

Transparency and Accountability Report

2017



June 2018





## Message from the Boards of Directors

Honourable Siobhan Coady  
Minister of Natural Resources  
Government of Newfoundland and Labrador  
P. O. Box 8700  
St. John's, NL  
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Dear Minister Coady:

In accordance with the *Transparency and Accountability Act*, I am pleased to submit the 2017 Annual Performance Report on behalf of the Board of Directors of Nalcor Energy.

The 2017-2019 Strategic Plan for Nalcor Energy outlined the applicable strategic directions of the Provincial Government in relation to the energy sector, as communicated by the Minister of Natural Resources.

This Performance Report will present performance results and accomplishments for the calendar year 2017 for Nalcor Energy. As the Board of Directors of Nalcor Energy, we are accountable for the preparation of this report and are accountable for the results.



Chair, Board of Directors  
Nalcor Energy



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## 1 OVERVIEW

Nalcor Energy (Nalcor), a Category 1 public body, is Newfoundland and Labrador’s energy company leading the development of the province's energy resources. The company’s business includes the development, generation, transmission and sale of electricity; the exploration, development, production and sale of oil and gas; industrial fabrication site management; and energy trading. Nalcor is leading the development of the province’s energy resources and has a corporate-wide framework that facilitates the prudent management of its assets while continuing an unwavering focus on the safety of its workers, contractors and the public.

Nalcor is a provincial Crown corporation established in 2007 under a special act of the Legislature of the Province of Newfoundland and Labrador. In 2016, Nalcor’s executive structure was reorganized to allow for the separation of Nalcor’s regulated business (Newfoundland and Labrador Hydro) from its unregulated business operations. Nalcor’s legal structure at December 31, 2017 included the entities listed below.

Entity Name	Description of Interest
Newfoundland and Labrador Hydro (Hydro)	Wholly owned subsidiary
Nalcor Energy – Oil and Gas Inc. (Oil and Gas)	Wholly owned subsidiary
Nalcor Energy – Bull Arm Fabrication Inc. (Bull Arm Fabrication)	Wholly owned subsidiary
Nalcor Energy Marketing Corporation (Energy Marketing)	Wholly owned subsidiary
Muskrat Falls Corporation (Muskrat Falls)	Wholly owned subsidiary
Labrador Transmission Corporation (Labrador Transco)	Wholly owned subsidiary
Labrador-Island Link Holding Corporation (LIL Holdco)	Wholly owned subsidiary
Labrador-Island Link Limited Partnership (LIL LP)	Limited partnership in which Nalcor, through LIL Holdco, owns 100 per cent of the 75 Class A and 1 Class C limited partnership units and, through LIL GP, 1 General Partner Unit.
Labrador-Island Link General Partner Corporation (LIL GP)	Wholly owned subsidiary
Labrador-Island Link Operating Corporation (LIL OpCo)	Wholly owned subsidiary
Lower Churchill Management Corporation (LCMC)	Wholly owned subsidiary
Churchill Falls (Labrador) Corporation Limited (Churchill Falls)	65.8 per cent owned joint operation of Hydro
Twin Falls Power Corporation Limited (Twin Falls)	33.3 per cent owned joint venture of Churchill Falls
Gull Island Power Corporation (GIPCo)	Wholly owned subsidiary (inactive)
Lower Churchill Development Corporation (LCDC)	51 per cent owned subsidiary of Hydro (inactive)

Headquartered in St. John's, Nalcor's energy portfolio is located throughout the province (see Appendix 1).

## **Mandate**

### **Nalcor**

The mandate of Nalcor, established in legislation under the *Energy Corporation Act*, is to invest in, engage in, and carry out activities in all areas of the energy sector in the province and elsewhere, including:

- Developing, generating, producing, transmitting, distributing, delivering, supplying, selling, exporting, purchasing and using power from wind, water, steam, gas, coal, oil, hydrogen or other products used or useful in the production of power.
- Exploring for, developing, producing, refining, marketing and transporting hydrocarbons and products from hydrocarbons.
- Manufacturing, producing, distributing and selling energy related products and services.
- Research and development.

## **Business Segments**

Nalcor has six business segments in its operating structure: Newfoundland and Labrador Hydro, Power Development, Power Supply, Offshore Development, Energy Markets and Corporate.

The activities of these business segments support the fulfillment of the strategic directions of the Provincial Government for the energy sector. A description of each of the business segments is presented below.

### **Newfoundland and Labrador Hydro**

Hydro is the primary generator of electricity in Newfoundland and Labrador. The utility delivers safe, reliable, and least cost power to utility, industrial, residential and commercial customers in more than 200 communities in the province.

Hydro activities can be grouped as follows:

- Electricity production – Hydro has an installed generating capacity of 1,763 megawatts (MW) which includes the operations of nine hydroelectric generating stations, one oil-fired plant, four gas turbines, and 25 diesel plants, including 20 isolated diesel generating and distribution systems.
- Transmission and distribution – Hydro operates and maintains over 4,400 kilometres of transmission lines and more than 50 high voltage terminal stations which connect to generation and delivery points for Newfoundland Power on the island, industrial customers, and Hydro’s rural distribution systems province-wide. Hydro also operates and maintains approximately 2,700 kilometres of distribution lines throughout the province.
- The Newfoundland and Labrador System Operator (NLSO) provides oversight of the electricity system to reliably meet the changing requirements of electricity customers by utilizing the combination of available generation and power delivery resources to provide service safely, reliably, and cost effectively.
- Customer service activities address the requirements of Newfoundland Power, industrial customers and over 38,600 direct residential and commercial customers in rural Newfoundland and Labrador.
- Electricity system planning involves forecasting electricity requirements in the province and advancing options to ensure adequate supply of generation resources and transmission and distribution infrastructure to reliably meet forecasted electricity demand.

### ***Power Development***

The development of the 824 megawatt Muskrat Falls hydroelectric generating facility on lower Churchill River in Labrador is a key component of the province's energy warehouse. The clean, stable, renewable electricity provides an opportunity for the province to meet its own domestic and industrial needs in an environmentally sustainable way, and also export excess electricity to other jurisdictions where the demand for clean, renewable energy continues to grow. Once construction is complete this asset will become part of the Power Supply segment.

### ***Power Supply***

Power Supply includes Churchill Falls (Labrador) Corporation, the Labrador Transmission Assets, Labrador-Island Link and the Menihek Generating Station.

Nalcor's operation in Churchill Falls is one of the largest underground hydroelectric powerhouses in the world, with a rated capacity of 5,428 megawatts (MW). Safely operating and maintaining its electricity assets, as well as municipal and community services in support of these electricity assets, drives the Churchill Falls strategy.

The Churchill Falls generating station provides clean, renewable electricity to millions of consumers throughout North America. A significant portion of that electricity is being sold to Hydro-Québec under a long-term contract. Churchill Falls sells 525 MW to Hydro for use in the province, with any surplus recapture exported via sales to Nalcor Energy Marketing.

The transmission component of Power Supply Labrador Transmission Assets and the Labrador Island Link comprise the new transmission component of Power Supply, and includes 1,600 km of transmission lines. The Labrador Transmission Assets connect Churchill Falls to the Muskrat Falls terminal station, and the Labrador Island link further connects Muskrat Falls to the construction of over 1,600 km of transmission lines from Churchill Falls Labrador to Soldiers Pond on the island's Avalon Peninsula (including a subsea transmission link connecting Labrador to the island).

Menihek is a 19 megawatt (MW) hydro power generating station located in north-western Labrador that provides electricity to customers in Schefferville, Quebec. It is wholly owned by Nalcor Energy and its operation funded by Hydro-Québec through a long term agreement.

### ***Energy Markets***

Nalcor Energy Marketing is a full service, 24 hour electricity trading operation and is Nalcor's face to the external electricity markets. Nalcor's current energy marketing portfolio includes recapture power that is not required by Hydro to meet electricity customer requirements in

Labrador and firm transmission capacity through Quebec. Nalcor's energy marketing portfolio will grow over the coming years with the completion of the Muskrat Falls hydroelectric facility and related transmission assets.

### ***Offshore Development***

Nalcor's Offshore Development includes Oil and Gas business and Bull Arm Fabrication. Nalcor Energy Oil and Gas manages oil and gas interests and is currently a partner in three developments in the Newfoundland and Labrador offshore oil and gas industry: the Hebron oil field, the White Rose Growth Project, and the Hibernia Southern extension. Through its multi-year exploration strategy, Nalcor Energy Oil and Gas also supports efforts toward further exploration and development of the province's potential offshore and onshore resources.

On March 27, 2018 the Province announced that the oil and gas subsidiary of Nalcor Energy would be established as a stand-alone crown corporation. Planning is underway to effect this transition, which is anticipated to be completed in 2018.

Bull Arm Fabrication manages Atlantic Canada's largest fabrication site. Close to international shipping lanes and Europe, this site has unobstructed, deep water access to the Atlantic Ocean. This facility spans over 2,550 hectares and has integrated and comprehensive infrastructure to support fabrication and assembly of three key project functions, simultaneously, in three separate theatres: Fabrication Yard, Marine Facility, and Deepwater Site. Most recently, the Bull Arm site was fully leased by ExxonMobil Canada Properties for the construction and commissioning phases of the Hebron Project. In 2017, Nalcor Energy issued a Request for Proposals (RFP) to assess proposed use for the Bull Arm Fabrication facility with the goal of securing a tenant(s) that will maximize site utilization and attract sustainable business opportunities.

### ***Corporate***

This business segment includes finance and accounting operations, corporate planning and reporting, corporate communications, shareholder relations, information management, human resources, safety, environment, community investment and all other shared service functions.

## **Values**

Employees of Nalcor and its subsidiaries, including Hydro, are committed to building a bright future for Newfoundland and Labrador, unified by the following core values:

<b>Open Communication</b>	Fostering an environment where information moves freely in a timely manner.
<b>Accountability</b>	Holding ourselves responsible for our actions and performance.
<b>Safety</b>	Relentless commitment to protecting ourselves, our colleagues, and our community.
<b>Honesty and Trust</b>	Being sincere in everything we say and do.
<b>Teamwork</b>	Sharing our ideas in an open and supportive manner to achieve excellence.
<b>Respect and Dignity</b>	Appreciating the individuality of others by our words and actions.
<b>Leadership</b>	Empowering individuals to help guide and inspire others.

