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September 7, 2012

Dear Mr. Byrne,

**Re: Newfoundland Power Inc.
2013 Capital Budget Application**

We have completed our review as requested in your letter dated August 17, 2012 relating to Newfoundland Power Inc.'s (the "Company's") 2013 Capital Budget Application as it pertains to the calculation of the 2011 actual average rate base and the calculations of the 2012 and 2013 forecast rate base additions, deductions and allowances.

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

**2011 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 2011 as calculated by the Company under the ARBM and provided in Schedule D of its Application is $876,356,000 compared to $875,210,000 for 2010.

The net change in the Company's average rate base from 2010 to 2011 can be summarized as follows:

| **(000's)** | **2011** | **2010** |
|---|---|---|
| Average rate base - opening balance | **$ 875,210** | $ 848,493 |
| Change in average deferred charges and deferred regulatory costs | **(4,340)** | (2,608) |
| Average change in: | | |
| Plant in service | **16,635** | 53,881 |
| Accumulated depreciation | **(6,959)** | (22,795) |
| Contributions in aid of construction | **2** | (2,191) |
| Weather normalization reserve | **(4,470)** | (3,931) |
| Unrecognized 2005 unbilled revenue | **2,309** | 4,618 |
| Other post employment benefits | **(3,600)** | |
| Future income taxes | **717** | (1,216) |
| Other rate base components (net) | **852** | 959 |
| Average rate base - ending balance | **$ 876,356** | $ 875,210 |

Return 3 of the Company's annual report to the Board reported an average rate base of $876,398,000. This balance has been decreased by $42,000 to reflect the reclassification of $84,000 from General Properties.

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 2011; 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 2011 average rate base, and therefore conclude that the 2011 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 2012 and 2013 in its 2013 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 2012 and 2013 and the actual additions in 2010 and 2011 as presented by the Company are as follows:

| ($000's) | Actual 2010 | Actual 2011 | Forecast 2012 | Forecast 2013 |
|---|---|---|---|---|
| Deferred Pension Costs | $ 102,549 | $ 97,628 | $ 99,961 | $ 104,438 |
| Deferred Credit Facility Issue Costs | 258 | 270 | 140 | 10 |
| Cost Recovery Deferral – Seasonal/TOD Rates | - | 228 | 133 | 150 |
| Cost Recovery Deferral – Hearing Costs | 507 | 253 | - | - |
| Cost Recovery Deferral – Amortizations | - | 1,642 | 3,319 | 3,319 |
| Cost Recovery Deferral – Conservation | 682 | 454 | 227 | - |
| Customer Finance Programs | 1,647 | 1,527 | 1,499 | 1,499 |
| Total Additions | $ 105,643 | $ 102,002 | $ 105,279 | 109,416 |

**Source**: Newfoundland Power Inc. - 2013 Capital Budget Application
Report on *Rate Base: Additions, Deductions & Allowance*s - Table 1

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

**Deferred Pension Costs**

Deferred pension costs 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 2012 and 2013 is $13,486,000 and $13,599,000 and the forecast pension plan expense is $11,153,000 and $9,122,000 for 2012 and 2013 respectively. The difference between the funding and the expense, as indicated below, represents the increase in deferred pension costs forecast for 2012 and 2013.

| **($000's)** | **Actual 2010** | **Actual 2011** | **Forecast 2012** | **Forecast 2013** |
|---|---|---|---|---|
| Deferred Pension Costs, January 1 | $ 103,723 | $102,549 | $ 97,628 | $ 99,961 |
| Pension Plan Funding | 4,999 | 5,137 | 13,486 | 13,599 |
| Pension Plan Expense | (6,173) | (10,058) | (11,153) | (9,122) |
| (Decrease)/increase in Deferred Pension Costs | (1,174) | (4,921) | 2,333 | 4,477 |
| Deferred Pension costs, December 31 | $ 102,549 | $ 97,628 | $ 99,961 | $ 104,438 |

**Source**: Newfoundland Power Inc. - 2013 Capital Budget Application
Report on *Rate Base: Additions, Deductions & Allowance*s - Table 3

With regards to the pension plan funding for 2012 and 2013, we have reviewed these amounts and agreed them to information prepared by the Company's actuary.

The forecast pension expense for 2012 and 2013 is $11,153,000 and $9,122,000 respectively compared to an actual expense in 2011 of $10,058,000. 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 2013 cannot be determined until after December 31, 2012. 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 2013 will be based upon a discount rate determined as of January 1, 2013 (or December 31, 2012).

The forecast pension funding for 2012 and 2013 is $13,486,000 and $13,599,000 respectively, compared to actual funding in 2011 of $5,137,000. According to the Company, pension funding for 2012 and 2013 is based on the latest actuarial report and assumes special funding payments of $10.7 million per year. The forecast funding amounts has been agreed to schedules provided by the Company's actuary.

Based on our review of forecast deferred pension costs, we confirm that we have not noted any discrepancies or unusual items.

