IN THE MATTER OF YUKON ELECTRICAL COMPANY LIMITED 2016-2017 GENERAL RATE APPLICATION

REPLY ARGUMENT

YUKON ENERGY CORPORATION

December 15, 2016

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1.0 INTRODUCTION

Yukon Energy Corporation ("Yukon Energy" or "YEC") submits the following arguments in Reply to the arguments filed by the Applicant, Yukon Electrical Company Limited ("YECL" or "AEY"), and the intervenors, the City of Whitehorse ("CW"), the Utilities Consumers' Group ("UCG"), John Maissan ("JM") and the Yukon Conservation Society ("YCS") (together the "Intervenors") in respect of YECL's 2016-2017 General Rate Application (the "Application").

As the primary generator and transmitter of electricity on the integrated system in Yukon, and also as a distributor, Yukon Energy has a material interest in the outcome of YECL's application. Yukon Energy's intervention has focused primarily on issues relevant to the integrated grid system and on matters of joint interest to Yukon Energy and Yukon Electrical in the context of decisions by the Yukon Utilities Board ("YUB" or "the Board") on the Application setting precedents that may potentially affect future Yukon Energy revenue requirement applications.

Yukon Energy's Reply is limited to submissions and comments on the following matters:

- Capital Structure & Return on Equity (ROE);
- Fuel Price Flow Through Deferral Account (Rider F);
- Diesel Displacement/ Renewable Energy Study;
- Demand Side Management (DSM); and
- Other Matters Raised by UCG in Argument.

Yukon Energy does not propose to address all matters covered in the Arguments submitted by YECL or other Intervenors, and lack of comment on an issue in this Reply Argument should not be taken as agreement with positions raised by other parties.

In particular, Yukon Energy has sought clarification and confirmation from the Board that matters related to the Yukon Energy Wholesale Rate Schedule 42 and the ERA are considered out of scope of the current AEY GRA process as a separate process is underway before the Yukon Court of Appeal[1]. In response, the Board confirmed that the terms and tariffs of Rate Schedule 42 are not part of the scope of the YECL GRA proceeding, but noted that charges to be incurred in the Purchase Power Flow Through Deferral Account (PPFTDA), including possible ERA amounts, can be tested in YECL's 2016-17 GRA. YECL in argument referenced its response to YUB-YECL-47(c), and re-iterated its comments regarding the ERA as noted in that IR response. Given the separate review process underway before the Yukon Court of Appeal, Yukon Energy will not comment in detail regarding this matter; however, this does not represent agreement with any issues raised or comments made by YECL in its IR responses or in Argument.

[1] See correspondence to the Board dated October 25, 2016 [Exhibit C1-4] and Board's response [Exhibit A-15].

2.0 CAPITAL STRUCTURE & RETURN ON EQUITY (ROE)

YECL asserts that the BC Utilities Commission (BCUC) Generic Cost of Capital (GCOC) benchmark return on equity (ROE) of 8.75% remains the most appropriate benchmark as it has been recently reviewed and is generally accepted by the parties; and that appropriate justification for the risk premium of 60 basis points has been provided through the expert evidence provided by Concentric.

UCG, JM and CW each assert that a risk premium is not justified in the circumstances; while JM and CW appear to accept the benchmark ROE of 8.75%, UCG recommends that the AUC benchmark ROE be used (which would provide an equity thickness of 37% and an ROE of 8.3% for 2016 and 8.5% for 2017) instead of the BCUC ROE benchmark.

