DISCUSSION PAPER

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The Next Step In Managing Yukon's Power System

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Yukon
Economic Development

EXECUTIVE SUMMARY

THE NEXT STEP IN MANAGING YUKON'S POWER SYSTEM

This Discussion Paper highlights YEC's ability, after ten years of external management by YECL/CU, to establish full Yukon control and management of its assets. Future options are reviewed for management and ownership of Yukon's power system.

INTRODUCTION

In 1987, the Northern Canada Power Commission (NCPC) transferred assets for generating and transmitting most of Yukon's power to the Yukon Government (YTG). The YTG set up the Yukon Energy Corporation (YEC) to own these assets.

Before the 1987 transfer, YTG requested proposals from potential external managers to manage and operate YEC's assets. The successful bidder was The Yukon Electrical Company Limited (YECL) and its owner, Canadian Utilities Limited (CU). A Management Agreement was initially established for five years.

The Management Agreement has now been in place for almost ten years, and will continue after December 31, 1997 for another five years unless either YEC or YECL decides by the March 31, 1997 deadline to terminate the Management Agreement.

Several options have been proposed for future management and ownership of Yukon's power system. Before considering these, it is important to understand the roles of YEC, YECL/CU and the Management Agreement.

BACKGROUND

Electricity is currently supplied to Yukon customers by two power utilities, YEC and YECL. No power is imported or exported. Each utility is regulated by the Yukon Utilities Board (YUB). Each utility has a separate owner, Board of Directors, and staff. YEC's plant operations are externally managed by YECL/CU, pursuant to the Management Agreement.

YEC is owned by the people of Yukon. It produces about 94% of Yukon's power, most of it sold to YECL (wholesale) and major mines (retail). YEC is also responsible for planning and developing new Yukon electric power infrastructure at the least possible long-term cost. Part of YEC's earnings are currently used by YTG to fund rate relief for non-government residential and general service (commercial) customers. YEC's approved net rate base in 1996 is $116 million, reflecting the depreciated cost of its assets.

YECL is privately owned by Alberta Power Limited (APL), which in turn is owned by CU. It provides management services for YEC and power utilities in the Northwest Territories. YECL only produces 6% of Yukon's power but is responsible for distributing power purchased from YEC, to 87% of Yukon's residential and commercial customers. YECL's approved net rate base in 1996 is $31 million.

The Management Agreement provides for YECL to manage the assets of YEC, subject to the review and approval by the YEC Board of Directors and head office staff. For example, YECL must obtain YEC's approval for YEC budgets, business plans, submissions for rate increases, and other policy matters. YECL maintains separate accounts for YEC's financial records, assets and employees.

Through the Management Agreement, YECL:

- employs staff resident in Yukon, who operate YEC's facilities
- provides support services to YEC through its parent company (CU), and
- pays expenses and bills customers on behalf of YEC.

The present management and ownership structure has expedited smooth and efficient operation of all aspects of Yukon's electric system, and encouraged professional management and regulation of YEC's assets and operations. However, the present structure has also raised concerns. One concern relates to the Noah's Ark Syndrome (two of everything) - two owners, two companies, and two Boards of Directors - which results in public confusion and added costs. YEC has incurred significant costs in overseeing YECL's role as external manager, and YEC's ability to pursue development goals and cost-effective options for various support services has been constrained. Finally, CU's present fee for support services will significantly exceed what is considered cost effective for future management and operation of YEC's assets.

The Management Agreement provides for effective transition and termination at the end of each term in order that YEC may proceed with alternative management arrangements.

OPTIONS FOR MANAGING YUKON'S POWER SYSTEM

Two separate issues will be addressed when the Yukon Government decides on the next step in managing Yukon's power system.

One issue is future management of YEC's assets after December 31, 1997, when the present term of the Management Agreement ends. Based on the experience gained since 1987, external management of YEC assets is no longer required. Two options are available, assuming that YTG continues to own YEC as a separate utility:

Option 1: Establish Yukon Management of YEC Assets. If this option is selected, it should be confirmed that YEC, and not YTG, will hire the employees transferred from YECL.

Option 2 (Status Quo): Retain External Management of YEC Facilities. If this option is selected, YTG must decide whether to tender a general management contract to all interested and qualified parties, including YECL/CU, or simply to continue retaining YECL/CU through an extended or renegotiated Management Agreement.

