

**Issues Identified by BCFS Regarding Calculation of MAAT in Order 11-01**

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**Data Input Error in Calculating Route Capacity Charge (Overhead)**

BCFS’ first point is that the MAAT appears to have been inadvertently calculated using the wrong number from BCFS’ revenue related expenses data table as an input. The result of this input error is that the MAAT is materially higher than it ought to be based on the Commissioner’s methodology.

By way of background, information provided by BCFS in Exhibit C-1 and Exhibit C-2 in the August 31, 2010 Filing to the Commissioner classified costs into four categories: Vehicle-related, Passenger-related, Revenue-related and Drop Trailer. These categories were done in a manner consistent with the annual route statement reports prepared for the Commissioner.

Route overhead charges were included in the Commissioner’s calculation of the MAAT. The Commissioner calculated the route overhead charges used in the MAAT by excluding the category of expenses classified by BCFS (in Exhibit C-1) as Passenger-related, and by including the total Revenue-related expenses (in Exhibit C-1). However, the total Revenue-related expenses in Exhibit C-1 contained both vehicle-related and passenger-related expenses. Consistent with the Commissioner’s exclusion of Passenger-related expenses in the calculation of the route overhead charge, the portion of Revenue-related expenses that are based on passenger revenue should also logically have been excluded.

In response to a request from the Commissioner in January 2011, BCFS provided the more detailed allocation for Revenue-related expenses between vehicles and passengers. The details provided by BCFS included the following data:

<b>Revenue Related Expenses</b>	<b>Route 1</b>	<b>Route 30</b>	<b>Combined</b>
Passenger revenue related expenses			
Vehicle revenue related expenses			
Total			

The Commissioner has included the value representing the total revenue related expenses (bottom row, above) in the route capacity charge that is included in the cost per vehicle foot for the MAAT. This appears to have been a simple matter of an error in transferring data from the evidence, as only the vehicle revenue related expenses (middle row, above) should have been included.

The Commissioner’s current route capacity charge which includes the total Revenue-related expenses is as follows. The table below is a rolled-up version of what appears in Appendix C of PWC’s report. The erroneous data appears in the second row of the table below, and the error flows through the calculation of the Per Foot Cost:



## Current Direct Cost of Operations

The Commissioner’s approach involved determining the direct expenses for drop trailer service and then straight-lining efficiencies to a mature level that he considered appropriate. However, the Commissioner, in determining BCFS’ direct expenses for drop trailer service only used data to March 31, 2010 without accounting for BCFS’ evidence of direct expenses for the six months thereafter. The exclusion of the most recent data is inconsistent with the Commissioner’s logic in Memorandum 42 (page 5) that “BCFS’ unit costs cannot reasonably be based on an initial start up volume of drop trailer traffic, which might be expected to increase quickly from a small base.”

The effect on the MAAT of not accounting for the most recent data is material. Fiscal 2010 (ending March 31, 2010) was the start up year for drop trailer operations, and as expected in a start up year, utilization was low while direct expenses were high. Within six months into the second year of operations, direct expenses were reduced by \$\_\_\_ per foot, while expenses related to assets increased \$\_\_\_ per foot reflecting the capital investment in hostling units, for an overall reduction of \$\_\_\_ per foot. The impact is demonstrated in the table below, which uses only data already in evidence:

Expenses	Fiscal 2010		Fiscal 2011	
	Actuals	\$/ft based on DT Capacity Used	YTD September actuals (6 months)	\$/ft based on DT Capacity Used
<i>Feet Carried (incl. hostling unit)</i>				
Labour				
Hostling Units				
Terminal				
Office & Admin				
<b>Total Direct Expenses</b>				
Drop Trailer assets				
Amortization				
Net Financing				
Income Tax Advantage				
<b>TOTAL</b>				



## Current Market Size

In calculating the MAAT, the Commissioner “accepts the expected costs at a horizon volume of traffic which is less than BCFS’ target mature state.” The Commissioner identified a specific percentage of the current (2010/2011) total market for drop trailer service as the horizon volume of traffic. However, the Commissioner’s determination of BCFS’ horizon market share did not reflect the full evidence regarding the current market size. The evidence is that the current market is larger than what was reflected in the Commissioner’s calculations.

The Commissioner appears to have used an estimate of the total current drop trailer market from BCFS’ response to Question 3, as submitted in the November 19, 2010 Supplemental Submission. However, Seaspan’s November 26 submission (page 16) included detailed information of Seaspan’s current volume, as well as an estimate of Vancouver Island Barge’s (VIBS) current volume. BCFS has provided its own actual volume data. The combined volume from Seaspan and BCFS alone, i.e. without accounting for VIBS at all, exceeds the estimate used by the Commissioner for the total drop trailer market. Adding in the low end estimate for VIBS volume that was provided by Seaspan, the result is significantly higher. BCFS submits that the Commissioner should rely on the best evidence as to the drop trailer market size.

The difference between the estimate used by the Commissioner and the sum of the actual and estimated vessel feet handled by each operator is material. The table below shows the magnitude of the discrepancy:

	Estimate used by Commissioner	2010/11 Market
BC Ferries (YTD Sept operating statement x 2)		
Seaspan (pg 16 of Nov 26 response)		135,000
VIB (pg 16 of Nov 26 response by Seaspan)		40,000
Total Market (units)		
BC Ferries horizon market share		
BC Ferries horizon volume		
Vessel feet per unit		
Vessel Feet		



**Selection of Consumer Price Index (CPI)**

In establishing the MAAT, the Commissioner applied a 2% CPI growth factor to fiscal 2010 expenses for fiscal 2011 and fiscal 2012. However, the CPI growth factor used in determining the MAAT differs from the CPI indexes that the Commissioner had already used in establishing the published price caps for fiscal 2011, and will use in establishing price caps for fiscal 2012. BCFS submits that the same CPI growth factor should be used in all matters relating to the regulation of BCFS. There was no evidence on CPI from BCFS or anyone else involved in this drop trailer process that would indicate anything to the contrary. In the absence of such evidence, BCFS submits that adopting a different CPI factor is inconsistent and represents an error. BCFS submits that the previously determined CPI growth factor should be used in calculating the MAAT for drop trailer operations.

