAAT under section 45.1(1) are either:

- **The First Branch:** “whether the ferry operator is pricing the service below the direct costs and an appropriate proportion of the indirect costs associated with providing that ferry transportation service”; or
- **The Second Branch:** whether the ferry operator has “an unfair competitive advantage, including, without limitation, an advantage resulting from the ferry operator having been provided with” (a) to (c).

If the Commissioner makes either one of these findings, then the Commissioner must act under section 45.1(2). In section 5.4, BCFS provides its comments on which of the two options under section 45.1(2) should be implemented, should the Commissioner’s determination invoke this section of the Act.

5.2 Application of the First Branch of Section 45.1(1) in Light of New Evidence

In 2011, the Commissioner found that BCFS was pricing drop trailer service “below the direct costs and an appropriate proportion of the indirect costs associated with providing that ferry transportation

service". The Commissioner should now interpret "appropriate proportion" in light of the present evidence. BCFS submits that, with the benefit of the new expert evidence of Dr. Ware and in light of the changed circumstances, the Commissioner should reach a different conclusion. BCFS submits that "an appropriate proportion of indirect costs" is zero because an average avoidable cost approach is appropriate and only the direct costs of drop trailer service are avoidable. The first branch of the section 45.1(1) test is not triggered so long as BCFS prices at or above its direct costs.

5.2.1 2011 Drop Trailer Decision Findings on First Branch

In Memorandum 42, the Commissioner made the following determinations under the first branch of section 45.1(1):

The findings respecting costs are as follows.

a) For costs directly attributable to the drop trailer service (labour to load/unload drop trailers to/from vessels, financing and amortization of hostler units, etc), the commissioner accepts BCFS' submissions for fiscal 2010. He also accepts BCFS' statement of the decline in direct costs per vessel-foot, due to economies of utilization, at higher throughput of drop trailers at a target "mature" state some years in the future.

b) For costs indirectly attributable to the drop trailer service, the commissioner finds it appropriate to apply a "route overhead charge" to the costs of drop trailer service to recognize the provision of terminal and deck space, and marine transport. In this respect the commissioner disagrees with BCFS' approach to costing the drop trailer service, whereby the cost of providing terminal and vessel capacity, and the cost of moving the vessel across the water, are excluded.

c) The commissioner considers that an after-tax return to equity is not a cost: it should not be included in the calculation of costs, direct or indirect, of the drop trailer service. In this the commissioner disagrees with BCFS' submission which made such an inclusion.³⁰ [Emphasis added.]

As is evident from the underlined portion of the above-quoted passage, the Commissioner's determination that the first branch of the test was triggered was premised on a finding that "an appropriate proportion of indirect costs" is a significant amount of overhead associated with terminal and vessel capacity. There are two reasons why this finding is no longer justified: (1) the new expert evidence of Dr. Ware on why a different allocation is appropriate and consistent with principles of fair competition and regulatory economics; and (2) the changes in circumstances outlined in Section 3 above.

5.2.2 Dr. Ware's Evidence Relevant to the First Branch

Dr. Ware's expert evidence, which was not available to the Commissioner in 2010, addresses principles of fair competition and regulatory economics relevant to the application of section 45.1 of the Act. In this section, BCFS summarizes the relevant evidence from Dr. Ware's report and explains how it applies to the drop trailer service.

³⁰ Memorandum 42, p. 2 of 6.

Competition Policy and Section 45.1

Dr. Ware's opinion is that it is appropriate to analyze the dimensions of competition within the drop trailer market using widely-accepted economic principles and policy used to distinguish appropriate competition from inappropriate competition.

Dr. Ware explains that the concept of "predatory pricing" is relevant for assessing fair competition in this market. He describes predatory pricing as follows:

22. Predatory pricing refers to exclusionary conduct practiced by a dominant firm, taking the form of pricing at unfairly low levels for the explicit purpose of forcing the exit of a rival, or at the very least disadvantaging a rival in some way that is incompatible with "normal" competition. The firm can then increase its prices once the rival exits the market.³¹

Dr. Ware explains that the widely-accepted approach used to assess whether predatory pricing is occurring invokes the concept of "average avoidable cost". He defines this concept as follows:

- 26 Average avoidable costs are those costs that would be avoided if a company decided not to provide the service in question. These costs include variable costs and product-specific fixed costs, but not sunk costs. Avoidable costs thus do not have to vary directly with the level of a firm's output. For example the rental, heat and maintenance costs of a building, or in this instance, the hosting units that drive the drop trailers on or off the ferries may count as partially avoidable costs as these units may be resold if the drop trailer service was discontinued.³²

As Dr. Ware explains, the established test for predatory pricing is whether a dominant firm is pricing below average avoidable cost. Competition legislation would be focussed on the actions of the dominant firm. Absent a provision like section 45.1, a non-dominant firm (like BCFS in the drop trailer business) could never be characterized as engaging in predatory pricing. There is every reason to apply similar standards under section 45.1, which is concerned with fair competition by BCFS irrespective of its market position. Those principles suggest that a firm that is pricing services at or above avoidable costs cannot be said to be engaging in predatory pricing. The application of this test to BCFS' drop trailer service is discussed later in this section.

Regulatory Economics and Section 45.1

In addition to providing his opinion on the applicable competition principles for the purposes of section 45.1 of the Act, Dr. Ware also explains the relevant principles from the perspective of regulatory economics.

Dr. Ware explains that from a regulatory economics perspective, the correct approach to section 45.1 would be a consideration of whether a ferry operator is engaging in cross-subsidization of drop trailer service. Cross-subsidization is a term used to indicate whether a firm or other entity is using a

³¹ Appendix A, Roger Ware Report, para. 22.

³² Appendix A, Roger Ware Report, para. 26.

revenue stream from one product line to support a different product line or class. Dr. Ware provides the following definition of “cross-subsidization”:

35. But how can we precisely identify cases of cross-subsidization? Cross-subsidization, in a regulatory context, is defined as being outside the bounds of stand-alone costs and incremental costs. Cross-subsidy tests provide a way to examine competition issues from the perspective of regulatory economics, and require an examination of “stand-alone costs” and “incremental costs.”
36. Stand-alone costs are defined for a given product class as the costs of producing that product class alone, in the absence of any other activities that the utility or entity is engaged in. In the current context, the relevant stand-alone costs are the costs of providing the passenger and vehicle services by themselves. The Stand Alone Cost test for cross-subsidization states that the rates for passenger and vehicle services must not exceed the stand alone cost of providing them. But this is precisely what a price cap is supposed to ensure, provided that the price cap is appropriately calculated. Provided that the current Price Cap for B.C. Ferries includes all the direct and indirect costs of operating the passenger and vehicle ferry services when capacity is set optimally, then the price cap by itself will ensure that the passenger and vehicle ferry service is not providing a cross subsidy to the drop trailer service.
37. The incremental cost test provides an alternative test of whether the drop trailer service is receiving a cross subsidy from the passenger and vehicle ferry services. The incremental costs of operating the drop trailer service are the additional costs of providing that service when the passenger and vehicle ferry services are already being supplied optimally. If rates for drop trailer service exceed incremental costs, the test passes and passenger and vehicle ferry services are not providing any cross subsidy to the drop trailer service. Thus, incremental costs for drop trailer service are exactly the direct costs of providing the service that I identified in section IV. That is, incremental costs and average avoidable costs are, in this context, exactly the same thing. In the current case, the incremental cost test and the average avoidable cost test are identical, and of course, will yield identical answers.
38. The two tests for cross-subsidization, stand-alone costs and incremental costs, are also equivalent under some conditions. Provided that BC Ferries is earning no more than a normal return on capital, it is not necessary to perform both tests because they are providing the same information. Henceforth, I will refer only to the incremental cost test for cross-subsidization, and the avoidable cost test for predatory pricing, which are themselves equivalent in the case at hand.³³

The analysis described by Dr. Ware is applicable in this case. BCFS is not earning more than “a normal return on capital”; in fact, the regulatory framework limits BCFS’ ability to earn a traditional return on equity. There is no cross-subsidization of drop trailer service when pricing is at or above direct costs of providing drop trailer service.

Overlap of Competition and Regulatory Economics Approaches to Section 45.1

Dr. Ware explains that, in the context of assessing competition under section 45.1, the tests for cross-subsidization (incremental costs) and predatory pricing (average avoidable costs) overlap and provide the same result:

³³ Appendix A, Roger Ware Report, paras. 35 to 38.

39. To conclude this section, an incremental cost test for cross subsidization arrives at exactly the same conclusion as the test I discussed for predatory pricing. Provided that the price for drop trailer service exceeds the direct or avoidable costs of providing that service, there will be no cross subsidization of drop trailer service by the passenger and vehicle ferry services, its customers or the taxpayer.³⁴

[Emphasis added.]

BCFS submits that the underlined passage from this excerpt from Dr. Ware's report sets out the appropriate test for the Commissioner to apply under the first branch of section 45.1(1).

Application of the Avoidable Cost Test to BCFS' Drop Trailer Service

For BCFS, the average avoidable costs represent the direct costs of the drop trailer business. The BCFS system is designed to be able to meet peak demand. The result of building the system to meet peak demand is that most of the time there will be unused space on the deck and the drop trailer service can use that space without imposing any opportunity cost on the other ferry services at all. BCFS' use of excess capacity means that no extra resources required for the passenger and vehicle ferry services are used in order to operate the drop trailer service. The costs of the passenger and vehicle services are not "avoidable"; if the drop trailer service were discontinued, none of these costs could be avoided. BCFS would run the same size vessels with or without drop trailer service (in fact, the vessels in use today pre-date drop trailer service).

As a result, BCFS submits that the only costs that are appropriately allocated to BCFS' drop trailer service under the principles described by Dr. Ware are BCFS' direct costs in providing the service. The previous approach adopted by the Commissioner of allocating a portion of indirect costs artificially distorts the market for freight services, and is detrimental to drop trailer customers. Either a MAAT is not required, or it should be set based on avoidable costs. This will benefit many market participants and encourage competition in the provision of transportation services to and from Vancouver Island.

The categories of direct costs associated with BCFS' drop trailer service today are the same as they were in 2010, which are currently reflected in the MAAT. Briefly, they include:

- Direct operating costs: the labour, hostling unit, property lease, utilities, repairs and maintenance, and office and administrative costs associated with providing drop trailer service.
- Direct asset costs: the amortization and financing costs associated with assets specific used to provide drop trailer service (hostling units, trucks, IT equipment and compound infrastructure).

³⁴ Appendix A, Roger Ware Report, para. 39.

The actual direct costs associated with drop trailer service are summarized in **Confidential Appendices B and C** (filed under separate cover), which also sets out the current MAAT under BCFS' proposed approach.

Negative Implications for Consumers of Requiring Overhead Allocation

In his report, Dr. Ware explains the harm that results from an allocation of costs that are indirect or unavoidable. He explains as follows:

48. As I have demonstrated, the appropriate measure of costs when setting a price floor is average avoidable cost. In earlier sections I have argued that the price floor imposed by the Commissioner in 2011 on drop trailer service was set at too high a level because it included a component corresponding to indirect costs. Such a pricing distortion is not innocuous. It implies that harm will be suffered by several groups including the customers of drop trailer services, both those using the BCF drop trailer service and those using the rival service operated by Seaspan. In addition, the customers of BCF passenger and vehicle ferry services are also likely to have suffered economic harm.
49. The first point is straightforward: there is the potential for aggressive head to head competition in drop trailer service, between the rival suppliers BCF and Seaspan. Aggressive competition of this kind would create benefits to direct customers and also to a large group of indirect customers for whom freight costs are an important part of their business. However, competition is currently being constrained and in effect disabled by the presence of the price floor, which has two effects on competition. First, BCF is prevented from pricing competitively in order to attract customers, and prevented from responding to rivals' aggressive attempts to gain market share. Second, Seaspan can regard the price floor in effect as a "price umbrella" which allows them to set their own prices at a level where BCF is constrained by the regulator from competing. The net result of these two effects is that, in equilibrium, prices for drop trailer service charged by both suppliers will be higher than they otherwise would be, and customers worse off.
50. Second, the net income from the drop trailer service that exceeds direct costs may act as a subsidy to passenger service users, leading to lower prices for passenger and vehicle fares, other things being equal. If a higher price floor reduces the number of clients of the drop trailer service, then passengers lose the subsidy from the drop trailer service, and may need to pay higher fares.³⁵

5.2.3 Changed Circumstances Affect "Appropriate" Indirect Costs

As indicated previously, the phrase "appropriate proportion" of indirect costs is undefined in the Act. While BCFS submits that the phrase should be interpreted according to the competition and regulatory economics principles articulated by Dr. Ware, the same conclusion on the first branch of the test would be reached simply by asking what proportion of indirect costs is most "appropriate" for protecting consumers in the present circumstances.

The Commissioner's role in regulating under section 45.1 must be viewed as being rooted in the importance of protecting consumers and the public, rather than in enforcing a straightforward transfer

³⁵ Appendix A, Roger Ware Report, paras. 48 to 50.

of wealth from drop trailer users, the customers of drop trailer users, and core ferry customers to Seaspan's shareholders.

Circumstances have changed over the past five years to such an extent that the MAAT, in its present form, can be expected to yield the perverse result of becoming increasingly detrimental to consumers. The MAAT insulates the dominant (and only other) market player from healthy competition from BCFS. In the process, the MAAT transfers to the shareholders of the dominant market player benefits that should be available to core ferry users and drop trailer users. This can be expected to have negative effects on goods and services pricing and ultimately disposable income to all consumers on Vancouver Island as a result of drop trailer fares being set artificially higher because of a fare regime that is no longer appropriate.

The MAAT, if required at all, should be set at a level that distorts the market to the minimum extent necessary to protect consumers. In the present context, the "appropriate proportion" is zero so as to avoid undesirable and unnecessary market distortion. Average avoidable costs should be the basis for any MAAT.

5.3 Application of the Second Branch of Section 45.1(1)

The second branch of section 45.1(1), which the Commissioner must also consider, is whether the ferry operator has "an unfair competitive advantage, including, without limitation, an advantage resulting from the ferry operator having been provided with" (a) to (c). In the 2011 Drop Trailer Decision (Memorandum 42), the Commissioner found unfair competitive advantage with respect to an exemption from income tax and in the price cap regulatory framework. BCFS submits that there is evidence to support different findings with respect to both of these items.

5.3.1 2011 Drop Trailer Decision Findings

In the 2011 Drop Trailer Decision (Memorandum 42), the Commissioner made the following determinations regarding unfair competitive advantage, the second branch of the test:

a) Determination re: use of vessels/terminals that are/were government-owned

The commissioner finds no competitive advantage from these factors.

b) Determination re: any tax exemption

The commissioner finds that BCFS exemption from income tax affords it an unfair competitive advantage.

c) Determination re: any subsidy

The commissioner finds no competitive advantage from subsidy.

d) Determination re: any other factor

The commissioner considered whether there were any other sources of unfair competitive advantage beyond the above three specified for examination.

The commissioner finds there is a competitive advantage for BC Ferries inherent in the price cap regulatory framework under which it operates. Every four years the commissioner must set maximum allowed fares for other (i.e. non-drop trailer) monopoly traffic, to meet BCFS' cost of providing contracted capacity on each route. This capacity cannot be changed without the consent of the Province through amendments to the contract. This means that, once price caps for a performance term have been set, BC Ferries may take the view that any vessel/terminal capacity used by incremental drop trailer traffic has already been paid for by monopoly base traffic. Because this framework is available to BC Ferries, and to no other operator for reasons of government policy, this advantage is unfair with respect to competitive services.

The commissioner identified no other sources of unfair competitive advantage.³⁶
[Emphasis added.]

As discussed in the following section, BCFS challenges the findings regarding (b) and (d) in light of the new evidence and changed circumstances.

5.3.2 Tax Exemption No Longer Confers Any Material Advantage

In the 2011 Drop Trailer Decision, the Commissioner had identified BCFS' tax exemption as an "advantage" in the context of drop trailer service, but characterized the advantage as only requiring a "relatively small adjustment".³⁷ The tax exemption continues to exist. However, the already modest "advantage" for BCFS' drop trailer business associated with a tax exemption that had existed in 2011 is now even smaller. In practice, the existence of a tax exemption would now be highly unlikely to affect pricing decisions and competition in the drop trailer market. Put another way, in practical terms the exemption is no "advantage" at all.

The second branch of section 45.1 is engaged only where there is "**an advantage resulting from**" the listed criteria, not just the mere existence of a tax exemption, etc. Section 45.1(1) is repeated here for ease of reference and with the key words in this analysis emphasized:

45.1 (1) If a ferry operator is providing a competitive service, the commissioner must determine whether the ferry operator ... has an **unfair competitive advantage, including**, without limitation, **an advantage resulting from** the ferry operator having been provided with

- (a) use of, access to or ownership of vessels or terminals that are or had been owned by the government or a government body within the meaning of the Financial Administration Act,
- (b) any tax exemption, or
- (c) any subsidy.

In the present context, the Commissioner must assess whether the continued tax exemption still confers an "advantage" on drop trailer service. The Act does not define "advantage". However, it is clear from the context of the section that it is referring to something that would affect pricing decisions in a competitive business, representing a departure from a truly competitive price.

³⁶ Memorandum 42, p. 3 of 6.

³⁷ Memorandum 42, p. 5 of 6.

The Commissioner correctly identified in the 2011 Drop Trailer Decision that the magnitude of the tax exemption was already small, making any “advantage” to BCFS marginal at best. The Commissioner had made a “relatively small adjustment ... equal to the equity directly and indirectly associated with the drop trailer service, multiplied by the difference between a pre- and post-tax percentage annual return.”³⁸ The implication of the tax exemption for the drop trailer service is now much smaller than in 2011 for two reasons:

- The first notable point is that the already “relatively small adjustment” was calculated based on a significant proportion of indirect costs being allocated to drop trailer service. BCFS has explained above why, going forward, any MAAT should be based on avoidable/direct costs only. In the event that the Commissioner accepts BCFS’ position in this regard, the effect of the tax exemption on the drop trailer business is significantly reduced.
- Second, as discussed in section 3.5 above, changes in BCFS’ fiscal framework since the 2011 Decision have limited BCFS’ opportunity to earn the same pre-tax return on equity. A lower pre-tax return on equity further reduces the effect of BCFS’ tax exemption on the drop trailer business.

The *de minimis* impact of the tax exemption on the drop trailer business today is reflected in **Confidential Appendices B and C** (filed under separate cover). The impact of the tax exemption is approximately one-ninth of what was reflected in the 2011 Decision.

Dr. Ware addressed the tax exemption as follows:

46. Any advantage received by BCF as a result of its tax exempt status is only a *competitive advantage* in the drop trailer market to the extent that it impacts on competition in that market. For example, if the advantage conferred by tax exempt status were entirely in the form of a lump sum, which did not vary with marginal decisions regarding price or output in the drop trailer business, then there would be no competitive advantage.³⁹ The income tax exempt status will affect competition only to the extent that it affects the marginal costs or revenues of BC Ferries in the operation of its drop trailer service. In effect, this amounts to the impact of the tax exempt status, if any, on avoidable cost. I believe that the magnitude of this impact is minimal, likely negligible. To conclude: in my opinion, the tax exempt status of BC Ferries confers no significant competitive advantage on BC Ferries’ drop trailer business.⁴⁰

BCFS submits that, for all practical purposes, the tax exemption no longer confers an “advantage” that could reasonably affect pricing and competition in the drop trailer market. If a MAAT is required at all, the adjustment attributable to the tax exempt status should be very small.

³⁸ Memorandum 42, p. 5 of 6.

³⁹ The only caveat here would be if the lump sum impacted on the decision of any competitor to *participate* in the drop trailer market, which given the minimal size of the tax benefit, is highly unlikely.

⁴⁰ Appendix A, Roger Ware Report, para. 46.

5.3.3 Price Cap Subsidy Finding Premised on Allocating Non-Avoidable Costs

As reflected in the underlined portion of the passage from Memorandum 42 set out on pages 29 and 30 above, the Commissioner's finding that price cap regulation creates an unfair competitive advantage was premised on the notion that some of the costs associated with providing core ferry services and that are currently reflected in price caps ought to be borne by drop trailer customers. In other words, the implicit premise in this finding was that an avoidable (or incremental) costing approach for drop trailer service is not appropriate. BCFS has described earlier in this Filing why, in light of the new expert evidence, that premise no longer holds.

Dr. Ware elaborated in his report:

42. However, as I noted above, BC Ferries' vessels are designed and constructed to meet ferry service demand at peak sailing times. Thus, the capital infrastructure of the business is optimized for these needs and the regulatory price cap should be set at a level that allows an appropriate return to the capital that is needed to meet this requirement. If BC Ferries is now able to add in a drop trailer service employing otherwise unutilized capacity without adding to indirect costs, then the price cap calculation is unchanged.
43. In fact it is the presence of the price floor that can create a distortion that affects the level of the price cap. The reason is that if the price floor is set at too high a level, such that BC Ferries is prevented from effectively competing in its drop trailer business, then the return to the corporation is constrained below the level it could attain with efficient competition. Such a reduction in income must be compensated for in the long run by a higher price cap, and unnecessary and additional costs imposed on core customers of BC Ferries.
44. In conclusion, given the absence of cross-subsidization from BC Ferries' core service to BC Ferries drop trailer service, and the (equivalent) absence of predatory pricing, the price cap imposed on BCF's services does not provide an unfair competitive advantage to the company's drop trailer business.⁴¹

If the Commissioner accepts that an "appropriate proportion" of indirect costs under the first branch of the section 45.1(1) is defined by average avoidable costs/incremental costing, then the Commissioner's previous finding that there is an "advantage inherent in the price cap regulatory framework" can no longer be sustained. BCFS submits that this is the appropriate result going forward.

5.4 MAAT vs. Alternative Service Provider

BCFS submits that section 45.1(2) is not triggered in the present circumstances where BCFS is pricing above avoidable costs and the tax exemption no longer confers any practical advantage on BCFS' drop trailer business. This section addresses the issue of how the Commissioner should approach BCFS' drop trailer service going forward if, contrary to BCFS' position, the Commissioner makes a determination under section 45.1(1) of the Act that engages the need to choose between a MAAT or the use of an alternative service provider. BCFS submits that the proper approach, if any order is required, is the continued use of a MAAT.

⁴¹ Appendix A, Roger Ware Report, paras. 42 to 44.

Section 45.1(2) of the Act states:

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

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

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

BCFS addressed the issue of the application of section 45.1(2) in its December 8, 2010 submission (the "December 2010 Filing"), which was its reply to comments received by the Commissioner regarding the August 2010 Filing. BCFS stated:

... an order under section 45.1(2)(a) (alternative service provider) would represent a fundamental change of course for BCF, with significant ramifications for the company and its customers.⁴²

In the 2011 Drop Trailer Decision (Memorandum 42), the Commissioner made the following determination:

Flowing from these findings, s. 45.1(2) requires that the commissioner must regulate by ordering BCFS either to:

(a) provide the service through an alternative service provider or

(b) charge for the service at least a minimum tariff.

The commissioner has decided on (b), i.e. to set a minimum tariff, as the simpler and more workable option for the drop trailer services on the major routes.⁴³

BCFS agrees with the Commissioner's 2011 determination that administering a minimum tariff is simpler and more workable than introducing an alternative service provider for drop trailer services on the major routes. However, as described above, the new evidence before the Commissioner necessitates revisiting the findings that were the primary drivers of the MAAT in 2011.

5.5 Application of the Proposed Approach

Confidential Appendices B and C (redacted versions attached) summarize:

⁴² December 2010 Filing, p. 38: http://www.bcferrycommission.ca/wp-content/uploads/2011/05/s43-69/2010_12_09_CLtr_to_MCrillywSubmissionsFINAL_copy.pdf

⁴³ Memorandum 42, p. 4 of 6.

- The MAAT under the approach approved in Order 11-01 as at fiscal 2010 and updated for fiscal 2015 (Appendix B).
- The MAAT for fiscal 2010 and fiscal 2015 as calculated using an avoidable/incremental costing approach, with an adjustment for the tax exemption. This analysis is the relevant point of comparison where the Commissioner concludes that there is only an unfair competitive advantage associated with the tax exempt status (Appendix C).

SECTION 6: FOUR QUARTER ROLLING AVERAGE

On September 30, 2011, BCFS filed a request for the Commissioner to vary the aspect of his initial Drop Trailer Order that had, in effect, required the MAAT to be met in each quarter.⁴⁴ In Order 11-01B, issued on October 31, 2011⁴⁵, the Commissioner declined to reconsider the original Order “at this time”. However, the Commissioner also made it clear that BCFS was at liberty to reapply once the Seaspan appeal of the original Order was concluded. The Seaspan appeal was dismissed on February 6, 2013, and another 12 quarters have passed since then. That additional experience has confirmed the challenges identified in the original request for reconsideration.

BCFS' September 30, 2011 letter is attached for reference as **Appendix G** to this Filing.

The practical result of using a single quarter's experience to assess compliance with the MAAT is that BCFS cannot set its annual service prices to achieve the MAAT without running the risk that changes in traffic and customer mix within a particular quarter could cause non-compliance in that quarter. It must therefore leave a significant margin on its annual fixed prices to account for fluctuations in volume and mix within the year. The adoption of a four quarter rolling average is now warranted in the event that the Commissioner reaffirms the use of the MAAT.

⁴⁴ Appendix G.

⁴⁵ Order 11-01B, p. 3.

SECTION 7: CONCLUSION AND ORDER SOUGHT

The Commissioner's determinations in 2011 were premised on a finding that a material portion of the costs of vessels and terminals should be allocated to drop trailer service in the circumstances. The expert evidence included in this Filing provides a more comprehensive evidentiary basis in support of an average avoidable / incremental costing approach and confirms that it is consistent with widely recognized principles of competition policy and economics. The circumstances in which BCFS is operating have also changed since 2010, and these changes can be considered in determining the "appropriate proportion of indirect costs". In the present circumstances, the tax exemption does not confer any practical advantage on BCFS' drop trailer business. BCFS submits that section 45.1(2) is not triggered in the present circumstances where BCFS is pricing above avoidable costs and the tax exemption no longer confers any practical advantage on BCFS' drop trailer business. No MAAT is required.

If there is to be a MAAT, it should reflect only avoidable costs and a very small tax exemption adjustment, as reflected in **Confidential Appendix C**. A four quarter rolling average approach to assessing compliance with the MAAT is also reasonable in light of the experience to date.

BCFS respectfully submits that granting the orders sought in this Filing will avoid constraining BCFS' ability to compete fairly for drop trailer business. It will help to ensure that, in light of the present circumstances, drop trailer users benefit from fair competition between the two drop trailer providers. Healthy and appropriate drop trailer competition can only benefit consumers on Vancouver Island. It will ensure that benefits (additional revenues) from the drop trailer business flow directly to BCFS' customers to help lower fares across the system.

APPENDIX A

REPORT OF DR. ROGER WARE

**REPORT ON THE SETTING OF A PRICE FLOOR FOR B.C. FERRIES
DROP TRAILER SERVICE**

**Dr. Roger Ware
Professor of Economics, Queen's University
January 14, 2016**

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I. INTRODUCTION

1. I have been retained by British Columbia Ferry Services Inc. (“BC Ferries”, “BCF” or “BCFS”) to discuss certain economic aspects of the drop trailer service operated by BC Ferries.
2. I have been asked by BC Ferries to review a number of documents and provide comments and opinion on the following three questions:
 - a) How would competition and antitrust principles define the appropriate costs to be allocated to BC Ferries’ drop trailer service to ensure that BC Ferries is not engaging in anticompetitive or predatory pricing?
 - b) If BC Ferries adheres to the principles articulated in the response to the first question, and appropriately allocates costs to the drop trailer service so that it is not engaging in anticompetitive or predatory pricing, then to what extent does the price cap regulation of BC Ferries’ passenger and vehicle ferry services provide a competitive advantage to BC Ferries?
 - c) What economic harm, if any, flows from a regulator setting a price floor for BC Ferries’ drop trailer service that is higher than what is necessary for BC Ferries to cover an appropriate allocation of costs as reflected in the response to the first question?

II. QUALIFICATIONS

3. I am a Full Professor of Economics at Queen’s University in Kingston, Ontario. I have held this position since 1996. The following is a summary of my qualifications in the area of Economics, Competition Policy and Industrial Organization. I have held full-time faculty positions for 34 years at the University of Toronto and Queen’s University, and a visiting position at the University of California, Berkeley in 1987-88. I have published many articles in the area of Industrial Organization, Competition Policy and Regulation, and a major textbook on the Economics of Industrial Organization, much of which is devoted to Antitrust

Economics and Regulation.¹ I teach three or four courses each year at both the undergraduate and graduate level, covering the Economics of Regulation and Industrial Organization and have taught Competition Law in the Queen's University Faculty of Law on several occasions. From 1993-94, I held the T.D. MacDonald Chair at the Competition Bureau, and provided advice to the Director and other officers on many cases and issues. I have testified, given evidence, and consulted in several matters involving competition and regulatory issues. Finally, I have been an invited speaker to the Canadian Bar Association Annual Competition Law Conference on several occasions.

4. A full version of my curriculum vitae is attached as Appendix A to this report. A list of materials that I have considered in preparing this report is attached as Appendix B.

III. SUMMARY OF OPINIONS

5. My findings and opinions are summarized as follows:
 - a) The appropriate cost concept from competition and antitrust principles for pricing in drop trailer service is that of average avoidable cost. Because of the design and operation of BC Ferries' passenger and vehicle² services, only the direct costs of operating the drop trailer service should be considered to be avoidable.
 - b) The drop trailer service operated by BC Ferries is designed to optimize the use of capacity on ferry sailings and imposes no additional costs on the passenger and vehicle ferry services. To the extent that BC Ferries is using this excess capacity for its drop trailer service, there is no cross-subsidy from the passenger and vehicle ferry services to the drop trailer service. A corollary is that the price cap calculated for all ferry services is an appropriate one and confers no unfair competitive advantage on the drop trailer service in the freight service market to and from Vancouver Island.

¹ Church, Jeffrey R., and Roger Ware. *Industrial Organization: A Strategic Approach*. McGraw-Hill-Irwin (2000), ("Church and Ware").

² "Vehicle" refers to both passengers' private vehicles and freight transportation vehicles through BC Ferries' roll-on, roll-off service.

- c) To the extent that the price floor incorporates costs that are over and above avoidable costs, the price floor imposed by the BC Ferries Commissioner is currently set a level that is too high to allow effective competition in the freight services market between BC Ferries and its dominant rival, Seaspan Ferries Corporation (“Seaspan”). As a result, freight customers will be exposed to higher rates for freight shipping services both with BC Ferries and with Seaspan. The high price floor allows Seaspan to exercise market power without the competitive check that would otherwise be imposed by effective competition from BC Ferries. In addition, because less income is earned by the drop trailer service than could potentially be the case, the passenger and vehicle customers of BC Ferries are also harmed, in that they are required to pay higher fares (and shipping rates for on demand truck customers) than would be the case with a price floor either removed or set at a lower and more appropriate level.

