

1 Q. On page 2, paragraph 3 of the cover letter to the Application, Hydro stated:
2 "If Hydro's application herein is approved, any incremental billings to these customers will flow
3 through to Newfoundland Power's balance in the Supply Costs Variance Deferral Account
4 through the Rural Rate Alteration. In this case the Rural Rate Alteration adjustment will reduce
5 the rural deficit being funded by Island Interconnected customers in the future but will not
6 reduce the recovery or alteration of Project Costs".

7 (a) For clarification purposes, please explain the mechanics of how the incremental billings
8 described above will reduce the rural deficit in the future.

9 (b) Please confirm that the balance in the Rural Rate Alteration account will be offset against
10 the allocation of the Project Costs in the Supply Cost Variance Deferral Account to be
11 recovered from Newfoundland Power. If not please explain why not.

12 (c) If (b) is confirmed, please explain how this would reduce the rural deficit. Is it not reducing
13 the Muskrat Falls project costs to be collected from Newfoundland Power?

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16 A. (a) The Rural Deficit represents the shortfall between the cost of serving Newfoundland and
17 Labrador Hydro's ("Hydro") Rural customers, and the revenue collected from those same
18 customers.¹ The Rural Deficit is funded through the rates paid by Newfoundland Power Inc.
19 ("Newfoundland Power") and Hydro's Rural Labrador Interconnected customers, as
20 determined through test year cost of service studies filed as a part of Hydro's General Rate
21 Applications.²

22 The Rural Deficit is calculated based upon the approved rates at the time the Cost of Service
23 Study is filed. Consistent with government direction and Hydro's policies for automatic rate
24 changes, as Newfoundland Power's rates change between test years, so to do the rates of

¹ Excluding those customers on the Labrador Interconnected System.

² In the 2019 Test Year, 96.1% or \$61.8 million of the \$64.3 million rural deficit was allocated to Newfoundland Power and 3.9% or \$2.5 million to Hydro Rural Labrador Interconnected customers. Please refer to "2017 General Rate Application – Compliance Application," Newfoundland and Labrador Hydro, July 11, 2019, exh. 14: p. 3 of 107.

1 many of Hydro's Rural customers. A rate increase to Hydro Rural customers between
2 Hydro's test years has the effect of increasing billings from Hydro Rural customers with the
3 amount of increased billings set aside in the Rural Rate Alteration ("RRA") component of the
4 Supply Cost Variance Deferral Account. The balance in the RRA is then allocated between
5 Newfoundland Power and Rural Labrador Interconnected customers.³ Newfoundland
6 Power's portion is transferred to the Newfoundland Power Current Plan balance for future
7 disposition through customer rates.

8 As a result, the increase in billings from Hydro's Rural customers resulting from Hydro's
9 application will be credited to the RRA and, over time, reduce the Rural Deficit funding
10 provided by Newfoundland Power's customers relative to the Rural Deficit amount reflected
11 in test year rates. Any future increase in billings resulting from rate increases to Hydro's
12 rural customers between Hydro's test years will also serve to decrease the Rural Deficit
13 funding by Newfoundland Power's customers through the RRA.

14 (b) Prior to the establishment of the RRA, the increased billings to Hydro as a result of flowing
15 through the rate changes of Newfoundland Power increased Hydro's net income. The RRA
16 component was added to the RSP in early 1990s subsequent to the provincial government
17 modifying legislation to require the Rural Deficit to be recovered through customer rates.
18 Since the RRA implementation, when rates have changed to Hydro Rural customers as a
19 result of a rate change to Newfoundland Power's customers, the change in billings to Hydro
20 has been transferred through the RRA to Newfoundland Power's RSP Current Plan balance.

21 The Supply Cost Variance Deferral Account calculates variances in the cost of supplying the
22 Island Interconnected System from a number of sources including project costs. The RRA is
23 not a specific offset against either particular source. While a credit balance in the RRA would
24 be helpful in offsetting debit balances owing from Newfoundland Power in the Supply Cost
25 Variance Deferral Account, Hydro views its purpose to be a rate benefit to Newfoundland
26 Power reflecting the funding of the Rural Deficit by its customers.

27 (c) Please refer to Hydro's response to part (b).

³ The Labrador Interconnected portion is written off to net income (loss).