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September 23, 2011

Dear Ms. Dray,

Re: Newfoundland Power Inc.
2012 Capital Budget Application

We have completed our review as requested in your letter dated August 16, 2011 relating to Newfoundland Power Inc.'s (the "Company's") 2012 Capital Budget Application as it pertains to the calculation of the 2010 actual average rate base and the calculations of the 2011 and 2012 forecast rate base additions, deductions and allowances.

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

2010 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 2010 as calculated by the Company under the ARBM and provided in Schedule D of its Application is $875,210,000 compared to $848,493,000 for 2009.

The net change in the Company's average rate base from 2009 to 2010 can be summarized as follows:

(000's)	2010	2009
Average rate base - opening balance	**$ 848,493**	$ 820,876
Adjustments related to adoption of ARBM		
Change in average deferred charges and deferred regulatory costs	**(2,608)**	(216)
Average change in:		
Plant in service	**53,881**	49,611
Accumulated depreciation	**(22,795)**	(22,766)
Contributions in aid of construction	**(2,191)**	(2,400)
Weather normalization reserve	**(3,931)**	(3,299)
Unrecognized 2005 unbilled revenue	**4,618**	5,914
Future income taxes	**(1,216)**	(1,149)
Other rate base components (net)	**959**	1,922
Average rate base - ending balance	**$ 875,210**	$ 848,493

The 2010 calculation agrees with the information submitted to the Board in Return 3 of the Company's 2010 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 2010; 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 2010 average rate base, and therefore conclude that the 2010 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 2011 and 2012 in its 2012 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.

RATE BASE ADDITIONS

The forecast additions to rate base for 2011 and 2012 and the actual additions in 2009 and 2010 as presented by the Company are as follows:

($000's)	Actual 2009	Actual 2010	Forecast 2011	Forecast 2012
Deferred Charges	$ 103,761	$ 102,807	$ 97,787	$ 95,856
Weather Normalization Reserve	3,919	(1,954)	(4,931)	(6,297)
Deferred Replacement Energy Costs	383	-	-	-
Cost Recovery Deferral - Depreciation	3,862	-	-	-
Cost Recovery Deferral - Conservation	948	682	455	228
Cost Recovery Deferral - Hearing Costs	201	507	253	-
Cost Recovery Deferral - Amortizations	-	-	1,642	1,642
Customer Finance Programs	1,679	1,647	1,647	1,647
Total Additions	$ 114,753	$ 103,689	$ 96,853	$ 93,076

Source: Newfoundland Power Inc. - 2012 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 2011 and 2012 and the actual deferred charges for 2009 and 2010 as presented by the Company are as follows:

($000's)	Actual 2009	Actual 2010	Forecast 2011	Forecast 2012
Deferred Pension Costs	$ 103,723	$ 102,549	$ 97,629	$ 95,798
Deferred Capital Stock Issue Costs	38	-	-	-
Deferred Credit Facility Issue Costs	-	258	158	58
Total Deferred Charges	$ 103,761	$ 102,807	$ 97,787	$ 95,856

Source: Newfoundland Power Inc. - 2012 Capital Budget Application
Report on Rate Base: Additions, Deductions & Allowance - Table 2

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 2011 and 2012 is $5,137,000 and $5,281,000 and the forecast pension plan expense is $10,057,000 and $7,112,000 for 2011 and 2012 respectively. The difference between the funding and the expense as indicated below represents the decrease in deferred pension costs forecast for 2011 and 2012.

($000's)	Actual 2009	Actual 2010	Forecast 2011	Forecast 2012
Deferred Pension Costs, January 1	$ 100,196	$ 103,723	$ 102,549	$ 97,629
Pension Plan Funding	4,866	4,999	5,137	5,281
Pension Plan Expense	(1,339)	(6,173)	(10,057)	(7,112)
Increase in Deferred Pension Costs	3,527	(1,174)	(4,920)	(1,831)
Deferred Pension Costs, December 31	$ 103,723	$ 102,549	$ 97,629	$ 95,798

Source: Newfoundland Power Inc. - 2012 Capital Budget Application
Report on Rate Base: Additions, Deductions & Allowance - Table 3

With regards to the pension plan funding for 2011 and 2012, we have reviewed these amounts and agreed them to information prepared by the Company's actuary.

