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November 26, 2010

Via Email & Courier

Ms. G. Cheryl Blundon
Director of Corporate Services and Board Secretary
Board of Commissioners of Public Utilities
120 Torbay Road
P.O. Box 21040
St. John's, NL A1A 5B2

Dear Ms. Blundon:

Re: Newfoundland Power Inc. - Other Post Employment Benefits (OPEBs) Proposal

Introduction

In Newfoundland Power's 2010 GRA, Newfoundland Power proposed

1. adoption of the accrual method of accounting for OPEBs costs for regulatory purposes commencing in 2010;
2. tax effecting all of its employee future benefits costs represented by OPEBs expense for regulatory purposes commencing in 2010; and
3. deferring consideration of the transitional obligation of \$46,200,000 until a further hearing to be determined by the Board.

At the GRA, the Consumer Advocate submitted in his Written Submission (p. 69/16-21) that it would be reasonable for the Board to

- (i) defer accrual accounting of OPEBs until Newfoundland Power has made a reasonable effort to reduce the cost of OPEB expense; and
- (ii) defer accrual accounting of OPEBs until the Board has had the opportunity to deliberate on the full impact upon rates of the accrual accounting of annual OPEB expense and transmittal costs and to consider any mechanisms to smooth the impact of the volatile expense.

In Order No. P.U. 43 (2009) the Board ordered:

The Board will not approve Newfoundland Power's proposal to move to accrual accounting for OPEBs costs on January 1, 2010. Newfoundland Power will be required to submit no later than June 30, 2010 a comprehensive proposal for the adoption of the accrual method of accounting for OPEBs costs as of January 1, 2011. This proposal should include recommendations and alternatives in relation to a deferral mechanism to capture annual variances arising from changes in the discount rate and other assumptions, as well as for the recovery of the transitional balance associated with the adoption of accrual accounting for OPEBs costs.

On 30 June, 2010, Newfoundland Power Inc. filed an Application with the Board requesting an Order from the Board on the following terms:

Order Requested

5. Newfoundland Power requests an Order from the Board:

(a) approving Newfoundland Power's recommended:

- (i) adoption, for regulatory purposes, of the accrual method of accounting for OPEBs costs and income tax related to OPEBs;
- (ii) recovery of the transitional balance, or regulatory asset, of approximately \$68.6 million as at January 1, 2011, over a 15-year period; and
- (iii) adoption of the OPEBs Cost Variance Deferral Account;

all with effect from January 1, 2011 and as described in Schedule A to this Application.

- (b) directing Newfoundland Power to file revised rates, tolls and charges effective for service provided on and after January 1, 2011 which reflect the determinations of the Board on this Application; and
- (c) Providing such other or alternate relief which may, upon review of the record of this Application, appear just and reasonable in the circumstances.

The Company's Report on other Post Employment Benefits of 30 June 2010 indicates that following the last GRA the Company decided to make a number of changes to its OPEBs benefits plan (Plan). The most prominent changes to the Plan are the introduction of a 50% member-paid cost sharing arrangement for retirees over the age of 65, the removal of the \$5,000.00 annual benefit cap and the introduction of drug dispensing fees. The Company reports (at Table 1) that with these changes it is forecasting that its accrued OPEBs obligation has been reduced in the range of \$15 to \$17 million and its annual OPEBs costs have been

reduced by approximately \$2.5 million per year over the period 2011 to 2013. This highlights that the Plan's benefit regime has a very direct rate impact upon customers.

In my correspondence to the Board of 17 September, 2010 (attached as Schedule "A") I submitted that the scope of the inquiry into the Company's Application should include an examination of the appropriateness and reasonableness of the OPEBs Plan benefits themselves. In particular, there was a concern that none of the Company's reforms will impact either existing retirees who have not yet reached age 65 or indeed those present employees who are eligible for full pension by December 31, 2012.

By letter dated October 18, 2010 (attached as Schedule "B") the Board, upon review of the position of the Consumer Advocate and the reply by Newfoundland Power, stated that it was satisfied that Newfoundland Power's filing complies with the requirements of Order No. P.U. 43 (2009) and stated that the Board will consider the proposal of Newfoundland Power as currently filed with the Board. The Board noted, however as follows:

"The Board notes that the cost make-up of the Plan can be addressed in the usual course as part of the next general rate proceeding."

The Consumer Advocate made Requests for Information to Newfoundland Power on 29 October and received the Company's replies to the same on 5 November, 2010.

On 12 November, 2010 the Consumer Advocate advised the Board and Newfoundland Power that he did not intend to file any further evidence or require a *vive voce* hearing but would be making submissions in writing in respect of the matter.

