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September 16, 2009

Dear Ms. Dray,

**Re: Newfoundland Power Inc.
2010 Capital Budget Application**

We have completed our review as requested in your letter dated September 11, 2009 relating to Newfoundland Power Inc.'s (the "Company's") 2010 Capital Budget Application as it pertains to the calculation of the 2008 actual average rate base and the calculations of the 2009 and 2010 forecast rate base additions, deductions and allowances.

The results of our review for each required task are noted below:

2008 AVERAGE RATE BASE CALCULATION

Pursuant to P.U. 32, (2007), the Board of Commissioners of Public Utilities (the "Board") approved the Company's proposal to complete its transition to the Asset Rate Base Method ("ARBM") commencing January 1, 2008. The actual average rate base for 2008 as calculated by the Company under the ARBM and provided in Schedule D of its Application is \$820,876,000 compared to \$793,703,000 for 2007 (as calculated under the previous method).

The net change in the Company's average rate base from 2007 to 2008 can be summarized as follows:

(000's)	2008	2007 (Note 3)
Average rate base - opening balance	\$ 793,703	\$ 752,917
Adjustments related to adoption of ARBM (Note 1)	(3,549)	-
Change in average deferred charges and deferred regulatory cost (Note 2)	3,351	11,710
Average change in:		
Plant in service (net)	49,713	45,282
Accumulated depreciation (net)	(22,402)	(19,771)
Contributions in aid of construction	(1,371)	(1,513)
Weather normalization reserve	(2,949)	208
Unrecognized 2005 unbilled revenue	4,962	3,593
Future income taxes	(592)	688
Other rate base components (net)	10	589
Average rate base - ending balance	\$ 820,876	\$ 793,703

Note 1: The following adjustments were required due to adoption of ARBM:

Customer Finance Programs	\$ 619
Municipal Tax Liability	(3,408)
Customer Security Deposits	(698)
Accrued Pension Obligation	(3,043)
Cash working capital Allowance	3,047
Materials and Supplies Allowance	(66)
Total ARBM adjustments	\$ (3,549)

Note 2: Excluded in the 2008 rate base are deferred charges relating to unamortized debt issue costs due to adoption of ARBM in 2008. In 2007, the average balance of unamortized debt issue costs was \$3,073,000.

Note 3: In Schedule D of its Application, the Company has restated 2007 average rate base to reflect the adoption of the ARBM in order to calculate the 2008 average rate base. The 2007 comparative average rate base summarized above is the actual 2007 average rate base as calculated under the previous method and as approved under P.U. 27 (2008).

The 2008 calculation agrees with the information submitted to the Board in Return 3 of the Company's 2008 annual report.

Our procedures with respect to verifying the calculation of the average rate base were directed towards the verification of the data incorporated in the calculations and the methodology used by the Company.

Specifically, the procedures which we performed included the following:

- agreed all carry-forward data to supporting documentation including audited financial statements and internal accounting records, where applicable;
- agreed component data (capital expenditures; depreciation; etc.) to supporting documentation;
- checked the clerical accuracy of the continuity of the rate base for 2008; and
- agreed the methodology used in the calculation of the average rate base to the Public Utilities Act to ensure it is in accordance with Board Orders and established policy and procedure.

Based upon the results of the above procedures we did not note any discrepancies in the calculation of the 2008 average rate base nor any discrepancies in our review of the specific adjustments required to complete the transition to ARBM in 2008, and therefore conclude that the 2008 average rate base included in Schedule D of the Company's Application is accurate and in accordance with established practice and Board Orders.

RATE BASE ADDITIONS, DEDUCTIONS AND ALLOWANCES

In compliance with P.U. 19 (2003), Newfoundland Power Inc. has filed evidence with the Board pertaining to its forecast deferred charges, including pension costs, to be included in the calculation of the forecast average rate base for 2009 and 2010 in its 2010 Capital Budget application. The report also provides a comprehensive review of all additions, deductions and allowances included in the rate base, with the exception of plant investment. Each, in turn, is reviewed including the forecast deferred charges which is included in the rate base additions section.

Certain additions, deductions and allowances for 2010 include the Company's proposals with respect to its 2010 General Rate Application ("GRA"). In the 2010 GRA, the Company has requested approval for a number of changes which, if not approved, will impact the 2010 forecast additions, deductions and allowances. However, these issues will be dealt with in the GRA.

