



Grant Thornton

An instinct for growth™

Board of Commissioners of Public Utilities
120 Torbay Road
Prince Charles Building
St. John's, NL
A1A 5B2

Attention: Ms. Doreen Dray

September 28, 2012

Dear Ms. Dray,

**Re: Newfoundland and Labrador Hydro
2011 Average Rate Base and 2011 Average Deferred Charges**

Grant Thornton LLP
187 Kenmount Road
St. John's, NL
A1B 3P9
T +1 709 722 5960
F +1 709 722 7892
www.GrantThornton.ca

We have completed our review of Newfoundland and Labrador Hydro's ("the Company's") 2013 Capital Budget Application (Section L) as it pertains to the calculation of the 2011 average rate base and 2011 average deferred charges.

The results of our review are noted below:

2011 Average Rate Base Calculation and 2011 Average Deferred Charges

The average rate base for 2011 and 2010 as calculated by the Company and provided in Section L, Page L-1 of its 2013 Capital Budget Application is \$1,493,218,000 and \$1,483,882,000 respectively. The average deferred charges for 2011 and 2010 provided in Section L, Page L-1 are \$68,047,000 and \$71,924,000, respectively.

Our procedures with respect to verifying the calculation of the 2011 average rate base and 2011 average deferred charges were directed towards the verification of the data incorporated in the calculations and the methodology used by the Company. Specifically, the procedures which we performed included the following:

- agreed all carry-forward data to supporting documentation including audited financial statements and internal accounting records and reports, where applicable;
- agreed component data (capital expenditures, depreciation, etc.) to supporting documentation;
- checked the clerical accuracy of the continuity of the rate base and deferred charges for 2011; and

- reviewed the methodology used in the calculation of the average rate base with reference to the Public Utilities Act, the Hydro Corporation Act and Board Orders.

Based upon the results of the above procedures we note the following:

- In P.U. 14 (2009) the Board approved the creation of a Conservation Cost Deferral Account with costs estimated at \$1.8 million. Pursuant to P.U. 4 (2011) Hydro received approval to defer 2011 costs related to the Conservation Plan estimated at \$840,000. Actual costs deferred in 2011 were \$474,000. According to the Company, the majority of the 2011 variance between estimated costs and actual CDM costs continues to be the Industrial Energy Efficiency Program and lack of participation. The Industrial program had a budget of \$564,000 for 2011 but only \$98,000 was spent and deferred.
- In 2011 the Company recorded an asset retirement obligation of \$19,126,000 which is associated with the Holyrood Thermal Generating Station - \$16,963,000 and the disposal of Polychlorinated Biphenyls - \$2,163,000. The Company has also recorded accumulated amortization of \$1,149,000 associated with the asset retirement obligations. The Company has disclosed in Note 8 to its 2011 financial statements that the total undiscounted estimated cash flows required to settle the asset retirement obligations at December 31, 2011 is \$30.4 million with payments expected to occur between 2012 and 2025. The \$19,126,000 represents the discounted estimated cash flows as at December 31, 2011. Under Generally Accepted Accounting Principles (“GAAP”) an asset retirement obligation is added to the cost of the associated asset. The Company has included this obligation in the cost of property, plant and equipment but has excluded the amount from rate base.
- The 2010 computation of rate base as presented in Return 3 in the amount of \$1,483,882,000 has been restated to exclude average net assets not in service from the average rate base. According to Hydro, these assets are not in operation and have been deemed to not be of benefit to current customers as they are not required in the provision of service. The impact of the adjustment to the average rate base for 2010 was \$777,000. The adjustment had a negligible impact on the rate of return on rate base for 2010. In P.U. 2 (2012) the Board fixed and determined the 2010 rate base at \$1,484,659,000. The impact on the calculation of average rate base for average net assets not in service for 2011 was \$423,000. A breakdown of assets not in operation at December 31, 2010 is as follows:

	As at December 31		
	<u>2009</u>	<u>2010</u>	<u>Average</u>
Island Interconnected			
Distribution			
BCX Barachois Dist Sys 107	-	255,387	127,694
EHW English Hr. West, Dist	-	227,592	113,796
FDL Fleur De Lys, Dist Sys 106	-	246,206	123,103
Terminal Stations			
SVL Abitibi, Stephenville	23,808	21,261	22,534
SVL Term Str, Stpville Gas	305,149	276,315	290,732
Transmission Lines			
SVL TL 238, SVL to SVL Atibi	98,621	95,987	97,304
Labrador Isolated			
General Plant			
NAT Natuashish Diesel System	952	845	898
Info Systems & Telecom Assets			
NAT Natuashish Diesel System	1,013	373	693
Grand Total	<u>\$429,543</u>	<u>\$1,123,966</u>	<u>\$776,755</u>

- In 2011 the Company included \$2,001,920 in capital assets that were included in the 'Allowance for Unforeseen Events' which the Board viewed as unauthorized expenditures. On April 16, 2012 the Board directed the Company to make an application within the next 30 days to remedy the breaches. An application was not filed by Hydro within the 30 days. Currently it remains uncertain if these costs can be included in the 2011 rate base. The following table provides the impact on average rate base under various scenarios:

Outcome	Impact on Average Rate Base	2011 Average Rate Base - revised
Board approves 'Allowance for Unforeseen Events' of \$2,001,920 as filed	-	\$1,493,218,000
Board approves 'Allowance for Unforeseen Events' of \$1,000,000 as approved in P.U. 5 (2012)	(\$500,000)	\$1,492,717,000
Board approves 'Allowance for Unforeseen Events' of \$1,482,000 relating to the 'Charlottetown Additional	(\$260,000)	\$1,492,958,000

Generating Capacity' project		
------------------------------	--	--

Based upon the results of the above procedures we noted the following discrepancies in the calculation of the 2011 average rate base:

- The 2010 computation of average rate base was restated to \$1,483,882,000 (an adjustment of \$777,000 to average rate base) due to Hydro removing assets that were not in operation and deemed to not be of benefit to current customers as they are not required in the provision of service.
- Included in the 2011 average rate base are 2011 capital asset purchases of \$2,001,920 where there is uncertainty whether these expenditures are authorized. The impact on the 2011 average rate base remains uncertain until the Board makes a decision what expenditures should be included in rate base.

We did not note any discrepancies in the 2011 average deferred charges, and therefore conclude that the average deferred charges of \$68,047,000, included in Section L, Page L-1 of the Company's Application is accurate and in accordance with Board Orders and established regulatory practice.

I trust this is the information you requested. If you have any questions, please contact me.

Yours sincerely,
Grant Thornton LLP



Steve Power, CA
Partner