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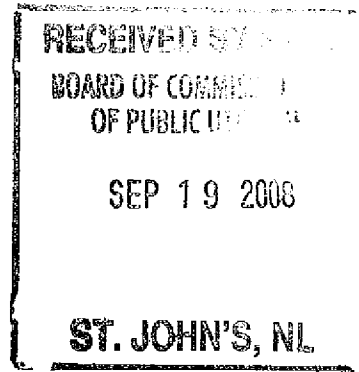
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Ms. Doreen Dray
Board of Commissioners of Public Utilities
120 Torbay Road
Prince Charles Building
St. John's, NL
A1A 5B2

September 5, 2008

Dear Ms. Dray,

**Re: Newfoundland Power Inc.
2009 Capital Budget Application**



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We have completed our review as requested in your letter dated August 5, 2008 relating to Newfoundland Power Inc.'s (the Company's) 2009 Capital Budget Application as it pertains to the calculation of the 2007 actual average rate base and the calculations of the 2008 and 2009 forecast deferred charges.

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

2007 Average Rate Base Calculation

The actual average rate base for 2007 as calculated by the Company and provided in Schedule E of its Application is \$793,703,000 compared to \$752,917,000 for 2006. The increase of \$40,786,000 in 2007 is primarily due to an increase in average net plant investment of \$25,511,000 resulting from additions during the year of \$68,800,000, partially offset by 2007 amortization expense. There was also an increase in deferred regulatory costs of \$11,710,000 largely relating to deferred depreciation expense, deferred replacement energy costs and deferred pension costs. In addition, there was a decrease in the unrecognized 2005 unbilled revenue balance of \$3,593,000. The 2007 calculation agrees with the information submitted to the Board in Return 3 of the Company's 2007 annual report.

We noted an error in the calculation of the 2006 comparative provided in Schedule E. The error was due to an erroneous figure included in the 'balance – previous year' line, resulting in an overstatement of \$687,000 in the 2006 average rate base calculation. This error did not extend into the 2007 calculation and does not impact the 2007 average rate base. The Company has advised that a revision to Schedule E of the 2009 Capital Budget Application has been submitted to the Board that now agrees to Return 3 and Schedule E of the 2008 Capital Budget Application in the amount of \$752,917,000 compared to \$753,604,000 in the original application.

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 2007; 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 2007 average rate base, and therefore conclude that the 2007 average rate base included in Schedule E of the Company's application is accurate and in accordance with P.U. 19 (2003).

Forecast Deferred Charges

In compliance with P.U. 19 (2003), Newfoundland Power Inc. has filed evidence with the Board relating to its forecast deferred charges, including pension costs, to be included in the calculation of the forecast average rate base for 2008 and 2009.

We confirm that, as indicated by the Company, the actual deferred charges for 2007 of \$124,460,000 are higher than the forecast of \$123,700,000 that was filed in the Company's prior year Capital Budget Application. The increase of \$760,000 is primarily due to the addition of deferred costs related to the Company's 2007 General Rate Application ("GRA") in the amount of \$1,250,000, partially offset by a decrease in deferred bond issued costs in the amount of \$327,000. It should be noted that the \$1,250,000 related to the GRA has not been included in the determination of the 2007 average rate base. These costs relate to the 2008 test year and are to be amortized over three years commencing in 2008 pursuant to P.U. 32 (2007). The unamortized balance of the costs will be included in the determination of 2008 and 2009 average rate base.

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

| (\$000's) | Forecast 2007 | Actual 2007 | Forecast 2008 | Forecast 2009 |
|---|------------------|----------------|------------------|------------------|
| Deferred Pension Cost | \$ 96,656 | \$ 96,654 | \$ 100,196 | \$ 103,400 |
| Weather Normalization Account | 10,683 | 10,516 | 9,150 | 7,784 |
| Unamortized Debt Discount & Issue Expense | 3,433 | 3,111 | 2,934 | 3,355 |
| Unamortized Capital Stock Issue Expense | 137 | 137 | 75 | 37 |
| Deferred Credit Facility Issue Costs | 58 | 59 | 69 | 44 |
| Deferred Depreciation Expense | 11,586 | 11,586 | 7,724 | 3,862 |
| Deferred Replacement Energy Cost | 1,147 | 1,147 | 764 | 381 |
| Deferred General Rate Application Costs | - | 1,250 | 398 | 199 |
| Total Deferred Charges | \$ 123,700 | \$ 124,460 | \$ 121,310 | \$ 119,062 |

Source: Newfoundland Power Inc. - 2009 Capital Budget Application
Report on Deferred Charges and Rate Base - Table 1

Our comments with respect to the deferred charges are noted below:

