IN THE MATTER OF YUKON ELECTRICAL COMPANY LIMITED 2008/2009 GENERAL RATE APPLICATION

REPLY ARGUMENT

YUKON ENERGY CORPORATION

November 10, 2008

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1.0 INTRODUCTION - FUNDAMENTAL ISSUES

1.1 OVERVIEW

Yukon Energy's reply argument is structured to address in the Introduction fundamental issues underpinning YECL's argument and the arguments of other intervenors. Subsequent sections of Yukon Energy's reply argument will then address issues raised by YECL and other intervenors using the structure of the Application.

In relation to YECL's final argument, Yukon Energy will avoid responding to the various comments about what YEC's counsel said which appear to arise from YECL's frustration, evident at the hearing, at being required to answer straightforward but pointed questions about why it chose to file a shareholder focused application and ignore approaches which would have moderated the 11% increase.

1.2 YECL'S ARGUMENT – FUNDAMENTAL ISSUES

YECL argues that, "from a high level perspective", the increases being requested in 2008 and 2009 from all firm retail customers in Yukon "are indeed reasonable for a Company that has not been before the Board for some 12 years" (YECL Argument, p 4).

In its introduction, YECL's argument also addresses other "general points" in order "to ensure that the Board and parties are approaching the consideration of Yukon Electrical's requested Revenue Requirements from the same perspective." In this regard, the following are noted by YECL:

- YECL references the Board's statutory mandate to argue that, regardless of historical information provided on the record, the Board "cannot in any way <u>penalize</u> Yukon Electrical based on what has occurred in the past, so as to deprive it of fair and reasonable rates for the Test Years", that YECL's fair and reasonable return for the Test Years "cannot be impacted by the level of achieved return over the Non-Test Years", and that "the past approved returns for ATCO Electric have no relevance to the matters before the Board and provide no assistance in establishing a fair and appropriate return on capital structure for Yukon Electrical".

- YECL argues that "collecting reasonable costs incurred in accordance with recommended and accepted practices, or in order to achieve a reasonable Return on Equity and Capital Structure, are not inappropriate or excessive costs" and "Such costs should not be disallowed simply because it would result in a decrease in the current year revenue requirement." YECL argues that an approach whereby "inappropriate measures…are adopted solely for the purpose of reducing the Test Year Revenue Requirements…does not fairly balance the interests of ratepayers and the company."

1.3 OTHER INTERVENOR ARGUMENTS – FUNDAMENTAL ISSUES

Other intervenors, in their respective introductions, argue that YECL's application has not adequately considered the interests of ratepayers, and that its projected costs are higher (and its projected revenues are lower) than should be reasonably expected. The following are also specifically noted:

- CW argues that, while YECL has its own requirements, CW also must consider the interests of its residents "and strive to ensure that the revenue requirement approved by the Yukon Utilities Board is not higher than required to meet those objectives."

- Leading Edge ("LE") argues at the outset, under "Overall General Impressions", that YECL "has made assumptions and requests that, overall, favour its sole shareholder and debt holder ATCO Electric over the ratepayers" and that "if YECL so desired, ratepayer interests could be better served, and in the author's view should be." LE also argues at the outset:
  - "The YECL GRA contained in virtually every cost category requests for increases that far exceeded costs experienced in the years preceding the two test years and significantly exceeded the growth rate in sales, numbers of customers, and inflation. This gives the impression that either both costs and projects have been deferred in recent years or everything possible has been added to this GRA since YECL is finally before the Board after 12 years – or both."
  - Since the last GRA some 12 years ago, YECL's manner of operating and return on equity being consistently above the average of other Canadian regulated utilities "shows that YECL is managed in a manner that makes it a very low risk utility."
  - The YECL witnesses "left the impression that the application was not well thought out or prepared in favour of YECL's owner or both."

- Utilities Consumers' Group ("UCG") argues at the outset, under "General", that "the YECL has not taken the best interests of their customers in acquiring the debt debenture from their parent company, rate of return amount, nor capital structure proposal. Furthermore, YECL proposes to seriously inflate its rate base in the two test years by proposing several expensive capital projects that are not necessary at this time to secure safe, reliable and cost-effective electricity."

1.4 YUKON ENERGY REPLY - FUNDAMENTAL ISSUES

As acknowledged in YECL's argument, a fundamental underpinning of YECL's GRA which permeates the entire application, including the testimony of its' witnesses at the hearing and its final submissions, is that the cost increases being requested are reasonable because YECL has not been before the YUB since 1996/1997.

This simplistic premise once analyzed carefully with the benefit of the actual results achieved by YECL over the last six years for which YECL provided evidence (earlier years were excluded from its filings), and using good regulatory oversight principles, is clearly unsustainable and must be rejected by the Board. In this regard, the Board must reject YECL's inconsistent argument that its past returns, costs, and sales during the past 12 years without regulatory review are not relevant to the Board's decision on its application for the test years. As argued by LE, the actual performance of YECL over the past 12 years demonstrates a very low risk utility able to sustain high shareholder returns regardless of any ongoing cost pressures.

Notwithstanding the fact that the 11% rate increase is being sought to fund significant controllable cost increases exceeding 20% for 2009 compared to 2007, Yukon Energy agrees with other intervenors that the evidence is devoid of any meaningful attempt by management to reduce the increase to more modest levels. YECL's management simply believes that because it has not requested an increase in 11 years this justifies its need for all of the large cost increases now requested.

Although Yukon Energy fully supports the view that the Board and parties must approach the review of YECL's application from the "same perspective," it rejects the perspectives advocated by YECL. In Yukon Energy's view, in order to fairly balance the interests of ratepayers and the company, the Board should not ignore the past performance of YECL, the allowed returns of its parent, or appropriate measures that can be adopted solely for the purpose of reducing the test year revenue requirements.

Yukon Energy agrees the Board's mandate is to establish fair and reasonable rates but, as also argued by the other intervenors, Yukon Energy submits that it must do so balancing the risks and interests of ratepayers against the risks and interests of YECL and its shareholders. The problem with the YECL perspective is that it is asking the Board to ignore in any meaningful way the importance of what has actually transpired over the last several years – YECL simply asserts that significant increases can be justified by mere reference to the long time period since the Board's last review, without regard to performance during this period. Further, although YECL's shareholders are entitled to collect in rates a fair return, YECL also seems to downplay the concept that ratepayer interests are paramount in assessing controllable non return cost increases.

Therefore, Yukon Energy submits that in the context of the very material cost increases being proposed, an important and relevant question in assessing the reasonableness of the cost increases being requested is whether or not YECL has done everything reasonably within its control according to accepted regulatory norms and principles to ensure that the controllable cost increases are moderate and reasonable in the circumstances.

Once the evidence is carefully analyzed (as opposed to relying on speculative and overly conservative predictions) the only conclusion that can be credibly reached in the circumstances is that YECL's management has not undertaken such a review. What the evidence demonstrates is the following:

- Over the last number of years, YECL has been able to provide safe and reliable service to its customers notwithstanding YECL acknowledges it was faced with "cost pressures".

- Notwithstanding these cost pressures it was able to manage its business in a manner that allowed them to earn a return which was substantially more than was allowed to their parent company and any other comparable regulated utility -- and substantially more than they would have earned had they elected to come back to the YUB during that period.

- It did so by intensely managing the business by ensuring cost increases were kept to a moderate level because during that time any risk of increased costs would have been borne by YECL and its shareholders and not ratepayers -- in other words when it is YECL's risk, YECL found a way to manage the business and earn high return.

- This has to be contrasted to the test years when any projected cost increase approved by the Board is no longer to YECL's risk -- unconstrained by its need to manage its business intensely it now forecasts huge increases in controllable costs, safe in knowing that the ratepayers will bear the brunt of those forecast cost increases that are approved by the Board – further, as YECL's risks are thereby shifted to ratepayers, its opportunities for shareholder returns are enhanced as well as the prospects to avoid for another lengthy period the need for YUB review of its revenue requirements.

Simply stated, Yukon Energy fundamentally disagrees that YECL's forecast costs for the test years are in keeping with the prudent approach to managing the utility through "cost pressures" which YECL took over the last ten years. Instead of looking to every opportunity to reduce the increase to a more modest level -- when faced with choices -- management consistently chose to follow regulatory approaches most beneficial to YECL and its shareholders. This attitude is clearly evident in the following examples:

1. **Forecasting costs which are exceedingly conservative and detrimental to ratepayers' interests, and ignoring updated evidence supporting cost reductions or net revenue increases**

   a. In general, as argued by LE, including, without recognition or adequate explanation, "…in virtually every cost category requests for increases that far exceeded costs experienced in the years preceding the two test years and significantly exceeded the growth rate in sales, numbers of customers, and inflation." Examples of rationales offered to support specific cost elements:
      i. Choosing an inflation rate that is not locally based but based on the highest inflation rate jurisdiction in Canada.
      ii. Forecasting a labour cost increase under its collective agreement at almost double the Alberta inflation rate (9%) before YECL has even begun negotiation on that collective agreement.
      iii. Choosing significantly lower vacancy rates than experienced in non test years, and inappropriately arguing that actual YECL vacancy rate experience over recent years should be ignored.

   b. Although YECL argues (p.3) that "this Board must arrive at decisions based on the <u>evidence</u> on the record", YECL also often inappropriately argues that the Board should ignore updated evidence justifying reductions in test year cost forecasts and instead approve YECL forecasts "based on the best information available to it at the time of filing". Examples of this approach from YECL's argument include arguing to ignore evidence on reduced property tax rates (p16), improved secondary sales forecasts (p8), updated lower inflation rates (p16), and reduced costs of debt (p28). (In contrast, in one instance YECL inconsistently argues (p16) to support low assumed test year vacancy rates based on new information that "only one position now is open" – ignoring that the same updated information (undertaking at page 321) confirmed the 2008 year-to-date actual vacancy of 3.1 FTEs through September versus 2.25 FTEs forecast for 2008 in the application).

2. **Proposing expensive and unnecessary capital expenditures, well in excess of the average capital expenditure amounts between 2003 and 2007, which increase YECL's return on equity**

   a. Proposing the addition of Carcross diesel plant for alleged grid reliability benefits without having any meaningful discussion with YEC concerning the benefits of adding such capacity to the system -- and then arguing during the hearing to justify the cost based on local reliability benefits without analyzing on the record (with the exception of a superficial and unhelpful exhibit - entered on the last day of the hearing - exhibit B1-17) all other options to deal with the reliability issue including upgrading of the radial line owned by YECL.
   b. Proposing an extremely expensive automated meter reading (AMR) system which is clearly not necessary at this time.
   c. Both investments if accepted will have a material negative impact on current ratepayers and materially positive impact on YECL's return.

