

Appendix A to Board order 2015-02

Reasons for Decision

1. Introduction

On October 27, 2014, pursuant to section 62 of the *Public Utilities Act* and section 31 of the Yukon Utilities Board Rules of Practice, Yukon Electrical Company Limited (YECL) filed with the Yukon Utilities Board (Board) an Application for Review and Variance (review application) regarding Board Order 2014-06 and Appendix A, Reasons for Decision, dated April 23, 2014 (Board Order). In its review application, YECL is requesting that the Board vacate its directions in the Board Order to (i) remove all project-related costs of the Watson Lake bi-fuel project from its proposed capital additions to rate base; (ii) reduce the cost of living adjustment (COLA) component of its defined benefit pension expense from 100 to 50 percent of Canadian Consumer Price Index (CPI) up to the three-percent maximum and to adjust its defined benefit pension funding requirement forecast accordingly; and (iii) vary the awarded rate of return on equity of 8.75% and the common equity ratio of 40%.

The grounds for review are as follows:

- i. Regarding the Watson Lake bi-fuel project, YECL alleges that fundamental changes in circumstances or facts have occurred since the Board Order; and
- ii. In relation to the directions on the COLA adjustment, the rate of return on equity, and the common equity ratio, YECL alleges the Board committed errors of law or jurisdiction, or an error of fact.

In its review application, YECL made submissions on each of these grounds and in support of the relief requested.

The Board uses a two-phase system for applications for review. In the first phase, the review applicant must establish a *prima facie* case sufficient to warrant a review. If it finds that this threshold for review has been met, the Board will hold a new hearing or other proceeding in accordance with its rules of practice to determine the review on its merits and whether the decision should be confirmed, changed or cancelled.

Before making a decision on the first phase of the review application before it, the Board issued a process letter on October 30, 2014, affording interveners an opportunity to submit comments on the first phase of the review application by November 20, 2014 and YECL to reply by December 11, 2014. The Utilities Consumers' Group (UCG) and Yukon Energy Corporation (YEC) submitted comments on the review application. The comments filed by YEC only addressed the rate of return on equity and the common equity ratio. YECL responded to these comments.

In its submission, UCG questioned the existence of fundamental changes in circumstances or facts alleged by YECL in relation to the Watson Lake bi-fuel project and disputed that such changes or facts occurred. UCG pointed to the record and the Board Order to address the issues raised in the review application. It concluded that YECL did not make a *prima facie* case that the Board made errors of law or jurisdiction, or an error of fact in the Board Order for the reasons set out in its submission.

YEC submitted that YECL did not establish a *prima facie* case that the Board erred in denying YECL a risk premium or an increase in its common equity ratio because the Board Order is consistent with prior Board rulings to select and implement a generic cost-of-capital model in accordance with principles established in Canada for utilities, based on the evidence then provided to the Board during each proceeding. In support of its submissions, YEC pointed to the record of the YECL proceeding in question, the statements of the Board in the Board Order regarding the risk premium and the common equity ratio and Board Order 2009-02, as well as Board Order 2013-1.

YECL replied to UCG's comments. It argued that the UCG was incorrect in its submissions for the reasons stated in its reply. YECL also took issue with the submissions of YEC. It reiterated its request that the Board convene a phase two review on the merits. It asked that, in the alternative, the Board could vacate the directions in questions and vary the rate of return on equity and the common equity ratio.

2. Test for review and variance

Section 62 of the *Public Utilities Act* (Act) states:

62 The board may review, change, or cancel any decision or order made by it, and may re-hear any application or complaint before deciding it.

The Board has enacted rules of practice under section 10 of the Act which include the following provisions regarding applications for review:

31. (1) Pursuant to section 62 of the *Act*, the Board will consider the following as grounds for review:

- a) the Board has made an error in jurisdiction;
- b) the Board has made an error in fact or law;
- c) there has been a fundamental change in circumstances or facts since the decision or order;
- d) a basic principle has not been raised in the original proceedings;
- e) a new principle has arisen as a result of the decision nor order;
- f) such other grounds as the Board may determine require a review.

