

YUKON UTILITIES BOARD

IN THE MATTER OF the *Public Utilities Act*
Revised Statutes of Yukon, 2002 c.186, as amended

and

IN THE MATTER OF an application by Yukon Energy
Corporation and Yukon Electrical Company Limited for Approval
of the Rider F — Fuel Adjustment Rider and Deferred Fuel Price
Variance Policy

ARGUMENT OF

UTILITIES CONSUMERS' GROUP

November 14, 2011

TABLE OF CONTENTS

| | Page |
|--|-------------|
| EXECUTIVE SUMMARY | 3 |
| INTRODUCTION AND OVERVIEW | 4 |
| UCG's POSITIONS ON FUEL ADJUSTMENT CLAUSES | 6 |
| UCG's SUGGESTED MODIFICATIONS | 9 |

1. The Utilities Consumers' Group views the Rider F fuel adjustment clause and the Diesel Contingency Fund as mechanisms utilized by the utilities to add revenues to increase their profits. UCG contends that the utilities have taken what is a very simple concept and made it into a complex maze of formulas, parameters and accounting that attempts to alienate ratepayers and make the rate setting process more complicated and costly.

2. UCG submits that the annual revenue requirement related to fuel expense is established for both Yukon Energy and Yukon Electrical as part of the General Rate Application review process administered by the Yukon Utilities Board. UCG does not understand why rates established to recover a legitimate revenue requirement need to be changed as the utilities' forecasts of energy consumption and cost levels do not match forecast. Why would we go through such a lengthy process of reviewing and establishing projected sales and cost levels if they were not to be used? Both utility companies have been given a risk premium in their rate of return for such variances to forecast. If they wish to change these forecasts, then it is their prerogative to apply through the general rates application process. Other non-regulated businesses must rely on efficiency gains and operations management to absorb increases in specific costs.

3. The utilities know the price of the diesel fuel for each particular three month filing period. It is a moot point that the fuel has mixed prices in the holding tanks. This will all work out at the end of the day, similar to how ratepayers are assured that errors in meter readings or estimated readings will be self-corrected.

4. UCG submits that the utilities have manipulated the interpretation of Order in Council 1995/90 to their advantage and have neglected their obligation of establishing rates in a transparent and full disclosure manner. While the utilities continue to pursue their terms, the Board itself has clearly identified its ongoing jurisdiction with respect to the Rider F fuel adjustment clause:

Board Order 2003-03, Appendix p. 3:

"The directive does not remove the Board's power or jurisdiction to regulate rates under the *Public Utilities Act*, but the interpretation and application of the directive is also a matter within the jurisdiction of the Board."

5. Interpretations and application of OIC 1995/90, regardless of what has transpired in the past, are now before this particular Board to make their decision on a going forward basis. UCG submits that the utilities need to step up and take responsibility for their load forecasts and operational decisions rather than transferring all the risk back to ratepayers. It seems unfair to expect ratepayers to pay rates that have been approved as fair by the Board and then allow the utilities to come back with additional recoveries through Rider F related to cost consequences of actual diesel consumption or weighted average fuel consumption; plus diesel efficiency values, plus line maintenance, plus mechanical maintenance plus whatever they see fit to add onto this rider.

6. The utilities complain that by applying GRA-approved fuel volumes, the Rider F mechanism would be rendered non-functional. UCG submits that this simple method serves the purpose of the OIC by protecting the companies and the ratepayers from fuel price variances that are outside the realm of forecasts. If we are to maintain a Rider F, UCG submits that it must be kept simple and less costly to regulate.

7. UCG submits that while extensive modifications to Rider F and the Deferred Fuel Price Variance Policy could be implemented and associated impacts determined, the Rider F fuel adjustment clause is not considered by UCG to be an effective mechanism for keeping electricity rates fair, responsible and predictable for ratepayers.

INTRODUCTION AND OVERVIEW

8. In preparing this submission, UCG has looked at the following issues:

- (1) whether the existing / proposed fuel adjustment clause procedures provide an adequate opportunity for public participation and scrutiny of that aspect of electricity rates;
- (2) whether the existing / proposed fuel adjustment clause procedures provide an adequate incentive for utilities to seek the lowest prices for the fuel they purchase;
- (3) whether there is a need for a mechanism within the fuel adjustment clause to encourage optimum availability, utilization and efficiency of electricity generation facilities; and
- (4) whether the existing fuel adjustment clause should be modified or eliminated in view of the apparent flaws in design and application.