3. **Increasing ratepayer costs, and reducing YECL risks, through options selected in dealing with Fish Lake**

   a. Ignoring regulatory precedent from the 1996/97 GRA and proposing a new and lower 10-year average for forecasting Fish Lake generation which ignores actual generation prior to 1998 and substantially reduces from a forecast perspective the amount of generation from Fish Lake. This effectively results in a significant benefit from a risk perspective to YECL, i.e., YECL gains when actual generation exceeds the new and lower forecast generation.

b. Failure to capitalize the added purchase power expense in rebuilding the Fish Lake facility, and instead electing to treat it as an O&M expense in the test years which is more beneficial to Yukon Electrical than present ratepayers, and which also further reduces the assumed Fish Lake generation to be reflected in ongoing rates charged by YECL to ratepayers.

4. Dismissing cost effective approaches to rate of return previously adopted by the YUB in order to propose a significant increase in equity returns

a. Notwithstanding YECL accepts the fact that the BCUC and AUC approaches to return on equity (ROE) are "essentially equivalent and are seeking to achieve the same thing," and that the BCUC approach has been previously adopted by the YUB, they chose to introduce a modified Alberta formula, rather than use the BCUC formula, and incur the related added rate case costs required to support this new proposal.
b. The evidence indicates that YECL introduced the modified AUC approach because it wanted to make an argument, unsupportable using the BCUC approach, of increasing YECL's equity component dramatically (from less than 40% in the 1996/97 GRA to a common equity ratio in the upper end of a range from 47.5% to 52.5%) - a "marked departure" from what YECL has historically maintained, and the YUB has approved, which increases both YECL equity returns and related return and income tax costs to be borne by ratepayers.
c. The evidence also indicates that the BCUC formula would have resulted in a lower ROE (at least 12 basis points) than the AUC formula as proposed.
d. In summary, instead of using the BCUC approach which would be much more beneficial to ratepayers, YECL elected to use a modified AUC approach which is much more beneficial to YECL and its shareholder and much more costly to ratepayers.
e. Notwithstanding that YECL filed evidence on the allowed ROE of its parent (ATCO Electric) in support of its ROE proposal, and that the YUB in past Orders has consistently allowed an ROE for YECL less than or equal to YECL's parent, YECL has inappropriately argued that the past approved returns of ATCO Electric have no relevance to the matters now before the Board.

5. **Electing to ignore an appropriate depreciation method previously accepted in Canada, including by the YUB, that would materially reduce current ratepayer costs**

    a. YECL had the opportunity, given the past ruling of the Board in relation to Yukon Energy, to change their depreciation approach to an ASL approach which would have a material beneficial effect in reducing the significant rate increase it was requesting.
    b. Instead of taking this approach (and notwithstanding the ASL approach has been adopted and approved for major power utilities in several other jurisdictions, including BC, NWT, Manitoba and Ontario), YECL chose to use the ELG approach which is more beneficial (from a cash perspective) to YECL and its shareholders.

6. **Electing to ignore the approach previously directed by the YUB to be applied to Yukon Energy regarding FRSR net salvage depreciation**

    a. Again notwithstanding this Board clearly articulated its view on FRSR as applied to Yukon Energy in 2005 when faced with the exact same argument as YECL is advocating in this application, YECL chose to ignore the YUB ruling and maintain an approach which is more beneficial from a cash perspective to YECL and its shareholders.
    b. The approach taken by YECL at the hearing emphasized how blatantly shareholder focused YECL's approach is: it inappropriately had Mr. Kennedy of Gannett Fleming try to discredit the Board's earlier ruling by giving new evidence (about new accounting rules which purportedly come into effect in 2011), evidence that could not be challenged at that point in the hearing.
    c. Mr. Kennedy's evidence (especially the new evidence relating to ASL and FRSR) must be reviewed in light of what can only be described as the "advocacy" position he took at the hearing in an attempt to defend YECL's approach. This attitude is demonstrated by the following examples:
        i. He tried to discredit the ASL approach (and the reasons behind why Yukon Energy's cause to change its policy), yet the evidence shows that there are many utilities other than Yukon Energy where the

current deprecation rates have been prepared by Gannett Fleming using the ASL approach (YEC-YECL-II-1); and

ii. in relation to FRSR, he testified at p. 242 of the October 8, 2008 transcript as follows:

"…the use of FRSR - by the time I'm finished today, I'm sure I'll mistake the acronym many times - is really a phenomenon of BC Hydro and YEC. I'm not familiar with the use of that type of fund or that terminology, anywhere else."

This statement is incredible given that one would have assumed he would have adequately prepared himself on how YECL reported on "net salvage" before preparing his evidence. In fact YECL itself actually uses the specific expression he finds so abhorrent. For example, Note 6 of YECL's 2007 financial statements says as follows (emphasis added): "Accumulated depreciation includes an amount provided for **future removal and site restoration**, net of salvage value, of $4,688,000." (T. vol 1, p73-74; CW-YECL-04 (a), Attachment 5, page 15 of 29)

7. Inconsistent treatment of deferral accounts and reserves

a. Notwithstanding YECL received a material benefit when the Mayo-Dawson line was connected to Stewart Crossing (substantial diesel and O&M savings), they chose to take the benefit of those cost savings as enhanced return instead of putting in place (or seeking YUB approval to establish) a deferral account to the benefit of ratepayers.
b. However, when it today has the opportunity to ameliorate its risk in relation to the Carmacks-Stewart line connection, YECL now proposes a deferral account to its benefit.
c. In dealing with its rate case reserve, the evidence indicates that YECL built up a reserve after the 1996/97 GRA of $450,000 by 2005, and then elected (without seeking Board review or approval) to remove this amount from the reserve account (where it was being retained to the benefit of ratepayers) and take it into retained earnings. Notwithstanding that YECL elected to ignore the Board's approvals and directions in the same order regarding several matters potentially beneficial to ratepayers (e.g., BCUC ROE approach, ASL and FRSR depreciation), YECL has justified its 2005

change in treatment of its rate case reserve "to be consistent with the treatment followed by YECL and supported by Board Order 2005/17" (YEC-YECL-45(c)).

In summary, the evidence demonstrates that notwithstanding continual cost pressures, when it is YECL's risk it has found ways over the last 12 years to manage cost increases to earn a rate of return higher than is allowed to their parent and other comparable regulatory utilities. Yet, when it is to the ratepayers' risk in the current application, YECL chooses a much less rigorous approach to managing cost increases – and consistently chose to follow regulatory approaches most beneficial to YECL and its shareholders.

Accordingly, Yukon Energy agrees with the arguments of the other intervenors that YECL's application has focused exclusively on its shareholder needs, and has failed to ensure that the revenue requirement approved by the YUB is not higher than required to meet the reasonable needs of ratepayers as well as YECL.

Yukon Energy submits that a fair and reasonable balancing of ratepayer and company interests by the Board will result in material reductions in the allowed O&M cost increases, deferral for now of at least two major new capital projects, and restoration of consistent regulatory treatment of several other elements beneficial to ratepayers (including treatment of Fish Lake, ASL and net salvage depreciation, allowed ROE and capital structure, and deferral accounts). Under this approach, YECL will retain an incentive for cost-effective management of the utility during the test years, as well as to return to the Board for future reviews without another gap similar to what occurred after the 1996/97 GRA.

2.0 SALES AND REVENUE

2.1 YECL ARGUMENT

To address evidence that its forecast sales are typically low compared to actual sales, YECL argues that comparisons between non-test year actuals and in-house YECL business forecasts are "inappropriate and unfair", stating that the level of scrutiny and detail used to formulate non-test year internal business plan forecasts is nowhere near as rigourous or comprehensive as used to derive the GRA quality forecasts included in the current filing. YECL argues that "the forecasts contained in its application must be judged based on the evidence provided on the record, and not the attempt by YEC to derive a comparison that simply does not exist".

To address specific concerns raised by CW with regard to YECL's methods used for its "detailed" test year sales forecasts, YECL argues that:

- The forecast provided is supported by detailed information, adjusted for known or one-time events;
- The normalized weather forecast is a standard and commonly used approach that provides consistent and reliable results;
- A community by community analysis is preferable to the aggregated approach suggested by CW; and
- The regression analysis is a tested and common method previously relied upon by Board, and that CW's suggestion that (in such analysis) an R^2 less than 0.7 was not a good fit should not be relied on.

To address updated and materially higher secondary sales revenue forecasts from Yukon Energy, YECL argues that these higher revenues will have "a small impact on its net income due to the small margin on Secondary Sales," and concludes that the initial application forecasts should be accepted as filed.

2.2 OTHER INTERVENOR ARGUMENTS

CW's argues, after in depth review of YECL's detailed sales forecast methods, that YECL's forecasts should be revised upwards for both residential and commercial customers for both 2008 and 2009:

1. **Residential sales forecast –** CW argues:
   a. "YECL went through a very complicated and demonstrably flawed exercise to come up with a forecast usage per customer" (UPC), and that (based on a simple trend line analysis) YECL's UPC forecast should be increased to 9.95 MWh (1.53% increase) for 2008 and to 10.04 MWh (a 2.45% increase) for 2009; specific concerns noted regarding YECL's UPC forecast methods included:
      i. Shortcomings and inconsistencies in normalization process, particularly regarding the regression analysis;

ii. Inconsistencies in time frames used for different communities when doing normalization based on regression ("YECL appears to be trying to maximize the amount of information it can use in this normalization process rather than considering whether or not certain data types should go together at all");

iii. Concerns about the use of R^2 values of less than 0.70 (CW submits that, as a good rule of thumb for regression, such values "would be considered not a good fit"); and

iv. Inconsistencies in the level of R^2 values YECL adopted in the application.

b. "That there is no detailed evidence to support YECL's substantial reduction to the growth rate of customers for 2009", and that the forecast growth rate in number of customers for 2009 should be 1.9% (the same as for 2008); and

c. Based on the above, CW's argument supports a 1.53% increase in 2008 and a 3.6% increase in 2009 above YECL's residential sales forecasts.

2. **Commercial sales forecasts -** CW submits that there is no substantial evidence to justify a levelling off of commercial UPC, let alone a reduction (as forecast by YECL), going forward to 2008 and 2009. CW reviews in detail the evidence provided, noting inconsistencies as well as limitations due to confidentiality and misleading comments, and proposes (based on a simple trend of the consolidated UPC data, adjusted for YECL's proposed 2007 reduction to UPC related to the Canada Winter Games) that YECL's forecast UPC should be increased to 55.3 MWh (a 1.28% increase) for 2008 and to 56.0 MWh (a 3.32% increase) for 2009.