Submissions

Recovery of the Transitional Balance

In commenting on the proposed Amortization Method (Straight-line Method versus Mortgage Method), the Grant Thornton Report observes that "The Company has noted that it is not aware of past practices from any rate regulated entity to amortize regulatory assets in this manner." This observation may have influenced the conclusions contained at page 9 of the Grant Thornton Report which states that "The use of the Mortgage Method would move the Company's accounting policies further away from those approved under GAAP."

The Consumer Advocate supports the adoption of the Mortgage Method since that approach will minimize the year-to-year impact of the recovery of the Transitional Balance on rates. In support of the appropriateness of the Mortgage Method, the Consumer Advocate notes that the Decision of the New Brunswick Energy and Utilities Board in the matter of a Motion by New Brunswick Power Distribution and Customer Service Corporation for the Approval of the Establishment of a Deferral Account and Consequential Relief dated August 23, 2007¹ approved the establishment of a deferral account that would permit NB Power Disco to levelize, on an annual basis, the amount of the benefit related to the settlement of a lawsuit

¹

<http://156.34.203.123/Documents/Decisions/Electricity/E/2007%2008%2023%20Brief%20on%20Disco's%20Motion%20complete%20Final%20Eng.pdf>

involving New Brunswick Power Holding Corporation and Petroleos De Venezuela, S.A that would be credited to the customers of Disco. Hence, there is clear precedent in Canada for the adoption of the Mortgage Method, in this case levelizing the flow of a benefit to customers so as to smooth rate impacts.

In addition, the Consumer Advocate notes that the Grant Thornton Report suggests that “the Board may wish to consider using a period that is equal to the Company’s EARSL rather than one that is ‘roughly equal’.” (p. 9) In the view of the Consumer Advocate, this suggestion has merit.

OPEBs, Cost Variance Deferral Account (OPEBs CVDA)

As the Company has noted (Section 6.3) the accrued benefits obligation and annual expense related to OPEBs are subject to year-to-year variability due to changes in the discount rate and other assumptions.

As the Company points out, for example, the discount rate used to value the OPEBs obligation, and thus determine annual OPEBs costs is established at December 31st of the preceding year and is not reasonably predictable. Other assumptions used to determine annual OPEBs costs are also subject to change in the future. These include assumptions related to health care cost trends and mortality rates for members in the Company’s Plan. Plan amendments may also impact the value of the OPEBs obligation and annual OPEBs costs.

In the Company’s last GRA, the parties and the Board saw how the annual expense to be accrued on account of OPEBs is not a stable amount. The original application proposed a revenue requirement increase on account of the move to accrual of \$5.6 million. By the Amended Application filed 28 September, 2009 this amount had increased by \$1.2 million to \$6.8 million (Original GRA - Tab 4, Table 8, p. 13 and Amended Application). This was just a change on account of a change in discount rate.

It is not only the discount rate that can change the annual accrual to be experienced on account of OPEBs. As was pointed out in the evidence at the GRA, just one of the factors, the medical trend, has changed as much as \$18 million year over year. The change in one factor may be balanced out by countervailing changes in other factors or it may exacerbate the expenses. There is no real linkage between the factors. [GRA Vol II, Tab 5, p. 11; Evidence of Jocelyn Perry, October 19, 2009, p. 59, lines 14-15]

Newfoundland Power recommends the creation of an OPEBs Cost Variance Deferral Account to capture future changes in OPEBs costs from that included in rates. The Company’s proposed definition for the account is as follows:

Proposed Definition

OPEBs Cost Variance Deferral Account

This account shall be charged or credited with the amount by which the *net OPEBs cost* for any year differs from that approved for the establishment of revenue requirement from rates.

Net OPEBs cost for the year is the total of (i) the OPEBs expense for regulatory purposes for the year, (ii) the amortization of OPEBs regulatory asset for the year, and (iii) the rate base effects associated with OPEBs for the year.

Disposition of any Balance in this Account

Newfoundland Power shall charge or credit any amount in this account to the Rate Stabilization Account as of the 31st day of March in the year in which the difference arises.

If there is an application before the Board for rates based on a new test year that is anticipated to be outstanding as of the 31st day of March in a year in which the new rates are expected to become effective, then Newfoundland Power shall apply to the Board for determination of the amount to be charged or credited to the account for that year and the timing thereof.

The Consumer Advocate supports the creation of the OPEBs CVDA provided that it is implemented in a manner that is consistent with the adoption of the Pension Expense Variance Deferral Account (PEVDA) which was approved by the Board in P.U. 43 (2000).

