IN THE MATTER OF YUKON ENERGY CORPORATION & YUKON ELECTRICAL COMPANY LIMITED RIDER F – FUEL ADJUSTMENT RIDER & DEFERRED FUEL PRICE VARIANCE POLICY

FINAL ARGUMENT OF YUKON ENERGY CORPORATION & YUKON ELECTRICAL COMPANY LIMITED

November 14, 2011

INTRODUCTION & BACKGROUND

Yukon Energy ("YEC") and Yukon Electrical Company Limited ("YECL") ("the Companies") filed the *Rider F – Fuel Adjustment Rider & Deferred Fuel Price Variance Policy* (the "Policy") with the Yukon Utilities Board (the "Board") on June 30, 2011, as required by Board Direction in Order 2010-13.

The Board in Order 2010-13 indicated its concern with large swings in the account "ranging from a negative $635,000 to a positive $600,000", and provided the following specific directions related to the Rider F – Fuel Adjustment Rider:

- That no later than June 30, 2011, the Companies file a written policy with the Board detailing how Rider F – Fuel Adjustment Rider is managed.

- That the Companies provide to the Board quarterly acknowledgement filings stating the balance in the Rider F account and concurrently post these filings on each company's website for easy public access, to allow all interested parties to monitor the balance in the Rider F account.

The *Rider F Fuel Adjustment Rider & Deferred Fuel Price Variance Policy* as subsequently filed sets out the current practice regarding the administration of the Deferred Fuel Price Variance Account (the "DFPVA") and sets out how Rider F changes are administered in Yukon based on well established past practice and specific order of the Yukon Government (Rate Policy OIC 1995/90).

The above direction suggested a limited scope proceeding focused on review of the Rider F Policy, and the administration of the DFPVA and related Rider F changes. In this regard, the Companies viewed issues relating to the Diesel Contingency Fund, Rider D or other issues related to utility costs as out of scope and more appropriately addressed as part of a GRA process.

Board Order 2011-10 (revised by Order 2011-13) established a written process for review of the Policy, with one round of interrogatories, written argument and reply. In letters dated September 8, 2011, UCG and LE sought Board Orders for further information from Yukon Energy and Yukon Electrical arguing that the information provided in responses filed September 6, 2011, was not fully responsive.

Board Order 2011-12 subsequently directed the Companies to provide further responses to the interrogatories indicated in Appendix A to the Order, and further directed the Companies to respond to additional interrogatories from the Board as provided in Appendix B to the Order. The Board in Appendix A to Order 2011-12 indicated a desire for "further clarity to how the Diesel Fuel Price Variance Account (DFPVA) works, and how OIC 1995/90 is interpreted", and need to clarify understanding regarding "whether there is a relationship between the Diesel Contingency Fund (DCF) and the DFPVA", and between the DCF, Rider D and the DFPVA. In this regard illustrative examples were requested to demonstrate how the DCF operates and show that there is or is not an interrelationship between the DCF and the DFPVA. The Board's additional interrogatories (provided in Appendix B of the Order) requested additional detail and supporting documentation regarding the above noted issues.

The Companies provided detailed additional responses as required by Order 2011-12 on October 28, 2011.

1.0 CLARITY REGARDING POLICY CONTEXT & OIC 1995/90

This proceeding is defined in large part by Section 8 of OIC 1995/90. Section 8 of OIC 1995/90 provides that Yukon Energy and Yukon Electrical can adjust their rate 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 from, the Board (see YUB-YEC/YECL-2-2(b)). In effect, pursuant to current policy and existing practice the Companies must be permitted (without need for, application to, or approval from the Board) to adjust their rates "so as to reflect fluctuations in the prices for which the two utilities pay for fuel". The adjustment mechanism, as directed, applies to all fuel consumed, not just GRA forecast fuel.

As noted in YUB-YEC/YECL-2-5(c) and (d), the principle basis for, and rationale underlying, the Yukon Rate Policy regarding the fuel price adjustment mechanism is to provide for stability relative to swings in fuel prices and address risks inherent in forecasting diesel fuel price. Absent a Rider F mechanism the utilities would have to base their forecast costs and rates for each GRA on "best guesses" as regard to fuel prices, and subsequent to customer rates being so determined, actual earnings of the utilities would be affected each time fuel prices change. To the extent that fuel costs are material to the utility's overall earnings, major changes in fuel prices would lead to pressures for new GRA hearings (either to lower rates or to raise rates in response to fuel price changes).