(2) The application for review should as a minimum set forth the following:

- a) the grounds upon which the application is based;
- b) a brief statement of facts supporting the alleged ground(s) for review;
- c) if new evidence is sought to be filed, a statement of the nature and purpose of the evidence;

d) any further matter that the applicant believes will assist the Board in reaching a decision to grant a review.

(3) The Board will use a two-phase system for applications for review. Such a process enables certain applications to be dealt with expeditiously and economically. An application for review will be subject to an initial screening phase where the applicant must establish a *prima facie* case sufficient to warrant full consideration by the Board. In the first phase, the Board will assess an application having regard to some or all of the following questions:

- a) Should there be a review by the Board?
- b) If there is to be a review, should the Board hear new evidence and should the parties be given the opportunity to present evidence?
- c) If there is to be review, should it focus on the items from the application for review, a subset of those items or additional items?

(4) Upon receipt of an application for review, the Board will invite registered parties to comment on the application for review regarding the questions set out in subsection (3) for the first phase of the review and the applicant for review may respond to the comments received.

(5) In the case of an alleged error, in order to advance to the second phase of the process, the application must show that:

- a) the claim of error is substantiated on a *prima facie* basis; and
- b) the error has significant material implications.

(6) If there is a second phase, then the Board will hear full arguments on the merits of the application.

In arriving at this decision on the screening phase of the review application, the Board has considered all arguments and submissions made by YECL and the comments of the UCG and YEC. The Board Order, the record of the proceeding including evidence at the hearing which resulted in the Board Order were also considered for this decision. References in this decision to specific arguments and submissions of YECL and comments of UCG and YEC, or specific parts of the Board Order or the record of the proceeding, are intended to assist the reader in understanding the Board's reasoning relating to a particular matter and should not be taken as an indication that it did not consider all relevant portions of the arguments, submissions, comments, Board Order or record with respect to any matter.

3. Discussion of the Board Order and grounds for review

The Board has divided its decision on the screening phase of the review application into two parts based on the grounds for review. First, the Board discusses the Watson Lake bi-fuel project to determine whether YECL has made a *prima facie* case that there has been a fundamental change in circumstances or facts since the Board Order was made.

Second, the Board discusses the COLA adjustment, the rate of return on equity, and the common equity ratio to determine whether YECL has made a *prima facie* case that the Board made an error in fact or errors law or jurisdiction.

i. Watson Lake bi-fuel project

The fundamental change in circumstances or facts alleged by YECL is that the liquid natural gas (LNG) market has developed sufficiently to enable the validation of the Watson Lake bi-fuel project lease costs using competitive tendering to show that these costs are at fair market value. Also, YECL stated that the Board's recommended approval of the YEC Whitehorse Diesel Project to Natural Gas Conversion Project enables a more conclusive understanding of how the benefits of its project will be assessed and determined.¹

The reasons of the Board for rejecting YECL's proposal to include the Watson Lake bi-fuel project in its rate base are as follows:

The Board considers of note YECL's submission that "this is a first-of-its-kind project, a pilot project that we're doing in a phased approach to prove on one unit at Watson Lake over a one-year period." The Board also has taken into account YECL's response that this "is a first-of-its-kind project, to be proven through demonstration on a single unit before proceeding to conversion of the remaining units while ensuring that a reliable supply of natural gas is available and the performance of the entire facility is acceptable."

...

The Board takes note of YECL's submission that when comparing the project capital costs to the cumulative fuel savings, a simple project payback of nine years was shown. However, in the same intervener request, YECL pointed out that a competitive market for LNG supply did not yet exist as there was only one Western Canadian supplier of LNG at the time, albeit two other suppliers were expected to be in the market in 2014.

