In the Matter of:

THE YUKON ENERGY CORPORATION ("YEC")
2008 - 2009 GENERAL RATE APPLICATION

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

June 5, 2009

1. Overview

1. Introduction

The City of Whitehorse (the City) filed argument in these proceedings May 22, 2009 on a limited number of issues of concern to its citizens and businesses, who are residential and commercial class customers of Yukon Energy Corporation (YEC). Concurrently on May 22, 2009, the Applicant YEC filed argument as well as intervenors Leading Edge Projects Inc. (LE) and the Utilities Consumers Group (UCG). The City will reply to a number of issues raised by the Applicant and other intervenors. The absence of reply on any particular issue raised by any party does not constitute agreement with that party's position on that issue.

2. Wholesale Sales to YECL (Issue 2 b. i)

YEC states in its Argument (p.11) that its 2008 and 2009 wholesale forecasts are reasonable and should be adopted.[1] However, YEC then proceeds to explain why the 2008 forecast is not as accurate as either YECL's initial 2008 forecast from the YECL GRA or the revised forecast from YECL's compliance filing.[2] YEC then defends the inaccuracy in the 2008 forecast by stating that since other forecasts such as O&M were also imprecise, it was not appropriate to pick and choose which forecast items to update.

CW submits that this very discussion makes it clear that YEC's 2008 wholesale forecast is not the best information available and YEC's defense of the inaccuracy of the forecast is deficient. CW submits that, where appropriate, YEC should use the best information available. CW submits it is appropriate in this case for YEC to be directed to adopt YECL's revised 2008 wholesale forecast (263,765 MWh)[3] not only because it is significantly more accurate than YEC's 2008 wholesale forecast (258,989 MWh)[4] but also because the revised forecast from the YECL compliance filing is GRA-tested and Board approved. Similarly, CW submits YEC should be directed to adopt the

[1] YEC Argument, pp11-12
[2] YEC Argument, pp11-12
[3] Ex. C2-7, Revised Schedule 3.1
[4] Ex. B-10, Schedule 11, line 31

revised 2009 wholesale forecast (267,747 MWh)[5] because it is GRA-tested and Board approved and also is very similar to the YEC forecast for 2009 (266,926).[6] CW notes that YECL in its argument (p.6) agrees with CW's position in this matter, stating that, for purposes of YEC's test years, the forecast recently approved by the Board in the context of the YECL 2008-2009 GRA should be approved for YEC as well.

YEC states in its Argument:

> "YEC's simplified forecast methods are also consistent with comments made in Board Order 2009-2 regarding the detailed and data-intensive statistical forecasting methods used by YECL. In that Order the Board acknowledges 'YECL performed a great deal of detailed analyses to arrive at its sales revenue forecasts as outlined in the Application', but notes that it 'is not convinced that a more simplified approach could not achieve reasonable results with far less effort and cost to ratepayers.' "[7]

CW disagrees with YEC's assertion in the quote shown above that YEC's forecasting methods are consistent with comments made in Board Order 2009-2 regarding the detailed and data-intensive statistical forecasting methods used by YECL. CW submits that the Board does not specify what a "more simplified approach" would look like, but was obviously addressing YECL and referencing YECL's forecasting methodology. CW submits that a "more simplified approach" to YECL's forecasting methodology is still likely considerably more complex and involved than YEC's very simple proposed methodology. CW agrees with the comments of YECL in its Argument (pages 5-6) that YEC relies upon a simple forecasting methodology, with no weather normalization, despite clearly acknowledging that weather directly impacts monthly sales and that YEC's arbitrary selection of a given period does not translate into the most appropriate forecast to use for GRA purposes.

