

DELIVERED BY HAND

November 26, 2010

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

Attention: G. Cheryl Blundon
Director of Corporate Services
and Board Secretary

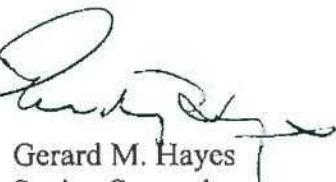
Ladies and Gentlemen:

Re: Newfoundland Power's Comprehensive Proposal on Other Post Employment Benefits

Enclosed are the original and eight copies of Newfoundland Power's Written Submissions.

A copy of this letter, together with a copy of the enclosure, has been forwarded directly to Geoffrey Young, Newfoundland & Labrador Hydro and Thomas Johnson, Consumer Advocate.

Yours very truly,



Gerard M. Hayes
Senior Counsel

Enclosures

c. Mr. Geoffrey Young
Newfoundland and Labrador Hydro

Mr. Thomas Johnson
Messrs. O'Dea, Earle



Join us in the fight against cancer.

IN THE MATTER OF the
Public Utilities Act, (the “Act”); and

IN THE MATTER OF a
comprehensive proposal for the
2011 adoption of accrual accounting
for other post employment benefit costs
for Newfoundland Power Inc.
(“Newfoundland Power”)

**Submission
of
Newfoundland Power Inc.**

November 26, 2010

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1.0 Introduction

1.1 Background

In Order No. P.U. 43 (2009), the Board required Newfoundland Power to submit a comprehensive proposal for the 2011 adoption of the accrual method of accounting for Other Post Employment Benefits (“OPEBs”) costs. The proposal was required to include recommendations and alternatives in relation to a deferral mechanism to capture annual variances in OPEBs costs arising from changes in the discount rate and other assumptions, as well as recovery of the transitional balance associated with the adoption of accrual accounting for OPEBs costs.

On June 30, 2010, Newfoundland Power filed the 2011 OPEBs Application (the “Application”) together with the *Report on Other Post Employment Benefits* in compliance with Order No. P.U. 43 (2009).

In the Application, Newfoundland Power proposed that, effective January 1, 2011:

- (i) it adopt, for regulatory purposes, the accrual method of accounting for OPEBs costs and income tax related to OPEBs;
- (ii) it recover the transitional balance, or regulatory asset, associated with the adoption of accrual accounting for OPEBs costs over a 15-year period using the Mortgage Method; and
- (iii) it adopt an OPEBs Cost Variance Deferral Account to capture annual differences in OPEBs costs arising from changes in assumptions associated with the valuation of OPEBs obligations.

The Board's financial consultant, Grant Thornton LLP ("Grant Thornton") reviewed the Application and concluded in its report that the calculations were accurate.

Reference: Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 13, lines 3 - 13.

In its letter of October 8, 2010, the Board confirmed its satisfaction that the Application complies with Order No. P.U. 43 (2009). The Board further stated that it would consider the Application as filed, and would not require examination of the amount and cost make-up of the components of the OPEBs plan at this time.

Reference: October 8, 2010 Letter of the Board Re: Newfoundland Power Inc. - Other Post Employment Benefits (OPEBs) Proposal

These are the written submissions of Newfoundland Power in support of the Application.

1.2 Evidentiary Matters

The Board is legally required to determine issues on the basis of the evidence before it.

The Application has been reviewed by Grant Thornton. In addition, the Company has responded to written interrogation by the Consumer Advocate. Neither of these processes has raised any material issue regarding the reasonable accuracy of the evidence placed before the Board by the Company. Accordingly, the procedural history of the Application has provided an evidentiary record which can be relied upon by the Board.