## **Primary Clients**

In addition to the clients of its subsidiary, Hydro, Nalcor's clients include:

- Partners in oil and gas projects
- Emera Energy
- Bull Arm Fabrication site tenants
- Supply and service companies in the energy sector and construction sector

## **Number of Employees, Physical Location and Other Key Statistics**

Nalcor, the province's energy corporation, is leading the development of the province's energy resources. As of December 31, 2017, Nalcor had 1,540 employees, with 61 per cent of these employees located in rural parts of the island and Labrador. The gender composition of Nalcor's employee group was 72 per cent male and 28 per cent female; up from 19 percent in 2016. Nalcor is currently implementing a multi-year action plan to support gender equity, diversity and inclusion across all lines of business. In addition to the target-setting initiative established in 2017, Nalcor is committed to implementing diversity and inclusion strategies to attract, recruit, develop and retain members of designated groups including Indigenous peoples, persons with disabilities and members of visible minorities. Nalcor has undertaken a

self-identification census to attain an understanding of the current representation of members of other designated groups within our existing workforce. This information informs initiatives to support increased representation of designated groups and an inclusive work environment for all employees. In 2017, such initiatives included a comprehensive review of Nalcor's recruitment and selection process through a diversity and inclusion (D&I) lens and the launch of a company-wide D&I Champions Committee.

Gender	Rural	Urban	Total	Per cent
Female	169	265	434	28%
Male	768	338	1106	72%
<b>Total</b>	937	603	1540	
<b>Per cent</b>	61%	39%		

### 2017 Consolidated Revenues and Expenses

In 2017, Nalcor had revenues of \$930 million. The majority of Nalcor's revenues are currently generated from electricity sales from Hydro and Churchill Falls and petroleum and natural gas sales in Oil and Gas. Approximately 33 per cent of Nalcor's 2017 expenditures related to fuels and power purchases with operating costs accounting for 25 per cent of expenses; depreciation, depletion, amortization and impairment totaling 35 percent and finance charges accounting for approximately eight per cent. The following table summarizes the 2017 consolidated revenue and expenses for Nalcor.

**Table 1: Nalcor Energy Consolidated Revenue and Expenses 2017**

<i>For the year ended December 31, 2017 (millions of dollars)</i>	\$	%
Revenue		
Energy sales	858	92.3
Other revenue	72	7.7
	930	
Expenses		
Fuels	226	26.1
Power purchased	62	7.1
Operating costs	219	25.3
Production, marketing and transportation costs	36	4.1
Transmission rental and market fees	25	2.9
Depreciation, depletion, amortization and impairment	300	34.6
Exploration and evaluation	1	0.1
Net finance expense	66	7.6
Other expense (income)	23	2.7
Regulatory adjustments	(91)	-10.5
	867	
Profit for the year	63	

The 2017 Consolidated Financial Statements for Nalcor are appended to this document (See Appendix 2).

## 2 HIGHLIGHTS AND PARTNERSHIPS

Nalcor works with a variety of agencies, departments and commissions to execute its mandate. During 2017, Nalcor worked closely with each of these organizations to advance the strategic directions of the Provincial Government related to the energy sector.

### **Department of Natural Resources**

Nalcor works with the Department of Natural Resources in policy-related areas for the various energy sector activities in which the companies engage and supports the companies' efforts to progress all the strategic issues outlined. In 2017, Nalcor and Hydro representatives served as members of the Rate Mitigation Committee, chaired by the Department of Natural Resources, which is analyzing options to mitigate future electricity rates.

The acquisition of working interests in offshore oil fields and the company's exploration strategy were coordinated efforts between the department and Nalcor Energy – Oil and Gas. Nalcor and the Department worked together to communicate insights from its exploration strategy to global exploration and production companies. These activities support fulfillment of the strategic direction of government related to the increased exploration and development of energy resources and realizing maximum benefits to the province through the strategic development of our resources

### **Department of Finance**

Nalcor works with the Department of Finance in relation to addressing requirements related to financial structure, dividend policies as well as providing guarantees for the company's debt financing activities. During 2017, the enhanced Federal Loan Guarantee and Nalcor's financing plans and equity requirements are examples of interactions between the Department and Nalcor.

### **Other Departments/Public Bodies**

Nalcor also shares commitments with the Department of Municipal Affairs and Environment, Service NL, and the federal Department of Fisheries and Oceans and Environment Canada in relation to the environmental aspects of the company's activities. Nalcor's subsidiary, NL Hydro, works with the Public Utilities Board and Newfoundland Power. This will be discussed in Hydro's 2017 Report.

### 3 OUTCOMES OF GOALS AND OBJECTIVES

The 2017-2019 Strategic Plan for Nalcor highlighted three strategic issues around which goals and objectives were established. These issues encompass the activities of Nalcor and its subsidiaries. A separate report will be filed by Hydro for 2017.

For each strategic issue, the 2017 objectives and indicators are provided along with a summary of related accomplishments.

#### ISSUE 1: ELECTRICITY SUPPLY

Nalcor's mandate, as established in legislation under the *Energy Corporation Act*, is to invest in, engage in, and carry out activities in all areas of the energy sector in the province and elsewhere. In carrying out this mandate, Nalcor is responsible for developing the province's energy resources to provide Newfoundlanders and Labradorians with a secure and reliable source of electricity to meet their ongoing needs. This mandate supports the strategic direction of government related to energy security and reliability in Newfoundland and Labrador. Through its subsidiary Hydro and its Churchill Falls line of business, Nalcor also undertakes a robust asset management program to ensure ongoing capital investments and maintenance of existing electricity assets to ensure long-term reliable operation of these assets.

During 2017, Nalcor advanced the construction of the Muskrat Falls Project to secure a reliable source of clean, renewable power for customers in the province.

Nalcor invested \$70.2 million in its assets at the Churchill Falls plant, in 2017, to ensure reliable operating condition to ensure these assets are fully functional beyond the expiry of current contractual commitments with Hydro-Quebec in 2041.

#### **Muskrat Falls Project**

Construction of the Muskrat Falls Project continued throughout 2017 with many milestones reached. The project is well advanced with overall construction reaching 89 per cent at the end of 2017.

#### *Power Development (Generation)*

The powerhouse, spillway and three dams are the primary components of the generating facility that span the lower Churchill River to create the reservoir, which is the source of power for the plant. At the end of the year, the intake and powerhouse structures were substantially completed. With the powerhouse building constructed and enclosed, work continued on the assembly and installation of the four generating units inside the powerhouse. In 2017, the

generation project reached an important milestone with the completion of the South and North Spur dams, two of the three dams required to create the Muskrat Falls reservoir. Significant progress was also made on the North dam with 40 per cent of work on that dam completed. First power from the generation project is expected late 2019.

#### *Power Supply (Transmission)*

In 2017, Nalcor completed construction of the Labrador-Island Transmission Link (LIL) travelling 1,100 kilometres from Muskrat Falls in Labrador to Soldiers Pond on the Avalon Peninsula. This achievement marked the completion of all transmission line construction required for the project including the Labrador Transmission Assets and the Strait of Belle Isle Marine Cable Crossing. The final key pieces of electrical equipment including transformers for Muskrat Falls, rotors, and stators required at Soldiers Pond were safely delivered to each site and installation work began on each. As construction continued on the switchyards and converter stations, work began on energizing the transmission assets. The transmission project remains on target to bring power from Labrador to the island in mid-2018.

#### **Churchill Falls - Asset Management**

Nalcor's operation in Churchill Falls is one of the largest underground hydroelectric powerhouses in the world, with a rated capacity of 5,428 megawatts (MW). Safely operating and maintaining its electricity assets, as well as municipal and community services in support of these electricity assets, drives the Churchill Falls strategy.

In 2017, Churchill Falls celebrated 46 years since first power. With the plant and related infrastructure aging, asset management is critical to keeping assets in reliable operating condition to provide reliable service to customers for the long-term and to ensure assets are fully functional well beyond the expiry of current commitments in 2041. From 2008-2017, \$399 million was invested to upgrade or replace Churchill Falls assets with annual capital expenditures steadily increasing year over year during a period of ongoing asset renewal to \$70.2 million in 2017. This capital investment, between 2008-2017, was the result of a focus on capital renewal / rehabilitation of aging assets, after approximately 35 years of operation by 2008.

Taking steps to ensure the continued performance of the Churchill Falls facilities through planning and strategic investment will drive the company's strategy for the 2018-2019 planning period and beyond. A long-term asset management plan has been developed that reflects the level of service required of the plant combined with key asset information including condition assessments and operating and maintenance experience. Currently, capital investments for 2018-2019 planning period are forecast to be in excess of \$132 million.

In advancing the Muskrat Falls project, including integration of Muskrat Falls assets into the provincial electricity system and interconnection with the North American grid, and continuing to invest in Churchill Falls assets, Nalcor is ensuring a secure and reliable source of electricity and supports the strategic direction of government related to Energy Security and Reliability for the long-term.

Issue 1: Electricity Supply and Reliability	
Goal: By December 31, 2019, Nalcor will have advanced long-term security and reliability of the province's electricity supply	
Indicators	<ul style="list-style-type: none"> <li>▪ Advanced construction of the Muskrat Falls Project.</li> <li>▪ Prepared for integration into the electricity system.</li> <li>▪ Prepared for interconnection with North American grid.</li> <li>▪ Continued to invest in Churchill Falls assets.</li> </ul>
<p><b>Objective</b></p> <p>By December 31, 2017, Nalcor will have advanced capital projects to enhance electricity supply and reliability for the province.</p>	
INDICATORS	2017 Accomplishments
Achieved key project milestones for generation portion of the Muskrat Falls Project.	<ul style="list-style-type: none"> <li>▪ Safety performance strong compared to industry benchmarks.</li> <li>▪ South Dam completed and North Spur stabilization work completed.</li> <li>▪ Significant work completed on the North Dam.</li> <li>▪ Powerhouse fully enclosed.</li> <li>▪ Successful impoundment to establish winter headpond for the reservoir.</li> <li>▪ Safety/debris/ice boom installed.</li> <li>▪ Balance of Plant contract awarded.</li> <li>▪ Spillway gates under operation by LCP Project Delivery Team.</li> </ul>
Achieved key project milestones for transmission portion of the Muskrat Falls Project.	<ul style="list-style-type: none"> <li>▪ Safety performance strong compared to industry benchmarks.</li> <li>▪ Construction of overland transmission including the Labrador Transmission Assets from Churchill Falls to Muskrat Falls and Labrador-Island Transmission Link from Muskrat Falls to Soldiers Pond substantially complete.</li> <li>▪ AC transmission line from Churchill Falls to Muskrat Falls was energized to support the Labrador East electricity load during winter 2017.</li> <li>▪ At Soldiers Pond, the AC assets are complete, have been handed over to Hydro, and are in operation.</li> <li>▪ The Strait of Belle Isle marine cable crossing complete and ready</li> </ul>

