Before the Yukon Public Utilities Board

In the Matter of:

THE YUKON ELECTRICAL COMPANY LIMITED ("YECL")
2008 - 2009 GENERAL RATE APPLICATION

REPLY ARGUMENT OF
THE CITY OF WHITEHORSE ("CW")

NOVEMBER 10, 2008

Introduction

This Reply Argument is submitted to the Yukon Utilities Board (the Board) on behalf of the City of Whitehorse (CW or the City) in reply to the positions advanced in Argument by the Yukon Electrical Company Limited (YECL) which the City considers to be in error, are incomplete or which unfairly represent the evidence presented in this proceeding. Lack of response to any the positions advanced by YECL or any other party should not be considered as acceptance of those positions. CW has received argument from and reviewed the arguments of the Utilities Consumer Group (UCG), Leading Edge, and the Yukon Energy Corporation (YEC).

The Evidentiary Record

YECL makes the broad claim that the only evidence on record has been put there by YECL and, by implication, that YECL's voice is the only voice to which the Board should pay attention.

> "On the matter of evidence, it should be absolutely clear that the only evidence on the record to these proceedings is that put forward by Yukon Electrical. This would include the original Application, the Supplementary Information filings by Yukon Electrical, Responses to Information Requests, oral testimony and responses to Undertakings. "[1]

Whereas YECL was the only party providing witnesses, it is not correct that the only evidence on the record is that of YECL. The Exhibits entered by parties other than YECL also form part of the evidentiary record. CW submits that the complete evidentiary record must be given weight by the Board.

As well, it is undeniable that the Board is free to draw its own conclusions as to the proper interpretation of and conclusions to be drawn from the evidence. The conclusions of the YECL witnesses and their interpretation of the facts are no more binding on the Board than those of any other party.

---

[1] YECL Argument, p. 3

The evidence provided by YECL's witnesses consists of both facts and opinions. CW does not dispute the hard facts placed on the record by YECL. It is the norm in rate applications that the evidence on the company's operations, finances and plans must come from the company itself. CW, as well as other intervenors, disputes many of the opinions and conclusions reached by the company's internal and expert witnesses. Even an expert witness with an extensive résumé, such as Ms. McShane, acknowledges that nothing in her particular area of expertise is a "precise science".[2]

The Board is the trier of fact and the trier of law. Before it finds that the evidence establishes a particular fact it must be satisfied that sufficient evidence has been provided on the point to discharge the onus. Where the Board finds the evidence to be inconsistent, flawed or unconvincing, it is free to reject it and find that it does not support a particular proposition, even if YECL claims that it does. Pursuant to subsection 52 (a) of the *Public Utilities Board Act,* the Board has the exclusive jurisdiction and authority to determine any question of fact, law, or mixed fact and law required to be decided."

Sales Revenue

Aggregate Approach versus Community by Community

CW suggested at the hearing that an aggregated approach to forecasting would be more appropriate than a community by community analysis because statistical analysis based on a larger data set would be less affected by irregularities and inconsistencies.[3] In its argument, YECL responds by citing the 'amount' of data used as the key reason why its method provides a more accurate forecast than any "general approach."[4] CW submits that this reasoning is flawed. YECL reemphasizes in argument its strategy to base its sales forecast statistical analyses on the 'maximum amount' of information accessible, which CW submits does not equate to the 'best' methodology available. YECL

[2] Tr. p. 170, ll. 7 - 8
[3] Tr.288
[4] YECL Argument, p. 6

highlights that it provided "a large amount of documentation"[5] and that YECL "makes use of all the data available."[6] CW submits that maximizing the amount of data used, for its own sake, is misguided because the mere availability of certain data does not prove its relevance to the process, its general appropriateness or its consistency with other forms of data used by YECL in the statistical analysis.

YECL also supported its forecasting methods as follows,

> "..., Yukon Electrical made use of historical information and utilized known and accepted methods, including the use of regression analysis, to develop its detailed forecasts."[7]

In the next section, CW responds to YECL's comments concerning the forecasting method of extending a trend line. CW notes that such a method also makes use of historical information and utilizes known and accepted methods, including regression analysis, to develop its detailed forecasts.