LE notes that "the only conclusion one can draw from this [the evidence] is that YECL is conservative in their forecasts and one can expect, as a matter of routine, the actual sales to exceed the forecasts." LE references evidence demonstrating that even in warmer winters YECL's actual sales exceeded forecast sales. LE recommends that YECL's forecasts be accepted as presented but monitored for future consideration.

2.3 YUKON ENERGY REPLY

Yukon Energy submits that, based on the evidence and the importance to reducing YECL's requested rate increase, YECL's firm retail sales and secondary sales forecasts are both unrealistically low, and need to be adjusted upwards.

Under-Forecast Firm Sales

As LE argues, the record consistently demonstrates that YECL under-forecasts firm sales.

Yukon Energy has relied on CW to review in detail YECL's test year residential and commercial sales forecast methods, and supports CW's detailed assessment as to its flaws and deficiencies. Despite all of YECL's data and complexity, CW shows how the analysis is flawed in many important ways that serve to under-forecast sales. Under the circumstances, CW's simple trend forecasts (and the resultant increases in YECL's forecasts) appear to offer a more solid basis than YECL's application for assessing these test year sales – and, at a minimum, provide further evidence that YECL's forecasts are too low.

Looking beyond detailed review of methods and data employed for test year forecasts, the Board must also review how well past YECL forecasts have compared to actual results.

No actual data from 2008 was made available by YECL that would have allowed intervenors and the Board to assess the accuracy of the current 2008 forecast. Aside from the forecasts provided for in the 1996/1997 test years in its last GRA, the forecasts from the 2003 to 2007 business plans are the only forecasting information available to parties for comparison purposes. There is no other measure available to assess the accuracy with which YECL forecasts sales, or to determine why issues related to routine under-forecasting of sales exist.

In this regard, Yukon Energy submits that there is no merit to YECL's argument that the Board should ignore YECL's consistent under-forecasting in its past business plans. Over the 2003 to 2007 period, the increases in WAF sales when forecasts were compared to actual were 2.7% for 2003, 4.1% in 2004, 1.4% in 2005, 4.0% in 2006 and 2.4% in 2007.

In reply to YECL's argument that the Board should focus on "GRA quality" forecasts, the only evidence as to past accuracy available on the record for comparison purposes (i.e., the forecast from the 1996/97 GRA) reinforces the relevance of the comparison of business plan forecasts vs. actual provided in Exhibit C1-18. Similar to the business plan forecasts from 2003 to 2007, the actual sales for 1996 and 1997 are higher than the sales forecast for the GRA test years by YECL[1]. The increases for actual versus GRA forecast sales in 1996 and 1997, at 3.9% higher actual sales than forecast in 1996 and 1.5% higher actual sales than forecast in 1997, fit comfortably within the 2003 to 2007 business plan "under forecast" range displayed in the evidence.

Under-forecasting of firm sales has very different revenue requirement implications for hydro-supplied versus diesel generation systems. While YECL bears the revenue requirement risks on its diesel supplied systems, under-forecasting of firm retail sales can benefit YECL on the hydro grid systems. Yukon Energy sought to obtain detailed information to allow WAF and non-WAF assessments for the last GRA sales forecasts (undertaking at p 268-270), however YECL was not able to find the requested information on either actual or forecast sales.

Given that 90% of YECL sales are on WAF where YECL purchases power from Yukon Energy, grid system firm retail sales forecasts that are too low will overstate the revenue requirement in the test years, and essentially provide YECL with an ongoing incremental windfall through additional sales revenues. Going forward, where the utility reaps an ongoing incremental benefit due to under-forecasting sales in the test years there is little incentive to return to the regulator to adjust the forecast. However, if lower than forecast sales start to be experienced, YECL has the ability to return to the Board for a reassessment of its future revenue requirement.

Due to the clarity of YECL's under-forecasting demonstrated by the record and the importance of WAF firm sales forecasts to the overall revenue requirement and rate increases requested, Yukon Energy supports CW's recommendation to increase these forecasts and does not support LE's recommendation only to monitor for future consideration.

Under-Forecast Secondary Sales

As regards secondary sales forecasts, YECL's forecasts need to be adjusted to reflect material adjustments to YEC's secondary sales forecast, regardless of YECL's assessment that such changes will have a small impact on consumer rates. As noted in

[1] YEC-YECL-2 (e) (revised): Actual sales in MWh were higher for both 1996 and 1997 than had been forecast in the 1996/97 GRA for the test years (8,932 MWh or 3.9% higher in 1996 and 3,535 MWh or 1.5% higher in 1997). Revenues from sales were also higher ($1.342 million or 4.8% higher in 1996 and $0.430 million or 1.5% higher in 1997).

YEC's written argument at page 44, this adjustment would provide an overall reduction to YECL's revenue shortfall of $34,000 in 2008 and $99,000 in 2009.[2]

3.0 PURCHASE POWER

3.1 YECL ARGUMENT

In response to concerns raised by intervenors regarding the Fish Lake Hydro Generation, YECL argues as follows to support the accuracy of its forecast for generation at Fish Lake:

- The 10-year average was discussed with YEC officials who indicated it was reasonable.
- YECL is in a new water license period and subject to restrictions.
- The 7 GWh, 10 year average is higher than actual output in 6 of the last 10 years.
- Expensing of purchase power costs incurred due to down time for rebuilds is "appropriate", even though this is a recognized as "a grey area."

3.2 OTHER INTERVENOR ARGUMENTS

LE argued as follows:

- A 10 year forecast generation of 6.962 GWh per year should be used as it is more transparent; any generation below the 6.962 GWh level should be documented and added to capital project cost.
- The purchase power costs should be added to capital project costs; the shut down periods during the test years could vary and result in benefits to YECL during test years.

[2] YECL's forecast lowers revenue at existing rates by approximately $220,000 and $650,000 in test year 2008 and 2009 respectively; corresponding reductions also occur in YECL's forecast secondary energy power purchases of approximately $186,000 in 2008 and $551,000 in 2009.

3.3 YUKON ENERGY REPLY

The substantive issues regarding purchase power cost forecasts relate to YECL's treatment of Fish Lake hydro generation – both as regards the reduced long term forecast adopted without adequate explanation and in contradiction of past regulatory precedent, and the proposal to further reduce Fish Lake generation by expensing test year purchase power costs due solely to rebuild of the facility. YECL's failure to adopt approaches consistent with regulatory practice in the Yukon results in a forecast for generation at Fish Lake that underestimates the generation normally available (as required under DCF and 1996/97 GRA principles), overestimates the costs to be spent on purchase power inside and outside the test years, and understates the capital cost for the rebuilds.

YECL's argument fails to discuss, let alone explain, why the "long-term average" forecast generation at Fish Lake has suddenly and precipitously declined (by approximately 30% from 10 GWh to 7 GWh) since the last GRA. No explanation is given in this regard, beyond reference to undocumented "discussions with YEC officials", for ignoring all Fish Lake generation records prior to 1998. YECL fails to address why it has elected to ignore the relevant regulatory precedents agreed to and directed at the last GRA in 1996/97, as outlined in Yukon Energy's final argument (section 3.1.1).[3] Although vague assertions are made regarding "restrictions" associated with the new licence, the record is totally devoid of any related useful information, and the Board has no basis to discount long-term average generation based on new licence conditions.

Where a material departure from past established regulatory practice is undertaken, the onus is on the applicant to fully justify that departure. YECL provides no clear rationale or justification regarding its departure from the practice established by 1996/97 GRA approved settlement for determining rates. There is simply no detail or rationale provided to support this material departure from established regulatory practice in Yukon.

YECL fails to provide any real justification for further lowering the forecast generation at Fish Lake by 0.8 GWh due to the rebuild purchase power needs, but merely reiterates that it has "adopted an appropriate approach", recognizing that this is a "grey area".

[3] The 1996/97 GRA Settlement established that, for rate setting purposes, long term average water expected to be available for generation is to be used to determine both rates and the DCF fund. This approach in the 1996/97 GRA yielded a long term average for the Fish Lake facility of 10.042 GWh, at the time of the settlement. The DCF calculations of long term average water available for generation in 1996/1997 GRA used the full hydrological record available for each facility, adjusted where required or feasible to account for changes to regulatory regimes or hydro generation capability.

YECL has provided no evidence, or argument, against accounting for the increased purchase power costs in the test years due to the Fish Lake rebuild as part of the costs of the rebuild project itself. YECL has not argued that this could not be undertaken, or that it is unreasonable – YECL has simply noted the approach that it has taken, which results in an artificial lower average generation at Fish Lake, and consequently overstates forecast purchase power expense and inflates the revenue requirement in the test years, is "appropriate".

Yukon Energy and LE agree that, since the capital costs incurred for the rebuild are amortized over time (due to the enduring benefit provided to the facility and ratepayers), costs incurred to undertake the rebuild (including the cost of increased power purchases from WAF required due to shutting the unit down during the rebuild) should be considered directly related to the rebuild project and included in its capital costs. Accordingly, YECL's 0.8 GWH/yr rebuild-related reduction to forecast Fish Lake generation should not be approved.

4.0 DIESEL FUEL COSTS

4.1 YECL ARGUMENT

In response to Yukon Energy questions about the proposed new Pelly Crossing deferral account, YECL's argument confirms that no deferral account was used earlier for Stewart Crossing primarily because the interconnection occurred in a non-test year and consequently no approval had been granted for a deferral account.

4.2 OTHER INTERVENOR ARGUMENTS

LE argues that the YECL's request for a new Pelly Crossing deferral account demonstrates YECL's sensitivity towards having to pay any fuel costs, noting that there was no deferral account for Stewart Crossing, and nothing preventing YECL from passing the net benefits of Stewart Crossing to ratepayers. LE makes the following recommendations related to the deferral account:

- It should be approved with any delays clearly documented and justified.
- If approved, the account should count towards YECL being considered a low risk utility.

LE observes that YECL has chosen not to have any active conservation or efficiency programs in diesel-served communities despite significant fuel costs for ratepayers, noting that because fuel price volatility is passed directly to ratepayers, YECL has no incentive to undertake such efficiency measures. LE makes recommendations that YECL be directed to establish active conservation and efficiency programs in diesel served communities.

4.3 YUKON ENERGY REPLY

Yukon Energy agrees with LE's basic assertion that YECL avoids undertaking any diesel cost related risk in its application, and uniformly implements measures that pass all fuel cost risks onto ratepayers. In this context, it makes sense for the Board to consider how YECL can have an incentive to consider active and effective conservation and efficiency programs in diesel served communities.