Issue 1: Electricity Supply and Reliability	
	for energization.
Prepared for commissioning of Muskrat Falls Assets.	<p><u>Power Development:</u></p> <ul style="list-style-type: none"> <li>▪ Site completion team hiring in preparation for upcoming electrical and mechanical commissioning scope was completed.</li> <li>▪ Working with contractors for the mechanical completion and commissioning scope population of the project completion system.</li> <li>▪ Contractor asset handovers of North Spur, South Dam, safety/Debris/ice boom and Spillways gates (first phase) and ancillaries are accepted.</li> <li>▪ Commissioned Spillway gates and powerhouse overhead crane.</li> </ul> <p><u>Power Supply:</u></p> <ul style="list-style-type: none"> <li>▪ Completed energization and integration of the AC assets at Soldiers Pond terminal station to Hydro’s distribution system.</li> <li>▪ Energization of bus extensions at Churchill Falls complete.</li> <li>▪ Ongoing static commissioning surveillance witnessing of Churchill Falls and Muskrat Falls substations, Soldiers Pond and Muskrat Falls converter stations, and Soldiers Pond Synchronous Condensers.</li> <li>▪ Achieved substantial completions activities at transition compounds and electrode sites.</li> <li>▪ Advanced recruiting site completion teams and commissioning surveillance personnel completed.</li> <li>▪ Ongoing development of energization procedures for converter stations, synchronous condensers, and Muskrat Falls terminal station.</li> <li>▪ Substantially advanced build out of Power Supply Operations team for new assets.</li> <li>▪ Finalizing documentation process for handover and turnover</li> </ul>
Supported commercial arrangements and regulatory requirement for integration of Muskrat Falls assets.	<ul style="list-style-type: none"> <li>▪ Completed interim agreements related to pre-Muskrat Falls commercial arrangement between Hydro and Nalcor Energy Marketing for the import of energy to displace fossil fuel based generation.</li> <li>▪ Supported the advancement of government legislative requirements for an open access transmission regime.</li> </ul>

Issue 1: Electricity Supply and Reliability	
<p>Prepared maintenance plans for assets going into operation in 2017-2018.</p>	<ul style="list-style-type: none"> <li>▪ Advanced the development of detailed maintenance requirements for transmission assets.</li> <li>▪ Established a team of asset specialists to develop maintenance tactics.</li> <li>▪ Identified initial maintenance requirements to be adopted from existing practices and Original Equipment Manufacturer recommendations for the new transmission facilities.</li> <li>▪ Contractor maintaining AC station assets during initial operation until assets are ready to be turned over to company in 2018.</li> <li>▪ Company reviewed and implemented operational maintenance requirements to support the new HVac transmission lines in Labrador which were turned over in 2017.</li> <li>▪ Entered into support agreements with experienced HVdc operators and maintainers to guide development of operations and maintenance requirements through initial operation of the Labrador Island Link HVdc equipment.</li> <li>▪ Established project team to operate and maintain Muskrat Falls spillway facilities during construction until ready to turn over to the operations team.</li> </ul>
<p>Established operating and Maintenance requirements for operation of the transmission facilities including those with Hydro and CF(L)Co.</p>	<ul style="list-style-type: none"> <li>▪ Drafted operating and maintenance scopes of work for Hydro and CF(L)Co to execute on the transmission facilities in preparation of completing formal agreements with these companies in 2018 prior to the assets being turned over to the operations organization to maintain and operate.</li> </ul>
<p>Completed support activities for the operation of Muskrat Falls assets.</p>	<ul style="list-style-type: none"> <li>▪ Advanced the completion of Master Service Agreements for Nalcor to provide all services for the companies which own the new assets.</li> <li>▪ Established a collective agreement between Nalcor and IBEW for operation and maintenance of the new assets.</li> <li>▪ Established the engineering organization within Nalcor to support the operation of the new assets.</li> <li>▪ Advanced the corporate support organization implementation for Finance, HR, Safety, Environment and Indigenous relations.</li> </ul>

Issue 1: Electricity Supply and Reliability	
Reviewed and updated five-year capital plan for CF(L)Co.	<ul style="list-style-type: none"> <li>2018-22 capital plan was reviewed and updated in 2018, and validated by a third party consultant.</li> </ul>
Completed planned 2017 capital investment in CF(L)Co assets.	<ul style="list-style-type: none"> <li>Successfully delivered 2017 capital program for rehabilitation of generation and transmission assets, with continuation of the following rehabilitation programs: transformers, switchyard, gates and structures, and transmission.</li> </ul>

The objectives and indicators for 2018 are consistent with the direction outlined in the 2017-2019 Strategic Plan.

Issue 1: Electricity Supply and Reliability	
<p><b>Objective</b></p> <p>By December 31, 2018, Nalcor will have progressed capital projects for enhancement of the long-term security and reliability of the province’s electricity supply.</p>	
Indicators	<ul style="list-style-type: none"> <li><u>Generation and Transmission:</u> <ul style="list-style-type: none"> <li>Maintained strong safety performance compared to industry benchmarks.</li> </ul> </li> <li><u>Generation Construction:</u> - Achieved Key Project Milestones, including: <ul style="list-style-type: none"> <li>Achieved Pit Free milestone for Unit 1 and Unit 2.</li> <li>Commenced Unit 1 Turbine Assembly.</li> <li>Completed Intake Unit 1 and Unit 2 guides.</li> <li>Completed placement of Roller Compacted Concrete (RCC) at North Dam.</li> <li>Completed planning for full Impoundment.</li> </ul> </li> <li><u>Generation Commissioning:</u> <ul style="list-style-type: none"> <li>Finalized Readiness Plan for Unit 1 Pre/Post Grid Synchronization Tests.</li> <li>Finalized Dynamic Commissioning &amp; Start-Up Plan and Schedule.</li> </ul> </li> <li><u>Transmission Construction:</u> - Achieved Key Project Milestones, including: <ul style="list-style-type: none"> <li>Completed all construction of HVdc Facilities and Transmission infrastructure for LTA and LITL.</li> </ul> </li> </ul>

## Issue 1: Electricity Supply and Reliability

- Transmission Commissioning:
  - Completed Testing and Trial Operation for all LTA Assets; LTA Assets Ready for Power Transfer
  - Completed Testing and Trial Operation for Pole 1 LITL Assets; Pole 1 Ready for Power Transfer.
  - Finalized Commissioning Plan for Bi-Pole Operation.

## ISSUE 2: VALUE FROM ELECTRICITY

As Nalcor carries out its work to safely and responsibly develop Newfoundland and Labrador's energy resources for the maximum benefit for the people of the province, it is keenly aware of the impact its operations have on electricity costs. This mandate supports the strategic direction of government regarding maximized value with regard to the development and export of energy. Capital and financing costs associated with Nalcor's capital projects - through its subsidiary Hydro and, in particular, the Muskrat Falls Project - are not only backed by taxpayers but also passed along to customers through electricity rates.

Nalcor continues to consider the opportunities for minimizing costs of capital while also increasing revenue from its operations. These measures will provide opportunities to manage and mitigate electricity rates for customers after the in-service of the Muskrat Falls Project. Nalcor is focused on successfully completing the Muskrat Falls Project. At the same time the company is continuing to explore and assess opportunities in export markets that could bring value to the province from the sale of surplus energy. The company is investigating all reasonable measures to minimize the impact of the Muskrat Falls Project on electricity customers.

Nalcor currently sells electricity as a participant in the competitive energy markets in Canada and the United States. The current portfolio includes electricity available from the 300 MW recapture energy block available from Churchill Falls to Hydro. To access export markets, Nalcor, through its subsidiary, Hydro, signed a Transmission Service Agreement with Hydro-Québec TransÉnergie (HQT) under HQT's Open Access Transmission Tariff in 2009 and in 2013, Nalcor renewed that agreement for another 10 years. The agreement is for long-term power transmission capacity from Labrador through Quebec to the New York border with the ability to transmit electricity to other markets. In 2017, net income from these activities totaled \$15 million and accounted for 24 per cent of total Nalcor income. During the planning period, Nalcor will pursue all opportunities to optimize the value of the province's electricity portfolio through export sales.

In 2010, CF(L)Co filed a motion with the Quebec Superior Court, requesting the court to amend the extremely low pricing terms of the 1969 Power Contract and the Renewed Power Contract between CF(L)Co and Hydro Québec. The Quebec Superior Court ruled against CF(L)Co in 2014, following which CF(L)Co filed an appeal, which was subsequently ruled against by the Quebec Appeal Court in 2016. Following such rulings against CF(L)Co, CF(L)Co filed an application for leave to appeal to the Supreme Court of Canada which was subsequently granted. The appeal

was heard by the Supreme Court of Canada in December 2017, however, the decision is still pending.

In a second, but unrelated, legal action filed by Hydro Québec in the Québec Superior Court in 2013, Hydro Québec sought a Declaratory Judgment relating to the interpretation of certain terms of the 1969 Power Contract and the Renewed Power Contract (commencing September 1, 2016 and expiring August 31, 2041). In this proceeding, Hydro-Québec sought the Court’s declarations with respect to i) “Continuous Energy” under the Renewed Power Contract and ii) CF(L)Co’s right to sell power beyond the 300 MW recall block provided for in the Power Contract and the Renewed Power Contract on an interruptible basis to third parties. The Quebec Superior Court ruled against CF(L)Co in August 2016. On September 7, 2016 CF(L)Co filed an appeal with the Quebec Court of Appeal. In December 2016, the appeal factum was filed. A court date for the appeal hearing is yet to be assigned.

Nalcor’s activities to extract maximum value from its electricity portfolio and to investigate options for reducing project costs all serve to support the strategic direction of government of maximized value.

Issue 2: Value from Electricity	
Goal: By December 31, 2019, Nalcor will have advanced efforts to maximize the overall value from the electricity resources for the people of the province.	
Indicators	<ul style="list-style-type: none"> <li>▪ Advanced opportunities to mitigate rates.</li> <li>▪ Advanced opportunities to maximize value from, electricity sales and new developments.</li> </ul>
<b>Objective</b>	
By December 31, 2017, Nalcor will have assessed options to increase value from electricity resources in the province.	
INDICATORS	2017 ACCOMPLISHMENTS
Investigated options to mitigate impact of Muskrat Falls Project costs on electricity rates.	<ul style="list-style-type: none"> <li>▪ Nalcor/Hydro representatives served as members of the Rate Mitigation Committee, chaired by the Department of Natural Resources, which is analyzing options to mitigate future electricity rates.</li> <li>▪ Nalcor and Hydro finalized commercial arrangements to import off-Island power purchases to offset production at the Holyrood Thermal Generating Station upon commissioning of the Maritime Link. As part of its 2017</li> </ul>

Issue 2: Value from Electricity	
	<p>General Rate Application, Hydro proposed that the savings that result from the off-island purchases be collected into a deferral account that would be used to smooth the customer transition to higher rates. This proposal remains under review as part of the General Rate Application before the PUB.</p>
<p>Continued to implement measures to maximize portfolio value such as targeting higher proceed markets and times to exceed the energy price benchmark.</p>	<ul style="list-style-type: none"> <li>▪ Nalcor Energy Marketing delivered 99 percent of available surplus Recapture to market.</li> <li>▪ Nalcor Energy Marketing exceeded its New York energy price benchmark performance measure by 52 per cent, primarily by timing deliveries towards higher priced hours combined with directing energy to higher priced markets.</li> </ul>
<p>Continued preparations for Upper Churchill Power Contract legal actions.</p>	<ul style="list-style-type: none"> <li>▪ The appeal hearing for the legal action brought by CF(L)Co in 2010 addressing the inequities of the 1969 Power Contract pricing terms was held before the Supreme Court of Canada on December 5, 2017. The decision is pending.</li> </ul>
<p>Assessed and engaged potential customers on potential future electricity development for the export market and industrial customer opportunities.</p>	<ul style="list-style-type: none"> <li>▪ Conducted a market sounding to identify opportunities for excess energy sales in Northeastern North American markets, and partnered with Emera Inc. in its proposal to sell energy in response to the Request for Proposals for clean energy issued by distributors in Massachusetts.</li> <li>▪ Engaged with the Federal Government, Atlantic Canadian Governments, and utilities in the Regional Electricity Cooperation and Strategic Infrastructure Initiative.</li> </ul>

The objectives and indicators for 2018 are consistent with the direction outlined in the 2017-2019 Strategic Plan.