IV. BACKGROUND

A. Overview of Drop Trailer Services

6. Drop trailer service is an auxiliary freight transportation service used by vessels for the efficient delivery of freight and adopted in 2009 by BC Ferries.³ BC Ferries vessels are designed primarily for on-demand or “roll-on, roll-off” service to vehicles carrying passengers and freight, and to foot passengers. Roll-on, roll-off services for commercial passengers are also referred to as “live” services, as a driver travels with the freight.⁴ The innovation in drop trailer service is that the driver (employed by the shipper) leaves their trailer in a specially designated parking facility at the Ferry Terminal, disconnects the cab, and drives the cab away.⁵ The trailer is picked up by a BC Ferries driver using a specially

³ “SCIC [Seaspan] and VIBS were the only two providers of drop trailer service to Vancouver Island at the time BC Ferries launched its drop trailer service in 2009.” BC Ferries, “Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service,” August 31, 2010, p. 12.

⁴ BC Ferries, “Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service,” August 31, 2010, p. 10.

⁵ BC Ferries, “Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service,” August 31, 2010, p. 3.

designed, compact hostling unit and drives the trailer onto a scheduled ferry service. At the destination terminal another driver from the shipping company picks up the trailer in another designated parking lot. This intermodal system *i.e.*, the drop trailer service, economizes on the highest labor costs, those of the shippers' truck drivers, who are otherwise required to wait at the ferry terminal for available ferry space, and to accompany the trailer for the entirety of the journey. Instead, truck drivers can drop off their load at the ferry terminal and move easily to a new assignment.⁶ As BC Ferries' drop trailer service is designed to use excess capacity, it is complementary to other ferry services, likely lowering the cost for both.⁷

7. BC Ferries' passenger and vehicle services are regulated by the British Columbia Ferries Commissioner ("the Commissioner") under the authority of the *Coastal Ferry Act*, 2003. This statutory framework was created to regulate ferry operators such as BC Ferries.⁸ The Commissioner establishes price caps for BC Ferries, balancing the interests of the company, ferry users and taxpayers.⁹ It is also my understanding that the *Coastal Ferry Act* was amended in 2010 to allow the Commissioner to oversee certain aspects of pricing practices in competitive lines of business.¹⁰ Specifically, the Commissioner's mandate in regards to the drop trailer service is described in Section 45.1, and is limited to ensure that BC Ferries does not price its fares below cost and that it does not enjoy an unfair competitive advantage over its competitors.¹¹

⁶ BC Ferries, "Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service," August 31, 2010, pp. 12-14.

⁷ BC Ferries, "Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service," August 31, 2010, p. 21.

⁸ "Coastal Ferry Services Contract between British Columbia Ferry Corporation and the Province of British Columbia," April 1, 2003, p. 1.

⁹ *Coastal Ferry Act*, s.38.

¹⁰ *Coastal Ferry Act*, s.45.1.

¹¹ "The Commission ensures that the average level of ferry fares charged by the company does not rise above a ceiling or 'price cap' set by the Commission. Other key tasks of the commissioner include monitoring BC Ferries' adherence to the terms of the Coastal Ferry Services Contract, approval of major capital expenditures, conducting performance reviews, regulating unfair competitive advantage and the approval and monitoring of BC Ferries' customer complaints process." British Columbia Ferry Commission, "Regulations," available at: <http://www.bcferrycommission.ca/regulations-probes/regulations/>. Accessed November 9, 2015; *Coastal Ferry Act*, s.45.1.

8. Each performance term, which is a four-year period, the Commissioner establishes price caps for all of BC Ferries' services, including passenger, passenger vehicles, and commercial vehicles (including drop trailers). The first performance term started on BC Ferries' "commencement date" of April 1, 2003.¹² For the passenger and vehicle services, each price cap decision can be summarized as the maximum increase in an aggregate price index that can be charged by the company per year. The price cap is calculated by taking a benchmark (based on the company's forecasted costs and revenues) and adjusting it upwards for inflation and downwards for a target level of efficiency gains.
9. In its 2011 decision, the Commissioner also established a price floor for BC Ferries' drop trailer service, based on the costs of providing that service. The quarterly total revenue from the drop trailer services on major routes, divided by the space occupied by the drop trailers and their hostler units should be no less than the price floor, or "minimum allowed average tariff," expressed on a "vessel-foot"¹³ basis.¹⁴ Additionally, the price floor is annually adjusted for inflation.¹⁵

B. Entities Providing Freight Services in the Relevant Markets

10. There have been some significant changes in structure in the market for freight services to and from Vancouver Island over the past six years. Although BC Ferries and other providers

¹² "Coastal Ferry Services Contract Between British Columbia Ferry Corporation And The Province of British Columbia," April 1, 2003, p. 3

¹³ "Vessel-feet are the lane-feet on a vessel occupied by a trailer and its attached BCFS hostler unit." British Columbia Ferry Commission, "Memorandum 42. Re: Summary of Determinations on Drop Trailer Inquiry under s. 45.1 of the *Coastal Ferry Act*," February 7, 2011.

¹⁴ "Beginning with service provided during the first quarter of fiscal 2012, BCFS shall report quarterly to the commissioner within 60 days of the end of each quarter: (a) the quarterly total revenue from its drop trailer tariff on the major routes and (b) the number of vessel-feet occupied (lane feet occupied by drop trailers and their hostler units). ... BCFS shall ensure that the amount (a) divided by (b), being the average revenue per vessel-foot for the quarter, shall not be less than the MAAT as defined above. When the drop trailer volume exceeds a rate of Y.YY (see note 1 overleaf) million vessel-feet per year, or at the discretion of the commissioner, the minimum tariff shall be re-set in light of experience with actual costs and drop trailer traffic volumes. For this purpose the commissioner has archived the electronic workbook files which he used to calculate unit prices and revenues based on data from fiscal 2010." British Columbia Ferry Commission, "Order 11-01 (non-confidential version) Determination," February 7, 2011.

¹⁵ "The drop trailer minimum allowed average tariff (MAAT) shall be set at \$X.XX (see note 1 overleaf) per vessel-foot for fiscal 2012, and shall be changed for each subsequent fiscal year by a consumer price index adjustment..." British Columbia Ferry Commission, "Order 11-01 (non-confidential version) Determination," February 7, 2011.

have served the “live freight” market, BC Ferries recently entered into the market for drop trailer freight services in 2009.¹⁶ At that time, there were two drop trailer services providers –Van Isle Barge Services (a small provider), and Seaspan (a larger player). There were three providers in this market until 2011, when Seaspan purchased Van Isle Barge Services and became the dominant provider of drop trailer freight services between the mainland and Vancouver Island.¹⁷

11. **BC Ferries** is a ferry operator providing passenger and vehicle services. The company owns 35 ferries, which provide service to 47 ports throughout coastal British Columbia, with the company’s busiest crossings being the routes between Vancouver Island and the mainland.¹⁸ BC Ferries started as a Crown corporation in 1960, focusing on passenger transportation, and became an independent corporation regulated by the British Columbia Ferries Commission in 2003. BC Ferries receives government subsidies on some routes to provide certain services for passengers and vehicles, but does not receive government subsidies on the routes where drop trailer service is provided, which are Routes 1 (linking Swartz Bay and Tsawwassen) and 30 (linking Tsawwassen and Nanaimo).^{19,20} In 2009, BC Ferries began to offer a drop trailer service between the mainland and Vancouver Island.²¹
12. **Seaspan Ferries** is part of a large maritime operator in the Pacific North West, which operates freighter services and engages in a wide variety of other shipping related industries

¹⁶ BC Ferries, “Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service,” August 31, 2010, p. 10.

¹⁷ “The appellant, Seaspan, is the dominant company and major competitor of BCFS in the drop trailer business in British Columbia,” Court of Appeal for British Columbia, “Seaspan Ferries Corporation v. British Columbia Ferry Services, Inc., 2013 BCCA 55,” available at: <http://courts.gov.bc.ca/jdb-txt/CA/13/00/2013BCCA0055.htm>. Accessed December 17, 2015.

¹⁸ BC Ferries, “Where We Sail,” available at: http://www.bcferreries.com/at_the_terminal/where-we-sail.html. Accessed December 15, 2015.

¹⁹ “Coastal Ferry Services Contract between British Columbia Ferry Services, Inc. and the Province of British Columbia,” April 1, 2003.

²⁰ BC Ferries, “Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service,” August 31, 2010, Appendix C – EES Consulting Report, p. 2.

²¹ BC Ferries, “History,” available at: <http://www.BCFerries.com/about/history/>. Accessed October 31, 2015.

including three shipyards in BC and a bunker fuel supplier.²² Seaspan provides a drop trailer service between Vancouver Island and the Lower Mainland. In March 2013, Seaspan appealed Commission Order 11-01 to the BC Court of Appeal, but this appeal was dismissed.^{23,24}

13. **Van Isle Barge Service (VIBS)** has entered and exited the market for freight services between the lower mainland and Vancouver over the past 22 years. VIBS introduced its drop trailer service in 1993. In 1995, Coastal Marine Operations (a subsidiary of Canadian Pacific Railway) acquired VIBS. In 1998, Coastal Marine Operations was acquired by the Washington Marine Group. VIBS re-introduced its drop trailer service in 2004, and therefore was offering drop trailer services between the lower mainland and Vancouver Island in 2009 when BC Ferries introduced its own drop trailer services.²⁵ VIBS was acquired by Seaspan in 2011.²⁶

C. The Regulatory Framework in Place

14. Section 45.1(1) of the *Coastal Ferry Act* states that if the Commissioner determines that BC Ferries is offering a competitive service, the Commissioner must then determine whether that service is being offered at a price which is below an appropriate measure of cost.
15. Section 45.2(b) of the *Coastal Ferry Act* specifies that the Commissioner will

²² Seaspan, “About Seaspan,” available at: <http://www.seaspan.com/about-seaspan>. Accessed November 1, 2015.

²³ British Columbia Ferry Commission, “Seaspan’s Appeal of Commission Order Dismissed,” available at: <http://www.BCferrycommission.ca/reports-press/whats-new/seaspans-appeal-of-commission-order-dismissed/>. Accessed November 1, 2015.

²⁴ Seaspan contended that “the Commissioner failed to act in a procedurally fair manner, that he erred in his interpretation of the *Coastal Ferry Act*, S.B.C. 2003, c. 14, and that he did not have jurisdiction to keep the tariff that he established confidential,” Court of Appeal for British Columbia, “Seaspan Ferries Corporation v. British Columbia Ferry Services, Inc., 2013 BCCA 55,” available at: <http://courts.gov.bc.ca/jdb-txt/CA/13/00/2013BCCA0055.htm>. Accessed December 17, 2015.

²⁵ “SCIC and VIBS were the only two providers of drop trailer service to Vancouver Island at the time BC Ferries launched its drop trailer service in 2009.” BC Ferries, “Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service,” August 31, 2010, p. 12.

²⁶ The Monitor, “Seaspan Swallows Another West Coast Player,” March 3, 2012. Available at: <http://dieselduck.blogspot.ca/2012/03/seaspan-swallows-another-west-coast.html#.VnB-akorLmE>, accessed December 15, 2015; Mid Island News Blog, “Waste to Energy: Who Wants to Burn Metro-Vancouver’s Garbage?” November 12, 2013. Available at: <http://midislandnews.com/waste-to-energy-who-wants-to-burn-metro-vancouvers-garbage>. Accessed December 15, 2015.

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

16. Relatedly, the Commissioner in his 2011 decision found that price cap regulation also conferred an unfair advantage to BC Ferries with respect to its drop trailer service product. The logic of his position seems to be that pricing the drop trailer services product at too low a level implies that excessive costs are being attributed to the passenger and vehicle ferry services – and that these costs are then recovered through the price cap on all services.
17. The Commissioner computed an amount “to recover the direct costs and an appropriate proportion of the indirect costs” in order to determine a price floor for BC Ferries’ drop trailer service.²⁷ By comparing the computed amount with the average price charged by BC Ferries for drop trailer service, the Commissioner determined that BC Ferries was pricing below cost, and imposed a price floor on BC Ferries drop trailer services rates.²⁸

V. APPROPRIATE PRINCIPLES FROM COMPETITION LAW AND ECONOMICS TO ENSURE THAT BC FERRIES IS ENGAGED IN FAIR COMPETITION IN DROP TRAILER SERVICE

18. Although the operations of B.C. Ferries are regulated through the *Coastal Ferry Act*, they also fall under the jurisdiction of the *Competition Act*.

²⁷ British Columbia Ferry Commission, “Order 11-01 (non-confidential version) Determination,” February 7, 2011, p. 2.

²⁸ “(i) For costs indirectly attributable to the drop trailer service, it is appropriate to apply a “route overhead charge” to the costs of drop trailer service to recognize the provision of terminal and deck space, and marine transport. This charge is in addition to the costs that BCFS considers to be appropriate as presented in its submissions; (ii) When the “route overhead charge” is taken into account, BCFS is pricing drop trailer service on its major routes below the sum comprised of its direct costs and an appropriate proportion of indirect costs associated with the service; [...] (iv) Having found that BCFS is pricing below cost, and also that BCFS has unfair competitive advantages, the commissioner is required to regulate BCFS drop trailer services on its major routes and will do so by establishing a minimum tariff as provided under s. 45.1(2)(b); and

K. The commissioner has calculated the amount that he considers would be charged as an average tariff per vessel-foot (being a lane foot onboard a vessel occupied by drop trailers and their hostler units) to recover the direct costs and an appropriate proportion of the indirect costs, were none of the factors in s. 45.1(1) present.” British Columbia Ferry Commission, “Order 11-01 (non-confidential version) Determination,” February 7, 2011, p.2.

19. The *Competition Act* invokes concepts that are well-understood in competition law and economics—those of fair and unfair competition. As such, when discussing the competitive provision of drop trailer services it is logical to analyze the dimensions of competition within this market using economic principles and analyses borrowed from the *Competition Act*.
20. The particular practice that I will focus on here is that of predatory pricing. In the latter part of the section I compare predatory pricing to cross-subsidization, which is a concept defined more within regulatory economics than competition law but which has considerable overlap with that of predatory pricing.
21. To the extent that a more interventionist program of regulation is not required, the *Competition Act* provides an important and appropriate framework to protect against the possibility of predatory pricing carried out either by BC Ferries or by its major rival in freight service to Vancouver Island, Seaspán. It is worth emphasizing that it is Seaspán and not BC Ferries that is the dominant provider within this market.²⁹

A. Predatory Pricing

22. Predatory pricing refers to exclusionary conduct practiced by a dominant firm, taking the form of pricing at unfairly low levels for the explicit purpose of forcing the exit of a rival, or at the very least disadvantaging a rival in some way that is incompatible with “normal” competition. The firm can then increase its prices once the rival exits the market.³⁰

²⁹ “The appellant, Seaspán, is the dominant company and major competitor of BCFS in the drop trailer business in British Columbia,” Court of Appeal for British Columbia, “Seaspán Ferries Corporation v. British Columbia Ferry Services, Inc., 2013 BCCA 55,” available here: <http://courts.gov.bc.ca/jdb-txt/CA/13/00/2013BCCA0055.htm>. Accessed December 17, 2015.

³⁰ Predatory pricing is now covered in the Abuse of Dominance Provisions (2012) published by the Competition Bureau. The relevant short section describing the Bureau’s approach to predatory pricing is reproduced in full below:

Predatory conduct involves a firm deliberately setting the price of a product(s) below an appropriate measure of cost to incur losses on the sale of product(s) in the relevant market(s) for a period of time sufficient to eliminate, discipline, or deter entry or expansion of a competitor, in the expectation that the firm will thereafter recoup its losses by charging higher prices than would have prevailed in the absence of the impugned conduct. Predatory pricing may be implicit (through discounts or rebates, for example), or explicit. The Bureau’s view is that average avoidable cost is the most appropriate cost standard to use when determining if a dominant firm’s prices are below cost. Avoidable costs refer to all costs that could have been avoided by a firm had it chosen not to sell the product(s) in question during the period of time the policy has been in place. The Bureau will examine whether an alleged predatory price is able to cover the dominant

23. The legal and economic tests for whether pricing conduct should be considered predatory have evolved over the past several decades to two essential elements.³¹

- The dominant firm must have set prices below average avoidable cost for a significant period of time.
- There must be a reasonable prospect for the dominant firm of recouping the losses sustained in the predatory pricing campaign from some future period of protected monopoly, or at least enhanced market power.³²

24. The first cost-based test for predatory pricing was developed by Areeda and Turner in a 1975 article in which they argued that a dominant firm's prices should remain above average variable costs in order to avoid charges of predation.³³ In the late twentieth century the Areeda-Turner test was widely adopted by courts in the United States, Canada and other jurisdictions.³⁴ Baumol argued in a 1996 paper that a more appropriate test would compare

firm's average avoidable cost of supplying the product(s) in question during the time period over which the alleged predation has occurred. As there are difficulties inherent in applying a price-cost test and in distinguishing between predatory and competitive pricing (as both involve lower prices in the short term), the Bureau generally uses various "screens" prior to conducting an avoidable cost analysis. Specifically, the Bureau will examine whether the alleged predatory price can be matched by competitors without incurring losses (suggesting that discipline or exclusion, and subsequent recoupment, is unlikely to occur), as well as whether the alleged predatory price is in fact merely "meeting competition" by reacting to match a competitor's price.

Competition Bureau, "The Abuse of Dominance Provisions - Sections 78 and 79 of the *Competition Act*," September 20, 2012, p.12.

³¹ Church and Ware, p.660; Hovenkamp, Herbert J. "The Law of Exclusionary Pricing." University of Iowa Legal Studies Research Paper (2006), pp.1-2.

³² Competition Bureau, "The Abuse of Dominance Provisions- Sections 78 and 79 of the *Competition Act*," September 20, 2012; Bolton, Patrick, Joseph F. Brodley and Michael H. Riordan, "Predatory Pricing: Strategic Theory and Legal Policy." *Georgetown Law Journal* (1999): 32-38, pp. 32-38.

³³ "Variable costs, as the name implies, are costs that vary with changes in output. They typically include such items as materials, fuel, labor directly used to produce the product, indirect labor such as foremen, clerks, and custodial help, utilities, repair and maintenance, and per unit royalties and license fees. The average variable cost is the sum of all variable costs divided by output"; and "Recognizing that marginal cost data are typically unavailable, we conclude that: (a) A price at or above reasonably anticipated average variable cost should be conclusively presumed lawful. (b) A price below reasonably anticipated average variable cost should be conclusively presumed unlawful." Areeda, Phillip, and Donald F. Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act." *Harvard Law Review* (1975): 697-733, pp. 700, 733.

³⁴ "Ever since the appearance in 1975 of the classic Areeda-Turner article, average variable cost (AVC) has played a key role in adjudication of charges of predatory pricing. This is so despite the conclusion by Phillip Areeda and Donald Turner that it is marginal cost (MC) rather than any form of average cost that constitutes the defensible borderline between a price that is predatory and one that is not. As in their article,

the alleged predator's prices with average avoidable cost rather than average variable cost.³⁵ Avoidable cost includes variable costs but also includes any fixed costs that could be "avoided" if the service in question were suspended. Subsequently, the test of whether a dominant firm is pricing below average avoidable cost has become the most widely accepted screen for determining whether a firm has engaged in predatory pricing.

i. Dominance

25. The application of the tests discussed above – and specifically the application of predatory pricing tests under the *Competition Act* – requires the appropriate identification of the dominant firm. A dominant firm "accounts for a significant share of a given market and has a significantly larger market share than its next largest rival."³⁶ The dominant position of a particular party cannot be assumed – it must be tested through a comparison of market shares within the relevant market(s). It is likely that Seaspan is the dominant competitor in the relevant market. Like all market players in unregulated markets, Seaspan is subject to the *Competition Act*. Therefore, the price floor imposed on BC Ferries may prevent BC Ferries from exerting valuable competitive discipline on Seaspan's prices, and may result in higher prices than would otherwise occur through a market-based outcome.

ii. Identifying Average Avoidable Costs

26. Average avoidable costs are those costs that would be avoided if a company decided not to provide the service in question. These costs include variable costs and product-specific fixed costs, but not sunk costs.³⁷ Avoidable costs thus do not have to vary directly with the level of

the courts have accepted the view that marginal cost is exceedingly difficult to determine in practice, so that, *faute de mieux*, one must apologetically accept average variable cost as an imperfect proxy, even though one knows full well that the magnitudes of the two costs can differ substantially." Baumol, William J., "Predation and the Logic of the Average Variable Cost Test," *Journal of Law and Economics* (1996): 49-72, p. 49.

³⁵ "In all this it should be recognized that the problem of determining an appropriate lower bound for price, as the Areeda-Turner test of predatory pricing undertakes to do, is very much like the problem of selecting such a price floor as a criterion of cross subsidy." Baumol, William J. "Predation and the Logic of the Average Variable Cost Test," *Journal of Law and Economics* (1996): 49-72, pp. 50-51.

³⁶ OECD, "Glossary of Statistical Terms: Dominant Firm," available at: <https://stats.oecd.org/glossary/detail.asp?ID=3199>. Accessed December 8, 2015; Church and Ware, Chapter 4.

³⁷ Competition Bureau of Canada, "The Abuse of Dominance Provisions- Sections 78 and 79 of the *Competition Act*," September 20, 2012.

a firm's output. For example the rental, heat and maintenance costs of a building, or in this instance, the hostling units that drive the drop trailers on or off the ferries may count as partially avoidable costs as these units may be resold if the drop trailer service was discontinued.

27. Clearly the time scale of an enquiry affects the costs that should be included as part of avoidable costs. Even though economists correctly state that all costs are variable in the long run, the avoidable costs analysis in this matter should use the time period relating to the alleged predatory pricing.
28. In the 2010 process, BC Ferries identified the following components of avoidable costs (also identified as direct costs):³⁸

- Hostling units (leasing, maintenance, fuel, insurance and return on equity at the pre-tax rate);
- Holding compounds and portable office spaces (leasing property tax, utilities, maintenance, security, insurance and return on equity at the pre-tax rate);
- Employees (salaries, benefits, uniforms and travel);
- Telecommunications and office equipment, including return on equity at the pre-tax rate; and
- Office supplies and materials.

29. There might be some debate about whether the costs of the hostling units are even avoidable at all. The market for used equipment of this kind may be fairly limited so that these costs are at least partially sunk.³⁹ The employees of the drop trailer service could, at least in part, be absorbed back into the overall complement of BC Ferries and so their employee costs should probably be counted as avoidable. The other elements above are clearly avoidable – if the drop trailer service were to shut down, these costs need not be incurred.

³⁸ BC Ferries, "Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service," August 31, 2010, p. 35.

³⁹ Sunk costs are by definition not avoidable. "Sunk costs must be paid whether the firm stays in business or not." Church and Ware, pp. 22-23.

iii. Why are BC Ferry costs (indirect costs) not “avoidable”?

30. The BC Ferries system is designed with a capacity able to meet peak demand. This naturally results in unused space on the deck throughout any given day, space the drop trailer service can use without imposing any opportunity cost on the other ferry services at all. So, to the extent that BC Ferries is using excess capacity, no extra resources of the passenger and vehicle ferry services are used in order to operate the drop trailer service.⁴⁰
31. Drop trailer utilization of otherwise unused space within a ferry system designed to accommodate peak demand does not make capacity-driven costs avoidable. In the broadest sense, if drop trailer service were discontinued, BC Ferries would continue to use the same size vessel and maintain the same terminal facilities for vehicle and passengers.
32. In addition, peak demand occurs at specific times on specific days, and as such demand is managed through reservations. As a consequence, reserved vehicles have priority and would not be bumped by a drop trailer.⁴¹ Vehicles without reservations are not guaranteed to sail without waiting. However, even bumping of other traffic by drop trailers does not necessarily mean that costs are avoidable. Even in the absence of drop trailer service, some traffic would occasionally get “bumped” from a specific ferry sailing.⁴²
33. Even if one were to consider some of the costs to be avoidable, in this instance, the relevant metric is not the percentage of sailings for which passenger and commercial vehicles are “bumped” by drop trailer customers – it is the percentage of passenger and commercial ferry

⁴⁰ “BC Ferries’ drop trailer service operates during off-peak times and uses surplus capacity, it is complementary to BC Ferries’ core services and benefits all ferry users by reducing the amount BC Ferries must recover on average from remaining ferry users.” BC Ferries, “Filing with the British Columbia Ferries Commissioner Regarding Section 45.1(1) of the *Coastal Ferry Act* and Trailer Service,” August 31, 2010, p. 3.

⁴¹ Note that all customers who reserve in advance are guaranteed a spot on a given sailing provided that they are checked in 30 minutes prior to the ferry’s departure time. BC Ferries, “Frequently Asked Questions,” available at: http://www.bcferrys.com/travel_planning/frequently_asked_questions.html. Accessed December 17, 2015.

⁴² Seaspan reports that 8% of BC Ferries sailings between March 2009 and August 2010 have bumped passenger cars while drop trailers have been onboard, but they do not report the percentage of drop trailer traffic that actually bumps a passenger or commercial customer, which is likely much lower. See “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. Available at: http://www.bcferrycommission.ca/wp-content/uploads/2011/05/s43-69/s45-SCIC_Submission_to_BCFC_2010-11-26.pdf. Accessed January 7, 2016.

space that is actually bumped by drop trailer traffic. If, for example, 5% of drop trailer shipments actually bumped a core customer, the avoidable portion of the indirect costs associated with the drop trailer shipments would be only 5% of the relevant indirect costs. Even this small portion of indirect costs may not be appropriate as customers without reservations that are not able to depart on one sailing will generally be carried on the next sailing. As it is my understanding that all traffic is carried on the same day of request, the any indirect costs that are appropriately attributable to the drop trailer service are likely minimal or negligible.

B. Cross-subsidization

34. Cross-subsidization is a term used to indicate whether a firm or other entity is using a revenue stream from one product line to support a different product line or class.⁴³ A cross-subsidy may exist “if the revenues from a product are less than its costs of production.”⁴⁴ This might, for example, allow the subsidized product class to be offered at a lower price. Cross-subsidization can take place across spatial markets as well as between different products, e.g., where an airline subsidizes sparsely populated regional markets with its revenues from high density urban travel centers.
35. But how can we precisely identify cases of cross-subsidization? Cross-subsidization, in a regulatory context, is defined as being outside the bounds of stand-alone costs and incremental costs. Cross-subsidy tests provide a way to examine competition issues from the perspective of regulatory economics, and require an examination of “stand-alone costs” and “incremental costs.”
36. Stand-alone costs are defined for a given product class as the costs of producing that product class alone, in the absence of any other activities that the utility or entity is engaged in. In the current context, the relevant stand-alone costs are the costs of providing the passenger and vehicle services by themselves. The Stand Alone Cost test for cross-subsidization states that the rates for passenger and vehicle services must not exceed the stand alone cost of providing them. But this is precisely what a price cap is supposed to ensure, provided that the price cap

⁴³ Church and Ware, Chapter 25.

⁴⁴ Church and Ware, p. 797.

is appropriately calculated. Provided that the current Price Cap for B.C. Ferries includes all the direct and indirect costs of operating the passenger and vehicle ferry services when capacity is set optimally, then the price cap by itself will ensure that the passenger and vehicle ferry service is not providing a cross subsidy to the drop trailer service.

37. The incremental cost test provides an alternative test of whether the drop trailer service is receiving a cross subsidy from the passenger and vehicle ferry services. The incremental costs of operating the drop trailer service are the *additional* costs of providing that service when the passenger and vehicle ferry services are already being supplied optimally. If rates for drop trailer service exceed incremental costs, the test passes and passenger and vehicle ferry services are not providing any cross subsidy to the drop trailer service. Thus, incremental costs for drop trailer service are exactly the direct costs of providing the service that I identified in section IV. That is, incremental costs and average avoidable costs are, in this context, exactly the same thing. In the current case, the incremental cost test and the average avoidable cost test are identical, and of course, will yield identical answers.
38. The two tests for cross-subsidization, stand-alone costs and incremental costs, are also equivalent under some conditions. Provided that BC Ferries is earning no more than a normal return on capital, it is not necessary to perform both tests because they are providing the same information. Henceforth, I will refer only to the incremental cost test for cross-subsidization, and the avoidable cost test for predatory pricing, which are themselves equivalent in the case at hand.
39. To conclude this section, an incremental cost test for cross subsidization arrives at exactly the same conclusion as the test I discussed for predatory pricing. Provided that the price for drop trailer service exceeds the direct or avoidable costs of providing that service, there will be no cross subsidization of drop trailer service by the passenger and vehicle ferry services, its customers or the taxpayer.

VI. DOES BC FERRIES HAVE A COMPETITIVE ADVANTAGE ARISING FROM THE PRICE CAP ADDRESSED TO ITS CORE SERVICES?

40. Section 45.1(1) of the *Coastal Ferry Act* requires the commissioner to determine whether BCF has any unfair competitive advantage in a business that has been deemed “competitive” as the drop trailer business to Vancouver Island has been. In general, as BC Ferries’ drop trailer service makes efficient use of excess capacity on the ferries, there is no unfair competitive advantage provided that the core services are not cross-subsidizing the drop trailer service. I elaborate on this point below.

A. No unfair competitive advantage from price caps

41. In his 2011 decision the BC Ferries Commissioner found that the price cap regulation imposed on BC Ferries’ core service also conferred an unfair competitive advantage on BCF in its drop trailer service.⁴⁵ The reasons presented by the Commissioner were that by allocating too high a proportion of its indirect costs to the core service, BC Ferries would obtain a higher price cap than would otherwise be the case, which would have the net effect of implying a cross subsidization from passenger and vehicle ferry customers to the drop trailer service.
42. However, as I noted above, BC Ferries’ vessels are designed and constructed to meet ferry service demand at peak sailing times. Thus, the capital infrastructure of the business is optimized for these needs and the regulatory price cap should be set at a level that allows an appropriate return to the capital that is needed to meet this requirement. If BC Ferries is now able to add in a drop trailer service employing otherwise unutilized capacity *without* adding to indirect costs, then the price cap calculation is unchanged.
43. In fact it is the presence of the *price floor* that can create a distortion that affects the level of the price cap. The reason is that if the price floor is set at too high a level, such that BC Ferries is prevented from effectively competing in its drop trailer business, then the return to the corporation is constrained below the level it could attain with efficient competition. Such a reduction in income must be compensated for in the long run by a higher price cap, and unnecessary and additional costs imposed on core customers of BC Ferries.

⁴⁵ British Columbia Ferry Commission, “Order 11-01 (non-confidential version) Determination,” February 7, 2011, p. 2.

44. In conclusion, given the absence of cross-subsidization from BC Ferries' core service to BC Ferries drop trailer service, and the (equivalent) absence of predatory pricing, the price cap imposed on BCF's services does not provide an unfair competitive advantage to the company's drop trailer business.