A separate issue to be addressed is whether to merge the ownership of YEC's assets with YECL's assets, thereby establishing one Yukon power utility. Any decision affecting assets currently owned by YECL will require agreement with CU. Two options are possible.

Option 3: Establish One Yukon Power Utility. This option would require YTG and CU to agree on key policy terms and conditions regarding ownership, appointment of directors, utility management, protection of minority shareholders in the new Yukon power utility, and timing for involving other Yukon participants in ownership of the new utility (e.g., Yukon First Nations, Yukon municipalities, other Yukon residents).

Option 4: Maintain Two Utilities and Modify Ownership. If it is decided not to pursue one Yukon utility, or if it is not possible to achieve agreement with CU on the key terms and conditions for merging YEC and YECL assets, YTG could still pursue options to rationalize assets between YEC and YECL or to diversify ownership of YEC to Yukoners.

For each option, YUB regulation of rates is assumed to continue. Rates recently approved for 1996 and 1997 would not change. Rates after 1997 would continue to be equalized throughout Yukon, with no variation between YEC and YECL service areas.

DISCUSSION PAPER

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INTRODUCTION

The Yukon Energy Corporation (YEC) was created by the Yukon Government in 1987 to own the assets for generating and transmitting over 90% of the electric energy consumed in Yukon.

When YEC acquired its assets in 1987, it elected during the first five years not to manage and operate these assets itself. Instead, YEC entered into a management services contract with The Yukon Electrical Company Limited (YECL) and its owners to have them manage and operate YEC's assets for a fee.

The second term of the management services contract between YEC and YECL (and its owners), formally known as the Management Agreement, would end on December 31, 1997 if Notice of Termination is given by either YEC or YECL on or before March 31, 1997. Failing such notice, the Agreement will automatically continue for a further five-year term, from January 1, 1998 to December 31, 2002.

In December 1995, the Auditor General of Canada provided a report to the Board of Directors of YEC on the Value for Money of the Management Agreement. The Auditor General's report identified potential areas of risk and provided the following summary conclusion:

> *"Based on our review, nothing has come to our attention to indicate that the Management Agreement is not providing value for money to the Yukon Energy Corporation with respect to the efficient and economic operation and safeguarding of assets." (page 14)*

YEC has subsequently reviewed achievements and concerns regarding the present management and ownership framework for Yukon's power system, the major issues relating to possible termination of the Management Agreement after its second term, and a viable approach for proceeding in the event that termination is selected by YEC or YECL. Based on this review, YEC concluded that it would be feasible to end external management of YEC after the second term of the Management Agreement. It is timely, therefore, to review future options for management and ownership of Yukon's power system prior to the decisions required to be made by March 31, 1997.

BACKGROUND ON YUKON POWER SYSTEM

Electricity is currently supplied to Yukon customers by two power utilities, YEC and YECL. Each utility has a separate owner, Board of Directors, and executive management. There are no power interconnections between Yukon and its neighbours, and therefore no power is imported or exported.

YEC

YEC is owned by the people of Yukon. It is a wholly-owned subsidiary of the Yukon Development Corporation (YDC), a Yukon Government Crown Corporation. YEC's Board of Directors is appointed from across Yukon by the Executive Council of the territorial government, and meets regularly to direct the affairs of the corporation. YDC head office facilities and staff are shared with YEC, including the President, Vice-President Finance and Administration, and Senior Utility Engineer. YEC's assets and operations currently are managed by YECL/CU pursuant to the Management Agreement (see below).

YEC operates as a rate-based investor-owned (YDC) utility that is regulated by the Yukon Utilities Board (YUB). Although subject to specific policy direction from its owners (YDC) or the Government of Yukon, YEC functions at arm's length from the Yukon Government (YTG). YEC's approved net rate base in 1996 is $116 million, reflecting primarily the depreciated cost of YEC's assets. YEC's net rate base today is about 15% higher than in 1991.

YEC produces about 94% of the territory's power, with hydro facilities at Whitehorse, Aishihik Lake and Mayo together accounting for three-quarters of YEC's generation. It also uses diesel generation facilities in Dawson City, as well as the Whitehorse-Aishihik-Faro (WAF) system. YEC owns all transmission facilities in Yukon in excess of about 35 kV.

