



Board of Commissioners of Public Utilities Newfoundland Power Inc.

2010 General Rate Application
Financial Consultants Supplementary Report

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Introduction and Scope

On September 28, 2009, Newfoundland Power Inc. (“the Company”) (“Newfoundland Power”) submitted an amended filing to the Board of Commissioners of Public Utilities (“the Board”) with respect to its 2010 General Rate Application (“the Amended Application”). The Amended Application primarily reflected the following changes from the May 28, 2009 filing:

- Changes in customer rates resulting from the July 1, 2009 rate stabilization adjustment approved by the Board in P.U. 26 (2009);
- Revised forecasts for pension and other post employment benefit costs (“OPEBs”) primarily due to a reduction in the discount rate from 7.5% to 6.50% partially offset by the impact of an increase in pension plan assets due an increase in the forecast rate of return for 2009;
- Revisions to the Company’s 2010 Customer, Energy and Demand Forecast to incorporate the Company’s most recent forecast assumptions dated September 2009;
- The effects of inclusion of supplemental capital expenditures for 2009 approved by the Board in P.U. 29 (2009) and P.U. 32 (2009);
- Revisions that reflect the *Settlement Agreement for the Proposed Resolution of Certain Issues Arising from the Application* negotiated between Newfoundland Power and the Consumer Advocate, with participation by Board hearing counsel, dated September 23, 2009 (“the Settlement Agreement”).

Grant Thornton has undertaken a review of the Amended Application focusing on the changes to Newfoundland Power’s 2010 test year forecast revenue requirement, forecast average rate base and forecast rate of return on average rate base. In conducting our review we have performed the following procedures:

- reviewed cost and sales revisions to identify the elements which give rise to adjustments in the forecast revenue requirement, forecast average rate base and forecast rate of return on average rate base and obtained evidence to support these revisions;
- reviewed the Amended Application, including the revised exhibits thereto containing certain revised Finance and Accounting Schedules, to assess whether the cost and sales revisions are appropriately reflected in the Amended Application;
- reviewed the revised Finance and Accounting schedules for accuracy and completeness;
- made enquiries and obtained additional documentation, where appropriate, to support the revisions to 2010 forecast revenue requirement, forecast average rate base and forecast rate of return on average rate base; and,
- verified the calculation of the proposed rates necessary to meet the forecast revenue requirement in the 2010 test year as set out in the Amended Application.

Observations and Findings

Revenue Requirement

In the Amended Application, the Company revised its 2010 Customer, Energy and Demand Forecast based on the most recent economic forecasts. As a result the Company decreased the forecast energy sales by 27 GWhs in comparison to the amount that was included in the original application. The reduction in forecast energy sales also included the elasticity impact of the higher proposed rate increase included in the Amended Application. It is important to note that the Company did not change the methodology in which the forecast was prepared; rather the inputs were updated based on more recent information. In the Settlement Agreement it was noted that Newfoundland Power was preparing a revised Customer, Energy and Demand Forecast and the parties agreed “that the Board may accept and rely upon the revised Forecast”.

As a result of the revisions to the Customer, Energy and Demand Forecast, the Company’s forecast power purchases for 2010 decreased by 28 GWhs and 9 MWhs of demand. This resulted in a decrease in purchased power expense of \$2,933,000.

In its Amended Application the Company’s 2010 forecast employee future benefit costs increased by \$3,406,000 as a result of the following revisions (note: the revised forecast for the defined benefit pension plan and OPEBs have been agreed to calculations provided by the Company’s actuaries):

- Increase in pension costs of \$2,495,000, represented by an increase of \$2,400,000 and \$95,000 relating to the defined benefit plan and defined contribution plan, respectively.
 - The defined benefit pension plan expense has increased due to a reduction in the forecast discount rate from 7.5% to 6.5%, offset partially by the effect of an anticipated increase in plan asset growth in 2009. The revised forecast pension plan rate of return for 2009 is 12% versus 7% in the Company’s original application.
 - The defined contribution plan expense is higher due to an increase in the Company’s forecast number of employees participating in the plan.
- Increase in OPEBs expense of \$911,000 due to the reduction in the forecast discount rate from 7.5% to 6.5%.

