

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

August 26, 2016

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Dear Mr. Byrne,

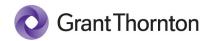
Re: Newfoundland Power Inc. 2017 Capital Budget Application

We have completed our review as requested in your letter dated August 5, 2016 relating to Newfoundland Power Inc.'s (the "Company's") 2017 Capital Budget Application as it pertains to the calculation of the 2015 actual average rate base and the calculations of the 2016 and 2017 forecast rate base additions, deductions and allowances.

The results of our review for each required task are noted below:

2015 AVERAGE RATE BASE CALCULATION

Pursuant to P.U. 32 (2007), the Board of Commissioners of Public Utilities (the "Board") approved the Company's proposal to complete its transition to the Asset Rate Base Method ("ARBM") commencing January 1, 2008. The actual average rate base for 2015 as calculated by the Company under the ARBM and provided in Schedule D of its Application is \$1,019,082,000 which is an increase of \$54,152,000 (5.6%) over the average rate base for 2014 of \$964,930,000.



The net change in the Company's average rate base from 2014 to 2015 can be summarized as follows:

(000's)	2015	2014
Average rate base - opening balance	\$ 964,930	\$ 915,820
Change in average deferred charges and		
deferred regulatory costs	(1,614)	3,200
Average change in:	, ,	
Plant in service	82,016	76,485
Accumulated depreciation	(22,498)	(21,605)
Contributions in aid of construction	(1,164)	(1,347)
Weather normalization reserve	4,735	1,582
Other post-employment benefits	(7,847)	(8,909)
Future income taxes	302	(13)
Rate base allowances	996	52
Other rate base components (net)	(774)	(335)
Average rate base - ending balance	\$ 1,019,082	\$ 964,930

Our procedures with respect to verifying the calculation of the average rate base 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, where applicable;
- agreed component data (capital expenditures; depreciation; etc.) to supporting documentation;
- checked the clerical accuracy of the continuity of the rate base for 2015; and
- agreed the methodology used in the calculation of the average rate base to the Public Utilities Act to ensure it is in accordance with Board Orders and established policy and procedure.

Based upon the results of the above procedures we did not note any discrepancies in the calculation of the 2015 average rate base, and therefore conclude that the 2015 average rate base included in Schedule D of the Company's Application is accurate and in accordance with established practice and Board Orders.



RATE BASE ADDITIONS, DEDUCTIONS AND ALLOWANCES

In compliance with P.U. 19 (2003), Newfoundland Power Inc. has filed evidence with the Board pertaining to its forecast deferred charges, including pension costs, to be included in the calculation of the forecast average rate base for 2016 and 2017 in its 2017 Capital Budget application. The report also provides a comprehensive review of all additions, deductions and allowances included in the rate base, with the exception of plant investment. The 2016 and 2017 forecast rate base additions, deductions and allowances are consistent with the calculation of the Company's 2016 and 2017 forecast average rate base approved in P.U. 25 (2016). Each, in turn, is reviewed below.

RATE BASE ADDITIONS

The forecast additions to rate base for 2016 and 2017 and the actual additions in 2014 and 2015 as presented by the Company are as follows:

(\$000's)	Actual 2014	Actual 2015	Forecast 2016	Forecast 2017
Deferred Pension Costs	\$ 103,939	\$ 98,829	\$ 94,775	\$ 93,314
Credit Facility Issue Costs	72	56	-	-
Cost Recovery Deferral – Seasonal/TOD Rates	68	49	-	-
Cost Recovery Deferral – Hearing Costs	322	-	800	400
Cost Recovery Deferral – Amortizations	1,107	-	-	-
Cost Recovery Deferral – 2012 Cost of Capital	588	-	-	-
Cost Recovery Deferral – 2013 Revenue	1,126	-	-	-
Shortfall				
Cost Recovery Deferral – Conservation	4,937	7,463	10,324	13,659
Customer Finance Programs	1,136	1,211	1,136	1,136
Total Additions	\$ 113,295	\$ 107,608	\$ 107,035	\$ 108,509

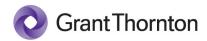
Source: Newfoundland Power Inc. - 2017 Capital Budget Application Report on Rate Base: Additions, Deductions & Allowances - Table 1

Our comments with respect to the additions to rate base are noted below:

Deferred Pension Costs

Deferred pension costs are the result of the pension funding exceeding the pension expense as determined in accordance with the recommendations of U.S. GAAP.