As noted in LE-YEC/YECL-1-2, to be effective, and to ensure that all fuel price risk is fully addressed, the fuel price adjustment mechanism must apply to all volumes of fuel consumed. In this regard, the Companies have noted that the DFPVA has been administered on a consistent basis for over two decades and is aligned with how deferrals for similar fuel price adjustment mechanisms operate in other jurisdictions where fuel price risk is handled outside of the setting of the normal regulated rates.

As noted in Appendix A of the *Rider F – Fuel Adjustment Rider & Deferred Fuel Price Variance Policy* and in the response to YUB-YEC/YECL-2-1(h) and (i) and YUB-YEC/YECL-2-3(b) and (c) the policy direction provided in section 8 of OIC 1995/90 has been in place in Yukon since 1988. Since the 1989/90 GRA the DFPVA has been administered on a consistent basis (and as approved by the Board in Orders 1989-1 and 1990-2). Material outlining the calculation of Rider F (and related DFPVA balances) has routinely been filed with the Board over the past two decades according to the current policy and practice and these filings have consistently illustrated that actual diesel fuel consumed (as opposed to fuel consumption levels approved at the last GRA) have been used for the calculation of the DFPVA balance and subsequent Rider F adjustments. The Rider F Deferral Fuel Price Accounts have most recently been approved by the Board for each Company in the Board Orders approving each Companies 2008/2009 GRA (Board order 2009-2 for YECL and Board Order 2009-8 for YEC). The Companies are not aware of any jurisdiction that provides a fuel price adjustment mechanism that only addresses fuel price variances for utility board approved fuel volumes. (See, LE-YEC/YECL-1-2 as well as LE-YEC/YECL-1-1 and LE-YEC/YECL-1-3).

As noted in response to YUB-YEC/YECL-2-2(b) at each GRA since 1988 base rates have been expected to be adjusted to reflect the fuel price forecast for the GRA, and to enable the Rider F determination to restart from this new reference point. Accordingly, the Board during each GRA has had the opportunity to review the DFPVA and address any issues relating to the DFPVA accounts during that process prior to approving test year forecasts and rates.

2.0 ADMINISTRATION OF DFPVA AND RIDER F ADJUSTMENT MECHANISM

The Policy and interrogatory responses fully address the issues noted in Order 2010-13 related to administration of the deferred fuel price variance account and related Rider F adjustment mechanism. The policy and the quarterly acknowledgement filings provide for greater understanding and awareness regarding DFPVA deferrals and related Rider F adjustments.

The Policy (Section 2) identifies two thresholds to guide administration of the DFPVA and establishes an objective to adjust over a 12 month period when the balance exceeds +/-$200,000 and a requirement to adjust over a shorter period (typically 6 months) when the balance exceeds +/-$400,000. (See YUB-YEC/YECL-1-3(a)).

- The $200,000 level was determined as a practical guide for administration in the 1990s (see, YUB-YEC/YECL-1-1), and provides the Companies with necessary flexibility to absorb price volatility of diesel without having to implement frequent rate changes which would have related administrative burden and associated costs (See, YUB-YEC/YECL-1-2(b)). To the extent that fuel prices remain within a reasonable range and can be forecast on an annualized basis it also provides for greater rate stability of customers and reduced administration costs (See, UCG-YEC/YECL-1-7).

- The +/- $400,000 threshold acknowledges that occasionally circumstances may result in the balance growing beyond the $200,000 threshold (see for examples discussion in LE-YEC-1-10); in these circumstances, the Companies must act more proactively to recover outstanding DFPVA balances over a shorter period of time (6 months) and adjust kWh unit prices to reflect higher fuel prices being experienced by the Companies.

As indicated by the +/-$200,000 objective and +/-$400,000 requirement thresholds, the timing of any collection/refund rider related to the DFPVA requires flexibility and use of best judgment to adjust to changes in circumstance (i.e., swings in fuel prices and external events such as GRA proceedings or pending Board Orders).

- While fluctuations in fuel costs occur from month to month, the Companies try to implement Rider F changes coincident with other rate changes when practical to reduce administration costs (see LE-YEC/YECL-1-11).