Wholesale sales to YECL account for 50% of YEC's sales, and retail sales to major mines (Faro and UKHM) account for 44% of YEC's sales. Distribution services, accounting for the remaining 6% of YEC's sales, are provided to about 1,840 residential and general service customers in Dawson, Faro and Mayo.

YEC's mandate includes responsibility for planning and development of new Yukon electric power generation and major transmission, as required, at the least possible long-term cost. YEC's capital spending to date, however, has been directed almost entirely to upgrade the power assets acquired from Canada in 1987. No new transmission, hydro or other non-diesel generation assets have been developed since 1987, other than a wind turbine generation facility near Whitehorse. YEC is currently working to prepare a new capital plan.

Between October 1993 and the end of 1995, approximately $6.2 million of YEC's earnings were used by the Yukon Government to fund rate relief in response to higher rates approved by the YUB, primarily for non-government residential and general service (commercial) customers. Rate relief funding will continue to be required from YEC until the present Yukon Government rate relief program is phased out.

YECL

YECL is a privately-owned utility active in Yukon since 1901. It is currently wholly owned by Alberta Power Limited (APL), which in turn is wholly owned by Canadian Utilities Limited (CU), an ATCO company. YECL provides management services for YEC as well as for power utilities controlled by CU in the Northwest Territories. YECL currently has slightly more than 100 employees resident in Yukon, and about half of these positions are required for management and operation of YEC assets. YECL pays charges to APL/CU for external support services.

YECL's operations in Yukon are regulated by the YUB, which recently approved YECL and YEC rates for 1996 and 1997. YECL's approved net rate base in 1996 is $31 million, which is about 55% higher than in 1991.

YECL produces about 6% of the territory's power, using diesel generation facilities in Watson Lake, Destruction Bay, Beaver Creek, Stewart Crossing, Pelly Crossing, Swift River and Old Crow, as well as a small hydro facility (McIntyre Creek) and some WAF diesel facilities.

YECL owns most of the equipment needed to distribute electricity to residential and commercial customers in Yukon. It distributes power to about 87% of Yukon's residential and general service customers, serving about 12,751 retail customers in Whitehorse, other WAF communities (excluding Faro), Watson Lake, and all other diesel-served communities other than Dawson City.

MANAGEMENT AGREEMENT

The Management Agreement was instituted in 1987 to facilitate the transfer of Northern Canada Power Commission (NCPC) assets to the Yukon Government. It provided for YECL/CU to manage the assets of YEC for an initial five-year term, subject to oversight and corporate governance by the YEC Board of Directors and head office staff. YECL was required to obtain YEC's approval for YEC budgets, business plans, submissions to the YUB, and other basic policy frameworks. The Agreement required YECL to maintain separate accounts for YEC's financial records, assets and employees.

As noted in the recent report of the Auditor General to YEC, it was considered at the time of the NCPC asset transfer in 1987 that the most expeditious method for YEC then to acquire the necessary electric utility management expertise was to seek a management services contract. After a process that sought out several electric utilities as YEC's potential external manager, APL/YECL was the successful bidder. The resulting Management Agreement with YECL/CU reflected the fact that YECL was already in place in Yukon, and the Agreement established integrated management of all power utility assets in Yukon.

The Agreement was renewed in 1992 for a second five-year term, which was recently extended by nine months from March 31, 1997 to December 1997.

Key features of the Management Agreement include:

- **System Employees:** YECL employs, and provides operational supervision of, employees resident in Yukon who operate the YEC system (System Employees); the operational supervision costs of YECL are recovered by allocating time and expenses to YEC. Approximately 47 of YECL's 103 employees resident in Yukon are System Employees allocated to work on YEC assets over 50% of their time, including 34 employees involved in energy supply on WAF plus 12 employees located in Dawson City, Mayo and Faro (responsible for customer service and diesel operation in these YEC service areas).

- **Support Services:** CU provides support services to YEC through employees resident outside of Yukon, including financial services, material services, technical/engineering services, managerial/consulting services and miscellaneous services (including public relations and appearances before regulatory bodies). Support service costs of CU are recovered by an annual flat management fee paid by YEC which escalates each year. YEC/YDC are obligated to pay the management fee even if this fee is not recovered through rates.