Prior to the application, YECL also avoided initiatives to allow ratepayers to secure the benefits of the Stewart Crossing connection to the Mayo Dawson grid. Yukon Energy's recommendations as to implementation requirements for the new Pelly Crossing deferral account (including ensuring it is closed out after connection to the grid occurs), as set out in YEC's argument (pp 45-46), are not addressed in YECL's argument.

5.0 OPERATIONS AND MAINTENANCE EXPENSES

5.1 YECL ARGUMENT

In response to intervenor concerns about the increase in quantum above actuals incurred in several prior non-test years, YECL acknowledges that "the obligation is squarely on it to justify why these increases are necessary for the forecast period, when such costs were not incurred in non-Test Years." As reviewed earlier (Introduction – Fundamental Issues), YECL argues that it has provided "detailed information of each specific requested increase", and that one of the primary drivers for this filing "was increased cost pressures that Yukon Electrical was experiencing at the present time, which could not be offset by customer growth and/or increased efficiencies."

On specific issues arising from the hearing YECL argues as follows:

- As regards a **5% cap** on annual test year O&M expense increases to reflect pre-test year cost increase experience, YECL argues that such a cap would be arbitrary, entirely inappropriate and unfair in the circumstances; further, any such cap should not apply to cost amounts linked to other decisions beyond O&M (e.g., depreciation expense, amortization of deferred costs/credits, and the amount of return).

- On **labour costs**, YECL re-iterates that it must access Alberta and other external markets for skilled trades and technical positions, and has forecast labour costs based on accurate information regarding what it needs to be competitive with rates paid by ATCO Electric and its affiliates (where collective bargaining agreements for 2008 and 2009 have been finalized), as well as information on the competitive marketplace via the Sierra System Study and other direct discussions. YECL references programs introduced to assist in attracting and retaining necessary resources, such as the community skills premium, and argues its ability to provide safe and reliable service will be compromised if the associated O&M costs are not approved for inclusion in YECL's revenue requirement.

- On **vacancy rates and current FTE complement**, YECL re-iterates its view that a "vacancy rate", as the term is commonly used in regulatory proceedings, did not exist for the non-test years. YECL argues that information tracking targeted FTEs against actual FTEs during pre-test year calendar years is of marginal value in assessing the vacancy rate for the test period, since programs to ensure that critical vacancies are filled on a go-forward basis have been implemented and (based on updated information) that only one position is now open. YECL argues that new employee positions are required to ensure the utility continues to operate in a safe and reliable manner, and that the current FTE compliment is the minimum requirement.

- On **non-labour costs**, YECL argues that Alberta inflation rates are appropriate since YECL acquires a number of services and materials from this province and requires Alberta-based transportation services to move materials and equipment to Yukon. YECL argues that a local inflation rate is not appropriate and further notes that the 5% Alberta based rate remains reasonable since the year on year Alberta inflation rate up to August is approximately 4%.

- On **affiliate costs**, YECL submits that the updated information (YEC-YECL-11) should be approved in this proceeding and not remain as placeholders as requested in the application. YECL argues that reductions from the collaborative process in Alberta are already incorporated in the filing, and that calculation of ITBS rate of $1.72 was appropriate as it excludes services not required by YECL.

- On **brushing costs**, YECL argues that increased costs for this program are aimed at reducing the number of tree related outages in its service area, and states that tree-related outages have decreased noticeably since the introduction of the program. YECL argues that the standards which YECL has adopted "are common to other jurisdictions and have paid immediate dividends in terms of a reduced number of outages" as well "a positive difference in reliability for customers".

5.2 OTHER INTERVENOR ARGUMENTS

As reviewed earlier (Introduction – Fundamental Issues), other intervenors argue that YECL's application has not adequately considered ratepayer interests and that its projected costs are higher than should be reasonably expected or required to meet ratepayer interests. At this overall level, UCG noted the significant 27.8% O&M increase proposed in a two year period and its concern that these high costs are not reflected in quality of service. UCG submits that the YECL files no regular customer reports to the YUB, and that the Electric Service Regulations offer no customer relief (only security for the utility providers).

Other intervenors argue on specific issues arising from the hearing as follows:

- On **labour costs, vacancy rates and current FTE complement:**

  - CW reviews vacancy rate issues in detail and, based on the stated list of benefits offered by competing companies, argues that YECL will not likely retain the employees they expect to retain as downward pressure on vacancy rates will be offset by employees wanting to work for other prominent companies in the North with superior benefits. CW recommends vacancies should be 3.5 FTEs for both test years (reflecting actual average annual experience 2003 to 2007), an increase from the 2.25 FTEs vacancy forecast for 2008 and the 1.0 FTE vacancy forecast for 2009.
  - LE notes a "modest" increase in capital labour costs, despite the large increase in proposed capital expenditures, and argues that the reasons provided by YECL for the large increase in O&M labour cost were not

very credible and not acceptable as it appears "that YECL is trying to increase its staff compliment as much as it possibly can hope to justify". LE recommends 55.43 FTEs in 2008 and 2009 (compared to application's 56.43 in 2008 and 57.43 in 2009), with a 1 FTE reduction once AMR as implemented. LE argues that the forecast vacancy rates seem low based on past history, but "may be achievable" with the forecast large increases in average compensation. LE concludes: "However, the substantial increase in FTEs plus the substantial increase in staff compensation results in cost increases that, in the author's opinion, exceed justification."

- On **non-labour costs**:

  - CW reviews the evidence in detail on this substantial proposed cost increase, and concludes that while YECL noted many specialty line materials were purchased from Alberta there was no accurate or relevant evidence provided as to the appropriate weighting for such costs from Alberta versus other areas. CW recommends a blended inflation rate based on Alberta (using the most recent 4% forecast for Alberta CPI) and Yukon which yielded an inflation rate of 3.25% for the test years.
  - LE notes that with the global financial crisis and declining commodity prices, it was not reasonable for all materials to be sourced for the highest cost jurisdiction in Canada. LE concludes that it was "not left with the impression that YECL did everything within their power to minimize cost increases to ratepayers", and recommends a 4% inflation rate for 2008 and a 2.5% inflation rate for 2009.

- On **affiliate costs**, CW reviews the evidence in detail and recommends acceptance of the forecast I-TEK and ITBS costs (as reduced in YEC-YECL-11(b)) as final for the purpose of setting Yukon rates, subject to the change in the inflation rate to be applied to non-labour costs (see above). CW submits that the Board should order YECL to file final I-TEK rates for information purposes that result from the Evergreen process along with the difference it would have made to revenue requirements for each test year.

- On **brushing costs**, LE argues that YECL should be required to consider wider cleared areas and selective tall tree cutting, and recommends that the program be approved with condition that detailed documentation be provided regarding all cost effective approaches to improved tree contact reliability.

5.3 YUKON ENERGY REPLY

Yukon Energy has already addressed (Introduction – Fundamental Issues) fundamental issues related to YECL's significant and unjustified proposed increase in its controllable O&M expenses. YECL fails to respond or provide any adequate explanation as to why the proposed big jump in O&M expenses is now justified or reasonable given the fact that it was able, up until the test years, to manage these costs within an average increase range of 5% per year over the period from 2003 to 2007. Furthermore, current market conditions emerging at this time provide ample caution about retaining assumptions of tight labour and other market conditions that have recently prevailed in Alberta and other western Canadian areas.

Under the circumstances, and given the lack of evidence to otherwise assist in this fundamental matter, Yukon Energy submits that the Board should consider a cap of 5% on overall annual average O&M expenses allowed YECL during the test years (see below).

On the other specific O&M issues addressed in arguments, Yukon Energy replies as follows (in addition to its arguments already advanced in its Final Argument):

- **On labour costs, vacancy rates and FTE complement –** O&M labour costs increase 36.7% from 2007 to 2009, compared to average annual increases of about 4.4% from 2003 to 2007, have not been adequately justified in the evidence. As other intervenors argue, forecasts regarding FTE complement growth, proposed remuneration increases and reduced vacancy rates draw particular attention. Yukon Energy specifically agrees that CW's recommended vacancy rates are reasonable in the circumstances. A reasonable cap on overall O&M cost increases, however, would avoid the need to interfere into the details of remuneration negotiations or FTE complements.

- **On non-labour costs –** Yukon Energy agrees with CW that a weighted inflation rate of 3.25% would reasonably reflect the evidence available in the hearing. The recent NWT PUB Decision 24-2008 of October 28, 2008 on Northlands Utilities (Yellowknife) Limited disallowed the same proposed 5% Alberta based inflation argument as YECL is advancing and, in the absence of reasonable evidence to the contrary, approved the Yellowknife CPI of 3.2% for non-labour costs.

- **On affiliate costs –** Yukon Energy agrees with the recommendation of CW as regards acceptance of the forecast I-Tek and ITBS costs (as reduced in YEC-

YECL-11(b)) as final for the purpose of setting Yukon rates, subject to the change in the inflation rate to be applied to non-labour costs.

- **On brushing costs –** Yukon agrees with LE that the brushing program be approved and monitored with reports documenting outcomes and effectiveness. Given issues raised by YECL regarding Carcross-Tagish area customer service reliability, it is not apparent from the evidence why a new program reflecting standards common to other jurisdictions was delayed in at least this area, or what impacts the program is having (or is likely to have) in materially improving service reliability for these customers.

Cap on O&M Cost Increases

In reply to YECL's argument on the matter of a cap being imposed on O&M cost increases for the purpose of setting test year rates, Yukon Energy does not agree that such a cap would be arbitrary, inappropriate or unfair in the circumstances. The following considerations are noted in this regard:

1. **5% cap is not arbitrary but based on historic experience**

The average year over year increases from 2003 to 2007 provide a reasonable estimate of the type of year over year growth that should have been expected for the test years based on recent trends and experience related to YECL's O&M expense prior to the test years. The 5% average year over year expected increase is thus not arbitrary, but based on an assessment of past overall O&M cost increases experienced prior to the test years. As noted at page 7 of YEC's Final Argument, average year over year increases from 2003 to 2007 were 4.4% for labour and 5.4% for non-labour as compared to 17.2% increase from 2007 to 2009 in labour and a 10.2% increase over the same period for non-labour. This provides a reasonable estimate for what YECL's increases in the test years should be barring extraordinary circumstances beyond the utility's ability to control.