- Filings may need to be deferred in order to avoid rate volatility with balances exceeding the established optimal range of +/-$200,000 (e.g., implementing a rate change that would later

need to be adjusted after a GRA was completed; see YUB-YEC/YECL-1-2 and LE-YEC/YECL-1-10, UCG-YEC/YECL-1-7).

A directive to file a Rider F adjustment within a fixed time period following exceeding a threshold, or to file an adjustment on a regular basis (e.g., quarterly) would not provide the necessary flexibility to adjust to specific situations (such as unresolved GRA proceedings) or changes in circumstances related to swings in fuel prices (that may negate the requirement for a Rider change). See YUB-YEC/YECL-1-2(a), YUB-YEC/YECL-1-3(b); and LE-YEC/YECL-1-10 which detail matters that may influence timing (deferral) of filings when the balance had reached the optimal range of +/-$200,000.

Rider F charges or rebates to customers do not affect the income of the Companies (see UCG-YEC/YECL-1-2(f)). Further, there is no interest expense accrued to ratepayers on account of the DFPVA balances carried by the Companies, the Companies are not reimbursed for carrying costs of the DFPVA balances owing from ratepayers and aside from standard monthly invoicing activities between Companies there is no cost to ratepayers for any intercompany transfers undertaken pursuant to the policy (see UCG-YEC/YECL-1-6).

3.0 CLARITY REGARDING DFPVA ADMINISTRATION & OPERATION

Prior to, and throughout, the current process to review the Policy, various parties have raised questions that indicated ongoing confusion regarding the calculation of, and basis for, deferrals to the DFPVA. The Board in Appendix A to Order 2011-12 also indicated a desire for "further clarity to how the Diesel Fuel Price Variance Account (DFPVA) works". The following specific assertions or concerns were noted by parties throughout the review process (in correspondence or in interrogatories):

(1) Assertions that the Companies through the DFPVA and Rider F are recovering a combined shortfall of higher fuel prices and increased diesel generation forecast for 2011.

(2) Assertions that the DFPVA account should not be allowed to collect fuel price variances related to fuel volumes in excess of Board approved amounts.

(3) Assertions that Rider F as proposed by the Companies transfers some of the risk of under forecast diesel requirements to ratepayers.

(4) Assertions that there must be an interaction between Rider F and its calculation methodology and the DCF (or Rider D) and its calculation.

Utility Risks Addressed by the DFPVA and Utility Risks Not Addressed by the DFPVA

The DFPVA currently protects <u>both</u> the utility and ratepayers from forecast risks related to diesel price variances, and its administration does not transfer risk from one party to the other.

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, including load changes[1], equipment availability[2] and generator efficiency[3] (see discussion in YUB-YEC/YECL-2-1(a) and (b)). The Policy and the responses to interrogatories have consistently noted that the Companies are at risk at GRA approved fuel prices for all costs associated with diesel generation volume variances from test year forecast as last approved by the Board.

By contrast, fuel price risks are subject to external market conditions and not within the utilities' control or ability to forecast, and as noted in response to YUB-YEC/YECL-2-5 (c) and (d), Rider F normalizes values for volatile and uncontrollable factors inherent in forecasting fuel prices, including all factors affecting future world oil prices and the relationship between world oil prices and diesel fuel prices charged to the utilities in the Yukon.

The Companies are protected through Rider F mechanism (DFPVA) for all situations where the price of diesel changes from the previous GRA-approved forecast levels, regardless as to the use or purpose of the diesel fuel (per OIC 1995/90). To ensure fuel price risk is fully addressed by the fuel price variance mechanism in Yukon (and in all other jurisdictions where fuel price risk is handled in a similar manner) the policy necessarily applies to all volumes of fuel consumed. If the DFPVA did not apply to all fuel volumes the Companies and ratepayers would not be fully protected from all diesel fuel price variance risk as is clearly contemplated by OIC 1995/90. As noted above, the Companies are not aware of any jurisdiction that provides a fuel price adjustment mechanism that only addresses fuel price variances for some previously set forecast volume of fuel.