According to the table below, the forecast pension plan funding for 2016 and 2017 is \$3,250,000 and \$3,361,000 and the forecast pension plan expense is \$7,304,000 and \$4,822,000 for 2016 and 2017 respectively. The difference between the funding and the expense, as indicated below, represents the decrease in deferred pension costs forecast for 2016 and 2017.



(\$000's)	Actual 2014	Actual 2015	Forecast 2016	Forecast 2017
Deferred Pension Costs, January 1	\$101,159	\$103,939	\$98,829	\$94,775
Pension Plan Funding Pension Plan Expense	13,864 (11,084)	10,213 (15,323)	3,250 (7,304)	3,361 (4,822)
Increase/(decrease) in Deferred Pension Costs	2,870	(5,110)	(4,054)	(1,461)
Deferred Pension costs, December 31	\$ 103,939	\$98,829	\$ 94,775	\$ 93,314

Source: Newfoundland Power Inc. - 2017 Capital Budget Application Report on Rate Base: Additions, Deductions & Allowances - Table 3

The forecast pension expense for 2016 and 2017 is \$7,304,000 and \$4,822,000 respectively compared to an actual expense in 2015 of \$15,323,000. According to the Company, the decrease in forecast expense in 2016 and 2017 is primarily related to updated participant data used in the most recent actuarial valuation resulting in an increase in the average remaining service life for active employees, reflecting the demographics of a closed plan. The increase in average remaining service life has extended the period over which actuarial gains and losses are amortized into expense for accounting purposes. The forecast pension expense included in the table above is consistent with calculations provided by the Company's actuary. Based on our review of information provided by the Company, the forecast pension expense is calculated in accordance with the recommendations of U.S. GAAP and relevant Board Orders.

The forecast pension funding for 2016 and 2017 per Table 3 of the Rate Base: Additions, Deductions & Allowances report is \$3,250,000 and \$3,361,000 respectively, compared to actual funding in 2015 of \$10,213,000. The forecast funding amounts have been agreed to schedules provided by the Company's actuary. The pension funding for 2015 included special funding payments of \$7.0 million. There are no special funding payments forecast for 2016 and 2017.

Based on our review of forecast deferred pension costs, we confirm that we have not noted any discrepancies or unusual items.

Deferred Credit Facility Issue Costs

In August 2014, the committed credit facility of 100 million was renegotiated to extend its maturity date to August 2019. Costs related to the amendment totalled \$80,000 and are being amortized over the 5-year life of the agreement, beginning in 2014.

For 2014 and 2015, the unamortized credit facility costs are included in rate base as the costs did not make up part of the Company's revenue requirements.

In the 2016/2017 General Rate Application, the Company proposed the unamortized credit facility costs for 2016 and 2017 be included as a component of the Company's cost of capital.



As these costs are to be reflected in revenue requirements for 2016 and 2017, they are not included in rate base for 2016 and 2017.

Based on our review of forecast deferred credit facility issue costs, we confirm that we have not noted any discrepancies or unusual items.

Cost Recovery Deferral - Seasonal/TOD Rates

On July 1, 2011 the Board approved the creation of the Optional Seasonal Rate Revenue and Cost Recovery Account by way of P.U. 8 (2011). This account is charged with: (i) the current year revenue impact of making the Domestic Seasonal – Optional Rate available to customers and (ii) the operating costs associated with implementing the Domestic Seasonal – Optional and the Time-of-Day Rate Study.

In the 2016/2017 General Rate Application, the Company did not propose that the Optional Seasonal Rate Revenue and Cost Recovery Account be maintained beyond 2015. Accordingly the December 31, 2015 balance was the final disposition to the RSA.

Based on our review of forecast deferred seasonal/TOD rates, we confirm that we have not noted any discrepancies or unusual items. The forecast deferred seasonal/TOD rates are consistent with approved Board Orders.

Cost Recovery Deferral – Hearing Costs

In P.U. 13 (2013), the Board approved a three year amortization period for the recovery of hearing costs related to the Company's 2013 General Rate Application "in the amount of \$1,250,000" beginning in 2013. The actual external costs incurred for the 2013 General Rate Application were \$965,000. These costs were fully amortized in 2015.

In P.U. 18 (2016), the Board approved hearing costs of up to \$1.0 million related to the 2016/2017 General Rate Application to be recovered in customer rates over the period July 1, 2016 through December 31, 2018.

Based on our review of forecast deferred cost recovery relating to hearing costs, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

Cost Recovery Deferral - 2010 Regulatory Amortizations

On November 29, 2010, the Board issued P.U. 30 (2010) to approve the deferred recovery of 2011 costs of \$1,642,000 after tax until a further Order of the Board.