Trend Line

In criticism of CW's suggested approach, YECL states:

> "Whitehorse went on to suggest that Yukon Electrical could simply extend a trend line based on past forecasts. Yukon Electrical submits that there are several points that must be noted regarding these views. First and foremost, Yukon Electrical has used a standard, consistent and logical approach to its forecasting and has not abandoned this approach when it would be convenient to do so. For example, even though the information confirmed that the residential use per customer for the City of Whitehorse was in fact declining on a trend basis, Yukon Electrical is proposing to use a three year normalized average notwithstanding the fact it is greater than the actual 2007 normalized UPC number."[8]

YECL's only purported criticism of CW's proposal to forecast UPC by extending a trend line seems to take the form of a defence of the proposed YECL methodology. As referenced in the above quotation, YECL claims that it has "used a standard, consistent

---

[5] YECL Argument, p. 5
[6] YECL Argument, p. 6
[7] YECL Argument, p. 6
[8] YECL Argument, p. 7

and logical approach to its forecasting and has not abandoned this approach when it would be convenient to do so." This implies that extending a trend line is not standard, consistent or logical. CW submits that the method of extending a trend line is standard practice as it has been adopted by the Alberta Utilities Commission, especially for smaller utilities in its jurisdiction.[9] It is a concise all-encompassing method, there is no inconsistency, and it is clearly logical. On the other hand, CW submits YECL's approach is neither standard, consistent, nor logical, as demonstrated by the discussion in this section. CW is not proposing that YECL change its forecasting approach because of convenience, as suggested in the above quote, but because YECL's methodology is demonstrably flawed. By contrast, CW's proposed trend line for residential customers' UPC is simple, sensible and better than YECL's methodology.

YECL's argument uses the above quotation to attempt to demonstrate the consistency of its forecasting process. YECL suggests that by proposing to use the three year normalized average for the City of Whitehorse even though that value is greater than the actual 2007 normalized UPC number, YECL is holding fast to its chosen methodology, which it touts as a consistent approach.

CW submits YECL's position is flawed for three reasons. First, the downward trend of the City of Whitehorse's residential annual normal UPC over the years 2005 through 2007 is very slight, averaging only 0.005% reduction per year from 10,585 kWh in 2005 to 10,472 kWh in 2007, so the difference between using a three year average versus a three year trend is not substantial. Second, CW is proposing a five year trend for total residential UPC, not a three year trend. Over that five year period from 2003 through 2007 the City of Whitehorse's residential annual normal UPC has actually trended upward from 10,367 kWh in 2003 to 10,472 kWh in 2007,[10] which is directionally similar to the trends of other communities. Accordingly, CW submits a 5 year trend is

[9] See for example Decision 2007-094 of the Alberta Utilities Commission at pages 26 to 28 in which the Commission adopted usage forecasts based on 5 year trend lines
[10] Application, Section 2, Attachment 1, p.1of 3

superior to a 3 year trend. Third, CW submits that YECL's approach is in fact a model of inconsistency. CW notes specifically that YECL's normalization process adopts all of the following normalization procedures at different points along the way:

- One year of normalized data using a normalization equation and a regression analysis;[11]
- Three year average of normalized data using a normalization equation and regression analyses based on 20 year HDD;[12]
- Three year average of normalized data using a normalization equation and regression analyses based on 12 year HDD;[13]
- Three year average of actual data; [14]
- Direct adjustment of normalized one year data.[15]

While CW recognizes there are numerous ways to "normalize" data, consistency suggests that the same method be used throughout any particular normalization process. CW submits that what is clearly not desirable is YECL's patchwork quilt methodology that picks and chooses among various different normalization methods in various situations. As such, CW is surprised with the following statement from YECL's argument:

> "In Yukon Electrical's view, it is entirely inappropriate to pick and choose the approach to be used, simply to achieve a predetermined end goal."[16]

Having used 5 different methods of forecasting UPCs among Yukon communities, CW submits YECL's actions speak louder than its words. It would appear that it is YECL that it is picking and choosing their methods at their discretion. It would not be unreasonable to infer that this is with the endpoint clearly in mind. CW submits that the above list of YECL's diverse normalization procedures not only demonstrates a lack of consistency in YECL's statistical analysis and normalization process, but also shows that the "pick and choose" tactics rebuked by YECL in the above quotation are the very foundation for YECL's own statistical analysis.

---

[11] Application, Section 2, p.2-3, lines 4-5
[12] Application, Section 2, p.2-2, lines 18-21
[13] Application, Section 2, p.2-2, lines 18-21
[14] CW-YECL-14(d)
[15] Application, Section 2, p.2-3, lines 9-11
[16] YECL Argument, p. 7

Notwithstanding the irony of the comment, it is clearly directed towards discrediting the forecasting method of extending a trend line. CW submits that a simple trend line as put forth by CW in its argument, unlike YECL's statistical analyses, does not have predetermined goals and the results speak for themselves.