RATE BASE ADDITIONS

The forecast additions to rate base for 2009 and 2010 and the actual additions in 2007 and 2008 as presented by the Company are as follows:

(\$000's)	Actual 2007	Actual 2008	Forecast 2009	Forecast 2010
Deferred Charges	\$ 97,453	\$ 100,723	\$ 103,964	\$ 104,298
Weather Normalization Account	10,516	5,910	2,683	1,317
Deferred Replacement Energy Costs	1,147	766	383	-
Cost Recovery Deferral - Depreciation	11,586	7,724	3,861	-
Cost Recovery Deferral - Conservation	-	-	1,516	1,137
Customer Finance Programs	1,811	1,776	1,750	1,750
Total Additions	<u>\$ 122,513</u>	<u>\$ 116,899</u>	<u>\$ 114,157</u>	<u>\$ 108,502</u>

Source: Newfoundland Power Inc. - 2010 Capital Budget Application
Report on Rate Base: Additions, Deductions & Allowance - Table 1

Our comments with respect to the additions to rate base are noted below:

Deferred Charges

The forecast deferred charges for 2009 and 2010 and the actual deferred charges for 2007 and 2008 as presented by the Company are as follows:

(\$000's)	Actual 2007	Actual 2008	Forecast 2009	Forecast 2010
Deferred Pension Costs	\$ 96,654	\$ 100,196	\$ 103,723	\$ 104,298
Deferred Capital Stock Issue Costs	137	75	38	-
Deferred Credit Facility Issue Costs	59	50	-	-
Deferred Hearing Costs	603	402	203	-
Total Deferred Charges	<u>\$ 97,453</u>	<u>\$ 100,723</u>	<u>\$ 103,964</u>	<u>\$ 104,298</u>

Source: Newfoundland Power Inc. - 2010 Capital Budget Application
Report on Rate Base: Additions, Deductions & Allowance - Table 2

The Company has properly excluded the unamortized deferred debt costs from the 2009 and 2010 forecast rate base. In P.U. 32 (2007) the Board approved the Company's proposal to complete the transition to the ARBM commencing in 2008, which incorporated excluding the

unamortized deferred debt costs in the rate base and including the costs in the calculation of the Company's weighted average cost of capital.

Deferred Pension Costs

Deferred pension costs are the most significant component of the deferred charges and are the result of the pension funding exceeding the pension expense as determined in accordance with the recommendations of the Canadian Institute of Chartered Accountants (CICA).

According to the table below, the forecast pension plan funding for 2009 and 2010 is \$4,866,000 and \$4,999,000 and the forecast pension plan expense is \$1,339,000 and \$4,424,000 for 2009 and 2010 respectively. The difference between the funding and the expense as indicated below represents the increase in deferred pension costs forecast for 2009 and 2010.

(\$000's)	Actual 2007	Actual 2008	Forecast 2009	Forecast 2010
Deferred Pension Costs, January 1	\$ 90,122	\$ 96,654	\$ 100,196	\$ 103,723
Pension Plan Funding	10,904	5,425	4,866	4,999
Pension Plan Expense	(4,372)	(1,883)	(1,339)	(4,424)
Increase in Deferred Pension Costs	6,532	3,542	3,527	575
Deferred Pension Costs, December 31	\$ 96,654	\$ 100,196	\$ 103,723	\$ 104,298

Source: Newfoundland Power Inc. - 2010 Capital Budget Application
Report on Rate Base: Additions, Deductions & Allowance - Table 3

With regards to the pension plan funding for 2009 and 2010, we have reviewed this amount and agreed it to the Company's Actuarial Valuation for Funding Purposes prepared by the Company's actuary as at December 31, 2008.