Key points for each argument are noted below:

- **UCG** submits that the rate of return on equity established by the AUC is "more current (i.e., October 2016) and relevant to the operations and governance of AEY since these rates apply to several of AEY's affiliates,"[2] and notes that YEC's return for the 2012/13 GRA was established using the Alberta benchmark. UCG asserts that "it is time to recognize that any risk premium is unnecessary in the Yukon and that it is time to introduce an earnings sharing mechanism so that ratepayers will get their over-payments back."[3]

- **JM** recommends that the 8.75% BCUC benchmark be used with a 40% equity thickness and no risk premium, noting that despite "significant economic variations and sales variabilities" that AEY has earned ROEs generally well above approved levels (with the exception of 2015). JM also notes that AEY "has flexibility in the way it manages its costs such that it fairly consistently over-earns its approved ROE, and therefor is not subject to nearly as much risk as it tries to make out it is." [4]

- **CW** notes that the Board should not approve YECL's requested risk premium as the approach used is premised on the Stand-Alone Principle which has consistently been rejected by the Board (in Order 2009-2 and Order 2014-06);[5] AEY's business risk has not materially changed since 2009 and "AEY acknowledged that for the test period 2013-15, the Board found that awarding a risk premium was not required in setting just and reasonable rates";[6] and Maritime Electric is not similar to YECL as it generates 24% of its load (while YECL generates only 9%).[7]

Yukon Energy Reply

Yukon Energy notes as follows in response to the arguments raised by UCG, JM and CW:

- **The Board has previously determined that the BCUC model is the precedent for Yukon; as such, in Yukon Energy's view there is no basis for using a different**

[2] UCG Argument, page 24, para 140.
[3] UCG Argument, page 25, para 146.
[4] JM Argument, page 6.
[5] CW Argument, pages 3-4.
[6] CW Argument pages 4-5.
[7] CW Argument pages 5-6.

benchmark ROE for the current review. In Order 2013-1 on the 2012/2013 YEC GRA, the Board noted that the precedent for Yukon has been to use the BCUC model "however, as YEC has noted, the BCUC model has not been updated since 2009, and therefore, YEC turned to the AUC model as its more recent decision covered the years 2011 and 2012."[8] Today, unlike the 2012/2013 YEC GRA, the evidence confirms access once again to an updated BCUC model - and the current YECL GRA has accordingly relied upon the updated BCUC benchmark as the basis for proceeding, based on past precedent for Yukon. While UCG notes that the AUC decision is more recent (dated October 2016), both the BCUC decision and the AUC decision are relatively recent (with the BCUC decision being provided in August 2016). In summary, UCG has not provided any reasonable basis for not using the BCUC benchmark, nor has it provided any solid rationale for the Board to adopt at this time the AUC benchmark over the BCUC benchmark.

- **The arguments raised by CW, UCG and JM fail to acknowledge the key elements that drive the requirement for a risk premium for BC and Yukon utilities – the size of utility and characteristics of the service area.** BCUC decisions referenced in the current Board proceedings have confirmed the requirement for a risk premium relative to the approved benchmark for various BC utilities to reflect the relative size of the utility and the characteristics of its service area. Prior GRA reviews and Board Orders in Yukon have focused on the same issues when considering and approving risk premiums for both Yukon Energy and YECL when adopting an applicable BCUC benchmark. Specifically, prior Board Orders have focused primarily on the service area to justify the requirement for a risk premium (e.g., Yukon has no intertie connections, while FortisBC Electric has intertie connections with other utility networks which reduce its risk).[9]

  Concentric has noted in evidence and in oral testimony that characteristics of the service area and utility size are a key consideration in determining utility risk for cost of capital and risk premium analysis as it provides diversity of load and resources.

  > "I think the most important differentiators for the company are its size and the characteristics of its service area. So I would say those take precedent over the others that I mentioned. So the others would be, I guess, by comparison, of lesser importance."[10]

  Further, Mr. Coyne noted as follows:

  > "Small utilities don't have the same resources that large utilities have. And another key issue there is the diversity of a large service area helps you ride out economic storms that may affect one segment of the economy that aren't affecting the other. But if you have a smaller non-diversified service area, then you're much more subject to shifts in your economy. And if you have a small utility operating in a territory such as the Yukon

[8] Board Order 2013-01, page 47.
[9] See Order 2005-12, pages 43 to 45; Order 2009-2 pages 27-29; Order 2009-8 pages 51-54.
[10] Transcript pages 79-80.

