Q. Reference: Section 3.4.3, Other Post-Employment Benefits
Vol. 2, Tab 4, Report on Other Post-Employment Benefits

(a) Please compare NP's current proposals for recognizing OPEBs using the Accrual Method instead of the Cash Method to the proposals contained in NP's evidence for the 2008 GRA. Identify all differences in the proposals and explain the rationale for each difference in the proposed approach.

(b) Please identify all changes in circumstance that affect the importance of changing to the Accrual Method for the 2010 test year as compared to the 2008 Test Year.

(c) Please explain the benefits of moving to the Accrual Method in 2010 without simultaneously determining the approach that will be used for addressing the Transitional Obligation of $46.2 million and the related impact on customer rates.

(d) Does NP consider it to be inappropriate to propose a method of addressing the Transitional Obligation that defers recognition without deferring the decision on the methodology? Please explain.

(e) Please elaborate on the discussion of the potential impact of recovering the Transitional Obligation contained in footnote 87 by explaining NP's recommended approach.

(f) Please confirm that unlike funding of NP's pension plans, OPEBs funding is a source of capital that is, in effect, a loan from customers that replaces a portion of NP's capital market financing requirements. This substitution is the reason that changing to the Accrual Method for recognizing OPEB costs will improve NP's credit metrics. If NP does not agree, please explain.

A. (a) Newfoundland Power's proposal for recognizing OPEBs using the Accrual Method contained in the Company's evidence for the 2010 GRA is consistent with the proposal contained in the Company's evidence for the 2008 GRA.

(b) The following are relevant changes in circumstance regarding the Company's proposed change to the Accrual Method of accounting for OPEBs for the 2010 test year:

(i) The Cash and Accrual Methods of accounting for OBEBs affect the *timing* of recovery of the OPEBs liability. Since filing the 2008 GRA, the OPEBs transitional obligation has grown from $34.1 million to $46.2 million. The transitional obligation is expected to continue to grow under the Cash Method of accounting for OPEBs.

(ii) Accrual accounting for OPEBs is mainstream regulatory practice in Canada. Based on results of a survey completed in 2009, more utilities are now using the Accrual Method of accounting for OPEBs.[1]

(c) Newfoundland Power's proposal to move to the Accrual Method of accounting for OPEBs in 2010 without simultaneously determining the approach that will be used to address the transitional obligation provides for customer rate stability.

For Newfoundland Power to fully address its OPEBs obligations, including the transitional obligation in 2010, would result in an increase in 2010 revenue requirement of approximately 1.8%.[2] Implementing Newfoundland Power's OPEB proposal in this Application will result in an increase in 2010 revenue requirement of approximately 1%. The Company's proposal reflects a two-stepped approach which will help moderate the immediate impact of the accounting change on customer rates.

Also, if the Company adopts the accrual method of accounting for OPEBs in 2010 as proposed in this Application, this $46.2 million legacy transitional obligation will not continue to grow, as it would under the Cash Method of accounting for OPEBs.

The Accrual Method of accounting for OPEBs also has the following impacts on the rates paid by current and future customers:[3]

(i) Under the Accrual Method of accounting, OPEBs costs are expensed and included in revenue requirement in the period during which the services giving rise to those costs are provided. Rates in each period therefore recover the cost of providing service in the period; no more and no less. Otherwise, as in the case of the Cash Method of accounting for OPEBs, costs that are not recovered from current customers would be recovered from future customers.

(ii) The Accrual Method of accounting for OPEBs serves to reduce Newfoundland Power's rate base, and therefore it's allowed return and revenue requirement, from what it would otherwise be. Put another way, the cash received in connection with OPEBs expense that is not paid out by Newfoundland Power to cover benefits premiums and retirement allowances serves to reduce, from what it would otherwise be, the amount of debt and equity financing required by Newfoundland Power. The cost of such financing is ultimately borne by customers.

[1] Of 24 Canadian utilities surveyed in 2009, 22 use the accrual method and 2 use the cash method. At the time of the company's last GRA, 6 Canadian utilities used the cash method. See page 4-5 of the *Report on Employee Future Benefits* found in *Volume 2: Supporting Materials, Tab 4.*

[2] Please refer to *Report on Employee Future Benefits* found in *Volume 2, Supporting Materials, Tab 4*, page 2.

[3] Please refer to (i) Finance Evidence, pages 3-17 and 3-18, (ii) Finance Evidence, pages 3-27 through 3-29, and (iii) *Report on Employee Future Benefits* found in *Volume 2, Supporting Materials, Tab 4*.

(iii) The Accrual Method of accounting for OPEBs also improves the Company's credit metrics. The resultant forecast credit metrics for 2010 should help maintain the Company's current investment grade credit rating, which allows the Company to have competitive access to capital markets. An investment grade credit rating reduces the cost of capital, which is borne by customers, from what it would otherwise be.

(d) Newfoundland Power considers it appropriate to determine the methodology of disposition of the transitional obligation at a future Company general rate proceeding. The methodology for disposition of the transition obligation will consider the customer rate impacts at the time of disposition. The future customer rate impacts will only be determinable at the time the matter is addressed.

(e) Newfoundland Power proposes that the disposition of the transitional obligation be addressed at a future Company general rate proceeding. A key determinant of the customer rate impact will be the period over which the Board authorizes recovery of the transitional obligation. In footnote 87 on page 3-29 of the Company's evidence, Newfoundland Power provided an estimate of the customer rate impact based on 5- and 10-year amortization periods and based on 2010 forecasted revenues. The future customer rate impacts will only be determinable at the time the matter is addressed.

(f) Newfoundland Power confirms that, unlike funding of the Company's pension plans, the cash received in connection with OPEBs expense that is not paid out by the Company to cover benefits premiums and retirement allowances serves to reduce, from what it would otherwise be, the amount of debt and equity financing required by Newfoundland Power.

Please refer to (i) Finance Evidence, pages 3-17 and 3-18, and (ii) pages 5 through 8 of *Report on Employee Future Benefits* found in *Volume 2, Supporting Materials, Tab 4.*