- **Funding Responsibilities:** YECL pays expenses and bills customers on behalf of YEC. However, financing costs of YEC, including all debt and equity requirements and all capital expenditures, are directly provided to YEC by the Yukon Government through YEC's owner, YDC, which also provides head office staff services. YEC's annual financial reports are audited by the Auditor General for Canada.

- **YUB Approvals:** Any cost allocations between YEC and YECL are subject to review by the YUB when it approves utility rates. Any YUB orders take precedence over the Management Agreement.

- **Termination Provisions:** The Agreement provides for effective termination at the end of each term in order that YEC may proceed with alternative management arrangements. The Agreement will enter its third five-year term, effective January 1, 1998, if no notice of termination is provided on or before March 31, 1997. In the event of termination, the Agreement provides for YECL to transfer System Employees to YEC (with employment by YEC on substantially the same terms and conditions as had applied with YECL), for CU to use its best efforts to ensure that there is an orderly transition, for CU (at YEC's request) to continue providing Support Services to YEC for up to 12 months after termination, and for CU to deliver to YEC all relevant books, records and manuals.

ACHIEVEMENTS

The present ownership and management structure has facilitated transition since 1987 to integrated operation of Yukon's electric system with respect to technical standards, rates, regulation and capital planning, and has had success in bringing the former NCPC assets and records to operational standard. It has encouraged professional management and regulation of YEC's assets and operations. It passed an Auditor General's audit in 1995.

The Yukon Government, through YDC, has earned considerable dividends on its investment in YEC, and these dividends in recent years have financed significant rate relief for Yukon residential, general service and municipal customers.

Under the present Management Agreement, production and distribution assets and employees for each utility have been kept separate for regulatory record keeping, and in accordance with the termination provisions of the Agreement. The Agreement continues to provide an orderly basis for termination at such time as YEC is able to establish full control and management of its assets.

CONCERNS

The present ownership and management structure has a privately-owned distributing electric utility managing and operating a publicly-owned wholesaling electric utility. This arrangement was described in the recent Auditor General's report as "unique in the electric utility industry".

The present structure has created public confusion and incurred added costs related to two separate owners (YDC and CU), two separate companies and Boards of Directors (YEC and YECL), and the senior management personnel separately retained by YEC and YECL. Continued reliance exclusively on external general management services also constrains YEC's ability to pursue strategic Yukon development goals as well as cost-effective options for various support services. Specific examples of these concerns include:

- **YEC head office costs:** Experience since 1987 has demonstrated a need for significant YEC costs related to head office staff, consultants, legal and other costs to provide necessary oversight of YECL/CU management and to pursue YEC's strategic development mandate.

- **Yukon strategic development goals:** CU/YECL's role as an external manager has been, perhaps of necessity, more of a caretaker than one of providing leadership in achieving the strategic goals of YEC and its owner (particularly as regards strategic infrastructure development planning).

- **Rationalization between YEC and YECL:** Rationalization of assets and role clarification between YEC and YECL have not occurred since 1987, despite various discussions during this period.

- **Hydro-related experience:** Limited hydro experience within APL/CU was noted in the recent Auditor General's report, and has required extensive YEC funding of third-party suppliers and consultants.

- **CU Support Services Fee:** CU's annual Support Services fee paid by YEC exceeds fair market value parent charges by APL/CU for similar services to wholly-owned subsidiary utilities such as YECL. The initial Support Services fee negotiated in 1987, at $648,000, was then estimated to be $448,000 higher than would apply for similar APL/CU parent charges. This fee was accepted by YEC in 1987, and again in 1991/92, in recognition of head office cost savings achieved relative to the pre-1987 NCPC ownership and management (cost savings estimated in 1987 by YEC at $400,000, net of CU's Support Services fee) as well as the likely costs for alternative external management services. However, continued annual payment of $800,000 or more for support service charges will significantly exceed what YEC currently considers to be cost-effective for future management and operation of YEC's assets.

OVERVIEW OF OPTIONS FOR MANAGING YUKON'S POWER SYSTEM

The next Yukon Government will address two separate issues when it decides on the next step in managing Yukon's power system. A decision will be required by early 1997, since termination of the present Management Agreement would require notice to YECL/CU by March 31, 1997.