> that itself doesn't have a very diversified economy, then those risks become one in the same. The risk of the territory becomes the risk to the utility serving it."[11]

- **While the quantum of the risk premium sought by YECL is high considering past Yukon precedents, when the BCUC comparator utilities are considered (i.e., FortisBC Energy and PNG-West), there is no basis for denying YECL any risk premium.** In 2009, the Board accepted "that when using the BCUC generic cost of capital, a risk premium is required for Yukon utilities."[12] FortisBC Energy and PNG-West are two BCUC comparator utilities that were relied on by the Board to determine the range of risk premium for Yukon utilities in 2005 and 2009, and these comparator BC utilities continue to provide a reasonable range of risk premium today. Prior YUB Orders have accepted that the risk premium for Yukon utilities lies somewhere between FortisBC Electric and PNG-West[13]. See Yukon Energy's November 24, 2016 Argument for further detail regarding the basis for the applicable risk premium range for Yukon utilities.

In summary, in reply to the intervenor arguments as reviewed above, Yukon Energy re-iterates the points made in its Argument that a simplified approach should continue to be used to determine the ROE for Yukon utilities. This simplified approach should rely on the BCUC ROE benchmark, where available, and not the AUC benchmark as advocated by UCG. The simplified approach should also include provision for risk premiums for Yukon utilities over the BCUC benchmark rather than no risk premium as argued by CW, JM, and UCG. The applicable risk premium based on a BCUC benchmark is to use FortisBC Electric and PNG-West to define the applicable range for the risk premium.

3.0 FUEL PRICE FLOW THROUGH DEFERRAL ACCOUNT (RIDER F)

YECL is proposing to include LNG price variance within the existing Rider F mechanism; and has requested the inclusion of LNG price variances in the Rider F deferral account. YECL asserts that this is justified as the principles supporting the diesel price variance deferral are the same as those supporting a LNG price variance deferral, including: (1) Commodity prices are subject to material fluctuations outside the control of AEY (or YEC); and (2) it is not in the interest of utilities, the Board or ratepayers to speculate on these price fluctuations. YECL notes in the alternative that it is within the Board's authority to approve deferral accounts and if the Board determines that the wording of the Rate Policy Directive does not allow for inclusion of LNG price variances to be included in the existing Rider F, that the Board should approve a new deferral account and Rider for LNG price variances that operates in the same manner as Rider F.[14]

UCG submits that the Board should not allow YECL to establish a LNG-related deferral account until a need is established and an application has been made to change the Fuel Adjustment Rider and Deferral Price Variance Policy. UCG notes the Board cannot approve the proposed Fuel Price Flow Through Deferral Account and the proposed methodology for calculating the deferral for fuel used in Watson Lake

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[11] Transcript pages 78-79.
[12] Order 2009-2, Appendix A, page 29.
[13] See Order 2005-12, page 45 and Order 2009-2 page 29 which provide prior Board directions regarding risk premiums for Yukon Energy and YECL.
[14] YECL Argument, page 9-10.

without changing the Fuel Adjustment Rider and Deferred Fuel Price Variance Policy and without having Section 8 of the Rate Policy Directive Order in Council 1995/90 changed to account for LNG.[15]

Yukon Energy Reply

In reply to UCG's argument, Yukon Energy sees no basis for requiring that Section 8 of the Rate Policy Directive be changed to account for LNG in the Fuel Price Flow Through Deferral Account or to use Rider F to disperse the account.

Section 8 of OIC 1995/90 requires the Board to permit Yukon Energy and YECL to adjust rates to customers so as to reflect fluctuations in the prices for which the two utilities pay for diesel fuel, without the requirement for specific application to and approval of the Board. The Board has implemented this directive through the Rider F mechanism. There is nothing in the OIC directive to prevent the Board from also specifically addressing LNG or natural gas fuel costs in Rider F and permitting YEC and YECL to flow changes in LNG or natural gas fuel costs through Rider F with the Board's approval.

In Yukon Energy's view, the Board has the authority under the PUA to approve YECL's requested approach (i.e., to use the Fuel Price Flow Through Deferral Account to address LNG price variances and to use the Rider F mechanism to refund (collect) account balances). Yukon Energy and YECL currently provide quarterly updates regarding Fuel Price Flow Through Deferral Account and Rider F; the Board and other intervenors have the ability to review this information each quarter. The Board can also review in detail the deferral accounts and charges during each utility's General Rate Application reviews.