1 Newfoundland Power is mindful that the Board requires evidence as the basis for its decision
2 making, and accordingly, these written submissions specifically address the evidence supporting
3 the Company's proposals which require Board approval. In particular, the evidence clearly
4 indicates that:

- 5 a) the forecast additional cost of 2011 adoption of accrual accounting for OPEBs by
6 Newfoundland Power is \$4 million;
- 7 b) the forecast customer rate impact of (i) adoption of accrual accounting for OPEBs by
8 Newfoundland Power in 2011, and (ii) amortization of the OPEBs regulatory asset
9 commencing in 2011, is between 0.84% and 1.75%, depending upon the amortization
10 method and term approved by the Board; and
- 11 c) the proposed OPEBs Cost Variance Deferral Account will limit the variability of net
12 annual OPEBs costs due to changes in assumptions, such as discount rates, as well as
13 changes due to rate base effects.

14 Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*,
15 page 4 and page 7, Table 5; Grant Thornton, *Report of the Review of*
16 *Newfoundland Power Inc.'s Application of A Comprehensive Proposal*
17 *on Other Post Employment Benefits*, page 8, lines 16 - 22, and page 10, lines
18 44 - 46.
19

20 Given the evidence on the record, it is submitted that the primary matters requiring the
21 application of regulatory judgement of the Board are the amortization method and term to be
22 approved for recovery of the OPEBs regulatory asset.

2.0 Accrual Method of Accounting

2.1 Accounting Standards

Implementation of International Financial Reporting Standards (“IFRS”) for Canadian entities with rate-regulated activities has effectively been postponed for one year by the Canadian Accounting Standards Board. Newfoundland Power intends to defer adoption of IFRS until January 1, 2012, at the earliest. This will practically require any Company adoption of accrual accounting for OPEBs costs on January 1, 2011, to be in accordance with current Canadian generally accepted accounting principles (“GAAP”), as opposed to IFRS.

Reference: Response to Request for Information CA-NP-11; Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 12, lines 1 - 22.¹

Grant Thornton observed that the Company's Application discloses the impact of its proposals on revenue requirement and customer rates under both Canadian GAAP and IFRS. Differences in these accounting standards modestly impact proposed OPEBs cost recovery in 2011. The proposals made in the Application would increase base rates by 0.99% under GAAP, and 1.04% under IFRS.

Reference: Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 12, lines 25 - 31; Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, page 11 - 15.

Due to the practical requirement for Newfoundland Power's accounting for OPEBs costs in 2011 to be in accordance with Canadian GAAP as opposed to IFRS, the Company has used Canadian GAAP for the presentation of OPEBs costs in these written submissions.

¹ The report of Grant Thornton indicated that IFRS adoption might be delayed for rate regulated enterprises to January 1, 2013. This was accurate as of the date of the report. Subsequently, the Canadian Accounting Standards Board decided to effectively delay IFRS adoption for rate-regulated enterprises to January 1, 2012.

2.2 Accrual Accounting for OPEBs

The Board has recognized that Newfoundland Power should move to the accrual method of accounting for OPEBs costs for regulatory purposes (the “Accrual Method”).

Reference: Reasons for Decision: Order No. P.U. 43 (2009), page 35, lines 19 - 21.

In their review of the Application, Grant Thornton noted that accounting for OPEBs costs using the Accrual Method is consistent with both the Company’s accounting for pensions and with the practice of Newfoundland and Labrador Hydro. The Company’s proposal to adopt the Accrual Method for OPEBs costs also is consistent with current Canadian regulatory practice and is in accordance with Canadian GAAP and IFRS.

Reference: Grant Thornton, *Report of the Review of Newfoundland Power Inc.’s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 5, lines 31 - 42.

2.3 OPEBs Costs

Newfoundland Power currently recognizes OPEBs costs on a cash basis for *regulatory purposes* (the “Cash Method”). The Company’s annual OPEBs expense under the Cash Method is equal to the retirement allowances and insurance premiums actually paid in the year. The amount of OPEBs costs included in the Company’s 2010 test year was approximately \$1.7 million.

Newfoundland Power’s forecast 2011 OPEBs costs calculated under the Accrual Method are approximately \$5.7 million.² The difference in forecast 2011 accrual OPEBs costs from that included in the 2010 test year is approximately \$4.0 million.

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, Page 4.

² Newfoundland Power’s forecast 2011 OPEBs costs are based on a discount rate of 6.50% which is the same discount rate used in Newfoundland Power’s amended 2010 general rate application. Actual discount rates will be determined annually and will vary over time.