9. In UCG's view, the utilities misapply such mechanisms like Rider F and the Diesel Contingency Fund to essentially influence the utilities ability to earn beyond their authorized revenue requirement and thus increase their return, an outcome inconsistent with traditional rate making. Without the Rider F and DCF, the utilities could always seek authority to increase its distribution service rates if it they were unable to raise sufficient revenues or realize operational efficiencies to satisfy its annual operational costs.

10. While UCG views the fuel adjustment mechanism procedures as a tool which can actually provide a closer and more timely oversight of fuel costs incurred by YEC and YECL, just because the rate rider is available, it doesn't mean that it has to be taken out and used. While the utilities have reminded the Yukon Utilities Board ("Board") ad nauseam in its filings in this proceeding that they are permitted to "*adjust their rates to retail customers, major industrial customers, and isolated industrial 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*" (Sec. 8, OIC 1995/90), the Board is obligated per the *Public Utilities Act* to ensure that rates and charges paid by ratepayers follow principles established in Canada for utilities and regulatory authorities. It is obvious to UCG that the utilities focus on their own welfare without considering what may be best

for Yukon ratepayers that are left paying for the utilities' operational preferences.

11. UCG submits that the Board does not have the authority to permit regulated utility companies to modify rates for electric power pursuant to an automatic fuel adjustment clause without following statutory safeguards established through the *Public Utilities Act*. The power to modify or adjust rates is the power to set rates, and this is exclusively with the Board. It is UCG's argument that this cannot be delegated.

12. UCG submits that there are weaknesses in any fuel adjustment mechanism such as Rider F:

- i. Fuel adjustment clauses reduce the utilities' incentive to pursue effective and efficient use of assets to minimize fuel costs.
- ii. Utilities may make inefficient investments which are biased towards lower capital and maintenance costs and higher fuel costs.
- iii. The utilities may earn excess return on investment by passing increases in energy costs and not passing savings in other areas of the utility to its customers.
- iv. Frequent rate changes may lower the customers' understanding of such changes and, as a result, the potential savings which could be achieved from conservation.

13. UCG submits that the Board must ensure that all costs to be recovered in rates are prudently incurred before recovery and rates are approved. UCG submits that any costs proposed to be recovered through a fuel adjustment clause such as Rider F must be proven to be prudently incurred before the Board can authorize recovery through billings to Yukon ratepayers. In order to properly ensure that the costs of fuel were prudently incurred and the aggregate charges applied to Yukon ratepayers are fair, the Board needs to ensure enough information is provided by the utilities on a regular basis to allow for a robust audit or review to be performed similar to costs reviews during general rates applications. UCG submits that it is not enough to simply rely on untested "advisory filings" by the utilities as has been the practice to date.

14. In particular, UCG submits that before any fuel cost recovery is authorized, the Board should at the very least ensure:

- a. that an adequate and appropriate fuel procurement policy at YEC and YECL exists in which the Board has confidence;
- b. the procedures utilized by the utilities assure that lowest reasonable prices at the time of purchase are paid for fuel;
- c. timely disclosure of complete and adequate information by YEC and YECL so as to ensure confidence that the procurement policy is being appropriately administered;
- d. public disclosure and transparency with respect to the administration of the fuel adjustment clause; and
- e. a meaningful audit / review process under the administration of the Board.

UCG's POSITION ON FUEL ADJUSTMENT CLAUSES

15. This submission summarizes positions of the UCG for the Board's consideration. It should not be assumed that the UCG is in agreement with YEC/YECL's positions on any issue for which the UCG has not provided specific comment on in this argument. Where the UCG has not specifically addressed an issue, it is believed that the Board has the benefit of the record of this proceeding to make informed decisions.

16. UCG submits that rates should be set at a level which is reasonable for the period the rates are to be in effect. Assuming that the utilities have access to the best information from which to develop accurate forecasts of generation requirements, the amount of fuel expense included in the base rates of YEC and YECL should be sufficient to cover the fuel prices and costs reasonably expected.

17. UCG understands that peak demand and customer energy requirements have a significant effect on fuel costs incurred by YEC and YECL. Growth in peak demand can effect generation planning, while growth in electric energy consumption drives up total fuel costs. As such, the electric load forecast, which provides an outlook on the energy and peak demand needs by month, is an essential part of planning future fuel costs. UCG submits that these load forecasts put forward by the utilities is not only vitally important to determining costs to be incurred and allocated among customer classes, but also plays a key role in what impact a fuel adjustment clause will have on ratepayers.

18. UCG notes that efforts to deliver effective conservation programs must first be optimized and better reflected in the load forecast.