2. **5% cap is based on information currently in evidence in the proceeding**

YECL, in its argument, admonishes that the Board must have regard to the totality of evidence on the record when determining allowable O&M expenses, but utterly fails to grasp or concede that its own past record of year over year increases (during a period when YECL itself, and not ratepayers, was at risk for cost increases) forms an integral part of the hearing record to be considered by the Board in these determinations. YECL is basically arguing that the Board must only assess the detailed information that YECL considers relevant, and in the context in which YECL would have it considered, without accepting that the enormous cost increases included in YECL's application must be assessed against its own past history of managing costs when YECL itself (and not ratepayers) was at risk. While YECL argues that it has provided detailed information to justify its cost increases in the test years, it can provide no similar justification related to how it managed its costs outside of the test years and why specifically it is unable to manage its costs similarly now.

3. The Board is not constrained in its approach to decision making

In stating that the Board does not have the luxury of adopting an "arbitrary" cap on allowed O&M expenses, YECL is basically trying to itself determine the Board's decision making process related to its determinations regarding what is a just and reasonable rate. Given that a cap of 5% would not be "arbitrary", as reviewed above, Yukon Energy submits that the Board is not constrained in considering this approach.

In *Consumer's Association of Canada (Man) et al v The Manitoba Hydro, Electric Board* (2005) MBCA 55 intervenors appealed a decision of the Manitoba Public Utilities Board ("PUB") on the following grounds:

- That given the PUB's rejection of a "bottom up" methodology for determining OM&A costs and its confirmation that an $11 million arithmetic error had occurred in the top down calculation, the regulatory erred by determining the reasonableness of projected revenues and rates.

- That the regulator failed to rely on a cost of service study when it ordered an across the board rate increase[4].

The Manitoba PUB argued that the issues raised were ones of methodology and that it had "complete discretion over the methodology to be employed in a rate hearing.[5]" The

[4] It was argued by one of the intervenors that there was no evidence upon which the Board could conclude that an across the board increase was reasonable. It was noted that this was outside of typical regulatory practice within the jurisdiction.

[5] Both the PUB and Manitoba Hydro relied upon *British Columbia Hydro and Power Authority Westcoast Transmission Co. Ltd. et al.*, [1981] 2 F.C. 646 (at pp 655-56) in argument (as noted at pages 17 and 22 of the Court of Appeal Decision) which notes that public utilities boards have a broad discretion with regard to determining a just and reasonable rate:

> The Board has authority to make orders designed to ensure that the tolls to be charged by a pipeline company be just and reasonable. But its power in that respect is not trammeled or fettered by statutory rules or direction as to how that function is to be carried out or how the purpose is to be achieved. In particular, **there are no statutory directions that, in considering whether tolls that a pipeline company proposes to charge are just and reasonable, the Board must**

Manitoba Court of Appeal refused leave to appeal the Manitoba Public Utilities Board decision, determining that the applicants were not raising a matter of law, but essentially raised a dispute over the opinion of the Manitoba PUB.[6] The Court noted that public utilities boards generally are afforded a broad discretion with regard to determining just and reasonable rates.

In holding that the determination of the Manitoba PUB was not arbitrary, the Manitoba Court of Appeal noted, after reviewing the record of the proceeding, that the regulator addressed the right question, i.e., the reasonableness of the proposed rates, did not rely on irrelevant evidence, or fail to consider relevant evidence, was "alive to the issues and alive to the implications of its decision" and did not apply inappropriate tests or apply appropriate tests or factors incorrectly.

In the present circumstances, where the applicant (YECL) is requesting an extraordinary increase in controllable costs, in the absence of extraordinary circumstances and without sufficient justification, Yukon Energy submits that it would be within the Board's discretion to take a top-down approach towards the O&M expenses and determine an amount for the increase that would be fair and reasonable based on past year over year increases. There is nothing that would legislatively prohibit such an approach, just as there is nothing that provides that the Board must systematically go through the application item by item and determine line by line, which expenses to allow into the revenue requirement and which expenses to disallow. In the circumstances of this particular application, capping the increase allowable for controllable O&M costs based on the average year over year increases experienced over the past five years could also not be considered arbitrary. The 5% figure is not "made up", but derived from an assessment of historical data.

> **adopt any particular accounting approach or device or that it must do so by determining cost of service and a rate base and fixing a fair return thereon.** [emphasis added]

[6] The court noted the following at paragraph 65 and 68 of their decision:

> All in all, the PUB addressed the right question, the reasonableness of approved rates. It did not rely on irrelevant evidence or fail to consider relevant evidence. The PUB was alive to the issues and alive to the implications of its decision. It did not apply inappropriate tests or apply appropriate tests or factors incorrectly. It did not make its decision in an arbitrary manner.
>
> When all of the arguments of the applicants are considered in light of the evidence the PUB heard and the decision it eventually made, I have not been convinced that what the applicants are complaining about is anything but the methodology the PUB utilized to arrive at that decision in the light of the interests of both the public and Hydro.

6.0 TAXES OTHER THAN INCOME

6.1 YECL ARGUMENT

YECL acknowledges in argument that during cross-examination by Board Counsel, it was noted that the actual property tax rate of increase for 2008 is 3.8% as compared to the 7.5% forecast in YECL's Application. YECL argues that 7.5% was based on the best information at the time of filing and it would be inappropriate to update this single aspect of GRA.

6.1.1 Yukon Energy Reply

Throughout its argument, YECL notes that the Board must have regard to the detailed evidence provided on the record by YECL for the test years (as opposed to historic information). However, with regard to test year property tax evidence YECL is arguing that it is not appropriate for the Board to consider the best information currently on the record regarding the property tax rates for 2008 (the accuracy of which YECL does not dispute). This argument has no merit, and the Board should direct that YECL's application be adjusted to provide for a property tax rate increase in 2008 of 3.8%, with consistent adjustments made as required also to the 2009 property tax forecasts.

7.0 DEPRECIATION

7.1 YECL ARGUMENT

YECL notes in argument that the average service life and net salvage estimates developed in the Gannett Fleming study were not challenged by any evidence or cross examination, and that the current depreciation study results in a decrease of $280,000 when depreciation rates from the current study are compared to expense for use of previously approved depreciation rates.

In response to YEC questioning on the ELG versus ASL issue, YECL argues the following in support of its continued use of the ELG procedure for the test years:

1. YECL is not requesting any change in procedure previously approved by the Board, and is simply seeking to continue to use the procedure approved for YECL for a number of years, noting that the ELG methodology has been used and approved in all prior YUB hearings with the exception of the 2005 YEC Application which requested the change.

2. ELG has been approved in a number of jurisdictions (and has specifically been approved by the NWT regulator).

3. In this proceeding and in the 2005 YEC proceeding, ELG was recognized by Gannett Fleming as the superior methodology in matching consumption of the asset to the costs.

4. Mr. Kennedy testified that ELG better complies with the new IFRS accounting standards “that are to be imposed shortly”, and that intergenerational equity issues develop when depreciation methods are changed midstream through an asset’s life.

5. YECL argues that it is inappropriate to change the depreciation procedure simply to decrease the revenue requirement in the test year while noting that a long term offsetting increase would occur.

In response to YEC questioning regarding FRSR, YECL argues that Mr. Kennedy is only aware of BC Hydro and YEC “using an FRSR fund”, that the collection of net negative salvage in depreciation rates is widely accepted across Canada and US, and that this approach “has long been approved by the YUB for Yukon Electrical”. YECL further argues that the recovery of net negative salvage through tolls and the establishment of an asset retirement obligation for financial reporting purposes are two different issues, and that “most utilities recognize there is a significant difference between ARO or FRSR and the recovery of costs of retirement through tolls”. YECL submits that recovery of net salvage through tolls “best complies with regulatory fairness”, and that its approach to negative salvage is fair and reasonable.

7.2 OTHER INTERVENOR ARGUMENTS

CW deferred its argument on ASL versus ELG depreciation pending review of YEC and YECL arguments. On FRSR issues, CW notes that YEC and YECL operate under the same environmental legislation, and argues that “there should be some regulatory consistency for removal and remediation costs among the YUB’s electric utilities.” CW notes that it was not able to determine from the evidence whether negative net savage should be capped or not, but that the depreciation reserve should be separated to calculate the total negative net salvage in the reserve.

LE concludes that there is not adequate justification to change YECL's method from ELG to ASL, with the possibility that there would be some benefit now and higher costs incurred later.

UCG assumes that YECL is currently using ASL, and wants to see ASL retained "as this would not impact the return for Yukon Electrical while at the same time offering a benefit to the ratepayer."

7.3 YUKON ENERGY REPLY

Yukon Energy has pursued two depreciation issues (ASL and FRSR) in essence to secure consistent regulatory treatment of the two Yukon utilities combined with material and timely reductions in current ratepayer costs. YECL has argued against adopting the ASL option, and has asserted that there is no need for it to consider the Board's FRSR directions to Yukon Energy.

Yukon Energy has reviewed in detail the basic issues and evidence in its Final Argument, as well as earlier in this reply argument (Introduction – Fundamental Issues), including specifically its response to the advocacy evidence of Mr. Kennedy on behalf of YECL at the hearing. Details already addressed are not revisited in the reply arguments set out below.

ELG versus ASL

As reviewed earlier (Introduction – Fundamental Issues), Yukon Energy submits that YECL has ignored and/or refused to propose an appropriate depreciation method (ASL) previously accepted in Canada for many major electric power utilities, including by the YUB for YEC and by the NWT PUB for NWTPC, that would materially reduce current ratepayer costs at a time when such savings would be timely.

YECL's argument simply confirms Yukon Energy's position, and offers no new basis for refusing to approve such ratepayer savings at this time.

Neither Mr. Kennedy nor YECL have made a case that use of ASL would be inappropriate. Given the evidence of Gannett Fleming continuing to prepare ASL-based depreciation for a wide range of regulated utilities, as well as continuing approval by regulators for ASL-based depreciation, no such case would be tenable. In this context, technical superiority of ELG versus ASL (as testified to by Mr. Kennedy both for YEC and for YECL applications) has no ultimate relevance or assistance to the Board.[7]

YECL's prime argument to differentiate itself from Yukon Energy's position is the readily apparent point that YECL's application is not requesting any change to move from ELG to ASL, whereas YEC's application in 2005 asked the Board to approve this change.

Yukon Energy notes that the record confirms that the fundamental concern underlying Yukon Energy's 2005 request for this change in depreciation methodology was the need to ensure rate stability given Yukon Energy's long absence from regulatory oversight and the current state of Yukon retail rates.[8] Clearly, YECL is not willing to consider today the approach adopted by YEC and approved by the YUB in 2005 to assist current ratepayers in a material way. Instead, YECL seeks to retain ELG with its higher current cash flows for the utility.

