YUKON ELECTRICAL COMPANY LTD. (“YECL”)

2016 - 2017 GENERAL RATE APPLICATION

PHASE I

ARGUMENT OF THE CITY OF WHITEHORSE

November 24, 2016

{B2206311.DOCX;1}

1. Introduction

1. This argument is filed on behalf of the City of Whitehorse ("CW" or the "City") which participates in this proceeding on behalf of the City and its residents, and is guided by what it considers to be in the best interests of the City as a corporation as well as what is in the best interests of its citizens.

2. The Yukon Electrical Corporation Ltd. ("YECL") carrying on business as ATCO Electric Yukon ("AEY") filed with the Yukon Utilities Board (the "Board") a general rate application (the "Application"),[1] dated May 11, 2016, for the 2016 and 2017 test years.

3. On July 11, 2016 The City filed information requests to YECL[2] and YECL responded to the City's requests on July 11, 2016.[3] YECL filed an update to the Application on October 24, 2016.[4]

4. A hearing on the Application was held in Whitehorse on November 1–3, 2016. The City of Whitehorse attended the hearing, cross –examined both evidence panels presented by AEY and seated a witness, Russ Bell, to speak to the evidence he prepared on the City's behalf. Mr. Bell is a professional accountant, and has over 35 years' experience in the utility industry, as discussed in his evidence[5] and testimony.[6]

5. In examining the Application, the City has pursued a limited number of issues that are of concern to its citizens. The absence of argument on any particular issue does not constitute agreement with any party's position on that issue.

[1] Exhibit BB-1
[2] Exhibit C3-2
[3] Exhibit B-4
[4] Exhibit B-13
[5] Exhibit C3-3, page 2 and Appendix A
[6] Transcript volume 3, page 534-535

Rate Of Return and Risk Premium

6. YECL's application, if approved, projects return of $6,945,000 in 2016, and $7,400,000 in 2017, as compared to actuals of $5,550,000, $5,782,000, and $5,838,000 in 2013, 2014 and 2015, respectively.[7]

7. YECL states: "The increases from 2015 approved to the 2017 forecast is primarily due to growth in rate base as a result of capital additions discussed in section 9 as well as an increase in the return on equity as discussed below."[8]

8. With respect to the latter point, YECL wants its rate of return set at the BCUC benchmark ROE (once released) plus a risk premium of 60 basis points.[9]

9. YECL then relates the background to the requested increase in the rate of return, and acknowledges that in Order 2014-06 with respect to YECL's 2013-2015 GRA, the Board stated that ATCO Electric Yukon "had not established a prima facie case to quantify the risk premium over the BCUC benchmark utility and directed ATCO Electric Yukon to provide a justification for a risk premium relative to the BCUC Generic Cost of Capital (GCOC) standard as part of its next GRA."[10]

10. Accordingly, YECL advanced the position that "the determination of whether a ROE premium is appropriate with respect to ATCO Electric Yukon should address the relative business risks of ATCO Electric Yukon compared to the BCUC benchmark utility and other similar type utilities across Canada, taking into account the stand-alone principle."[11]

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[7] Exhibit BB-1, page 8-1
[8] Ibid
[9] Exhibit BB-1, page 8-2
[10] Exhibit BB-1, page 8-2
[11] Ibid

11. Further to this approach, YECL engaged Concentric Energy Advisors Inc. ("Concentric") to prepare a study of the kind described just above (the "Concentric Report").[12] Mr. Jim Coyne of Concentric appeared at the hearing and provided oral testimony in support of the Concentric Report.

12. The City's position is that for three reasons at least, as explained below, and despite YECL's incurring the costs estimated at over $120,000 in USD,[13] the Board should <u>not</u> approve YECL's requested risk premium.

<u>Stand-Alone Principle</u>

13. The Concentric Report acknowledges that "the Board historically has not accepted the Stand-Alone principle."[14] Yet the Concentric Report and YECL's entire approach to this question are founded on this principle.

14. In Appendix A to Board Order 2014-06, at page 54 of 105 the Board states as follows:

> The direction given regarding the stand-alone principle in Appendix A to Board Order 2009-02 speaks for itself. The Board has not been persuaded in this proceeding to alter that position.

15. An examination of the paragraphs just preceding that cited above, will show that arguments similar to those advanced here by YECL were advanced in that proceeding and found not to be persuasive. For instance, the Board cites YECL as saying that BCUC supported the principle,[15] and that "respect for the stand-alone principle is a critical factor that allows for a fair and reasonable assessment of its business risk and the requested ROE and equity ratio."[16]

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[12] Exhibit BB-1, Section 8, Attachment 8.1 ("Concentric Report")
[13] Exhibit B-18
[14] Concentric Report, page 25
[15] Appendix A to Board Order 2014-06, at page 53 of 105
[16] Ibid, page 54 of 105

16. The direction given by the Board in Appendix A to Board Order 2009-02 is as follows:

> In response to YUB-YECL-33(c), YECL responded:
>
> Yes, in principle Yukon Electrical would contribute to the size of CU Inc., and thus provide some small contribution to the size and diversification of the entity which provides its debt.
>
> The Board interprets this response to mean that YECL also contributes (albeit in a small way) to the size, diversification and capital structure on AE. Given that capital in the form of either debt or equity flows to YECL through AE (or through CU), and that there is a strong management influence68 on YECL through AE, and given the significant affiliated transactions and contracts between YECL, AE and other ATCO companies, this Board rejects the stand-alone principle....