3. Fuel Costs (Issue 3 b)

YEC continues to base its fuel costs on an outdated forecast and at a cost that is inconsistent with YECL. YEC cites several reasons for this inconsistency:

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[5] Ex. C2-7, Revised Schedule 3.1
[6] Ex. B-10, Schedule 11, line 31
[7] YEC Argument, p.14

> "As noted in response to YUB-YEC-1-30 (and in discussion at transcript page 235), and following past practice in Yukon (including YEC 2005 hearing and YECL 2008/2009 GRA) YEC is seeking approval of the fuel price forecast as initially filed in October 2008 and is not seeking to further update that forecast. The Application was filed using the best information available to YEC at the time. Fuel prices have been volatile since 2008 and are likely to remain uncertain for the future. Historically in the Yukon, a GRA fuel price forecast is typically retained as filed with any subsequent adjustments made, as required to deal with variations between actual prices paid and GRA forecasts, through the Rider F process.
>
> CW-YEC-1-16(e) describes the impacts that would follow were the fuel price forecast updated to then current fuel price levels noting the combined impact would have an overall adverse impact on the revenues required from firm rates of approximately $0.448 million (i.e., the overall rate decrease would be lower)."[8]

YEC's reasons can apparently be summarized as follows: 1) past practice; 2) the forecast is based on the best information available; 3) the forecast really doesn't matter as deferral accounts will take care of the admittedly pessimistic fuel price forecast; and 4) YEC's revenue requirement will increase if the fuel price forecast is decreased. Reasons 3) and 4) have been adequately discussed in the City's argument.[9] The matter of updating applications to the best available information at the time of the hearing, reason 2), was discussed with respect to the cost of debt but is equally applicable to the forecast cost of fuel. For regulatory purposes, the best forecast of the cost of fuel is the cost of fuel set for YECL in Order 2009-2, or $0.96/litre.

With respect to past practice, it is trite to say that the past does not necessarily govern the future. This is intimated by YEC's argument that "Fuel prices have been volatile since 2008 and are likely to remain uncertain for the future." Volatility implies that what goes up will with equal probability go down. The evidence[10] filed by YEC is that fuel prices have definitely declined since the date of this "best information available to YEC".

[8] YEC Argument, page 18.

[9] Argument, pages 8-10

[10] Ex. B-11, CW-YEC-1-16 (e)

4. Insurance for Reserve for Injuries and Damages (RFID) (Issue 3 g.)

YECL discusses the RFID and concludes that YEC requires a formal, concise policy for the operation of the RFID and the materiality criteria for charges to the RFID.[11] The City agrees with YECL that formal policies are required beyond the CFO's discretion[12] and beyond the advice of YEC's insurance broker.[13] However, the City considers that any changes to the RFID must include all insurance as part of a review of the utility's risk management strategy. The City recommends that an independent risk management consultant determine the appropriate balance between self-insurance, deductible amounts, commercial insurance and the criteria for charging repairs to the RFID versus normal operations and maintenance expense.

5. Cost of Service Study (Issue 4)

YEC now professes to understand the Board's intentions respecting separating revenue requirement matters (Phase I) from rate design matters (Phase II) in its opening statement[14] and confirmed in argument:

> "Yukon Energy also understands, through Board Order 2009-1 and Exhibit A-10, that it is the Board's desire that a joint YEC/YECL cost-of-service study now be undertaken and a that a joint YEC/YECL Phase II application be prepared for review by the Board. Yukon Energy has proposed to YECL that as soon as possible following this hearing, the two utilities meet to discuss and plan the joint YEC/YECL Phase II application."[15]

The City understood that no rate changes would be proposed in this proceeding when YEC stated "While the joint cost-of-service study is being prepared, we have proposed to YECL that rate design issues and options also be examined. This will include rate design changes based on current relevant OIC directives not dependent on cost-of-service study outcomes, as well as planning for future rate design issues that will arise once the OICs expire in 2012."[16] Now it appears as if YEC is proposing rate design changes prior to obtaining the results of a cost of

[11] YECL Argument pages 9 -10
[12] YECL-YEC-1-29 (a)
[13] Tr. p. 117, lines 1 - 7
[14] Tr. p. 35, line 12 – p. 36, line 14
[15] YEC Argument, p. 29
[16] Tr. p. 36, lines 6 -14

service study, including a proposal to sidestep the results of Order 2008-16 through its Rider U proposal.