The forecast pension expense for 2009 and 2010 is \$1,339,000 and \$4,424,000 respectively compared to an actual expense in 2008 of \$1,883,000. The principal reason for the increase in pension expense in 2010 compared to 2009 and 2008 is due to the amortization of the \$41,000,000 loss in asset value experienced in 2008 in the Company's defined benefit pension plan. As discussed in the Company's 2008 annual report, the expected long term rate of return on pension assets was 7.5% for 2008 but the actual rate of return was a loss of (16.6)%. The 2008 loss in asset value is not fully reflected in 2009 pension expense due to the Company's use of the market-related method of valuing pension assets for purposes of determining pension expenses. The 2009 pension expense is forecast to decrease in comparison to 2008 principally due to a 2% increase in the discount rate used to value the defined benefit pension obligation. The actual and forecast pension expense included in the table above is consistent with calculations provided by the Company's actuary. Based on our review of information provided by the Company, the forecast pension expense is calculated in accordance with the

recommendations of the CICA and relevant Board Orders, and is determined in a manner consistent with prior years and Board Orders.

It is important to note that the final pension expense for 2010 cannot be determined until after December 31, 2009. Under the accrual basis of accounting for pension plans, which the Company currently follows, the pension expense for a particular year is based on a number of assumptions, certain of which are not known until the start of the fiscal year in which the expense relates. For example, under CICA 3461 *Employee Future Benefits* the discount rate used to calculate interest cost on the accrued benefit obligation is determined as of the beginning of the period (or the end of the prior period). This means that interest costs included in pension expense for 2010 will be based upon a discount rate determined as of January 1, 2010 (or December 31, 2009).

Based on our review of forecast deferred pension costs, we confirm that we have not noted any discrepancies or unusual items. The information filed by the Company is consistent with prior years.

Deferred Capital Stock Issue Expense

The forecast decrease in this account represents the normal amortization of these costs.

Deferred Credit Facility Issue Costs

The Company incurred \$50,000 in costs in 2008 related to the amendment of its committed credit facility. The amendment was approved in P.U. 22 (2008). The forecast reflects the normal amortization of these costs and other prior period issue costs.

Deferred Hearing Costs

In P.U. 32 (2007), the Board approved a three year amortization period for the recovery of hearing costs in the amount of \$1,250,000. In the completion of our 2008 Annual Review of the Company, it was noted that the actual external costs relating to the 2008 GRA were \$603,000, and this amount is being amortized at \$201,000 per year over the three year period ending 2010.

In addition, the Company has estimated \$750,000 in 2010 GRA forecast costs to be incurred by the Board and the Consumer Advocate. In the 2010 GRA, the Company is proposing that these costs be amortized in 2010. The Company has noted that the rates set as a result of the 2010 GRA are not currently expected to be in effect beyond 2010.

The forecast properly reflects the amortization of 2008 GRA costs. Based on the proposal included in the 2010 GRA, the forecast properly reflects the amortization of the 2010 GRA costs. However, this proposal has not yet been considered by the Board.

Weather Normalization Reserve

The changes in the forecast weather normalization reserve for 2009 and 2010 reflect the amortization of the \$6.8 million non-reversing balance in the Degree Day Normalization Reserve over a period of five years (\$1.366 million annually) as approved in P.U. 32 (2007). The 2009 balance also reflects a credit for \$1,861,000 due to the normal operation of the reserve based on actual data to March 31, 2009. The 2010 forecast assumes normal stream-flows and weather patterns from January 2010 through December 2010.

Based on our review of the forecast weather normalization reserve, we confirm that we have not noted any discrepancies or unusual items.

Deferred Replacement Energy Costs

Under P.U. 39 (2006) the Board approved Newfoundland Power's application to defer \$1,147,000 in after tax costs for 2007 associated with the purchase of replacement energy during the refurbishment of the Rattling Brook hydroelectric plant. During the construction period the Company had to purchase replacement energy to replace the normal production of the Rattling Brook plant while it is out of service. The forecast properly reflects the amortization of the deferred replacement energy costs over a three year period beginning January 1, 2008 pursuant to P.U. 32 (2007).

Based on our review of forecast deferred replacement energy costs, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

Cost Recovery Deferral – Depreciation

Pursuant to P.U. 40 (2005) and P.U. 39 (2006), the deferral of depreciation expense relates to the increase in depreciation expense arising from the conclusion of the amortization period for the 2003 depreciation reserve variance. The forecast properly reflects the amortization of the deferred depreciation expense over a three year period beginning January 1, 2008 pursuant to P.U. 32 (2007).