Issue 2: Value from Electricity	
<p><b>Objective</b> By December 31, 2018, Nalcor will have advanced opportunities to extract maximum value from the province's electricity resources.</p>	
<p>Indicators</p>	<ul style="list-style-type: none"> <li>▪ Investigated options and, as appropriate, acted upon options to mitigate impact of Muskrat Falls Costs on electricity rates.</li> </ul>

**Issue 2: Value from Electricity**

- Continued to implement measures to maximize portfolio value such as targeting higher priced markets and times to exceed the energy price benchmark.
- Take action, as required, upon receiving a decision from the Supreme Court of Canada addressing the inequities of the 1969 Power Contract pricing terms.
- Continued preparations relating to the appeal of the Declaratory Judgement legal proceedings.
- Assessed and engaged potential customers on potential future electricity development for the export market and industrial customer opportunities.

### ISSUE 3: OIL AND GAS INTERESTS, EXPLORATION AND DEVELOPMENT

The mandate of Nalcor, established under the *Energy Corporation Act (2008)* included exploring for, developing, producing, refining, marketing and transporting hydrocarbons and products from hydrocarbons. Through its subsidiary, Nalcor Energy - Oil and Gas Inc., these activities supported fulfillment of the strategic direction of government related to advancing the oil and gas industry in the province for the past decade.

In February, 2018 the Province of Newfoundland and Labrador launched a policy document entitled *The Way Forward* on Oil and Gas as part of its Advance 2030 plan. In support of this document the Province announced on March 27, 2018 that the oil and gas subsidiary of Nalcor Energy would be established as a stand-alone crown corporation. Planning is underway to effect this transition, which is anticipated to be completed in 2018.

Nalcor Oil and Gas has developed a multi-year strategy that outlines priorities for increasing exploration interest in the province. Oil and gas exploration, when successful, can lead to significant discoveries and new developments. Nalcor Oil and Gas exploration strategy is driven by a desire to replace reserves that have been produced, add sufficient reserves to allow for growth in production, and discover new resources that will provide the basis for a long term industry that yields significant economic benefits for the people of the province. This strategy aims to encourage more exploration and drilling by international exploration and production companies through investment in the provision of high-quality seismic data.

Nalcor Oil and Gas also currently manages oil and gas interests in three developments offshore Newfoundland and Labrador. Nalcor Oil and Gas holds a five per cent working interest in the White Rose Extension project. This project includes the North Amethyst field, West White Rose and South White Rose Extension. The company also has a 10 per cent working interest in the Hibernia Southern Extension (HSE) and is a co-venturer in the Hebron oil field holding a 4.9 per cent working interest in the province's fourth offshore oil project. Total production in 2017 was 3.2 million barrels and net income was \$9 million.

Over the planning period, the new corporation formed by Q4, 2018 will continue to work with its partners to advance work plans and achieve project milestones.

- White Rose Extension Project: The North Amethyst field produced first oil in May 2010 and has produced over 50 million barrels through December 2017. In 2015, first production from the South White Rose Extension was achieved and in 2016, first production was achieved from the first producer in the Hibernia formation at the White Rose field. In 2017, the White Rose Extension project was sanctioned, with first oil anticipated in 2022. For the

2018-2020 period, key activities will include the construction of the Wellhead Platform and the further delineation of the White Rose area’s future oil and gas potential.

- Hibernia Southern Extension: First oil was achieved from the Hibernia Southern Extension (HSE) in 2011, supplementing production from the original Hibernia project area, helping the overall field in achieving the one billionth barrel of oil on December 21, 2016. Accelerated drilling progress in 2016 and 2017 helped achieve record production levels from the HSE area. For the 2018-2020 period, the focus will be on the sustainment of maximum production levels through sound reservoir management.
- Hebron: First oil was achieved from Hebron on November 27<sup>th</sup>, 2017, one month ahead of schedule. For the 2018-2020 period, activities will focus on safe and environmentally sound ramp up of production rates from the platform, as well as the investigation and analysis of future upside potential in the field.

In addition to the economic value provided through equity, the ownership position provides the newly formed corporation with a seat at the decision-making table and direct involvement in the management of the development of our resources. The knowledge, information and understanding that this participation brings, will enable this corporation to foster relationships that help ensure better alignment between the provincial interest and the partners in the project. Over the planning period, the new corporation will continue to exercise its rights under joint venture agreements to pursue issues of interest to enhance sustainable long-term exploration and development of our resources.

Issue 3: Oil and Gas Interests, Exploration and Development	
Goal: By December 31, 2019, Nalcor Energy-Oil and Gas will have advanced opportunities to increase exploration and development of the Province’s oil and gas resources. <sup>1</sup>	
Indicators	<ul style="list-style-type: none"> <li>▪ Managed equity interests in offshore development in support of planned project advancements.</li> <li>▪ Advanced knowledge of resource potential through execution of multi-year exploration strategy.</li> </ul>
<b>Objective:</b> By December 31, 2017, Nalcor Energy-Oil and Gas will have supported the advancement of offshore projects and advanced acquisition and communication of geoscience data.	
INDICATORS	
2017 ACCOMPLISHMENTS	
Exercised Joint Venture	<ul style="list-style-type: none"> <li>▪ Discovery of additional oil resources through the drilling of</li> </ul>

<sup>1</sup> Nalcor, Oil and Gas is maintaining its current reporting structure for this report. Changes will be reflected as we move through the transition to the new corporation.

Issue 3: Oil and Gas Interests, Exploration and Development	
voting rights and committee representation in the three offshore developments to support the advancement of progress toward planned project milestones.	<p>the A-78 well in the North West White Rose region.</p> <ul style="list-style-type: none"> <li>▪ Worked with partners to sanction the White Rose Extension project.</li> <li>▪ Successful completion of the Hebron platform construction, with subsequent tow out in June, 2017.</li> <li>▪ Hebron First Oil November 27<sup>th</sup>, one month ahead of schedule.</li> <li>▪ Continued high performance at Hibernia South.</li> </ul>
<p>Acquired geoscience data:</p> <p>Continued offshore exploration data surveys.</p> <p>Continued multiyear exploration strategy.</p>	<ul style="list-style-type: none"> <li>▪ 9800 square kilometer 3D seismic survey completed.</li> <li>▪ Over 21,000 line kilometers of 2D seismic completed.</li> <li>▪ Seabed coring, multibeam and heatflow survey completed.</li> <li>▪ Resource Assessment for the NL01_LS (Labrador South area) completed.</li> <li>▪ Rock wash study on cataloging core and cuttings completed</li> <li>▪ Phase 2 Metocean Study completed.</li> <li>▪ Nominated Area of Interest to the CNLOPB for the Southern Newfoundland Sector – Submitted.</li> </ul>
Communicated Nalcor geoscience results to the global oil and gas industry.	<ul style="list-style-type: none"> <li>▪ Presented technical geoscience work at multiple international oil and gas conferences.</li> <li>▪ Individual company meetings on the prospectivity of the region continued throughout the year.</li> </ul>

The objectives and indicators for 2018 are consistent with the direction outlined in the 2017-2019 Strategic Plan.

Issue 3: Oil and Gas Interests, Exploration and Development	
<b>Objective</b>	
By December 31, 2018, Nalcor Energy-Oil and Gas will have supported efforts to further advance offshore project milestones and further enhanced knowledge of the province’s oil and gas resource potential.	
Indicators	<ul style="list-style-type: none"> <li>▪ Supported transition of Oil and Gas to a new stand-alone corporation; develop and execute on a consolidated plan for</li> </ul>

**Issue 3: Oil and Gas Interests, Exploration and Development**

	<p>a successful transition.</p> <ul style="list-style-type: none"><li>▪ Continued to exercise Joint Venture voting rights and committee representation in the three offshore developments in support of the advancement of progress toward planned project milestones.</li><li>▪ Continued to acquire geoscience data:<ul style="list-style-type: none"><li>▪ Continue offshore exploration data surveys.</li><li>▪ Continue multiyear exploration strategy.</li></ul></li><li>▪ Communicated Nalcor geoscience results to the global oil and gas industry.</li></ul>
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## **4 OPPORTUNITIES AND CHALLENGES**

Implementing the remaining priorities outlined for 2018-2019, in the current strategic plan, will require Nalcor to continue to build on its accomplishments and address future challenges and opportunities. The key challenges and opportunities that will be addressed reflect the next phase of Nalcor's strategy in support of the Provincial Government's energy sector strategic directions.

### ***Electricity Supply and Reliability***

#### **Muskrat Falls Project**

During the 2018-2019 planning period, Nalcor will continue to advance Muskrat Falls Project to secure a new reliable source of clean, renewable power. The integration of Muskrat Falls assets into the provincial electricity system and interconnection with the North American grid will continue to support energy security and reliability.

#### **Churchill Falls – Asset Management**

During the next phase of the planning period, Nalcor will continue to safely operate and maintain its electricity assets in Churchill Falls. Its long-term asset management plan and strategic investment will ensure the continued performance of Churchill Falls and contribute to long-term energy security and reliability.

### ***Value from Electricity***

Nalcor's energy marketing portfolio continues to grow. Over the remainder of the planning period, Nalcor will advance its plan for energy marketing operations, continuing to maximize opportunities to enhance value from electricity exports, bringing value to the province. Currently, Nalcor and Hydro, along with members of the Department of Finance and Department of Natural Resources are representatives on the Rate Mitigation Committee, chaired by the Assistant Deputy Minister, Energy Policy. The Rate Mitigation Committee is tasked with analyzing initiatives to help mitigate future electricity rates in an integrated manner to ensure that maximum results to achieve rate mitigation are achieved. Nalcor and Hydro support all reasonable measures to minimize the impact of the Muskrat Falls Project on rate payers of the province.