17. If the Board has not been persuaded that it was wrong in not applying the stand-alone principle in the past, then it should find that the whole foundation of YECL's request for a risk premium is removed and it has once again not established a case for one to be approved.

<u>Relative Riskiness Over Time</u>

18. One of the approaches taken in the Concentric report is to point to the 2009 decision in which the Board approved a risk premium of 46 basis points above the benchmark utility in B.C. and then consider whether "there had been any changes in AEY's business risk since 2009 that would materially impact the Company's risk profile."[17]

19. After going through this exercise, Concentric concludes that "In most respects, AEY's business risk has not materially changed since 2009."[18]

20. However, as alluded to above, AEY acknowledged that for the test period 2013-2015, the Board found that awarding a risk premium was not required in setting just and reasonable

[17] Concentric Report, page 29
[18] Ibid, page 31

rates.[19] If AEY's business risk has not changed materially since 2009, then that statement is equally true of the period since 2014, when no risk premium was found to be necessary. Therefore, if it was not necessary then, neither is it necessary now.

Comparison to Other Canadian Utilities

21. The Concentric Report includes a significant focus on comparing YECL to other Canadian utilities, and then comparing the equity thickness and ROE approved for those utilities to that afforded to AEY. At present, AEY has an approved ROE of 8.75% on an equity thickness of 40%.

22. The City would draw the attention of the Board to Concentric's assertion that the "business risk profile of AEY is most similar to that of Maritime Electric,"[20] and that "Maritime Electric has an authorized ROE of 9.35 percent on 40.9 percent common equity."[21]

23. However, Concentric asserts that "investors and credit rating agencies view companies that own generation a higher risk than pure transmission and/or distribution utilities."[22]

24. This point was confirmed by Concentric's witness, Mr. Coyne on the stand.[23]

25. And despite Concentric's and Mr. Coyne's attempts to characterize the relative business risks for AEY and Maritime Electric arising from company owned production as being similar, the fact is, as Mr. Coyne acknowledged, and Mr. Tenney confirmed, that AEY generates only about 9 percent of its load, as compared to Maritime Electric where the number is 24 percent, more than two and a half times as much on a percentage basis.[24]

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[19] Exhibit BB-1, page 8-2
[20] Concentric Report, page 32
[21] Ibid
[22] Concentric Report, pages 4-5
[23] Transcript, volume 1, page 24, lines 4-23
[24] Transcript, volume 1, page 36 line 22 to page 37, line 19

26. Viewed from this perspective, the City submits that the request for a risk premium of some 60 basis is unwarranted. In fact, as compared to Maritime Electric, with its significantly greater percentage of company owned production, the City submits that the small differences in their present equity thickness and ROE can be rationally justified.

Mr. Bell's Evidence - Forecast Accuracy

27. In its Application, the Yukon Electrical Company Limited has demonstrated a pattern of over forecasting. Forecast accuracy is important to regulators, and customers, as rates are based on forecast costs. The regulator approves just and reasonable rates to charge to customers. These rates are based on forecast costs approved in a General Rate Application (GRA). A reasonable forecast is one where there is a likelihood that the actual costs could be higher or lower than the forecast. When the approved forecast is continually higher than the actual costs for a cost category or item, it means that customers are paying for costs that the utility will not incur.[25]

28. In a forward-looking test period environment, such as is the case in the Yukon, the City submits that one of the goals of regulation is, or should be, to provide incentives to the utility to be more efficient. As the City's witness, Mr. Bell, stated in oral testimony:

> That is one of the benefits of a future test period, is that the utility is incented to find efficiencies. The issue is where there's consistent overforecasting, then one has to question whether the utility is finding true efficiencies or is, in fact, using forecasting methodologies that should be changed.[26]

29. When there is a consistent pattern of forecast error in the utility's favor, customers are paying costs that the utility will never incur, and the benefit is not a result of gained efficiencies, but a result of forecast methodology. This cannot result in just and reasonable rates.

[25] Exhibit C3-3, Evidence of Russ Bell, A5
[26] Transcript volume 3, page 544

30. Mr. Bell's evidence demonstrates that there are three areas of concern with YECL's historical pattern of forecast error:

- Production Costs
- Capital Additions for new extensions
- Forecast cost of new debt.

Production Costs

31. As noted in Mr. Bell's evidence, for Production costs, on a per unit basis, either cost per customer or per MWh, have historically been over forecast by 14.9%.[27] This is the average of the three years of actual results for 2013, 2014, and 2015. In each of the years, there was a material over-forecast of costs. This over-forecast resulted in the utility receiving revenue for costs that it did not incur.