Adoption of the Accrual Method for OPEBs will result in Newfoundland Power's annual OPEBs costs recovered in customer rates exceeding its annual cash cost of OPEBs for the foreseeable future. This excess will reduce Newfoundland Power's rate base, which will, in turn, reduce the Company's financing requirements. The customer benefits of these reduced financing requirements, or Rate Base Effects, are cumulative – they will increase over time.

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, page 5.

These Rate Base Effects resulting from the adoption of the Accrual Method of accounting for OPEBs were noted by Grant Thornton in their review of the Company's OPEBs Application to be consistent with (i) the asset rate base method adopted by the Company in 2008 and (ii) the inclusion in the Company's rate base of assets and liabilities related to the Company's defined benefit and defined contribution pension plans.

Reference: Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 5, lines 21 - 29.

2.4 Submission

Newfoundland Power submits that the Board should approve, effective January 1, 2011, the adoption for regulatory purposes of the accrual method of accounting for OPEBs costs and income tax related to OPEBs under current Canadian GAAP.

There is no evidence on the record which raises any question as to the appropriateness of the Company's adoption of accrual accounting for OPEBs costs commencing in 2011. In addition,

the evidence on the record is clear as to the 2011 cost of adoption of accrual accounting for OPEBs by Newfoundland Power.

3.0 The OPEBS Transitional Balance

The OPEBs transitional balance represents the cumulative difference between accounting treatments up to the implementation date of the Accrual Method of accounting for OPEBs costs. This transitional balance is reflected in Newfoundland Power's financial statements as a regulatory asset. The value of this regulatory asset is forecast to be approximately \$52.4 million at the end of 2010.

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, page 4 and page 12; Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 9, lines 17 - 20.

The Company's proposal for adoption of the Accrual Method for OPEBs costs would result in no further additions to this regulatory asset.³

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, page 4.

3.1 Amortization Method

Newfoundland Power's proposal addresses both the amortization method and the term for recovery of the OPEBs transitional balance. The Company recommends use of an amortization method that considers the cumulative Rate Base Effects of adoption of accrual accounting for OPEBs costs (the "Mortgage Method"). Under the Mortgage Method, the amortization amount

³ Upon Newfoundland Power's adoption of the accrual method of accounting for OPEBs costs, the value of the OPEBs transitional balance, or regulatory asset, would change only due to (i) amortization of the balance, or (ii) change in accounting standards. For example, anticipated changes in the OPEBs transitional balance as a result of adoption of IFRS are described at pages 10 to 13 of the *Report on Other Post Employment Benefits*.

increases annually, effectively offsetting increasing Rate Base Effects, to achieve more stable recovery of net OPEBs costs over time.

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, pages 5 and 7; Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 8, lines 1 - 6.

Grant Thornton noted that the Mortgage Method is not consistent with Canadian GAAP or IFRS. There can, however, be differences between regulatory accounting policies and GAAP due to differing objectives. Newfoundland Power's analysis shows that amortization using either the Mortgage Method or a simple straight-line method would achieve the same level of OPEBs obligation recovery over the amortization period.⁴

Reference: Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 9, lines 22 – 28; Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, page 8.

3.2 Amortization Term

The term for amortization of the transitional balance proposed by the Company is 15 years. This term provides a reasonable balance between the rate impact on customers and the duration of the impact. A 15-year term roughly corresponds to the estimated average remaining service life ("EARSL") for Newfoundland Power employees who are members of the OPEBs plan.

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, pages 7 and 9.

⁴ Newfoundland Power's interpretation of an alternative amortization method presented in Request for Information CA-NP-8 is that (i) it would not result in recovery of the Company's accrued 2011 OPEBs costs under Canadian GAAP or IFRS; (ii) it would not result in any recovery of the OPEBs transitional balance in 2011, but rather would result in further growth of the transitional balance in 2011; and (iii) it would not capture annual variances in OPEBs costs due to changes in discount rate and other assumptions, but rather would tend to greater variability in OPEBs costs due to assumption changes in later years of the amortization term. In these respects, the amortization method presented in Request for Information CA-NP-8 does not comply with Order No. P.U. 43 (2009). See Response to Request for Information CA-NP-8.