The Board has taken into account the lack of a competitive tendering process as evidenced by YECL's submission that a "competing lease provider was not in the market at the time to meet the needs of the Watson Lake project in 2012." However, YECL submitted that YECL had full visibility into the:

...competitive process for the storage vapourization equipment... and are working with ATCO Gas under the conditions of a fair market value arrangement then with what we'll provide with respect to the pricing components that are

¹ YECL review application page 4

within that various components for the equipment and for the services that are being provided and for a return on the project.

In the Board's view, fair market value is best determined through a competitive tender process. In this case, the lack of such a process leads the Board to question the costs of the proposed project. The Board considers that the markup in determining the lease price appears high. (footnotes omitted)²

The Board was aware that a market was starting to be established for the supply of LNG and that the evaluation of the LNG facility was an emerging market and the reasons for YECL proposing a lease for equipment and services.³ The Board took into account the YECL submission that in 2012 there was no competing lease provider in the market to meet the needs of the Watson Lake bi-fuel project in 2012.

The Board Order was made on the evidence before it which included the hearing held in November 2013. During the hearing, the issue of the potential changes in the LNG market for the supply of LNG and LNG facilities was canvassed at length and is addressed in the Board's reasons. In its reasons, the Board stated its view that fair market value is best determined through a competitive tender process rather than as argued by YECL that its lease agreement with ATCO Gas was a fair market value arrangement. The Board questioned the costs of the proposed project because of the lack of a competitive process and considered that the markup in determining the lease price appeared high. Also, in part, the Board rejected the project because it was the first of its kind and was going to be tested as a pilot project. Contrary to YEC's submissions in its review application, the Board did not take issue with YECL's submissions that when comparing the project capital costs to the cumulative fuel savings, a simple project payback of nine years was shown.

The Board is of the view that the fundamental change in circumstances or facts must be construed narrowly to preserve the integrity of the decision which was based on the business case presented to the Board. The Board considers that a review on the grounds of a fundamental change in circumstances or facts cannot be used to subsequently bolster a business case for the Watson Lake bi-fuel project that the Board rejected for a number of reasons. During the course of the proceeding, the Board was aware of the potential changes in the LNG market for the supply of LNG and for LNG facilities. Given that the Board was aware of potential changes in the LNG market, the Board is not persuaded that there is a fundamental change in circumstances or facts on which to base the consideration of new evidence which was prepared by YECL a number of months after the Board Order was rendered in this case.

² Appendix A, Reasons for Decision, pages 81 and 82

³ Transcript, Volume 1, November 4, 2013 page 87 and 88

Also, the Board does not accept the submissions of YECL that subsequent considerations of the Board of the economic benefits of the YEC Whitehorse Diesel to Natural Gas Conversion Project warrant a reconsideration of the Watson Lake bi-fuel project. In its reasons, as noted above, the Board did not reject the Watson Lake bi-fuel project based on the economic benefits of the project. It did not take issue with YECL's submission that when comparing the project capital costs to the cumulative fuel savings, a simple project payback of nine years was shown.

Further, the Board does not consider the two projects are comparable and YECL cannot attempt to present additional evidence based on subsequent assumptions accepted by the Board in a different case.

For these reasons, the Board considers that YECL has not made a *prima facie* case to warrant a review on the basis of a fundamental change in circumstances or facts in relation to the Watson Lake bi-fuel project.

ii. Errors in fact and errors of law or in jurisdiction

a. COLA adjustment

YECL alleged that the Board failed to consider the prudence of the COLA costs and the presumption of prudence, failed to assess the prudence of COLA costs independently of potential impact on ratepayers, and overlooked the new pension evidence. The Board does not accept YECL's arguments that the Board failed to consider the prudence of the COLA costs and that a presumption of prudence exists in relation to these costs for the following reasons.

First, in this case, YECL mainly argued that these costs were reasonable and appropriate and that the historical practice of including the COLA adjustment costs should be continued.