The City submits that no rate restructuring should be carried out in advance of a cost of service study because the cost of service study provides the evidence for changes in rates. This is because the cost standard is the standard by which rates are judged to be just and reasonable. This Board has long recognized the cost standard in rate design by approving an objective of 90% to 100% and setting a target objective of 95% to 105% for the revenue to cost ratio of all customer classes in its 1992 report on cost of service and rates.[17] The City recognizes that there may be some conflict between the cost standard and the constraints of the various Orders-in-Council of the Yukon Territorial Government[18] that will require resolution in a Phase II process, which YEC now recognizes is necessary.

The City, in argument, suggested several areas that could be explored in the Phase II Application in addition to cost of service. These included:

> "...issues of fairness of treatment among rate cases, the validity of the assumptions underlying the proposal, whether there may be viable alternatives to the proposal such as increasing green generation of all kinds in combination with demand side management initiatives, the movement towards pricing based on the incremental cost of diesel without corresponding evidence that the cost of providing the power during the test periods will require diesel generation, the effect of the rate increase on consumers and their behaviors and the question of whether a movement to burning fuel oil for residential space heating would be a net benefit or detriment to the environment.[19]

and;

> "The City notes that there are a number of matters to be dealt with in the Cost of Service/Phase II process unrelated to the matter of increases across rate classes. YEC refers to directions from Decision 2009-2 regarding DSM and IPP initiatives.[20] The City also notes that YEC's evidence states that current

[17] Review of Cost of Service to and Rates charged to Electricity Customers in the Yukon, June 1, 1992
[18] Application, S. 10
[19] Argument page 2, footnote 4
[20] Ex. B-13, and Order 2009-2, page 42

> residential fixed charges do not recover their fully allocated costs.[21] YEC in the Application proposed increases to the energy runoff rate for the residential rate class based on the marginal cost of diesel generation. The City believes that some weight should be given to the cost of service when designing the components of rates."[22]

The City notes that YEC's argument appears to support none of these matters as appropriate considerations for a Phase II Application. The City submits that all these matters are in the public interest and should be included in any joint Phase II proceeding.

6.0 Return on Rate Base

6.1 Yukon Energy Fair ROE for 2008 and 2009 (Issue 8. b)

The City, in its argument,[23] accepts the ROE as filed by YEC based on the BCUC formula for both test years. LE reluctantly accepts the ROE as filed by YEC despite its opinion that the risks of YEC are minimal.[24] The UCG apparently accepts the BCUC formula but does not accept the 52 basis points additional risk premium requested by YEC.[25] The City does not agree with the UCG's proposition for two reasons. First, the adjustment of risk premium to fit a utility's risk profile is an essential feature of the BCUC model.[26] The City argued in YECL's GRA that a regulator's generic ROE method results in a valid fair return as long as the BCUC's method is followed in its entirety. Secondly, the risk premium requested by YEC is subject to a legislated reduction of 50 basis points, resulting in a net risk premium of two basis points.[27] The City does not consider two basis points return on 40% of capital structure to be a material reduction in these proceedings. The City submits that the Board should approve YEC's ROE of 8.64% for 2008 and 8.49% for 2009.

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[21] Ex. B-11, CW-YEC-1-11 (a & b)
[22] Argument, page 14
[23] Argument of the City of Whitehorse, p. 15
[24] LE Argument, S. 18, p. 11
[25] UCG Argument, p. 30, paragraph 166 and ff.
[26] YECL 2008-2009 GRA Application S. 8, p.5, lines 136 - 141
[27] Tr. p. 312, lines 10 - 18

YECL recommends neither approval nor denial of YEC's filed ROE. YECL argues that the BCUC method as employed by YEC does not constitute a precedent. YECL suggests that "more refined and more recent approaches" should be considered by the Board in the future. The City agrees with YECL that the Board is not bound by any precedent to use the BCUC approach in future proceedings. However, the City does not agree that a more "refined" and presumably more complex ROE model will result in a more fair return. The Board should judge a result not by the complexity or level of "refinement" of the tests employed to obtain the result but by whether the result is fair to the customers as well as the utility's shareholder(s). The relative cost of differing methodologies is also a legitimate concern to be weighed against any evidence of improved fairness or accuracy. The City submits that, in these proceedings, the BCUC method has provided a fair and equitable result, at minimal cost to ratepayers.