The first issue is whether to pursue a proposal to merge the ownership of YEC's assets with YECL's assets, thereby establishing one Yukon power utility. Yukon's ability to proceed with any merger option, however, will depend on agreement with the owner of YECL's assets (CU). Accordingly, the second issue is future management of YEC's assets after 1997 in the event that merger is not feasible. Based on the experience gained since 1987, external general management of YEC assets is no longer required and options to the status quo arrangements can therefore be considered.

Two options are available for future management of YEC's assets, assuming that YTG continues to own YEC as a separate utility:

- **Option 1: Establish Yukon Management of YEC Assets:** The status quo could be modified by terminating external general management of YEC assets after December 31, 1997, and by establishing YEC management of YEC assets. The current Management Agreement with YECL/CU provides for orderly termination at the end of the current term, including transfer of the YECL employees who currently operate YEC assets (System Employees). External suppliers would provide specific support services as required in a cost-effective manner. If this option is selected, it should be confirmed that YEC, and not YTG, will hire the transferred System Employees.

- **Option 2: Retain External Management of YEC Assets:** The status quo reflects the two existing utilities with general management of YEC assets by an external manager (currently YECL/CU). External management of YEC assets could continue after December 31, 1997 for a further five-year term by retaining YECL/CU as general manager of YEC (extend, or renegotiate, the present Management Agreement), or by tendering a general management contract to all interested and qualified parties, including YECL/CU.

Two additonal options are identified to address possible changes in the current utility ownership status quo:

- **Option 3: Establish One Yukon Power Utility:** The status quo could be modified to establish one Yukon power utility that merges the ownership of both YEC and YECL in one new entity. This option would require the mutual agreement of the Yukon Government and CU on key policy terms and conditions for ownership, appointment of directors, utility management, and protection of minority shareholders in the new Yukon power utility. Ownership in any new entity could initially involve only YTG and CU; however, this could be expanded in future to establish multiple ownership (potential additional participants might include Yukon First Nations, Yukon municipalities, and/or other Yukon residents).

- **Option 4: Maintain Two Utilities and Modify Ownership:** The status quo reflecting the two existing utilities could be maintained with modifications to the present ownership arrangements. This option would occur in combination with either Option 1 or Option 2 arrangements to manage YEC assets, and could involve options to rationalize assets between YEC and YECL, as well as options to diversify ownership of power system components. Changes to YECL ownership would require the agreement of CU.

Each of the above options and sub-options is reviewed below, without ranking or recommendations.

Regardless of which option is selected by the Yukon Government, YUB regulation of rates is assumed to continue pursuant to the current rate directive (Order-in-Council 1995/90). Rates recently approved by the YUB for 1996 and 1997 will not be affected. Rates after 1997 will continue to be equalized as at present throughout Yukon for each rate class, with no variation between YEC and YECL service areas.

OPTION 1: ESTABLISH YUKON MANAGEMENT OF YEC ASSETS

So long as YEC continues to operate as a separate entity owned and controlled by YDC, it will be relevant for the Yukon Government to consider options to the status quo for management of YEC's assets and operations.

After ten years of transition, YEC no longer needs to retain external management of its assets to achieve its strategic goals, and general management of YEC by any external party is no longer likely to deliver the cost savings envisaged in 1987.

Based on the experience gained since 1987, general management functions in future could be carried out inside YEC or YDC, as appropriate, utilizing existing YEC management (including the recently-hired senior VP of Finance who has extensive senior utility experience with Nova Scotia Power). Specific support services could also be retained as required in future by YEC on a cost-effective basis from different external sources (including CU, where appropriate) for billing and collections, hydrology and water management, EIA requirements, capital planning, financial and accounting functions, and other services. Common technical standards could continue to be applied for YEC and YECL, in future, and the integrated Yukon power system now established for operations, rates, and major capital plans could also be retained. This degree of flexibility is something new, and reflects the extent to which the situation has evolved since transfer of NCPC assets to Yukon ownership.

Termination of the existing Management Agreement would result in the transfer from YECL to YEC of the System Employees required to operate YEC's assets, in the same manner as Yukon employees were initially transferred from NCPC to YECL in 1987. No significant cost or supervisory problems are anticipated for YEC with respect to such transfers. Transferred personnel would become employees of YEC, rather than employees of the Yukon Government, in accordance with YEC's mandate to operate without day-to-day direction from the Yukon Government, as a rate-based utility regulated by the YUB.

