IN THE MATTER OF YUKON ENERGY CORPORATION APPLICATION FOR REQUESTED APPROVALS RELATED TO THE POWER PURCHASE AGREEMENT BETWEEN YEC AND ALEXCO RESOURCE CORP. ET AL.

REPLY ARGUMENT

YUKON ENERGY CORPORATION

DECEMBER 15, 2010

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1.0 INTRODUCTION

1.1 OVERVIEW

Yukon Energy's reply argument addresses key issues raised in the two intervenor arguments regarding the Yukon Energy application (the "Application") for requested approvals related to the implementation of the Power Purchase Agreement ("PPA") that Yukon Energy has concluded with Alexco Resource Corp. et al. ("Alexco").

Section 2 of the Reply responds to specific issues raised in the Leading Edge ("LE") and Utilities Consumers' Group ("UCG") arguments. The third intervenor who asked IRs (Yukon Electrical Company Limited) did not submit an argument.

2.0 SPECIFIC ISSUES RAISED IN INTERVENOR ARGUMENTS

2.1 REPLY TO LEADING EDGE ("LE")

LE recommends that the Board approve the Application, subject to the following two specific issues:

- YEC Capital Cost to negotiate & conclude PPA – reject Alexco paying
- Other Matters – Beyond Requested Approvals

2.1.1 YEC Capital Costs To Negotiate & Conclude PPA – Reject Alexco Paying

LE Argument

LE argues that there is no precedent for Alexco to be charged these costs, that it is perverse for Yukon Energy to charge a customer to negotiate with that customer, that this removes any incentive for Yukon Energy to be cost effective and expedient in its negotiations, and that there are already benefits in excess of negotiation costs to all other customer classes as a result of Alexco becoming an industrial customer (i.e., industrial class pays about 109% of the COS).

YEC Reply

Although there is no precedent for Alexco to be charged these costs, Yukon Energy does not agree that it is perverse for an industrial customer to pay for YEC's costs and expenses "reasonably incurred to conclude and negotiate this Agreement" or that this removes any incentive for YEC to be cost effective and expedient in its negotiations.

Currently, industrial customers are the only class where a PPA is now expected to be negotiated to receive electric service, in part to establish clarity as to various matters for the customer as well as YEC, and in part to provide the basis for applying to the Board for certain rate-related approvals. All non-industrial retail ratepayers are currently paying for the costs to negotiate and conclude the Minto PPA, which established the currently approved template for a PPA with an industrial customer. It is now appropriate that Alexco, and future industrial customers, pay YEC's costs to negotiate and conclude subsequent PPAs that are to be based on the Minto PPA template. This approach, which Alexco has agreed to in the Alexco PPA, provides incentive for the industrial customer to be cost effective and expedient in its negotiations while retaining incentives for Yukon Energy to be cost effective and expedient in its negotiations, i.e., the customer is only required to pay such YEC costs as are "reasonably incurred to conclude and negotiate this Agreement."

In effect, the Alexco PPA ensures that non-industrial retail ratepayers are not exposed to material costs (or cost risks) for transmission or PPA negotiation capital costs related to the connection of new industrial customers. Costs for related regulatory proceedings, however, continue to be recovered from all retail customers.

2.1.2 Other Matters – Beyond Requested Approvals

LE Argument

LE argues as follows on matters beyond YEC's requested approvals:

- The number based definition of "ampere" in the Alexco PPA, based on the Bonneville Power Administration website may be in error and YEC should consult its electrical engineers and correct the apparent error (or define ampere in words only).
- YEC should bring certain matters to the next Phase II Rate Application, namely "the issue of what metering and billing techniques are appropriate to industrial customers (and perhaps General Service customers) with multiple points of delivery" and "its proposals with respect to requiring industrial customers to pay for the Utilities' PPA negotiation costs".

YEC Reply

On the definition of ampere, Yukon Energy suggests that if this matter is of any concern to the Board, the portion of the definition in brackets (which references the disputed numbers) can simply be deleted. This definition was not included in the Minto PPA and accordingly can be removed from the Alexco PPA without any material impact. In practice, any metering of electric purchases will be done by standard meters and in accordance with the Board's approved ESRs or Terms and Conditions. Further, YEC is not seeking Board approval of this definition in the PPA.

Yukon Energy does not support LE's suggestions that any added matters be directed by the Board to be brought forward by YEC or YECL in the next Phase II Rate Application. YEC and YECL have already proposed amended Terms and Conditions which fully address totalized metering options for multiple points of delivery when the customer and the utility agree in a contract – and the proposal by the utilities would not otherwise require this to be done for any customer. Similarly, YEC has proposed in the Application approval where the industrial customer agrees to pay for YEC's negotiation costs – accordingly, this matter can and should be resolved in the current proceeding and there is no merit or benefit in revisiting the matter in any subsequent proceeding.

2.2 REPLY TO UTILITIES CONSUMERS' GROUP ("UCG")

UCG recommends, in summary (para 53), that the Alexco PPA "be sent 'back to the drawing board' incorporating all concerns and directions coming out of this process", and "Until such time as a comprehensive agreement is brought forward for approval by the Board,…that Alexco pays the commercial service rates for all points of service."