19. UCG submits that if YEC and YECL are to retain a fuel adjustment clause, they should be required to demonstrate that the changes in fuel costs resulting from fluctuations in fuel prices constitute a significant proportion of their costs of providing electricity. Otherwise, the risk of price fluctuations is covered by the premium included in their rates of return.

20. YEC and YECL claim that they are at risk for increased or decreased costs due to changes in the amount of diesel generation required compared to what was forecast due to higher or lower than anticipated load and that this risk is partly mitigated to the extent that utility revenue increases or decreases concurrent with such variances in loads from the Board's last approved forecasts at approved rates (per response to YUB-YEC/YECL-2-1(a)). UCG submits that it is the ratepayers that carry the risk of decreased costs resulting from lower diesel generation requirements than are built into rates, not the utilities.

21. UCG submits that YEC and YECL are not accurate with their submission that fuel price risks are not within the utilities' control or ability to forecast (YUB-YEC/YECL-2-1(a)). The utilities have always had the ability to limit the risk of price fluctuations through their procurement process. UCG submits that the utilities have never been held accountable to their responsibility to make every reasonable effort to acquire long term fuel supplies so as to provide electricity to Yukoners at the lowest fuel cost reasonably possible.

22. The utilities state that "it is generally expected that the utilities are responsible for and account for the risks to which they are properly exposed within their GRA load forecasts" (per response to YUB-YEC/YECL-2-1(a)). UCG submits that this is a pretty vague statement and that it contradicts the utilities' position that Rider F should protect them for all situations where the price of diesel fuel changes from the previous GRA-approved forecast levels "regardless as to the use or purpose of the diesel fuel" (per response to YUB-YEC/YECL-2-1(a)). Whether the utilities are aware or not of any jurisdiction that provides a fuel price adjustment mechanism that only addresses fuel price variances for some previously set forecast volume of fuel, what is at issue here is what is just for Yukoners.

23. In UCG's view, approving the Rider F as just and reasonable is a fundamental change in rate design that shifts all business risk to ratepayers and ignores the Rider's likely adverse impact on the quality of service provided to Yukon ratepayers. The utilities have failed to address evidence and arguments demonstrating the Rider F will actually impede energy efficiency and conservation programs within the Yukon and have failed to consider evidence that the Rider F will remove the economic incentive for YEC and YECL to properly maintain the reliability of the electricity distribution system.

24. UCG submits that the utilities are mistaken in their characterization of the Diesel Contingency Fund as a mechanism that "serves to stabilize Yukon Energy's and Yukon Electrical's costs to serve firm loads on WAF" (YUB-YEC/YECL-2-4(a)). Like the Rider F, the DCF is simply another mechanism that serves to duplicate the guarantee of a higher rate of return for the utilities than would be realized had they been required to rely upon their own forecasts and operations management abilities to become more efficient. UCG contends that this does not follow generally accepted rate making principles.

25. In their application (page 3), the utilities indicate that "actual fuel consumption is recorded as an expense at the weighted average cost in the Fuel Expense Account". UCG notes that the utilities have not been following this policy given their statement that the "actual" litres consumed calculation involves taking the actual kW.h of diesel generator output and converting this to litres using an average efficiency level (per response to YUB-YEC/YECL-2-1(a), note 5). This is obviously an estimation process.

26. UCG submits that the fuel adjustment clause diminishes any incentive the utilities have to minimize fuel costs both from the standpoint of not bargaining hard enough for the least-cost procurement of fuel and of being indifferent to the needs or optimization of their generation mix.

27. UCG submits that the evidence submitted in this proceeding does not demonstrate that the utilities are unconcerned about fuel costs. But, neither does it suggest that the utilities, when confronted with choices affecting operating costs, act to the benefit of ratepayers and contrary to the interests of their shareholders. UCG is convinced that in order to facilitate optimal decision-making from the standpoint of keeping system costs as low as possible, it makes sense to put all costs, to the extent practicable at least, on an equal footing.

28. In fact, the utilities have not provided evidence that any of the actual increases in fuel cost recovered through the fuel adjustment clause have not been offset by actual decreases in other operating expenses. **The lack of a thorough review of all costs when contemplating the activation of a fuel adjustment clause is a significant flaw in the fuel adjustment clause process.**

29. UCG submits that it is obvious from the response to YUB-YEC/YECL-2-2(f) that the utilities are splitting hairs when it comes to identifying the potential for recoveries through Rider F to positively impact their earnings. As stated above, the Rider F mechanism helps to guarantee that the utilities not only recover a fair return but also gives them an opportunity to over earn while relying on section 8 of OIC 1995/90.