Calculation of DFPVA Deferrals

The response to YUB-YEC/YECL-2-1(a) and (b) summarized the calculation of DFPVA deferrals under the current Policy. As noted above, since the 1989/90 GRA the DFPVA has been administered on a consistent basis (and as approved by the Board in Orders 1989-1 and 1990-2). Material outlining the calculation of Rider F (and related DFPVA balances) has routinely been filed with the Board over the past two decades according to the current policy and practice, and these filings have consistently illustrated that actual diesel fuel consumed (as opposed to fuel consumption levels approved at the last GRA) has been used for the calculation of the DFPVA balance and subsequent Rider F adjustments.

YUB-YEC/YECL-2-3(e) provides calculation and explanations respecting the 2008, 2009, 2010 and 2011 DFPVA balances and weighted average cost per litre of fuel that forms the DFPVA calculation for YECL and YUB-YEC/YECL-2-3(f) provides the same information with respect to YEC. As noted, to ensure that

[1] Companies are at risk for increased or decreased costs due to changes in the amount of diesel generation requirement compared to what was forecast due to higher or lower than anticipated load (including for ongoing load growth, or for weather variability impacts). This risk is partly mitigated to the extent that utility revenues increase or decrease concurrent with such variances in loads from the Board's last approved forecast at approved rates.

[2] The Companies are generally at risk for diesel required for unexpected maintenance or outages of equipment, except where such charges are appropriately part of insurance claims or uninsured losses.

[3] The Companies are at risk for changes in the efficiency of their generating units from the levels forecast at the last GRA, and the consequent diesel generation required or saved.

fuel price risk is fully addressed by the fuel price variance mechanism in Yukon the policy applies to all volumes of fuel consumed.

Specifically, the Companies pay for all fuel purchased and record the diesel generation (kWh) required, convert it to litres at the GRA efficiency level, then take the difference between the fuel price paid and the GRA approved price (the "fluctuation" per OIC 1995/90) and charge or credit that difference to the DFPVA. The now "normalized" cost litres are then charged to the appropriate account at the normalized price. This process was followed by both utilities after the 1996/97 GRA test years throughout the extensive period of non-test years.

YUB-YEC/YECL-2-2(a) also specifies that the only GRA approved forecast used to calculate deferrals to the DFPVA is the GRA fuel price forecast and that the monthly fuel volume forecasts used to calculate the DFPVA amounts are not based on GRA forecasts, but are based on the most recent available business plan (YUB-YEC/YECL-2-2(c) specifically details the mechanisms in place for testing retail sales forecast and underlying generation forecasts). YUB-YEC/YECL-2-2(a) and specifically Attachment 1 to this response detail the specific calculations and inputs.

Suggested Alternate Approaches to Calculating Deferrals to the DFPVA

Alternate approaches related to calculating deferrals to the DFPVA were reviewed in YUB-YEC/YECL-2-1 (l), (m) and (n). Suggested approaches posed included: (1) a monthly calculation that multiplies the approved forecast volume times the diesel price variance (actual-forecast) in order to determine a DFPVA balance; (2) utilizing the last approved retail forecast in order to arrive at a Rider F rate; and (3) a minimum threshold amount to facilitate an easy perusal and understanding by both the Board and intervenors in respect of the Companies' proposed Rider F and DFPVA quarterly reporting.

The Companies note that the suggested approaches are not considered to be advisable for the following reasons:

- The suggested approaches would not permit the Companies to adjust their rates so as to reflect the fluctuations in the prices for which the two utilities pay for diesel fuel which is the explicit requirement of OIC 1995/90. In effect, this would make it ineffective as a mechanism to ensure that fuel price risk is fully addressed as it would not apply to the required volume of fuel consumed. This would be at odds with all other jurisdictions the Companies are aware of where all fuel price risk is handled outside the setting of normal regulated rates;

- It would be unprecedented in all Canadian regulatory experience reviewed by the Companies and not consistent with the related direction set out in Section 3 of OIC 1995/90[4]; and

[4]Section 3 of OIC 1995/90 provides, " Normal principles to apply - Except to the extent otherwise stated by this Directive or the Act, the Board must 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".

- It would not be consistent with the risk distribution between the Companies and ratepayers that has existed for more than two decades (including the basis on which the two utilizes have established their revenue requirements and had their risk profiles reviewed by experts and the Board).

Further, as noted in response to YEC/YECL-2-1(n), an approach that uses a minimum threshold amount would not reflect best current information and would not set the best potential rate to deal with balance in a 6 or 12 month period. Specifically, to the extent actual sales differ from forecast, the actual collection/refund would differ from forecast and affect the ability to balance the fund within expected timeframe (typically 6-12 months).