In addition to the above revisions, the Company also made the following amendments:

- Increase of \$20,000 in other revenue due to an increase in the net joint use revenue.
- Increase of \$42,000 in depreciation expense due to an increase in forecast capital expenditures in 2009 (as approved by the Board in P.U. 29 (2009) and P.U. 32 (2009)).
- Increase of \$133,000 in income taxes due to the effect of changes to net income before tax and changes in future tax resulting from the revisions to the OPEBs /pension costs. The effective income tax rate for 2010 test year remains the same as the original application.
- Increase in the return provided to common equity holders of \$66,000 necessary to maintain an 11.0% regulated return on book equity, partially offset by a \$5,000 decrease in preferred dividends due to redemption of preferred shares.
- Decrease of \$84,000 in finance charges due to the combined impact of the above changes to revenue requirement.

In the Amended Application the Company also amended the definition of the *Pension Expense Variance Deferral Account*. The amended definition is consistent with that agreed to in the Settlement Agreement. This amendment has no impact on revenue requirement, average rate base or return on average rate base.

The overall impact on 2010 test year forecast revenue requirement can be summarized as follows:

Change in 2010 Test Year Revenue Requirement

(000's)	<u>2010</u>
Revenue Requirement, Original Application	\$ 545,312
Increase (decrease) in 2010 Test Year Revenue Requirement	
Power Supply Cost	(2,933)
Pension Expense	2,495
OPEBs	911
Income Taxes	133
Finance Charges	(84)
Return on Preferred and Common Equity	61
Depreciation	42
Other Revenue	<u>(20)</u>
Total increase in Revenue Requirement	<u>605</u>
Revenue Requirement, Amended Application	<u>\$ 545,917</u>

We have reviewed the revised forecast and obtained appropriate evidence to support the revisions. In addition, we have ensured these changes have been appropriately incorporated into the revised forecast revenue requirement, forecast average rate base and forecast rate of return on average rate base.

Average Rate Base and Rate of Return on Average Rate Base

2010 forecast average rate base included in the Amended Application increased by \$1,845,000 compared to the original filing (\$867,396,000 in the original filing versus \$869,241,000 in the Amended Application). The increase in the forecast average rate base resulted in a decrease in the forecast rate of return of average rate base to 9.13% in the Amended Application from 9.15% in the original application.

The increase in forecast average rate base was due to the following:

Increase (decrease) in 2010 Test Year Average Rate Base

(000's)	2010
Increase in 'Net Plant Investment'	\$ 697 ¹
Increase in 'Weather Normalization Reserve'	2,377 ²
Decrease in average Pension & OPEBs liability, net of future income taxes	(1,206) ³
Less: other items	(23) ⁴
Total Increase in 2010 Test Year Average Rate Base	\$ 1,845

Note 1: Reflects supplemental capital expenditures in 2009 approved in P.U. 29 (2009) and P.U. 32 (2009).

Note 2: Reflects an updated forecast due to the normal operation of the reserve based on actual data to August 31, 2009.

Note 3: Reflects updated pension and OPEBs costs due to a reduction in the discount rate from 7.5% to 6.5% and the effect of an anticipated increase in plan asset growth in 2009 with a forecast pension plan return of 12% versus 7%, net of effects of future income taxes.

Note 4: Other items include the result of an updated cash working capital allowance based on current forecast costs, an updated material and supplies allowance due to a change in forecast inventory levels, and an updated forecast for customer finance programs and customer security deposits based on August, 2009 data.

Conclusion

Based on our review of the Amended Application, the Settlement Agreement and the completion of the procedures described in the scope of our report, we present the following findings for the Board's consideration:

- the revised forecast 2010 test year revenue requirement to be recovered from electrical rates of \$545,917,000 appropriately incorporates the impact of the revised forecast included in the Amended Application;
- the revised forecast 2010 average rate base of \$869,241,000 appropriately incorporates the impact the revised forecast included in the Amended Application;
- the proposed revised rate of return on average rate base of 9.13% for 2010 appropriately incorporates the impact the revised forecast included in the Amended Application; and,
- the revenue requirement from rates as proposed by the Company is calculated based upon the revised Schedule of Rates, Tolls and Charges effective January 1, 2010 and the factors proposed in this Amended Application.

Grant Thornton LLP

St. John's, Newfoundland
October 8, 2009

Chartered Accountant