YECL's argument advocates inconsistent treatment for the two Yukon utilities, based solely on the policy position of each utility. Yukon Energy submits that consistent treatment using ASL would be in the interests of current ratepayers and would not be unfair to YECL.

FRSR

As reviewed earlier (Introduction – Fundamental Issues), Yukon Energy submits that YECL is electing to ignore the approach previously directed by the YUB to be applied to Yukon Energy regarding FRSR net salvage depreciation.

[7] In its Final Argument YECL notes Mr. Kennedy's attempt to further justify the superiority of the ELG method as complying better with IFRS accounting standards "to be imposed shortly." As noted by YEC in its argument, this was essentially new evidence brought up during the hearing and intervenors did not have sufficient time or opportunity to test this evidence. Further, while unacknowledged in YECL's argument, it was acknowledged at the hearing that these new accounting standards will not be in place until after the test years. Further, Mr. Kennedy's assertions basically present IFRS as a threat, without providing any substance or detail. He states ELG better complies with IFRS without providing any information or detail with would support this bald assertion or that could be tested.

[8] At the time of its 2005 application, YEC had been absent from regulation for 9 years, and was concerned that ratepayers not be faced with major new rate increases. In this vein, YEC explored and implemented approaches that would allow the utility to recover its revenue requirement while mitigating adverse rate impact on ratepayers. This included opting to change from the ELG to the ASL method of depreciation. This toll-based rationale underlying use of ASL in YEC's 2005 Required Revenues and Related Matters application was noted in Mr. Kennedy's 2005 depreciation study conducted for YEC (IR YEC-YECL-II-2(b)(iii) at page I-5), in cross examination at the hearing (Transcript page 146-48) and has been reiterated in Yukon Energy's Final Argument (pages 16-18).

YECL's final argument fails completely to recognize, let alone address, Board Order 2005-12 directions on this major matter of consistent regulatory treatment of the two Yukon utilities.

YECL ignores the fact that YEC did not elect to implement the FRSR method in the 2005 review, but the YUB itself determined that FRSR should be implemented in Yukon in Order 2005-12. Yukon Energy argued strenuously against the adoption of this method. Notably, the points made in argument by YEC in 2005, points that were considered and rejected by this Board, are identical to the arguments made by YECL during this GRA hearing process. Further, there is no distinction on the record between YEC and YECL that would support dealing differently with YECL on this matter. As addressed earlier, YECL's financial statements specifically report on the net salvage value at year end for "future removal and site restoration" - and depreciation for both utilities, prior to Board Order 2005-12, included recording an annual provision for FRSR.

YECL's entire argument ignores the fact that the Board itself raised this issue in 2005, considered the arguments against implementing the changes regarding FRSR, and decided that in Yukon this particular approach to net salvage would be taken.

Given the fact that YEC implemented these changes subsequent to Order 2005-12 being issued, and has continued to use this approach in its currently application, in order that the utilities be treated fairly and consistently, YECL should be directed to make the necessary changes to adopt the FRSR approach ordered by the Board in Order 2005-12.

8.0 RETURN ON RATE BASE

8.1 YECL ARGUMENT

YECL acknowledges that a number of components provide inputs to the requested return on rate base for the test years, including cost of capital (proposed ROE and capital structure), as well as the cost of long term debt. YECL elects to argue separately on each of these three elements.

YECL argues the following related to **Return on Equity (ROE)** issues:

- By using the formula ROE as a point of departure, YECL argues the "focus is then on the capital structure issue."

- Its approach is based on the AUC formula rather than first principles, and recognizes the following:
  - That formula approaches are used by most Canadian utilities; and
  - That existing formulas are currently under review by two major jurisdictions (AUC and NEB).

- YECL argues against the use of the BCUC formula approach based on the following:
  - YECL argues that it did not consider using the BCUC approach as it received recommendations from Ms McShane which it accepted.
  - YECL notes it argued against the BCUC approach during the 2005 hearing and notes that YEC said at that time that use of the BCUC approach in its application was not precedent setting.
  - YECL argues that since methodological reviews are being undertaken by the AUC and NEB, an extensive debate over use of alternate methodologies should be avoided at this time.

- YECL argues that it is academic to debate which formula approach should be used by the Board "as the end point derived is essentially in the same range" (9.14% versus 9.25%).

- YECL argues that Ex. C1-12 information on historic returns for YECL and approved returns of ATCO Electric "is of no probative value in addressing the issues to be considered in these proceedings", and that there is no evidence indicating that YUB awards for YECL have been lower than Alberta awards for ATCO Electric.

YECL's argument on **capital structure** issues, focusing on its proposal for a significant increase in its equity ratio, includes the following points:

- YECL's proposal recognizes that "the capital structure and ROE are inextricably related."
- YECL's proposed change in capital structure to 47.5% equity by the end of 2008 is based on the changes that have occurred in the market and the conditions which have changed since this matter was last examined; in particular, markets have become more global and competition is with utilities across North America.

- The proposed equity ratio reflects analysis of YECL's business risk and principles for the determination of capital structure (the stand alone principle, compatibility of capital structure with business risk, and maintenance of financial integrity and creditworthiness); Ms. McShane estimated that the common equity ratio which would make the generic AUC ROE of 8.75% applicable to YECL would be the upper end of a range of 47.5% to 52.5%.

- YECL argues that Ms. McShane's analysis concludes that "as a very small utility operating in a service territory with an undiversified economic base and facing significant geographic physical/operating challenges" YECL is "exposed to a significantly higher degree of business risk than the typical electricity distribution utility in Canada and is of higher than average business risk within the spectrum of Canadian utilities."

- YECL argues that the increase in ROE to 9.25% was based on the view that formula driven ROE's are inadequate, and Ms McShane's resulting recommendation that YECL move to a common equity ratio of 47.5% and that the Board adopt an ROE of 9.25% equal to the generic ROE of 8.75% plus an incremental equity risk premium of 0.5% to compensate equity shareholders for the higher financial risk in the 47.5% equity ratio relative to the 52.5% ratio "required to equate Yukon Electrical to an average risk utility."

YECL's argument on **cost of debt** issues acknowledges that CUI will not have another debt issue in 2008 (given current market conditions) and that, contrary to the 6.60% forecast cost of new debt in the application for 2008, "the current proposal is to mirror down funds to Yukon Electrical at the weighted average cost of 5.623% incurred by ATCO Electric". YECL acknowledges that this debt rate is lower than that included in its application but then "reiterates the view that the forecast included in its Application was based on the best information at the time and, as such, should be accepted by the Board and approved as such." With regard to the observed decrease in yields based on prevailing market conditions, YECL argues that the offsetting increase in spreads must be considered, with the result that utilities are not able to borrow at lower rates – in fact, YECL argues, this will yield higher utility debt costs.

On **no cost capital** issues, YECL notes brief questioning related to the treatment of other post employment benefit plans (OPEB). YECL notes it proposes to treat OPEB on a cash basis as this will ensure consistency with its parent and allow benefits to be passed on to ratepayers.

On **deferred charges and credits** issues, YECL addresses questioning related to YECL's "proposed rate case reserve account" and explains that the reserve would operate to "flow through to customers the costs associated with its GRAs" and operate similarly to the reserve for injuries and damages, with a constant amount amortized each year. YECL argues that the $750,000 for Phase 1 and Phase 2 GRAs is reasonable and includes all outside costs such as expert consultants. YECL also notes that it is using a reserve account to flow through to customers costs associated with major cyclical diesel plant overhauls and rebuilds, consistent with treatment for overhauls approved in 1996/97.

8.2 OTHER INTERVENOR ARGUMENTS

CW addressed **ROE and capital structure** issues as an integrated argument, noting as follows:

- Ms. McShane used the AUC's generic cost of capital for 2008 as a "point of departure" for her recommendations; however, Ms. McShane departed from the benchmark rate of return recommending a 50 basis point premium for a rate of return, or 9.25% and a deemed equity of 47.5%.
    a. In Order 2007-347, the AUC set a generic rate of return on equity for 2008 at 8.75%; for YECL's parent company, the AUC's predecessor in Decision 2004-052 determined that a fair return on equity portion of capital structure of the distribution arm of YECL's parent ATCO should be calculated at a deemed equity ratio of 37%.
    b. The YEC 2008/2009 GRA uses the BCUC approach and a capital structure of 40% equity.
    c. For regulatory consistency it would be preferable that YECL use the BCUC approach; however, CW had no objection to using the AUC approach "if and only if the EUB/AUC rationale is respected and the result yields a fair and reasonable return". In this vein, it was noted that YECL's proposed altering of the AUC generic cost of capital does not respect AUC's rationale.

- The matter of an appropriate capital structure "reduces to the question of whether the risk profile of YECL warrants an equity thickness of 52.5%." After detailed review of the evidence, CW recommends that a deemed equity portion of rate base applicable to an ROE of 8.75% should be in the range of 40-42%:

a. CW addresses each specific element of business risk noted in YECL's evidence (e.g., industrial customers,[9] trees, generation assets) and concludes that an equity thickness in a narrow range somewhat above 37% would be appropriate.
b. CW notes that YUB comments respecting YEC, a primarily generation utility, in Order 1992-1, and concludes "that YECL's appropriate capital structure is closer to 37% equity than 52.5% equity."
c. CW concludes that, for Ms. McShane, "the matter of risk boils down to a matter of size" and that NUL(YK) provides the best risk comparison to YECL. CW notes:
   i. The last approved capital structure for NUL(YK), as stated in the evidence, was 40% equity.
   ii. YECL is nearly twice as big as NUL(YK) and eight times as big as NUL(NWT).
   iii. Based on Ms. McShane's proposition that risk is inversely proportional to size, YECL's capital structure should include less equity than the 40% allowed NUL(YK).
d. CW notes that a 52.5% equity ratio results in a FFO interest coverage ratio of 4.7 times, while a FFO interest coverage ratio of 3.8 times, equivalent to the average of Canadian utilities, could be achieved by YECL with an equity thickness of 42% - and if the embedded cost of debt is reduced as recommended by CW, an equity thickness lower than 42% would result in an FFO interest coverage ratio of 3.8 times.

- With regard to US utility comparisons provided in evidence, CW noted that such comparisons should not be used for determining ROE or capital structure as US comparisons are retrospective in nature and the Board has a duty to set a prospective rate. Further there is no information regarding whether US regulatory risks are comparable, or whether company's noted are electric power distributors.