In order to proceed with this option, YEC would need to provide YECL/CU with Notice of Termination on or before March 31, 1997.

Option 1 would establish full YEC management of YEC's assets and operations. It would reduce future YEC and overall Yukon system costs (primarily through savings related to the CU Support Services fee), enhance YEC's future ability to control development of the Yukon power system, and provide opportunities to improve efficiency and effectiveness in its management. Yukon ratepayers would be best served under this option by continued YEC/YECL cooperation on joint purchasing, collaborative safety and training programs, common technical standards (e.g., CU/APL technical standards), shared staff utilization and capital planning where appropriate, and other matters.

Option 1 is assumed not to require any change to existing YDC ownership of YEC, the self-financing commercial mandate of YEC, the YUB regulation of YEC, or the policy of YEC operation without day-to-day direction from the Yukon Government. If this option is selected, it is assumed that YEC (and not YTG) will hire the System Employees transferred from YECL.

Option 1 could provide a logical next step towards diversified ownership of YEC's assets among Yukon interests (including Yukon First Nations) and/or the potential future development of one stand-alone power utility controlled by resident Yukon interests, since it would ensure that the dominant share (80%) of Yukon power assets is locally managed by YEC.

The most significant concerns associated with this option relate to the perpetuation of two separate utilities (YEC and YECL) and the potential for reduced cooperation.

OPTION 2: RETAIN EXTERNAL MANAGEMENT OF YEC ASSETS

Option 2 reflects the status quo for utility ownership and general management of YEC assets.

The achievements of the Management Agreement have been noted for the ten-year period since 1987. Considerable experience has now been gained, many major improvements have occurred, and common standards have been established throughout Yukon's power system. The transition from the earlier NCPC era has now taken place.

If YEC continues as a separate utility owning 80% of the Yukon system assets, YEC will continue to require head office staff and facilities to oversee and direct any external party which is retained to provide general management of YEC assets and operations.

Two sub-options available to YEC for retention of future external general management services are reviewed below:

- **Retain YECL/CU as General Manager:** CU has confirmed its willingness to continue the existing arrangement to manage YEC's facilities. Extension of the present Management Agreement without modification, however, would do nothing to address the concerns identified with respect to the present arrangements. It would prevent changes that could reduce ratepayer costs in future, improve overall efficiency and effectiveness, and facilitate improved realization of Yukon Government objectives related to energy infrastructure development and relationships with the public.

  Subject to agreement with CU, renegotiation might be pursued with YECL/CU, prior to the March 31, 1997 Notice of Termination deadline, to modify substantively the present Management Agreement prior to any future extension for another term. Possible priorities could include elimination of CU support services charges to YEC in excess of those normally charged by CU/APL to wholly-owned subsidiaries, provision for YEC to obtain support services from non-CU sources, rationalization of assets and clarification of roles between YEC and YECL, and improved efficiency and effectiveness related to YECL/CU services provided in specific areas.

  Any renegotiated agreement with YECL/CU would perpetuate external management of YEC's wholesaling power assets by a privately-owned distributing electric utility. This situation is likely to perpetuate public confusion, perceived and potential conflicts, and other concerns identified to date. Retention of external management for YEC inhibits the establishment of full Yukon control and management of YEC's assets.

- **Tender General Management Contract:** If it is decided to retain external general management of YEC's assets without renegotiating the agreement with YECL/CU, a management services contract could be tendered to all potential suppliers (e.g., including YECL/CU and other utilities and/or consultants who manage similar assets). The tender process could examine modifications to the terms and conditions of the present Management Agreement.

  YECL/CU was initially selected in 1986 after the Yukon Government conducted a form of tendering to different utilities. The earlier experience highlighted YECL/CU's advantages over other potential competitors due to its established utility activity in Yukon, and this advantage might discourage serious proposals from other parties. Even if third-party external management services could be identified that are less costly than (or competitive with) YECL/CU, the introduction of any new third-party general manager into the Yukon could easily add confusion and problems without resolving many of the current concerns.

Any tender process would need to be concluded prior to the March 31, 1997 Notice of Termination deadline.