Grant Thornton noted that the Board may wish to consider a term that is equal to EARSL. As of December 31, 2009, EARSL was 14 years.

Reference: Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 9, lines 28 - 30, and page 8, lines 12 - 14.

The impact of such a reduction in amortization term is reasonably estimable from the evidence.

Table 1 provides the pro forma 2011 rate impacts of amortization over 10, 15 and 20-year terms.

Table 1
Pro Forma 2011 Rate Impacts
OPEBs Regulatory Asset Amortization Alternatives
(%)

	10-Year	15-Year	20-Year
Straight-Line Method	1.75	1.43	1.26
Mortgage Method	1.33	0.99	0.84

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, page 7, Table 5.

The impact of a change in amortization term appears to be approximately linear within this range of alternatives. That is, the 2011 rate impact of a 14-year term would be approximately 1/15th higher than that of a 15-year term. This is true both for the Mortgage Method and for a simple straight-line basis of amortization.

The Board has recognized that recovery of the transitional balance raises challenges due to competing regulatory principles, particularly the cost of service standard and the principles of customer rate stability and intergenerational equity. Newfoundland Power has considered an appropriate balance of these regulatory principles in developing a comprehensive proposal

1 regarding future OPEBs cost recovery. The Company's proposal reflects a fair and equitable
2 application of relevant regulatory principles. Grant Thornton concurred with the Company's
3 assessment of the appropriate amortization method and term with respect to regulatory
4 principles.

5 Reference: Reasons for Decision: Order No. P.U. 43 (2009), page 35, lines 21 - 24; Evidence
6 of Newfoundland Power, *Report on Other Post Employment Benefits*, pages 8 - 9,
7 and Appendix B; Grant Thornton, *Report of the Review of Newfoundland Power*
8 *Inc.'s Application of A Comprehensive Proposal on Other Post Employment*
9 *Benefits*, page 9, lines 20 - 22.
10

11 **3.3 Submission**

12 Newfoundland Power submits that the amortization method and term to be approved by the
13 Board for recovery of the regulatory asset is a matter of regulatory judgement based on the
14 evidence before the Board. The use of the Mortgage Method and a 15-year amortization term is
15 reasonable based upon the evidence before the Board. Newfoundland Power submits that this is
16 not the *only* reasonable approach. It is Newfoundland Power's submission that the use of the
17 straight-line method and/or a shorter amortization term based on EARSL, as raised for
18 consideration by Grant Thornton, are also reasonable alternatives.
19

20 **4.0 OPEBS Cost Variance Deferral Account**

21 **4.1 The Account**

22 Newfoundland Power proposes the creation of an OPEBs Cost Variance Deferral Account to
23 capture future changes in OPEBs costs from those included in rates. This regulatory mechanism
24 fulfills the requirements of Order No. P.U. 43 (2009) that Newfoundland Power submit
25 recommendations and alternatives in relation to a deferral mechanism to capture annual
26 variances arising from changes in discount rate and other assumptions. The OPEBs Cost

Variance Deferral Account proposed is similar to that approved in Order No. P.U. 43 (2009) for pension expense.

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, Appendix K; Reasons for Decision: Order No. P.U. 43 (2009), page 9, lines 34 - 35 and page 36, lines 8 - 10.

Grant Thornton observed that, similar to pension expense, OPEBs expense is impacted by changes in assumptions. Grant Thornton concluded that the use of the OPEBs Cost Variance Deferral Account will limit the variability of net OPEBs costs due to changing assumptions, such as discount rates, as well as changes related to rate base effects. Grant Thornton also concluded that the existing provisions of the Rate Stabilization Clause allow the flexibility for the disposition of the balance in this deferral account.

Reference: Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 10, lines 20 - 22 and lines 44 - 49.

Grant Thornton noted that the Board may consider removing the Rate Base Effects from the OPEBs Cost Variance Deferral Account definition by replacing 'net OPEBs cost' with 'OPEBs expense'.