### ***Oil and Gas Interests, Exploration and Development***

Nalcor Energy Oil and Gas currently manages oil and gas interests in three developments offshore Newfoundland and Labrador and has economic value through its equity interests. Once established, the newly announced oil and gas corporation will continue to enhance sustainable long-term exploration and development of our resources.

Over 2018, Nalcor will support the transition of Oil and Gas to a new stand-alone corporation. It will also advance engagement and evaluation activities for the Bull Arm Fabrication site, advance a long-term operations plan for the site to ensure optimized asset integrity, and continue lease monitoring activities.

*Appendix 1*

Energy Portfolio

## ENERGY PORTFOLIO

### LEGEND

- Hydroelectric Generation Station

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- Thermal Plant/Combustion Turbine

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- ▲ Diesel Plant

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- ⚡ Wind Generation

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- 🛢️ Offshore Oil Projects

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- ★ Industrial Fabrication Site

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- ◆ Diesel Plant operated on behalf of Mushuau Innu First Nation

\* OPERATED UNDER LICENCE FROM THE GOVERNMENT OF NEWFOUNDLAND AND LABRADOR

PPA POWER PURCHASE AGREEMENT



## Appendix 2

### Nalcor Energy Consolidated Financial Statements

**NALCOR ENERGY**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2017**

## Independent Auditor's Report

To the Lieutenant-Governor in Council, Province of Newfoundland and Labrador

We have audited the accompanying consolidated financial statements of Nalcor Energy, which comprise the consolidated statement of financial position as at December 31, 2017, and the consolidated statements of profit and comprehensive loss, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### Managements Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Nalcor Energy as at December 31, 2017 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Deloitte LLP*

Chartered Professional Accountants  
March 8, 2018

**NALCOR ENERGY**  
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

*As at December 31 (millions of Canadian dollars)*

Notes

2017

2016

**ASSETS**

Current assets

Cash and cash equivalents	5	143	143
Restricted cash		1,037	1,378
Short-term investments	10	1,052	91
Trade and other receivables	6	395	294
Inventories	7	116	93
Current portion of other long-term assets	11	2	82
Prepayments		20	16
Derivative assets		3	1
<b>Total current assets</b>		<b>2,768</b>	<b>2,098</b>

Non-current assets

Property, plant and equipment	8	14,554	11,417
Intangible assets	9	30	76
Long-term investments	10	332	34
Other long-term assets	11	233	274

**Total assets** 17,917 13,899

Regulatory deferrals 12 117 164

**Total assets and regulatory deferrals** 18,034 14,063

**LIABILITIES AND EQUITY**

Current liabilities

Short-term borrowings	14	369	435
Trade and other payables	13	584	1,162
Current portion of long-term debt	14	7	143
Derivative liabilities		8	5
Current portion of other liabilities	16, 17, 18	2	5

**Total current liabilities** 970 1,750

Non-current liabilities

Long-term debt	14	9,386	5,873
Class B limited partnership units	15	491	399
Deferred credits	16	1,752	1,161
Deferred contributions	17	11	11
Decommissioning liabilities	18	86	82
Long-term payables	19	52	58
Employee future benefits	20	126	117

**Total liabilities** 12,874 9,451

Shareholder's equity

Share capital	21	123	123
Shareholder contributions	21	3,693	2,861
Reserves		(71)	7
Retained earnings		1,336	1,273

**Total equity** 5,081 4,264

**Total liabilities and equity** 17,955 13,715

Regulatory deferrals 12 79 348

**Total liabilities, equity and regulatory deferrals** 18,034 14,063

Commitments and contingencies (Note 32)

Subsequent event (Note 35)

*See accompanying notes*

On behalf of the Board:

DIRECTOR

DIRECTOR

**NALCOR ENERGY**  
**CONSOLIDATED STATEMENT OF PROFIT AND COMPREHENSIVE (LOSS) INCOME**

<i>For the year ended December 31 (millions of Canadian dollars)</i>	Notes	2017	2016
Energy sales	23	858	779
Other revenue	23	72	45
<b>Revenue</b>		<b>930</b>	<b>824</b>
Fuels		226	168
Power purchased		62	61
Operating costs	24	219	207
Production, marketing and transportation costs	25	36	26
Transmission rental and market fees	26	25	22
Depreciation, depletion, amortization and impairment	8,9	300	135
Exploration and evaluation		1	2
Net finance expense	27	66	72
Other expense (income)	28	23	(4)
<b>Expenses</b>		<b>958</b>	<b>689</b>
<b>(Loss) profit before regulatory adjustments</b>		<b>(28)</b>	<b>135</b>
Regulatory adjustments	12	(91)	(1)
<b>Profit for the year</b>		<b>63</b>	<b>136</b>
Other comprehensive loss			
Total items that may or have been reclassified to profit or loss:			
Actuarial loss on employee future benefits	20,29	(3)	-
Net fair value (loss) gain on available-for-sale financial instruments	29	(2)	13
Net fair value loss on cash flow hedges	29	(66)	(2)
Reclassification adjustments related to:			
Available-for-sale financial instruments	29	(8)	(10)
Cash flow hedges recognized in profit or loss	29	1	(6)
<b>Other comprehensive loss for the year</b>		<b>(78)</b>	<b>(5)</b>
<b>Total comprehensive (loss) income for the year</b>		<b>(15)</b>	<b>131</b>

See accompanying notes

**NALCOR ENERGY**  
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

<i>(millions of Canadian dollars)</i>	Notes	Share Capital	Shareholder Contributions	Fair Value Reserve	Employee Benefit Reserve	Retained Earnings	Total
Balance at January 1, 2017		123	2,861	34	(27)	1,273	4,264
Profit for the year		-	-	-	-	63	63
Other comprehensive (loss) income							
Net change in fair value of available-for-sale financial instruments	29	-	-	(2)	-	-	(2)
Net change in fair value of cash flow hedges	29	-	-	(66)	-	-	(66)
Net change in fair value of financial instruments reclassified to profit or loss	29	-	-	(7)	-	-	(7)
Actuarial loss on employee future benefits	20,29	-	-	-	(3)	-	(3)
<b>Total comprehensive (loss) income for the year</b>		-	-	(75)	(3)	63	(15)
Shareholder contributions	21	-	832	-	-	-	832
<b>Balance at December 31, 2017</b>		123	3,693	(41)	(30)	1,336	5,081
Balance at January 1, 2016		123	2,204	39	(27)	1,137	3,476
Profit for the year		-	-	-	-	136	136
Other comprehensive (loss) income							
Net change in fair value of available-for-sale financial instruments	29	-	-	13	-	-	13
Net change in fair value of cash flow hedges	29	-	-	(2)	-	-	(2)
Net change in fair value of financial instruments reclassified to profit or loss	29	-	-	(16)	-	-	(16)
<b>Total comprehensive (loss) income for the year</b>		-	-	(5)	-	136	131
Shareholder contributions	21	-	657	-	-	-	657
<b>Balance at December 31, 2016</b>		123	2,861	34	(27)	1,273	4,264

See accompanying notes

## NALCOR ENERGY

### CONSOLIDATED STATEMENT OF CASH FLOWS

<i>For the year ended December 31 (millions of Canadian dollars)</i>	Notes	2017	2016
<b>Operating activities</b>			
Profit for the year		63	136
Adjusted for the following non-cash items:			
Depreciation, depletion and impairment - property, plant and equipment	8	203	125
Amortization and impairment - intangible assets	9	97	10
Accretion	27	7	7
Loss on disposal of property, plant and equipment	28	20	7
Sinking fund earnings		(13)	(15)
Regulatory adjustments	12	(91)	(1)
Other		5	(4)
		<b>291</b>	<b>265</b>
Changes in non-cash working capital balances	33	<b>(81)</b>	<b>(46)</b>
<b>Net cash provided from operating activities</b>		<b>210</b>	<b>219</b>
<b>Investing activities</b>			
Additions to property, plant and equipment	34	(2,748)	(2,741)
Additions to intangible assets	9,34	(51)	(36)
Change in long-term receivables	11	28	(24)
Change in sinking fund		90	(6)
Withdrawal from reserve fund	11	15	16
Change in short-term investments		(961)	935
Change in long-term investments		(298)	57
Proceeds on disposal of property, plant and equipment		12	1
Other		(1)	(2)
Changes in non-cash working capital balances	33	(623)	177
<b>Net cash used in investing activities</b>		<b>(4,537)</b>	<b>(1,623)</b>
<b>Financing activities</b>			
Proceeds from long-term debt	14	3,516	-
Retirement of long-term debt	14	(150)	(225)
Change in restricted cash		341	458
Class B limited partnership unit contributions	15	55	168
Change in short-term borrowings		(66)	338
Change in shareholder contributions	21	832	657
Rate stabilization plan payout	12	(131)	-
Settlement of cash flow hedges		(67)	-
Other		(3)	2
<b>Net cash provided from financing activities</b>		<b>4,327</b>	<b>1,398</b>
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>-</b>	<b>(6)</b>
Cash and cash equivalents, beginning of year		143	149
<b>Cash and cash equivalents, end of year</b>		<b>143</b>	<b>143</b>
Interest received		51	27
Interest paid		317	277

See accompanying notes

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 1. DESCRIPTION OF BUSINESS

Nalcor Energy (Nalcor or the Company) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the Province) as a Crown corporation and its business includes the development, generation, transmission and sale of electricity, oil and gas, industrial fabrication and energy marketing. Nalcor's head office is located at 500 Columbus Drive in St. John's, Newfoundland and Labrador A1B 0C9, Canada.

#### 1.1 Subsidiaries

Nalcor holds interests in the following subsidiaries:

A 100% interest in Newfoundland and Labrador Hydro (Hydro), whose principal activity is the generation, transmission and sale of electricity. Hydro's operations include both regulated and non-regulated activities.

A 100% interest in Nalcor Energy – Oil and Gas Inc. (Oil and Gas). Oil and Gas has a mandate to engage in the upstream and downstream sectors of the oil and gas industry. Upstream includes exploration, development, and production activities, while downstream includes transportation and processing activities.

A 100% interest in Nalcor Energy – Bull Arm Fabrication Inc. (Bull Arm Fabrication), an industrial fabrication site with a fully integrated infrastructure to support large-scale fabrication and assembly. Its facilities include onshore fabrication halls and shops, a dry-dock and a deep water site.

A 100% interest in Nalcor Energy Marketing Corporation (Energy Marketing), a subsidiary established to market Nalcor's energy throughout North America.

A 100% interest in Muskrat Falls Corporation (Muskrat Falls), created to develop, construct, finance and operate the Muskrat Falls plant, an 824 megawatt (MW) hydroelectric generating facility in Labrador.

