Q. Reference: Page 14, Lines 16-19

Does Mr. Todd agree that the recognition of OPEBs on an accrual basis improves intergenerational equity, which provides benefits to future customers and better reflects cost causality? If not, why not?

A. Moving from the Cash to the Accrual Method of accounting for OPEBs for regulatory purposes has several implications for intergenerational equity.

As an ongoing methodology, the Accrual Method of accounting for OPEBs would improve intergenerational equity if it were not subject to fluctuations in values due to changes in interest rates and other factors. But the GT Report notes:

> *However, we also conclude that the accrued benefit obligation related to OPEBs is subject to variability due to uncertainty regarding assumptions, in particular discount rates. As the Company's proposed definition for the Pension Expense Variance Deferral Account related to pensions only, the variability in OPEBs still exists.*

The latest actuarial assessment of OPEBs (NP Evidence, Volume II, Tab 5) indicates that the fluctuations in the valuation due to factors other than the accrual of future obligations can be significant. This is evident from the table in the Principal Expense and Disclosure information that is presented at page 2 of the report which is reproduced below.

Components of Net Periodic Benefit Cost[1]	Fiscal Year Ending December 31, 2008	Fiscal Year Ending December 31, 2007
1. Current service cost	$1,384,000	$1,412,000
2. Interest cost	3,901,000	3,698,000
3. Actual return on plan assets	0	0
4. Actuarial loss (gain)	(14,885,000)	(3,383,000)
Costs arising in the period	**($9,600,000)**	**$1,727,000**
Differences between costs arising in the period and costs recognized in the period in respect of:		
• Return on plan assets	0	0
• Actuarial loss (gain)	15,894,000	4,710,000
• Transitional obligation (asset)	1,428,000	1,428,000
Net periodic benefit cost recognized	**$7,722,000**	**$7,865,000**

The table shows that while the current service cost is quite stable across the 2007 and 2008 fiscal years, the actuarial losses and gains are highly volatile.

This variability related to actuarial losses and gains undermines intergenerational equity in that when there is a change in valuation, it implies that in prior years customers were either over- or under-paying relative to the "corrected" value of the future OPEBs obligations that should have accrued been in prior years. Thus, each change in valuation implies a failure of intergenerational equity. Subsequent to a change in valuation, customers will be either over- or under-paying by an amount equal to the change in the OPEBs valuation. Of course, a "correction" in a year could be reversed by a subsequent reversal in financial market conditions.

In addition, disposing of the Transitional Obligation will represent a clear violation of intergenerational equity in that customers will be paying more than their equitable share of the accrued value of OPEBs. If intergenerational equity were to be adhered to strictly (i.e., without regard to other regulatory principles), the Transitional Obligation would have to be written off since it reflects an under-recovery in past years that would translate into over-recovery from customers in future years if it is recovered in future rates. Put simply, at best intergenerational equity will not be achievable until the Transitional Obligation is eliminated, but the faster it is eliminated, the greater the degree of intergenerational inequity.

Furthermore, the OPEBs obligations that are attributable to any year (i.e., under the Accrual Method) are dependent on the benefits to which retired employees are entitled. Any changes to this entitlement will change the "correct" amount of the accrual in all years, including prior years during which the retirees were working. Hence, any changes to the benefit package for retirees would have an impact on intergenerational equity. As NP states in its response to CA-NP-337 (lines 27-28): "Further, Newfoundland Power observes that *any* change from current employee post retirement benefits will impact annual OPEBs costs."

NP further notes in its response to CA-NP-345 (p. 4, lines 28-31) that: "In March 2009, Newfoundland Power agreed with the IBEW Local 1620 to review the group benefit program affecting current employees of the Company. Newfoundland Power intends to review the group benefit program which currently applies to retirees of the Company in concert with this agreed review." Any changes to the entitlement of retirees would have an impact on the OPEBs valuation that would imply a change to the prior year accrued values. Such changes would change the valuation of OPEBs reflecting an implicit over- or under- recover of the "correct" accrued amounts in prior years, which would further compromise intergenerational equity.