In particular, the Consumer Advocate agrees with the comment and recommendation at page 10 of the Grant Thornton Report:

“In the 'Reasons for Decision' accompanying P.U. 43 (2009), the Board noted that Newfoundland Power confirmed that “It is not the purpose of the Pension Expense Variance Deferral Account to address pension cost variances that result from factors within the Company's control that impact pension expense, such as an early retirement program". We recommend that the Board obtain a similar confirmation from Newfoundland Power regarding the OPEBs Cost Variance Deferral Account.”

The Consumer Advocate supports this recommendation.

Furthermore, it is important that any future changes to the OPEBs cost due to changes in the Plan benefits be reviewed on a timely basis by the Board and if the changes (e.g., reduction as proposed by the Consumer Advocate) are accepted by the Board for rate-setting purposes, then the reduction in costs should be reflected in rates.

The Consumer Advocate also believes that it is important that neither the Company nor the Board view the flow through to rates of amounts associated with the PEVDA and the OPEBs CVDA as being automatic within any given year. It is important that discretion be retained to defer the recovery of some or all of the amounts transferred from the PEVDA and OPEBs CVDA into the RSA where circumstances warrant. In particular, if in any year, the disposition of the PEVDA and OPEBs CVDA, together with other factors including the

disposition of the other amounts in the RSA, result in a significant rate impact, the Board should consider the benefits of deferring the recovery of some or all of the PEVDA and OPEBs CVDA amounts. Flexibility in this regard will be particularly important in the event that the change in actuarial assumptions giving rise to an increased valuation is related to a transient change in the interest rate or some other factor that is likely to reverse itself in subsequent years. The goal is to smooth rate impacts, not pass through the impact of changes in actuarial assumptions that result in rate shocks for customers. In seeking disposition of the RSA, it will be essential to ensure that the rate effect details of the disposition of both the OPEBs CVDA and the PEVDA are fully disclosed so that it can be properly scrutinized prior to being approved.

Finally, as a point of clarification, the Consumer Advocate understands that when there are changes in actuarial assumptions, such as a change in the discount rate, the annual amortization amount will be recalculated and it is the change in the annual amortization and not the change in the present value of the regulatory asset that will be captured in the OPEBs CVDA. Hence, the unrecovered amount of the recalculated value of the regulatory asset will be recovered over the remaining term in a manner consistent with the Mortgage Method.

We trust that the foregoing is found to be in order.

Yours very truly,

O'DEA, EARLE

A handwritten signature in black ink, appearing to read "Thomas Johnson", written in a cursive style.

THOMAS JOHNSON

TJ/cel
encl. - Schedules "A" and "B"

cc: Newfoundland Power Inc.
Attention: Mr. Gerard Hayes

Schedule "A"

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September 17, 2010

Ms. G. Cheryl Blundon
Board of Commissioners of Public Utilities
120 Torbay Road, P.O. Box 21040
St. John's, NL
A1A 5B2

Dear Ms. Blundon:

Re: Newfoundland Power Inc. - Other Post Employment Benefits Application

The purpose in writing is to address whether the scope of inquiry into the company's application should include an examination of the appropriateness and reasonableness of the OPEBs Plan benefits themselves.

The company's proposal recommends inter alia that it adopt, for regulatory purposes, the accrual method of accounting for OPEBs costs and income tax related to OPEBs and that it recover the transitional balance, or regulatory asset, of approximately \$68.6 million as at January 1, 2011 associated with the adoption of accrual accounting for OPEBs costs, over a 15 year period.

The company's Report on Other Post Employment Benefits of June 30, 2010 (Schedule "A" to the Application) states that effective 2011, the company is making a number of changes to its OPEBs benefits plan (Plan). At footnote 5 at page 3 it states:

"5 The most prominent changes to the Plan are the introduction of a 50% member-paid cost sharing arrangement for retirees over the age of 65, the removal of the \$5,000.00 annual benefit cap, and the introduction of drug dispensing fees. The plan changes will not impact existing retirees or employees eligible for full pension by December 31, 2012. Changes to the Plan have reduced Newfoundland Power's forecast accrued OPEBs obligation by almost 20%. The changes have reduced forecast accrual OPEBs costs by about 30%."

Table 1 at page 3 of the company's report sets out the forecast impacts of the OPEBs Plan changes. Changes to the Plan are forecast to reduce Newfoundland Power's accrued OPEBs obligation in the range of \$15 to \$17 million and reduce its annual OPEBs costs by approximately \$2.5 million per year over the period 2011 to 2013. Obviously, the Plan's benefit regime has a very direct rate impact upon customers.