B. Income tax exemption

45. In his 2011 decision, the BC Ferries Commissioner found that BC Ferries enjoys an unfair competitive advantage arising from its income tax exempt status. Specifically, this tax exempt status requires a "relatively small adjustment ... equal to the equity directly and indirectly associated with the drop trailer service, multiplied by the difference between a pre- and post-tax percentage annual return."⁴⁶

46. Any advantage received by BCF as a result of its tax exempt status is only a *competitive advantage* in the drop trailer market to the extent that it impacts competition in that market. For example, if the advantage conferred by tax exempt status were entirely in the form of a lump sum, which did not vary with marginal decisions regarding price or output in the drop trailer business, then there would be no competitive advantage.⁴⁷ The income tax exempt status will affect competition only to the extent that it affects the marginal costs or revenues of BC Ferries in the operation of its drop trailer service. In effect, this amounts to the impact of the tax exempt status, if any, on avoidable cost. I believe that the magnitude of this impact is minimal, likely negligible. To conclude: in my opinion, the tax exempt status of BC Ferries confers no significant competitive advantage on BC Ferries' drop trailer business.

VII. BC FERRIES' HIGH PRICE FLOOR REQUIREMENT HARMS CONSUMERS, BUSINESSES, AND THE BC ECONOMY

B. Overview of Economic Effects

47. The drop trailer business developed by BC Ferries has the potential to create benefits for all BC Ferries customers – as well as for the larger BC economy. The efficient (or inefficient) operation of the supply chain may also have wide-ranging effects across the markets that

⁴⁶ British Columbia Ferry Commission, "Memorandum 42. Re: Summary of Determinations on Drop Trailer Inquiry under s. 45.1 of the *Coastal Ferry Act*," February 7, 2011, p. 5.

⁴⁷ The only caveat here would be if the lump sum impacted on the decision of any competitor to *participate* in the drop trailer market, which given the minimal size of the tax benefit, is highly unlikely.

depend on ferry-based transportation services to and from Vancouver Island, extending far beyond BC Ferries' direct customers of either drop trailer services or passenger services.

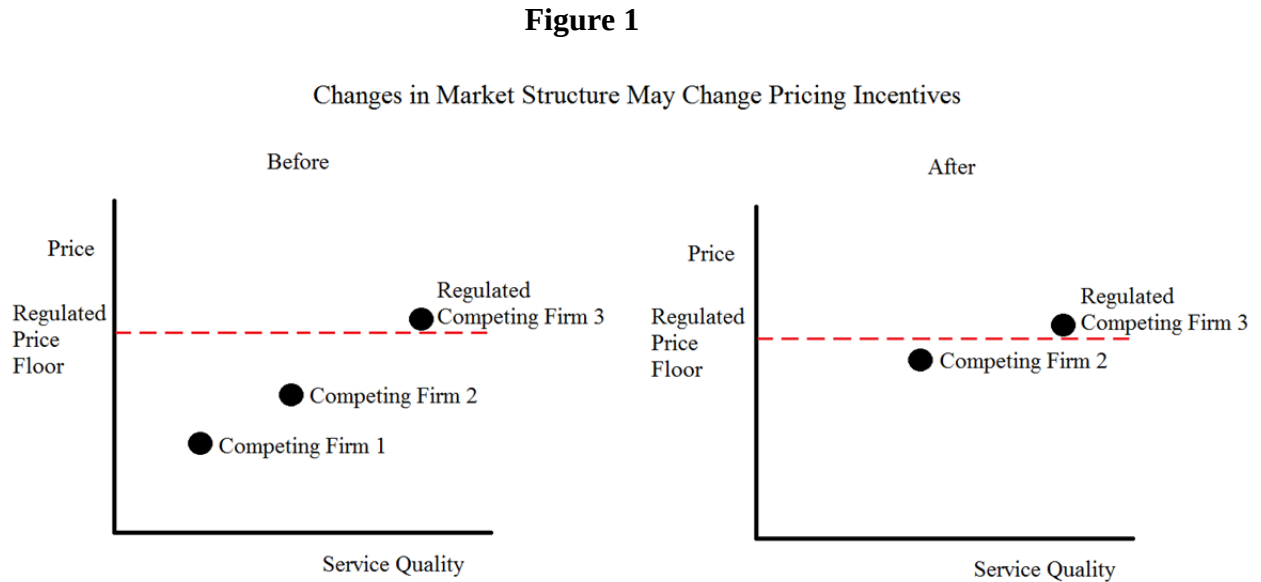
48. As I have demonstrated, the appropriate measure of costs when setting a price floor is average avoidable cost. In earlier sections I have argued that the price floor imposed by the Commissioner in 2011 on drop trailer service was set at too high a level because it included a component corresponding to indirect costs. Such a pricing distortion is not innocuous. It implies that harm will be suffered by several groups including the customers of drop trailer services, both those using the BCF drop trailer service and those using the rival service operated by Seaspan. In addition, the customers of BCF passenger and vehicle ferry services are also likely to have suffered economic harm.
49. The first point is straightforward: there is the potential for aggressive head to head competition in drop trailer service, between the rival suppliers BCF and Seaspan. Aggressive competition of this kind would create benefits to direct customers and also to a large group of indirect customers for whom freight costs are an important part of their business. However, competition is currently being constrained and in effect disabled by the presence of the price floor, which has two effects on competition. First, BCF is prevented from pricing competitively in order to attract customers, and prevented from responding to rivals' aggressive attempts to gain market share. Second, Seaspan can regard the price floor in effect as a "price umbrella" which allows them to set their own prices at a level where BCF is constrained by the regulator from competing. The net result of these two effects is that, in equilibrium, prices for drop trailer service charged by both suppliers will be higher than they otherwise would be, and customers worse off.
50. Second, the net income from the drop trailer service that exceeds direct costs may act as a subsidy to passenger service users, leading to lower prices for passenger and vehicle fares, other things being equal. If a higher price floor reduces the number of clients of the drop trailer service, then passengers lose the subsidy from the drop trailer service, and may need to pay higher fares.

B. The Market Power Implications of a More Concentrated Market Structure

51. After BC Ferries entered into the drop trailer services market in 2010, Seaspan purchased the low-cost unregulated competitor, VIBS. In the parlance of merger analysis, this is known as a “three-to-two” merger. In markets where the barriers to entry are substantial, the economic effects following acquisitions must be analyzed.
52. Since Seaspan faces no significant competitors other than BC Ferries, the acquisition of VIBS services assured its ability to price at or just below the price floor established by the BC Ferry Commission for BC Ferries drop trailer services. Indeed, Seaspan has little to no market-based incentive to lower prices or otherwise compete for business when it can simply lobby for a high price floor and guarantee itself a high return on its truck and trailer transportation services.⁴⁸

⁴⁸ The economic literature examines the effect of a regulated firm’s participation in an unregulated market by focusing on the possible impact on the customers within the regulated market. “Participation in both regulated and unregulated markets by a single firm poses a dilemma for policy makers. On the one hand, regulators and customers of a regulated service may well be concerned that higher regulated service prices might result from the firm’s activity in a competitive market, perhaps fearing that the firm might somehow utilize its position in the regulated market to ‘cross subsidize’ its competitive venture. On the other hand, a blanket prohibition on participation in both types of markets would not serve public policy well. In many cases there may be economies of scope, so cost reductions can be realized when a single enterprise is able to offer both regulated and unregulated services. Thus, a central policy problem that must be addressed is how to structure the regulatory system to take advantage of economies of scope without burdening ratepayers of the regulated service.” Braeutigam, Ronald R., and John C. Panzar, “Diversification Incentives under ‘Price-Based’ and ‘Cost-Based’ Regulation,” *The RAND Journal of Economics* (1989): 373-391; *See also* Posner, Richard A., “Social Costs of Monopoly and Regulation,” *Journal of Political Economy* (1974): 807-828.

53. In **Figure 1** below, I provide a stylized example of changes to market structure, and how pricing incentives can change when there are mergers in markets where some firms are regulated, and others are not.



54. The graphical representation can be used to understand the possible effects of changes in the structure of the freight services market to Vancouver Island following BC Ferries’ entry into the freight services market and Seaspan’s 2011 acquisition of VIBS. In the absence of a second, low-cost competitor, it is clear that Seaspan has every incentive to ask for a high price floor on BC Ferries’ drop trailer rates. A higher price floor is likely to limit the extent of competitive discipline that BC Ferries can exert on Seaspan’s prices. In other words, Seaspan’s acquisition of VIBS likely enabled Seaspan to substantially increase its prices. Without this second competitor, all drop trailer consumers (as well as all “downstream” consumers) therefore face higher prices and are not necessarily compensated by a corresponding increase in service quality.

55. It is therefore critical that the pricing structure regulating BC Ferries drop trailer services contemplates and reflects the appropriate economic framework. An appropriately established price floor – reflecting avoidable costs alone – is likely to benefit many market participants and encourage competition in the provision of transportation services to and from Vancouver Island.

VIII. CONCLUSION

56. The price floor currently imposed on the drop trailer services offered by BC Ferries restricts competition and artificially distorts the market for freight services. Although the regulatory framework implies that the regulator is merely constraining the income that BC Ferries could earn from its drop trailer services, this reduction in income implies that, other things being equal, passenger and vehicle ferry services customers would have to pay more than they should have, and that price caps for passenger and vehicle ferry services may need to be set higher. A price floor set at a level that reflects the appropriate avoidable / incremental costs of providing drop trailer services will allow BC Ferries to effectively compete, providing benefits to all customers of BC Ferries as well as the customers of competing service providers. The use by BC Ferries of the drop trailer services to optimize the use of its assets is not unfair competition; rather it represents a globally efficient use of its resources.



Roger Ware, Ph.D.
January 14, 2016

Appendix A

CURRICULUM VITAE

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EDUCATION:

Ph.D.	Economics, Queen's University, Canada
M.A.	Industrial Economics, University of Sussex, England
M.A.	Economics, Cambridge University, England
B.A. (Hon)	Economics, Cambridge University, England

POSITIONS HELD

1997 - present	Professor, Queen's University
1991 - 1997	Associate Professor, Queens University
1993 - 1994	Holder of T.D. MacDonald Chair in Industrial Economics, Bureau of Competition Policy, Ottawa
1989 - 1990	Associate Professor, University of Toronto
1987 - 1988	Visiting Associate Professor, Department of Economics, University of California, Berkeley
1986 - 1987	Sabbatical Leave. Visiting Research Scholar, Carleton University and National Bureau of Economic Research, Stanford University
July 1986	Promoted to Associate Professor with Tenure, University of Toronto
1981 - 1986	Assistant Professor in Economics, Erindale College, University of Toronto
1980 - 1981	Lecturer in Economics, Erindale College, University of Toronto
1979 - 1980	Instructor, Introductory Economics, Queen's University

1977 - 1979	Various Tutorial and Research Assistantship Positions held, Queen's University
1975 - 1977	U.K. Department of Industry, Industrial Policy Analysis and Briefing Division Provided advice on government support for research and development, and special assistance schemes for industry. During this period I completed a cost-benefit study of cost sharing support for industrial development projects
1973 - 1975	U.K. Department of Industry Economic Assistant, working on an econometric forecasting model of U.K. trade flows. Promoted to Senior Economic Assistant, October 1974

AWARDS

Awarded by the Social Sciences and Humanities Research Council:

- Three year research grant, 1992. Amounts: \$19,500, \$4,300, \$2,300
- Research grant, 1989. Amount: \$14,250
- Leave Fellowship, 1986-1987
- Post-Doctoral Fellowship, 1983-1984 and 1984-1985
- Research grant, 1983. Amount: \$6,760

R. Samuel Mclaughlin Scholarships

- Graduate studies at Queen's University, 1977-1978, 1978-1979 and 1980-1981 sessions

MAJOR FIELDS OF RESEARCH INTEREST

Industrial Organization:

- Antitrust Economics and Competition Policy
- Strategic Behaviour
- Research and Development
- Dynamic Modelling
- Trade and Industrial Policy

Public Economics

BOOKS

Industrial Organization: a Strategic Approach. (with Jeffrey Church, University of Calgary) 2000. Boston: Irwin McGraw-Hill.

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RECENT PROFESSIONAL ACTIVITIES

Invited to present at the Canadian Economics Association (CEA) Meetings, June 2015, May 2015 and June 2014.

Invited to present at the Canadian Bar Association Annual Conference, October 2015 and October 2014.

Invited to present at the Calgary Electricity Pricing Conference, May 2014.

Invited to present at the Telecom Conference, Toronto, June 2014.

Invited to present in Melbourne, Australia at the Law and Economics Society and the Australian Competition Commission, February-March 2012.

Invited to at the New Zealand Competition Commission, March 2012.

Participated in a panel session on Competition Policy at the CEA Meetings, Ottawa, June 2011 and Vancouver, June 2008.

Presented the paper “Market Power in Natural Gas”, co-authored with David Brown, Ontario Energy Board, and David Harding, Competition Bureau at the 2007 CEA Meetings, Halifax, June 2007.

Presented the paper “Efficiencies and the Propane Case” at the Canadian Bar Association Competition Law Section Meetings, Ottawa, September 2000.

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MEMBERSHIP OF PROFESSIONAL SOCIETIES

Member of Canadian Economics Association

Appendix B

LIST OF MATERIALS CONSIDERED

Legal Documents

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APPENDIX B

MAAT CALCULATION SUMMARY BASED ON APPROACH APPROVED IN ORDER 11-01 (REDACTED)

**The contents of this Appendix are commercially sensitive and have been redacted.
An unredacted version has been provided to the Commissioner on a CONFIDENTIAL basis
under separate cover.**

BC Ferries Drop Trailer (DT)**MAAT (minimum average annual tariff per foot)**

Commissioner: Order Number: 11-01	F2010 per foot	F2015 per foot
Direct Operating Costs*	< >	< >
Direct Asset costs - Amortization and Net Financing costs**	< >	< >
Route Overhead Allocation	< >	< >
Income Tax Advantage	< >	< >
	< >	< >
Efficiency gains projected to 'mid point' of 5 year growth outlook	< >	< >
MAAT (After applying CPI increases at 2%)	< >	< >

Notes:

*Direct operating costs represent the labour, hostling unit, property lease, utilities, repairs and maintenance, and office and administrative costs associated with providing drop trailer service

**Represents the amortization and financing costs associated with assets specific used to providing drop trailer service (hostling units, trucks, IT equipment and compound infrastructure)

The calculated return on asset is predicated on a rate of return of 13.16%. A 13.16% rate of return was assumed in establishing price caps for Performance Term 2 under Memorandum 25 (December 14, 2007). Under Order Number: 12-02, the provision for a rate of return was removed and replaced with earnings that provided equity not lower than 17.5% of total capitalization and a debt service coverage ratio of 2.5x or higher for Performance Term 3.

APPENDIX C

MAAT CALCULATION SUMMARY BASED ON PROPOSED APPROACH (REDACTED)

The contents of this Appendix are commercially sensitive and have been redacted. An unredacted version has been provided to the Commissioner on a CONFIDENTIAL basis under separate cover.

BC Ferries Drop Trailer (DT)**MAAT (minimum average annual tariff per foot)**

Direct (avoidable) Costs	F2010 per foot	F2015 per foot
Direct Operating Costs* (including management salary allocation)	< >	< >
Direct Asset costs - Amortization and Net Financing costs**	< >	< >
	< >	< >
<i>Income Tax Advantage for DT specific assets***</i>	< >	< >

Notes:

*Direct operating costs represent the labour, hosting unit, property lease, utilities, repairs and maintenance, and office and administrative costs associated with providing drop trailer service

**Represents the amortization and financing costs associated with assets specific used to providing drop trailer service (hostling units, trucks, IT equipment and compound infrastructure)

***Represents the calculated income tax benefit associated with earning a return on assets specific to providing drop trailer service

The calculated return on asset is predicated on a rate of return of 13.16%. A 13.16% rate of return was assumed in establishing price caps for Performance Term 2 under Memorandum 25 (December 14, 2007). Under Order Number: 12-02, the provision for a rate of return was removed and replaced with earnings that provided equity not lower than 17.5% of total capitalization and a debt service coverage ratio of 2.5x or higher for Performance Term 3.

APPENDIX D

EXCERPT FROM SEASPAN WEBSITE

Source: <http://www.seaspan.com/history>

Printed on January 14, 2016

History

CH Cates & Sons

- | | |
|------|---|
| 1886 | Charles Henry Cates arrives in Vancouver and begins his first business operations |
| 1921 | CH Cates and Sons Limited is officially incorporated and established at the foot of Lonsdale Avenue |
| 1988 | CH Cates and Sons Limited acquires Seaforth Towing |

Vancouver Tug

- | | |
|------|---|
| 1898 | Vancouver Tug formed by Harry A. Jones |
| 1919 | Harry A. Jones sold Vancouver Tug and passed away four years later |
| 1924 | Vancouver Tug business revived by Harold Jones (Harry Jones' son). Business re-named Vancouver Tug Boat Company |
| 1954 | To cut costs and further integrate its operations, Vancouver Tug purchased Vancouver Shipyards (originally incorporated in 1902) |
| 1956 | Harold Jones passed away leaving Vancouver Tug to Beverly McCarvill O'Toole. During that time Arthur Lindsay and Captain James Stewart guided the company into a major expansion and rebuilding program |
| 1962 | Vancouver Tug acquired Vancouver Barge Transportation |
| 1963 | Vancouver Tug acquired Pacific Tanker |
| 1965 | Vancouver Tug acquired Western Tug & Barge |
| 1966 | Vancouver Tug launches the pride of their fleet – a 3500 horsepower, 136 foot tug named the Harold A. Jones |
| 1969 | Vancouver Tug and Vancouver Shipyards purchased by Dillingham Corporation and vacated locations at the foot of Denman Street, in Vancouver, to move across Burrard Inlet to a 40 acre waterfront site at the foot of Pemberton Avenue, in North Vancouver |

Island Tug & Barge

- | | |
|------|--|
| 1924 | Island Tug & Barge formed by Harold B. Elworthy |
| 1926 | Elworthy acquired Gardner Towing |
| 1937 | Elworthy purchased a 1500 horsepower US Coastguard cutter named Snohomish, equipped it for towing and salvage and made it the company flagship |
| 1954 | Island Tug & Barge acquired a vessel named Sudbury, which for more than a decade was BC's most famous tug |

1956	Island Tug acquired Young & Gore
1958	Island Tug acquired Victoria Tug
1960	McAllister Towing, of Montreal, purchased Island Tug and then Griffiths Steamship Company in 1961

Seaspan is Born - Genstar Appears

1969	Genstar Ltd. acquired Island Tug & Barge
1970	Genstar joined with Dillingham Corporation to merge Island Tug and Vancouver Tug into a new corporate identity, Seaspan
1972	Seaspan acquired FM Yorke & Sons Ltd.
1973	Genstar obtained full ownership of Seaspan by purchasing Dillingham's interest
1977	Seaspan acquired Gulf of Georgia Towing
1986	Imasco Ltd. acquired Genstar and gained controlling interest in Seaspan
1986	Imasco sold Seaspan to McLuan Capital Group
1991	Seaspan acquired Vancouver Drydock Company

Washington Companies

1992	CH Cates and Sons purchased by Dennis Washington
1994	Vancouver Shipyards (Esquimalt) Ltd. (now Victoria Shipyards) was created at the Public Works and Government Services' Esquimalt Graving Dock to fill the void left when Yarrows Shipyard Limited went bankrupt
1994	Dennis Washington acquires a partial interest in Seaspan International Ltd. (now Seaspan ULC)
1995	Dennis Washington acquires Norsk from Fletcher Challenge
1996	Dennis Washington purchased the remaining shares in Seaspan and its subsidiaries to become 100% owner of the company
1996	Seaspan acquires a 50 percent interest in Marine Petrobulk Limited
1997	Kingcome Navigation acquired by Dennis Washington from MacMillan Bloedel
1998	Dennis Washington purchased Seaspan Coastal Intermodal (now Seaspan Ferries) from Canadian Pacific
1999	Cates, Seaforth, Norsk & Kingcome amalgamated to Seaspan
2010	Seaspan acquires the tug and barge assets of SMIT Marine Canada
2011	Seaspan Ferries acquires the business of Van Isle Barge Services Ltd.

APPENDIX E

SEASPAN PRESS RELEASE

Source: <http://www.seaspan.com/seaspan-ferries-corporation-awards-contract-build-two-new-liquefied-natural-gas-fuelled-vessels>)

Printed on January 14, 2016

Seaspan Ferries Corporation Awards Contract To Build Two New Liquefied Natural Gas Fuelled Vessels

Posted November 19, 2014 & filed under [Press Releases \(http://www.seaspan.com/category/press-releases\)](http://www.seaspan.com/category/press-releases).

For Immediate Release – November 19, 2014

Delta, BC – Seaspan Ferries Corporation (SFC) announced today that Sedef Shipyard of Istanbul, Turkey has been awarded the contract for the construction of two new dual-fuelled (diesel and liquefied natural gas) ferries.

The 148.9 metre ferries, both expected to be in operation by late 2016, will accommodate up to 59 trailers. Construction is scheduled to start in early 2015.

“Seaspan is pleased to partner with Sedef Shipyard to build two new state-of-the-art ferries,” said **Steve Roth**, Vice President, Seaspan Ferries Corporation. “Today’s announcement demonstrates a clear commitment to our drop-trailer customers through the modernization of an aging fleet.”

“One of Seaspan’s Core Values is care for the environment and we are committed to ensuring the conservation of Canadian oceans and waterways,” said Steve. “These new, technologically advanced ferries will reduce our greenhouse gas emissions significantly compared to current alternatives while ensuring the highest level of efficiency, performance and reliability.”

SFC’s contract award comes on the heels of an extensive and competitive procurement process that included more than 40 shipyards around the world, as well as a thorough analysis of Seaspan Shipyard’s capacity to construct these vessels at its new facility at Vancouver Shipyards.

“Our decision to have a non-Seaspan shipyard build our new ferries was not made lightly, but it was a simple decision based on capacity,” said **Jonathan Whitworth**, CEO, Seaspan.

“We are laser-focused on successfully delivering our multi-year, multi-billion dollar project to build vessels for the men and women of the Royal Canadian Navy and Canadian Coast Guard under the National Shipbuilding Procurement Strategy (NSPS). We have established a world-class shipbuilding and ship repair centre of

excellence, and are working to returning B.C.'s shipbuilding industry to its once thriving roots, as evidenced by our recently completed state-of-the-art facility at Vancouver Shipyards. For the next five to seven years, our new vessel building capacity will be solely dedicated to the NSPS Non-Combat vessels.”

Sedef Shipyard is world renowned for its shipbuilding capability and expertise, having built more than 175 vessels since it was first founded in 1975. Sedef is owned by Turkon Holdings, which provides marine transportation and shipbuilding services, along with marinas, hotels and other tourism ventures.

“We feel very honoured to be chosen as Seaspan’s shipbuilding partner and we will take great pride in building their new ferries,” said **Orkun Kalkavan**, Board Member of Sedef Shipyard. “The technical side of the project is also a matter of pride due to the dual fuel-LNG hybrid particulars of the vessels, which we feel demonstrate our shipyard’s commitment to building sophisticated and environmentally friendly vessels. The entire shipyard is excited about this project and dedicated to building Seaspan’s ships on-time and on-budget.”

– 30 –

Jeff Taylor

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Mobile: (778) 879-8993

SFC New Vessels – Media Backgrounder – Final (<http://www.seaspan.com/wp-content/uploads/SFC-New-Vessels-Media-Backgrounder-Final.pdf>)



http://www.seaspans.com/wp-content/uploads/197-Seaspans-fwd-stbd_0.jpg

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APPENDIX F

**BRITISH COLUMBIA FERRY SERVICES INC. FILING WITH THE BRITISH
COLUMBIA FERRIES COMMISSIONER REGARDING SECTION 45.1(1) OF THE
COASTAL FERRY ACT AND DROP TRAILER SERVICE – AUGUST 31, 2010
(WITHOUT APPENDICES)**

British Columbia Ferry Services Inc.

Filing With the British Columbia Ferries
Commissioner

Regarding

Section 45.1(1) of the *Coastal Ferry Act*

And

Drop Trailer Service

August 31, 2010

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Section 1 – Introduction and Overview

British Columbia Ferry Services Inc. ("BC Ferries" or "BCF") submits this Filing pursuant to section 45.1(1) of the *Coastal Ferry Act* ("Act") and the British Columbia Ferries Commissioner's ("Commissioner") Memorandum 37, dated July 19, 2010. BC Ferries respectfully seeks the following determinations:

- BC Ferries' drop trailer service is priced in a manner that reflects BC Ferries' direct costs and an appropriate proportion of indirect costs associated with providing drop trailer service; and
- BC Ferries is competing on a fair basis with the incumbent providers of drop trailer service.

The Cost of Service analysis (COSA) performed by BCF using an industry-standard cost allocation methodology demonstrates that the prices for drop trailer service are well in excess of BC Ferries' direct costs and an appropriate proportion of indirect costs associated with providing the drop trailer service.

BC Ferries has also addressed the potential sources of "unfair competitive advantage" identified in the Act. The information included in this Filing demonstrates that: BC Ferries paid fair value for assets used in providing drop trailer service; price caps are determined based on BC Ferries having a pre-tax return on equity,¹ thus rendering BC Ferries' tax exempt status of no consequence in competing for drop trailer customers; and, the major routes, on which BC Ferries offers drop trailer service, are unsubsidized. The COSA takes all of these factors into account, including the pre-tax rate of return on equity applied to the assets used in the drop trailer service.

In short, BC Ferries is competing on a fair basis with the incumbent providers of drop trailer service, relying on competitive advantages that arise because of BC Ferries' operating model and the favourable attributes of its service. In the course of competing fairly for drop trailer business, BC Ferries is benefiting the truck transportation sector (which now has another option for drop trailer service) and all other ferry users (who benefit from the more efficient use of BC Ferries' existing infrastructure).

1.1 Overview

This section provides a brief overview of the Filing.

¹ Commission Memorandum 25 dated December 14, 2007

Drop Trailer Service

BC Ferries' drop-trailer service enables commercial customers to drop off their semi-trailers full of goods at one of the designated BCF terminals and to pick up their trailers on the other side of the route.

As described below in Section 2, BC Ferries' entry into the drop trailer market, which previously had been occupied by only two providers, represents a positive development from the perspective of providing additional choice to the truck transport sector. The truck transport sector has become increasingly sensitive to the relatively higher cost of BC Ferries' premium "live" service versus the drop trailer alternative, and BC Ferries can provide greater frequency of service and other beneficial attributes relative to the incumbent providers of drop trailer service. At the same time, because BC Ferries' drop trailer service operates during off-peak times and uses surplus capacity, it is complementary to BC Ferries' core services and benefits all ferry users by reducing the amount BC Ferries must recover on average from remaining ferry users.

Regulation of Drop Trailer Service

BC Ferries' offering of drop trailer service is regulated only to the extent provided for in section 45.1 of the Act, which took effect in June 2010.² This Filing provides the Commissioner with the necessary information to determine that BC Ferries' has not priced its drop trailer service below the direct costs and an appropriate proportion of the indirect costs associated with providing the service, and that it does not enjoy an unfair competitive advantage over its competitors.

The Act now provides:

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

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

² On April 29, 2010, Bill 20, the *Miscellaneous Statutes Amendment Act (No. 3)* was given First Reading in the Legislature. The Amending Act was given Royal Assent on June 3, 2010.

1 (b) any tax exemption, or

2 (c) any subsidy.

3
4
5 In Memorandum 37, the Commissioner determined that the drop
6 trailer service provided by BC Ferries is a competitive service, as the
7 Act defines that term. Accordingly, section 45.1 of the Act now
8 requires the Commissioner to determine whether either:

- 9
10 • BC Ferries is pricing its drop trailer service below the direct
11 costs and an appropriate proportion of the indirect costs
12 associated with providing that ferry transportation service, or
13
14 • BC Ferries has an unfair competitive advantage in providing
15 drop trailer service.
16

17 Below, an overview of how this Filing addresses each component of the
18 analysis is provided including the basis for the determinations BC
19 Ferries' seeks.
20

21 **Cost of Service**

22
23 The first determination sought by BC Ferries in this Filing requests the
24 Commissioner to compare the price charged by BC Ferries for drop
25 trailer service against the direct costs and an allocated portion of
26 indirect costs. The information included in this Filing demonstrates
27 that BC Ferries has priced drop trailer service in a manner that
28 conforms to the statutory test.
29

30 As convenient shorthand, the direct costs and appropriate proportion
31 of indirect costs can be referred to as BC Ferries' drop trailer "cost of
32 service". The drop trailer cost of service must be determined by
33 applying a cost of service allocation, or COSA, methodology. The
34 methodology that BC Ferries has employed in its COSA was developed
35 by EES Consulting, experts in the field of cost allocation in regulated
36 industries. The methodology is based on generally accepted allocation
37 principles used in the context of rate regulation both in British
38 Columbia and elsewhere.
39

40 The conclusion of Gary Saleba, President of EES Consulting, is that:

41
42 *"Based on my experience as a Cost of Service expert, it is*
43 *my opinion that the analysis and approach described in*
44 *this letter and applied by BC Ferries meets the generally*
45 *accepted principles for cost allocation and results in a fair*
46 *and equitable methodology to determine the cost of*
47 *serving the drop trailer class. In my opinion, the costs*

1 *assigned to the drop trailer class by employing the*
2 *discussed methodology include the direct cost and an*
3 *appropriate portion of the indirect costs associated with*
4 *this new drop trailer service. As the average revenues per*
5 *foot from the drop trailer service class are higher than the*
6 *calculated cost of service per foot, it can be concluded*
7 *that BC Ferries drop trailer service is priced in excess of a*
8 *fair allocated portion of the revenue requirement from*
9 *Routes 1 and 30.”³*

10
11 The inputs in the cost allocation analysis is included in Confidential
12 Appendices A and B. Supporting data is available as required. This
13 information demonstrates that:

- 14
15 • total revenue from drop trailer service exceeds the direct costs
16 of providing drop trailer service and an appropriate allocation of
17 indirect costs; and
- 18
19 • no individual customer is paying less for drop trailer service than
20 the cost of providing drop trailer service to that individual
21 customer.

22
23 BC Ferries submits that the Commissioner should find, on the basis of
24 the COSA performed by BC Ferries in conjunction with EES Consulting,
25 and the pricing information provided by BC Ferries, that the first
26 component of the test is satisfied. BC Ferries thus submits that the
27 Commissioner should make the first determination sought by BC
28 Ferries.

29 30 ***Fair vs. Unfair Competition***

31
32 The Commissioner must also assess whether or not BC Ferries is
33 competing on a fair basis with the incumbent providers of drop trailer
34 service. There are two points to emphasize in addressing this
35 component of section 45.1(1) of the Act:

- 36
37 • first, the reference to “unfair competitive advantage” [Emphasis
38 added] highlights that fair competition remains appropriate; and
- 39
40 • second, fairness must be determined with reference to the
41 wording of section 45.1 considered within the overall context of
42 the Act, and not based on subjective criteria.

