

**BC Ferry Commission
MEMORANDUM 31**

To: Mr. Rob Clarke
Executive Vice President and
Chief Financial Officer, BCFS

From: Martin Crilly
BC Ferry Commissioner

Date: December 1, 2008

Re: Three Quarter “Grace Period”

This Memorandum 31 follows Memorandum 27 dated January 17, 2008, which assured the company that we would:

- not apply a penalty for average fares over-cap for a second consecutive quarter for the March 31 2008 measurement point of the weighted average fare (in other words, permit a “two-quarter grace period”); and
- confirm our position on this matter for measurement points after March 31 2008 after properly examining other effects of the two-quarter grace period in other circumstances.

You have pointed out that:

- the minimum one-quarter grace period required by the Act does not allow enough time for BC Ferries to recognize an over-cap condition developing, and to devise, advertize and implement a rational price strategy to bring the average price under cap.
- the method of calculating the phase-in of the price cap index, which uses quarterly revenue weights from the previous year, produces a year-to-year drift in the phase-in of the price cap toward the back end of the financial year, which reinforces itself in the next year. This is an unintended distortion in the quarterly profile of the price cap through the year. You have indicated that a longer grace period would help correct this by providing some flexibility.

We have sympathy on both points.

Findings

We have examined the effects of extending the grace period. The findings rest on the principle that weighted average fares are calculated from trailing four-quarter traffic and revenue data.

One key finding is that a grace period of as many as three quarters does not allow BC Ferries permanently to retain above-cap revenue above the capped level. That is, provided (4-quarter trailing weighted average) fares are within cap at least every fourth quarterly measurement point, BC Ferries is properly returning revenue overcharged in any quarter back to customers.

Another finding is that a three-quarter grace period allows recovery of past quarters' foregone revenue from "undercharging". We have no objection to this going forward. In particular the three-quarter grace period allows recovery of the immediate:

- three past quarter's foregone revenue by "overcharging" in the current one quarter; or
- two past quarter's foregone revenue by "overcharging" in the current quarter and next quarter; or
- one past quarter's foregone revenue by "overcharging" in the current quarter and next two quarters.

Confirmations

Accordingly, we confirm that:

- the two-quarter grace period is extended through the December 31 2008 measurement point; and
- starting at the March 31 2009 measurement point, a three-quarter grace period will apply.

This means that a return of the average fare index to the price cap index cap at least every fourth quarter will be strictly enforced.