6.2 Cost of Debt (Issue 8. c. ii)

YEC states that "In accordance with the financial policy (attached to CW-YEC-1-26) interest rates attached to the YDC advances are the Long-Term Benchmark Canada Bond Yields for December 31 of the respective year plus 120 basis points. In accordance with the financial policy (attached to CW-YEC-1-26) interest rates attached to the YDC advances are the Long-Term Benchmark Canada Bond Yields for December 31 of the respective year plus 120 basis points." If YEC were following this policy with respect to its Application, it would have updated its 2008 cost of new debt to the actual rate of 4.65%, as noted by Mr. Osler at the hearing, not the 5.28% as filed and not updated. YEC does not defend its filed cost of debt except to erroneously state that the 5.28% reflects the financial policy attached to CW-YEC-1-26.

The City notes that YEC's refusal to update its cost of new debt is inconsistent with its position taken in argument[28] and reply in the recent YECL proceedings where it stated:

> "Each intervenor in this proceeding has raised significant concerns related to the accuracy of YECL's calculated cost of debt. <u>While YECL argues that its cost of debt was based on the "best information at the time" CW has noted that YECL</u>

[28] YEC Argument in YECL 2008-2009 GRA, page 41

> had ample warning that the forecast Canada bond yields in the 2008 test year would be significantly lower than forecast in November 2007.
>
> Yukon Energy agrees with CW as to the reductions that should be ordered for YECL's cost of new debt in 2008 and 2009."[29] (emphasis added)

The City submits that there was equally an "ample warning" between YEC's original filing and its updated filing that the cost of debt, as originally filed, was too high.

YEC states that "The cost of debt is forecast to increase to 6.19% in 2009 up from a level of 5.18% in 2005." The City estimates that the forecast 2009 embedded cost of debt will decline by 5 basis points to 6.14% if the Board accepts 4.65% as the best information available for the cost of new debt. This 5 basis point reduction excludes any benefits that would accrue to customers from immediately renegotiating the TD Canada Trust Note. As noted in the City's argument, the repayment terms are likely not as onerous as YEC claims.[30]

7.0 Matters Raised by Other Parties

7.1 Rates to Recover Revenue Requirement

The UCG at three different points proposes that the existing interim rates continue in place with any surplus or deficiency to be refunded or collected only after the Phase 2 process has been completed.[31] The details of the proposal are provided as follows:

> "4. UCG submits that once YEC's 2008 and 2009 revenue requirements are established by the Board, existing rates should continue to be applied until the Board makes a determination on rates following the upcoming Phase 2 review. UCG a deferral account be established to record the revenue surplus / deficit realized in 2008 (which has been reduced, according to YEC's update, to a $30,000 surplus1) and 2009 (which YEC submits by way of update is a $1.331 million surplus) pending the results of the Phase 2 review.

[29] YEC Reply in YECL 2008-2009 GRA, page 39
[30] Argument, pages 16 to 19
[31] e. g. UCG Argument, page 3, paragraphs 4-5, page 5, paragraph 23, page 20, paragraphs 97 to 98

> 5. Given the apparent commitment of YEC to work with Yukon Electrical Company Limited ("YECL") to assemble cost of service and other Phase 2-related evidence,2 UCG submits that any adjustments to rates and charges applied to the bills of Yukon ratepayers be deferred until after the Phase 2 evidence has been reviewed."[32]

The City supports deferring rate restructuring, such as the proposal to increase the residential runoff rate, until the Phase 2 process has been completed. However, deferring changes to rate structures is a different matter from deferring the recovery of utility revenue requirement through rates. The City's view differs in principle from that of deferring rate increases or decreases when changes in a utility's circumstances are known or once revenue requirement is finalized by a Board decision. Deferral of changes in rates increases the adjustment riders required to recover or refund revenue requirement, which can lead to rate shock. As noted in the City's argument, the nature of deferral accounts creates intergenerational inequities.[33] As the UCG's analysis demonstrates in the above quotation, the 2009 test year could well result in a large surplus. The City sees no reason why the refund of this surplus to customers should be deferred.