By updating the MAAT as determined in the Commissioner’s order with the CPI used in establishing price caps (all other things remaining the same) the MAAT result is \$\_\_\_\_:

	CPI as applied in Order 11-01		CPI used in establishing price caps	
	Average applied in Order 11-01	MAAT (fiscal 2010 x CPI)	CPI known and used in establishing price caps	MAAT (fiscal 2010 x CPI)
F2010 MAAT as calculated in Order 11-01				
F2011			(0.03)%	
F2012			1.39%	
<b>F2012 MAAT</b>				





## Recognition of Duty Remission received for Coastal Class Vessels

Two expenses included in the MAAT are linked to the asset values of the Coastal Class Vessels: amortization and income tax advantage. The asset value used in calculating these expenses, however, did not reflect the fact that BCFS received duty remission and related GST on the three coastal class vessels in October 2010 of \$82.3 million.

BCFS reported this development to the Commissioner in another context. The new information did not affect the calculations under BCFS' proposed methodology, and thus BCFS did not update the calculations. However, the information has a material impact on the Commissioner's determination of the MAAT. The duty remission and related GST had the effect of reducing the initial asset value that forms the basis for calculating amortization and income tax advantage. As such, amortization and income tax both decrease.

Although the price caps have not been adjusted for the duty remission, the Commissioner is aware that the current price caps are not providing the regulated rate of return as was previously intended.

By updating the MAAT as determined in the Commissioner's order with the correct Coastal Class Vessels value the MAAT result is \$\_\_\_\_ (all other things being equal). The MAAT in the original order is reduced by \$\_\_\_\_ as depicted below: \$\_\_\_\_ for impact on income tax advantage, and \$\_\_\_\_ for impact on amortization.

Income tax advantage correction:

	NBV of Coastal Class Vessels (prior to duty remission)	NBV of Coastal Class Vessels (post duty remission)	NBV Reduction due to duty remission
Allocation to route (vessel sailing hours)			
Route 1			
Route 30			
<b>Total</b>			
Passenger allocation			
Vehicle allocation			
% of vehicle allocation			
Income Tax advantage			
Total vehicle feet			
Per vehicle foot			

Amortization correction:

Allocation to route (vessel sailing hours)	Amortization of Coastal Class Vessels (prior to duty remission)	Amortization of Coastal Class Vessels (post duty remission)	Amortization Reduction due to duty remission
Route 1			
Route 30			
<b>Total</b>			
Passenger allocation			
Vehicle allocation			
Total vehicle feet			
Per vehicle foot			

**Terminal Cost Allocation**

In Order 11-01, the Commissioner applied a “route overhead charge” to the costs of drop trailer service to recognise the provision of terminal and deck space, and marine transport. However, the route overhead charge was based on an incorrect assumption that BCFS’s classification of terminal related costs excluded costs appropriately assigned as passengers.

By way of background, in BCFS’ August 31, 2010 filing, BCFS took the position that drop trailer operations is a non-core service and should therefore not be allocated core operational costs. As a result, the core operational route costs were allotted into categories and classified as “vehicle-related, passenger-related, and revenue-related” based on the method used to allocate costs between routes. The route allocation methodology, however, is intended to allocate costs between routes and uses vehicle throughput only as the allocator for terminal related costs. Thus, for route allocation purposes, there does not need be any further detailed allocation of terminal costs as between vehicles and passengers.

This absence of a more detailed allocation of terminal related costs between passengers and vehicles did not affect BCFS’ methodology for allocating drop trailer costs, and thus the additional allocation was not performed. However, the additional allocation does need to be performed in order to apply the methodology outlined by the Commissioner. The effect of not doing so is to assume that there are no passenger-related terminal costs at all. There is no evidentiary basis for that position, and it is clearly not correct given that terminals are used to provide service to passengers as well as vehicles. Given that the Commissioner has now determined that a different approach is to be used, BCFS submits that the Commissioner requires evidence regarding how much of the terminal costs are truly vehicle related and how much are actually passenger related.

BCFS has prepared the following table to illustrate the materiality of this error, demonstrating the impact on the MAAT of allocating 10% of terminal costs to passengers for illustrative purposes.

	<b>Total terminal operations and maintenance expenses</b>	<b>Less: 10% allocated to Passengers</b>	<b>90% allocated to Vehicles</b>
Terminal Operations			
Terminal Maintenance			
Amortization			
<b>TOTAL</b>			
Total vehicle feet capacity			
Cost per foot			

For every 10% of terminal operations and maintenance expenses allocated to passengers (all other things remaining equal), the route overhead charge allocated to drop trailer feet reduces by \$\_\_\_\_\_.

## Summary

The impact of the above items on the MAAT is summarized below:

Original Direct Expenses and Route Overhead base	
Corrected for:	
Passenger revenue related expenses	
Current direct operating expenses	
Current market size	
10% (illustrative) of terminal operation & maintenance costs assigned to passengers	
Corrected Direct Expenses and Route Overhead base	
CPI applied: Year 1 @ (0.03)%	
Year 2 @ 1.39%	
Original Amortization, Net Financing and Income Tax Advantage base	
Corrected for:	
Duty Remission – income tax advantage	
- amortization	
<b>MAAT</b>	