A 100% interest in Labrador Transmission Corporation (Labrador Transco), created to develop, construct, finance and operate transmission assets connecting the Muskrat Falls plant to the existing hydroelectric generating facility in Churchill Falls.

A 100% interest in Labrador-Island Link General Partner Corporation (LIL GP) and Labrador-Island Link Holding Corporation (LIL Holdco), created to control, manage and hold Nalcor's interest in the Labrador-Island Link Limited Partnership (LIL LP).

A 100% interest in Labrador-Island Link Operating Corporation (LIL Opco), created to operate and maintain the Labrador-Island Link (LIL).

A 100% interest in Lower Churchill Management Corporation (LCMC), created to carry out the project development and management functions for Phase 1 of the Lower Churchill Project (LCP) including planning, engineering and design management, construction management, risk management, finance, procurement and supply chain management.

A limited partnership interest in the LIL LP, created to develop, construct, finance and operate the assets and property constituting the LIL, a transmission link to be constructed between the Muskrat Falls plant and the Newfoundland and Labrador Island Interconnected System. LIL Holdco holds 100% of the Class A and Class C limited partnership units.

Nalcor also holds a 100% interest in Gull Island Power Company Limited (GIPCo) and, through Hydro, a 51.0% interest in Lower Churchill Development Corporation Limited (LCDC), both of which are inactive.

#### 1.2 Investment in Joint Arrangement

Nalcor holds a 65.8% beneficial interest (through Hydro) in Churchill Falls (Labrador) Corporation Limited (Churchill Falls), a joint operation that owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador with a rated capacity of 5,428 MW.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Nalcor holds a 33.33% beneficial interest (through Churchill Falls) in Twin Falls Power Corporation Limited (Twin Falls).

### 1.3 Structured Entities

Nalcor consolidates the results of structured entities in which it holds a financial interest and is the primary beneficiary. Nalcor has determined that it is the primary beneficiary of the LIL Construction Project Trust (the IT) and, as a result, has included the financial statements of the IT in these annual audited consolidated financial statements. Nalcor has determined that it is not the primary beneficiary of the Muskrat Falls/Labrador Transmission Assets (MF/LTA) Funding Trust or the LIL Funding Trust and therefore the operations of these trusts are not reflected in these annual audited consolidated financial statements.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### 2.1 Statement of Compliance and Basis of Measurement

These annual audited consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). Nalcor has adopted accounting policies which are based on the IFRS applicable as at December 31, 2017 and includes individual IFRS, International Accounting Standards (IAS), and interpretations made by the IFRS Interpretations Committee and the Standing Interpretations Committee.

These annual audited consolidated financial statements have been prepared on a historical cost basis, except for financial instruments at fair value through profit or loss (FVTPL) and available-for-sale (AFS) which have been measured at fair value. The annual audited consolidated financial statements are presented in Canadian Dollars (CAD) and all values rounded to the nearest million, except when otherwise noted. The annual audited consolidated financial statements were approved by Nalcor's Board of Directors (the Board) on March 2, 2018.

### 2.2 Basis of Consolidation

The annual audited consolidated financial statements include the financial statements of Nalcor, its subsidiary companies and its share of investments in joint arrangements. In addition, the financial statements of all structured entities, for which Nalcor has been determined the primary beneficiary, are included in these annual audited consolidated financial statements. Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls, and Hydro-Québec entered into a shareholders' agreement (the Shareholders' Agreement) which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec on Churchill Falls' Board of Directors. Although Hydro holds a 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of a joint operation. Accordingly, Hydro has recognized its share of assets, liabilities and profit or loss in relation to its interest in Churchill Falls subsequent to the effective date of the Shareholders' Agreement.

Churchill Falls' investment in Twin Falls is accounted for using the equity method.

Substantially all of Oil and Gas' activities are conducted jointly with others and, accordingly, these annual audited consolidated financial statements reflect only Nalcor's proportionate interest in such activities.

### 2.3 Cash and Cash Equivalents and Short-term Investments

Cash and cash equivalents consist of amounts on deposit with Schedule 1 Canadian Chartered banks, as well as highly liquid investments with maturities of three months or less. Investments with maturities greater than three months and less than twelve months are classified as short-term investments. Cash and cash equivalents are measured at cost which approximates fair value, while short-term investments are measured at fair value.

### 2.4 Restricted Cash

Restricted cash consists of cash held on deposit with Schedule 1 Canadian Chartered banks and administered by the Collateral

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Agent for the sole purpose of funding construction costs related to the LIL, Labrador Transmission Assets (LTA) and Muskrat Falls' hydroelectric plant, including pre-funded equity requirements required under the Labrador-Island Link Limited Project Finance Agreement (LIL PFA) and MF/LTA Project Finance Agreement (MF/LTA PFA). The Project draws funds from these accounts in accordance with procedures set out in the LIL PFA and MF/LTA PFA. Restricted cash also includes accounts administered by the Trustee of the IT which are associated with the establishment of the IT. Restricted cash is measured at cost which approximates fair value.

### 2.5 Trade and Other Receivables

Trade and other receivables are classified as loans and receivables and are measured at amortized cost using the effective interest method.

### 2.6 Inventories

Inventories are carried at the lower of cost and net realizable value. Cost is determined on a weighted average basis and includes expenditures incurred in acquiring the inventories and bringing them to their existing condition and location. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

### 2.7 Property, Plant and Equipment

Items of property, plant and equipment are recognized using the cost model and thus are recorded at cost less accumulated depreciation and accumulated impairment losses. Cost includes materials, labour, contracted services, professional fees and, for qualifying assets, borrowing costs capitalized in accordance with Nalcor's accounting policy outlined in Note 2.11. Costs capitalized with the related asset include all those costs directly attributable to bringing the asset into operation. When significant parts of property, plant and equipment are required to be replaced at intervals, Nalcor recognizes such parts as individual assets with specific useful lives and depreciation rates, respectively. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied. All other repairs and maintenance costs are recognized in profit or loss as incurred. Property, plant and equipment is not revalued for financial reporting purposes. Depreciation of these assets commences when the assets are ready for their intended use.

#### Hydro

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Generation plant	
Hydroelectric	45 to 100 years
Thermal	35 to 65 years
Diesel	25 to 55 years
Transmission	
Lines	30 to 65 years
Terminal stations	40 to 55 years
Distribution system	30 to 55 years
Other assets	5 to 55 years

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dikes, tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks, and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dikes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Terminal stations assets are used to step up voltages of electricity and to step down voltages for distribution. Distribution system assets include poles, transformers, insulators, and conductors.

Other assets include telecontrol, buildings, vehicles, furniture, tools and equipment.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### Churchill Falls

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Hydroelectric generation plant	25 to 100 years
Transmission and terminals	30 to 65 years
Service facilities and other	5 to 45 years

Hydro and Churchill Falls assets' residual values, useful lives and method of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate. The carrying value of property, plant and equipment is reviewed for impairment whenever events indicate that the carrying amounts of those assets may not be recoverable.

### Oil and Gas

#### (i) Development and Production Costs

Items of property, plant and equipment, which include petroleum and natural gas development and production assets, are carried at cost less accumulated depreciation, depletion and impairment. Development and production assets are grouped into cash-generating units (CGUs) for impairment testing.

Expenditures on the construction, installation or completion of infrastructure facilities such as processing facilities and the drilling of development wells, including unsuccessful development or delineation wells, are capitalized within property, plant and equipment, as long as it is technically feasible and economically viable to extract identified reserves.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the decommissioning costs and, for qualifying assets, borrowing costs. The purchase price or constructed cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Capitalized petroleum and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis.

Gains and losses on disposal of an item of property, plant and equipment, including petroleum and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recorded in other expense (income).

#### (ii) Subsequent Costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the asset will flow to Oil and Gas and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Routine repair and maintenance costs are charged to profit or loss during the period in which they are incurred.

#### (iii) Depletion

The net carrying value of development and production assets is depleted using the unit of production method by reference to the ratio of production in the year to the related proved and probable reserves, and considering estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

Proved and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate,

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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with a specified degree of certainty, to be recoverable in future years from known reservoirs and which are considered commercially viable. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all (or substantially all) of the expected petroleum and natural gas production; and
- evidence that the necessary production, transshipment and transportation facilities are available or can be made available.

### Other Assets

Office equipment and computer hardware are carried at cost less accumulated depreciation. Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful life of 5 to 20 years. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

### Lower Churchill Project

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Project support assets	4 to 7 years
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As use of the project support assets are directly attributable to the construction of the Muskrat Falls hydroelectric plant and LTA, related depreciation costs are capitalized as incurred, until such time as the assets are substantially ready for their intended use or sale.

## **2.8 Exploration and Evaluation Assets**

Pre-license exploration and evaluation costs are recognized in profit or loss as incurred. Costs of exploring for and evaluating licensed petroleum and gas properties are capitalized and the resulting intangible exploration and evaluation assets are tested for impairment in accordance with IFRS 6 and IAS 36.

Exploration and evaluation costs related to each license/prospect are initially capitalized with "Exploration and Evaluation Assets." Such exploration and evaluation costs may include costs of license acquisition, technical services and studies, exploration drilling and testing, directly attributable overhead and administrative expenses and the projected costs of retiring the assets. General prospecting or evaluation costs incurred prior to having obtained the legal rights to explore an area are expensed directly to profit or loss as they are incurred.

Exploration and evaluation assets are not depleted and are carried forward until technical feasibility and commercial viability of extracting a mineral resource is considered to be determined. The technical feasibility and commercial viability of extracting a mineral resource is considered to be determined when proved reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proved reserves have been discovered.

Upon determination of proved reserves, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to property, plant and equipment.

## **2.9 Investment Property**

Investment property is property held for the purpose of generating rental income or capital appreciation, but not for sale in the ordinary course of business, use in the production or supply of goods or services or for administrative purposes. As at December 31, 2017, investment property includes the Bull Arm Fabrication site and facilities.

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Investment property is recognized using the cost model and thus is recorded at cost less accumulated depreciation and accumulated impairment losses. Cost includes materials, labour, contracted services and professional fees. Costs capitalized with the related asset include all those costs directly attributable to bringing the asset into operation. When significant parts of investment property are required to be replaced at intervals, Nalcor recognizes such parts as individual assets with specific useful lives and depreciation, respectively. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of the investment property as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognized in the Consolidated Statement of Profit and Comprehensive (Loss) Income as incurred. Investment property is not revalued for financial reporting purposes. Depreciation of these assets commences when the assets are ready for their intended use.

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Computer equipment, vehicles and office equipment	5 years
Buildings	18 years
Topsides module hall door	26 years
Visitor center	42 years

The assets' residual values, useful lives and method of depreciation are reviewed at each fiscal year end and adjusted prospectively, if appropriate. The carrying value of investment property is reviewed for impairment whenever events indicate that the carrying amounts of those assets may not be recoverable.