In Yukon Energy's view, there is no reasonable basis provided in UCG's other ten pages of argument to support its summary recommendation as set out above to incur further costs and delays on this matter. More specifically, Yukon Energy replies as follows to the specific issues raised in the balance of UCG's argument:

- **Industrial firm rates and COS -** UCG argues (para 4) that "of particular concern is the lack of a cost of service analysis which ensures that the rates proposed …are based on a comprehensive cost of service study and recover all costs associated with the proposed services." Subsequently, UCG's argument devotes several paragraphs (para 20-31) to OIC 1995/90 directives on this matter, prior cross examination and evidence from earlier hearings, and the alleged need to consult stakeholders on the proposed firm mine rate. However, UCG subsequently admits (para 36) that it is fully aware that industrial rates have been "fixed by the Yukon government for several years". In other paragraphs (para 41to 44) UCG also admits it is fully aware of OIC 2007/94 that included this direction. Accordingly, UCG's argument regarding any need for a COS at this time is without any merit or relevance to the current proceeding. Further, Yukon Energy is concerned that UCG sets out arguments to suggest any issue as to industrial rates covering cost of service – such arguments flagrantly ignore the recently tested 2009 COS on these matters, with its clear confirmation that industrial customers are in fact paying rates that are well above costs.

- **Costs and risks not considered –** UCG argues that "the lack of guarantees indicates that there remains a very real possibility that Yukoners…will end up paying more of the costs of the proposed service that YEC is indicating" (para 6), implies that costs to negotiated the PPA are not included and that regulatory costs should be included for recovery from Alexco (para 7), and "that there are several risks that have not been considered or quantified" (para 9). These broad brush attacks on the PPA are generally without merit or substance, ignoring the scoping precedents set by the approved Minto PPA (i.e., it is not relevant here to raise issues re: lack of "guarantees", unsubstantiated concerns about non-capital costs, or secondary sales reductions) and ignoring in some instances what is provided for in the Alexco PPA (e.g., recovery of costs to negotiate this PPA). As regards specific changes that UCG advocates for the PPA, these can and should be addressed today in the current proceeding without incurring further delays and costs on this matter.

- **Other matters raised by UCG –** Beyond the "UCG summary position points" addressed above, UCG raises a variety of other matters. Many of these matters are beyond addressing anything that YEC has sought Board approval for in this proceeding, and have no basis for consideration at this time. Specific matters touching on the current Application typically reflect assertions that ignore the evidence, and therefore also do not merit any consideration. Yukon Energy specifically provides replies on the following:

- **Calculation of Fixed Charge –** UCG's brief comments on this (para 32) ignore the evidence (YEC Final Argument, section 3.1) as to the Faro Mine where the 85% direct assignment to that mine of Faro-Whitehorse line costs was also made notwithstanding the evidence that the Faro Mine accounted for over 96% of the load on that line.
- **Take or Pay for Fixed Charge –** UCG's argument (para 33) that a take-or-pay provision should be in place for Alexco for the fixed charge is without merit. The evidence shows that the fixed charge is a share of existing costs incurred for the Mayo-Keno line before Alexco negotiated with YEC to take service as an industrial customer, and that the basis proposed for Alexco paying the fixed charge relates to Alexco's share of the existing transmission line usage while it is taking service from the Mayo-Keno line as an industrial customer. There is no reasonable basis to hold Alexco responsible for the fixed charge before it comes on the system or after it leaves the system. In summary, the PPA requires Alexco to pay this charge as part of its monthly charge so long as it is an industrial customer – and, should Alexco shutdown prematurely without notice, ratepayers will not be at risk here for any "outstanding fixed costs" that would not have otherwise existed without the Alexco PPA.
- **Clarity as to points of delivery –** UCG's argument (para 34) that the Board needs to know in this PPA which points of delivery to Alexco will be under other rate schedules is without merit, as the PPA only needs to address the points of delivery related to the Firm Mine Rate covered by the PPA (all other points of delivery will be charged in accordance with General Service rates).
- **Premium rate for electric heat -** There is no basis or merit to the UCG argument (para 35 and 38) as to a premium rate for electric heat use and/or billing at points of delivery where the Firm Mine Rate applies, i.e., contrary to UCG's assertions, there is no precedent or basis (or proposal by YEC) to charge any customer in Yukon a "premium rate for electric heat". YEC has proposed a higher runoff rate for all retail use in the retail runoff rate blocks (as amended and discussed in the recent Phase II rate hearing) – and, as discussed in response to YECL-YEC-7(c), the Firm Mine Rate already has provision for a similar runoff rate when diesel is on the margin. (The referenced response noted "…in the event that diesel is forecast to be on the margin, YEC has the option in this regard to apply to the Board to implement the Base Load Energy rate provisions of Rate Schedule 39 in order to address this risk as regards existing Major Industrial Customer loads.")
- **Start of Industrial service** – UCG's arguments (para 37, 40) as to lack of evidence as to the date for starting Rate Schedule 39 charges to Alexco or that such charges must be delayed until the Board approves the PPA are without merit, and ignore the approved Rate Schedule 39 to which OIC 2007/94 applies and which Alexco is entitled to be charged for service when its mine/mill facilities have a peak demand for electricity exceeds 1 MW (which the evidence establishes to have been the case as of November 1, 2010).