43
44 The information included in the Filing demonstrates that BC Ferries is
45 competing fairly and our drop trailer service satisfies the statutory
46 test.

³ See Appendix C attached.

Section 45.1(1) only identifies “unfair competitive advantage” [Emphasis added] as being subject to regulation by the Commissioner under section 45.1(2). The section is not protectionist in nature, such that it would limit BC Ferries’ ability to provide drop trailer service, but rather addresses the way in which BC Ferries competes with the existing providers of drop trailer service. BC Ferries can compete with existing providers of drop trailer service, but must compete without “unfair competitive advantage”.

Section 45.1(1) identifies factors that may, but do not necessarily, give rise to “unfair competitive advantage”. These factors are ownership of assets by the Province, tax exemptions and subsidies. While this list is inclusive, not exhaustive, it is readily apparent that the factors identified relate to external benefits conferred upon BC Ferries rather than advantage arising from the way in which BC Ferries operates. This makes sense particularly given that the Act also mandates BC Ferries to take a commercial approach to its core operations and price caps are set accounting for an efficiency factor. Inherent in a commercial approach is the efficient use of assets and capitalizing on economies of scale where possible.

BC Ferries is engaging in fair competition, without “unfair competitive advantage” in the sense contemplated in section 45.1(1) of the Act. As discussed in Section 3 of this Filing, BC Ferries owes its competitive advantage to two factors:

- it is cheaper for BC Ferries to provide more marine transportation services than less; and
- BC Ferries is an efficient marine transportation service provider overall.

Regulation passes on the benefits of those advantages to ferry users. The more services BC Ferries provides, the more benefits accrue to ferry users.

BC Ferries makes the following points with respect to the examples of potential “unfair competitive advantage” contemplated in section 45.1(1) of the Act, as well as what constitutes fair competition in relation to the *Competition Act*.

- BC Ferries paid fair value for the vessels it owns and terminals it leases, by either acquiring them from the Province in 2003, or purchasing them from suppliers since that time;
- Price caps at BC Ferries include a pre-tax return on equity identical to that which any other private operator would be

entitled, and thus the tax exemption confers no benefit on BC Ferries in terms of setting drop trailer rates;

- BC Ferries receives no service fees or subsidies from the Province for serving Routes #1 and #30, on which BC Ferries offers drop trailer service; and
- BC Ferries has complied with all legislation governing anti-competitive practices in offering its drop trailer service.

BC Ferries submits that, even if the Commissioner were to determine that BC Ferries has obtained an advantage from any of the three factors identified in section 45.1(1), the Commissioner may still determine that the benefit obtained is fair.

Thus, put another way, the object of the legislation is not to protect what amounted to a non-regulated monopoly of the incumbent providers of drop-trailer service from healthy competition, or to transfer the benefits that ferry users should be entitled to receive to the shareholders of the incumbent drop trailer service providers.

1.2 Organization of this Filing

This Filing is organized as follows:

- Section 2 addresses the evolution of the marketplace for marine transportation and describes the attributes of BC Ferries' drop trailer service.
- Section 3 identifies the source of BC Ferries competitive advantage and explains why that competitive advantage is a fair one.
- Section 4 describes the standard cost of service methodology applied to confirm that BC Ferries is pricing drop trailer service in excess of the direct costs of drop trailer service and an appropriate proportion of indirect costs.
- Section 5 provides a conclusion and discusses the order sought.

Section 2 – Drop-Trailer Service

BC Ferries' drop trailer service is complementary to its existing business and benefits the transport industry and other ferry users. Prior to BC Ferries' entry into the drop trailer service, there were two existing providers. There is market demand in excess of what these incumbent providers have delivered and BC Ferries has introduced healthy competition in this area. This additional competition is advantageous to users of drop trailer service, providing a natural check on service providers. It is advantageous to all ferry users for BC Ferries to make efficient use of underutilized non-peak capacity.

The organization of Section 2 is as follows:

- 2.1 explains the state of the marketplace before BC Ferries' entry into the drop trailer market;
- 2.2 explains how BC Ferries' drop trailer service is a response to erosion in its "live" service, and also market demand not met by incumbent drop trailer providers;
- 2.3 describes the nature of the drop trailer service offered by BC Ferries;
- 2.4 elaborates on how BC Ferries' participation in the drop trailer market enhances competition for the benefit of the transportation industry, and benefits other ferry users through the efficient use of underutilized capacity; and
- 2.5 concludes that the drop trailer service fulfills an outstanding market need, is consistent with a commercial approach to the delivery of ferry service and introduces healthy competition to the market.

2.1 History of Services to Vancouver Island and the Incumbent Providers of Drop Trailer Service

Since the turn of the twentieth century, competition for the movement of freight on and off Vancouver Island has existed. The changes in delivery of marine transport service since then were a response to the changing needs of the marketplace. Typically, when a service provider has not responded to the changing needs of the market, a competitor has entered the market to meet that need. As discussed later, BC Ferries initiation of drop trailer service is a continuation of this story.

History of Services to Vancouver Island

Canadian Pacific Railway (CPR) was the dominant transportation service provider in BC coastal shipping due to their position in the rail sector.⁴ In 1903, CPR formed the BC Coast Steamship Service (BCCSS) expanding their service offering to over 30 "Princess" vessels during the twentieth century, two of which (*Carrier Princess* and *Princess Superior*) are still in service today.

CPR provided a lift on/lift off (lo-lo) service using tugboats and barges. CPR lifted railcars or bulk goods onto their barge at their terminal. A tugboat then towed the barge across Georgia Strait. Upon arrival, CPR lifted the freight out of the barge and onto the terminal where the customer picked it up or it continued on the railway. The defining characteristic of the lo-lo service was cost effectiveness in moving goods. The tugboat and the barge, being separate units, allowed CPR to load the barges slowly while maintaining the efficiency of their tugboats. However, the tug and barge service lacked speed.

During the pre-war era, as the demand for automobile travel grew, CPR also invested in vessels designed to serve the emerging market for passenger and automobile marine transportation. This new service introduced passenger amenities and speed to the market. These vessels became the precursors to a "roll on/roll off" (ro-ro) freight service. Ro-ro service refers to vessels designed to carry wheeled vehicles that are driven on and off the vessel on their own wheels.

Competition for CPR's marine transportation to Vancouver Island grew in the post-war era for the passenger/automobile segment with Blackball Ferries (formerly Puget Sound Navigation) entering the marketplace. Newly designed vessels carried automobiles, passengers, commercial trucks and box railcars for the first time. These vessels pioneered a significant competitive advantage that enabled Blackball to challenge the market dominance CPR had enjoyed for decades. Namely, Blackball produced efficiencies by serving multiple customer types with a single vessel design to minimize their capital costs and to provide greater frequency and speed to the marketplace.

By the early 1950's vessels capable of carrying 1,500 passengers were making multiple daily trips to the Island. Each sailing also had available capacity for freight. This new service provided end

⁴ As part of the creation of CPR, it received \$25,000,000 in credit from the federal government and a grant of 25,000,000 acres of land. In addition, the federal government transferred existing sections of the railway to CPR. The federal government also paid the surveying costs and exempted CPR from property taxes for 20 years. In 1897 the federal government offered a subsidy to CPR known as the "Crows Nest Freight Rate". This rate enabled CPR to expand westward over the Canadian Rockies and reduce the transportation costs for farmers in the Canadian Prairies.

1 consumers with greater access to more markets. No longer did a
2 consumer have to wait for products to arrive from the mainland.
3 Instead, they could travel on the ferry and purchase the goods
4 themselves without waiting. This put pressure on the retailers to have
5 greater speed and frequency of transportation of goods from the
6 mainland. "Live" service quickly became the dominant market-share
7 leader over lo-lo because it met the total needs of the market most
8 efficiently, despite the fact that lo-lo service did not require a driver
9 and tractor to travel with the commercial goods. Irrespective, end
10 consumers were the beneficiaries of the greater overall efficiency of
11 the "live" service.

12
13 In 1958, a strike by the Seaman's International Union forced CPR to
14 cease all sailings. Within two months, workers at Blackball were also
15 on strike. These strikes cut island residents off from access to the
16 mainland, to goods produced elsewhere and to markets for goods
17 produced on Vancouver Island and the surrounding islands. The
18 Provincial government of W.A.C. Bennett was not empowered to order
19 the workers of CPR back to work. However, the Province was able to
20 order the Blackball workers back to work, which they did within a few
21 days. Shortly after, the Province announced it would create its own
22 ferry service.

23
24 In June of 1960, BC Ferries was operational and providing scheduled
25 service between the Island and Mainland.⁵ Late in 1961, the Provincial
26 government announced the purchase of Blackball Ferry Service –
27 Canada. BC Ferries focussed on providing "live" ro-ro service for
28 passengers, automobiles and commercial vehicles. Meanwhile, CPR
29 during this period was divesting itself of passenger services across all
30 business lines including marine transportation, instead choosing to
31 focus on ro-ro freight movements – non "live".

32
33 While the "live" ro-ro service introduced efficiencies into the marine
34 transportation marketplace from the mainland, it also meant that it
35 carried the extra expense of a driver and drive unit to accompany the
36 freight. This was an efficiency that lo-lo provided that was lost in the
37 new service.

38
39 In response, in the 1960's CPR introduced the *Trailer Princess*, a
40 converted US Navy vessel that had the capabilities to take ro-ro freight
41 without requiring a driver and drive unit. This vessel had no
42 passenger amenities and the associated high costs; rather it provided
43 for freight transportation only. The success of this vessel led CPR to
44 invest in this particular vessel prototype. In the early 1970's they

⁵ WAC Bennett said – "they have Princesses, we have Queens" when the ship names for BC Ferries were first created.

1 introduced the *Carrier Princess*, which provided service between
2 Vancouver and Swartz Bay.

3
4 This service was a non-“live” ro-ro service via CPR that enabled
5 customers to drop their semi trailers at the CPR lot. Hostling tractors
6 would then connect to these trailers and back them onto a vessel that
7 only moved commercial goods. The hostling units would then
8 disconnect from the trailer and continue this process to fill the vessel
9 with freight. Once filled, the vessel would depart across the water
10 where an awaiting driver would pick up the recently transported
11 trailer. This innovative new service responded to the needs of the
12 market by recognizing labour as a key cost component and eliminating
13 it in the movement of goods. Customers know this service as the
14 “drop-trailer” service, a reference to a customer dropping a trailer at
15 CPR’s lot and picking it up at its destination point. Despite the drop
16 trailer service’s ability to reduce costs, it still did not provide the depth
17 of service that BCF’s “live” service provided in terms of frequency,
18 speed of crossing, and access to capacity. At this time, the market
19 was defined by two principle modes of transportation for goods; the
20 BCF “live” service which provided premium service and, the CPR “drop-
21 trailer” service which reduced labour and operating costs.

22
23 CPR (through BCCSS) created Coastal Marine Operations (CMO) in the
24 late 1970’s. By the early 1980’s, CPR had completely divested itself of
25 passenger services while focussing on freight services. In 1990, BCF
26 introduced the mid-island express service connecting Tsawwassen and
27 Duke Point. In 1993, Van-Isle Barge Services Ltd. (VIBS) introduced a
28 drop trailer service between Vancouver Island and the Mainland. In
29 1995, CMO acquired the VIBS barge service and moved its Vancouver
30 terminal from downtown Vancouver (currently Canada Place site) to
31 Tilbury Island, Delta BC. By 1998 CPR was engaging in a
32 rationalization of their business and was looking to divest of CMO.

33
34 On November 17th, 1998, the Washington Marine Group (WMG)
35 entered the Island – Mainland marine transportation market with the
36 purchase of CPR’s existing CMO, which included the vessels, terminals,
37 employees and infrastructure. WMG renamed the company Seaspan
38 Coastal Intermodal Company (SCIC). Intermodal refers to the linking
39 of different modes of transportation services such as rail and marine,
40 as WMG already owned the Southern Railway of BC (SRY).⁶

41
42 By 2004, commercial customers were seeking to extract more
43 efficiency from their trailer assets. The terminals of SCIC were nearing
44 capacity which was causing delays and inefficiency in the supply chain.
45

⁶ SRY was at one time the Crown Corporation BC Hydro Railway.

1 VIBS re-introduced a drop trailer service from Vancouver to Nanaimo
2 in 2004 using a Sea-Link pusher barge that had been part of the SCIC
3 fleet up until that time.

4
5 This past year, SRY (owned by WMG) developed infrastructure at its
6 Annacis Island facility⁷ to allow for the movement of railcars and truck
7 trailers to Vancouver Island. According to the SCIC website:

8
9 *"The terminal, which will provide rail and truck access, creates,*
10 *for the first time, a physical link between Seaspan, Seaspan*
11 *Coastal Intermodal (SCIC) and SRY Rail Link's operations on*
12 *Vancouver Island and the Lower Mainland."*⁸

13
14 Currently, the marine transportation component of the WMG
15 transportation network in British Columbia is a drop trailer commercial
16 service.

17 ***Incumbent Providers of Drop Trailer Service***

18
19
20 SCIC and VIBS were the only two providers of drop trailer service to
21 Vancouver Island at the time BC Ferries launched its drop trailer
22 service in 2009. Each of these providers of drop trailer service
23 operates under a different business model.

24
25 VIBS uses a pusher barge vessel for its drop-trailer service mid-island.
26 The pusher barge takes over 5.5 hours to cross Georgia Strait but
27 requires less fuel to do so than a self-propelled vessel. As a result,
28 VIBS can offer the market lower prices for drop trailer service but
29 cannot provide frequency or speed of service. VIBS has limited
30 market penetration due to the relatively long crossing times and
31 limited service alternatives.

32
33 VIBS provides the marine distribution function in "third party logistics"
34 (3PL), an industry term. 3PL service includes repackaging goods for
35 final delivery (Pick-Pack), warehousing and final distribution. Their
36 business strategy is to provide broader supply-chain efficiencies and
37 back-haul revenue off Vancouver Island resulting in cost savings for
38 the customer. VIBS has attracted large customers that can reduce
39 their costs by using the 3PL functions and smaller price-driven
40 customers. However, they are limited to the Nanaimo market.

41
42 SCIC provides drop-trailer marine transportation service in the
43 southern corridor between Vancouver and Victoria and the mid-island
44 corridor between Vancouver and Nanaimo. SCIC provides barged

⁷On September 5, 2008, the Government of Canada announced investments in short sea shipping in BC including \$4.6 million to SRY for the B.C. Rail Barge Ramp and \$7.0 million to Seaspan International for the Mountain View Apex Container Terminal

⁸www.sryrailink.com/news/news_Annacis.html

1 marine transportation using an intermodal business model. SCIC
2 partners with other companies to provide some of their customers a
3 3PL service. Their source of competitive advantage is two-fold:
4 physical assets (more vessels) and greater depth of service (access to
5 Nanaimo and exclusive access to Victoria). SCIC's service is attractive
6 to large transportation customers.
7

8 **2.2 BC Ferries Drop Trailer Service Responds to Erosion of Live** 9 **Service Business and Market Need**

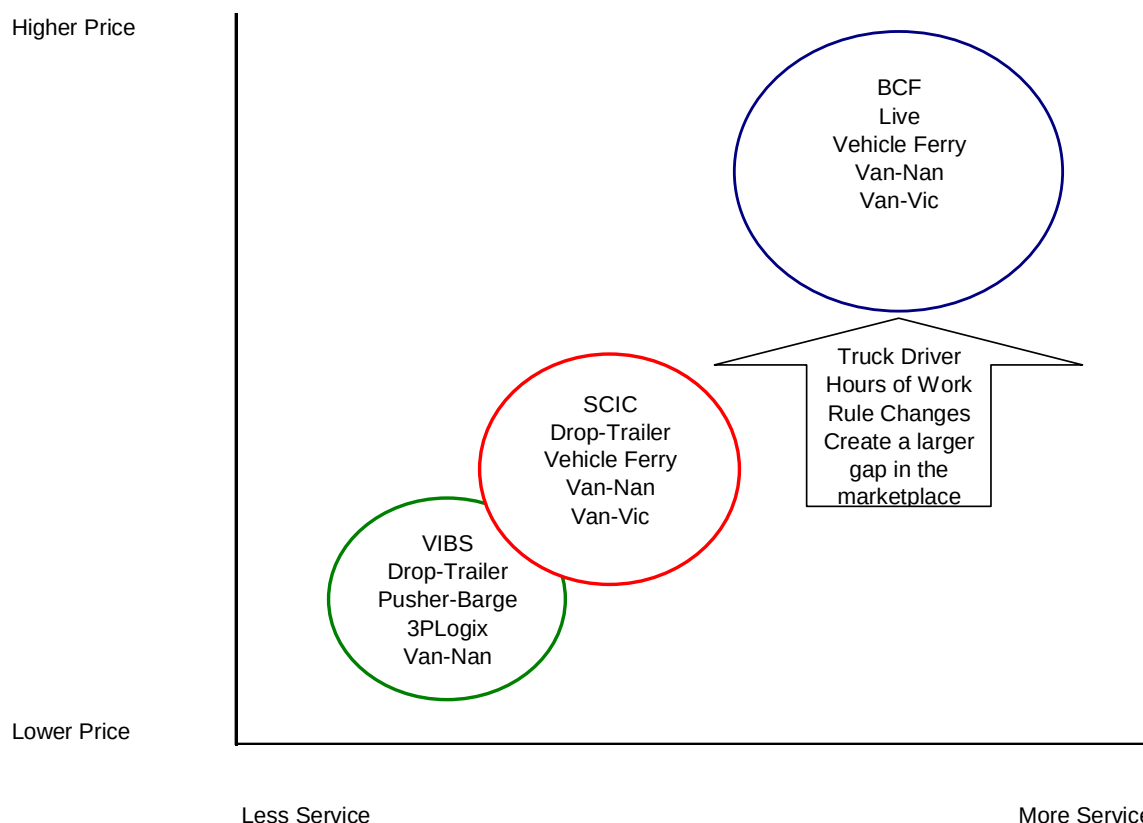
10
11 Until recently, BC Ferries had focussed on providing the higher value
12 added frequency and choice of corridors through the "live" ro-ro
13 service, leaving drop trailer service to be provided by SCIC and VIBS.
14 However, market pressures forced BC Ferries to rethink its approach
15 to commercial transportation. Responding to such market pressures
16 mirrors BC Ferries' mandate to take a commercial approach to its core
17 market operations.
18

19 ***Truck Driver Hours of Work***

20
21 Recent changes to legislation now require truck drivers to record their
22 time at a ferry terminal as hours of work. This change has increased
23 the cost of using the "live" service and changed the nature of the value
24 equation between the drop-trailer and "live" services. Higher fuel
25 costs, just-in-time inventories, changes in hours of work rules and a
26 recession have put increasing pressure on freight companies. In
27 response, freight companies have placed greater priority on cost rather
28 than service.
29

30 The market for transportation service to Vancouver Island is depicted
31 graphically in Figure 1 below. It illustrates that VIBS and SCIC are
32 able to provide a lower cost service by dispensing with some of the
33 premium attributes associated with BC Ferries' "live" service. It also
34 illustrates how changes in the hours of work rules in the transportation
35 sector have caused a shift towards the lower cost transportation
36 alternatives.
37

Figure 1: Market for Transportation Services to Vancouver Island Prior to BC Ferries Drop Trailer Service



BC Ferries has seen significant share erosion in its "live" service over the past decade. The BC Ferries "live" offering has a disadvantage due to the increased value placed on a driver's work hours by requiring a driver to be present during marine transportation, thus increasing a customer's cost to serve.

Serving the Mid-Island

At the same time, the mid-island began to experience urban growth, but BC Ferries had a disadvantage servicing that growth. One driver cannot make several stops and deliver loads originating from the Mainland or further points such as Calgary and return in the same day back to the Mainland. The driver's hours would run out on the Island and the driver would have to stay in a hotel, thus adding to the customer's overall cost of transportation.

BCF Response Was a Commercial Approach

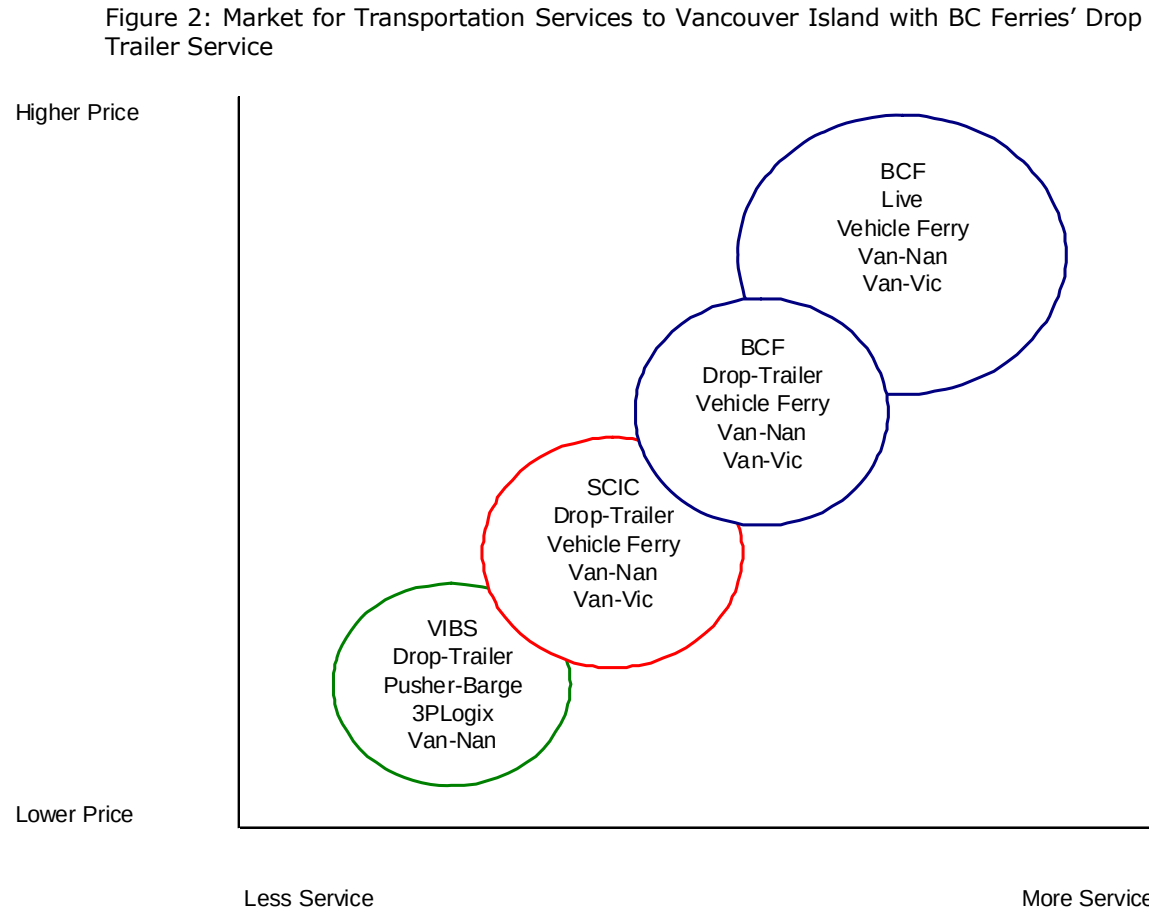
Prior to BC Ferries' entry into the drop trailer service, the options for customers were limited. In an effort to better service the changing

marketplace, BC Ferries worked closely with the customers of the Vancouver Island market to understand and identify their needs. These discussions confirmed that customers place a great deal of emphasis on a lower cost-to-serve model and greater service and that market participants still were not meeting these needs. Customers wanted greater access to markets and efficient utilization of assets with the following characteristics:

Table 1: Market for Transportation Services to Vancouver Island Prior to BC Ferries' Drop Trailer Service

Greater Access	Greater Efficiency
Drop Trailer Services were low frequency	Driver had to wait in the terminal, make the crossing and potentially stay in a hotel when using live service
Drop Trailer Services were not available at convenient times of day	Tractor down time in terminals and on ships as well as being tied up on the Island when using live service
Drop Trailer Services had extended crossing times	Trailers were sitting for extended periods of time waiting to be transported when using drop trailer service

The BC Ferries solution was to provide a drop-trailer service that optimizes the existing assets by offering the service in non-peak sailing times, but still produces greater sailing frequency and access than the existing providers of drop-trailer service. The introduction of BC Ferries drop trailer service fills a market gap created by new truck driver hours of work rules. The market now has the following attributes.



The result is a healthy market for commercial marine transportation services. Section 2.4 of this Filing discusses some of the benefits flowing from the addition of BC Ferries' drop trailer service to the market.

2.3 The Nature of BC Ferries Drop Trailer Service

BC Ferries began providing a drop-trailer service on two of the three major routes in March of 2009. The two routes are Route #1, Tsawwassen – Swartz Bay (Victoria) and Route #30, Tsawwassen - Duke Point (Nanaimo). The drop-trailer service enables commercial customers to drop off their semi-trailers full of goods at one of the designated BCF terminals and to pick up their trailers on the other side of the route. BC Ferries designed the service and adopted operating practices in a manner that complements BC Ferries' existing business.

Hostling Units

The BC Ferries schedule requires that vehicles be unloaded and loaded in 20 minutes. It was not possible to meet these critical turnaround timelines using one tractor to load several trailers onto a sailing, as is done by other providers of drop trailer service. Time-motion studies

1 identified that the only way to ensure that there would be no impact to
2 the BCF schedule was to have the hostling units stay attached to the
3 customer's trailer during the sailing. This requires that each drop
4 trailer moving on a BC Ferries vessel have a hostling unit attached. BC
5 Ferries' drop trailer service utilizes a purpose-built "hostling unit" to
6 move trailers in an efficient and safe manner.
7



8
9 Hostling tractor unit (made by TICO)

10
11 BC Ferries' hostling units, pictured above, provide the ability to quickly
12 and safely load/unload a trailer, while taking up the least possible
13 space on the vessel (approximately 9½ feet versus 14 feet for a
14 highway tractor). However, they are restricted to moving trailers
15 within BC Ferries' terminals, as they cannot travel on the highway.
16

17 Another key feature of BC Ferries' drop trailer service process is the
18 role of the BC Ferries driver. It would be inefficient to have the driver
19 travel on the sailing and unload the trailer at the arriving terminal for
20 the same reasons that it customers do not wish to send their own
21 drivers on the ferry. Therefore, the drivers must be land (terminal)
22 based.
23

24 ***Holding Compound***

25
26 Each of the BC Ferries terminals in Tsawwassen, Swartz Bay (Victoria)
27 and Duke Point (Nanaimo) has a designated holding compound that is
28 used to conduct the transfer and short-term holding of customer
29 trailers. The work performed in the holding compounds at each
30 terminal includes: loading customer trailers on to BC Ferries hostling
31 units; performing necessary safety checks and processing paper work;
32 redeeming reservations; and, customer pick-up of arriving trailers. The

holding compounds at Tsawwassen and Swartz Bay are within the terminals but enclosed within non-BC Ferries core operational space. In the case of Tsawwassen, the holding compound is the underutilized parking lot; for Swartz Bay it is the former staff parking area. At Duke Point, the space required to perform the above tasks would encroach on the existing core service area and impact the ferry users. As a result, several changes were required including leasing an offsite compound and building a separate offloading ramp.

The Tsawwassen and Duke Point compounds are pictured below.



Tsawwassen



Duke Point off site

Service Process

The following is a simplified step-by-step process of how the BC Ferries drop trailer service operates. These steps avoid any impact to the core customer's access to peak capacity. BC Ferries utilizes its existing operating procedures for the marine transportation component of the service.

1. Customers arrive at the BCF compound to drop off their trailers. They then unhook or "drop" their trailers for processing. BCF processes each drop trailer through the terminal in the same manner as a "live" tractor-trailer unit.
2. The BCF driver attaches the BCF hostling unit to each customer's trailer and completes the safety pre-trip forms and custody transfer paperwork.

3. The BCF driver then prints the ticket for the next available underutilized sailing using a standard BCF point-of-sale (POS) terminal located in the holding compound.
4. Prior to the standard BCF cut-off times (30 minutes prior to the sailing), the BCF driver drives the drop trailer unit into the staging lane that the tower designates. The units wait in these lanes until they receive direction from the terminal loading staff to board the vessels.
5. Under direction of existing BCF terminal staff, drop-trailers load along with other vehicles using standard procedures.
6. Once loaded onto the vessel, the BCF driver leaves the vessel and remains onshore when the vessel departs. From the perspective of the vessel, these tractor-trailers look identical to a "live" tractor-trailer customer, with the notable exception that BCF hostling units are smaller and use less deck space.
7. At the receiving terminal, other BCF drivers board the vessel when instructed by BCF terminal staff. The BCF driver locates the drop-trailer on the vehicle deck and performs a safety check.
8. The BCF driver then drives the drop-trailer unit off the vessel when instructed by vessel staff.

Product Offering

BC Ferries' drop trailer service is a 365 days a year operation. The service utilizes many of the scheduled sailings on Route #1 and Route #30. BC Ferries has a rolling 24 hour cut-off for orders.

BC Ferries offers two drop trailer products that cater to different customer delivery needs.

- The first product is called an **"At"** product. The "At" product requires the customer to specify the desired delivery time for their goods. For example, using the Route #30 schedule, if Company X wants delivery of their goods at 3:00 p.m. tomorrow, they need to call BCF by 3:00 p.m. today to place the request and have their trailer at the terminal by 9:15 a.m. tomorrow. The "At" product provides flexibility to manage loads between **two available sailings**. An "At" product is attractive to customers that have predictable and precise supply-chains and are less flexible with delivery times.
- The second product is called a **"By"** product. The "By" product purchase takes place when a customer calls by the 24 hour cut-off and requests delivery of their goods by a specific time. Again, using the Route #30 schedule, if Company X wanted delivery of their goods by 5:30 p.m. tomorrow, they would need to call in by 5:30pm today to place the request and have their trailer at the terminal by 6:45 a.m. tomorrow. "By" products

provide the flexibility to manage loads **between four sailings**.
A "By" product is attractive to customers that have less predictable and time sensitive supply-chains and are more flexible with delivery times.

The combination of the available sailings and the two products enables BC Ferries to deliver higher quality service to the market without affecting the core service schedule or access to peak capacity.