### 2.10 Intangible Assets

Intangible assets that are expected to generate future economic benefit and are measurable, including computer software costs, costs of technical services, feasibility studies, exploration assets and intellectual property are capitalized as intangible assets in accordance with IAS 38.

Intangible assets with finite useful lives are carried at cost less accumulated amortization and accumulated impairment losses. The estimated useful life and amortization method are reviewed at the end of each year, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives are carried at cost less accumulated impairment losses.

Amortization is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Computer software	5 to 10 years
Feasibility studies	5 to 20 years
Seismic data acquisitions	6 years

### 2.11 Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in the Consolidated Statement of Profit and Comprehensive (Loss) Income in the period in which they are incurred.

### 2.12 Impairment of Non-Financial Assets

At the end of each reporting period, Nalcor reviews the carrying amounts of its non-financial assets, except for exploration and evaluation assets, to determine whether there is any indication that those assets may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Exploration and evaluation assets are assessed for impairment when they are reclassified to plant, property and equipment and also if there are indicators that suggest that the carrying amount exceeds the recoverable amount.

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Where it is not possible to estimate the recoverable amount of an individual asset, Nalcor estimates the recoverable amount of the CGU to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual CGUs, or otherwise they are allocated to the smallest group of CGUs for which a reasonable and consistent allocation basis can be identified. The recoverable amount is the higher of fair value less costs of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. Value in use is generally computed by reference to the present value of future cash flows expected to be derived from non-financial assets.

Exploration and evaluation assets are allocated to the CGUs on a project basis when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their reclassification to property, plant and equipment.

If the recoverable amount of an asset or CGU is estimated to be less than its carrying amount, the carrying amount of the asset or CGU is reduced to its recoverable amount. An impairment loss is recognized immediately in the Consolidated Statement of Profit and Comprehensive (Loss) Income.

### 2.13 Investments in Joint Arrangements

A joint arrangement is an arrangement of which two or more parties involved have joint control. Control exists when Nalcor has the power, directly or indirectly, to govern the financial and operating policies of another entity, so as to obtain benefits from its activities. A joint arrangement is either classified as a joint operation or a joint venture based on the rights of the parties involved.

Nalcor holds equity stakes in the Hebron, Hibernia South Extension and White Rose Extension projects. These projects are classified as joint operations as multiple parties hold joint control and stakeholders have rights to the project assets and obligations for its liabilities. Nalcor accounts for its oil and gas investments by recognizing its share of assets, liabilities and profit or loss in relation to its interest in the joint operation.

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Québec entered into the Shareholders' Agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec on the Board of Directors of Churchill Falls. Although Nalcor (through Hydro) retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of joint operators. This investment is accounted for using the proportionate consolidation method.

Hydro's joint operation, Churchill Falls, holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives Churchill Falls joint control of Twin Falls. This investment is accounted for using the equity method. Under the equity method, the interest in the joint venture is carried in the Statement of Financial Position at cost plus post acquisition changes in Churchill Falls' share of net assets of the joint venture. The Consolidated Statement of Profit and Comprehensive (Loss) Income reflects the share of the profit or loss of the joint venture.

### 2.14 Employee Future Benefits

#### (i) Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. Contributions by Nalcor to this Plan are recognized as an expense when employees have rendered service entitling them to the contributions. Liabilities associated with this Plan are held with the Province.

#### (ii) Other Benefits

Nalcor provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a retirement allowance.

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The cost of providing these benefits is determined using the projected unit credit method, with actuarial valuations being completed on an annual basis, based on service and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs.

Actuarial gains and losses on Nalcor's defined benefit obligation are recognized in reserves in the period in which they occur. Past service costs are recognized in operating costs as incurred. Pursuant to Order No. P.U. 36 (2015), Nalcor recognizes the amortization of Hydro's employee future benefit actuarial gains and losses in the Consolidated Statement of Profit and Comprehensive (Loss) Income as a regulatory adjustment.

The retirement benefit obligation recognized in the Consolidated Statement of Financial Position represents the present value of the defined benefit obligation.

### 2.15 Provisions

A provision is a liability of uncertain timing or amount. A provision is recognized if Nalcor has a present legal obligation or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognized for future operating losses. The provision is measured at the present value of the best estimate of the expenditures expected to be required to settle the obligation using a discount rate that reflects the current market assessments of the time value of money and the risks specific to the obligation. Provisions are re-measured at each Consolidated Statement of Financial Position date using the current discount rate.

### 2.16 Decommissioning, Restoration and Environmental Liabilities

Legal and constructive obligations associated with the retirement of property, plant and equipment are recorded as liabilities when those obligations are incurred and are measured as the present value of the expected costs to settle the liability, discounted at a rate specific to the liability. The liability is accreted up to the date the liability will be incurred with a corresponding charge to net finance expense. The carrying amount of decommissioning, restoration and environmental liabilities is reviewed annually with changes in the estimates of timing or amount of cash flows added to or deducted from the cost of the related asset or expensed in the Consolidated Statement of Profit and Comprehensive (Loss) Income if the liability is short-term in nature.

### 2.17 Revenue Recognition

#### Electricity Sales

Revenue from the sale of energy is recognized when Nalcor has transferred the significant risks and rewards of ownership to the buyer, recovery of the consideration is probable and the amount of revenue can be reliably measured. Sales within the Province are primarily at rates approved by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), whereas export sales and sales to certain major industrial customers are either at rates under the terms of the applicable contracts, or at market rates.

Churchill Falls provides energy to two primary customers: Hydro-Québec and Hydro.

A power contract with Hydro-Québec dated May 12, 1969 (the Power Contract) provides for the sale of a significant amount of the energy from Churchill Falls. The Power Contract had a 40-year term that expired August 31, 2016, and was followed by a Renewed Power Contract with Hydro-Québec for an additional 25 years beginning September 1, 2016. The rate was predetermined in the Power Contract and was 2.5426 mills per kWh. The rate during the term of the Renewed Power Contract is 2.0 mills per kWh.

Churchill Falls also recognizes revenue from Hydro-Québec under a Guaranteed Winter Availability Contract (GWAC) through 2041. The GWAC was signed with Hydro-Québec in 1998 and provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Québec during the months of November through March in each of the remaining years until 2041.

Under the Power Contract and Renewed Power Contract, Churchill Falls has the right to recall 300 MW (Recall Power). All of the

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Recall Power is sold by Churchill Falls to Hydro. Churchill Falls also provides an additional 225 MW to Hydro.

### Petroleum and Natural Gas Sales

Revenue from the sale of crude oil is recognized when the amount of revenue can be reasonably measured, the significant risks and rewards of ownership have passed to the buyer and collection is reasonably assured. This typically occurs when the oil has been produced and delivered to the transshipment facility.

Revenue from properties in which Nalcor has an interest with other producers is recognized on the basis of Nalcor's net working interest of petroleum and natural gas produced (the entitlement method). Under this method, crude oil produced below or above Nalcor's net working interest results in an under-lift or over-lift position. Under-lift or over-lift positions are measured at market value and recorded as an asset or liability, respectively.

### Other Revenue

Revenue associated with the sale of geoscience data is recognized when the terms and conditions governing sales have been met, the amount of revenue can be reliably measured and recovery of the consideration is probable.

## **2.18 Leasing**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

### Lessor accounting

Amounts due from lessees under finance leases are recognized as receivables at the amount of Nalcor's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on Nalcor's net investment outstanding in respect of the leases.

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized on a straight-line basis over the lease term.

### Lessee accounting

Assets held under finance leases are initially recognized as assets of Nalcor at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the Consolidated Statement of Financial Position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognized immediately in profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with Nalcor's general policy on borrowing costs (Note 2.11). Contingent rental costs are recognized as operating costs in the periods in which they are incurred.

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognized as a liability. The aggregate benefit of incentives is recognized as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

## **2.19 Foreign Currencies**

Transactions in currencies other than Nalcor's functional currency (foreign currencies) are recognized using the exchange rate in effect at the date of transaction, approximated by the prior month end close rate. At the end of each reporting period, monetary

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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items denominated in foreign currencies are translated at the rates of exchange in effect at the period end date. Foreign exchange gains and losses not included in regulatory deferrals are recorded in the Consolidated Statement of Profit and Comprehensive (Loss) Income as other expense (income).

### 2.20 Income Taxes

Nalcor is exempt from paying income taxes under Section 149(1) (d.1) of the Income Tax Act.

### 2.21 Financial Instruments

Financial assets and financial liabilities are recognized in the Consolidated Statement of Financial Position when Nalcor becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Financial instruments are classified into the following specified categories: financial assets at FVTPL, AFS financial assets, loans and receivables, held-to-maturity investments, financial liabilities at FVTPL, financial instruments used for hedging and other financial liabilities. The classification depends on the nature and purpose of the financial instruments and is determined at the time of initial recognition.

#### Classification of Financial Instruments

Nalcor has classified each of its financial instruments into the following categories: financial assets at FVTPL, loans and receivables, held-to-maturity investments, AFS financial assets, financial liabilities at FVTPL, financial instruments used for hedging and other financial liabilities.

<u>Financial instrument</u>	<u>Category</u>
Cash and cash equivalents	Loans and receivables
Restricted cash	Loans and receivables
Short-term investments	AFS financial assets
Trade and other receivables	Loans and receivables
Derivative instruments	At FVTPL and financial instruments used for hedging
Sinking funds – investments in same Hydro issue	Held-to-maturity investments
Sinking funds – other investments	AFS financial assets
Reserve fund	AFS financial assets
Long-term receivables	Loans and receivables
Long-term investments (including current portion)	Held-to-maturity investments
Trade and other payables	Other financial liabilities
Short-term borrowings	Other financial liabilities
Long-term debt	Other financial liabilities
Long-term payables	Other financial liabilities
Class B limited partnership units	Other financial liabilities

#### (i) Effective Interest Method

The effective interest method is a method of calculating the amortized cost of a financial instrument and allocating interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial instrument, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Income or expense is recognized on an effective interest basis for financial instruments other than those financial assets and liabilities classified as at FVTPL.

#### Financial Assets

##### (ii) Financial Assets at FVTPL

Financial assets are classified as at FVTPL when the financial asset is either held for trading or it is designated as FVTPL.

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A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling it in the near term; or
- on initial recognition it is part of a portfolio of identified financial instruments that Nalcor manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with Nalcor's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on re-measurement recognized in other expense (income). The net gain or loss incorporates any dividends or interest earned.

(iii) Loans and Receivables

Trade receivables, loans and other receivables with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

(iv) Held-to-Maturity Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity dates that Nalcor has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment, with revenue recognized on an effective yield basis.

(v) AFS Financial Assets

AFS financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the previous categories. Gains and losses arising from changes in fair value are recognized in other comprehensive loss and accumulated in the fair value reserve with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognized in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the fair value reserve is reclassified to profit or loss.