Second, the presumption of prudence, as argued in the review application by YECL, did not apply in this case because there was material put on the record at the hearing adduced by way of cross-examination which did not support the position taken by YECL and YECL gave testimony at the hearing in relation to its pension plans and that these were the same pension plans that were considered by the Alberta Utilities Commission in Decision 2010-189 and Decision 2011-391. The applicability of these decisions is further supported by the submissions of YECL in its review application.

Third, in Undertaking No. 3 filed subsequent to the oral hearing, YECL filed additional information which the Board considered. In its review application, YECL referred to this information as the new pension evidence. This information was filed prior to argument and reply; therefore, the opportunity to test this information was not available. This new pension information was the Mercer report dated November 4, 2013, on the total remuneration review of ATCO Utilities, which YECL contended supported the reasonableness of its request for 100 percent of the COLA adjustment. Further, as noted in the Board Order, the evidence and the submissions of YECL in argument and

reply addressed this issue and the review application reiterates YECL's arguments on the new pension information in the proceeding.

Fourth, in making its finding to reduce the COLA adjustment, the Board relied on evidence on the record, and argument and reply of the parties. The COLA adjustment costs are forecast costs for the test years in question and these forecast costs did not engage a prudence test. The Board was considering the reasonableness of the forecast costs and YECL had the onus to show that the costs were reasonable. In making its direction to reduce the COLA adjustment, the Board was not satisfied that YECL had demonstrated that the COLA adjustments forecast costs were reasonable and required for the provision of utility service.

As a result, the Board finds that YECL has not substantiated its claim of errors on a *prima facie* basis.

b. Rate of return and common equity ratio

YECL alleged that the Board failed to set a fair return on rate base for YECL, used the wrong test in determining the return on rate base and overlooked or disregarded YECL's extensive evidence regarding its business risk, failed to apply the stand-alone principle in setting YECL's capital structure, and unfairly deviated from its recent prior capital structure rulings. In its consideration of these allegations, the Board reviewed the Board Order in relation to the setting of the rate of return and the record of the proceeding. In the Board Order, the Board stated:

In Board Order 2009-02, the Board made its views known regarding generic cost-of-capital models. The Board set out three questions that need to be answered in relation to applicable generic cost-of-capital models and risk premiums:

- (1) Which generic cost-of-capital model should be used and from which jurisdiction?
- (2) Should a risk premium be applied?
- (3) What risk premium should be applied to YECL? ⁴

In response to the first question, the Board stated that the parties agreed that the British Columbia Utilities Commission (BCUC) generic cost-of-capital benchmark of 8.75% should be used and that this was in keeping with the Board's precedent and practice. The Board added that this benchmark is only used to determine return on equity but not equity thickness. The Board continued by stating that:

[a]t the time of Board Order 2009-02, the BCUC benchmark utility was FortisBC. For the most recent BCUC decision, the benchmark utility is Fortis Energy.

⁴ Appendix A Reasons for Decision pages 49 and 50

Regarding the question on the application of a risk premium, in Board Order 2009-02, the benchmark utility was FortisBC and evidence had previously been submitted regarding the comparability of the BCUC benchmark utility to YEC. Appendix A, Reasons for Decision, attached to Board Order 2005-12...

...
Determination [Appendix A to Board order 2005-12]

The Board is of the opinion that the rate of return on common equity that YEC is requesting is reasonable, given their level of risk in relation to other utilities within their peer group. Using the BCUC automated adjustment mechanism as a proxy of rate of return on equity does not impose a precedent in the Yukon, and is an expedient and means of determining return for the current one year period. As for the issue of risk premium, the Board agrees that YEC likely falls somewhere between PNG at 65 basis points, and FortisBC at 40 basis points. To ensure that there is sufficient forecast risk within the revenue requirement model, YEC should be at risk for their forecasts of load, OM&A and capital expenditures. (Page 45)

However, the Board considered that YECL had not provided an assessment within the proceeding in question regarding the comparability of YECL to the BCUC benchmark utility, Fortis Energy. It stated:

BCUC Order G-75-13 — the Stage 1 GCOC proceeding decision dated May 10, 2013 — identifies Fortis Energy as a gas distribution utility. Other than it being a distribution and regulated utility, no other comparisons to YECL can be gleaned from the benchmark decision. As a result, the determination of whether a risk premium should be applied is not clear.