OPTION 3: ESTABLISH ONE YUKON POWER UTILITY

The 1987 transfer of NCPC's assets to the Yukon Government constituted a major change in ownership to enhance Yukon control of the power system. Prior to, and after, the 1987 transfer it has often been suggested that Yukon's comparatively small system also might benefit from the establishment of one Yukon power utility which efficiently integrates all ownership and management.

Creation of one Yukon power utility would simplify the current situation, facilitate reduced management and regulatory costs, and clarify the power system for the Yukon public. However, despite these readily apparent benefits, YEC and YECL have continued with separate ownership, Boards of Directors, head office staff, accounts and records, and public images. In order to assess prospects to change the ownership status quo, it is relevant to review the separate interests of the two existing owners.

YUKON GOVERNMENT INTERESTS

The current two-company structure provides the Yukon Government with 100% ownership and control of YEC, which results in Yukon ownership of approximately 80% of the overall system's net rate base and almost all of the system's major generation and transmission facilities. The present structure enhances Yukon control of strategic development initiatives as well as of potential rate relief initiatives. It minimizes ratepayer costs related to ownership of these utility assets, since government-owned assets are exempt from income tax and YEC is directed to receive a lower return on equity than would apply for a privately-owned utility. Finally, the Yukon Government retains full capability under the current structure to modify future management arrangements related to operation and development of YEC's assets.

Any modification of the present structure would need to enhance, rather than curtail, Yukon control and the minimization of ratepayer costs. Accordingly, it is not feasible to create one Yukon power utility through sale of YEC to CU. The creation of one stand-alone utility could, however, meet Yukon requirements if it expanded Yukon control over distribution system assets and reduced overall ratepayer costs for management and regulation.

In short, Yukon interests might best be served through the creation of one stand-alone utility which provides for Yukon management reporting solely to a Yukon-controlled Board of Directors, with majority ownership being held by various resident Yukon interests, and without any requirement for external management of the Yukon system.

CU INTERESTS

At present, CU owns almost all of the distribution assets in Yukon through YECL. The present structure provides CU with 100% ownership and control of YECL, and has yielded opportunities for asset growth related to the expansion of Yukon's distribution systems. Any modification of this structure must, from CU's perspective, protect the value of its shareholder investment and provide enhanced opportunity to increase its shareholder value.

Traditionally, CU's interests would be satisfied through majority ownership and control of any venture in which CU invests. It is apparent however, that any CU involvement with the Yukon Government to create "one Yukon utility" would require CU to accept a non-controlling, minority ownership position in the new utility.

CU has recently confirmed its willingness to combine YECL with YEC to form one Yukon utility owned by three distinct groups (namely, the Yukon Government, other Yukon investors, and CU), with the majority of the ownership residing in the Yukon, but with none of the three ownership groups having majority control. CU has also proposed a first step to enter into an ownership arrangement with the Yukon Government initially having majority ownership. In any such arrangement, CU would expect that in time the government would sell a portion of its interests to Yukon investors, and that safeguards would also be in place to protect CU (and other) minority shareholders.

CU has indicated its flexibility and willingness to work with the Yukon Government to develop an electric power industry structure that will meet the needs of the Yukon.

POLICY FACTORS RELATING TO ANY YEC MERGER WITH YECL

A joint ownership or merger approach involving YEC and YECL assets offers many potential benefits to Yukoners. It could establish one stand-alone power utility controlled by Yukon residents, while retaining the benefit of CU's experience, support, and participation. In the event that the Yukon Government sold a portion of its existing interests, the cash received by the government could be used to develop future energy-related infrastructure in Yukon. Four policy factors, however, need to be considered in assessing Yukon requirements relating to any such merger:

1. **Minimum Yukon Control Requirements:** The Yukon Government currently owns and controls approximately 80% of the power system assets. It is necessary to determine what requirements must be met in each of the following areas to ensure satisfactory Yukon control of any merged entity:

    - ownership shares held by the Yukon Government, and CU at the outset, when the YEC/YECL assets are merged, and at later periods when and if interests are sold to other Yukon investors.

    - appointment of members to the Board of Directors by the Yukon Government and CU at the outset, and how this would change when and if other Yukon investors become involved (a related issue is the extent to which rights to appoint directors reflect shares of ownership in the new entity).