Precedent for this approach with regard to Rider F is also provided in Order 2005-12 where the Board approved a quarterly secondary sales rate setting mechanism and the use of the Rider F deferral account to normalize the Secondary Sales revenues for any changes after January 2005 to the Secondary Sales retail range from the 5.5 cents/kW.h forecast included in the 2005 Requirement Revenues and Related Matters Application.[16] The Board approved a quarterly rate setting mechanism for secondary sales and also agreed that in order to manage revenue or earnings fluctuations as a result of the quarterly rate-setting process, YEC could normalize Secondary Sales revenues by recording the revenue changes in Rider F.[17]

4.0 DIESEL DISPLACEMENT / RENEWABLE ENERGY STUDY

YECL notes that the purpose of the proposed $500,000 of deferred charges for renewable energy studies in 2016 and 2017 is to identify the potential, optimal size and configuration of company built, owned and operated renewable and alternative energy generation (including energy storage systems and possible

[15] UCG Argument, pages 16-17.
[16] See requested approvals as summarized in Order 2005-12, page 2 and direction provided at page 19 of Order 2005-12. During the hearing the Board requested YEC to provide its interpretation of the Public Utilities Act and the sections that permit quarterly rate setting. The Order notes that during that proceeding YEC in Argument provided references to sections 27, 28, 30 and 31 of the Act, as well as the definition of the term "rate" and noted its view that section 28(1) of the Act provides the YUB with the discretion to set rates and that the definition of the word "rate" found in section 1 of the Act provides the YUB with considerable latitude as to what is considered to be a rate. The Board agreed that it had the jurisdiction to set quarterly rates in the manner proposed for the automatic adjustment mechanism for secondary sales.
[17] Board Order 2005-12, page 19.

energy efficiency improvements through waste heat recovery opportunities) in each of the five isolated communities served by YECL and that currently rely on diesel power generation. YECL asserts that proposed costs are consistent with the Board's statement on page 77 of Order 2013-01 where the Board acknowledged the need to explore alternatives to diesel generation. Once the studies are complete, YECL proposes that any projects that are technically and economically feasible will be brought forward in business cases in a stand-alone proceeding for approval by the Board as soon as practical without the need to wait for a subsequent general rate application. YECL also submits that the proposed costs are reasonable and prudent, and that subject to any confidentiality issues the studies would be made public in connection with the next relevant Board application.[18]

JM notes concern regarding AEY developing company owned renewable and alternative energy sources that would be in direct competition with IPP proponents presently planning projects; and asserts that it is inappropriate for ratepayers to be funding AEY to compete with the private sector who put their own monies at risk and remove operational risks from AEY (or Yukon Energy) customers who ultimately benefit from these projects. JM specifically notes as follows:[19]

- Collection of wind or solar resource data, and any pre-feasibility studies or feasibility studies of projects (without first soliciting and encouraging IPP opportunities for that purpose), which would be in competition with the private sector should not be included in the proposed study.
- AEY is duplicating studies and research being undertaken by other organizations (e.g., research undertaken in Alaska; research undertaken by Research Chair in Northern Energy located in Yukon College's Cold Climate Research Centre).

JM recommends that AEY be ordered to submit the detailed Terms of Reference for each proposed study to the Board and registered intervenors at the time the RFPs are issued, and that comments be solicited before awarding any contracts for these studies; that the Board instruct AEY to file the completed study reports with the Board and registered intervenors as soon as they are completed; and that the Board order AEY to come back before the Board before implementing any action arising out of the study findings.

YCS notes that if YUB allows the renewable and alternative energy study into rate base, the study must be shared as soon as it is completed and not withheld from the public until the next GRA.[20]

Yukon Energy Reply

In reply to JM's argument regarding concern about AEY developing renewable and alternative energy sources that are in competition with IPP proponents, Yukon Energy is not aware of any basis for the Board to restrict prudent expenditures by YECL or Yukon Energy on studies to assess renewable generation options that the utility may implement to supply its customers. Yukon Energy notes the following in this regard:

[18] YECL Argument, page 21.
[19] See JM Argument pages 10-12.
[20] YCS Argument, page 5.