The Board finds that YECL has not established a *prima facie* case to quantify a risk premium over the BCUC benchmark utility. Therefore, the Board directs YECL, in its compliance filing to use an ROE of 8.75 percent, an ROE equal to that for the BCUC GCOC benchmark utility. YECL is also directed to provide justification for a risk premium relative to the BCUC GCOC standard in its next GRA.⁵

Based on its review of the Board Order and the record of the proceeding, the Board is of the view that YECL has not substantiated a *prima facie* case of error regarding the setting of its rate of return for the test period. The Board Order on the rate of return is consistent with prior Board decisions to select and implement a generic cost-of-capital model in accordance with principles established in Canada for utilities, based on the evidence provided to the Board during each proceeding. As stated above, the Board has set out the questions that the Board must address in selecting in any specific proceeding an applicable cost-of-capital model and risk premiums. After selecting a

⁵ Appendix A, reasons for Decision page 51

specific generic cost-of-capital model in a specific proceeding, the Board does not consider modifications from other jurisdictions that are not consistent with the selected model. The Board was consistent with the analysis set out in its reasons to Board Order 2005-12 to consider whether there was evidence comparing YECL to the peer group considered by BCUC. There was no evidence before the Board in the YECL proceeding on updated risk premiums for the BCUC generic cost-of-capital model. YUB-YECL-33(b) confirms that the Board during this proceeding had no evidence on an approved rate of return for FortisBC Inc., FortisBC Energy (Vancouver Island), FortisBC Energy (Whistler), Pacific Northern Gas Ltd. or Pacific Northern Gas (N.E.) Ltd., the likely comparator group for determining a risk premium. Also, YECL did not show that its risks had changed to warrant a risk premium.

Regarding the common equity ratio, the Board stated:

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

In terms of equity thickness, this Board has not relied upon the results of generic proceedings from other jurisdictions. Although past references have been acknowledged regarding other North of 60 utilities, the Board has used utilities within Yukon in its decision-making. In this proceeding, YECL has stated that its business risks are somewhat less than those of YEC. YECL has also stated that its business risks for this application are largely consistent with those assessed in its 2008-09 Application.

The Board accepts the position of YEC that if YEC's business risks are higher than those of YECL, then it would not make sense to approve an equity ratio for YECL higher than that approved for YEC.

Further, although YECL has provided examples of jurisdictions where higher equity thicknesses have been granted the benchmark utility in the BCUC GCOC proceeding was awarded an equity thickness of 38.5 percent. The Board considers that the equity thickness presented for the NWT jurisdiction or for the BCUC GCOC benchmark utility is not comparable to YECL. Therefore, the Board allows YECL to continue to have an equity thickness that is equal to that awarded to YEC — that is, 40 percent — and directs YECL to reflect such in its compliance filing. Further, as YECL has stated that its business risks are consistent with those in its 2008-09 GRA application, the Board is satisfied that maintaining the same equity thickness it has allowed in YECL's 2008-09 GRA is fair and reasonable.⁶

⁶ Appendix A, Reasons for decision, page 54

Based on the above findings, the Board considers it has consistently applied recent previous determinations on capital structure including the determination in Board Order 2009-02 that the stand-alone principle did not apply to YECL. Even though it was not persuaded by the submissions of YECL on the stand-alone principle in this proceeding, the Board awarded the same common equity ratio that it had awarded to YECL in Board Order 2009-02 and to YEC in Board Order 2013-01, although YEC's business risks are higher than those of YECL and YEC is a stand-alone utility. Accordingly, YECL has not substantiated a *prima facie* case that the Board erred in setting YECL's common equity ratio.

Conclusion

Based on the above, the Board did not need to consider the materiality threshold and dismisses YECL's review application.