Table 2 shows the published BC Ferries commercial fee schedule for both "live" service and drop trailer service:

Table 2: BCF commercial fee schedule

Tariff for the trailer per/ft	\$6.75 per foot
Terminal Charge	\$31per unit
Hot-Shot Fee	\$13.50 per foot
Reservation Cancellation/Change Fee	\$3.38 per foot
No-show Fee	\$6.75 per foot
Parking and Storage Fee	\$75 per unit
Live Semi Trailer	\$5.25 per foot
Passenger Fee	\$14.00 per pax

Drop Trailer Service Definitions:

Terminal Charge - the hook and unhook fee for trailer transport.
Hot-Shot Fee - delivery of goods within 24hours of booking.
Reservation Cancellation/Change Fee - any alteration to a reservation from the time of the initial booking.
No-show Fee - missing the appointment cut-off time of the "at" or "by" products. It is assessed at the drop trailer tariff list price in effect.
Parking & Storage Fee - any trailer left on the terminal beyond 24hrs are subject to charges of \$75.00 per 24hrs or portion thereof.

BC Ferries will consider altering the fee schedule for a specific drop trailer customer based on a variety of considerations. BC Ferries assesses the net value a customer places on the drop-trailer service through customer specific research and discussions with the customer. When evaluating the fit of a particular customer for the drop trailer service, the BC Ferries sales team will generally consider items such as:

- What level of service is required – expedited service or a slower service?
- What is the scale of their volume commitment?
- How predictable is their volume?
- How flexible is their schedule?

- Is the business complementary to our core segments in terms of seasonality?
- What types of goods is the customer carrying?

Through careful assessment of the customers needs, BC Ferries matches the products to that customer to ensure that they receive value from the drop trailer service. At the same time, this careful analysis ensures BC Ferries maintains the ability to deliver the same schedule, frequency and overall access for the core customers. Finally, this process ensures that BC Ferries receives the maximum value for this service, which it ultimately redistributes to core customers through lower fares.

2.4 BC Ferries' Drop Trailer Service Benefits Transport Industry and Complements its Core Business

BC Ferries' drop trailer service is an important innovation because it meets the needs of the drop trailer customers, the "live" customers, and the existing operations. In this way, the service delivers better efficiency and value for all ferry users. Addressed below are the:

- benefits to commercial customers by providing another service option; and
- benefits to all ferry users flowing from drop trailer service.

Commercial Customer Benefits

The BC Ferries drop trailer service has three key attributes that are attractive to commercial customers and set BC Ferries drop trailer service apart from drop trailer service provided by the two incumbent providers. These three attributes are:

- First, unlike VIBS but similar to SCIC, BCF provides service to two locations on Vancouver Island: Victoria and mid-island.
- Second, BCF drop trailer service is available on a large number of off-peak scheduled sailings to and from both locations on Vancouver Island. Comparatively, both VIBS and SCIC combined provide less frequent service than BCF.
- Third, the crossing time between the Mainland and the Island is between 90 and 120 minutes depending on the route. This enables BCF to process a customers' trailer and have it at the designated terminal ready for pick up in just over 2½ hours. This is a significant improvement versus the traditional drop trailer providers where it can take 5 – 12 hours.

1 With the frequency of sailing and speed of crossing, fresh product
2 customers are able to deliver goods faster and schedule their
3 deliveries at times that are more convenient. This can reduce waste
4 and improve the customer's brand image, translating into greater
5 profits. In addition, the increased frequency of trips can allow retailers
6 experiencing large sales spikes to replenish inventories quickly. This
7 enables them to reduce the number of products they must carry in
8 inventory to reduce the potential that the products may become "out
9 of stock".

10
11 Warehouse customers can realize the same benefits as fresh product
12 customers. They can also realize better trailer utilization as the
13 potential to secure faster round trips permits the customer to use the
14 same trailer multiple times in the same day. It is important for
15 warehouse customers to have access to both Nanaimo and Victoria to
16 plan their loads and minimize mileage.

17
18 These service attributes provide the potential for BCF customers to
19 realize savings that they would not normally associate with a traditional
20 drop trailer service. The "trickle down" economic benefits for
21 Vancouver Island can include reduced inefficiencies within the supply
22 chain that affect the cost of products on the Island. This facilitates
23 better selection of products for the Island consumer, as well as
24 promoting Island-based consumption that supports the Island
25 economy.

26 27 ***Drop-Trailer Complements the Core Business***

28
29 Drop trailer service allows BC Ferries to maximize existing assets
30 without driving increased vessel capacity requirements. This produces
31 benefits for all ferry users for the reasons described below.

32
33 Customer demand is not evenly distributed across each day in a
34 uniform manner from one day to the next. It is natural to have a peak
35 period of demand followed by larger periods of lower demand. The
36 primary peak occurs in the months of July and August on Sunday
37 afternoons. A secondary peak occurs during the off-peak months at
38 7:00 a.m. on the Vancouver-Victoria route.

39
40 Much of the core demand at BC Ferries is time sensitive. This has two
41 implications:

- 42
43 • First, the service expectations of the core customers preclude a
44 business model that requires a customer to arrive at the BC
45 Ferries terminal and wait as long as it takes to fill the vessel
46 before the vessel departs. The wait time facing a customer
47 under this type of model, based on the demand experienced by
48 BC Ferries, could often be many hours. Some sailings might not

1 depart at all until the following day. The market will not tolerate
2 such a business model.

- 3
- 4 • Second, customers would not tolerate a model where BC Ferries
5 employs undersized vessels leading to extended overload
6 situations as a normal course of business. Again, the effect of
7 this would be that customers would not know how long they
8 would have to wait until they could travel. They would know that
9 they would have to wait in most cases.

10

11 There is a pronounced peak demand and customer expectations
12 require that BC Ferries serve the peak demand while maintaining
13 frequent service. Therefore, the ability of a vessel to meet the needs
14 of the core customer demand, particularly the reduction of overloads
15 during periods of peak demand in the summer, is a key determinant in
16 the approval of capital expenditures for price cap setting. As the
17 Commissioner stated in his decision approving BC Ferries' proposal to
18 acquire three vessels:

19

20 *"Overload situations are a frequent occurrence, especially*
21 *in the peak summer months when almost all sailings are in*
22 *an "overload" situation."*⁹

23

24 Put another way, the primary peak demand, occurring in the months
25 of July and August on Sunday afternoons,¹⁰ drives vessel capacity
26 requirements.¹¹ While there are other times that vessels do
27 overload,¹² those periods do not drive the capacity requirements of the
28 ships. Only the primary peak demand period determines ship capacity
29 sizes and therefore, overall capacity costs.

30

31 Since the primary peak demand drives capacity, it follows that there is
32 a predictable amount of unutilized capacity in off-peak periods. BC
33 Ferries must incur the cost of unutilized capacity and that cost is
34 unavoidable. However, this characteristic can enhance the efficiencies
35 of a multi-modal business model in which BC Ferries provides service
36 to multiple market segments i.e., commercial and passenger vehicles.

37

38 The demand for commercial service occurs on weekdays and is less
39 time sensitive. There is little demand for commercial service from
40 Friday night through Sunday night. Therefore, the only times that

⁹ Commission Order 04-01 page 4, IN THE MATTER OF Statutes of British Columbia Bill 18 – 2003 The Coastal Ferry Act Section 55 and A Capital Expenditure for up to Three Vessels Proposed by British Columbia Ferry Services Inc.

¹⁰ For July and August in 2008, 2009 and 2010 (to August 25), 90 percent of Sunday evening sailings on routes 1 and 30 overloaded.

¹¹ In fact, in the absence of sufficient capacity to deal with core peak demand, BCF would not be able to generate sufficient tariff revenues to cover the operating losses of the other three seasons without a significant lift in the individual tariff charged.

¹² For off-peak months on route 1, since January 2008, 70 percent of the weekday 7:00 am sailings overloaded.

commercial demand coincides with passenger vehicle demands are on weekdays. Weekday mornings are periods in which total demand is somewhat higher due to the coincident demand of both passenger vehicle and commercial markets, but the demand does not reach the levels of the primary peak demand times (Sunday evenings in the summer) that drive vessel capacity. Using the flexibility of both "At" and "By" products for drop trailer service, BCF can meet the demands of drop trailer customers using the unutilized capacity each day while continuing to provide high quality service to the passenger vehicle market.

In this way, the drop trailer service contributes revenue without adding to the capacity requirements and associated capital investment requirements of the core service. Ultimately, with price cap regulation, everything that BCF earns from drop trailer returns to other users through lower rates.

2.5 Summary of the Drop Trailer Market

Prior to BC Ferries introducing the drop trailer service there were two incumbent service providers using a different business model. Changes in the trucking industry labour laws drove up the overall cost of "live" service and left a market gap for lower cost, higher frequency service. BC Ferries is now delivering a competitive service that responds to the needs of the market for marine transportation of commercial goods with a drop trailer service. The BC Ferries drop trailer service is innovative, efficient and responsible. This new service enhances the market for commercial marine transportation and redistributes the benefits to ferry users both directly and indirectly.

Section 3 – Competitive Advantage

BC Ferries has a competitive advantage providing drop trailer service, but it is a fair advantage that arises from the BC Ferries business model. BCF's competitive position on drop trailer service is unaffected by the previous or current ownership of BCF assets used to provide service, tax exemptions, or subsidies earmarked for other Routes. Further, even prior to the inclusion of section 45.1 in the Act, the law precluded BCF from pricing the drop trailer product lower than the cost of the service with the intent of gaining market power or dominance. It is appropriate and consistent with the requirements of the Act for BCF to make efficient use of its assets. BCF takes this responsibility seriously, since the regulatory framework ensures that the benefits flowing from improvements in efficiency ultimately flow to ferry users.

The organization of Section 3 is as follows:

- 3.1 demonstrates how efficiency is the true source of the BCF competitive advantage in providing drop trailer service; and
- 3.2 explains why ownership, taxability and subsidies do not confer upon BCF any further competitive advantages.

3.1 Efficiency is the Source of the BCF Competitive Advantage

Efficiency is the source of BC Ferries' competitive advantage. There are two aspects to this efficiency. First, the multimodal business model of BCF (i.e. offering both passenger vehicle and commercial vehicle service) delivers highly efficient marine transportation service. Second, drop trailer service makes efficient use of existing assets.

Multimodal Business Model

For marine transportation, a multimodal business model means that it costs less to have one ship provide both passenger vehicle and commercial vehicle service than it does to have one ship provide passenger vehicle service and another ship to provide commercial vehicle service regardless of the relative size of each market. Each service requires a hull with a driveline and deck space, two terminals with loading lanes, ramps and staff to operate all of the above. The fact that one service is for commercial trucks and the other is for passenger vehicles may produce small differences in cost. However, the savings of eliminating an entire redundant ship and set of terminals and labour more than offsets the additional cost of providing both services.

1 The incumbent providers of drop trailer service do not serve multiple
2 markets for marine transportation. Their business model is different
3 and they seek to generate efficiencies in a different manner than BCF
4 does. The result is a competitive advantage for BCF compared to the
5 drop trailer competitors.

6
7 ***Drop Trailer Service uses Underutilized Capacity Off-Peak***

8
9 The fact that BC Ferries' drop trailer service uses underutilized
10 capacity on existing assets contributes to BCF's competitive
11 advantage.

12
13 To recap what was described in Section 2 of this Filing, BC Ferries has
14 vessels and a schedule designed to meet the core peak demands
15 during the summer. The core peak demand is the primary driver for
16 the capacity of the ship. There are two general reasons for this:

- 17
18
 - for the majority of core customers, their travel needs are time
19 sensitive; and
 - the general homogeneity of the core customers means that they
20 will demand the service at approximately the same times.

21
22 That same capacity required for serving the core peak demand is not
23 in demand at all times, leaving some unutilized capacity on a daily
24 basis.¹³ Based on the nature of the demand at BCF, a portion of this
25 unutilized space is reasonably predictable.

26
27 The unutilized capacity available on a daily basis has no avoidable
28 operating costs associated with it, i.e. the marginal cost is \$0. At all
29 times, BCF must incur the cost of providing the capacity that serves
30 the peak. The current drop trailer service at BCF matches specific
31 customers with particular times of the day when BCF knows there will
32 be available capacity. This service is an off-peak service, the terms of
33 which allow for delays to occur depending on the available capacity.

34
35 Providing the drop-trailer service access to the unutilized capacity does
36 require BCF to incur some additional costs to ensure that the core
37 service maintains the same schedule frequency and access. There are
38 also some limitations on the potential scope of the drop trailer
39 business as a revenue source. Notably:

40
41
42

¹³ The fact that BCF must serve a core peak demand has occasionally given rise to the incorrect notion that BCF is inefficient and could use smaller ships. In fact, BCF balances the need for capacity in terms of both ship size and schedule in a highly efficient manner designed to maximize the utilization of the assets while serving all of the demand. Despite this efficiency in serving the core market demands, it is unavoidable to have some space go empty.

- In order to meet the tight turnaround times for loading and unloading, and avoid impacts on delivery of core service levels, BCF requires more labour and equipment than it would if the vessel were in the berth for longer. Additional hostling units are necessary since there is not enough time to disconnect them from the trailers on the ships. BCF must also license and insure the hostling units to travel on highways since the BCF terminals used in the drop trailer service are gazetted highways.
- BCF must also overcome some challenges that arise because of the multimodal business model. The BCF passenger service limits the types of Dangerous Goods that it can carry. In addition, during inclement weather BCF may not sail given the needs for passenger comfort & safety.

BC Ferries takes care to select customers that will benefit from the attributes of the drop trailer service as well as fit with the operational realities and constraints of the BCF drop trailer business. The selection process often requires extensive discussions with customers. Sometimes BCF needs to adjust the price of the service to arrive at an agreement that delivers value for all parties involved. However, BCF has taken care to develop the drop trailer business slowly and has sought to maintain prices as high as the market will bear so as to maximize the contribution to ferry users as a whole.

In summary, the current drop-trailer service at BCF is an off-peak, flexible service making efficient use of available unused capacity, reducing the opportunity cost of the unutilized capacity. While the service does not cause an increase in the general operating costs, it does have specific directly assignable costs. However, because the marginal cost of the unused capacity is \$0, BCF can incur the additional costs required to facilitate access to this capacity and increase efficiency overall. This is a significant source of competitive advantage in providing drop trailer service.

Ferry Users Benefit from Regulation, Competition and BCF Drop Trailer Service

The drop-trailer service is in the interests of core ferry users because drop trailer prices are higher than the cost of providing the drop trailer service, and that positive difference will reduce the prices to core users without affecting their access to service. The drop-trailer service provides greater capacity in the market for existing drop-trailer customers and greater value for the service. The greater the revenues compared to the costs of the service, the greater the benefits for core ferry users.

1 The additional costs of adding a service are lower than the average
2 costs for providing all the services. Economists call this a “subadditive
3 cost function”. Generally, a business will be more likely to have a
4 subadditive cost function when it has high fixed costs of operation.
5

6 Regulation of capacity and prices enables and requires BCF to pass on
7 the efficiency gains due to the subadditive cost function to all ferry
8 users. Accordingly, regulation creates a desirable outcome for users
9 of BCF when it adds or maintains a service that has a lower additional
10 cost to serve than both the average costs of providing all services and
11 the additional revenues the service generates.
12

13 An unregulated natural monopoly will tend to limit capacity in the
14 market and raise prices to a level that maximizes the profit on that
15 capacity. This will leave unmet demand for the service in the market
16 and extract the maximum amount of revenue possible from the
17 customers it actually serves. Prior to BCF entering the drop trailer
18 market, there was unmet demand for service. The BCF drop trailer
19 service responds to that gap and introduces healthy competition in the
20 market for drop trailer service.
21

22 As noted earlier, the design of the business model encourages BCF to
23 take a commercial approach to the delivery of ferry service.
24 Therefore, BCF should compete for all markets where the additional
25 cost of providing a service is lower than the existing average costs of
26 providing service.
27

28 **3.2 BCF Does Not Enjoy Unfair Competitive Advantages**

29

30 Section 45.1(1) of the Act identifies three factors that may potentially
31 give rise to an unfair competitive advantage as part of a non-
32 exhaustive list: the ownership of the vessels or terminals used to
33 provide the service, any tax exemptions or government subsidies. BCF
34 explains below that the competitive advantage that BCF has in
35 providing drop-trailer service is independent of the identified factors,
36 or like factors. Specifically, BCF makes the following points:
37

- 38 • BCF paid fair value for the vessels it owns and terminals it
39 leases, by either acquiring them from the Province in 2003, or
40 purchasing them from suppliers since that time;
41
- 42 • Price caps at BCF include a pre-tax return on equity identical to
43 that which any other private operator would be entitled, and
44 thus the tax exemption confers no benefit on BCF in terms of
45 setting drop trailer rates;
46

- BCF receives no service fees or subsidies from the Province for serving Routes #1 and #30, on which BCF offers drop trailer service; and
- BCF has complied with all legislation governing anti-competitive practices in offering its drop trailer service.

Fair Value of the Assets Previously Owned By Government

Section 45.1(1) requires the Commissioner to assess whether BCF enjoys an unfair competitive advantage by virtue of having been provided with "use of, access to or ownership of vessels or terminals that are or had been owned by the government or a government body within the meaning of the Financial Administration Act." The terminals leased to BCF are owned by the Province. Some (but not all) of the vessels used by BCF in providing drop trailer service were previously owned by the Province. However, these facts cannot give rise to an unfair competitive advantage because BCF paid fair value for the vessels it owns and terminals it leases, by either acquiring them at fair value from the Province in 2003, or by purchasing them from suppliers in the open market since that time.

The fair value of BCF long-lived assets equals the carrying value determined in accordance with generally accepted accounting principles (GAAP). The CICA handbook, at Section 3063.03(b), defines the fair value of long-lived assets as:

"The amount that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are not under compulsion to act"

Based on the Share Repurchase Agreement between the Province and BCF of April 2, 2003, the price of the shares of BCF equalled the shareholder's equity on the balance sheet at March 31, 2003. As such, the fair value of BCF at the time of purchase was equal to the carrying value of the assets, or the net book value. The current price cap was determined using net book value as well.

There is no active market to assess the value of the long-lived assets of BC Ferries. This has to do with the nature of the assets themselves, not the ownership of the assets. The market circumstance would be the same if any party other than BCF owned these assets. The CICA handbook, Section 3063 A4, indicates that in the absence of market prices,

"a present value technique is often the best available technique with which to estimate the fair value of a long-lived asset and generally includes the following elements:

- a) *An estimate of the series of future cash flows at different times*
- b) *Expectations about possible variations in the amount or timing of those cash flows*
- c) *The time value of money, represented by the risk-free rate of interest, and*
- d) *The price for bearing the uncertainty inherent in the asset or liability”.*

The present value of the future cash flows at BCF is equivalent to the net book value of BCF. This is because the price cap is set to provide revenues sufficient to recover expenses and financing charges, and provide a pre-tax return on equity based on the net book value of the assets. As such, the price that BCF paid for the assets represents fair value and is consistent with GAAP.

Since April 2, 2003, BCF has purchased or upgraded the long-lived assets of the company. Significant activities include acquisition of new ships and additional land, improvements to terminals and ships and divestiture of retired ships. The net book values also accurately reflect all of these activities.

The balance sheet of BCF as of March 31, 2010 shows a net book value of assets worth \$1,807.0 million. Since 2003, BCF has spent \$1,239.7 million on new ships, life extensions of ships and upgrading existing ships. In addition, BCF has spent \$289.6 million on terminal assets, either replacing or revitalizing aging marine structures and land side terminal assets to improve safety and service delivery.

The only other available alternative to evaluate the fair value of the long-lived assets would be the BC assessed property tax values for the terminal lands and structures. On April 1, 2003, under the Master Agreement, BC Ferries sold 43 terminals and the related land to the BC Transportation Financing Authority for \$330,593,563, which is the amount that the BC Assessment Authority had recorded on its books for property tax evaluations. The net book value of these assets at the time was \$252,844,000.

The net book value reflects all of the activities BCF has engaged in since April 2, 2003, whereas BCF challenged the BC assessed values in 2006. The BCF challenge was successful in lowering the values by substantial amounts. This means that the BC assessed values as of April 1, 2003 may have been overstated.

In summary, the fact that BCF purchased the assets used in providing drop trailer service provides a full answer to this question of whether BCF obtained an unfair competitive advantage by virtue of provincial ownership of assets prior to 2003. The price BCF paid for the assets

1 represented fair value in the circumstances, reflecting net book value
2 and the present value of future cash flows.
3

4 ***BCF Income Tax Exemption has No Effect on Prices or Costs***
5

6 Section 45.1(1) of the Act also requires the Commissioner to assess
7 whether BCF enjoys an unfair competitive advantage by virtue of "any
8 tax exemption". BCF is income tax exempt, but the exemption does
9 not affect the prices BCF charges for drop trailer service. Thus, there
10 is no unfair competitive advantage arising from the tax exemption.
11

12 When the Commissioner sets a price cap for BCF, that price cap must
13 enable the ferry operator to receive a pre-tax rate of return on
14 equity.¹⁴ Regardless of whether BCF is taxable or not, for the
15 purposes of rate setting, the economic costs must include a return on
16 the equity of the company sufficient to provide the appropriate pre-tax
17 return on the equity.
18

19 The approved pre-tax rate of return on equity for the current price cap
20 at BCF is 13.16%¹⁵. This explicitly treats the price cap at BCF as
21 though BCF were taxable at the prevailing income tax rate. In this
22 manner, the rates at BCF are identical whether the company is actually
23 a taxable entity or not.
24

25 The tax exemption at BCF increases the retained earnings of the
26 company compared to what they would be if the company were
27 taxable. This helps to offset the constraint imposed on BCF by its
28 ownership structure. Namely, BCF is not able to issue any more equity
29 shares to raise capital. Instead, BCF must finance all capital through a
30 combination of debt and retained earnings. The approved pre-tax
31 return on equity helps to make this possible, so that ferry users may
32 continue to receive safe and reliable service. The shareholder cannot
33 provide any new capital, nor can BCF issue any new shares of equity.
34 While privately held or widely held equity shares would attract income
35 tax, such an operator would also be free to issue more shares at will to
36 raise capital. In any event, the pre-tax rate of return on equity is
37 identical in both cases, nullifying any effects in terms of rate setting.
38

39 Thus, BCF's tax exemption has not accorded an unfair (or any)
40 competitive advantage in providing drop trailer service.
41

¹⁴ *Coastal Ferry Act*, Section 41 (2) (b)

¹⁵ Commission Memorandum 25

BCF Does Not Receive Any Government Subsidies on the Major Routes

Section 45.1(1) of the Act also requires the Commissioner to assess whether BCF enjoys an unfair competitive advantage by virtue of "any subsidy". BCF's ferry service on Routes #1 and #30 are self-funded, and thus BCF does not enjoy an unfair (or any) competitive advantage from "any subsidy".

BCF receives no ferry service fees or Federal subsidy for the major routes. When the Commissioner sets a price cap for a route group, the Commissioner subtracts any ferry service fees and Federal subsidies from the amount that the price cap is designed to enable BCF to recover in tariffs for the particular route group. For the major routes, there are no service fees or Federal subsidies to subtract. Fares on the major routes must recover in their entirety, the costs of providing that service, including a pre-tax return on the equity.

For the purposes of setting the price caps for the Second Performance Term under the Coastal Ferry Services Contract, the Commissioner assumed that the major routes were capitalized using thirty-five (35) percent equity. This increases the required return on the major routes for rate setting purposes above the actual equity share of less than twenty percent for all of BCF. Conversely, for all of the other route groups, the Commissioner assumed that the equity share was five percent. As a result, the major routes produce the vast majority of the earnings at BCF despite the fact that they receive no service fees. The existence of the service fees associated with the other route groups does not enable BCF to offer lower rates on the major routes than it otherwise would be able to without providing service to those routes. To underscore this point, BCF has an outstanding offer to SCIC to sell it the rights to serve the other routes and receive the ferry service fees and Federal subsidies.

The Province provides travel assistance for selected residents of BC. Certain medical travel passengers, seniors on Mondays to Thursdays, disabled residents and their escorts and students all receive assistance with paying their fares on BCF. However, the customers are the recipients of the assistance, not BCF. BCF merely administers this program by billing the Province directly for the travel. There is no effect on price by the amount of the assistance and therefore the Provincial travel assistance program has no effect on the ability of BCF to set prices for drop trailer service on the major routes.

Regulation of BCF Prices Occurs through the Price Cap and the Competition Act

BCF has always complied with laws governing anti-competitive behaviour in pricing and delivering drop trailer service.

Regulation of prices at BCF occurs through a price cap mechanism. Price cap regulation provides pricing flexibility to BCF to generate more traffic by adjusting prices for customers based on the value they place on the service. The price cap does not directly put a boundary on individual prices. What the price cap does is ensure that BCF cannot access monopoly profits at the expense of ferry users. At an individual price level, the price cap actually creates an incentive for BCF to price competitive services as low as necessary to generate more business. This is good because it ensures that BCF focuses on its primary objective, which is to produce the most efficient utilization of the fixed assets possible.

While the price cap creates an incentive to lower prices, BCF still cannot engage in predatory pricing. The simple fact remains that it is illegal in Canada to incur a loss on the sales of a product with the intent of gaining and exercising market power and dominance. Specifically the Competition Bureau of Canada evaluates whether a pricing policy is designed to exert market power by measuring a price/cost comparison. They say this about how to administer that test:

*"While variable costs can be a proxy for marginal costs, the Bureau's view is that average avoidable costs is the most appropriate cost standard to use when determining if prices are predatory, since average avoidable costs capture opportunity costs. Avoidable costs refer to the costs a firm could have avoided had it chosen not to sell the product(s) in question during the period of time the policy has been in place. By addressing certain incremental costs, including opportunity costs, associated with a practice or policy of predatory pricing, avoidable costs provide a closer proxy of marginal costs than variable costs alone. As well, most firms produce two or more products, and multi-product firms generally have fixed costs incurred in common on behalf of two or more of their products. **Using average total costs as a standard for measuring cost in predatory pricing analysis is inappropriate [emphasis added]**, in part because of the difficulty of allocating common costs among two or more products. The avoidable cost test avoids the*

1 *problems of having to allocate common costs to*
2 *individual products.”¹⁶*
3

4 For BCF, the average avoidable costs represent the direct costs of the
5 drop trailer business.
6

7 The competitive advantage that BCF has in providing drop-trailer
8 service on the major routes enables all customers to receive the
9 benefits of that greater efficiency through the regulation of BCF. In
10 addition, the laws of Canada prevent BCF from unfairly pricing to gain
11 market share. The federal government of Canada also states how to
12 calculate an appropriate and fair cost against which to measure the
13 prices.
14

15 It is fair and reasonable for BCF to take advantage of efficiencies to
16 engage in open competition for drop trailer service on the major
17 routes. To prevent BCF from competing in drop trailer service on an
18 efficient basis, would result in a transfer of wealth from ferry users to
19 the private shareholders of the unregulated competitors.
20

21 **3.3 Conclusion Regarding Competitive Advantage** 22

23 Ultimately, the competitive advantage at BCF arises from two sources.
24 First, it is cheaper for BCF to provide more marine transportation
25 services than less. Second, the efficiency of the drop trailer service
26 means that it is inherently cost effective to provide the service. This is
27 a fair competitive advantage. The Act mandates that ferry operators
28 should take a commercial approach to delivering core ferry service and
29 the price caps then redistribute the efficiencies competition drives back
30 to the ferry users. BCF’s drop trailer service aligns with the statutory
31 mandate to engage in a commercial approach. The regulatory model
32 for BCF rewards the ferry users for the innovation and efficiency of
33 BCF providing drop trailer service.
34
35

¹⁶ Competition Bureau Canada Enforcement Guidelines Predatory Pricing Final Version – July 2008

Section 4 – Cost Allocation Methodology

Section 45.1(1) of the Act requires the Commissioner to "...determine whether the ferry operator is pricing the service below the direct costs and an appropriate proportion of the indirect costs associated with providing that ferry transportation service." BCF retained EES Consulting, experts in cost allocation with many years of experience with regulated businesses, to assist in developing a cost allocation approach in line with the considerations outlined in section 45.1(1) of the Act. The report prepared by EES Consulting is included in Appendix C. The application of this model, and the comparison of the resulting allocated costs associated with providing drop trailer service to the revenues generated by the service demonstrates that the service is priced appropriately and has been since the inception of the service. Further, all of the prices that drop trailer customers are paying are higher than the fairly allocated unit costs.

The organization of section 4 is as follows:

- 4.1 describes the direct costs attributable to the drop trailer service and confirms that they have been allocated fairly to drop trailer service;
- 4.2 explains the allocation of an appropriate share of indirect costs; and
- 4.3 summarizes the findings of EES Consulting.

4.1 Direct Costs of Providing Drop Trailer Service

The direct costs represent the costs that BCF could avoid by not providing drop trailer service. Prior to March 2009, BCF did not provide a drop trailer service. In order to provide the drop trailer service described in section 2, BCF purchased additional assets and hired additional employees. The carrying costs of those capital expenditures, the operating expenses associated with running those assets and the salaries and wages of the employees are easily identifiable.

The direct costs of providing drop trailer service include:

- hostling units (leasing, maintenance, fuel, insurance and return on equity at the pre-tax rate);
- holding compounds and portable office spaces (leasing, property tax, utilities, maintenance, security, insurance and return on equity at the pre-tax rate);

- employees (salaries, benefits, uniforms and travel);
- telecommunications and office equipment, including return on equity at the pre-tax rate; and
- office supplies and materials.

In short, this identifies the types of costs that would not have been incurred “but for” the drop trailer service and did not exist prior to March 2009 when BCF introduced the drop trailer service.

Of note is that the price cap for Performance Term Two did not consider any of these incremental costs at the time it was set. BCF was not openly considering the prospect of the drop trailer service in September 2006, when the price cap review took place. As described in Section 2.2, BCF initiated drop trailer service in response to amendments to the BC Labour Code in 2007 that brought structural changes to the commercial marketplace. Since inception, the drop trailer service has had to be commercially viable on a sustainable basis. BCF has taken great care to ensure that once established, the drop trailer service is commercially viable and recovers the incremental economic cost of providing service to each customer. Further, it is a requirement of the Competition Bureau of Canada that BCF needs to recover at least the direct costs on average from drop trailer customers. BCF has met this requirement throughout.

4.2 Allocation of an Appropriate Share of Indirect Costs for Drop Trailer Service

Even though BCF cannot avoid any of the indirect costs by terminating drop trailer service, BCF has performed an allocation of the common costs of the company. The allocation exercise was undertaken in two key steps:

- BCF first applied the allocation methodology accepted by the Commissioner for determining route costs, which capture indirect costs; and
- BCF then applied an established methodology developed with EES Consulting to allocate a share of the route costs to drop trailer service.

The application of these steps results in an appropriate proportion of the indirect costs being allocated to drop trailer service.

The Accepted Route Statement Allocation Uses Fair Asset Values, a Pre-Tax Return and has No Reductions from Subsidies

BCF first applied the allocation methodology accepted by the Commissioner for determining route costs, which captures indirect costs while using fair asset values and a pre-tax return on equity, without being reduced by subsidies.