In last year's GRA, the Consumer Advocate took issue with the manner in which the company had been managing its OPEBs Plan. (see Consumer Advocate, Written Submission p. 66-69) At the GRA, the company gave no details as to what it was proposing in its then upcoming review with the union representing its two bargaining units¹. All that was known at the time was that changes might be coming to the Plan.

Now the company has completed its OPEBs review, has made changes to its Plan effective January 1, 2011 and wishes to proceed with recovery of the transitional balance or regulatory asset of \$68.6 million as of January 1, 2011 over a 15 year period. The question that arises is whether this proceeding will now afford an opportunity for the Consumer Advocate to question the extent of the Plan changes the company has made before we turn to proceeding to amortize such a significant recovery balance.

Given the very significant effects that Plan changes can have upon both the accrued obligation and annual costs, is it not appropriate in this proceeding to examine the changes that the company has made to its Plan? For instance, the company proposes that none of the reforms will impact either existing retirees or employees eligible for full pension by December 31, 2012. According to the actuarial report (at Volume 2, Tab 5, p. 14-15) filed in the 2010 GRA, as of December 31, 2008 NP had 235 retirees who were less than age 65. It will be recalled that NP's present OPEBs Plan requires any retiree less than age 65 to pay 50% of the cost of the benefits. It follows that the 235 retirees who were less than age 65 as at December 31, 2008, were already paying one-half the cost of these benefits. Some of these retirees are several years away from age 65 and would have had ample notice to allow them to adjust to *continuing* to be responsible for one-half of their benefits costs upon reaching age 65². The company's revised Plan, indeed, grandfathered other certain employees who have not even yet retired. These existing employees will receive free benefits when they reach age 65, after having paid one-half of the benefits from the date of their retirement to age 65.

If amounts are to be crystalized and collected from customers over a period of years, the amount to be crystalized must be questioned for reasonableness and appropriateness. The

¹No provision exists in the NP Collective Agreements with respect to post-employment group benefits (Transcript of October 19, 2009, p. 66, lines 6-12).

²Retirees are given express notice by means of a benefit booklet that benefits terminate with the expiry or termination of the group insurance contract. There is no written document whereby a promise or contract is made to employees that free group benefits will continue to be available to them after age 65 (Transcript of October 19, p. 66 - line 23; p. 77 - line 19).

appropriateness of these costs must be tested in the context of the present Application in the Consumer Advocate's respectful submission.

We trust that the foregoing is found to be in order.

Yours very truly,

O'DEA, EARLE

A handwritten signature in dark ink, appearing to read "Earle O'Dea", written over the printed name.

THOMAS JOHNSON

TJ/cel

cc: Newfoundland Power Inc.
Attention: Mr. Gerard Hayes



NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

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2010-10-08

Mr. Gerard Hayes
Newfoundland Power
55 Kenmount Road
St. John's, NL A1B 3P6

Mr. Tom Johnson
Consumer Advocate
O'Dea Earle
323 Duckworth Street
St. John's, NL A1C 5X4

Dear Sirs:

Re: Newfoundland Power Inc. – Other Post Employment Benefits (OPEBs) Proposal

The Board has reviewed the correspondence of the Consumer Advocate, dated September 17, 2010 and Newfoundland Power's response dated September 24, 2010 relating to the scope of the proposal by Newfoundland Power to adopt the accrual method of accounting for OPEBs. Newfoundland Power filed the proposal on June 30, 2010 in accordance with Order No. P.U. 43 (2009) arising from Newfoundland Power's last general rate application.

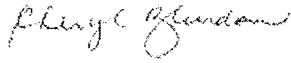
The Consumer Advocate has requested the opportunity to question the reasonableness and appropriateness of the amount and cost make-up of the components of the OPEBs plan. Newfoundland Power, however, states that forecast costs should be tested in a general rate proceeding in the context of the review of overall changes in the cost of service.

Order No. P.U. 43(2009) required Newfoundland Power to make a proposal on the adoption of the accrual method of accounting for OPEBs. The Board did not direct an examination of the amount and cost make-up of the components of the OPEBs plan. The Board notes that the cost make-up of the plan can be addressed in the usual course as part of the next general rate proceeding.

The Board is satisfied that Newfoundland Power's filing complies with the requirements of the Order and will consider the proposal of Newfoundland Power as currently filed with the Board.

If you have any questions please contact me at 726-8600 or the Board's Legal Counsel, Jacqueline Glynn at 726 - 6781

Yours truly,

A handwritten signature in cursive script, appearing to read "Cheryl Blundon".

Cheryl Blundon
Board Secretary

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