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October 22, 2010

Yukon Utilities Board
Box 31728
Whitehorse, Yukon
Y1A 6L3

Att: Mr. Bruce McLennan
Chair

Dear Mr. McLennan:

**Re: Yukon Electrical Company Limited ("YECL") and Yukon Energy Corporation ("YEC")**
**2009 Phase II Rate Application**
**YECL Separate Argument on Phase II Issues**

Please find attached the Yukon Electrical Company Limited's Argument filed in accordance with the Board's Schedule.

Yours truly,

Loyola G. Keough
Attachs.

**YUKON UTILITIES BOARD**

**YUKON ELECTRICAL COMPANY LIMITED and**

**YUKON ENERGY CORPORATION**

**2009 PHASE II RATE APPLICATION**

**YUKON ELECTRICAL COMPANY LIMITED**

# ARGUMENT

## 1. INTRODUCTION

The following constitutes the separate Argument of Yukon Electrical Company Limited ("YECL") with respect to two separate and distinct matters addressed in these proceedings. The first of these matters relates to Rate Design; while the second addresses the separate YECL Rider D Application that was filed with the Board under cover of letter dated March 1, 2010.

YECL will not repeat the introductory remarks contained in its Joint Argument with YEC that is concurrently filed herewith, but rather will focus this separate Argument solely on the above matters.

## 2. RATE DESIGN

### (i) Overview

As noted in the Introduction to the Joint YECL/YEC Argument, there are many aspects of the proposed Rate Design where both of the Applicants share common views and are advancing a consistent position before the Board. As noted, these matters were detailed in the Opening Statement made on behalf of YEC during these proceedings and need not be repeated here. It is likewise recognized that Rate Design is grounded in a series of well recognized principles, many of which are contradictory or competing in nature. Hence, the challenge with respect to Rate Design is to achieve a reasonable balance between the various competing objectives and, in the end result, derive a conclusion that is fair to all customer classes. It is also recognized that Rate Design is seldom "black and white", wherein there is a single correct solution that

should be adopted to exclusion of all others. However, YECL submits that when examining competing options it is critical to assess the relative fairness of the respective options to all customer classes and different customer groups within each rate class, in terms of both the impacts on such rate classes and customer group; and the consistency of the signals which are being sent via the accepted Rate Design.

In the context of this proceeding, the Board now has before it four options with respect to the potential Rate Design which should be adopted at this time. In addition to YECL's proposed Rate Design-Option B, which is set out in Tab 4YECL of the Application, there are two Rate Design options (Option A and Option C) from YEC, as well as, the alternative put forward by Leading Edge.

While YECL appreciates the efforts of YEC to now advance Option C as its preferred Option, given that it is not as extreme as the original Option A, YECL is not able to see its way clear to support Option C, as it still does not achieve an appropriate balance between the various customers within a rate class and does not send appropriate and consistent price signals to all customers. The purpose of introducing block rates at this time is to commence a process, that will move forward in a measured way, as diesel generation is expected to play an increasingly prominent role in the process of setting rates in Yukon. Likewise, the alternative advanced by Leading Edge, which may have been seen as an attempt to present a compromise position between the original Options A and B, still does not achieve the desired objectives discussed above and should not be accepted for the same reasons. In addition, the proposed rate design approach by Leading Edge only considered the residential rate class. The remaining rate classes including General Service and Lights were not put forward for consideration, which does not allow the Board and interested parties a complete record to properly evaluate and analyze the position advanced by Leading Edge. While YECL appreciates the efforts by Leading Edge to produce an alternative rate design for discussion, the absence of a complete rate design package for all rate classes is another reason why this proposal should not be accepted.

As noted in the Application, Tab 4YECL, Option B is based on introducing a three block tier for residential customers and a four block tier for general service customers. As noted, YECL is proposing to make measured and modest adjustments to rates at this time. The purpose for adopting such an approach is abundantly clear, particularly given that the Board cannot currently move forward with inter-class rebalancing because of the existing OICs. Given this constraint, any change to current rates within a class must be offset by counterbalancing changes to other customer groups within the same class. This context is far different than a situation where inter-class rebalancing is permissible and when appropriate price signals can be sent to all rate classes, based upon the above-referenced Rate Design principles.