Based on our review of forecast deferred cost recovery relating to depreciation, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

Cost Recovery Deferral – Conservation

Prior to the Company's filing of the 2010 GRA, the Board approved pursuant to P.U. 13 (2009) the creation of a Conservation Cost Deferral Account. This account provides for the deferred recovery, until a further Order of the Board, of 2009 costs (net of tax) related to the implementation of the Conservation Plan. These costs were estimated at the time to be \$1.4 million (net of tax).

In the 2010 GRA the Company has indicated that the 2009 costs to be deferred are forecast to be \$1,516,000 (pre-tax). The Company is proposing in the 2010 GRA that these costs be amortized over the remaining four years (\$379,000 per year) of the five year Energy Conservation Plan. Based on the proposal included in the 2010 GRA, the forecast properly reflects the amortization of these costs beginning in 2010 over a four year period. However, this proposal has not yet been considered by the Board.

Based on our review of the deferred cost recovery relating to conservation costs, we confirm that we have not noted any discrepancies or unusual items.

Customer Finance Programs

As indicated by the Company, Customer Finance Programs are loans provided to customers for purchase and installation of products and services related to conservation programs and contributions in aid of construction.

As part of the Company's transition to ARBM, inclusion of certain other assets and liabilities was required, including Customer Finance Programs receivables. The 2009 and 2010 forecast Customer Finance Programs receivable balance is consistent with 2008 and 2007.

RATE BASE DEDUCTIONS

The forecast deductions to rate base for 2009 and 2010 and the actuals for 2007 and 2008 as presented by the Company are as follows:

(\$000's)	Actual 2007	Actual 2008	Forecast 2009	Forecast 2010
2005 Unbilled Revenue	\$ 16,446	\$ 9,236	\$ 4,618	\$ -
Accrued Pension Liabilities	2,943	3,142	3,380	3,624
Municipal Tax Liability	4,089	2,727	1,365	-
Future Income Taxes	-	1,184	3,050	1,764
Purchased Power Unit Cost Variance Reserve	1,650	895	448	-
Demand Management Incentive Account	-	426	-	-
Customer Security Deposits	612	785	643	643
Accrued OPEBs Liability	-	-	-	5,674
Total Deductions	\$ 25,740	\$ 18,395	\$ 13,504	\$ 11,705

Source: Newfoundland Power Inc. - 2010 Capital Budget Application

Report on Rate Base: Additions, Deductions & Allowance - Table 12

Our comments with respect to the deductions to rate base are noted below:

2005 Unbilled revenue

In P.U. 40 (2005) the Board ordered Newfoundland Power to deduct from rate base the average balance in the Unrecognized 2005 Unbilled Revenue account. This unbilled revenue balance arose as a result of the approval to adopt the accrual method of revenue recognition in 2006. P.U. 32 (2007) approved the 2008 amortization of \$2,592,000 to offset the 2008 tax settlement payment and the amortization of the remaining balance of the 2005 unbilled revenue of \$13,854,000 over a three year period, which commenced in 2008. The forecast properly reflects the amortization of the 2005 Unbilled Revenue over a three year period beginning January 1, 2008 pursuant to P.U. 32 (2007).

Based on our review of forecast 2005 Unbilled Revenue, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

Accrued Pension Liabilities

Accrued pension liabilities represent the executive and senior management supplemental pension benefits comprised of a defined benefit plan (Pension Uniformity Plan - PUP) and a defined contribution plan (Supplementary Employee Retirement Plan - SERP). The balance represents the cumulative costs of these unfunded plans, net of associated benefit payments.

As part of the transition to ARBM the inclusion of accrued pension liabilities was required as a component of rate base. The 2009 and 2010 forecast accrued pension liabilities are consistent with 2008 and 2007.

Municipal Tax Liability

The Municipal Tax Liability arose due to a timing difference between the recovery and payment of municipal taxes. This account is being amortized over a three year period commencing in 2008 pursuant to P.U. 32 (2007). The forecast properly reflects the amortization of the Municipal Tax Liability over a three year period beginning January 1, 2008 pursuant to P.U. 32 (2007).

Based on our review of forecast Municipal Tax Liability, we confirm that we have not noted any discrepancies or unusual items.

Future Income Taxes

Future Income Taxes arise due to the Board's approval of the Company's use of tax accrual accounting related to plant investment and more recently pension costs, as approved in P.U. 32 (2007). The 2010 forecast also includes the Company's proposal, included in the 2010 GRA, to adopt tax accrual accounting related to other post employment benefits ("OPEBs") for regulatory purposes.