The forecast pension expense for 2011 and 2012 is $10,057,000 and $7,112,000 respectively compared to an actual expense in 2010 of $6,173,000. As discussed in the Company's 2010 annual report, "...in 2011, the Company expects the pension expense related to its primary defined benefit pension plan to increase by approximately $3.9 million compared to 2010. This is primarily driven by the amortization of net actuarial losses that arose in prior years, and a decrease in the discount rate used in the measurement of the accrued pension benefit 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 2012 cannot be determined until after December 31, 2011. 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 2012 will be based upon a discount rate determined as of January 1, 2012 (or December 31, 2011).

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 deferred capital stock issue costs were fully amortized in 2010.

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). These deferred credit facility issue costs were fully amortized in 2009.

On August 27, 2010 the committed credit facility was renegotiated to extend the maturity date to August 27, 2013 and implement a revised pricing schedule. P.U. 22 (2008) approved "such further extensions of the maturity date as may be requested by Newfoundland Power and agreed to by the lenders". However, the Board Order was silent on the treatment of the issue costs of the credit facility. The Company has applied its past practice of deferring and amortizing these costs, and including the unamortized balance in rate base. Legal and other administration costs of $300,000 resulting from the amendment are being amortized over a 3-year period beginning in August, 2010.

Weather Normalization Reserve

The changes in the forecast weather normalization reserve for 2011 and 2012 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 2011 balance also reflects a credit for $1,611,000, due to the normal operation of the reserve, based on actual data to February 28, 2011. Consistent with prior years, the 2012 forecast assumes normal stream-flows and weather patterns from January 2012 through December 2012.

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. The balance of the deferred replacement energy costs was fully amortized in 2010.

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. The balance of the deferred cost recovery relating to depreciation was fully amortized in 2010.

<u>**Cost Recovery Deferral – Conservation**</u>

In P.U. 13 (2009), the Board approved the creation of a Conservation Cost Deferral Account. This account provides for the deferred recovery of 2009 costs (net of tax) related to the implementation of the Conservation Plan. The actual costs incurred in 2009 were $948,000 (net of tax).

In P.U. 43 (2009), the Board approved the after tax recovery of the 2009 deferred conservation costs over the remaining four years of the five year Energy Conservation Plan, which effectively would have resulted in amortization of $237,000 over the years from 2010 to 2013.

In our review of the forecast deferred cost recovery relating to conservation costs, we noted that amortization of $266,000 was recorded in 2010. This amortization was based on an original estimate of conservation costs of $1,500,000 (after-tax $1,064,000) amortized evenly over four years. The unamortized balance of the actual costs at December 31, 2010, $682,000, is being amortized evenly over the remaining three years. Amortization of $227,000 is forecast for 2011 and 2012.

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

<u>**Cost Recovery Deferral – Hearing Costs**</u>

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 was being amortized at $201,000 per year over the three year period ending 2010. The balance of these deferred hearing costs was fully amortized in 2010.

In P.U. 43 (2009), the Board approved a three year amortization period for the recovery of hearing costs "in the amount of $750,000" beginning in 2010. The actual costs incurred relating to the 2010 GRA were $760,000. The Company has deferred the full $760,000 and is amortizing this over a three-year period commencing in 2010.

Based upon our review of P.U. 43 (2009) only $750,000 of the hearing costs are eligible for deferral. This amount is to be amortized over a three year period ending 2012 at an amount of $250,000 per year. The excess of $10,000 is not eligible for deferral; however, we assess this amount as immaterial.

<u>**Cost Recovery Deferral – 2010 Regulatory Amortizations**</u>

In P.U. 32 (2007), the Board ordered the amortization over a three-year period, concluding in 2010, of a number of items of revenue and cost recovery deferrals. In 2009 the Company filed a general rate application adopting a 2010 test year revenue requirement, which reflected the last year of these amortizations, effectively reducing the revenue requirement by $2,363,000.

The Board, in P.U. 46 (2009), approved rates for the Company based on this 2010 test year revenue requirement, without addressing the revenue shortfall in 2011 caused by the expiry of the credit associated with the amortizations.

On November 29, 2010, the Board issued P.U. 30 (2010) to approve the deferred recovery of these costs in 2011 until a further Order of the Board. The Company has included in its forecast the after-tax balance of $1,642,000.

Based on our review of forecast Cost Recovery Deferral – 2010 Regulatory Amortizations, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

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 in 2008, inclusion of certain other assets and liabilities was required, including Customer Finance Programs receivables. The 2011 and 2012 forecast Customer Finance Programs receivable balance is fairly consistent with 2010.