Other intervenor arguments by LE and UCG on **ROE and capital structure** included the following points:

[9] With regard to risk the following was noted: (1) Minto is customer of YEC, not YECL; (2) a lag between the mine closure and any impact on residential/ commercial customers would allow YECL time to file a rate application;
(3) Most customers are in Whitehorse; (4) trees present the same risk in Alberta; (5) generation risk mitigated by fact that 90% of power is purchased and 10% risk mitigated by fuel deferral accounts.

- LE argued that YECL is a low risk utility, and recommended that the ROE either be 8.75%, with equity of 47.5%, or 9.25% with equity of 42.5%.

- UCG argued that a fair ROE should be set at 8.485%, subject to potential reductions as noted in its argument, and that YECL's capital structure should remain at the 40% common equity ratio.

On **cost of debt** issues, other intervenors argue that YECL's forecast costs are too high and should be reduced:

- CW argues that the cost of debt for 2008 should be based on the actual known cost of debt of 5.623%, that YECL had "ample indication at the time of filing that its forecasts cost of debt was too high," that the issues noted for 2008 raise concerns related to the 2009 cost of debt, and that YECL should be directed to reduce its forecast cost of Series U (2009 new debt) to incorporate a rate of 6.09%.

- LE recommends that YECL's cost of debt for 2008 should be 5.623% and for 2009 should be capped at 6%.

- UCG argues that YECL's cost of debt should remain at the approximate level experienced for the past two years and the 6.6% debenture rate is inflated, and not prudent. UCG argues that there should be Board approval of debenture rates for YEC and YECL before they are implemented.

On **deferred charges and credits**, LE addressed **rate case reserve** issues as follows:

- "The fact that about $450,000 of ratepayers' contributions could be taken straight into YECL's bottom line is most disturbing," and recommends that the Board investigate the matter in order to determine whether this was "an error of judgment on YECL's part" or, as claimed by YECL "an unintended result of the Board's Order 2005-17."

- LE notes that this account was comprised of ratepayers' money, and would have "paid for a large portion of the cost of this GRA for which ratepayers are now having to pay 'again'."

- LE argues that the $450,000 should have been set aside by YECL to cover current hearing costs and recommends that if the Board cannot require the $450,000 to be returned, than the Board should disallow YECL's rate case costs by an amount equal to reserve when it was absorbed.

8.3 YUKON ENERGY REPLY

ROE and Capital Structure

Yukon Energy agrees with YECL that ROE and capital structure issues are inextricably related, and submits that the Board needs in this instance to ensure that these issues are addressed concurrently.

YECL's argument is, at its heart, a proposal to significantly increase its equity ratio allowed for setting rates – with some slight added bump up along the way for the ROE, but even this is based on YECL's argument for a 52.5% equity ratio. Yukon Energy submits that, when all of the evidence is reviewed, the Board's past decisions on these matters for YECL and Yukon Energy as well as the balance of the evidence clearly indicate that YECL's equity ratio should not exceed 40%, and its allowed ROE should be between 8.75% (AUC approach) and 9.02% (BCUC approach).

YECL arguments regarding Ex C1-12 are without merit. YECL itself filed evidence on the allowed ROE of its parent, ATCO Electric. Further, the comparison of past YUB orders clearly demonstrates a consistent approach taken by this Board in past reviews whereby the allowed ROE for YECL was determined to be less than or equal to that of its parent. These past precedents, in part reflecting past Board review of evidence by Ms. McShane, are clearly relevant to the Board's review of YECL's latest application as consistency of regulation is one important consideration for all parties.

YECL attempts to argue that it opted to use an AUC "formula-based" approach as a result of recommendations from Ms. McShane. Aside from ignoring past YUB decisions on these matters, and that both YECL and Ms. McShane note at numerous times that Foster Associates was <u>directed</u> to use the AUC approach as "a point of departure", YECL opted to take a hybrid approach which essentially allows it to both increase its ROE beyond that which would be allowed considering by past Yukon precedent, the BCUC benchmark ROE or the AUC benchmark approach, while also allowing the utility to increase the equity component of its capital structure to levels well above historic levels and higher than both YEC and other comparable Canadian utilities. The approach advocated by YECL as "formula based" departs significantly from the AUC methodology cited by YECL and produces results that leave YECL with both a higher common equity level and a higher ROE than comparable Canadian utilities in British Columbia and Alberta.

YECL argues that "in the current context" an "extensive debate" over the use of "alternative methodologies" should be avoided. YECL's view of the "current context" seems to be that the formula-based approach is undergoing a review in two other jurisdictions (AUC and NEB), and it would be preferable to await the results of that review before conducting any debate in the current Yukon-based proceeding. YECL also argues that there is little difference in outcomes if one selects AUC versus BCUC approaches.

YECL fails to recognize that while methodology debates are occurring in Alberta and at NEB, the BCUC approach was last reviewed in 2006 and is not currently undergoing any regulatory review. On this basis, it is particularly strange to advocate that the YUB at this time shift from past consideration of the BCUC approach to consider now a hybrid AUC approach. YECL has a recent history of returning for regulatory review only infrequently. Setting an ROE based on an untested hybrid approach without fairly debating, testing and assessing that approach relative to available alternatives known to the Board is unreasonable.

In contrast, the BCUC approach is currently not under review. Ms. McShane's testimony confirms that the BCUC approach should yield results as acceptable as the AUC approach. If anything, YECL's argument supports reliance on the BCUC methodology at this time, with future reconsideration of other options at the next GRA after the results of the NEB/AUC reviews have been completed. It makes little sense to rely today upon approaches that are currently being reviewed.

YECL submits that whether or not the BCUC approach or the AUC approach is followed is essentially an academic debate because the approaches are equivalent and are seeking to achieve the same thing, and that the end point derived is essentially in the same range. Contrary to YECL's assertions there is a material difference between the 9.14% ROE derived by YECL using the BCUC methodology and the 9.25% ROE derived using YECL's hybrid AUC methodology.

- YECL is arguing that both the BCUC approach and the YECL hybrid approach lead to ROE's that are within the same range. YECL's argument on this point fails to consider the material deviations in YECL's approach that allow it both a higher ROE than would be allowed under the BCUC approach, while also increasing its common equity substantially in a way that would never be considered under the BCUC approach.

The 9.25% ROE derived in YECL's GRA is not derived using any benchmarking approach currently followed or implemented in any of British Columbia, Alberta or for the NEB. YECL has designed an entirely new and untested methodological approach that allows it to establish an ROE for the test years greater than either BCUC or AUC would allow, while simultaneously allowing YECL to increase its common equity beyond that historically allowed in Yukon for the utility and beyond that allowed for similarly situated utilities regulated by the AUC. YECL is significantly deviating from both past regulatory practice in this jurisdiction, and from any tested methodological benchmark.

- There would be a material difference in the ROE calculated were YECL to properly apply each of the BCUC methodology and the AUC methodology. As noted at page 41 of the YEC Final Argument, were the BCUC method applied correctly, taking into consideration the fact that YECL is a lower risk utility than YEC, the risk premium for YECL would be lower than the 52 basis points established for Yukon Energy in Order 2005-12, and would likely not exceed the 40 basis points approved for Fortis BC. Using the 2008 benchmark ROE of 8.62%, this would result in a 9.02% ROE, not the 9.14% ROE noted in YECL's argument. Further, were the AUC methodology to be applied correctly (and not as a point of departure) the ROE allowed would be 8.75%.

When dealing with the AUC approach, unlike the BCUC approach, a central requirement is the consideration of capital structure as the means to address business risk. YECL has consistently been held by the YUB to be a low risk utility, and YECL's own expert witness has agreed that YECL is a lower risk utility than Yukon Energy which has a capital structure with 40% equity. In this context, Yukon Energy agrees with CW that the matter of an appropriate capital structure "reduces to the question of whether the risk profile of YECL warrants an equity thickness of 52.5%." Yukon Energy also agrees with CW, based on all of the available evidence, that YECL is clearly less risky than YEC or

NUL(YK) - and on that basis, under the AUC approach with a benchmark ROE of 8.75%, YECL's deemed equity ratio should be less than the range of 40-43%.[10]

Cost of Debt

Each intervenor in this proceeding has raised significant concerns related to the accuracy of YECL's calculated cost of debt. While YECL argues that its cost of debt was based on the "best information at the time" CW has noted that YECL had ample warning that the forecast Canada bond yields in the 2008 test year would be significantly lower than forecast in November 2007.

Yukon Energy agrees with CW as to the reductions that should be ordered for YECL's cost of new debt in 2008 and 2009.

Yukon Energy has identified additional issues in its Final Argument, not addressed in other arguments, related to the method of calculating interest.

Deferred Charges and Credits - Rate Case Reserve

YECL's Final Argument has failed to address concerns raised during the hearing related to the rate case reserve amounts of $450,000 taken into income in 2005. This issue was noted in LE's argument, as well as in YEC's Final Argument. Had this amount been properly accounted for by YECL and not taken into YECL's income without prior Board review or approval, it may have been available to offset current rate case costs, mitigating some of the impacts of YECL's proposed rate increase. Yukon Energy agrees with LE that this matter should be addressed by the Board.

Yukon Energy is separately concerned that YECL's argument may suggest that YECL is proposing to set up a new ongoing "rate case reserve account" wherein it will accrue an annual expense equal to one-half of $750,000 even for years beyond the test years (in the same manner as occurs for the Reserve for Injuries and Damages). Yukon Energy did not understand this to be what was sought in the YECL application, and submits that the Board should ensure that the rate case account is only established for the specific costs allowed by the Board for YECL's current application. In this regard, Yukon Energy

[10] YEC's equity ratio is 40%. Based on the latest decision of the PUB of the NWT (Decision 24-2008), after review of essentially the same Ms. McShane evidence to support a 52.5% equity ratio for NUL(YK), the board approved a 43.5% equity ratio in conjunction with a return on equity of 9.1% for each of the years 2008, 2009 and 2010. The board noted that the 9.1% ROE reflects a 5% long Canada bond rate, i.e., at the lower long Canada bond rate of 4.5% assumed in YECL's ROE evidence, the 9.1% ROE would presumably be materially lower.

assumes that the $750,000 amount will be reviewed by the Board as to its reasonableness – and that the Board will note, contrary to YECL's argument, that these costs include internal YECL and AEL costs for phases 1 and 2.

9.0 CAPITAL ADDITIONS

YEC notes that given the significant increase in YECL's controllable costs, capital expenditures in the test years are without merit unless a solid business case is provided or other rationale exists that would support such expenditures are absolutely necessary for the continued safe operation of the utility during the test years or immediately thereafter.