Reference: Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 11, lines 1 - 3.

Adoption of accrual accounting for OPEBs will result in Newfoundland Power's annual OPEBs costs recovered in customer rates exceeding its annual cash cost of OPEBs for the foreseeable future. This excess will reduce Newfoundland Power's financing requirements.

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, page 5.

1 In its report, Grant Thornton recommended the Board obtain confirmation from Newfoundland
2 Power to ensure that factors within the Company's control that may impact OPEBs expense are
3 not included in the variances addressed by the OPEBs Cost Variance Deferral Account.

4 Reference: Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application*
5 *of A Comprehensive Proposal on Other Post Employment Benefits*, page 10, lines
6 37 - 42.
7

8 **4.2 Submission**

9 Newfoundland Power confirms that, similar to the Pension Expense Variance Deferral Account,
10 the purpose of the OPEBs Cost Variance Deferral Account is not to address OPEBs cost
11 variances that result from factors within the Company's control such as a change in plan benefits.

12
13 On the issue of the proposed inclusion of Rate Base Effects in the OPEBs Cost Variance Deferral
14 Account, Newfoundland Power submits that it included Rate Base Effects as part of its
15 comprehensive proposal to fully reflect the customer benefits of reduced financing requirements
16 resulting from the adoption of the Accrual Method for OPEBs costs. There is no evidence that
17 these benefits will be reflected in customer rates on an ongoing basis if they are not accounted
18 for in the OPEBs Cost Variance Deferral Account.⁵

19
20 Newfoundland Power submits that the Board should approve the OPEBs Cost Variance Deferral
21 Account filed as Appendix K to the *Report on Other Post Employment Benefits*.

⁵ In this respect Newfoundland Power's unfunded OPEBs plan differs from its funded pension plan. Pension plan funding serves to reduce annual pension expense, and these reductions are captured by the Pension Expense Variance Deferral Account on an annual basis. The customer benefits of pension plan funding are thus reflected in customer rates on an ongoing basis.

5.0 Cost Recovery

Newfoundland Power proposes that an appropriate level of increased OPEBs cost recovery for the Company in 2011 would include the recovery of (i) accrual OPEBs costs, and (ii) an amortization of the OPEBs transitional balance, or regulatory asset, as determined by the Board. Given that Newfoundland Power will not be adopting IFRS in 2011, these amounts should be determined in accordance with Canadian GAAP.

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, page 13; Response to Request for Information CA-NP-11.

Newfoundland Power's customer rates currently recover approximately \$1.2 million in operating costs related to OPEBs. Recovery of the additional amounts, based upon use of the Mortgage Method and a 15-year amortization term, as proposed by the Company, would require an increase in 2011 revenue requirement of approximately \$5.2 million and an increase in 2011 base rates of 0.99%. Revenue requirement and base rate impacts will vary depending upon the transitional balance amortization method and term approved by the Board.

Reference: Evidence of Newfoundland Power, *Report on Other Post Employment Benefits*, page 14, table 9; Grant Thornton, *Report of the Review of Newfoundland Power Inc.'s Application of A Comprehensive Proposal on Other Post Employment Benefits*, page 13, lines 10 - 13.


The Board's application schedule has a targeted decision date of December 10, 2010. A Board order by this date will enable the necessary changes to customer rates to be made for Newfoundland Power to effect a comprehensive adoption of accrual accounting for OPEBs costs as of January 1, 2011.

Reference: 2011 OPEBs Application Schedule.

6.0 Conclusions

In Order No. P.U. 43 (2009), the Board required Newfoundland Power to submit a comprehensive proposal for the 2011 adoption of the accrual method of accounting for OPEBs costs, by no later than June 30, 2010. Newfoundland Power has fully complied with this order. The evidence submitted on this Application provides a sound basis for regulatory decision-making to enable Newfoundland Power to adopt the accrual method of accounting for OPEBs costs as of January 1, 2011.

RESPECTFULLY SUBMITTED at St. John's, Newfoundland and Labrador, this 26th day of November, 2010.



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