As noted in the Application, YECL supports the introduction of tiered blocks at this time and also supports the commencement of the process that would establish rates that seek to recognize a time in the future when diesel generation will be on the margin. YECL agrees that it is important to start this process now, as long as the steps are measured and supported by the present facts and circumstances. Underlying YECL's approach is the view that it is counter-intuitive to establish a Rate Design today, that sends a group of customers within a particular rate class a signal that their rates will decrease, even though the circumstances which are supposedly being addressed are associated with a significant increase in costs, because of the increasing use of diesel generation to meet system requirements. YECL does not consider it fair or appropriate to send a group of customers a price signal that says their rates are decreasing at a time when the purpose of the Rate Design is to address circumstances when the overall costs of generation are likely to increase significantly. Such a price signal is seen as being perverse in the circumstances.

Once YECL arrived at the view that the first block should not see a price reduction, the balance of the proposals reflected in Option B became fairly clear. Again, an increase in the rates to one block would necessarily result in a decrease to the rates for another block. As such, YECL adopted modest step increases for the remaining tiered blocks. This is contrasted with the Options proposed by YEC and Leading Edge, which send inappropriate price signals to the first and third blocks.

The second main driver behind YECL's Option B is that, from a Rate Design perspective, customers should be sent a signal indicating that costs increase as consumption increases. The Rate Design should be reflective of the economic implications associated with the incremental cost of diesel generation based on the facts as we know them today. In this regard, YECL does not see a reason why certain customers within a rate class should see punitive price signals today, while other customers in the same rate class would see rate reductions today. To the contrary, all customers within a rate class should see an appropriate and consistent price signal that tells them that costs will increase if consumption increases.

In advancing Rate Design Option B YECL recognizes that it needs to begin Rate Design adjustments today to signal customers that production costs will increase if consumption is not controlled as we move into the future. However, YECL is of the view that such measures should take place in an orderly manner, in order to ensure that customers within a rate class (regardless of consumption levels) are provided the correct economic signals without resulting in rate shock, at a time when the cost signals are not actually being seen on the system. As such, while YECL fully endorses the view that actions should be commenced at this point in time, it does not agree with the position that dramatic shifts need to take place in the context of this Phase II proceeding. The other alternatives proposed herein result in such undesirable and dramatic shifts.

In sum, Yukon Electrical recognizes the need to develop an orderly process for dealing with the current cost environment and how it may impact customer rates (ie. rate shock) and in the coming years, when supply conditions with respect to high cost diesel generation in the hydro zone is more predominant (see: page 4YECL-6). YECL submits that this is best achieved via its proposed Option B.

**(ii) Reflecting Economy and Efficiency in Rates**

As noted by YECL during the proceeding, it has been unable to find a clear definition for the term "economy and efficiency" as it currently relates to Yukon (YUB-YEC/YECL-1-22; CW-YEC/YECL-1-12). Nonetheless, YECL understands that in the

past Rate Design was linked to the short-term incremental costs of diesel, in order to provide signals to customers that as consumption increases so do costs. In YECL's view, economy and efficiency embodies broader concepts which must also recognize the principle of fairness to all customers in the price signals which are being sent by the approved Rate Design. YECL is of the view that, to the extent possible, Rate Design should seek to ensure that customers pay for the costs that they impose on the system. In the Yukon context YECL acknowledges that rates for electricity are tied to some level of incremental costs. However, the challenge at this time is whether fairness to customers means designing rates in the current cost environment which incorporate a link to certain costs that are not actually forecast to be incurred for some time. This view is summarized in YUB-YECL/YEC-1-24 (p. 2) wherein it is stated that:

> "The Companies noted in 1992 submission on COS and Rate Design, that an important step in promoting efficient use of electric energy is the provision of an effective price signal to the customer, such that the price paid for extra energy consumption reflects the cost of providing that same extra energy." (emphasis added)

In this regard, YECL is very concerned that the other options placed before the Board for approval seek to impose significant costs on certain members of a customer class when those costs are not actually being experienced at this point in time.

Another guiding principle which impacts the development of an appropriate Rate Design is the desire to minimize cross-subsidization of one ratepayer group by another. Economic theory would suggest that optimal economic efficiency occurs when costs and benefits are aligned. Cross-subsidization is considered a symptom of economic inefficiency, that should be avoided to the extent possible in Rate Design. Even though a rebalancing of customer classes is not possible at this point in time, the principles of economy and efficiency should be manifested to the extent possible in the design of rates and rate blocks within each customer class. YECL submits that this can best be achieved by ensuring, to the extent possible, that customers pay for the costs that they impose on the system (CW-YEC/YECL-1-12, page 4).