Commercial Sales

YECL states,

> "Yukon Electrical submits that it has developed a rigorous and detailed forecast of expected changes in customers and use per customer for each community it serves for the Test Period. In fact, each aspect of Yukon Electrical's forecast is supported by detailed information and has been adjusted for known or one time events. For example, Yukon Electrical chose to use one year of actuals for Whitehorse Commercial UPC, in order to capture the impact of the arrival of several large institutions and big-box stores in 2007 and also to be able to adjust for the impact of the Canada Winter Games."[17]

To be clear, YECL is simply wrong in stating that its forecast is supported by detailed information as it pertains to the commercial UPC. As outlined in CW's argument, due to confidentiality issues, detailed information about forecast new commercial customers for 2008 and 2009 was not made available by YECL. Rather, the information provided was very general in nature.

Also CW notes YECL's reference to its choice to use, "one year of actuals for Whitehorse Commercial UPC, in order to capture the impact of the arrival of several large institutions and big-box stores in 2007..." This is not consistent with the description in the application which states that these larger commercial customers have, "come on line in 2005, 2006 and 2007."[18] Therefore, CW submits the use of the trend line for forecasting Commercial UPC discussed in CW's argument is more appropriate because it truly captures the impact of all commercial customers coming online in 2005,

---

[17] YECL Argument, p. 8

[18] Application, Section 2, p.2-3, lines 8-9

2006 and 2007, not just 2007 as proposed by YECL. Also, the R^2 value for the 5 year commercial trend line put forward by CW in its argument is 0.8445, which represents a good fit.

Depreciation

ASL vs. ELG Methodology

In Argument, CW deferred to YEC on the matter of Average Service Life (ASL) versus Equal Life Group (ELG) remaining life methodology for calculating depreciation rates and, hence, expense. YEC strongly recommended that the Board direct YECL to discontinue use of ELG and adopt the ASL method.[19] CW will not review all of YEC's reasons for this recommendation except to say that it is in agreement with YEC's reasoning. CW will address only one of the points in YEC's argument and that is the matter of consistency.

CW submits that consistency and even-handedness of regulation is the primary factor that reduces regulatory risks. Consistent regulation does not mean that the regulator should accept everything that the utility proposes in an application. Investors expect that the Board will accept many of the intervenors' proposals for mitigating the effects of rising costs. Consistency does mean that investors expect that issues in an application should be treated by the regulator in a consistent manner from application to application. Investors expect a predictable outcome on contentious issues based on the regulator's past treatment of the issue for other utilities under the Board's jurisdiction. In this respect, YECL's evidence is that the Board has been an even-handed and consistent regulator.[20] As the Board has approved the ASL method of depreciation for YEC, it would be consistent to adopt the same treatment for YECL.

In adopting the ASL method, the Board should bear in mind that it is not preventing YECL from recovering its capital investment; YECL will recover all its invested capital

[19] YEC Argument pp. 16-18
[20] CW-YEC-40

over time. YEC's recommendation does not disallow depreciation expense but it defers the expense. CW submits that treating depreciation of YECL in a consistent manner reduces regulatory risk and the resultant rate of return required by the utility. It also has the effect of lowering costs and revenue requirement during the test period and hence mitigating any requirement for rate increases.

Negative Net Salvage

YECL provides for site restoration and remediation costs by including these costs as negative net salvage in its depreciation rates. CW noted in argument the inconsistent accounting for site restoration and remediation costs between YEC and YECL.[21] YEC also noted the inconsistent treatment of the two utilities in argument and requested that the Board make an order similar to the direction in Board Order 2005-12 regarding YEC's FRSR fund.