In the absence of a currently-approved cost of service study, the City considers that the fairest method to refund or collect revenue surpluses or deficiencies is to apply any adjustments to rates required to recover the revenue requirement during the test years across the board to all base rates, including the residential runoff rate, as soon as practical after receipt of YEC's compliance filing. Across the board adjustments would also be consistent with the Rider G and Rider R proposed by YECL and approved in Order 2009-5.[34] Riders G and R respectively collect the revenue deficiencies of the two test years and going forward on an across the board basis.

7.2 YEC's Rate Restructuring Proposals

YEC requests approval of four rate changes outside of the Phase II process and in the absence of a joint cost of service study. These changes are purported to be with the assent of intervenors.

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[32] UCG Argument, page 3
[33] Argument p. 9
[34] Order 2009-5, page 2

> "All parties appear to recognize that some rate changes can and should be implemented as part of the current Application without waiting to complete the Phase II application and hearing process, including changes to pass on the firm rate reduction to retail customers, adjustments to bring Pelly Crossing into the hydro rate zone, changes to secondary sales baseline prices and the fixed industrial Rider F (as required to support the firm rate reductions), and likely the changes as proposed to Secondary Sale Rate Schedule 32."[35]

YEC, in a subsequent section of its argument, resurrects its residential rate restructuring proposal in advance of a Phase II Application:

> "The proposed Rider U focuses the remaining 2009 retail firm rate reduction on first block energy rates, thereby ensuring that second block or runoff rates do not move further away from efficient price signals and that rate reductions benefits for the majority of YEC and YECL retail customers will be materially enhanced."[36]

YEC provides no reference for any agreement among parties to rate changes, especially the resurrected proposal for restructuring the residential runoff rates relative to the first block rate. The City's position on rate design outside of a Phase 2 proceeding was set out in the interim rates proceeding and has not changed since then.

> "CW is concerned that changes to the existing rate design should not be considered in an interim rate application because the level of scrutiny necessary to review these proposed changes to rate design is not possible in the time available. CW submits that it is more appropriate to consider the proposed rate restructuring in the context of a Phase II process."[37]

The actual positions of other parties also show no change since the interim rate application on the matter of rate design changes outside of a Phase II hearing. YECL considers that YEC's rate proposals are a "fragmented approach to rate design"[38] and "haphazard and piecemeal".[39] The UCG states: "Specifically with respect to the proposal to adjust the runoff rates for residential customers, UCG submits that it is premature, based on the current record, to make such

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[35] YEC Argument, p. 30
[36] YEC Argument, page 31
[37] City of Whitehorse letter of October 21, 2008
[38] YECL Argument, page 2
[39] YECL Argument, page 14

changes."[40] LE notes that "Yukon Energy's proposal will send a higher cost signal to only about 16% of all residential bills [Tr P 393 L 13-21], about 70% of residential bills will get a full lower cost signal (opposite the intended signal), and the other 14% will get a small lower cost signal;" and concludes "While it may appear easy simply to increase the retail residential runoff rate to send out a cost efficiency signal, this has the effect of sending the exact opposite message to the vast majority of customers."[41] The City agrees with these comments and, in particular, LE's analysis of the effects of the restructuring residential rates. This analysis is equally applicable to the proposed Rider U.