### (iii) Fairness Among Customers

Another of the main drivers behind YECL's proposed Option B is to ensure that customers at all ranges of consumption see appropriate price signals. This does not occur in a situation where customers that are consuming in a low range see a rate reduction, whereas customers at a higher consumption level see a significant price increase (2T402). As noted above, a common trait of the Rate Design proposals put forward by YEC (Options A and C) and Leading Edge is that 70% of the customer bills for the residential non-government rate class would see a rate reduction when their revenue to cost ratio is at approximately 80%. At the same time, customers in this rate class at the high end of consumption would receive punitive price signals, when they may not be able to reduce consumption through no fault of their own. As noted by YECL, reducing rate shock across customer classes was an important consideration in YECL's development of its recommended Option B (see YUB-YEC/YECL-1-24). In addition, the potential rate changes, which in YECL's view demonstrate rate shock, are outlined in Tables 1 to 3 provided in YEC's opening remarks (Ex. B-14). YECL submits that adopting an option which results in such rate shock impacts is unnecessary at this time, as such rate shocks for both residential and general service customers are excessive. YECL submits that, to the extent possible, an effective Rate Design that incents customers to shift or reduce consumption should not do so at the expense of other customers. This is precisely what would occur should Options A, C or Leading Edge be adopted by the Board.

### (iv) Avoiding Unintended Consequences

As noted by YECL (see YUB-YEC/YECL-1-24) one of the other key Rate Design principles that is critical to the development of an appropriate Rate Design is that revenues collected must be adequate to recover all system costs (both fixed and variable). In fact, the recovery of approved Revenue Requirement is seen as a critical component of any Rate Design. As noted previously, the inclining Rate Design reflected in Options A, C and Leading Edge results in large step changes in rates that

are not linked to changing incremental costs. In other words, one lower kWh in sales and revenue does not result in one lower kWh in costs.

YECL would direct the Board to Table 1 of Ex. B-11 (YEC's proposed Option C) which sets out the rates by block for residential and commercial customers. As noted therein, residential customers see a 17% step change between block 1 and block 2 rates. Likewise, another 45% step change occurs between block 2 and block 3 rates. Should customers actually respond to the price signal, and hence reduce consumption, they could move from a higher block to a lower block and thereby increase the risk of revenues falling below the approved Revenue Requirement. The opposite is also true if a party moves from a lower block to a higher block.

A similar situation occurs with respect to general service rates, which would see a 37% step change between block 1 and block 2 rates and a further 55% step change between block 2 and block 3 rates. YECL views these step changes as unreasonable and unnecessarily creating a risk that the approved Revenue Requirement would not be collected. Exposing YECL to such revenue variability risk is not consistent with a responsible Rate Design.

**(v) Summary**

For all of the above reasons, YECL submits that the best option available at this time is its recommended Option B. This Option sets the process in motion to recognize that, at some future time (which is currently uncertain) diesel will be on the margin and hence customers should start to receive a price signal at this point in time.

However, as the increased costs are not actually being experienced today, it is unnecessary and unwarranted to implement a Rate Design that is rooted in such costs actually being incurred today. Furthermore, as Rate Design changes are presently restricted to intra-class movements, a significant change now will result in perverse consequences for different members of a specific rate class.

YECL submits that its Option B achieves the best balance between all of the competing objectives that the proposed Rate Design is seeking to address. YECL submits that Option B should be approved, as filed.

## 3. RIDER D

At the outset it is critical to understand that the issue before the Board in this proceeding is the approval of Rider D, which is designed to clear balances, positive or negative, from the existing deferral account approved by the Board in YECL's 2008 – 2009 GRA, Board Order 2009-2. The approval of this deferral account is not before the Board for consideration in this Phase II proceeding. Rather, the sole issue before the Board is the approval of the mechanism which would allow the balances accumulated in the deferral account, positive or negative, to be cleared. The Rider D mechanism will deal with variances between the actual and forecast cost of purchase power for the hydro zone during periods when diesel generation is on the margin and when the energy reconciliation adjustment ("ERA") in Rate Schedule 42 is evoked. As explained in YECL's response to Undertaking (Ex. B-26) Rider D will ensure that increases or decreases to the run-out rates will be flowed through to Yukon customers.

An important consideration in the approval of the requested Rider D is that YECL is simply seeking to be treated in exactly the same fashion as YEC regarding situations where diesel is on the margin and incremental costs associated with such diesel generation are incurred. There is no dispute that YEC is able to recover its costs from both YECL and its industrial customers, as per OIC 1995/90, should circumstances arise where diesel is on the margin and Rate Schedule 42 is engaged. YECL is not disputing YEC's right to collect such costs in these unforecasted circumstances. Rather, YECL is simply seeking to be treated in the same manner.

There appears to be a number of reasons why YEC is seeking to deny YECL the ability to receive similar treatment. As will be discussed below, none of these reasons have any merit and hence they should be rejected by the Board and the requested Rider D approved herein.