- Each utility has a mandate to ensure ongoing safe, reliable and cost effective service to its customers as part of the regulatory compact. This requires ongoing planning by each utility to be able to meet the future generation requirements of each specific service area (i.e., for Yukon Energy this is the integrated grid and for YECL this relates to the isolated diesel communities that are not connected to the integrated grid), and this planning must ensure that all reasonable resource options (including reasonable renewable and alternative resource options that the utility may itself develop) are examined.
- As part of the above mandate, each utility is responsible to develop the best available resource options as required to supply its customers, without any restriction in this regard on developing utility owned and operated renewable generation options.
- Deferred costs incurred by a utility for reasonable and prudent studies in this regard should accordingly be included in rate base, without any restrictions that assume a need to protect IPP proponents who may also be examining potential renewable resource options.
- The Board's mandate in this regard is to determine the prudent costs to be included in rates for each utility, including in the future any costs related to utility owned and operated generation and any IPP contracts undertaken with IPP proponents.

With regard to JM and YCS arguments about sharing study results prior to the next GRA, and YECL's proposal to bring forward business cases in a stand-alone proceeding for approval by the Board as soon as practical without the need to wait for a subsequent general rate application, Yukon Energy is not aware of any mandate for the Board to address such proposals.

5.0 DEMAND SIDE MANAGEMENT (DSM)

YECL is proposing to move costs related to approved DSM program out of the deferral account and into capital to recover these costs over a five year term, and notes that this treatment is consistent with the direction of the Board in section 12.1 of Order 2014-06. YECL notes that the prudence of these costs is demonstrated by the Interim Evaluation Reports filed as Exhibit B-14.

UCG asserts that the estimated avoided cost of new generation combined with the benefits of reduced energy use by ratepayers "should have warranted AEY coming forward with a new DSM program beyond 2015".[21] UCG asserts that AEY should be directed to bring forward a new DSM plan following discussion with stakeholders. UCG also submits that "deferred DSM costs should not be treated as a capital asset because AEY is only entitled to return of, not a return on, prudently incurred DSM costs."[22]

[21] UCG Argument, page 35.
[22] UCG Argument, page 35

Yukon Energy Reply

Yukon Energy and YECL brought forward a joint DSM plan for Board review as part of the YECL 2013-15 General Rate Application. As part of its decision on the 2013-15 GRA, the Board provided the following comments regarding the proposed DSM plan and potential future DSM programing:

- The Board noted that it "must carefully weigh the benefits arising from the [DSM] program with the costs of implementing the program, and if, in the Board's view, the project is not in the best interest of ratepayers, the Board cannot approve the project even if it was supported by intervenors."
- The Board noted that "although the estimates demonstrate that there is a substantial opportunity for cost savings over the lifetime of the DSM program, the Board has a number of reservations with respect to the DSM program and therefore, cannot approve the program in its entirety."[23]
- The Board did not approve the program for the five-year term requested and directed that the Utilities were to make a formal application to the Board before expanding the DSM program elements beyond that approved above or beyond 2015.[24]

AEY has filed information in this proceeding that indicates that DSM programs have been cost effective, and have met or exceeded most key performance indicators. This includes Exhibit B-14 which provides the 2015-2016 Evaluation Report, Demand Side Management Program Portfolio for the Yukon. This report notes that LED and Automotive Heater Timer programs were adopted well by Yukoners, and energy efficient products were well received; KPI's were met or exceeded in most program areas; programs performed well financially; and annual budgets were respected. Further, programs achieved an overall Ratepayer Impact Measure (RIM) ratio of 1.0.[25]

Pursuant to the Board's direction and noted concerns, the utilities expect to review any future DSM plans with the Board prior to expanding DSM program elements beyond what was previously approved in Order 2014-06. Yukon Energy is in the process of reviewing requirements for new DSM programming as part of its current resource planning process. Any new programming will be brought forward by the utilities for review with the Board at an appropriate time after this planning process has been completed.