Deferred Pension Costs

Deferred pension costs is the most significant component of the deferred charges and is 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 2008 and 2009 is \$5,425,000 and \$4,298,000 and the forecast pension plan expense is \$1,883,000 and \$1,094,000 for 2008 and 2009 respectively. The difference between the funding and the expense as indicated below represents the increase in deferred pension costs forecast for 2008 and 2009.

| (\$000's) | Forecast 2007 | Actual 2007 | Forecast 2008 | Forecast 2009 |
|-------------------------------------|------------------|----------------|------------------|------------------|
| Deferred Pension Costs, January 1 | \$ 90,122 | \$ 90,122 | \$ 96,654 | \$ 100,196 |
| Pension Plan Funding | | | | |
| - Current Service Funding | 3,598 | 3,597 | 3,847 | 4,000 |
| - Special Funding | 7,308 | 7,307 | 1,578 | 298 |
| Total Pension Plan Funding | 10,906 | 10,904 | 5,425 | 4,298 |
| Pension Plan Expense | (4,372) | (4,372) | (1,883) | (1,094) |
| Increase in Deferred Pension Costs | 6,534 | 6,532 | 3,542 | 3,204 |
| Deferred Pension Costs, December 31 | \$ 96,656 | \$ 96,654 | \$ 100,196 | \$ 103,400 |

Source: Newfoundland Power Inc. - 2009 Capital Budget Application
Report on Deferred Charges and Rate Base - Table 2

With regards to the pension plan funding for 2008 and 2009, we have reviewed this amount and agreed it to supporting documentation where appropriate. The 2008 and 2009 forecast current service funding is reasonable in comparison to 2007. The special funding consists of two components; a special funding requirement as determined by previous Board Orders and Letters of Approval; and special funding as determined by the Company's actuary in accordance with pension guidelines. The decrease in special funding in 2008 is due to the Company's past service obligations being fully funded. The 2009 forecast special funding relates to an ad-hoc pension increase granted to pensioners who met certain eligibility criteria effective July 1, 2006 to be funded over 15 years at a cost of \$298,000 per year.

The forecast pension expense for 2008 and 2009 is \$1,883,000 and \$1,094,000 respectively compared to an actual expense in 2007 of \$4,372,000. The primary reason for the decrease forecast for 2008 and 2009 is that the actuarial report filed with the 2008 GRA predicts that the defined benefit plan's past service obligations will be fully funded in 2008. This results in an increase in plan assets which increases returns resulting in a net decrease in pension expense. 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 2009 cannot be determined until after December 31, 2008. In accordance with CICA recommendations, the 2009 expense will be determined based on the market value of pension plan assets as of December 31, 2008, and as well the discount rate that is required to be used in the calculation will be the actual market rate of interest at December 31, 2008.

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.

Weather Normalization Reserve

The changes in the forecast weather normalization reserve for 2008 and 2009 reflects 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 2008 and 2009 forecasts assume normal weather conditions from January 2008 through December 2009.

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

Unamortized Debt Discount and Issue Expense

The 2007 forecast estimated the issuance of \$60 million in Series AL First Mortgage Sinking Fund Bonds with forecast issue cost equal to 1% of the face value (\$600,000). During 2007, \$70 million was issued with actual issue costs for the private placement of \$273,000. In December 2009, the Company is anticipating an additional issue of a First Sinking Fund Bond with forecast issue costs of \$600,000 based on 1% of the expected face value. The decrease in Unamortized Debt Discount and Issue Expense forecast is due to normal amortization of these costs.

Commencing in 2007 these costs are classified as a reduction in long term debt in the Company's financial statements. This is in accordance with the new financial instrument standards under Canadian Generally Accepted Accounting Principles (CICA Handbook Section 3855).

In P.U. 32 (2007) the Board approved the Company's proposal to complete the transition to the Asset Rate Base method commencing in 2008, which incorporates 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. Therefore commencing in 2008 these costs will no longer be included in rate base.

Unamortized Capital Stock Issue Expense

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

Deferred Credit Facility Issue Costs

The Company is anticipating an additional \$75,000 in credit facility issue costs in 2008 and is reflected in the 2008 forecast. The forecast reflects the normal amortization of these costs and other prior period issue costs.

Deferred Depreciation Expense

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 depreciation expense, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

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.

Deferred General Rate Application (GRA) Costs

The deferral of GRA costs are the estimated costs of \$1,250,000 of external costs related to the Company's 2007 GRA pursuant to P.U.32 (2007). In 2008, the Company reduced its estimate by \$653,000 to \$597,000 as a result of lower than anticipated costs. The actual amount of \$597,000 consist of external costs specifically relating to the Consumer Advocate, Board of Commissioners of Public Utilities and its respective experts. The forecast properly reflects the amortization of these costs over a three year period beginning January 1, 2008 pursuant to P.U. 32 (2007).

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

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

Yours sincerely



Kim Simms, CA
Principal
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