> "In order to provide consistent regulatory direction to both utilities, and to provide test year revenue requirement reductions of material benefit to ratepayers and without penalty to either utility, Yukon Energy recommends that the Board direct YECL to discontinue recording its annual depreciation provision for FRSR costs effective January 1, 2008, along with other related directions consistent with Board Order 2005-12 directions to Yukon Energy on FRSR related matters."[22]

While CW considers that it is appropriate to collect certain future costs in the present, over-collecting negative net salvage through rates results in present customers paying the costs of future customers. If the actual cost of site restoration and remediation is less than what was collected in rates, intergenerational inequity will result. Furthermore, if an unused surplus of salvage costs continues to accumulate, at some point, a proposal from YECL to simply flow the portion not required to shareholders can be expected. One can imagine YECL's argument simply being that forecasts were based on the best information at the time, that forecasts can be wrong either way and if the money is no longer required for utility service, then it belongs to shareholders. This approach would

[21] CW Argument, pp. 25-26
[22] YEC Argument, page 20

be consistent with that taken by YECL's affiliates in applications such as the Harvest Hills application before the Alberta Utilities Commission[23].

CW notes that YEC estimates the amount of total accumulated negative net salvage at year-end 2007 to be $4,688,000 and forecast to grow to $6,448,000 over the test years and historically has spent less on negative net salvage than it has collected in rates.[24] CW submits that the Board should apply the same reasoning to YECL's accumulated negative net salvage as the Board applied to YEC in Board Order 2005-12 and cap YECL's provision for site restoration and remediation by removing negative net salvage from YECL's depreciation rates. Consistent regulation of different utilities results in a reduction of regulatory risk to all utilities.

Cost of Debt

YECL requests that the Board accept a 2008 forecast cost of 6.60% of debt for the $2,150,000 issue rather than the 5.563% rate that was actually mirrored down from its parent.

> "While Yukon Electrical recognizes that this debt rate is below that included in its Application, it reiterates the view that the forecast included in its Application was based on the best information available at the time and, as such, should be accepted by the Board and approved as such."[25]

CW disputes YECL's assertion that its forecasted cost of debt was based on the best information available at the time. The 6.60% forecast is based on an outdated forecast of long Canada yields and a premium that was based on a sister utility's general rate application, not the advice of the staff at the entity that would actually be issuing debt.

---

[23] See AUC Decision 2007-101, at pages 2-6. The Decision deals with an application by ATCO Gas to sell a four acre parcel of land within its rate base to a buyer for a sale price in the range of $1.6 million and flow all of those proceeds to customers. Although the land was part of a larger lot originally purchased for construction of a regulating station, ATCO's position was that the land to be sold was not required for utility service.

[24] Tr. p. 71, l. 26 – p. 72, l. 14

[25] YECL Argument, p. 28

There is evidence that YECL knew at the time of filing that CU was actually issuing debt at a coupon rate that was well below its forecasted rate in the Application.[26] Finally, it is inconsistent of YECL to request that the amount of the issue be adjusted to reflect the actual issue amount but that the issue rate should not be adjusted to actual.

Return on Equity and Capital Structure

YECL's argument on return on equity capital structure appears to be a recounting of Ms. McShane's methods. CW and the Board understand quite well Ms. McShane's method and there is no need to reply to the bulk of YECL's argument on this matter. CW takes issue with YECL's concluding characterization of Ms. McShane's results.

> "In summary, Ms. McShane's analysis demonstrated that a common equity ratio at the upper end of the range of 47.5% to 52.5% would be required to fully compensate for Yukon Electrical's higher business risks, to be consistent with debt ratings in the A category, and, in conjunction with an ROE applicable to an average risk Canadian utility, would meet the comparable returns standard."[27]

In fact, Ms. McShane's recommendations result in an interest coverage that is well above the comparable returns of her own sample.[28] Only the recommendation of CW of an ROE of 8.75% and an equity ratio in the 40-42% range results in an interest coverage ratio that is comparable to that of an average Canadian electric utility.[29]

<u>The Northlands Utilities</u>

In Argument, CW noted the relevance of Ms. McShane's comparison of Northlands Utilities Limited Yellowknife (NUL (YK)) as the Canadian utility most comparable in risk to YECL.[30] Ms McShane made this comparison despite the fact that YECL is nearly twice as big as NUL (YK) and eight or nine times as big as NUL Northwest Territories

---

[26] Tr. p. 178, ll. 12 - 19
[27] YECL Argument, p. 26
[28] Undertaking to Mr. Marriott Tr. p. 172, l. 27
[29] Undertaking to Mr. Marriott Tr. p. 173, ll. 1-3
[30] CW Argument, p. 32

(NWT).[31] The Public Utilities Board of the Northwest Territories (PUBNWT) released on October 27, 2008 Decisions 24-2008 and 25-2008 regarding the 2008/09/10 general rate applications of NUL (YK) and NUL (NWT) respectively. In summary, the PUBNWT awarded these two sister utilities of YECL the following prospective rates of return and deemed equity portion of capital structure:

