

1     Q.     Please explain in full the research conducted by Hydro into the fairness of allocation  
2             of the rural subsidy.

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5     A.     In Hydro's fairness of allocation of the rural deficit, Hydro reviewed the record of  
6             the 1992 Cost of Service Methodology review and the Board's Report on the review.  
7             On page 84 of the COS Methodology Report, the Board provided guidance on  
8             assessing fairness for rural deficit allocation when it stated:

9                     Fairness cannot be assessed as due to the method used but instead we must  
10                    assess fairness on the basis of the result, a shared burden among the classes  
11                    of customers that is fair to all and not discriminatory.

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13             Hydro also reviewed the Board Order following Newfoundland Power's General  
14             Rate Application in 1996 in which Newfoundland Power (NP) proposed to create a  
15             rural deficit surcharge to apply to customer bills. Order No. P.U.7(1996-97), the  
16             Board stated with respect to the rural deficit (page 89):

17                    The matter of whether or not the transfer of the Rural Subsidy from  
18                    Government to Hydro and then on to its customers is a tax or cross-subsidy  
19                    between utility customers was debated before the Board and dealt with in  
20                    its report entitled "Referral by Newfoundland and Labrador Hydro for the  
21                    Proposed Cost of Service Methodology" in February 1993. The Board's  
22                    conclusion in that Report was that the Rural Subsidy was not a tax, but a  
23                    form of cross-subsidization even through it was in the extreme.

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25             In that same Order, the Board also stated:

26                    The Board confirms its previous opinion in the February 1993  
27                    (notwithstanding recommendations made in its October 10, 1995 Report  
28                    which was not accepted by Government) that the Rural Subsidy is a form of  
29                    cross-subsidization, and must be dealt with as all other expenses.

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31             Hydro has also reviewed the methodology approved by the Board for NP to use in  
32             allocation of the rural deficit among its customer classes. The documentation of

1 NP's cost of service study method states the "Rural Surcharge is allocated to Class  
2 based upon total cost before Rural Deficit, RSA & MTA".<sup>1</sup> Based on Hydro's review  
3 of the rural deficit method employed by NP, it appears NP's approach to allocation  
4 of the rural deficit among customer classes is comparable to the revenue  
5 requirement approach proposed by Hydro.

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7 Hydro also reviewed the changes in the rates to customers on the Labrador  
8 Interconnected System since 1992 and the recovery of the rural deficit from these  
9 customers. There have been material changes in the rates on the Labrador  
10 Interconnected System since 1992, including the transition to a uniform rate design  
11 approach and the phase-out of the CFB Goose Bay Secondary revenue credit from  
12 offsetting the impact of the rural deficit allocation on customer bills. The existing  
13 methodology results in materially higher billing impacts for customers on the  
14 Labrador Interconnected System (an average of \$653 per year for customers on the  
15 Labrador Interconnected System and \$217 per year for customers of NP). The  
16 higher customer rate impact for customers on the Labrador Interconnected System  
17 is primarily because they have higher electricity usage as a result of living in an area  
18 of the Province where the climate is materially colder.

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20 In summary, Hydro's research and analysis concluded that: (i) the rural deficit is not  
21 a tax, but a form of cross-subsidization; (ii) the rural deficit must be treated as an  
22 expense; (iii) the Board has approved the use of total costs allocated by class  
23 (before the rural deficit) as a reasonable basis for NP to allocate the rural deficit  
24 among customer classes, and (iv) the existing methodology does not meet the  
25 fairness standard established by the Board in which "we must assess fairness on the

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<sup>1</sup> Source: 2011 Cost of Service Study, Section 1.3, page 2 of 2 filed in the NP 2013 GRA.

- 1 basis of the result, a shared burden among the classes of customers that is fair to all
- 2 and not discriminatory.”