BCF performs an allocation of costs to each route. The Commissioner accepted the allocation method when setting the Performance Term Two price caps. This Commissioner-accepted allocation method generates an amount that prices should recover in total for the route group by summing up the amount allocated to each route. The costs include:

- an offset for any service fees, subsidies and ancillary revenue sources;
- all operations, maintenance and general and administration expenses;
- amortization expenses;
- interest expenses; and
- a pre-tax return on equity.

There are not any subsidies or service fees applicable to the routes that provide drop trailer services. Therefore, there is not a reduction in the costs for these routes.

The equity component of the assets on the routes that provide drop trailer services is set at 35%. The total asset values for both debt and equity on these routes equals the net book value, as discussed earlier.

In addition, the pre-tax return on that equity is equal to 13.16%. Subsequently, the cost allocation to these routes includes an amount for income tax and a full economic return that is higher than the corporate total, which is based on an equity component below 20%.

The resulting allocation to Routes #1 and #30 represents the appropriate starting point for determining the appropriate allocation between types of service (core service and drop trailer service) offered on those routes.

The Allocation of Route Costs Uses Generally Accepted Methodologies

The cost allocation must consider the appropriate allocation of Route #1 and #30 costs between, on one hand, drop trailer service, and on the other hand all other services offered on Routes #1 and #30. BCF's application of a generally accepted cost allocation methodology has ensured that costs have been allocated appropriately, and form a legitimate basis for comparing the prices charged by BCF for drop trailer service.

Since regulation of BCF occurs through a price cap mechanism, this is the first time a rate class allocation has been done for regulatory purposes. Accordingly, BCF obtained the services of EES Consulting, experts in cost allocation, to establish the appropriate principles and calculations as well as to evaluate the reasonableness of the results. Appendix 3 contains the report of EES Consulting, which includes discussion of:

- EES Consulting's expertise in cost allocation;
- accepted allocation principles that formed the basis of their recommended allocation methodology;
- the application of the recommended methodology to the present context; and
- EES Consulting's overall opinion supporting the appropriateness of the allocation exercise undertaken by BCF.

The allocation methodology recommended by EES Consulting includes:

- all direct costs; and
- an appropriate proportion of indirect costs, based on:
 - o fair asset values,
 - o a pre-tax return on equity, and
 - o no artificial cost reductions from subsidies.

Gary Saleba, President of EES Consulting, concludes as follows¹⁷:

"Based on my experience as a Cost of Service expert, it is my opinion that the analysis and approach described in this letter and applied by BC Ferries meets the generally accepted principles for cost allocation and results in a fair and equitable methodology to determine the cost of serving the drop trailer class. In my opinion, the costs assigned to the drop trailer class

¹⁷ See Appendix C attached.

1 *by employing the discussed methodology include the direct cost*
2 *and an appropriate portion of the indirect costs associated with*
3 *this new drop trailer service. As the average revenues per foot*
4 *from the drop trailer service class are higher than the*
5 *calculated cost of service per foot, it can be concluded that BC*
6 *Ferries drop trailer service is priced in excess of a fair allocated*
7 *portion of the revenue requirement from Routes 1 and 30."*

8
9 Further, an examination of the confidential prices charged for drop
10 trailer service demonstrates that BC Ferries has never charged a price
11 for drop trailer service since the inception of the service in March
12 2009 that is below the unit costs that the EES allocation methodology
13 produces using pro-forma fiscal 2009/2010 costs.

14 15 **4.3 Conclusion Regarding Allocation of Costs**

16
17 The application of the methodology developed by EES Consulting has
18 resulted in direct costs and an appropriate proportion of the indirect
19 costs associated with providing that drop trailer service being
20 allocated to drop trailer service. A comparison of those costs to the
21 prices charged establish that the prices BCF charges for drop trailer
22 service do recover more than a fair share of the cost of providing
23 service. All BCF prices for drop trailer service are above this measure
24 currently and have been since the inception of the drop trailer service.

Section 5 – Requested Findings and Process

The information provided in this Filing supports the two findings requested by BC Ferries, namely that:

- BC Ferries' drop trailer service is priced in a manner that reflects BC Ferries' direct costs and an appropriate proportion of indirect costs associated with providing drop trailer service; and
- BC Ferries is competing on a fair basis with the incumbent providers of drop trailer service.

BC Ferries submits that the information provided in this Filing is, in and of itself, sufficient basis for the Commissioner to make the requested determinations. However, should the Commissioner wish to access additional data to support the evidence, it is available for viewing by the Commissioner and its consultant.

BC Ferries also submits that the Commissioner can and should make these findings in the course of a bilateral process involving only BC Ferries, as contemplated in section 45.1 of the Act. Confidentiality should be maintained as contemplated in section 54 of the Act over the commercially sensitive information included in the confidential appendices, and any other confidential data provided to the Commissioner upon request. Further explanation on the issue of confidentiality is set out in the cover letter for the Confidential Appendices.

Similar concerns regarding confidentiality exist in the context of the Commissioner's decision regarding this Filing. Notably, were the Commissioner to publish a specific drop trailer "floor price", or to make known the inputs into the determination of a "floor price", it would confer a significant competitive advantage upon the incumbent providers of drop trailer service. As those providers are unregulated, they could price their own offering below that "floor price" established by the Commissioner for BC Ferries, so long as their price remained above their marginal cost of providing service. BC Ferries would not be in a position to compete based on price, and this would present a serious impediment to BC Ferries' long-term participation in the drop trailer market. Restoring the incumbent providers' previous market power as sole providers of drop trailer service on key routes is contrary to the interests of the trucking industry and the public that depends on that industry. As indicated previously, ferry users will also be adversely affected by reductions in drop trailer revenue. For this reason, BC Ferries respectfully submits that the Commissioner's decision should assess BC Ferries' pricing and offering against the test

1 under section 45.1(1) of the Act, without stipulating a “floor price” or
2 referencing details regarding BC Ferries’ cost structure in the decision.
3

4 In the event that the Commissioner is unable to make the findings
5 sought, BC Ferries respectfully requests that the Commissioner permit
6 BC Ferries to provide further submissions and evidence on the
7 appropriate order under section 45.1(2) of the Act.
8

APPENDIX G

**BCFS LETTER OF SEPTEMBER 30, 2011,
SEEKING TO VARY ORDER 11-01**

September 30, 2011

Mr. Gordon Macatee
British Columbia Ferries Commissioner
BC Ferry Commission
RPO Hillside
P.O. Box 35119
Victoria, BC V8T 5G2

Dear Commissioner,

Re: Order 11-01A (Drop Trailer Service) – British Columbia Ferry Services Inc. (“BCFS”) Request for Reconsideration and Variance of the Quarterly Application of the Minimum Allowed Average Tariff (“MAAT”)

On April 29, 2011 the Commissioner issued Reasons for Determination for Order 11-01 on the Drop Trailer Services matter. By this letter, BCFS is respectfully requesting that the Commissioner reconsider and vary one aspect of Item 4 of Order 11-01A. Specifically, BCFS is requesting that our quarterly compliance with the MAAT be assessed *based on BCFS’ average performance over the previous four-quarters* (i.e. a four-quarter trailing average), rather than on data from a single quarter. BCFS submits, for the reasons set out in this letter, that the requested change will better achieve the intention of the MAAT by accounting for fluctuations in drop trailer traffic volumes and customer mix during the year that although beyond our control can affect BCFS’ average revenue per vessel-foot from quarter to quarter.

Below, BCFS addresses:

- (a) the determination of compliance with the MAAT under Order 11-01A;
- (b) the grounds and rationale for reconsideration and variance; and
- (c) the order sought and implementation.

A. Order 11-01A – Assessing Compliance Based on Data from One Quarter

Order 11-01A, supported by the Reasons for Determination, specified how the MAAT is to be determined, and then how compliance is to be measured. Item 3 of the Order specified quarterly reporting requirements and Item 4 specified how compliance with the MAAT is to be measured on a quarterly basis:

3. Beginning with service provided during the first quarter of fiscal 2012 (which starts on 1 April 2011), BCFS shall report quarterly to the commissioner within 60 days of the end of each quarter: (a) the quarterly total revenue from its drop trailer tariff on the major routes and (b) the number of vessel-feet occupied (lane feet occupied by drop trailers and their hostler units).

4. BCFS shall ensure that the amount (a) divided by (b), being the average revenue per vessel-foot for the quarter, shall not be less than the MAAT as defined above.

Item 4 contemplates BCFS' quarterly compliance with the MAAT being calculated based on results from a single quarter. BCFS is compliant with the MAAT for Q1 F2011 when calculated on this basis. However, for the reasons described below, BCFS submits that the Order should be varied to reflect a quarterly calculation *based on a four-quarter trailing average*.

B. Basis for Reconsideration and Variance

In this section, BCFS addresses the grounds for reconsideration and the rationale for adopting a four-quarter trailing average for determining BCFS' compliance with the MAAT. BCFS submits that there are legal grounds for reconsideration and variance, and that the Commissioner should exercise his discretion to make the orders articulated in section C.

Legal Grounds for Reconsideration

The Commissioner's adoption of the MAAT in Order 11-01A was based on the Commissioner's own evaluation and analysis; it was not an approach advocated by any participant in the process. As such, this reconsideration and variance application is the first real opportunity that BCFS has had to address substantive elements of the Commission's Order 11-01A relating to the implementation of the MAAT. The grounds for reconsideration and variance can be characterized as follows:

- a basic principle – namely, the approach to evaluating compliance with the MAAT - had not been raised in the original proceedings; and
- a new principle – namely the proper implementation of the MAAT - has arisen as a result of the Commissioner's decision to adopt the MAAT.

The Commissioner has discretion to reconsider and vary the decision on these grounds. The rationale for the Commissioner to exercise his jurisdiction in the present circumstances is discussed next.

Rationale for Adoption of Four-Quarter Trailing Average

Under Items 3 and 4 of the Order, compliance with the MAAT is determined after the fact by dividing:

- (a) the quarterly total revenue from BCFS' drop trailer tariff on the major routes, by
- (b) the number of vessel-feet occupied (lane feet occupied by drop trailers and their hostler units).

This equation results in the average revenue per vessel foot for the quarter. Item 4 of Order 11-01A specifies that the average revenue per vessel foot for the quarter must exceed the MAAT. The nature of this calculation is such that BCFS' compliance is a function of not only the price charged for the drop trailer service, but also some factors beyond BCFS' control.

Our customers desire cost certainty over longer periods of time, as their customers also depend on price certainty and require notice of price changes. In order to meet this customer expectation, BCFS negotiates annual contracts with our drop trailer customers.

Drop trailer service rates are relatively predictable from quarter to quarter, and they are negotiated on an annual basis. As indicated in the Drop Trailer Filing, BCFS is pricing drop trailer service in such a way as to obtain the highest possible price for drop trailer service that the market will bear in an effort to maximize revenues. Significantly, however, the average revenue per vessel foot in a given quarter is also a function of the mix of drop trailer customers, even if overall drop trailer traffic volumes remain relatively constant over the course of the year.

Each customer is subject to its own business cycles, which result in each customer requiring varying amounts of drop trailer service throughout the year. The drop trailer service requirements of individual customers will differ depending on, for example, the industry sectors in which they operate, work disruptions, and economic conditions. Thus, over the course of a year, the mix of customers making up the total drop trailer traffic volume will change. As different customers pay different rates for drop trailer service that have been determined in advance, these changes in customer mix can have a significant impact on the average revenue per vessel foot from quarter to quarter. In times where high revenue customers make up most of the mix, BCFS average revenues per vessel foot could be well above the MAAT. Conversely, in quarters where the lower revenue (but higher volume customers over the whole year) dominate the mix the average revenues per vessel foot will potentially be much lower. Over the year, however, these cycles tend to even out.

As indicated above, our customers expect BCFS to provide pricing stability over the course of a year; even if BCFS could accurately predict traffic and volume mix, customers do not want drop trailer rates to fluctuate in response to changes in traffic volumes and traffic mix even if they tend to even out over the course of a year. Thus, the practical result of using a single quarter's experience to assess compliance with the MAAT is that BCFS cannot set its annual service prices to achieve the MAAT without running the risk that changes in traffic and customer mix within a particular quarter could cause non-compliance in that quarter. BCFS must leave a significant margin on its annual fixed prices (which are already priced to maximize revenue) to account for fluctuations in volume and mix within the year, while remaining above the MAAT.

BCFS understands that the purpose of the MAAT established by the Commissioner was to set a floor price that was sufficiently high so as to ensure other market participants can continue to compete on fair terms, but not so high as to preclude BCFS from competing effectively and fairly in the drop trailer market. BCFS must remain competitive on drop trailer service in order to generate revenues for the benefit of all ferry users. The Commissioner has stated (Reasons, p.43) that the MAAT "accounts for direct costs and an appropriate proportion of the indirect costs attributable to providing drop trailer service were none of the factors referred to in [s.45.1(1)] present".

The use of single quarter results to determine compliance has a significant impact on BCFS' ability to compete in the drop trailer market, and undermines the overall purpose of setting a MAAT as a fair price for drop trailer service that covers direct costs and an appropriate proportion of indirect costs without accounting for any of the advantages as identified by the Commissioner. It also stands to reason that drop trailer customers of all three drop trailer providers will pay more, as the competitors can also adjust their prices upwards.

In addition, the calculation of the MAAT itself is based on annual costs, increased annually by a projected CPI, to the forecasted year in which BCFS is expected to reach a horizon annual traffic volume. There are seasonal variations in both costs and traffic within a year which have been smoothed away in determining the MAAT. Compliance with the MAAT should also be calculated on a four-quarter trailing average to smooth variations in traffic volume and mix, in the same manner the calculation of the MAAT itself has smoothed seasonal variations.

Precedent for Using Four-Quarter Trailing Average

In Order 05-01, the Commissioner determined that a four-quarter trailing average is to be used in assessing BCFS' compliance with price caps as it will moderate the impact of seasonal fluctuations in traffic volumes and mix on BCFS' compliance with price caps. A three quarter grace period was subsequently incorporated into the price cap compliance framework in Memorandum 31 which, combined with the four-quarter trailing average methodology adopted by the Commissioner for assessing compliance with price caps, enables BCFS to be even better equipped to moderate the impact of seasonal fluctuations.

BCFS is, at this time, only requesting a four-quarter trailing average be applied in the case of drop trailer service, i.e. BCFS is not proposing to add the three quarter grace period component. BCFS currently expects that a four-quarter trailing average will sufficiently moderate the potential that BCFS' compliance with the MAAT can be affected by fluctuations in drop trailer traffic volumes and mix that result from factors unrelated to the fairness of drop trailer pricing. BCFS submits that the logic employed by the Commissioner in adopting the four-quarter trailing average for assessing price cap compliance should apply equally in the case of the assessment of compliance with the MAAT as both the MAAT and price cap compliance are affected by similar seasonality.

C. Order Sought and Implementation

BCFS believes, for the reasons described above, that the fairest way of implementing the MAAT is to delay the assessment of BCFS' compliance with the MAAT until four full quarters of data are available, upon which a four-quarter trailing average can be calculated. However, BCFS has instead proposed a transitional measure that allows for compliance to be assessed based on data as it is accumulated throughout 2012, until the four full quarters of data are available.

BCFS is respectfully requesting an Order that:

1. Item 4 of Order 11-01 be varied to read:

4. Subject to the transitional provisions set out below, BCFS compliance with the MAAT shall be determined on a four-quarter trailing average basis. That is, BCFS shall ensure that the amount (a) divided by (b), being the average revenue per vessel-foot, when considered on average over the previous four quarters, shall not be less than the MAAT (as determined above) over the previous four quarters.

. . . /5

5. As a transitional measure to using a four-quarter trailing average as described in Item 4, BCFS compliance with the MAAT for the next two quarters shall be determined as follows:

(a) BCFS compliance for Q2 F2012 (ending September 30, 2011 and reported on November 29, 2011) shall be based on a two-quarter trailing average; and

(b) BCFS compliance for Q3 F2012 (ending December 31, 2011 and reported on February 29, 2011) shall be based on a three-quarter trailing average.

D. Conclusion

BCFS has completed the calculation for Q1 of F2012 (April 1, 2011-June 30, 2011), which is the first quarter since the MAAT took effect. BCFS has complied with the MAAT for that quarter based on the existing methodology that uses only traffic data from Q1. However, a four-quarter trailing average moderates the potential for traffic fluctuations changes and changes in customer mix throughout the year to influence the calculation of the average revenue per vessel foot from quarter to quarter. The requested change will best account for uncontrollable factors that can affect MAAT compliance from quarter to quarter, and still allow BCFS to charge a fixed and fair annual price for drop trailer service throughout the year. This is, in turn, in the interests of all ferry users.

BCFS respectfully requests a determination on this application by October 31, 2011, such that the result of the Commissioner's determination will be known with sufficient time (approximately one month) for BCFS to assess the implications of the decision for our Q2 2012 reporting and for our pricing going forward.

Thank you for your consideration of this request.

Yours truly,

BRITISH COLUMBIA FERRY SERVICES INC.



Robert P. Clarke
Executive Vice President
and Chief Financial Officer

Copy: Mr. Gino Crisanti, Van Isle Barge Services
Mr. Richard Plecas, Seaspans Ferries Corporation

February 4, 2016

Mr. Gordon Macatee
British Columbia Ferries Commissioner
BC Ferry Commission
PO Box 9279 Stn Prov Gov
Victoria BC V8W 9J7

Dear Mr. Macatee:

Re: Notice of Procedures Regarding Drop Trailer Regulation under Section 45.1 of the *Coastal Ferry Act*

We write in regard to the Notice of Procedures Regarding Drop Trailer Regulation that was recently posted on your website. We have reviewed the seven other submissions received by the British Columbia Ferries Commissioner ("Commissioner") regarding the drop trailer service and section 45.1 of the *Coastal Ferry Act*. British Columbia Ferry Services Inc. ("BC Ferries") will file its response to those submissions pursuant to the procedural schedule in place.

BC Ferries is the only party to have provided a comprehensive and detailed filing at this time. This is understandable in the circumstance, as we appreciate that the other persons and entities who filed submissions may need to review and consider our position on this matter before providing their own substantive responses. However, this means that when BC Ferries files its responsive submission on March 1, 2016, the other participants will have seen BC Ferries' primary submission on the issues, but BC Ferries will not have seen nor had the ability to reply to the primary submissions of the others. Seaspam, in particular, has indicated its intent to file more substantial submissions.

Depending on the content of the materials filed by the other participants on March 1, BC Ferries may well need to reply. We would expect this to be the case, based on the 2010 process relating to drop trailer service. This proceeding is addressing a matter of significant importance for BC Ferries and its customers, and a fair process is important.

BC Ferries is prepared to defer a formal request for a right of reply until after March 1. However, we believe that the fairest and most efficient approach is for the Commissioner to incorporate a right of reply in to the process at this time, before participants have to file their March 1 submissions. We would, of course, be agreeable to other participants having the opportunity to reply to the materials that BC Ferries will file on March 1.

.../2

We have taken the liberty of copying Seaspan on this letter, as it has already indicated its intent to file further submissions on March 1.

Sincerely,

A handwritten signature in dark ink, appearing to read "Dennis M. Dodo". The signature is fluid and cursive, with the first name "Dennis" being more prominent than the last name "Dodo".

Dennis M. Dodo, MBA, CPA
Chief Financial Officer

Cc: Mr. Steve Roth, Vice President, Seaspan Ferries Corporation



February 15, 2016

Mr. Dennis Dodo
Chief Financial Officer
British Columbia Ferry Services Inc.
Suite 500, 1321 Blanshard Street
Victoria BC V8W 0B7

Dear Mr. Dodo:

**Re: Notice of Procedures Regarding Drop Trailer Regulation under Section 45.1 of the
*Coastal Ferry Act***

We acknowledge receipt of your letter dated February 4, 2016 in connection with our Notice of Procedures Regarding Drop Trailer Regulation under Section 45.1 of the *Coastal Ferry Act* which was posted on the commissioner's website on February 1, 2016. In your letter you have suggested that the commissioner should incorporate a right of reply in to the process to allow BC Ferries to reply to further submissions the commissioners may receive on or before March 1, 2016. You also state that you are agreeable to other participants having the opportunity to reply to the materials that BC Ferries will file on March 1, 2016.

The Commissioner's Office will assess the submissions received by the March 1 deadline before making a determination on the issue of further process.

Yours truly,

A handwritten signature in black ink, appearing to read "Gord Macatee", is positioned above the printed name.

Gord Macatee
BC Ferries Commissioner

cc: Mr. Steve Roth, Vice President, Seaspan Ferries Corporation

February 17, 2016

Mr. Gord Macatee
BC Ferries Commissioner

Via e-mail: info@bcferrycommission.ca

Dear Commissioner:

We have had an opportunity to review and consider the submissions filed by British Columbia Ferry Services Inc. (“BC Ferries”) dated January 15, 2016. We also have considered your February 1, 2016 notice of procedures.

Based on our review, we write to request three things: (1) clarification as to the scope of the questions you will consider; (2) greater disclosure, including an opportunity to pose questions to BC Ferries; and (3) leave to file a submission and supporting evidence after the March 1 deadline.

Clarification as to Scope

Paragraph 6(a) of your notice of procedures asks whether BC Ferries has an “unfair competitive advantage” (as that phrase is used in s. 45.1 of the *Coastal Ferry Act*) in the drop trailer business, and requests evidence in support of any assertion that BC Ferries has such an advantage.

Section 45.1 requires the Commissioner to make two determinations: “whether the ferry operator is pricing the service below the direct costs and an appropriate proportion of the indirect costs associated with providing that ferry transportation service, or has an unfair competitive advantage” (emphasis added). Your notice of procedures invites submissions and evidence about the second of those tests, but not the first.

When Commissioner Crilly made Order 11-01, he not only found an “unfair competitive advantage”; he also found that BC Ferries was pricing its drop trailer service below the direct costs and an appropriate portion of the indirect costs associated with the service. While the minimum average annual tariff (“MAAT”) ordered by the Commissioner should theoretically have cured BC Ferries’ below-cost pricing, it remains necessary for you to consider in your present review what “the direct costs and an appropriate proportion of the indirect costs” are. It is only after having done so that you can determine an appropriate tariff pursuant to s. 45.1(2)(b) – in particular, a tariff that will “recover the direct costs and an appropriate proportion of the indirect costs attributable to providing the service”. For this reason, cost allocation was a central issue in the proceedings that gave rise to Order 11-01.

BC Ferries now argues (in section 5 of its submission) that it is not pricing drop trailer service below an appropriate allocation of costs, and says that an appropriate proportion of indirect costs

is zero (p. 24). This assertion goes to the heart of the issue that s. 45.1 requires you to resolve. Seaspan should be able to respond to BC Ferries' argument and to submit evidence on the subject of cost allocation. We therefore seek your confirmation that such submissions and evidence are permissible and that you will address that portion of your s. 45.1 mandate in these proceedings.

Disclosure

There are three aspects to Seaspan's request for further disclosure at this time.

First, the existing MAAT should be disclosed to Seaspan. As noted by the Court of Appeal in the appeal from Order 11-01, "principles of openness and public accountability are negatively affected by confidential orders" (para. 91). BC Ferries has a published tariff for its "live" trailer service. The present MAAT is an important starting point for the analysis you will undertake. To our knowledge it is unprecedented for a regulated entity's tariff to be withheld from other market participants. And there is no public interest in secrecy: if Seaspan can offer lower prices than the tariff, consumers in the relevant market can only benefit. Seaspan has no intention of engaging in predatory pricing or other anti-competitive behaviours; and indeed, the *Competition Act* ensures that nothing of the sort will take place.

Second, the experts and legal counsel engaged by Seaspan should be granted complete access to BC Ferries' cost data and related operating statistics, on undertakings that they alone will have access to the information. This approach will enable Seaspan to make meaningful and helpful submissions, at no risk of harm to the financial or economic interests of BC Ferries. The default rule at common law is that disclosure of all material documents is required, even where confidentiality is claimed. The leading writers in the field of administrative law, Donald Brown, Q.C. and the Honourable John Evans, write the following in *Judicial Review of Administrative Action in Canada*:

Given the fundamental need for disclosure in order for a person to be able to participate in the decision-making process, particularly where the process is adjudicative in nature, it is exceptional for the courts to hold that a desire to keep information confidential will outweigh disclosure.

[...]

[W]here non-disclosure of confidential information is warranted [...] it may be provided to counsel on terms, such as that it not be disclosed to a client, a practice followed by the Canadian International Trade Tribunal, and in connection with judicial review of decisions of the Privacy Commissioner. [pp. 9-74, 9-77 to 9-78]

While the Court of Appeal was satisfied that the present regulatory context does not require you to follow procedures of this kind, such an approach of course remains open to you. We urge you to depart from the approach taken by your predecessor on this point by making the requested

disclosure, on the undertakings proposed above. In our respectful view, it is in the public interest that your proceedings be as robust, transparent and participatory as possible. Doing so can only serve to assist you in formulating an appropriate outcome to this inquiry, and will have the added benefit of enhancing public confidence in that outcome.

Third, one key operating statistic required by Seaspán is the frequency with which passenger vehicles on the major routes are left to wait for the next sailing, while drop trailers occupy deck space. A lynchpin of BC Ferries' argument is that "most of the time there will be unused space on the deck and the drop trailer service can use that space without imposing any opportunity cost on the other ferry services at all" (p. 27). BC Ferries' language here is vague. Depending on the actual percentages and volumes that are meant by "most of the time", the premise of BC Ferries' submission may be faulty: if offering drop trailer service means that significant volumes of passenger vehicle traffic are delayed, then it cannot be right that an appropriate allocation of indirect costs is zero. Seaspán and its expert should be able to test the extent to which scarce vessel capacity is being allocated to drop trailers at passengers' expense.

To be clear, in addition to these items, Seaspán envisages an opportunity to pose specific questions to BC Ferries, to obtain information necessary to properly and completely reply to your request for evidence concerning BC Ferries and the drop trailer market. This would include the opportunity to request supporting data for specific claims advanced by BC Ferries and its expert, and interrogatories to determine the bases and scope of the expert's opinion. Such opportunities are consistent with the practices of other administrative decision-makers, including commissions and tribunals.

Extension of Time for Submissions and Evidence

BC Ferries' submission reveals that its intention is to relitigate almost every material point that the Commissioner resolved in 2011. The breadth of the debate invited by BC Ferries is, candidly, much wider than one could reasonably have anticipated. Seaspán therefore needs more time to prepare its submissions than the March 1 deadline would allow. An extension of time is in keeping with the Commissioner's past practice: in the proceedings that led to Order 11-01, BC Ferries' submissions were filed on August 31, 2010, and Seaspán's were filed almost three months later, on November 24, 2010.

Additional time will enable Seaspán to meet your request for evidence, as well as to assist you by way of expert analysis. In 2010, Seaspán tendered a report of Joe N. Linxwiler, Jr., a utility business consultant and analyst, in support of the view that BC Ferries' proposed fees were not fairly or appropriately priced. Seaspán again intends to retain Mr. Linxwiler, to consider and comment upon the drop trailer market, and also respond to the economic analysis proffered by BC Ferries' expert, Dr. Roger Ware. We respectfully suggest that your analysis will benefit from a diversity of expert opinion.

Seaspán therefore requests that the scoping and disclosure issues canvassed above be resolved before a final deadline for submissions is set. That way, Seaspán and its expert will know the issues and will know what information is available to resolve those issues, before preparing their materials. There is no urgency: the MAAT has been in place for approximately five years

without causing any apparent mischief. Ensuring a fair process with a reasonable opportunity to make meaningful submissions is more important in this context than a speedy outcome.

We look forward to hearing from you in respect of these matters. Again, Seaspan thanks you for the opportunity to be involved in this process, which is of great significance to the health of the commercial ferry market in BC.

Yours truly,

A handwritten signature in cursive script that reads "Steve Roth".

Steve Roth
Vice President
Seaspan Ferries Corporation

cc Dennis M. Dodo, Chief Financial Officer, BC Ferries



February 26, 2016

Mr. Dennis Dodo
Chief Financial Officer
British Columbia Ferry Services Inc.
Suite 500, 1321 Blanshard Street
Victoria BC V8W 0B7

Dear Mr. Dodo:

This letter refers to our letter of response dated February 26, 2016 to Seaspan's letter dated February 17, 2016 on the matter of our Notice of Procedures regarding drop trailer regulation under Section 45.1 of the *Coastal Ferry Act*. BC Ferries has been copied on both these letters.

As stated in our response to Seaspan, we invite BC Ferries to comment on Seaspan's letter dated February 17, 2016. We would ask that you provide any comments you may have by March 15, 2016.

Yours truly,

A handwritten signature in black ink, which appears to read "Gord Macatee", is positioned below the "Yours truly," text.

Gord Macatee
BC Ferries Commissioner

cc: Steve Roth, Seaspan Ferries Corporation
Cynthia Lukaitis, BC Ferries



February 26, 2016

Mr. Steve Roth
Vice President
Seaspan Ferries Corporation
7700 Hopcott Road
Delta, BC V4G 1B6

Dear Mr. Roth:

This letter is in response to your letter dated February 17, 2016 on the matter of our Notice of Procedures dated February 1, 2016 regarding drop trailer regulation under Section 45.1 of the *Coastal Ferry Act*.

We can confirm that we will consider and make both of the determinations referenced in Section 45.1.

With regard to the other matters raised in your letter, we will invite BC Ferries to provide a response by March 15, 2016. In the meantime, the deadline for further submissions is suspended pending a response by BC Ferries and subsequent determinations by the Commissioners.

Yours truly,

A handwritten signature in black ink, which appears to read "Gord Macatee", is positioned above the printed name.

Gord Macatee
BC Ferries Commissioner

cc: Dennis Dodo, BC Ferries
Cynthia Lukaitis, BC Ferries

Your way ahead



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February 26, 2016

BC Ferry Commission
PO Box 9279 Stn Prov Govt
Victoria, BC V8W 9J7

Re.: Notice of Procedures Regarding Drop Trailer Regulation under Section 45.1 of the Coastal Ferry Act

Dear Commissioner:

Thank you for this additional opportunity to provide comment. The BC Trucking Association (BCTA) represents member companies that depend on BC Ferries to move goods between the Lower Mainland and Vancouver Island. Among other freight, BCTA members provide Vancouver Islanders with food products and other necessities. As such, we are pleased to respond to the request for additional input in response to the comments submitted to the BC Ferries Commission on BC Ferries' Drop Trailer Service in January 2016.

Consistent with BCTA's past submissions, and the points raised by other stakeholders during this consultation, we offer the following additional comments:

- The drop trailer service should not reduce or otherwise impinge on the space and level of service provided to live commercial traffic as BC Ferries is the only live service provider.
- We agree with the premise that rates for the drop trailer service should be a matter of public record and readily accessible to any interested party just as BC Ferries' rates for commercial live traffic currently are.
- There should be no cross-subsidization between the drop trailer service and any other service or route BC Ferries provides. It should be a completely self-sufficient, stand-alone business unit.
- It is not appropriate for BC Ferries to compete with the trucking industry by providing services beyond shunting trailers for the purpose of loading, unloading, or repositioning them within its terminals.