9.1 YECL ARGUMENT

YECL acknowledges that the quantum of capital additions requested in the test period is materially above the level experienced prior to the test period, noting that three key projects are primarily responsible for the increase: the North of 60 Billing System, Automated Meter Reading ("AMR"), and purchase of the Carcross diesel unit.

Regarding the **North of 60 Billing System**, YECL argues that the existing system is 30 years old, and is based on IMS data base technology that is no longer economically supportable. In support if the system, YECL notes that a detailed business case has been provided and extensive work has been undertaken to ensure the proposed billing system is the best option from a functional and technical perspective as well as a and cost perspective. YECL notes that there will be cost sharing with other affiliates to minimize costs to all ratepayers.

Regarding the **AMR project**, YECL argues as follows:

- The AMR will provide the opportunity for significant enhanced benefits in the future.

- The business case is based on economic benefits that will be derived from the conversion over the project's life, without consideration of future additional benefits.

- The project is justified solely on the basis of cost savings over the life of the project based on its current intended use.

- The project is forecast to provide $900,000 in long term savings over the life of the project.

- The time has come to implement this "significant technological advance" and "proven technology" that has been implemented by ATCO Electric and other smaller utilities.

- Notes fees paid to ATCO Electric for assistance are for work vital to the implementation of the project.

- Information on record demonstrates both short and long-term benefits.

Regarding the **Carcross Diesel Project**, YECL argues as follows:

- The YEC 20-Year Resource plan provides that communities such as Carcross "are candidates" for installation of a diesel unit and that this was one of the factors considered in the decision to purchase the Carcross diesel.

- Higher outage levels in Carcross compared to other communities with their own diesel provide further justification for the purchase of the unit.

- YECL notes as the distributor it has a responsibility to address outages and a requirement to provide non-discriminatory service to its customers.

- YECL notes that Ex B-17 depicts outages experienced in Carcross/Tagish versus areas of similar size with backup diesel and counts this as support for its position that local diesel generation would significantly increase the level of reliability and decrease the duration of outages.

Regarding the **Haines Junction diesel**, YECL argues that this unit should be included in rate base. YECL argues that YEC attempted to "narrow the focus of the justification" to a requirement to add system support, but that this was clearly not the rationale which supported the construction of the unit. YECL argues that the record is clear that the rationale for the unit was extended outages and lengthy restoration times.

9.2 OTHER INTERVENOR ARGUMENTS

LE provides general views on capital additions, noting that capital expenditures appear higher than reasonable and that YECL gives the appearance of "catching up in test years for costs carefully managed in the past", and recommending that discretionary projects be deferred and capital expenditures be reduced such that net additions to rate base do not exceed $6.5 million per year ($9 million per year including contributions in aid of construction).

Regarding the **North of 60 Billing System**, other intervenors argue as follows:

- LE notes that, "in addition to the capital costs [$1.488 million] that will be recovered from ratepayers over time this project will increase operating costs by some $130,000 per year (LE-YECL 22) over the existing billing system." Noting that it is "suspicious about all of the charges that pass from YECL to its affiliates," and that detailed information has not been made available, LE concludes the "it has a flavour of unreasonableness." LE recommends the new system be approved subject to YECL providing a detailed O&M cost comparison between the existing system and the new system.

- UCG recommends the new system not be allowed as the costs are not prudent.

Regarding the **AMR project**, other intervenors argue as follows:

- CW notes concerns that benefits will either not be immediately realized (i.e., cross-over point is at 9 years, assuming no cost over-runs) or would require additional expenditures to implement. CW is also concerned with the overstatement of benefits to this AMR project, and submits that this creates doubts about the validity of the business case and apprehension about potential cost over-runs. While CW does not oppose approval of the project, CW is concerned that significant cost over-runs could cause the AMR project to become financially unsound and submits that the Board place a cap on the capital expenditures, i.e., approval should be based on a maximum capital expenditure 10% greater than the forecast capital cost of $4.185 million "to make certain that customers are no worse off under this alternative."

- LE notes that the benefits cited would not be included in the initial project but would involve additional costs, no savings related to meter reading would occur in the test years, there is no data related to meter reading error rates, and for eight years following implementation the new AMR will be more expensive than the current system, and with a 10% cost overrun the cross-over point is year 15. LE concludes that this is a weak project that should be deferred until it can be implemented with less rate impact.

- UCG recommends that the AMR project be denied.

Regarding the **Carcross Diesel Project**, other intervenors argue as follows:

- LE notes that YECL has not examined alternatives or performed a cost benefit analysis regarding the units. With regard to reliability concerns LE notes YECL's evidence that enhanced brushing has reduced outages throughout the YECL service area, and notes that providing higher power poles in areas where there are tall trees when pole replacements are undertaken may be another option for increasing reliability. LE recommends that the diesel unit be approved noting the frequent outages and the fact that Carcross is the only significant established community in Yukon that does not have back up diesel generation.

- UCG concludes there is no justification for the expenditure on the Carcross diesel, noting that Exhibit B-17 was not provided in YECL's Application, and there is no evidence or analysis on the record related to options to purchasing the diesel unit.

9.3 YUKON ENERGY REPLY

Given the significant controllable cost increases present in YECL's application, Yukon Energy submits that the Board should only approve those projects where there is satisfactory evidence to support the position that the project is absolutely necessary in the test years for the utility to continue to provide safe and reliable service to its customers. Elective projects should be deferred until a later date.
Of all three major capital projects included, the **North of 60 Billing Project** appears to have the most merit at this time, and Yukon Energy supports LE's recommendation.

As reviewed by CW and LE, the **AMR project** is fraught with cost and other risks and lacks any justification as being required or essential for the test years. Yukon Energy agrees with LE and UCG that this project not be approved at this time for inclusion in YECL's revenue requirement.

As noted in YEC's Argument at pages 26-33, the purchase of the **diesel unit for Carcross** is not supported by the WAF and MD Community Planning criteria contained in the 20-Year Resource Plan, nor by any other business case or cost benefit analysis provided on the record of this proceeding. There is no evidence on the record that any other options were meaningfully considered from either a feasibility perspective or a cost-benefit perspective. As noted by both LE and UCG, YECL has provided no real assessment that the purchase of the unit would serve to alleviate any reliability issues identified. Yukon Energy submits that YECL also has utterly failed to provide any meaningful evidence of reliability concerns at Carcross. Yukon Energy submits that there is no reasonable basis for the Board to approve proceeding with this project for the test years, and that prior to considering such a project in future the Board should require YECL to provide the relevant information on reliability performance, options and cost benefit assessments as set out in more detail in Yukon Energy's Final Argument.

As regards the **Haines Junction diesel unit**, there is minimal information on the record regarding the need for the unit or any alternatives that were considered. No business case was provided and there is nothing on the record that would confirm the purchase of the unit for Haines Junction materially reduced the impact of outages in the area, or that it has proven a cost effective option for enhancing reliability in the area. Yukon Energy submits that the Board should require YECL to provide such information prior to approving this unit's inclusion in approved rate base.

10.0 INCOME TAX

10.1 YECL ARGUMENT

YECL notes that no issues were raised regarding income tax during the hearing process and states that the Board should approve the requested income tax rate deferral account "to ensure that it can pass through the benefits of anticipated reductions in income tax rates to customers over the Test Period".

10.2 OTHER INTERVENOR ARGUMENTS

LE notes that changes to income tax rates are expected to be modest over the test period (from 34.5% to 34.0% equating to a dollar amount of $60,000). LE notes that in the circumstances, the magnitude of the change does not seem significant enough to warrant a deferral account. Although expressing doubts about the account, LE argues that this deferral account should be approved and as a result YECL should be considered a low risk utility.

10.2.1 Yukon Energy Reply

Yukon Energy has no specific issue with the proposed income tax deferral account, and agrees with LE that this is one more confirmation that YECL is a low risk utility. Of more importance, Yukon Energy notes that recommendations regarding ROE and capital structure will have a direct impact on YECL income tax costs included in its revenue requirement, and that this is an added key argument in support of an ROE and equity ratio that are each lower than that applied for by YECL.

11.0 SALES OF PROPERTY

11.1 OTHER INTERVENOR ARGUMENT

UCG addresses the issue of income from the sale of property at pages 7-8 of its Final Argument, noting that the revised response to UCG-YECL-6 provides that $506,000 of YECL land and property was sold since the 1996/97 GRA and that these proceeds went to YECL's shareholders. UCG notes YECL's acknowledgement that the properties were placed in rate base with taxes and improvements paid through yearly O&M charges. UCG argues that YECL has not sought regulatory approval for the transactions and has not provided evidence that these properties were no long used or useful for the provision of utility services, or that the sale would not cause harm to ratepayers. UCG submits that the necessary detail regarding the sales has not been provided and recommends that the Board and Board counsel investigate this issue further.

11.2 YUKON ENERGY REPLY

Other than the response to UCG-YECL-6 Revised and cross examination at transcript pages 342-43, there is little on the record regarding this issue.

UCG and YECL have made reference to, but do not specifically cite, an Alberta-based case on this issue[11]; it appears based on the constituent legislation of the regulator in that case that the Court held that the Board did not have jurisdiction to allocate part of the proceeds of the sale of non-depreciable property to ratepayers.

[11] It would appear that parties are making reference to ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board), [2006] 1 S.C.R. 140, 2006 SCC 4.

It is noted, there also exists past Yukon-based precedent related to the issue of the sale of non-depreciable property,[12] which provides the following principle related to the allocation of gains from non-depreciable property:

> As a matter of principle it would appear reasonable that the regulated owner of lands no longer used or useful in providing service should receive the benefit of any gain less what it has been allowed to recover in the rates to offset the effect of inflation over the period the lands were in the rate base. I would not recognize any deduction from the realized gain in respect of taxes and other items which reflect maintenance of the property as the lands in equations were in the rate base and were presumptively used or useful in providing service. As such, the owner was entitled to recover such expenses."

The Court concluded that Yukon Electrical was entitled to the gain on the sale of lands no longer used or useful in providing service and disposed of to third parties in arms length transactions after deducting from such gain the aggregate of any proportionate recovery in the allowed return as compensation for inflation since the lands in question became part of the rate base.

Based on past practice in Yukon, YECL should be entitled to the gain on the sale of lands no longer used or useful with necessary deductions for inflation.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

P. John Landry
Counsel for Yukon Energy Corporation

November 10, 2008

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[12] Yukon Energy Corporation and The Yukon Electrical Company Limited v. Yukon Utilities Board, 1996 CanLII 2558 (YK C.A.) reviewed whether the Board erred in directing the proceeds in excess of original cost to be accounted for in a manner which would reduce the rate base and enhance the revenue permitted to be earned.