Net New Extensions

32. By its own admission, YECL indicates that the forecast for Net New Extensions are 47.7% higher than forecast for the 2013-2015 period.[28]

New Debt

33. Similarly, the cost of new debt has a pattern of over-forecasting. The cost of 2014 debt was 0.96 percentage points lower than forecast, and the cost of 2015 new debt was 1.08 percentage points lower than forecast.[29] Further, the utility was protected from the forecast error in 2013, where the actual was higher than the forecast, as the actual cost was used in setting the cost in the decision.[30]

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[27] Exhibit C3-3, Evidence of Russ Bell, A6
[28] Ibid, A8
[29] Ibid, A9
[30] Ibid

34. The issue is that there is a consistent pattern of over-forecasting. As noted by Mr. Bell:

> Any forecast by its very nature will not be exactly what you see in the actuals. My concern arises when there's a consistent pattern of overforecasting. When a utility has a reasonable methodology, my expectation is you would see variances because by the very nature forecasts are not precise.
>
> But one would expect those variances to fluctuate on either side of the forecast.[31]

35. In the case of each of production costs, new extensions, and new debt costs, there is a pattern of over-forecasting, and not any random dispersion around the forecast. This indicates an issue with forecast error that the Board should address.

Forecast Trends

36. Distribution and General O&M costs have been relatively stable over the 2013, 2014, and 2015 period. On a per MWh basis, Distribution costs average $9.69 over the 2013-2015 period, while the 2016 period increases to $10.37 or a 6.56% increase[32]. This same level of increase appears on a per customer basis. For General O&M the increase in 2016 is even greater, at 18.25%.[33] These increases are not in line with the pattern of historic costs per customer or per KWh. Further, YECL has not refuted or rebutted these assertions.

Summary

37. First, the City notes that YECL did not file any rebuttal evidence, nor did it cross examine Mr. Bell. As such, Mr. Bell's evidence remains uncontroverted.

38. During the hearing, Ms. Sabo discussed with Mr. Bell the differences in assessing a forecast on a line by line basis or on a global basis.[34] Mr. Bell supports the assessment of

31 Transcript volume 3, page 541
32 Exhibit C3-3, Evidence of Russ Bell, A6
33 Ibid
34 Transcript volume 3, pages 547-550

forecasts on a line by line basis[35]. That is how the PUB assess the forecast items. It reviews each item in turn, and renders a decision. Further, each item could be forecast using a different methodology[36]. As such, ruling on an overall basis removes the incentive to refine and improve forecast methodologies.

39. Also, as pointed out by Mr. Bell,[37] the line by line costs are the basis of any Phase II proceeding, where costs are allocated to rate classes, and customers. Without accurate line by line forecasts, there are issues with allocation of costs to each rate class.

40. Accordingly and based on the evidence as summarized above, the City supports Mr. Bell's recommendations that:

- The forecast for production be reduced by 15% based on the historic over-forecasting, resulting in a reduction of $314,000 in 2016 and $306,000 in 2017.

- The increase in distribution and general O&M is not supported by the historical costs. The historical costs, on a per customer or MWh basis are relatively constant, while the forecasts show dramatic increases. Further, there is an increase in customers forecast, which should result in economies of scale. As such, for distribution and general O&M, the City recommends the forecast be limited to the three year average cost per customer. This would result in a reduction of $272,000 in 2016 and $369,000 in 2017.

- Based on YECL's own admission, the City recommends that the forecast for Net New extensions in this application should be reduced by 47.7% to account for the systemic forecast error.

- The City recommends that the forecast cost of new debt for 2016 and 2017 be reduced by 0.50% to reflect the historic over forecasting.

[35] Transcript volume 3, page 549
[36] Ibid, page 548
[37] Ibid, page 548/549

LED Street Lighting

41. In its Application, ATCO Electric Yukon stated:

> ATCO Electric Yukon has been in discussions with its customers/municipalities regarding recent developments surrounding converting existing streetlight to Light-Emitting Diode (LED) lamps. Considering there is significant capital outlay associated with the conversion of existing streetlights to LED and in order to understand the rate implications of LED streetlight conversion, ATCO Electric Yukon is seeking Board direction as to the appropriate method of accounting for the capital costs associated with customers requesting conversions of existing streetlights to LED. ATCO Electric Yukon considers there to be two available options:
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> 1) A full customer contribution required for all associated capital costs; or
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> 2) All capital costs associated with requested conversions would be a system cost, not subject to a customer contribution.[38]

42. The City supports the conversion of existing streetlights to LED lamps, along with other forms of green infrastructure. However, the City does not consider it appropriate for ATCO Electric Yukon to request the Commission to issue a direction as to the appropriate method of accounting for the associated capital costs in the absence of a fully-supported proposal by ATCO Electric Yukon on that issue. The City recommends that the Commission direct ATCO Electric Yukon to put forward a proposal, supported by evidence, which can be tested and reviewed by all parties, and which would allow the Commission to make a determination on this issue on the basis of a complete record and a recommendation from ATCO Electric Yukon.

All of which is respectfully submitted this 24th day of November, 2016.

(Gy) Bo Ogto

THOMAS D. MARRIOTT, Q.C.
Counsel for the City of Whitehorse

[38] Exhibit BB-1, pdf page 167

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