On October 27, 2011, the Board issued P.U. 22 (2011) to approve the deferred recovery of 2011 costs of \$1,677,000 after tax until a further Order of the Board.



In P.U. 13 (2013) the Board approved the amortization of these deferrals over three years using the straight-line method, commencing in 2013. These costs were fully amortized in 2015.

Based on our review of forecast Cost Recovery Deferral – 2010 Regulatory Amortizations, we confirm that we have not noted any discrepancies or unusual items. Cost Recovery Deferral – 2010 Regulatory Amortizations are consistent with approved Board Orders.

Cost Recovery Deferral - 2012 Cost of Capital

The Board issued P.U. 17 (2012) approving the deferred recovery of the amount of the difference in revenue for 2012 which was an after tax amount of \$1,766,000 relating to the determination of Newfoundland Power's 2012 cost of capital.

In P.U. 13 (2013), the Board approved the amortization of the deferral over three years using straight-line method, commencing in 2013. The costs were fully amortized in 2015.

Based on our review of forecast Cost Recovery Deferral – 2012 Cost of Capital, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

Cost Recovery Deferral - 2013 Revenue Shortfall

In P.U. 13 (2013), the Board approved the proposed amortization over three years, commencing in 2013, of the 2013 revenue shortfall resulting from the implementation of new rates after January 1, 2013.

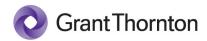
In P.U. 23 (2013), the Board approved the revenue shortfall in the amount of \$2,815,000 after tax. These costs were fully amortized in 2015.

Based on our review of forecast Cost Recovery Deferral – 2013 Revenue Shortfall, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

<u>Cost Recovery Deferral – Conservation</u>

On April 17, 2013, the Board issued P.U. 13 (2013) and approved the deferral of annual customer energy conservation program costs and the amortization of annual costs over seven years beginning in 2014 with recovery through the Rate Stabilization Account.

Based on our review of forecast deferred cost recovery relating to conservation and amortization of annual costs, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.



Customer Finance Programs

As indicated by the Company, Customer Finance Programs are loans provided to customers for purchase and installation of products and services related to conservation programs and contributions in aid of construction.

As part of the Company's transition to Asset Rate Base Method (ARBM) in 2008, inclusion of certain other assets and liabilities was required, including Customer Finance Programs receivables. The 2016 and 2017 forecast Customer Finance Programs receivable balance is fairly comparable with 2015 and 2014 and therefore appears reasonable.

RATE BASE DEDUCTIONS

The forecast deductions to rate base for 2016 and 2017 and the actual figures for 2014 and 2015 as presented by the Company are as follows:

(\$000's)	Actual 2014	Actual 2015	Forecast 2016	Forecast 2017
Cost Over Recovery – 2016 Revenue Surplus	\$ -	\$ -	\$ 1,465	\$ 733
Weather Normalization Reserve	1,640	(4,411)	-	-
Other Post-Employment Benefits	32,435	39,208	45,829	51,608
Customer Security Deposits	660	1,286	700	700
Accrued Pension Liabilities	4,635	4,955	5,266	5,589
Future Income Taxes	2,529	1,268	2,320	5,135
Demand Management Incentive Account	446	-	-	-
Excess Earnings	49	49	-	
Total Deductions	\$ 42,394	\$ 42,355	\$ 55,580	\$ 63,765

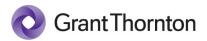
Source: Newfoundland Power Inc. - 2017 Capital Budget Application Report on Rate Base: Additions, Deductions & Allowances - Table 12

Our comments with respect to the deductions to rate base are noted below:

Cost Over Recovery - 2016 Revenue Surplus

As a result of the Board's decisions included in P.U. 18 (2016) the 2016 revenue shortfall proposed by the Company shifted to a revenue surplus of \$2,600,000 (\$1,800,000 after tax). The Board order provided for a credit of the 2016 revenue surplus through a regulatory amortization beginning July 1, 2016 and concluding on December 31, 2018.

Based on our review of the forecast cost over recovery – 2016 revenue surplus, we confirm that we have not noted any discrepancies or unusual items.



Weather Normalization Reserve

In P.U. 13 (2013) the Board approved the disposition of the annual balance in the Weather Normalization Reserve Account through the Rate Stabilization Account. At this time the Board also approved the amortization of the 2011 ending balance in the Weather Normalization Reserve of \$5,020,000 over three years beginning in 2013. The 2011 ending balance was fully amortized during 2015.

The disposition of the December 31, 2015 balance to the Rate Stabilization Account as of March 31, 2016 was approved in P.U. 11 (2016).