- **Board approval of PPA** – UCG's argument (para 39) that the Board must approve all elements of the Alexco PPA ignores the fact that the *Public Utilities Act* as referenced only addresses those elements of a contract "relating to a rate", and the authority of the Board "on application of one of the parties, to increase or reduce the rates [in a contract] to a rate that the board considers fair and reasonable". Further, UCG ignores Order 2008-13 that approved the current Rate Schedule 39 but specifically declined to approve amendments to the Minto PPA that were not needed to approve Rate Schedule 39. The current Application requests specific approvals that are consistent with the Board's jurisdiction and precedents as noted here.

- **Escalations & changes to Firm Mine Rate** – UCG's arguments (para 41-43) regarding rate escalation adjustments pursuant to OIC 2007/94 ignore the Board's determinations in Order 2008-13 as regards YEC's past commitments as to the annual timing for these adjustments (including provision, as referenced in response to UCG-YEC-1-3(e), that YEC is not required to file its annual change until December 5 of each year), which YEC has complied with and which provide the basis for YEC's actions on this matter.

- **Infrastructure charges to Alexco** - UCG's argument (para 44) that "Alexco should be responsible for some additional infrastructure costs (as Minto was in the past) such as those related to the Carmacks-Stewart transmission line and Aishihik 3" ignores the following evidence:

  - The Alexco PPA in fact charges Alexco all transmission capital costs that can reasonably be directly assigned to it based on the Minto PPA precedent (i.e., there is no reasonable basis to charge Alexco for any of the Carmacks-Stewart Transmission line costs) as well as the earlier Faro Mine precedent (as it affects assignment of existing fixed costs for transmission lines).

  - There is no Minto PPA or other precedent in evidence to support directly charging (as an assigned cost) an industrial customer any infrastructure capital costs or operating costs related to Aishihik 3 or any other existing or proposed YEC generation facilities, beyond the precedent of assigning on site diesel operating costs for facilities operated at the direction of the mine and solely to serve the mine (e.g., as discussed in response to YUB-YEC-1-3(c) local operating spinning reserve was required during operation of Faro mine in order to maintain power quality due to the impacts of that customer's load).

- **Ongoing reporting to YUB** – UCG's argument (para 47) that YEC be directed to provide regular reports of the electricity requirements of the Alexco facilities, so that the Board can "provide direction on a more timely basis should actual electricity requirements start dropping significantly and potentially drive the rates of other Yukon ratepayers" is without merit and should be ignored by the Board. There is no evidence that the Board should be concerned by, or provide direction on, such matters. There is also no precedent for such a direction, either with regard to the Minto PPA or the earlier Faro Mine agreement. In reality, as the Faro Mine experience fully demonstrated, YEC has ample incentive and ability to inform the Board on a timely basis when mine load changes necessitate the need to review rates charged.

- **Failure to set out all benefits** – UCG's argument (para 48) that all benefits are not set out has no merit or relevance, i.e., the PPA and the evidence address the matters that are required to be addressed, and there is no precedent or reasonable basis for UCG to suggest that YEC or Alexco have been deficient in this regard.

- **Lack of business case** – UCG's argument (para 49) that YEC has failed to provide evidence necessary to justify moving forward with the proposed PPA, due to the lack of any feasibility study or business case analysis, fails to reflect the evidence throughout the PPA and the proceeding that all capital cost risks undertaken by YEC related to Alexco are to be fully funded by Alexco at the outset of any Mine Facilities operation such that there is no reasonable basis for requiring YEC to have prepared or review such feasibility studies or to provide a further business case analysis to justify this PPA.

- **Changes to established definitions** – UCG's argument (para 56) that the PPA varies the definition of Major Industrial Customer from that used in OIC 1995/90 is without merit and ignores the evidence that the Alexco PPA definition in this regard mirrors the Minto PPA definition previously reviewed by the YUB, except to the extent that the Alexco PPA explicitly provides for "any future replacement definition or replacement service capacity threshold applicable to manufacturing, processing or mining activities of Alexco, as approved by the YUB." As noted in response to UCG-YEC-1-15(a), both the Minto PPA definition and the Alexco PPA definition comply with the definition in OIC 1995/90 and incorporate the factors that define industrial customers under the current rate policy.

- **Alexco should pay regulatory costs** - UCG argues (para 7, para 51) that Alexco should pay "any costs that can be directly assigned to a customer" and that "all regulatory costs for these types of specific purchase power proposals should be included in the Alexco case." This is one specific cost which YEC has not proposed be assigned to Alexco or any other industrial customer, based on precedents and general principles that all such regulatory costs should continue to be borne by all customer classes, in part reflecting the extent to which the industrial customer cannot reasonably affect or control such costs.

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ALL OF WHICH IS RESPECTFULLY SUBMITTED

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