RATE BASE DEDUCTIONS

The forecast deductions to rate base for 2011 and 2012 and the actuals for 2009 and 2010 as presented by the Company are as follows:

($000's)	Actual 2009	Actual 2010	Forecast 2011	Forecast 2012
2005 Unbilled Revenue	$ 4,618	$ -	$ -	$ -
Accrued Pension Liabilities	3,379	3,548	3,802	4,062
Municipal Tax Liability	1,363	-	-	-
Future Income Taxes	2,297	3,617	1,243	(459)
Purchased Power Unit Cost Variance Reserve	447	-	-	-
Demand Management Incentive Account	-	676	1,016	1,016
Customer Security Deposits	581	705	705	705
Accrued OPEBs Liability	-	-	7,236	14,245
Total Deductions	$ 12,685	$ 8,546	$ 14,002	$ 19,569

Source: Newfoundland Power Inc. - 2012 Capital Budget Application
Report on Rate Base: Additions, Deductions & Allowance - Table 13

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. The balance of the 2005 Unbilled Revenue account was fully amortized in 2010.

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 in 2008 the inclusion of accrued pension liabilities was required as a component of rate base. The 2011 and 2012 forecast accrued pension liabilities are consistent with 2010 and 2009.

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. The balance of the Municipal Tax Liability account was fully amortized in 2010.

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, pension costs and OPEBs.

Based on our review of Future Income Tax balances, we confirm that we have not noted any material discrepancies or unusual items, and it is consistent with approved Board Orders.

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. The forecast properly reflects the amortization of the PPUCVR over a three year period beginning January 1, 2008 pursuant to P.U. 32 (2007). The Purchased Power Unit Cost Variance Reserve was fully amortized in 2010.

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. In 2009 there was no transfer to the DMI account. The 2010 balance reflects a charge of $676,000 due to the normal operation of the account. The Company was required to file an application with the Board no later than March 1, 2011 for the disposition of the balance in the DMI account as at December 31, 2010. This was done on February 28, 2011, and as a consequence P.U. 7 (2011) approved the disposition of the 2010 balance of the DMI and related income tax effects by means of a credit in the amount of $994,207 ($676,000 after tax) to the Rate Stabilization Account as of March 31, 2011. The forecast for 2011 properly reflects this disposition.

The forecast 2011 balance reflects a charge of $1,016,000 due to the normal operation of the account. The calculation incorporates actual results to February, 2011. The Company is required to file an application with the Board no later than March 1, 2012 for the disposition of the balance in the DMI account as a December 31, 2011.

Based on our review of forecast DMI, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders. We do note that the forecasts for 2011 and 2012 do not reflect the disposition of the December 31, 2011 balance of $1,461,346 ($1,016,000 after tax), as approval from the Board is required for this based on a future application to be filed by the Company.

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 in 2008 the inclusion of Customer Security Deposits was required as a component of rate base. The 2011 and 2012 forecast Customer Security Deposits are consistent with 2010.

Accrued OPEBs Liability

On June 30, 2010, the Company submitted an application to the Board requesting approval for the 2011 adoption of accrual accounting for OPEBs for regulatory purposes. Under the accrual basis, OPEBs costs are recognized as an expense as employees earn the benefits that they will receive after retirement. The application also addressed treatment of the projected OPEBs transitional balance as at January 1, 2011 and the creation of an OPEBs Cost Variance Deferral Account. On December 10, 2011 P.U. 31 (2010) approved the adoption of the accrual method of accounting for OPEBs costs and income tax related to OPEBs effective January 1, 2011 and the amortization using the straight line method over a 15-year period of the transitional balance estimated to be $52,400,000.

In its 2012 Capital Budget Application, the Company forecasts amortizing a transitional balance in the amount of $52,560,000 over a 15-year period, an increase of $160,000 over the estimate mentioned in the Board Order. This results in annual amortization amounting to $3,504,000, as compared to the original estimate of $3,493,000.

The total amount of the deduction to rate base related to OPEBs for 2011 is $7,236,000. This amount includes the amortization of $3,504,000, accrued OPEBs expense (recorded in accordance with Canadian GAAP) of $5,895,000 less benefit payments of $2,163,000.

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. The 2011 and 2012 forecast CWC allowance and the Materials and Supplies allowance are based on the 2010 test year data.

Based on our review of the Rate Base Allowances, we confirm that we have not noted any discrepancies or unusual items and the forecast for 2011 and 2012 is consistent with the 2010 test year data.

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

Yours sincerely,

Grant Thornton LLP

Steve Power, CA
Partner