There is no basis to support UCG's suggestion that DSM costs, which are clearly an investment with costs to be recovered over a specified number of years, should not be treated as a capital asset and earn a return on the same basis as other rate base elements. As such, in Yukon Energy's view this recommendation should be disregarded by the Board.

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[23] Order 2014-06, page 100. The Board noted concern that not all program elements presented pass the Rate Impact Measure; the Board also noted that it did not agree that DSM programing should be extended to government buildings or the commercial sector at the time, and noted "before the Utilities consider other additional initiatives, the Board wants to see that the Utilities can deliver on the promised electricity and cost savings of the proposed program elements first."
[24] Order 2014-06, page 101.
[25] See Exhibit B-14, page (i).

6.0 OTHER MATTERS RAISED BY UCG IN ARGUMENT

UCG has made a number of comments and recommendations in its argument that relate generally to utility rate regulation in Yukon and that relate to both Yukon Energy and YECL, including the following issues:

- Yukon Energy and YECL joint annual filings or joint rate applications (UCG Argument para 6, 14 and 72);
- Comments regarding lack of cooperation from/ between utilities (UCG Argument para 5, 6, 8); retroactive rate setting (para 12, 17 and 39-64);
- Establishing a filing timeline for a Phase 2 proceeding and deferring rate changes until after a Phase 2 proceeding and other Phase 2 considerations (para 15-16, 18, 19 and 34);
- Benchmarking and establishing performance based rate regulation (para 31, 33, and 247-250); reliability performance measures (Para 37, 231-232);
- Requirement for Part 3 hearings for projects of $1 million or more (para 35, 183-187, 1889-192, 193-197, 198-202, 203-207, 208-212 and 213-217); and
- Bill mitigation measures (para 38, and 243-246).

Many of these issues have been raised by UCG in argument in past Yukon Energy and YECL General Rate Applications, and each utility has previously provided their comment on these matters.[26] Further, the Board has had the opportunity to consider these issues in rendering prior decisions. Many of the issues raised fail to recognize the specific regulatory context in Yukon and in some cases are contrary to established practice for setting rates. Accordingly, Yukon Energy does not see merit in addressing and responding to these issues in detail in detail at this time beyond the following:

- Yukon Energy and YECL are separate utilities with separate cost drivers that may require the utilities to apply for rates at different times and with different test years.
- Assertions by UCG regarding retroactive ratemaking fail to recognize established practice of the Board in accordance with the PUA; and ignore past practice before the Board, the legislative base under which the Board is granted its ratemaking jurisdiction and the myriad of cases before this Board where rates have been set for YECL as well as YEC.

[26] See Yukon Energy Reply Argument for its 2012/13 General Rate Application (December 12, 2012), pages 14-15 (benchmarking); pages 43-45 which address UCG comments regarding retroactive rates and Phase 2 Issues; and pages 48-50 (Other Matters Raised Under Rates) which address UCG comments on bill mitigation; Phase II Cost Allocation and Rate Design; and Performance Based Regulation. See, YECL Reply Argument for its 2013-15 General Rate Application, pages 51-52 which addresses UCG assertions regarding consultation and stakeholder input; revenue requirement and rates approval being a joint undertaking between YEC and YECL; that existing rates should continue until a Phase 2 proceeding is concluded; retroactive rates; and reliability performance measures. See also page 36 of the same argument that addresses assertions regarding Part 3 requirements for capital projects of $1 million or more.

- Assertions that existing rates should be maintained until a Phase 2 hearing has been completed are contrary to established practice of the Board in accordance with the PUA, and contrary to the pursuit of transparent as well as stable rates for ratepayers.
- Projects must be designated by OIC as “Regulated Projects” to be reviewed pursuant to a Part 3 process under the PUA; absent such designation, issues related to whether or not project costs have been prudently incurred can be reviewed only as part of a General Rate Application process.