YEC appears to assert that YECL did not have a Rider D in the past to cover circumstances where diesel was on the margin. YECL acknowledges that this was the case, but submits that the historic circumstances referenced by YEC are significantly different from the circumstances that exist today and are forecast to prevail in the future. As noted by YECL, there is now a significant disconnect between Rate Design and the current Rate Schedule 42 (3T585). As noted by YECL (see Ex. B-26) the current rates are collecting production costs of approximately 8.3¢ per kWh. The current incremental cost of diesel is approximately 27¢ per kWh. This is in excess of a 200% increase in costs over which YECL has no control. Furthermore, the forecast is that of YEC not YECL. These circumstances are markedly different from the mid-1990s when there was a strong link between the costs and the incremental revenues, which no longer exists. As noted by YECL, the issue going forward is that there is a disconnect in terms of the revenues YECL would receive from its customers, regardless of which block they are in, and the costs which would be incurred as a result of diesel being on the margin (3T610). The significant change in circumstances which has occurred is the reason why YECL is now bringing forward the proposed Rider D to act as a mechanism to clear the previously approved deferral account.

The ERA, as part of Rate Schedule 42, is evoked when actual wholesale purchases on the WAF system exceed forecast wholesale purchases that results in YEC having to generate with diesel on the margin. In the past, the mechanism worked reasonably well as there was very little difference between the energy charges in block 1, as well as block 2 of the residential non-government hydro zone rate schedules, and the incremental cost of diesel. As a result, in circumstances where diesel generation was on the margin, the incremental revenue from usage by customers was adequate to recover the incremental costs (3T610). This is far different from the circumstances which exist today, where the incremental revenue that would be received by YECL in such circumstances would fall materially short of the incremental cost of diesel that YECL would have to pay to YEC under Rate Schedule 42. YEC appears to ignore the fact that circumstances have changed materially. As such, references to the distance past are of no assistance in understanding why the current requested Rider D is appropriate.

YEC also appears to suggest that YECL is already compensated for the risks associated with the above circumstances in its approved Rate of Return. Curiously, YEC itself does not appear to consider that it is already compensated in its approved return for this very same risk. Rather, it requires an ability to flow-through the incremental costs it incurs pursuant to Rate Schedule 42 as a measure in addition to, and outside of, its approved Rate of Return. YECL submits that there is not a shred of evidence on the record which supports the view that YECL should be exposed to this risk when YEC is covered, via a separate and distinct mechanism (being Rate Schedule 42), so that it can recover its costs associated with the incurrence of the very same event. Furthermore, this risk did not exist in the past and there is no evidence to suggest that it was taken into account in the establishment of the approved Rate of Return. In fact, this is why YECL sought and obtained approval of the associated deferral account. YECL submits that it is entirely inconsistent for YEC to suggest that it is not covered for these circumstances by its Rate of Return yet somehow YECL is covered for this event. As stated above, YECL is not advancing a position that YEC should not be entitled to recover these reasonably incurred legitimate costs. To the contrary, YECL is suggesting that both utilities should be treated in the same manner and that both should be entitled to such recovery.

In addition, as noted in Information Response UCG-YEC/YECL-21, YECL indicated that similar Rider mechanisms are provided in other jurisdictions, including the Northland Utilities in the Northwest Territories. YECL submits that these mechanisms are a recognized manner of dealing with a risk that is not normally absorbed by the utility and which allows appropriate recovery of these unforecasted costs from customers.

Furthermore, as noted by YECL (3T553) it is important to understand that this proposed Rider provides a degree of protection for both the company and customers regarding circumstances beyond their control. If YECL faces circumstances where it could incur these significant costs and the requested Rider mechanism has not been approved YECL will have no choice but to trigger a Phase I Rate Application and force the incurrence of the significant costs associated with a rate proceeding. This would

obviously lead to significant additional costs for customers. YECL submits that this is not a desirable result.

In summary, YECL submits that the approval of the requested Rider D is not only consistent with the establishment of the deferral account, which was previously approved during YECL's Phase I Application, but is also consistent with properly addressing the risks to which YECL is exposed and providing it with an opportunity to recover its reasonably and prudently incurred costs. As noted, YEC has a mechanism to pass these very costs along to YECL and we are now dealing with the situation of whether YECL could likewise collect such unforecasted and potentially significant costs. YECL submits that it is fair and appropriate that it be entitled to recover costs that it must pay to YEC in these circumstances. As such, the requested Rider D should be approved as filed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 22nd day of October, 2010.

Loyola Keough
Counsel for Yukon Electrical Company Limited