Q. Please provide Mr. Brockman's opinion on whether the current methodology for allocating the rural deficit continues to be appropriate or whether it should be modified as proposed by a number of intervenors. In the reply explain in detail what alternatives to the current methodology, if any, does Mr. Brockman think should be considered for approval.

A. **A. Introduction**

Mr. Brockman observes that the requirement that Newfoundland Power's customers and Labrador Interconnected customers subsidize the service provided to Hydro's other distribution customers is not consistent with the *user pay* principle which is a cornerstone of cost of service analysis. From a cost of service perspective, there is no principled basis to review alternatives for recovery of costs incurred to serve one class of customers from other classes of customers.

A review of a range of alternatives for recovery of the costs to supply those Hydro distribution customers served at a loss was conducted in the 1990s. In Mr. Brockman's opinion, for the Board to change the allocation methodology developed at that time, it should have evidence before it to justify that change.

B. The 1993 Methodology

The current methodology for allocation of Hydro's rural deficit was adopted in 1993.

This methodology resulted in the apportionment of the rural deficit between Newfoundland Power's customers, Island Industrial customers, Labrador Industrial customers and Labrador Interconnected customers as shown in Table 1.

Table 1
Rural Deficit Allocation
1995[1]

	($ million)	**(%)**
Newfoundland Power	23.8	70.0
Island Industrials	5.5	16.2
Labrador Industrials	1.3	3.8
Labrador Interconnected	3.4	10.0
Total	**34.0**	**100.0**

[1] From the *Report of the Board of Commissioners of Public Utilities to the Honourable Minister of Natural Resources Government of Newfoundland and Labrador on a Referral by the Lieutenant-Governor in Council Concerning Rural Electrical Service*, October 10, 1995, page 24.

The 1995 allocation of the rural deficit contemplated the recovery of *average* subsidies from each of Newfoundland Power's customers and Labrador Interconnected customers as shown in Table 2.[2]

Table 2
Average Subsidy
1995

	Gross Cost ($)	Customers[3]	Average Subsidy[4] ($ per customer/yr)
Newfoundland Power	23,800,000	207,780	115
Labrador Interconnected	3,400,000	7,859	433

C. Hydro's 2013 Proposal

In its 2013 General Rate Application, Hydro has proposed that the methodology for allocating the rural deficit which was adopted in 1993 continue to be used. This results in the apportionment of the rural deficit between Newfoundland Power's customers and Labrador Interconnected customers shown in Table 3.

Table 3
Rural Deficit Allocation
2013 Test Year[5]

	($)	(%)
Newfoundland Power	53,882,421	88.8
Labrador Interconnected	6,842,261	11.2
Total	**60,724,682**	**100.0**

[2] The Board did not appear to explicitly derive *average* subsidies in coming to its 1993 recommendation concerning allocation of the rural deficit between Newfoundland Power's customers and Labrador Interconnected customers. However, the Board would have been aware of the number of Newfoundland Power customers and Labrador Interconnected customers at the time of considering the matter.

[3] The number of Newfoundland Power customers is from Newfoundland Power's 1995 Annual Report to the Board. The number of Labrador Interconnected customers is from response to Request for Information LWHN-NLH-055, Attachment 1.

[4] This is the Gross Cost divided by the number of customers.

[5] See Exhibit 13, page 3 of 109.

Hydro's proposed 2013 test year allocation of the rural deficit will result in *average* subsidies being recovered from each of Newfoundland Power's customers and Labrador Interconnected customers as shown in Table 4.

Table 4
Average Subsidy
2013 test year

	Gross Cost ($)	**Customers[6]**	**Average Subsidy[7] ($ per customer/yr)**
Newfoundland Power	53,882,421	255,618	211
Labrador Interconnected	6,842,261	10,854	630

D. Assessment

Since 1995, Hydro's total rural deficit has increased from approximately $34.0 million per year to approximately $60.7 million per year. This is an increase of approximately 79%.[8]

Over this period, the amount of the rural deficit allocated to Newfoundland Power's customers has increased from approximately $23.8 million per year to approximately $53.9 million per year. This is an increase of approximately 126%.[9]

Over the same period, the amount of the rural deficit allocated to Labrador Interconnected customers has increased from approximately $3.4 million per year, calculated based on the 1993 methodology, to approximately $6.8 million per year. This is an increase of approximately 100%.[10]

Since 1995, the amount of the rural deficit allocated to Labrador Interconnected customers, based on the 1993 methodology, has increased *less* than the amount allocated to Newfoundland Power's customers.

[6] The number of Newfoundland Power customers is from Newfoundland Power's 2013 Annual Report to the Board. The number of Labrador Interconnected customers is from response to Request for Information LWHN-NLH-056, Attachment 1.

[7] This is the Gross Cost divided by the number of customers.

[8] This is the growth in the rural deficit, $26.7 million ($60.7 - $34.0 million) divided by $34.0 million.

[9] This is the growth in the subsidy allocated to Newfoundland Power, $30.1 million ($53.9 - $23.8 million) divided by $23.8 million.

[10] This is the growth in the subsidy allocated to Labrador Interconnected customers, $3.4 million ($6.8 - $3.4 million) divided by $3.4 million.

Table 5 shows the relative changes in the average subsidies, calculated based on the 1993 methodology, for Newfoundland Power customers and Labrador Interconnected customers over the period 1995 to 2013.

Table 5
Average Subsidy
1995 to 2013 test year

	1995 ($)	**2013 test year ($)**	**Increase ($)**	**Increase (%)**
Newfoundland Power	115	211	96	83
Labrador Interconnected	433	630	197	45

Hydro's 2013 test year proposal reflects the 1993 methodology recommended by the Board. This results in Newfoundland Power's customers being allocated a higher overall proportion of the rural deficit than in 1995 (70.0% in 1995 vs. 88.8% in 2013).[11]

In addition, the *average* subsidy proposed to be recovered from each of Newfoundland Power's customers in 2013 from application of the 1993 methodology has increased materially from what it was in 1995.

Based upon these factors, it does not appear to Mr. Brockman that a reasonable basis exists at this time to change the methodology for determining the subsides so that the subsides required from Newfoundland Power's customers would increase more while those required from Labrador Interconnected customers would decrease.

[11] The primary cause of the increase in allocation to Newfoundland Power was the elimination of funding of the rural deficit by Industrial Customer as required by the Electrical Power Control Act 1994.