However, the City does not oppose YEC's proposal to bring Pelly Crossing into the hydro rate zone as this will better reflect the new cost of service for Pelly Crossing. The City does not agree to the Updated Fixed Rider 'F' as proposed in the Updated GRA Filing of April 24, 2009.[42] The updated filing is inconsistently based on an updated diesel fuel cost for YECL but not an updated diesel fuel cost for YEC. The City opposes the proposed changes to Secondary Sales Rate 32 Terms and Conditions from a forward seven-day basis to a five-day basis.[43] YEC's reasons are based on an unavailability of five-day forecasts from Environmental Canada and a need to extrapolate these five-day forecasts to seven days.[44] The City submits that this change is unnecessary as Environment Canada now provides seven-day weather forecasts.[45]

Finally, the Board should deny Rider U as proposed. The City considers that any reductions to rates as a result of a Board decision regarding 2008 and 2009 revenue requirement "should be applied uniformly on an across-the-board basis to all current rates until such time as the Board issues a Phase II decision."[46]

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[40] UCG Argument, page 18, paragraph 91
[41] LE Argument, p. 3
[42] Ex. B-10, pages A2-A3 and Table 4.2 Revised
[43] Application page 4.5, lines 22-33
[44] CW-YEC-1-10 (c)
[45] e.g. http://weatheroffice.gc.ca/city/pages/yt-16_metric_e.html
[46] City of Whitehorse letter of October 21, 2008

7.3 No-Cost Capital

The UCG suggests that deferral accounts such as the DCF serve to reduce the business risks of YEC, which leads to the UCG's proposal for a reduction to the 52 basis points additional risk premium under the BCUC model. The City agrees with the UCG's principle that deferral accounts reduce a utility's risk profile by transferring risk to customers. The City, as noted in Section 6.1 of this Reply, would prefer not to tamper with the BCUC method by altering the 52 basis points additional equity risk premium. Instead, customers should be compensated for the additional risk by recognizing deferral account balances as no-cost capital in the utility's structure. Notably, YEC does not include no-cost capital in the utility's capital structure. The City considers that all sources of no-cost capital should be included in the utility's capital structure for the purposes of determining a return on rate base. YECL includes no-cost capital within its capital structure.[47]

Although YEC was asked directly to provide a total of all sources of no-cost capital,[48] it is difficult from YEC's response to determine an exact total of the funds that are held to customers' credit. As YEC notes, the DCF funds are invested and earn interest[49] but it is not clear whether customers benefit to an appropriate degree from all the funds they supply through their rates. The City recommends that all sources of no-cost capital including but not limited to the Faro Dewatering Fund, the Diesel Contingency Fund, the RFID, the Fund for Removal, Salvage and Remediation (FRSR), Rider F, and customer contributions should be included as no-cost capital in the capital structure.

7.4 Other Leading edge Recommendations

LE makes several recommendations related to ensuring that the Compliance Filing arising from the Board's decision in this matter will include status updates on various projects, such as vehicle

[47] See Schedule 8.1, YECL GRA financial schedules
[48] Tr. p. 305, lines 10-16
[49] Tr. p. 307, lines 21 - 24

purchases, the spill regulation project and Electronic Document Management project, etc[50]. The City would support a direction that the Compliance Filing include what LE calls "realistic updates of all projects and anticipated costs". This information will be useful as the most accurate reference point for the next General Rate Application.

The City supports the LE recommendation that the Board direct YEC to formalize and institute an internal DSM program[51] as this is consistent with the City's position on Phase 2 matters[52]. With respect to LE's submissions regarding an Order directing YEC to seriously examine other power supply alternatives (including serious DSM, IPP power projects, wind power etc)[53], the City would support a direction requiring YEC to provide the evidence analyzing and weighing the feasibility of these alternative power sources[54] including cost-benefit analyses at the time of the next general rate application.

All of which is respectively submitted on behalf of the City of Whitehorse this 5th day of June 2009.

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Thomas D. Marriott

[50] LE Argument, pages 12-13, items 22, 24, and 25
[51] LE Argument, page 9, item 12
[52] See above at page 5 and Argument page 2, footnote 4
[53] LE Argument, pages 5-6, item 7
[54] The City considers that geothermal generation should be included in the list of alternatives receiving consideration.