30. In response to YUB-YEC/YECL-2-2(h & i), the utilities indicate that they provide Rider F calculations to the Board but do not explain how intervenors would have any opportunity to review this information when the utilities do not circulate it to interested parties. Not only are interested parties not notified of these filings, but the Board has not established any process to review the filings since the utilities continually hide behind section 8 of OIC 1995/90. If the utilities continually provide only “information filings” to the Board regarding pending changes to Rider F and they are not in the form of an application, how can the utilities claim that interested parties need only submit a complaint to get the Board to consider reviewing a new Rider F? Either the utilities have come up with a way for the Board to circumvent the OIC provision preventing the requirement for a specific application to and approval from the Board or they are assuming that interested parties such as the UCG will be too confused to know what is actually happening to the bills of ratepayers.

31. In response to YUB-YEC/YECL-2-3(a), the utilities state that the difference between the most recent GRA approved fuel price and the actual weighted average cost per litre of fuel consumed is used when calculating the DFPVA balance (as opposed to difference between the most recent GRA-approved fuel price and the actual cost per litre of fuel consumed) because it is not possible to distinguish one litre of fuel in inventory purchased at a certain price from another litre of fuel in inventory purchased at another price and a weighted average cost of all fuel in inventory must be used. UCG does not understand why the utilities would not be able to use a first in – first out accounting process to better match fuel costs to actual costs incurred especially when they indicate in response to YUB-YEC/YECL-2-3(d)(ii) that the fuel cost values used for any given month are tracked on a first-in first-out basis.

32. UCG questions the claim of YEC and YECL that “the collection (or refund) of amounts related to fluctuations in fuel price via Rider F is consistent with regulatory practice in every other jurisdiction reviewed that maintains similar fuel price variance accounts” (LE-YEC/YECL-1-7 REVISED).

UCG’s SUGGESTED MODIFICATIONS

33. UCG submits that modifying the application of the existing fuel adjustment clause is an alternative for the Board to consider. The utilities failed to provide the Board and other parties with evidence of modification alternatives to the existing fuel adjustment clause designed to correct some or all of the perceived deficiencies in the existing clause. Accordingly, here are some of our preferences.

34. The existing fuel adjustment clause permits the recovery / refund of any increase / decrease to the price of fuel for diesel-fired generation. The Rider F mechanism covers roughly a sixty-day period because only actual fuel prices can be used and, hence, an entire month must elapse before a utility is in a position to determine actual fuel costs for that month. These costs are then determined in the following month and billed in the next following month so that sixty days after the end of the month in question, the additional / reduced costs can be recovered / refunded.

35. UCG submits that any modified fuel adjustment clause would need to address the problem of providing utility customers with price signals in advance of consumption rather than after consumption has already taken place. Fuel adjustment clauses, in and of themselves, do not provide proper price signals from the utilities because customers are always billed after the fact. In other words, the increase in fuel costs signalled by an increase in the fuel adjustment factor on a customer's bill is not communicated to that customer until after the customer has consumed the higher cost power.

36. UCG submits that the fuel adjustment clause is not always applied to all kilowatt-hours sold, so some customer classes have had to shoulder the entire burden of higher fuel prices (response to UCG-YEC/YECL-1-12 REVISED). It has not been lost on UCG that the industrial class started seeing the Rider F on their bills once it was in a credit position starting in December 2009.

37. UCG submits that, as is done in other jurisdictions like Nova Scotia, the existing fuel adjustment clause could include an incentive / penalty mechanism such that the Rider F mechanism only passes through a portion of the difference between actual fuel prices and the price of fuel built into rates. For variances up to a pre-determined threshold (i.e., a significant impact on cost of service) on a \$/MWh basis, 90 percent of any savings or increases will be passed from the utilities to customers. The utilities would remain responsible for 10 percent of the increase or retain 10 percent of the fuel savings. The portion of any annual variance in excess of the threshold would be the responsibility of customers.

38. While there has been no evidence submitted in this proceeding to prove that changes in fuel prices will have a significant impact on the earnings of the utilities, the utilities simply use the historical existence of some form of fuel adjustment clause to classify it as both necessary and proper. UCG submits that, at the very least, the utilities should have provided evidence which set forth their earnings for a recent twelve-month period and the reduction in earnings which would have occurred if no fuel adjustment clause had been in effect during that twelve-month period. As indicated in response to YUB-YEC/YECL-2-5(c), the utilities have not provided any evidence regarding what impact fuel costs have on earnings.