Table 1 – Awards of the PUBNWT For 2008, 2009 and 2010

	NUL (YK)[32]	NUL (NWT)[33]
Return on Equity	9.1%	9.1%
Equity Portion of Capital Structure	43.5%	44%

CW notes that the ROE awards represent a 35 basis point premium over the AUC's 2008 generic return on equity of 8.75%. The PUBNWT based the 9.1% return on equity on a forecast long Canada bond yielding 5%, 50 basis points higher than the rate of Ms. McShane's forecast long Canada bond. Correcting for the different forecast in bond yield and the 75% change in equity risk premium associated with the change in the risk-free rate in the AUC method, the NWT's award equates almost exactly to the 8.75% as recommended by CW.

Concerning risk factors, the Board stated:

> "The Board agrees NUL's business risks are somewhat higher than those of an average electric utility due primarily to its small size and economic characteristics of the service area. On the other hand NUL does not own generation assets, which suggests, lower regulatory risks compared with an integrated utility. Further NUL's purchased power costs and certain significant capital additions are subject to deferral account treatment. In the Board's view these factors would tend to have an offsetting effect on the increased risk resulting from small size and economic characteristics of the service area."[34]

---

[31] Tr. P. 190, ll. 18 - 20
[32] PUBNWT Decision 24-2008, dated October 27, 2008
[33] PUBNWT Decision 25-2008, dated October 27, 2008
[34] PUBNWT Decision 24-2008, pp. 14 -15

These factors are almost the same factors included in Ms. McShane's assessment of YECL's risks. Clearly the PUBNWT placed greater weight on the size factor as the smaller of the two NUL utilities has the greater thickness of common equity in its capital structure. Since YECL is twice the size of NUL (YK), the PUBNWT awards should accordingly be adjusted downward to correspond to the upper end of CW's recommended common equity thickness for YECL.

The PUBNWT noted the results of its awards on FFO interest coverage:

> "The Board notes the coverage ratios resulting from a 43.5% common equity ratio together with a 9.1% return on equity will not be out of line with those achieved by NUL in 2006. The Board notes the FFO interest coverage ratios in 2008, 2009 and 2010 of 4.0, 4.2 and 4.2 would be higher than those applicable to the average Canadian utility of about 3.8 times. (McShane Testimony, p. 29, *l.* 762)"[35]

In the case of NUL (NWT), the PUBNWT noted that the ROE and capital structure awarded in Decision 25-2008 would result in FFO interest coverage ratios in 2008, 2009 and 2010 of 4.3, 4.8 and 4.9, also greater than the Canadian average.[36] Although the results are not out of line with NUL (YK) and NUL (NWT)'s actual results, the PUBNWT acknowledged that the prospective results of the awards are extremely generous compared to the Canadian average. Ms. McShane justifies placing YECL's FFO interest coverage well above the average on the basis of YECL's higher business risks.

> "...an FFO Interest Coverage ratio for Yukon Electrical in the range of 4.2X to 4.7X would be higher than the achieved ratios of other Canadian transmission and distribution utilities (3.8X), which would be reasonable given Yukon Electrical's higher business risk."[37]

However, at the hearing Ms. McShane was unable to identify any business risks of YECL that exceeded the risks of an average Canadian utility.[38] CW submits that YECL has not

---

[35] PUBNWT Decision 24-2008, p. 17
[36] PUBNWT Decision 25-2008, p. 16
[37] Report of Foster and Associates, page 30, ll. 797 - 800
[38] CW Argument, pp. 30 - 32

established in evidence or provided any credible argument as to why its FFO interest coverage ratio should exceed the Canadian average and, therefore, why its equity thickness should lie outside the 40-42% range.

It is always difficult to compare the awards of different regulators' prospective returns of utilities because it involves an element of circularity. Nonetheless, CW considers that the PUBNWT Decisions 24-2008 and 25-2008 support CW's recommendations of 8.75% return on equity and a range of 40-42% equity portion of deemed capital structure. CW's recommendations are appropriate for YECL after adjusting for the relative sizes of the three utilities compared, the differences in the forecast of the long Canada rate and for the PUBNWT awards for three test years rather than YECL's two test year period.

All of which is respectively submitted on behalf of the City of Whitehorse this 10th day of November 2008.

Brownlee LLP
Solicitors for the City of Whitehorse

Per:
THOMAS D. MARRIOTT