Interaction of DFPVA and other Rate Adjustment Mechanisms (DCF and Rider D)

In interrogatories, the Board and intervenors have sought clarity regarding whether there is a relationship between the DCF (and Rider D) and the DFPVA. Interrogatory responses fully clarify that the specific risk addressed by Rider F is very different from the risk addressed by the DCF, and there is no interrelationship between the DCF and the DFPVA. (See YUB-YEC/YECL-2-4(g) as well as LE-YEC/YECL-1-4 REVISED and LE-YEC/YECL-1-5 REVISED for detailed explanations and explanations regarding how the DCF and Rider F are not interrelated). Specifically, the DCF mechanism deals with a separate set of risks unrelated to diesel fuel price risk and consequently the DCF mechanism is not related to DFPVA deferrals or Rider F charges.

The following is specifically noted in this regard:

- Rider F is a fuel price adjustment mechanism that addresses only risk related to change in fuel price from GRA approved forecast fuel prices, and does not address risk (at GRA approved fuel prices) for any changes in diesel generation fuel volume from the GRA forecast. All fuel price-related risks are addressed by Rider F.

- The DCF deals with a separate set of risks unrelated to diesel fuel price risk. The origin and role of the DCF and the approved mechanics were discussed in detail in response to LE-YEC/YECL-1-4 REVISED and YUB-YEC/YECL-2-4 (a) to (c) and in supporting documentation related to the approval and operation of the DCF provided as an attachment to that response. In sum, the DCF, established in 1996/97, was designed to stabilize utility costs of diesel due to fluctuations in generation related to higher or lower than average long term hydro generation due to water availability. The DCF is not affected by fuel price variances, nor by the fact that diesel volumes change (absent such changes being due to variances in hydro generation capability). Accordingly and consequently the DCF mechanisms are not related to the DFPVA deferrals and Rider F charges.

- The fuel included in the DCF calculation is at the GRA approved price (i.e., the DCF only addresses risks related to water level fluctuations at the GRA-approved price and not at the actual diesel fuel price). By contrast, the Rider F addresses risks related to the difference

between the GRA approved fuel price and actual fuel price and GRA forecast plant efficiencies for each actual litre of fuel consumed (but does not address risks related to change in diesel generation volume at GRA approved fuel prices).

- Board approval of the DCF in the 1996/97 GRA was provided at a time when Rider F had been in operation for many years, and no suggestion was made at that time that the DCF in any way reduced the need for, or role of, the Rider F mechanisms. Further, detailed illustrative examples provided in LE-YEC/YECL-1-4 REVISED demonstrate that there is no interrelationship between the DCF and the DFPVA. Further examples were provided in LE-YEC/YECL-1-5 REVISED.

Parties have also sought clarity regarding whether or not there is a relationship between the DCF, Rider D and the DFPVA. The operation of Rider D in relation to the DFPVA and the DCF was discussed with relevant examples provided in LE-YEC/YECL-1-6 REVISED. Order 2010-13 observed that Rider D as proposed by YECL would only address dispensation of the balances in YECL's Board approved wholesale purchase power deferral account as approved in Order 2009-2 which relates to variances between forecast and actual costs of purchase power by YECL for the hydro zone during the period when diesel generation is on the margin and when approved run out rate set under the ERA in Rate Schedule 42 is different than rates used to determine the forecast cost of purse power for diesel generation. In this regard the following is noted:

- Rider D as proposed by YECL and as described in Order 2010-13 would have no relationship to YEC's average or actual hydro generation, and thus has no relationship to the DCF; and

- Rider D as proposed by YECL and as so described in Order 2010-13 would depend on YECL variances in purchase power volumes and the variance between the stated runout rate charged to residential NG customers in the hydro zone (as per Rate Schedule 42) and the approved YEC incremental diesel generation cost, i.e., none of these factors have any bearing on the DFPVA applicable to either YEC or YECL, or to any variance between actual and GRA approved fuel prices.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 14th day of November, 2011.

YUKON ELECTRICAL COMPANY LIMITED	YUKON ENERGY CORPORATION
Original signed by	**Original signed by**
Rob Pitzel Financial Services Supervisor	Ed Mollard Chief Financial Officer