39. UCG submits that the utilities bear the burden of demonstrating that the Rider F is just and reasonable and that without it, the utilities cannot earn a fair rate of return. In UCG's opinion, this burden has not been met, and any concerns the utilities may have about their ability to fund distribution service operations can be cured by appropriate rate design focused on ensuring YEC and YECL face no impediment to collecting its distribution service operating costs.

40. UCG submits that the utilities should have also provided evidence of whether fuel prices/costs have risen more rapidly during the past several years as a percentage of total operating expenses than other categories of cost. In other words, if one cost category such as fuel expense represents 30 percent of utility revenues while its earnings represent 10 percent of revenues, a 10 percent increase in fuel costs which is not immediately recoverable by an increase in rates will reduce earnings by 3 percent (30 percent times 10 percent) to a level of 7 percent. If the proportion of fuel costs increases to 40 percent of revenues, then the reduction in earnings will be 4 percent.

41. UCG questions whether an automatic pass-through mechanism for fuel price changes is necessary. While totally eliminating the fuel adjustment clause from the tariffs of YEC and YECL may be premature, UCG submits that the YUB should adopt regulations requiring YEC and YECL to submit proof periodically of their continued need for a fuel adjustment clause, as well as of the efficiency of their operations and purchases affecting fuel costs. UCG submits that this may ultimately result in the "phasing-out" of a fuel adjustment clause since methods may be developed to achieve reliable rate case estimation of fuel costs.

42. YEC and YECL argue that the ability to recover increases in fuel costs between rate cases eliminates some of the lag inherent in the regulatory process and, hence, reduces the risk that a regulated utility will not earn its allowed rate of return. They further maintain that the reduced risk is rewarded in the market place by a lower cost of capital to the utility and eventually lower rates to its customers. They also maintain that fuel adjustment clauses permit utilities to more properly price their service to the general public and, to the extent that the price of electricity does not reflect its cost, customers are encouraged to consume more electricity which results in a misallocation of resources in that utilities must invest in additional capacity which would not have been necessary if their services had been priced at cost.

43. UCG submits that the lag inherent in the regulatory process (i.e., the differential between the time a utility experiences higher costs and the time when it is permitted to recover these higher costs through higher rates) should be preserved as an incentive for YEC and YECL to hold down

costs. In UCG's view, regulatory lag substitutes for the competitive forces experienced by non-regulated industries where cost increases may not be immediately reflected in higher prices because of competitive pressures.

44. While the utilities have argued that the preservation of regulatory lag implied by the elimination of the fuel adjustment clause would necessarily result in greater rate case activity, UCG submits that the rate case setting is the proper arena to address cost increases because all costs are considered (both increases and decreases) and the additional burden on the YUB and other parties is immaterial because it is the function of the YUB to regulate regardless of the time it takes.

45. UCG submits that the design of the fuel adjustment clause permits the recovery of costs other than the costs associated with an increase in the price of fuel. In other words, fuel prices can remain a constant over the course of a year but fuel adjustment revenues increase over that same year because the utility met its load with a more expensive generation mix, because the load is greater or because of increased outages on the cheaper generating units or a combination of the two.

46. UCG submits that while the YUB has the authority to grant a rate adjustment to YEC and YECL per Section 8 of Rate Policy Directive OIC 1995/90 to reflect fluctuations in the prices for which the two utilities pay for diesel fuel, the OIC is silent in identifying how much of a price fluctuation should trigger a rate adjustment. The YUB is obligated under this same OIC to review and approve rates in accordance with principles established in Canada for utilities, including those principles established by regulatory authorities of the Government of Canada or of a province regulating hydro and non-hydro electric utilities. UCG submits that there has been no evidence submitted by the utilities which explains that the principles of the Yukon's current fuel adjustment clause are in any way similar to any other jurisdiction.

47. UCG submits that general rate case proceedings are the proper forum for determining the costs upon which future base rates will be set. UCG submits that the YUB has already established an annual fuel cost for each utility as part of their allowed revenue requirements and any rate adjustment outside of a general rate case proceeding should be based on the total cost of operations including fuel costs and not based solely on fuel price fluctuations from a level established at one point in time on a forecast basis.

48. UCG submits that the existing fuel adjustment clause rewards the utilities which do not minimize their fuel costs. Furthermore, the fuel adjustment clause should not provide a mechanism for the automatic recovery of increased fuel costs due to abnormal outages of a utility's more economical generating units or increased fuel costs due to a utility not promoting conservation initiatives which is less expensive than the kilowatt hours which the utility would otherwise have to generate.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 14th DAY OF NOVEMBER, 2011.