- controls and commitments related to management and staffing, (any new utility could be a stand-alone entity, internally managed and fully independent of either YTG or CU; alternatively, it could be managed through a contract with either CU or YTG).

2. **Ratepayer Cost Reductions:** Merger would be expected to yield cost savings related to utility management and regulatory costs, assuming that the new utility is internally managed as a stand-alone entity. However, increased private sector ownership of overall system assets above the present CU/YECL level of approximately 20% would attract higher costs for income taxes and rate base return.

3. **Yukon Strategic Development:** Merger proposals might be designed to facilitate future strategic development of non-diesel generation and transmission facilities.

4. **Protect Minority Shareholder Interests:** Minority private shareholders, including CU at the outset, must be protected in a way that also protects Yukon control. (For example, any minority shareholder might have the ability, at any time, to require that the Yukon Government purchase its interests at a reasonable market value. This would allow the minority shareholder to protect its investment, while also ensuring that Yukon has the ability to retain control of the power system asset ownership in the event of any ownership interest sale by non-Yukon Government shareholders.)

SUB-OPTIONS FOR OWNERSHIP OF ONE YUKON UTILITY

Option 3 would require the mutual agreement of the Yukon Government and CU on the key policy factors reviewed above. Two sub-options have been identified with respect to ownership in any new entity:

- **Merged YTG/CU Ownership:** This option has been proposed as an initial step towards multiple ownership (see below) of one Yukon utility, assuming that neither CU nor the Yukon Government is prepared to sell off all of its existing assets.

Multiple Ownership (YTG, CU, Yukon First Nations, Yukon municipalities, and/or other Yukon residents): This sub-option has been proposed as a possible long-term target, assuming it is feasible to secure agreement and participation among some or all of the potential parties.

OPTION 4: MAINTAIN TWO UTILITIES AND MODIFY OWNERSHIP

If it is not feasible to establish one Yukon power utility (Option 3), the status quo reflecting the two existing utilities could be retained with modifications to the present ownership arrangements. This option would occur in combination with either Option 1 or 2 arrangements to manage YEC assets. Changes to YECL ownership would require the agreement of CU. A wide range of different sub-options might be pursued and no specific deadlines are identified for any of these possibilities. Two types of sub-options are reviewed briefly below.

- **Options to Rationalize Assets Between YEC and YECL:** In the event that these two utilities continue to operate in Yukon, opportunities to rationalize existing and future assets and mandates could be reviewed by function (distribution versus other functions), generation type (hydro versus diesel), or distribution service areas (may affect YEC in Faro, Dawson or Mayo). Discussions since 1987, however, have failed to yield progress on rationalization of asset ownership.

  Rationalization of asset ownership might help to clarify the public mandate and role of each utility; it would be unlikely, however, to modify significantly any near-term ratepayer costs. Aside from the possible transfer of YECL's McIntyre Creek hydro facility to YEC, rationalization has typically been perceived in the past as involving the transfer to YECL of YEC distribution facilities (Faro, Mayo and Dawson City), as well as non-WAF diesel generation at Dawson City.

- **Options to Diversify Ownership of Power System Components:** If the existing Management Agreement is ended, and it is not feasible to create one new combined utility, CU has indicated that it would revert to operating YECL as a stand-alone company. Under these circumstances, the Yukon Government and CU could each examine other options for future evolution of the Yukon power system in addition to the rationalization options noted above.

  Based on trends in other jurisdictions, a variety of ownership options might merit consideration in future for distribution assets in Yukon, including ownership that continues to be separate from the major generation or transmission assets. Ownership of YEC and YECL, for example, might be diversified to include participation by Yukon residents. Municipal ownership might, for example, be considered for distribution assets in major communities. Independent private power producers might also be encouraged to develop and own new non-diesel generation facilities in Yukon, e.g., coal, gas, or small-scale hydro generation facilities.

- Each option to diversify ownership would need to be examined separately to assess impacts on Yukon control, ratepayer costs, power system efficiency and effectiveness, and Yukon strategic development. The small size of Yukon's power system, the absence of import/export interconnections with neighbouring jurisdictions, and ongoing system risks related to mine loads may all suggest practical constraints on diversifying the number of separately owned and managed power-related companies in Yukon. These same factors, however, might not constrain greater ownership diversification of the two existing utilities.