Please do not hesitate to contact me if you have any questions.

Sincerely,

A handwritten signature in blue ink that reads "Louise Yako". The signature is fluid and cursive, with the first name "Louise" and last name "Yako" clearly distinguishable.

Louise Yako
President & CEO

March 11, 2016

Mr. Gordon Macatee
British Columbia Ferries Commissioner
BC Ferry Commission
PO Box 9279 Stn Prov Gov
Victoria BC V8W 9J7

Dear Mr. Macatee:

**Re: Comments of British Columbia Ferry Services Inc. in Response To
Seaspan Letter of February 17, 2016**

Further to your letter dated February 26, 2016, this letter provides British Columbia Ferry Services Inc.'s ("BCFS") comments in response to Seaspan Ferries Corporation's ("Seaspan") letter dated February 17, 2016.

Clarification as to Scope

Under the first heading in its letter, Seaspan sought clarification regarding the scope of issues that the British Columbia Ferries Commissioner ("Commissioner") will address in this proceeding under section 45.1 of the *Coastal Ferries Act* ("Act"). The Commissioner confirmed that he will make both of the determinations referenced under section 45.1(1). BCFS agrees that the Commissioner should consider and make determinations regarding both of the matters addressed in that section.

Disclosure

The second topic raised in Seaspan's letter is disclosure of information to Seaspan. In response to these submissions, BCFS sets out the binding law that governs this proceeding with respect to disclosure, and then turns to the specific issues raised by Seaspan. Further details of the need for confidentiality are set out in section 1.3 of the BCFS Filing.

The Framework for Addressing Disclosure Issues

Section 54 of the Act sets out a legislated mandatory requirement for the Commissioner to keep certain kinds of information confidential:

54 Despite any obligation imposed on the commissioner under this Act to obtain, maintain or make available information or records, the commissioner, every deputy commissioner, every employee of the commissioner and every inspector must not disclose or be compelled to disclose any information or record that is obtained in, or that comes to the person's knowledge during, the course of the administration of this Act or the course of any inspection authorized under this Act, unless and only to the extent that such disclosure is consistent with the *Freedom of Information and Protection of Privacy Act*. [Emphasis added.]

The relevant provision of the *Freedom of Information and Protection of Privacy Act* ("FIPPA") in the context of the drop trailer proceeding is section 17. Section 17 of FIPPA provides an exemption for disclosure of information which could reasonably be expected to harm the financial or economic interests of a public body. Under Schedule 2 of FIPPA, a "ferry operator" is a "public body" and therefore BCFS is a public body under FIPPA. This section of FIPPA is relevant because Seaspan, who is the dominant company and major competitor of BCFS in the drop trailer market, seeks to obtain disclosure of financially sensitive information from BCFS.

To the extent that any information filed by BCFS in this proceeding meets the criteria of section 17, the Commissioner *must not disclose* the information and there is no discretion for the Commissioner to do otherwise. As explained in section 1.3 of the BCFS Filing, certain cost information filed by BCFS meets the criteria for exemption from disclosure. As explained below, all of the information requested by Seaspan in its February 17 letter also meets the criteria, and therefore cannot be disclosed to Seaspan.

In Order 10-01 from the previous proceeding, the Commissioner recognized that the disclosure of certain cost information would cause harm to BCFS, and on that basis and relying on section 54 of the Act, refused to disclose to Seaspan BCFS's cost information. Seaspan appealed the Commissioner's decision regarding disclosure, and other issues from the previous drop trailer decision, to the Court of Appeal for British Columbia. Seaspan's position in the appeal was that it ought to have been provided with all of the information filed by BCFS, and that the failure to disclose this information was a breach of common law procedural fairness.

In *Seaspan Ferries Corporation v. British Columbia Ferry Services Inc.*, 2013 BCCA 55, the court rejected Seaspan's argument regarding the issue of disclosure and dismissed this, and all other grounds of Seaspan's appeal. In doing so, the Court held:

[81] It must be recognized that the issues dealt with under s. 45.1 of the Coastal Ferry Act are typically financially sensitive. Given the nature of the tribunal, and the nature of the rights at stake under that section, I am unable to agree with Seaspan that procedural fairness requires that it have full disclosure of all of the material that is filed with the Commissioner.

[82] What is required is that Seaspan have sufficient information to allow it to participate in a meaningful manner in the proceedings. In my view, the Commissioner made no error in finding that detailed financial information did not need to be provided to Seaspan in order to give it that ability. The information that was disclosed to Seaspan afforded it the ability to meaningfully participate in the proceedings and to make valuable submissions to the Commissioner.

[83] In my view, the Commissioner did not act unfairly when he concluded that the financial harm that might be caused by disclosure of BCFS's detailed financial records to a competitor might be unduly damaging to it.

[84] In the result, I would not give effect to Seaspan's contention that its right to procedural fairness was breached by the Commissioner's decision. In the circumstances, it is not necessary to consider the BCFS's argument that, in any event, the *Freedom of Information and Protection of Privacy Act*, R.S.B.C. 1996, c. 165 prohibited the Commissioner from disclosing information. [Emphasis added.]

As a result, there is binding authority on the Commissioner that in the context of a proceeding under section 45.1 of the Act, procedural fairness does not require full disclosure of all material that is filed with the Commissioner. The Court of Appeal firmly rejected any such proposition. What is required is that the information disclosed to Seaspan affords it the ability to meaningfully participate in the proceeding. There is no requirement for detailed, financially sensitive information to be provided to the Seaspan.

The Court of Appeal did not have to turn its mind to the issue of the impact of section 54 of the Act on the issue of procedural fairness. Having found that there was no breach of the duty of procedural fairness, there was no need to do so. However, even if the Court had found a breach of procedural fairness, the law is clear that statutory provisions can override common law procedural fairness. In *Ocean Port Hotel Ltd. v. British Columbia (General Manager, Liquor Control and Licensing Branch)*, 2001 SCC 52, the Court held that the common law right to procedural fairness in an administrative process that "may be ousted by express statutory language or necessary implication": at paragraph 22. The Court in *Ocean Port Hotel* explained at paragraphs 21 and 22:

Confronted with silent or ambiguous legislation, courts generally infer that Parliament or the legislature intended the tribunal's process to comport with principles of natural justice ...

... Ultimately, it is Parliament or the legislature that determines the nature of a tribunal's relationship to the executive. It is not open to a court to apply a common law rule in the face of clear statutory direction. ...

In this case, section 54 is clear statutory direction that certain categories of information cannot be disclosed by the Commissioner under any circumstance, regardless of whether a proceeding is underway or not. Accordingly, where section 54 is engaged and applies to certain documents it is not open to the Commissioner to apply a common law rule of disclosure regarding such documents.

As a result, pursuant to binding legal authority the Commissioner must address disclosure issues on the basis that:

1. procedural fairness does not require full disclosure of financially sensitive information to Seaspan; and
2. the overriding question regarding disclosure issues is whether the disclosure is permitted under section 54 of the Act, which overrides any procedural fairness rights that may apply.

With this framework in mind, BCFS provides responses to the four disclosure issues raised by Seaspan in its submission.

Seaspan's Issue #1 - Disclosure of the Existing the MAAT

Seaspan submits that the existing Minimum Average Allowable Tariff ("MAAT") should be disclosed to Seaspan. BCFS's position is that it should not. In support of its position, Seaspan quotes the Court of Appeal's cautionary language from its unsuccessful appeal as follows:

[89] While Seaspan has raised, as an issue on appeal, the question of whether the Commissioner had the power to keep parts of his order confidential, it has not made independent arguments on this issue. Instead, it says, simply, that "This question stands to be resolved by the same analysis that governs the disclosure issue".

[90] Given that Seaspan's argument on this issue depends on it having succeeded on the disclosure issue, I would also dismiss this ground of appeal.

[91] In dismissing this aspect of the appeal, I would note that principles of openness and public accountability are negatively affected by confidential orders. To some degree, such orders may also be seen as being contrary to the Rule of Law. While I recognize that it may sometimes be necessary for aspects of tribunal orders to remain confidential, I think it important to emphasize that the practice of making confidential orders is to be discouraged.

This obiter comment does not support Seaspan's position. On the contrary, while the court cautioned against keeping portions of orders confidential, the court recognized that in some cases tribunals will have to keep aspects of their orders confidential. Drop trailer is one of those examples.

In the case of the drop trailer proceeding, making the existing MAAT (in unredacted form) open to the public would disclose BCFS's financially sensitive cost information. As the Commissioner recognized in the previous proceeding, disclosure of such information would likely allow a competitor such as Seaspan to engage in pricing incentives which would likely erode BCFS's customer base. Disclosure of the data in the existing MAAT to Seaspan would be harmful to the business interests of BCFS, and would also be harmful to BCFS's customers and ferry users. As a result, section 54 applies and the Commissioner is prohibited from disclosing the confidential, non-public version of the existing MAAT. It is accordingly irrelevant that BCFS publishes the tariff for its "live" trailer service; that fact does not make the confidential MAAT something that the Commissioner can disclose.

BCFS notes that Seaspan provides an assurance that if it is provided with confidential information that it "has no intention of engaging in predatory pricing". With respect, this assurance is legally irrelevant to the disclosure issue because section 54 prohibits disclosure. BCFS further notes that Seaspan's concerns regarding the fairness of this proceeding should be allayed by the fact that it is the Commissioner, who is an independent administrative tribunal assisted by an independent third party accounting firm (PricewaterhouseCoopers), who sets the MAAT, not BCFS.

For all of these reasons, BCFS submits that the existing MAAT cannot and should not be disclosed to Seaspan in this or any other proceeding. BCFS further submits that if a MAAT is ordered following this proceeding, then the Commissioner should issue an order that is transparent but also protects BCFS's commercially sensitive information by keeping underlying cost information confidential. This topic was raised in the Commissioner's Notice of Procedures issued February 1, 2016, and BCFS intends to address that issue in detail in a further submission once the Commissioner has addressed the issues in Seaspan's February 17 letter and determined the process going forward.

Seaspan's Issue #2 - Counsel's Eyes Only Access to Cost Data

Seaspan's second position is that its experts and legal counsel should be granted "complete access to BC Ferries' cost data and related operating statistics on undertakings that they alone will have access to the information". BCFS's position is that no such access can or should be granted.

BCFS repeats the submissions in the previous section and in section 1.3 of the BCFS Filing that disclosure of such cost and operating data would cause harm to BCFS. Accordingly, the kind of "counsel's and expert's eyes only" access requested by Seaspan is not permitted by section 54 of the Act. There is no basis for the Commissioner to "depart" from the previous approach taken in the drop trailer proceeding, as urged by Seaspan; such an approach would violate section 54 of the Act. Furthermore, for the reasons set out above this kind of disclosure is not required by the common law of procedural fairness for a fair hearing. Seaspan has the tools it needs to make a full submission, just as it did last time.

For these reasons, BCFS submits that the counsel's and expert's eyes only type of disclosure requested by Seaspan must be denied.

Seaspan's Issues #3 and #4 - Operating Statistics and Other Interrogatories

Seaspan states that it "envisages an opportunity to pose specific questions to BC Ferries" in this proceeding, including a request for certain operating statistics. BCFS submits that Seaspan has no right or ability to pose such questions or make such requests to BCFS in this proceeding.

The Commissioner has jurisdiction to order BCFS to provide certain information under section 67 of the Act. This section provides that a ferry operator must provide to the Commissioner information reasonably required *by the Commissioner*. Any information provided to the Commissioner pursuant to this section is subject to the requirements of section 54 as described above.

Accordingly, for the purposes of this proceeding, as in the last one, if Seaspan wants further information from BCFS, then it will need to make its requests to the Commissioner, who will decide whether or not to rely on section 67 to make an information request of BCFS. If BCFS is directed to provide information to the Commissioner, then it will be provided to the Commissioner, and not Seaspan, and it will be subject to section 54 of the Act. BCFS would state its position on any concerns about confidentiality in response to any information requests made. Information subject to section 54 would not be disclosed to Seaspan.

BCFS does not believe that such a process should be followed in this proceeding. BCFS submits that the public version of the BCFS filing provides all of the information that Seaspan requires in order to be afforded the ability to meaningfully participate in the proceeding and to make valuable submissions to the Commissioner. The Commissioner should strive to keep this process efficient and to avoid transforming this inquisitorial process into something akin to litigation, which it is not.

Extension of Time for Submissions and Evidence

For the reasons stated above, BCFS does not believe that any further information should be provided to Seaspan in this proceeding, beyond the public version of the BCFS Filing. The disclosure issues raised by Seaspan are repetitive of issues raised in the last proceeding, which were fully addressed and answered by the Court of Appeals' decision dismissing its appeal from the last decision, and by section 54 of the Act.

Seaspan has had this filing since January 15, 2016, and it should be well on its way to preparing its responsive materials. As no more information can or should be provided to Seaspan, this proceeding should proceed in an orderly and efficient manner, so that this matter can be determined in a timely way.

BCFS submits that April 15 is a reasonable deadline for Seaspan to provide its submissions; by that date it will have had three months to prepare its response materials, which is similar to the timeframe from the last proceeding. BCFS will then require sufficient time to provide its reply to Seaspan and any other submissions received, and to provide its comments regarding the matters that the Commissioner intends to address as outlined in the Notice of Procedures issued on February 1, 2016. BCFS submits that three weeks for its reply is reasonable.

Yours truly,

A handwritten signature in black ink, appearing to read "Dennis M. Dodo". The signature is fluid and cursive, with the first name "Dennis" being more prominent than the last name "Dodo".

Dennis M. Dodo, MBA, CPA
Chief Financial Officer

cc: Steve Roth, Seaspan Ferries Corporation

March 15, 2016

Mr. Gord Macatee
BC Ferries Commissioner

Via e-mail: info@bcferrycommission.ca

Dear Commissioner:

We write to provide a brief reply to BC Ferries' March 11, 2016 response to our requests. We trust it will be of assistance, given that BC Ferries raised certain new matters in its response.

BC Ferries' response is based primarily on s. 54 of the *Coastal Ferry Act*, which enables disclosure to Seaspan of information you obtain from BC Ferries "only to the extent that such disclosure is consistent with [FIPPA]." BC Ferries' main point is that the combination of this provision with s. 17 of *FIPPA* means that if the information filed by BC Ferries "meets the criteria of section 17, the Commissioner *must not disclose* the information" (italics in original). This assertion underpins much of what follows in BC Ferries' argument.

As a starting point, BC Ferries appears to assume that you will find that all the information requested by Seaspan will be "information the disclosure of which could reasonably be expected to harm the financial or economic interests of a public body", for purposes of s. 17. On the other hand, if you do not make that affirmative finding in respect of some or all of the records, then the default rule in s. 4 of *FIPPA* applies: the records are to be produced. Importantly, since the last proceeding before the Commissioner under s. 45.1, the Supreme Court of Canada has clarified that to establish a reasonable expectation of harm in the access to information context, there must be evidence sufficient to establish "that there is a direct link between the disclosure and the apprehended harm and that the harm could reasonably be expected to ensue from disclosure": *Merck Frosst Canada Ltd. v. Canada (Health)*, 2012 SCC 3, [2012] 1 S.C.R. 23, para. 219.

BC Ferries establishes no such "direct link" in relation to disclosure to Seaspan's counsel and experts. There is only the bald assertion that harm will follow, without any detailed explanation of how commercial harm would arise. That assertion does not meet the test adopted by the Supreme Court of Canada, and you should therefore reject it. Instead, Seaspan submits that you should be guided by what other economic regulators do in similar circumstances.

A recent example close to home is the National Energy Board's 2012 order to Chevron to disclose detailed financial information relating to its Burnaby refinery to counsel and experts retained by competing refiners located in Alberta and Washington state. Those competitive dynamics are just as, if not more, intense than those that exist between BC Ferries and Seaspan. The NEB's order came in response to "information requests" about Chevron's application for priority access to the Trans Mountain pipeline. A copy of the associated NEB order is attached as Appendix 1.

Information requests are a standard part of many regulatory tribunal processes. While BC Ferries suggests the procedure invited by Seaspan would be “something akin to litigation”, information requests in fact are efficient, and far less onerous than litigation discovery. Of note, your predecessor provided for an information request process on the same issues in 2010. Since BC Ferries seeks to re-litigate many of those same issues, it is appropriate to repeat a similar process now.

Moreover, what BC Ferries’ submission overlooks is that s. 17 of *FIPPA* is not mandatory; it is discretionary. It provides that the “head of a public body” – in this case, the Commissioner – “may refuse to disclose information the disclosure of which could reasonably be expected to harm the financial or economic interests of a public body” – in this case, BC Ferries. This may be compared with s. 21, which states that you “must” refuse to disclose information that would harm the business interests of a “third party”. Under s. 17, by contrast, you have a choice: you have the power to refuse disclosure, but also the power to disclose. This reflects the Legislature’s choice to allow for transparency with respect to public bodies like BC Ferries, even if you find there is some risk of financial or economic injury.

Thus, while BC Ferries’ repeatedly emphasizes the Court of Appeal’s finding that your duty of fairness does not oblige disclosure, that misses the point. Seaspan’s fundamental point is that you should choose to exercise your discretion in favour of disclosure, because the risk of harm to BC Ferries is non-existent if you require that only Seaspan’s expert and counsel have access, and because doing so will enable meaningful submissions that will aid you in your task. For example, the premise of BC Ferries’ submission is that its drop trailer service only makes use of excess capacity (p. 27), but Dr. Ware’s report recognizes that bumping of unreserved passengers by drop trailer service will occur (para. 32). This sort of discrepancy needs to be understood. Additional, relevant information from BC Ferries can only help you in your task of testing whether an unfair competitive advantage exists, determining an appropriate allocation of costs, and taking appropriate steps.

This last point is important, because it highlights a circularity in BC Ferries’ submission. You should not interpret the statutory regime to require you to protect BC Ferries from commercial “harm” caused by competitive behaviour (of the kind that would result from, for instance, making the MAAT public), when the very purpose of section 45.1 of the *Coastal Ferries Act* is to ensure a competitive marketplace. The “harm” caused by competition, if harm it be, is necessarily what the Legislature intended to achieve. Correspondingly, the prospect of such competition ought not to be an obstacle to disclosure; to approach the matter otherwise would be to make the legislative scheme self-defeating.

With regard to process, BC Ferries submits that any further requests for information should be made by Seaspan to the Commissioner, rather than presented to BC Ferries directly. Presumably, in keeping with the above, when faced with any request by Seaspan you would apply ss. 4 and 17 of *FIPPA*, which will also involve an exercise of your discretion if you find that s. 17 applies. Subject to your direction, Seaspan is content to proceed that way.

Finally, with regard to the appropriate timeline, everything turns on the degree of access to information you are prepared to provide. Seaspan should have certainty about the information it

will have in hand before it dedicates resources to its expert and to developing submissions on the basis of that information.

If BC Ferries' position is accepted, Seaspán can provide its submissions within 30 days of communication of your decision in that regard. If, on the other hand, Seaspán's position is accepted, then no deadline should be set at this stage; rather, it should await completion of the disclosure process.

We thank you for your consideration of this reply.

Yours truly,

A handwritten signature in cursive script, reading "Steve Roth". The signature is written in dark ink and is positioned above the printed name and title.

Steve Roth
Vice President
Seaspán Ferries Corporation

cc Dennis M. Dodo, Chief Financial Officer, BC Ferries



File OF-Tolls-Group1-T260-2012-05 01
29 October 2012

Ms. Miriam Kresivo
General Counsel
Chevron Canada Limited
1500 – 1050 West Pender Street
Vancouver, BC V6E 3T4
Facsimile 604-668-5320

Mr. Chris W. Sanderson, Q.C.
Lawson Lundell LLP
1600 Cathedral Place
925 West Georgia Street
Vancouver, BC V6C 3L2
Facsimile 604-669-1620

Mr. Keith Bergner
Lawson Lundell LLP
1600 Cathedral Place
925 West Georgia Street
Vancouver, BC V6C 3L2
Facsimile 604-669-1620

Dear Ms. Kresivo, Mr. Sanderson and Mr. Bergner:

Hearing Order AO-001-MH-002-2012 dated 21 August 2012
Chevron Canada Limited (Chevron)
Application for a Priority Destination Designation (PDD) dated 19 June 2012
Chevron Notice of Motion dated 16 October 2012 to treat certain Information
Request responses as confidential pursuant to section 16.1 of the *National Energy*
Board Act (Act)
Ruling No. 2

The National Energy Board (Board) has received the filing of Chevron with responses to Information Requests (IRs) and its Notice of Motion and supporting affidavits requesting that certain attachments be treated as confidential pursuant to section 16.1 of the Act (Motion). The Motion also requested that the Board grant an Order setting out the procedure for dealing with confidential information with terms analogous to those granted in the MH-2-2005 proceeding regarding a previous Chevron Application for Priority Destination Designation. In that proceeding, the Board prescribed terms under which limited access to confidential information would be provided to qualifying individuals in Order PO-1-MH-2-2005.

The Board established a written process to hear the Motion. On 18 October 2012 the Board requested comments from parties in respect of Chevron's Motion. The Board received responses from Phillips 66 Canada ULC (P66) and Shell Canada Trading (Shell), Imperial Oil Limited (Imperial), BP Canada Energy Group ULC (BP Canada), Trans Mountain Pipeline ULC (Trans Mountain), Tesoro Canada Supply & Distribution Ltd. (Tesoro) and the Government of Alberta (Alberta). Chevron provided reply submissions on 24 October 2012. The Board has carefully considered the submissions.

Notice of Motion and Reply

Confidentiality pursuant to section 16.1 of the Act

Chevron requested confidentiality for attachments to its IR Responses to NEB IR 1.2(a), BP Canada IR 1.3(a), Imperial IR 7(a), and P66/Shell IR 1.8(a) pursuant to section 16.1 of the Act.

.../2

Chevron submitted that the disclosure of the information could reasonably be expected to result in a material loss to Chevron and prejudice its competitive position. It also asserted that the information is financial, commercial or technical information that is confidential and has been consistently treated as confidential by Chevron and that the interests of Chevron in confidentiality outweigh any public interest in disclosure.

In its reply comments, Chevron submitted that the release of the information to its competitors could impact Chevron's ability to secure future competitive crude oil supply. Chevron is concerned that the greater particularization contained in the current filing compared to 2005 would enable competitors to simulate refinery operations and economics in a manner that is highly prejudicial to Chevron.

In order to provide a greater level of public information, Chevron prepared and enclosed with its reply comments, versions of Attachments Imperial IR 7(a) and BP Canada IR 1.3(a) that show the headings (without numbers) and indicated that these filings will provide (publicly) greater insight into the nature of the information contained in the confidential Attachments. Chevron also prepared a "rolled up" version of Attachments NEB IR 1.2(a), which provides some of the information contained in the original Attachments NEB IR 1.2(a) in an aggregated form. It contains the headings that were included in the original.

Procedure for dealing with Confidential Information

In the covering letter to the Motion, Chevron indicated that the motion sought relief analogous to relief that the Board previously granted to Chevron in connection with its Application for Priority Destination designation in 2005. Chevron requested that the Board make the order sought so that it could provide the confidential information to counsel for any other party that requires it and is prepared to sign the Undertaking.

In its reply comments Chevron clarified that it is prepared to grant access to independent experts retained by intervenors, if a Board Order is granted on terms analogous to those granted in 2005. With regards to the submissions of BP Canada and Imperial on the issue of access by company personnel, Chevron submitted that BP Canada and Imperial are Chevron's competitors. The issue of access by company personnel was expressly considered and rejected by the Board in its 2005 Order as the risk of inadvertent disclosure was too high. Chevron submitted that BP Canada and Imperial have not provided any information to distinguish the current circumstances from those in 2005 and that the 2005 Order remains apt in the current circumstances.

Chevron also submitted that it is not opposed to access being provided to the individuals named by Trans Mountain in the current proceedings on the basis that Trans Mountain (a) is not a competitor to Chevron; (b) routinely has access to information about Chevron of the sort and type of some of the confidential information; and (c) has established practices in place to keep such information confidential (and not accessible to Chevron's competitors).

Comments from Other Parties

Confidentiality pursuant to section 16.1 of the Act

P66/Shell noted that in the MH-2-2005 proceeding, Chevron provided much of the information that is requested in the NEB IR 1.2(a) and (c) (the same information sought by P66/Shell) on a non-confidential basis. P66/Shell submitted that Chevron should be required to satisfy the Board that there is now a principled reason for requesting confidential treatment of this information. P66/Shell argued that any subsequent process relating to the information that is in fact produced would be required to also be subject to confidentiality constraints. P66/Shell questioned whether confidentiality is justified given its impact on the efficiency and complexity of further process.

Imperial noted that much of the confidential information that was filed by Chevron in the 2005 proceeding related to the financial position of the Burnaby refinery, a matter which Chevron now asserts to be irrelevant. Imperial views the claimed confidential information in the present proceeding as much more limited in scope – consisting primarily of historic information about sources of feedstock, refinery investments, and rail and truck costs.

BP Canada does not object to the Board issuing an Order allowing Chevron to file the certain information in confidence and submits that the confidential information described in paragraph 2 of the Notice of Motion appears to include information of both a technical and financial nature.

Procedure for dealing with Confidential Information

P66/Shell's position on who should have access to the confidential information is that it should mirror the scope of dissemination reflected in the 2005 Order. Tesoro took a similar view.

BP Canada's position is that it should be made available to non-legal representatives of BP Canada on the same terms and conditions as confidential information is made available to legal counsel and to consultants.

Imperial's position is that it should be made available not only to legal counsel and consultants, but also to the company employee that is instructing counsel and consultants.

Trans Mountain requested that its external counsel of record in this proceeding and those internal to Trans Mountain instructing external counsel be provided with access to the information that the Board determines is entitled to confidential treatment.

Alberta submitted that legal counsel and several individuals employed with the Alberta Department of Energy require access to the information that may be determined to be confidential in this proceeding.

Board Decision

Confidentiality pursuant to section 16.1 of the Act

The Board is of the view that the attachments to NEB IR 1.2(a), BP Canada IR 1.3(a), Imperial IR 7(a) and P66/Shell IR 1.8(a) (the Confidential Information) should be treated confidentially, pursuant to section 16.1 of the Act.

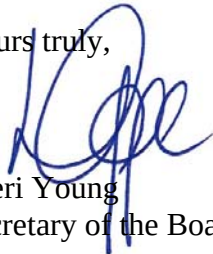
The Board finds that disclosure of the Confidential Information could reasonably be expected to result in a material loss to Chevron or gain to others, or could reasonably be expected to prejudice Chevron's competitive position. In addition, the Board finds that the Confidential Information is financial, commercial or technical information that was confidentially supplied to the Board and has been consistently treated as confidential by Chevron. Disclosure of it to its competitors could impact Chevron's ability to secure future competitive crude oil supply.

The Board notes Chevron's submission of revised versions of Attachments Imperial IR 7(a) and BP Canada 1.3(a) and Attachments NEB IR 1.2(a) in order to provide the public with greater insight into the nature of the information contained in the confidential Attachments. The Board considers that Chevron's interest in confidentiality of the Confidential Information specific to its business operations outweighs the public interest in disclosure.

Procedure for dealing with Confidential Information

The parties disagree as to who should have access to the information. The Board is not persuaded that access to the Confidential Information should be provided to the internal business people of the corporate intervenors, except in the case of Trans Mountain. The Board has decided that except for the access that Chevron consents to for the individuals named in Trans Mountain's response to the Motion, the scope of the 2005 Order is appropriate in all respects and adopts the directions and procedures set out in Ruling Number 5 in the MH-2-2005 proceeding. Order PO-001-MH-002-2012 gives effect to this Ruling and is attached as Attachment 1 hereto. Attachment 2 sets out the directions and procedures (based on Ruling Number 5 in the MH-2-2005 proceeding) and forms part of this Ruling.

Yours truly,


for
Sheri Young
Secretary of the Board

c.c. All Parties to Hearing Order MH-002-2012

Attachment 1 – Order PO-001-MH-002-2012 including Appendix A, Undertaking of Confidentiality; and Appendix B, Statutory Declaration;

Attachment 2 – Procedure for dealing with Confidential Information



ORDER PO-001-MH-002-2012

IN THE MATTER OF the *National Energy Board Act* (the Act) and the regulations made thereunder; and

IN THE MATTER OF an application for priority destination designation by Chevron Canada Limited (Chevron) under file OF-Tolls-Group1-T260-2012-05 01 (the PDD Application); and

IN THE MATTER OF Hearing Order MH-002-2012; and

IN THE MATTER OF an application by Chevron for an order pursuant to section 16.1 of the Act for the filing in confidence of certain information in Information Requests (IR) National Energy Board (NEB/Board) IR 1.2(a), BP Canada Energy Group ULC (BP Canada) IR 1.3(a), Imperial Oil Limited (Imperial) IR 7(a) and Phillips 66 Canada ULC and Shell Canada Trading (P66/Shell) IR 1.8(a).

BEFORE the Board on 29 October 2012.

WHEREAS Chevron applied for an order pursuant to section 16.1 of the Act for the filing in confidence of certain information requested in NEB IR 1.2(a), BP Canada IR 1.3(a), Imperial IR 7(a) and P66/Shell IR 1.8(a) (the Confidential Information);

AND WHEREAS the Board determined that the disclosure of the Confidential Information could reasonably be expected to result in a material loss to Chevron or gain to others, or could reasonably be expected to prejudice Chevron's competitive position;

AND WHEREAS the Board determined that the Confidential Information is financial, commercial or technical information that was confidentially supplied to the Board and has been consistently treated as confidential by Chevron;

AND WHEREAS the Board considered that Chevron's interest in confidentiality outweighs the public interest in disclosure of the Confidential Information in the MH-002-2012 proceeding;

AND WHEREAS the Board has determined that the Confidential Information is entitled to confidential treatment pursuant to section 16.1 of the Act;

AND WHEREAS the Board considered the comments of the parties with respect to the scope of this Order;

.../2

IT IS HEREBY ORDERED THAT:

1. The Confidential Information filed by Chevron is entitled to the protection set out herein. Unless the Board otherwise directs, or as otherwise required by law, all persons who have access to the Confidential Information pursuant to this Order shall comply with the process for dealing with the Confidential Information, as set out in Clauses 2 to 15 below.
2. Except as authorized in this Order, access to the Confidential Information shall not be given to any person, including corporate or individual intervenors or experts.
3. Any person permitted access to the Confidential Information pursuant to clauses 4 to 6, inclusive, or other persons authorized by order of the Board, shall execute an undertaking to comply with the terms of this Order, in the form attached as Appendix A to this Order (the Undertaking), and provide an original thereof to each of the Board and Chevron.
4. Legal counsel of record for each intervenor in the MH-002-2012 proceeding, both external and in-house, shall have access to the Confidential Information.
5. Legal counsel who have been provided access to Confidential Information pursuant to this Order shall be entitled to permit partners, associate lawyers and support staff of external legal counsel to review the Confidential Information to the extent that viewing the Confidential Information, or portions thereof, is, in the opinion of legal counsel, necessary in order for those persons to provide assistance to legal counsel with respect to the Confidential Information, and which assistance is normally consistent with the duties of those persons.
6. Independent expert consultants, not employed by, or under permanent contract to, either an intervenor or an affiliate of an intervenor to this proceeding, may have access to the Confidential Information, if, in the opinion of legal counsel, access to the Confidential Information is necessary in order for that expert consultant to provide assistance to legal counsel, or to provide expert testimony in connection with the Confidential Information.
7. Chevron shall provide one copy of the Confidential Information, contained in a red-coloured cover and stamped "Confidential", to legal counsel and any other person permitted to view the Confidential Information pursuant to clauses 4 to 6 inclusive, or by order of the Board, forthwith following filing with the Board and delivery to legal counsel for Chevron, of an originally executed Undertaking by that legal counsel or person.