Based on our review of the forecast weather normalization reserve, we confirm that we have not noted any discrepancies or unusual items.

OPEBs Liability

On June 30, 2010, the Company submitted an application to the Board requesting approval for the 2011 adoption of accrual accounting for OPEBs for regulatory purposes. Under the accrual basis, OPEBs costs are recognized as an expense as employees earn the benefits that they will receive after retirement. The application also addressed treatment of the projected OPEBs transitional balance as at January 1, 2011 and the creation of an OPEBs Cost Variance Deferral Account. On December 10, 2011, P.U. 31 (2010) approved the adoption of the accrual method of accounting for OPEBs costs and income tax related to OPEBs effective January 1, 2011 and the amortization using the straight line method over a 15-year period of the transitional balance estimated to be \$52,400,000. The actual transitional balance was \$52,560,000 resulting in annual amortization of \$3,504,000.

The total amount of the deduction to rate base related to OPEBs for 2015 is \$39,208,000 with \$45,829,000 and \$51,608,000 forecast for 2016 and 2017 respectively. The actual and forecast OPEBs are consistent with calculations provided by the Company's actuary.

Customer Security Deposits

Customer Security Deposits are provided by customers in accordance with the Schedule of Rates, Rules and Regulations.

As part of the transition to ARBM in 2008 the inclusion of Customer Security Deposits was required as a component of rate base. The 2015 balance of Customer Security Deposits is higher than 2014 and forecast 2016 and 2017 as a result of a new commercial customer that was required to pay a security deposit of approximately \$600,000. According to the Company deposits of this nature are not considered common and the 2016 and 2017 forecast are based on a historical average that generally do not include onetime occurrences such as this large deposit included in the 2015 balance.



Accrued Pension Liabilities

Accrued pension liabilities represent the executive and senior management supplemental pension benefits comprised of a defined benefit plan (Pension Uniformity Plan - PUP) and a defined contribution plan (Supplementary Employee Retirement Plan - SERP). The balance represents the cumulative costs of these unfunded plans, net of associated benefit payments.

As part of the transition to ARBM in 2008 the inclusion of accrued pension liabilities was required as a component of rate base. The 2016 and 2017 forecast accrued pension liabilities are increasing each year by a comparable amount as experienced in 2015.

Future Income Taxes

Future Income Taxes arise due to the Board's approval of the Company's use of tax accrual accounting related to plant investment, pension costs and other employee future benefit costs.

According to the Company, the increase in deferred income taxes for 2016 and 2017 forecast is primarily due to accelerated write offs for tax purposes (i.e. capital cost allowance (CCA)) on certain large capital projects. Based on our review of Future Income Tax balances, we confirm that we have not noted any material discrepancies or unusual items, and it is consistent with approved Board Orders.

Demand Management Incentive Account

In P.U. 32 (2007) the Board approved the Company's proposal to establish the Demand Management Incentive Account ("DMI").

In P.U. 7 (2014) the Board approved a debit transfer of \$383,000 equal to the balance in the 2013 DMI account plus related income tax effects to the Rate Stabilization Account as at March 31, 2014.

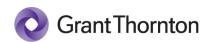
In P.U. 8 (2015) the Board approved a credit transfer of \$628,000 equal to the balance in the 2014 DMI account plus related income tax effects to the Rate Stabilization Account as at March 31, 2015.

The 2015 DMI was \$Nil as there was no supply cost variance outside the Deadband.

Based on our review of forecast DMI, we confirm that we have not noted any discrepancies or unusual items, and it is consistent with approved Board Orders.

Excess Earnings

In P.U. 23 (2013) the Board approved the definition of the Excess Earnings Account. In 2013, Newfoundland Power's regulated earnings exceeded the upper limit of allowed regulated earnings by \$49,000 after tax.



In P.U. 25(2016) the Board approved the 2016 and 2017 revenue requirements which included the excess earnings amount. The balance of the excess earnings account will be zero as of December 31, 2016.

RATE BASE ALLOWANCES

The Rate Base allowances included in the Company's rate base are the Cash Working Capital ("CWC") allowance and the Materials and Supplies allowance. These represent the average amount of investor-supplied working capital necessary to provide service. The 2016 and 2017 forecast CWC and the Materials and Supplies allowance are based the method used to calculate the 2016/17 average rate base as approved by the Board in P.U. 18 (2016).

Based on our review of the Rate Base Allowances, we have not noted any discrepancies or unusual items and the forecast for 2016 and 2017 is consistent with 2016/17 test year data.

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

Yours sincerely,

Grant Thornton LLP

Steve Power, CPA, CA

Partner