Based on our review of Future Income Tax balances, we confirm that we have not noted any discrepancies or unusual items. In addition, we confirm that it is consistent with approved Board Orders and the Company's proposal to adopt tax accrual accounting for OPEBs as part of the 2010 GRA. However, this proposal has not yet been considered by the Board.

Purchased Power Unit Cost Variance Reserve and Demand Management Incentive Account

In P.U. 44 (2004) the Board approved the establishment of a reserve mechanism as proposed by Newfoundland Power in relation to Newfoundland Hydro's proposed demand and energy rate structure. This reserve mechanism is the Purchased Power Unit Cost Variance Reserve ("PPUCVR") and was used to limit variations in the cost of purchased power associated with the demand and energy structure implemented as of January 1, 2005. In P.U. 32 (2007) the Board approved the amortization of the 2006 balance of \$1,342,000 over a three year period beginning in 2008. In P.U. 6 (2008) the Board approved the disposition of the 2007 balance of

the PPUCVR for \$308,000 by means of a credit to the Rate Stabilization Account as of March 31, 2008. The forecast properly reflects the amortization of the PPUCVR over a three year period beginning January 1, 2008 pursuant to P.U. 32 (2007).

P.U. 32 (2007) also approved the Company's proposal to discontinue the PPUCVR and establish the Demand Management Incentive Account ("DMI"). In P.U. 21 (2009) the Board approved the disposition of the 2008 balance of the DMI for \$426,000 by means of a credit to the Rate Stabilization Account as of March 31, 2009.

Based on our review of forecast PPUCVR and DMI, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

Customer Security Deposits

Customer Security Deposits are provided by customers in accordance with the Schedule of Rates, Rules and Regulations.

As part of the transition to ARBM the inclusion of Customer Security Deposits was required as a component of rate base. The 2009 and 2010 forecast Customer Security Deposits are consistent with 2008 and 2007.

Accrued OPEBs Liability

The Company proposes to adopt the accrual method of accounting for OPEBs costs for regulatory purposes in its 2010 GRA. Under the accrual basis, OPEBs costs are recognized as an expense as employees earn the benefits that they will receive after retirement. The Company currently follows the cash basis whereby only amounts paid during the year are expensed.

The Company has presented in its 'Report on Other Post Employment Benefits' included in the 2010 GRA pre-filed evidence that the adoption of the accrual basis for OPEBs will result in an estimated increase in 2010 expenses of \$5.7 million (expense under the accrual basis of \$7.4 million, less expense under the cash basis of \$1.7 million). These amounts exclude the effect of income taxes. The forecast OPEBs liability for 2010 is consistent with calculations provided by the Company's actuary.

Based on our review of the forecast OPEBs liability, we confirm that we have not noted any discrepancies or unusual items and it is consistent with the proposals included in the 2010 GRA. However, these proposals have not yet been considered by the Board.

RATE BASE ALLOWANCES

The Rate Base allowances included in the Company's rate base are the Cash Working Capital ("CWC") allowance and the Materials and Supplies allowance. These represent the average amount of investor-supplied working capital necessary to provide service. As part of the 2010 GRA, the Company has updated its calculations of the Rate Base Allowances to reflect changes that occurred since the last detailed review in the 2008 GRA.

The 2009 forecast CWC allowance is based on the 2008 test year data and is consistent with 2008. The impact of the updated calculations resulted in a decrease in the 2010 CWC allowance from 2008 and forecast 2009 primarily due to the Company's revised HST adjustment and a decrease in the CWC factor from 2.1% for the 2008 test year to 2.0% for the 2010 test year.

The updated calculation for the Materials and Supplies allowance resulted in a revised expansion factor of 20.2% for the 2010 test year versus 19.4% calculated for the 2008 test year. The revised calculation did not have a significant impact on the allowance; the 2009 and 2010 forecast is consistent with 2008.

Based on our review of the Rate Base Allowances, we confirm that we have not noted any discrepancies or unusual items and it is consistent with the updated calculations included in the 2010 GRA. However, these updated calculations have not yet been considered by the Board.

I trust this is the information you requested. If you have any questions, please contact me.

Yours sincerely,



Steve Power, CA
Partner