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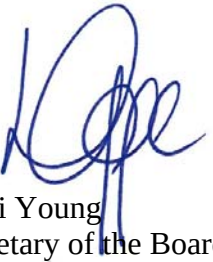
8. No additional copies shall be made of the Confidential Information, by any means, by any persons other than Chevron or Chevron's legal counsel, unless leave is granted by the Board. If additional copies of the Confidential Information are required, persons requiring those copies shall contact Chevron for same. Additional copies shall be provided in a red-coloured cover and stamped "Confidential".
9. Confidential Information incorporated into written or oral argument, or used for the purpose of evidence or notes for cross-examination for this proceeding or any appeal, review or rehearing therefrom shall not constitute additional copies for the purposes of clause 8.
10. The Confidential Information shall be held in confidence, and used only for the purpose of this proceeding on Chevron's PDD Application and any appeal, review or rehearing from the Board's decision in this proceeding. No disclosure is to be made of the Confidential Information to any persons who have not executed and delivered an Undertaking, unless required by law, in which case, the person being required to disclose shall forthwith notify Chevron and the Board in writing of such requirement.
11. All reasonable, necessary and appropriate efforts to protect the Confidential Information from disclosure will be used. Confidential Information, and any material that contains reference to, or portions of the Confidential Information, shall be segregated and clearly labeled as "Confidential" and, where possible, transmitted in hard copy only.
12. All persons who have executed and delivered an Undertaking are entitled to be present at those portions of the MH-002-2012 proceeding where the Confidential Information is referenced.
13. With the exception of one copy to be maintained by the Board in confidence for its records, all written copies of the Confidential Information, and any portions of the evidence, transcripts, notes, working papers, calculations, analysis or other materials based on or using the Confidential Information (Related Materials), shall either be returned to Chevron or destroyed on or prior to the later of
 - a) 40 days from the Board's decision on Chevron's PDD Application; or
 - b) 40 days from the conclusion of either
 - i) any appeal proceedings undertaken pursuant to section 22 of the Act with respect to Chevron's PDD Application, and any subsequent appeal proceedings therefrom; or
 - ii) any review or rehearing proceedings undertaken pursuant to section 21 of the Act with respect to Chevron's PDD Application, and any subsequent appeal proceedings therefrom;

.../4

(the Return or Destroy Date).

14. All electronic versions of the Confidential Information and the Related Materials shall be expunged from all electronic apparatus and data storage media on or prior to the Return or Destroy Date set out in clause 13 above.
15. Within seven days from the Return or Destroy Date set out in clause 13, all persons who have executed an Undertaking shall provide Chevron and the Board with an originally executed statutory declaration, in the form attached as Appendix B to this Order, confirming compliance with the terms of this Order, and, in particular, that the Confidential Information and any Related Materials have been returned or destroyed in accordance with clauses 13 and 14.
16. Unless an application is made to the Board prior to 31 December 2022 for an extension of this Order, this Order shall expire on 31 December 2022.

NATIONAL ENERGY BOARD


for
Sheri Young
Secretary of the Board

UNDERTAKING OF CONFIDENTIALITY

TO: The National Energy Board

AND TO: Chevron Canada Limited (Chevron)

WHEREAS the Board set down for hearing, in proceeding MH-002-2012, an application by Chevron for Priority Destination Designation (the PDD Application);

AND WHEREAS Chevron applied for an order pursuant to section 16.1 of the *National Energy Board Act* for the filing in confidence of certain information requested in information requests;

AND WHEREAS the Board determined that the Confidential Information was entitled to confidential treatment pursuant to section 16.1 of the Act;

AND WHEREAS the Board issued Order PO-001-MH-002-2012, dated 29 October 2012, setting out the terms and conditions of access to the Confidential Information;

AND WHEREAS _____ (the Recipient) is one of the persons referenced in Order PO-001-MH-002-2012 who has been granted access to the Confidential Information, or is a person who has otherwise been granted access to the Confidential Information by order of the Board, conditional upon the Recipient executing this Undertaking and providing an original hereof to each of the Board and Chevron;

NOW THEREFORE, in consideration of receiving access to the Confidential Information, the Recipient hereby agrees and undertakes as follows:

1. I agree that the capitalized terms used herein that are not otherwise defined shall have the meaning ascribed thereto in Order PO-001-MH-002-2012.
2. I agree to observe the terms and conditions for access to the Confidential Information set out in Order PO-001-MH-002-2012 and herein.
3. I will not make any additional copies of the Confidential Information, by any means, unless leave is granted by the Board to do so.

4. I will hold the Confidential Information in confidence, and use it only for the purpose of this proceeding on the PDD Application and any appeal, review or rehearing from the Board's decision in this proceeding. I will disclose the Confidential Information only to those persons who are authorized by the Board to receive access to the Confidential Information and who have executed an Undertaking, unless otherwise required by law, in which case, I will promptly give written notice to the Board and Chevron that such disclosure has been required.
5. I will use all reasonable, necessary and appropriate efforts to protect the Confidential Information from disclosure. Confidential Information shall be segregated and clearly labeled as confidential and, where possible, transmitted in hard copy only.
6. Unless otherwise directed by the Board, I will either return to Chevron or destroy all written copies of the Confidential Information, and any evidence, transcripts, notes, working papers, calculations, analysis or other materials based on or using the Confidential Information (Related Materials), on or prior to the later of
 - a) 40 days from the Board's decision in this proceeding; or
 - b) 40 days from the conclusion of either
 - i) any appeal proceedings undertaken pursuant to section 22 of the Act with respect to Chevron's PDD Application, and any subsequent appeal proceedings therefrom; or
 - ii) any review or rehearing proceedings undertaken pursuant to section 21 of the Act with respect to Chevron's PDD Application, and any subsequent appeal proceedings therefrom;

(the Return or Destroy Date).
7. I will expunge all electronic versions of the Confidential Information and the Related Materials from all electronic apparatus and data storage media on or prior to the Return or Destroy Date set out in clause 6 above.
8. Within seven days from the Return or Destroy Date set out in clause 6, I will provide Chevron and the Board with a with a statutory declaration, in the form attached as Appendix B to Board Order PO-001-MH-002-2012, confirming compliance with the terms and conditions of Order PO-001-MH-002-2012, and this Undertaking and, in particular, that the Confidential Information and any Related Materials have been returned or destroyed in accordance with clauses 13 and 14 of the Order and clauses 6 and 7 of this Undertaking.
9. If Order PO-001-MH-002-2012 is subsequently varied or amended, I agree that the terms of the varied or amended Order shall prevail over the terms in this Undertaking.

10. I acknowledge and agree that any breach of the terms of this Undertaking or Order PO-001-MH-002-2012 will cause material and irreparable harm and damage to Chevron. I agree that Chevron shall be entitled to injunctive relief to prevent breaches of this Undertaking or Order PO-001-MH-002-2012, and to specifically enforce the terms and provisions thereof, in addition to any other remedy to which Chevron may be entitled at law.
11. I agree that no failure or delay by the Board or by Chevron in exercising any right or privilege in respect to a breach of this Undertaking or Order PO-001-MH-002-2012 shall operate as a waiver thereof.
12. I acknowledge that any breach of Order PO-001-MH-002-2012 may be the subject of contempt proceedings in the Federal Court of Canada.

MADE AT _____, in the province of _____, this ____ day of _____, 2012.

Recipient's Signature

Witness's Signature

Recipient's Printed Name

Witness's Printed Name

STATUTORY DECLARATION

CANADA

PROVINCE OF

IN THE MATTER OF the *National Energy Board Act* and the regulations made thereunder; and

IN THE MATTER OF an application for priority destination designation, by Chevron Canada Limited (Chevron), under File OF-Tolls-Group1-T260-2012-05 01 and Hearing Order MH-002-2012 (the PDD Application); and

IN THE MATTER OF the information filed by Chevron, pursuant to section 16.1 of the *National Energy Board Act* and determined by the Board to be Confidential Information.

I, _____, of the City of _____, in the province of _____, do solemnly declare as follows:

1. That the capitalized terms used herein that are not otherwise defined shall have the meaning ascribed thereto in National Energy Board Order PO-001-MH-002-2012, dated 29 October 2012, and my Undertaking to the Board and Chevron, dated _____.
2. That I have fully complied with my Undertaking and Order PO-001-MH-002-2012.
3. That I have made no use of the Confidential Information or of the Related Materials except as permitted by my Undertaking or Order PO-001-MH-002-2012.
4. That I have not disclosed the Confidential Information in any manner except as permitted by my Undertaking or Order PO-001-MH-002-2012.
5. That I have either returned to Chevron or destroyed all written copies of the Confidential Information and any Related Materials in my possession or under my control.

6. That I have expunged all electronic versions of the Confidential Information and the Related Materials from all electronic apparatus and data storage media.

I make this solemn declaration conscientiously believing it to be true and knowing that it is of the same force and effect as if made under oath.

DECLARED before me at the City of _____,)
in the Province of _____, this _____)
day of _____, 2012.) _____
) _____
) _____
) _____
) _____
_____)
A Notary Public
for the Province of _____

**Hearing Order MH-002-2012 Chevron Canada Limited (Chevron)
Application for a Priority Destination Designation (the PDD Application)**

Procedure for dealing with Confidential Information

Who should have access to the Confidential Information

The Board is of the view that both external and in-house legal counsel should be allowed access to the Confidential Information, conditional upon each counsel signing a confidentiality undertaking, in the form attached as Appendix A to Order PO-001-MH-002-2012 (the Undertaking), and delivering an original thereof to both counsel for Chevron and the Board. Legal counsel are subject to strict professional obligations with respect to confidentiality and the Board is of the view that these professional obligations are not lessened for in-house legal counsel. In addition, external counsel may require that in-house counsel access the Confidential Information in order for the external counsel to receive adequate instruction from the client. However, the Board would remind in-house legal counsel that, if they choose to view the Confidential Information, there may be situations in which in-house counsel may be required to excuse themselves from internal discussions of the company for which they are employed, if they are of the view that they are unable to clearly segregate the Confidential Information in their mind from the topic of discussions of the company.

The Board is also of the view that external legal counsel may provide access to the partners, associate lawyers and support staff of that legal counsel to the extent that viewing the Confidential Information, or portions thereof, is, in the opinion of legal counsel, necessary in order for those persons to provide assistance to legal counsel with respect to the Confidential Information, and which assistance is normally consistent with the duties of those persons. Access to the Confidential Information is contingent upon those persons executing and delivering an original Undertaking to each of Chevron and the Board.

In addition, the Board finds that external consultants, unaffiliated with a corporate party or its affiliates and retained by legal counsel, may have access to the Confidential Information if legal counsel is of the opinion that expert advice from that consultant is required for the purpose of interpreting the Confidential Information, preparing evidence with respect to the Confidential Information, or assisting legal counsel with respect to the testing of the Confidential Information in this proceeding. Access to the Confidential Information is contingent upon those persons executing and delivering an original Undertaking to each of Chevron and the Board.

In order for the Board and Chevron to determine which consultants are entitled access to the Confidential Information, and which are to execute the Undertaking, legal counsel for the intervenors shall send a letter to the Board and Chevron indicating that they have determined that they need an expert consultant and providing the name of the expert consultant.

Unless otherwise ordered by the Board, no other persons are entitled to receive the Confidential Information. This restriction includes the internal business people of the corporate intervenors, as the risk of inadvertent disclosure is too high. The Board is of the view that this restriction should not impede any intervenor's participation in this proceeding to any significant extent, given that the nature of the Confidential Information has been made public and the Confidential Information itself forms only a small portion of the total evidence produced thus far in the proceeding.

Process for Handling the Confidential Information

On receipt of an executed Undertaking, Chevron shall provide one copy of the Confidential Information to the person who executed the Undertaking. The Confidential Information shall not be copied by any person having access to it other than Chevron. If additional copies are required, that person will contact Chevron for same. All copies of the Confidential Information will be marked "Confidential" and delivered under a red-coloured cover. The Board suggests that Chevron number the copies to enable easier tracking of the Confidential Information.

The Confidential Information shall be held in confidence, and used only for the purpose of this proceeding on Chevron's PDD Application and any appeal, review or rehearing from any decision the Board may make in this proceeding.

All reasonable, necessary and appropriate efforts to protect the Confidential Information from disclosure shall be used. Confidential Information, and any material that contains reference to, or portions of the Confidential Information, shall be segregated and clearly labeled as "Confidential" and, where possible, transmitted in hard copy only.

During and after the oral portion of the Hearing

The Board is of the view that everyone who has executed and delivered an Undertaking is entitled to be present at those portions of the MH-002-2012 proceeding where the Confidential Information is referenced. All other persons will be asked to leave the hearing until that *in camera* portion has concluded. During the oral portion of the hearing, a separate transcript will be taken, and the hearing will not be broadcast over the Board's Livelink system during the *in camera* portions of the hearing in which the Confidential Information is discussed.

At this point in the proceeding, it is premature to issue directions for dealing with the Confidential Information in final argument; however, the Board will issue further procedural directions on this aspect at a later time. The Board is of the view that some flexibility and accommodation in the presentation of their cases and in the Board's normal procedures will be required in order to maintain the confidentiality of the Confidential Information.

With the exception of one copy to be maintained by the Board in confidence for its records, all written copies of the Confidential Information, and any portions of the evidence, transcripts, notes, working papers, calculations, analysis or other materials based on or using the Confidential Information (Related Materials), shall either be returned to Chevron or destroyed 40 days after the later of the Board's decision on the PDD Application or the conclusion of any appeal, rehearing or review proceedings thereon (the Return or Destroy Date). All electronic versions of the Confidential Information and the Related Materials are to be expunged from all electronic apparatus and data storage media at the same time.

Within seven days from the Return or Destroy Date above, all persons who have executed an Undertaking shall provide Chevron and the Board with a statutory declaration, in the form attached as Appendix B to Order PO-001-MH-002-2012, confirming compliance with the terms of the Order, and, in particular, that the Confidential Information and any Related Materials have been returned or destroyed in accordance with the Order.

Expiry of Order

Given that the Order restricts the otherwise public access to the Board's proceedings and information that the Board considers in its decision, the Board is of the view that the Order should not remain in force indefinitely, unless there is sufficient reason for it to do so. At this point in time, the Board is not satisfied that sufficient reason has been shown. However, given the commercial sensitivity of the Confidential Information, the Board is of the view that it is entitled to a fairly lengthy protection period. Accordingly, the Board has determined that the Order shall remain in force for 10 years. If, prior to or nearing the end of the 10 years, any party is of the view that the term of the Order should be extended, they are free to apply to the Board to do so at that time, providing a justification why the Confidential Information continues to require protection.

Other Procedural Matters

Any further terms and conditions for the distribution, process in the hearing and return and disposal of the Confidential Information not mentioned in this Ruling are set out in Order PO-001-MH-002-2012.



March 22, 2016

Mr. Steve Roth
Vice President
Seaspan Ferries Corporation
7700 Hopcott Road
Delta, BC V4G 1B6

Dear Mr. Roth:

This is a further response to your letter of February 17, 2016, and March 15, 2016. As indicated in my initial response, dated February 26, 2016, BC Ferries has been provided an opportunity to respond to your February 17th letter. You were copied on BC Ferries response, and an additional copy is attached to this letter for your reference.

BC Ferries has agreed with you that the scope of my review should include a determination of both tests in section 45.1. I can reconfirm my intention to do so.

With regard to your request for further disclosure of certain information contained in BC Ferries' submission of January 15, 2016, BC Ferries maintains that the specified information is commercially sensitive and therefore must be protected as confidential information under section 54 of the *Coastal Ferry Act*. As I see no reason to depart from the previous ruling of the BC Court of Appeal on this matter, I have determined that BC Ferries' request for confidentiality regarding certain information in their January 15, 2016, submission is reasonable and therefore such information will not be disclosed to any other party. It is my intention to make determinations and disclose all information which is not found to be confidential from all submissions received during this proceeding. Reasons for my determinations in this regard will follow my final decision in this matter.

BC Ferries has supported your request for additional time for submissions and evidence, comparable to the time provided in the proceedings that led to Order 11-01. The deadline is extended to April 22, 2016, being more than 3 months after the deadline for initial submissions. BC Ferries has requested an additional step in this process, to allow it and any other participant to submit a final response to any submissions received by the April 22nd deadline. I have accepted this request and accordingly final responses will be due no later than May 13, 2016.

.../2

A revised Notice of Procedures has been posted to the BC Ferry Commission website.

Yours truly,

A handwritten signature in black ink, appearing to read "Gord Macatee". The signature is fluid and cursive, with a large initial "G" and a stylized "M".

Gord Macatee
BC Ferries Commissioner

Attachment

cc: Dennis Dodo, BC Ferries
Cynthia Lukaitis, BC Ferries

March 11, 2016

Mr. Gordon Macatee
British Columbia Ferries Commissioner
BC Ferry Commission
PO Box 9279 Stn Prov Gov
Victoria BC V8W 9J7

Dear Mr. Macatee:

**Re: Comments of British Columbia Ferry Services Inc. in Response To
Seaspan Letter of February 17, 2016**

Further to your letter dated February 26, 2016, this letter provides British Columbia Ferry Services Inc.'s ("BCFS") comments in response to Seaspan Ferries Corporation's ("Seaspan") letter dated February 17, 2016.

Clarification as to Scope

Under the first heading in its letter, Seaspan sought clarification regarding the scope of issues that the British Columbia Ferries Commissioner ("Commissioner") will address in this proceeding under section 45.1 of the *Coastal Ferries Act* ("Act"). The Commissioner confirmed that he will make both of the determinations referenced under section 45.1(1). BCFS agrees that the Commissioner should consider and make determinations regarding both of the matters addressed in that section.

Disclosure

The second topic raised in Seaspan's letter is disclosure of information to Seaspan. In response to these submissions, BCFS sets out the binding law that governs this proceeding with respect to disclosure, and then turns to the specific issues raised by Seaspan. Further details of the need for confidentiality are set out in section 1.3 of the BCFS Filing.

The Framework for Addressing Disclosure Issues

Section 54 of the Act sets out a legislated mandatory requirement for the Commissioner to keep certain kinds of information confidential:

54 Despite any obligation imposed on the commissioner under this Act to obtain, maintain or make available information or records, the commissioner, every deputy commissioner, every employee of the commissioner and every inspector must not disclose or be compelled to disclose any information or record that is obtained in, or that comes to the person's knowledge during, the course of the administration of this Act or the course of any inspection authorized under this Act, unless and only to the extent that such disclosure is consistent with the *Freedom of Information and Protection of Privacy Act*. [Emphasis added.]

The relevant provision of the *Freedom of Information and Protection of Privacy Act* ("FIPPA") in the context of the drop trailer proceeding is section 17. Section 17 of FIPPA provides an exemption for disclosure of information which could reasonably be expected to harm the financial or economic interests of a public body. Under Schedule 2 of FIPPA, a "ferry operator" is a "public body" and therefore BCFS is a public body under FIPPA. This section of FIPPA is relevant because Seaspan, who is the dominant company and major competitor of BCFS in the drop trailer market, seeks to obtain disclosure of financially sensitive information from BCFS.

To the extent that any information filed by BCFS in this proceeding meets the criteria of section 17, the Commissioner *must not disclose* the information and there is no discretion for the Commissioner to do otherwise. As explained in section 1.3 of the BCFS Filing, certain cost information filed by BCFS meets the criteria for exemption from disclosure. As explained below, all of the information requested by Seaspan in its February 17 letter also meets the criteria, and therefore cannot be disclosed to Seaspan.

In Order 10-01 from the previous proceeding, the Commissioner recognized that the disclosure of certain cost information would cause harm to BCFS, and on that basis and relying on section 54 of the Act, refused to disclose to Seaspan BCFS's cost information. Seaspan appealed the Commissioner's decision regarding disclosure, and other issues from the previous drop trailer decision, to the Court of Appeal for British Columbia. Seaspan's position in the appeal was that it ought to have been provided with all of the information filed by BCFS, and that the failure to disclose this information was a breach of common law procedural fairness.

In *Seaspan Ferries Corporation v. British Columbia Ferry Services Inc.*, 2013 BCCA 55, the court rejected Seaspan's argument regarding the issue of disclosure and dismissed this, and all other grounds of Seaspan's appeal. In doing so, the Court held:

[81] It must be recognized that the issues dealt with under s. 45.1 of the Coastal Ferry Act are typically financially sensitive. Given the nature of the tribunal, and the nature of the rights at stake under that section, I am unable to agree with Seaspan that procedural fairness requires that it have full disclosure of all of the material that is filed with the Commissioner.

[82] What is required is that Seaspan have sufficient information to allow it to participate in a meaningful manner in the proceedings. In my view, the Commissioner made no error in finding that detailed financial information did not need to be provided to Seaspan in order to give it that ability. The information that was disclosed to Seaspan afforded it the ability to meaningfully participate in the proceedings and to make valuable submissions to the Commissioner.

[83] In my view, the Commissioner did not act unfairly when he concluded that the financial harm that might be caused by disclosure of BCFS's detailed financial records to a competitor might be unduly damaging to it.

[84] In the result, I would not give effect to Seaspan's contention that its right to procedural fairness was breached by the Commissioner's decision. In the circumstances, it is not necessary to consider the BCFS's argument that, in any event, the *Freedom of Information and Protection of Privacy Act*, R.S.B.C. 1996, c. 165 prohibited the Commissioner from disclosing information. [Emphasis added.]

As a result, there is binding authority on the Commissioner that in the context of a proceeding under section 45.1 of the Act, procedural fairness does not require full disclosure of all material that is filed with the Commissioner. The Court of Appeal firmly rejected any such proposition. What is required is that the information disclosed to Seaspan affords it the ability to meaningfully participate in the proceeding. There is no requirement for detailed, financially sensitive information to be provided to the Seaspan.

The Court of Appeal did not have to turn its mind to the issue of the impact of section 54 of the Act on the issue of procedural fairness. Having found that there was no breach of the duty of procedural fairness, there was no need to do so. However, even if the Court had found a breach of procedural fairness, the law is clear that statutory provisions can override common law procedural fairness. In *Ocean Port Hotel Ltd. v. British Columbia (General Manager, Liquor Control and Licensing Branch)*, 2001 SCC 52, the Court held that the common law right to procedural fairness in an administrative process that "may be ousted by express statutory language or necessary implication": at paragraph 22. The Court in *Ocean Port Hotel* explained at paragraphs 21 and 22:

Confronted with silent or ambiguous legislation, courts generally infer that Parliament or the legislature intended the tribunal's process to comport with principles of natural justice ...

... Ultimately, it is Parliament or the legislature that determines the nature of a tribunal's relationship to the executive. It is not open to a court to apply a common law rule in the face of clear statutory direction. ...

In this case, section 54 is clear statutory direction that certain categories of information cannot be disclosed by the Commissioner under any circumstance, regardless of whether a proceeding is underway or not. Accordingly, where section 54 is engaged and applies to certain documents it is not open to the Commissioner to apply a common law rule of disclosure regarding such documents.

As a result, pursuant to binding legal authority the Commissioner must address disclosure issues on the basis that:

1. procedural fairness does not require full disclosure of financially sensitive information to Seaspan; and
2. the overriding question regarding disclosure issues is whether the disclosure is permitted under section 54 of the Act, which overrides any procedural fairness rights that may apply.

With this framework in mind, BCFS provides responses to the four disclosure issues raised by Seaspan in its submission.

Seaspan's Issue #1 - Disclosure of the Existing the MAAT

Seaspan submits that the existing Minimum Average Allowable Tariff ("MAAT") should be disclosed to Seaspan. BCFS's position is that it should not. In support of its position, Seaspan quotes the Court of Appeal's cautionary language from its unsuccessful appeal as follows:

[89] While Seaspan has raised, as an issue on appeal, the question of whether the Commissioner had the power to keep parts of his order confidential, it has not made independent arguments on this issue. Instead, it says, simply, that "This question stands to be resolved by the same analysis that governs the disclosure issue".

[90] Given that Seaspan's argument on this issue depends on it having succeeded on the disclosure issue, I would also dismiss this ground of appeal.

[91] In dismissing this aspect of the appeal, I would note that principles of openness and public accountability are negatively affected by confidential orders. To some degree, such orders may also be seen as being contrary to the Rule of Law. While I recognize that it may sometimes be necessary for aspects of tribunal orders to remain confidential, I think it important to emphasize that the practice of making confidential orders is to be discouraged.

This obiter comment does not support Seaspan's position. On the contrary, while the court cautioned against keeping portions of orders confidential, the court recognized that in some cases tribunals will have to keep aspects of their orders confidential. Drop trailer is one of those examples.

In the case of the drop trailer proceeding, making the existing MAAT (in unredacted form) open to the public would disclose BCFS's financially sensitive cost information. As the Commissioner recognized in the previous proceeding, disclosure of such information would likely allow a competitor such as Seaspan to engage in pricing incentives which would likely erode BCFS's customer base. Disclosure of the data in the existing MAAT to Seaspan would be harmful to the business interests of BCFS, and would also be harmful to BCFS's customers and ferry users. As a result, section 54 applies and the Commissioner is prohibited from disclosing the confidential, non-public version of the existing MAAT. It is accordingly irrelevant that BCFS publishes the tariff for its "live" trailer service; that fact does not make the confidential MAAT something that the Commissioner can disclose.

BCFS notes that Seaspan provides an assurance that if it is provided with confidential information that it "has no intention of engaging in predatory pricing". With respect, this assurance is legally irrelevant to the disclosure issue because section 54 prohibits disclosure. BCFS further notes that Seaspan's concerns regarding the fairness of this proceeding should be allayed by the fact that it is the Commissioner, who is an independent administrative tribunal assisted by an independent third party accounting firm (PricewaterhouseCoopers), who sets the MAAT, not BCFS.

For all of these reasons, BCFS submits that the existing MAAT cannot and should not be disclosed to Seaspan in this or any other proceeding. BCFS further submits that if a MAAT is ordered following this proceeding, then the Commissioner should issue an order that is transparent but also protects BCFS's commercially sensitive information by keeping underlying cost information confidential. This topic was raised in the Commissioner's Notice of Procedures issued February 1, 2016, and BCFS intends to address that issue in detail in a further submission once the Commissioner has addressed the issues in Seaspan's February 17 letter and determined the process going forward.

Seaspan's Issue #2 - Counsel's Eyes Only Access to Cost Data

Seaspan's second position is that its experts and legal counsel should be granted "complete access to BC Ferries' cost data and related operating statistics on undertakings that they alone will have access to the information". BCFS's position is that no such access can or should be granted.

BCFS repeats the submissions in the previous section and in section 1.3 of the BCFS Filing that disclosure of such cost and operating data would cause harm to BCFS. Accordingly, the kind of "counsel's and expert's eyes only" access requested by Seaspan is not permitted by section 54 of the Act. There is no basis for the Commissioner to "depart" from the previous approach taken in the drop trailer proceeding, as urged by Seaspan; such an approach would violate section 54 of the Act. Furthermore, for the reasons set out above this kind of disclosure is not required by the common law of procedural fairness for a fair hearing. Seaspan has the tools it needs to make a full submission, just as it did last time.

For these reasons, BCFS submits that the counsel's and expert's eyes only type of disclosure requested by Seaspan must be denied.

Seaspan's Issues #3 and #4 - Operating Statistics and Other Interrogatories

Seaspan states that it "envisages an opportunity to pose specific questions to BC Ferries" in this proceeding, including a request for certain operating statistics. BCFS submits that Seaspan has no right or ability to pose such questions or make such requests to BCFS in this proceeding.

The Commissioner has jurisdiction to order BCFS to provide certain information under section 67 of the Act. This section provides that a ferry operator must provide to the Commissioner information reasonably required *by the Commissioner*. Any information provided to the Commissioner pursuant to this section is subject to the requirements of section 54 as described above.

Accordingly, for the purposes of this proceeding, as in the last one, if Seaspan wants further information from BCFS, then it will need to make its requests to the Commissioner, who will decide whether or not to rely on section 67 to make an information request of BCFS. If BCFS is directed to provide information to the Commissioner, then it will be provided to the Commissioner, and not Seaspan, and it will be subject to section 54 of the Act. BCFS would state its position on any concerns about confidentiality in response to any information requests made. Information subject to section 54 would not be disclosed to Seaspan.

BCFS does not believe that such a process should be followed in this proceeding. BCFS submits that the public version of the BCFS filing provides all of the information that Seaspan requires in order to be afforded the ability to meaningfully participate in the proceeding and to make valuable submissions to the Commissioner. The Commissioner should strive to keep this process efficient and to avoid transforming this inquisitorial process into something akin to litigation, which it is not.

Extension of Time for Submissions and Evidence

For the reasons stated above, BCFS does not believe that any further information should be provided to Seaspan in this proceeding, beyond the public version of the BCFS Filing. The disclosure issues raised by Seaspan are repetitive of issues raised in the last proceeding, which were fully addressed and answered by the Court of Appeals' decision dismissing its appeal from the last decision, and by section 54 of the Act.

Seaspan has had this filing since January 15, 2016, and it should be well on its way to preparing its responsive materials. As no more information can or should be provided to Seaspan, this proceeding should proceed in an orderly and efficient manner, so that this matter can be determined in a timely way.

BCFS submits that April 15 is a reasonable deadline for Seaspan to provide its submissions; by that date it will have had three months to prepare its response materials, which is similar to the timeframe from the last proceeding. BCFS will then require sufficient time to provide its reply to Seaspan and any other submissions received, and to provide its comments regarding the matters that the Commissioner intends to address as outlined in the Notice of Procedures issued on February 1, 2016. BCFS submits that three weeks for its reply is reasonable.

Yours truly,

A handwritten signature in black ink, appearing to read "Dennis M. Dodo".

Dennis M. Dodo, MBA, CPA
Chief Financial Officer

cc: Steve Roth, Seaspan Ferries Corporation