**Deferred Credit Facility Issue Costs**

On August 27, 2010 the Company's committed credit facility was renegotiated to extend the maturity date to August 27, 2013 and implement a revised pricing schedule. Legal and other administration costs of $300,000 resulting from the amendment were deferred and amortized over a 3-year period beginning in August, 2010.

On June 10, 2011 the committed credit facility was again renegotiated to extend the maturity date to August 27, 2015 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 $130,000 resulting from the amendment are being amortized over a 3-year period beginning in June 2011. Under Canadian Generally Accepted Accounting Principles these costs are also expensed over the term of the agreement.

Based on our review of forecast deferred credit facility issue costs, we confirm that we have not noted any discrepancies or unusual items.

**Cost Recovery Deferral – Seasonal/TOD Rates**

On July 1, 2011 the Board approved the creation of the Optional Seasonal Rate Revenue and Cost Recovery Account by way of P.U. 8 (2011). This account is charged with; (i) the current year revenue impact of making the Domestic Seasonal – Optional Rate available to customers and (ii) the operating costs associated with implementing the Domestic Seasonal – Optional and the Time-of-Day Rate Study.

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

**Cost Recovery Deferral – Hearing Costs**

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. In the 2012 capital budget review we noted that the Company deferred the full $760,000 and began amortizing this full amount over a three-year period commencing in 2010.

The Board ordered the Company to adjust the recovery of its 2010 hearing costs to reflect total costs of $750,000 in P.U. 26 (2011). During our review we noted evidence of this adjustment being processed in both the 2011 actual figures and 2012 forecast.

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

**Cost Recovery Deferral – 2010 Regulatory Amortizations**

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.

On October 27, 2011, the Board issued P.U 22 (2011) to approve the deferred recovery of these costs in 2012 until a further Order of the Board. The Company has included in its forecast the after-tax balance of $1,677,000.

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.

**Cost Recovery Deferral – Conservation**

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. The unamortized balance of the actual conservation costs at December 31, 2010 was $682,000. This balance was to be amortized evenly over the three year period from 2011 to 2013.

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.

**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 2012 and 2013 forecast Customer Finance Programs receivable balance is fairly consistent with 2011 and therefore appears reasonable.

## RATE BASE DEDUCTIONS

The forecast deductions to rate base for 2012 and 2013 and the actual figures for 2010 and 2011 as presented by the Company are as follows:

| ($000's) | Actual 2010 | Actual 2011 | Forecast 2012 | Forecast 2013 |
|---|---|---|---|---|
| Weather Normalization Reserve | $1,954 | $ 5,020 | $ 6,682 | $6,682 |
| Other Post Employment Benefits | - | 7,199 | 14,403 | 21,207 |
| Customer Security Deposits | 705 | 695 | 759 | 759 |
| Accrued Pension Liabilities | 3,548 | 3,778 | 4,041 | 4,312 |
| Future Income Taxes | 3,617 | 862 | 110 | 519 |
| Demand Management Incentive Account | 676 | 1,252 | 923 | 1,182 |
| Total Deductions | $10,500 | $18,806 | $26,918 | $34,661 |

**Source**: Newfoundland Power Inc. - 2013 Capital Budget Application
Report on *Rate Base: Additions, Deductions & Allowance*s - Table 10

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

### Weather Normalization Reserve

The changes in the forecast weather normalization reserve for 2012 and 2013 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 2012 balance also reflects a credit for $296,000, due to the normal operation of the reserve, based on actual year to date data for 2012. Consistent with prior years, the 2013 forecast assumes normal stream-flows and weather patterns from January 2013 through December 2013.

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

### 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. The actual transitional balance was $52,560,000 resulting in annual amortization of $3,504,000.

The total amount of the deduction to rate base related to OPEBs for 2011 is $7,199,000 with $14,403,000 and $21,207,000 forecasted for 2012 and 2013 respectively.

**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 2012 and 2013 forecast Customer Security Deposits are comparable to the actual amount reported in 2011.

**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 2012 and 2013 forecast accrued pension liabilities are fairly comparable with actual reported amounts for 2010 and 2011.

**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.

**Demand Management Incentive Account**

In P.U. 32 (2007) the Board approved the Company's proposal to establish the Demand Management Incentive Account ("DMI"). The 2011 balance reflects an opening charge of $676,000 and an additional $576,000 due to the normal operation of the account. The Company was required to file an application with the Board no later than March 1, 2012 for the disposition of the balance in the DMI account as at December 31, 2011. In P.U. 9 (2012) the Board approved the transfer to the Rate Stabilization Account ("RSA") at March 31, 2012 of $1.8 million equal to the balance in the DMI account for 2011 inclusive of related income tax effects.

The forecast 2012 balance reflects a charge of $923,000 due to the normal operation of the account. The Company is required to file an application with the Board no later than March 1, 2013 for the disposition of the balance in the DMI account as at December 31, 2012.

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 2012 reflect the disposition of the December 31, 2011 balance of $1,252,000, as approved by the Board. Further the 2013 forecast does not reflect the disposition of the December 31, 2012 forecasted balance as approval from the Board is required for this based on a future application to be filed by the Company.

## 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.

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 2012 and 2013 is comparable with the 2011 actual 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