Financial Liabilities and Equity Instruments

(vi) Financial Liabilities at FVTPL

A financial liability may be classified as at FVTPL if the contracted liability contains one or more embedded derivatives, and if the embedded derivative significantly modified the cash flows or if the embedded derivative is not closely related to the host liability. Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising from re-measurement recognized in profit or loss.

(vii) Other Financial Liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial

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liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

### (viii) Derivative Instruments and Financial Instruments Used for Hedging

Derivative instruments are utilized by Nalcor to manage risk. Nalcor's policy is not to utilize derivative instruments for speculative purposes. Derivatives are initially measured at fair value at the date the derivative contracts are entered into and are subsequently measured at their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging relationship.

Nalcor may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between the price movements in the derivative instruments and the hedged items. Nalcor formally documents all hedges and the related risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

Hedges which meet the strict criteria for hedge accounting are accounted for as follows:

#### Cash Flow Hedges

The effective portion of the gain or loss on the hedging instrument is recognized directly in other comprehensive loss, while any ineffective portion is recognized immediately in the Consolidated Statement of Profit and Comprehensive (Loss) Income for the year.

Amounts recognized in other comprehensive loss are transferred to the Consolidated Statement of Profit and Comprehensive (Loss) Income for the period when the hedged transaction affects profit or loss, such as when the hedged financial income or financial expense is recognized or when a forecast sale occurs.

## 2.22 **Derecognition of Financial Instruments**

Nalcor derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If Nalcor neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, its retained interest in the asset and any associated liability for amounts it may have to pay is recognized. If Nalcor retains substantially all the risks and rewards of ownership of a transferred financial asset, it continues to recognize the financial asset and also recognizes the collateralized borrowing for the proceeds received. Nalcor derecognizes financial liabilities when, and only when, its obligations are discharged, cancelled or they expire.

## 2.23 **Impairment of Financial Assets**

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

Evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- the borrower, more probable than not, entering into bankruptcy or financial re-organization.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include Nalcor's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with defaults on receivables.

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For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive loss are reclassified to profit or loss in the period.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

### 2.24 Government Grants

Government grants are recognized when there is reasonable assurance that Nalcor will comply with the associated conditions and that the grants will be received.

Government grants are recognized in profit or loss on a systematic basis over the periods in which Nalcor recognizes as expenses the related costs for which the grants are intended to compensate. Specifically, government grants whose primary condition is that Nalcor should purchase, construct or otherwise acquire non-current assets are recognized as deferred revenue in the Consolidated Statement of Financial Position and transferred to the Consolidated Statement of Profit and Comprehensive (Loss) Income on a systematic and rational basis over the useful lives of the related assets.

Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to Nalcor with no future related costs are recognized in the Consolidated Statement of Profit and Comprehensive (Loss) Income in the period in which they become receivable.

### 2.25 Regulatory Deferrals

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service methodology. The preliminary estimate of Hydro's allowed rate of return based upon Board Order No. P.U. 49 (2016) is 6.6% in 2017 and 6.6% in 2016 +/- 20 basis points. Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally, these policies result in the deferral and amortization of costs or credits which are expected to be recovered or refunded in future rates. In the absence of rate regulation, these amounts would be included in the determination of profit or loss in the year the amounts are incurred. The effects of rate regulation on the annual audited consolidated financial statements are disclosed in Note 12.

## 3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the annual audited consolidated financial statements in conformity with IFRS requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ materially from these estimates, including changes as a result of future decisions made by the PUB. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period in which the estimate is reviewed if the revision affects only that period or future periods.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 3.1 Use of Judgments

(i) Asset Impairment and Reversals

Nalcor applies judgment in evaluating impairment and impairment reversal indicators based on various internal and external factors.

The recoverable amount of a CGU or asset is determined based on the higher of fair value less costs of disposal and its value in use. Management uses factors including expected future oil prices and proved and probable reserves from third party specialists and discount rates to determine the recoverable amount, as well as judgments regarding the occurrence of future events. Changes in these factors will affect the recoverable amount of CGUs and assets, which may result in a material adjustment to their carrying value.

(ii) Property, Plant and Equipment

Nalcor's accounting policy relating to property, plant and equipment is described in Note 2.7. In applying this policy, judgment is used in determining whether certain costs are additions to the carrying amount of the property, plant and equipment as opposed to repairs and maintenance. If an asset has been developed, judgment is required to identify the point at which the asset is capable of being used as intended and to identify the directly attributable borrowing costs to be included in the carrying value of the development asset. Judgment is also used in determining the appropriate componentization structure for Nalcor's property, plant and equipment.

(iii) Revenue

Management exercises judgment in estimating the value of electricity consumed by retail customers in the period, but billed subsequent to the end of the reporting period. Specifically, this involves an estimate of consumption for each retail customer, based on the customer's past consumption history.

When recognizing deferrals and related amortization of costs or credits in Hydro Regulated, Management assumes that such costs or credits will be recovered or refunded through customer rates in future years. Recovery of some of these deferrals is subject to a future PUB order. As such, there is a risk that some or all of the regulatory deferrals will not be approved by the PUB which could have a material impact on Hydro Regulated's profit or loss in the year the order is received.

(iv) Functional Currency

Functional currency was determined by evaluating the primary economic environment in which Nalcor operates. As Nalcor enters into transactions in multiple currencies, judgment is used in determining the functional currency. Management considered factors regarding currency of sales, costs incurred, and operating and financing activities and determined the functional currency to be Canadian Dollars.

(v) Determination of CGUs

Nalcor's accounting policy relating to impairment of non-financial assets is described in Note 2.12. In applying this policy, Nalcor groups assets into the smallest identifiable groups for which cash flows are largely independent of the cash flows from other assets or groups of assets. Judgment is used in determining the level at which cash flows are largely independent of other assets or groups of assets.

(vi) Discount Rates

Certain of Nalcor's financial liabilities are discounted using discount rates that are subject to Management's judgment.

(vii) Consolidation of Joint Arrangements

Management exercises judgment when applying the criteria outlined in IFRS 11 to determine whether joint arrangements constitute joint ventures or joint operations. Management has determined that its interest in Churchill Falls is considered a joint operation and its interest in Twin Falls is considered a joint venture.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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(viii) Consolidation

Management applies its judgment when determining whether to consolidate structured entities in accordance with the criteria outlined in IFRS 10. Management has determined that the Company should consolidate the IT but should not consolidate the MF/LTA and LIL Funding Trusts.

### 3.2 Use of Estimates

(i) Property, Plant and Equipment

Amounts recorded for depreciation are based on the useful lives of Nalcor's assets. The useful lives of property, plant and equipment are determined by independent specialists and reviewed annually by Nalcor. These useful lives are Management's best estimate of the service lives of these assets. Changes to these lives could materially affect the amount of depreciation recorded.

(ii) Investment Property

Due to the nature of the property and lack of comparable market data, the fair value of Nalcor's investment property is determined using the present value of the future cash flows. Significant assumptions used in the determination of fair value include estimates of the amount and timing of future cash flows and the discount rate.

(iii) Intangible Assets

Amounts recorded for amortization are based on the useful lives of Nalcor's assets. These useful lives are Management's best estimate of the service lives of these assets. Changes to these lives could materially affect the amount of amortization recorded.

(iv) Oil and Natural Gas Reserves

Oil and natural gas reserves are evaluated by independent reserve engineers. Reserve estimates are used in calculating depletion, impairment and decommissioning liabilities. Estimates of recoverable reserves are based upon variable factors and assumptions regarding historical production, production rates, ultimate reserve recovery, marketability of petroleum and natural gas, and timing and amount of future cash expenditures. Changes to these amounts could materially affect these calculations.

(v) Partnership Unit Liabilities

LIL LP determines the fair value of the Class B limited partnership units at each financial reporting date. These units represent the limited partners' ownership interests in the Partnership. Due to the nature of the liabilities and lack of comparable market data, the fair value of these units is determined using the present value of future cash flows. Significant assumptions used in the determination of fair value include estimates of the amount and timing of future cash flows and the discount rate.

The process of valuing financial liabilities for which no published market price exists is based on inherent uncertainties and the resulting values may differ from values that would have been used had a ready market existed for the liability. These differences could be material to the fair value of the financial liability.

(vi) Decommissioning Liabilities

Nalcor recognizes a liability for the fair value of the future expenditures required to settle obligations associated with the retirement of property, plant and equipment. Decommissioning liabilities are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of decommissioning liabilities is included in the Consolidated Statement of Profit and Comprehensive (Loss) Income through net finance expense. Differences between the recorded decommissioning liabilities and the actual decommissioning costs incurred are recorded as a gain or loss in the settlement period.

(vii) Employee Future Benefits

Nalcor provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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severance payment upon retirement. The expected cost of providing these other employee benefits is accounted for on an accrual basis, and has been actuarially determined using the projected unit credit method prorated on service, and Management's best estimate of salary escalation, retirement ages of employees, and expected health care costs.

(viii) Revenue

In the absence of a signed agreement with Hydro-Québec relating to the Annual Energy Base (AEB), Churchill Falls has an agreement with Hydro-Québec to continue to use the 2008 AEB on an interim basis until final judgment is obtained in the Declaratory Judgment case.

### 3.3 Use of Assumptions

(i) Derivative Assets

Fair value assumptions for financial transmission rights have been based on internal valuation techniques and models that extrapolate observable external market inputs, such as commodity prices, and include significant judgment regarding the expected impact of seasonality and locational adjustments.

## 4. CURRENT AND FUTURE CHANGES IN ACCOUNTING POLICIES

*IAS 7 - Disclosure Initiative* became effective for accounting periods commencing on January 1, 2017 and did not have a material impact on Nalcor's annual audited consolidated financial statements.

The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The amendments do not prescribe a specific format to disclose financing activities; however, an entity may fulfil the disclosure objective by providing a reconciliation between the opening and closing balances in the Statement of Financial Position for liabilities arising from financing activities.

The following is a list of standards/interpretations that have been issued and are effective for accounting periods commencing on January 1, 2018 or January 1, 2019, as specified.

- *IFRS 9 - Financial Instruments*<sup>1</sup>
- *IFRS 15 - Revenue from Contracts with Customers*<sup>1</sup>
- *IFRIC 22 - Foreign Currency Transactions and Advance Consideration*<sup>1</sup>
- *IFRS 16 - Leases*<sup>2</sup>

<sup>1</sup>Effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

<sup>2</sup>Effective for annual periods beginning on or after January 1, 2019, with earlier application permitted.

### 4.1 IFRS 9 - Financial Instruments

In July 2014, the IASB finalized the reform of financial instruments accounting and issued IFRS 9 (as revised in 2014), which contains the requirements for a) the classification and measurement of financial assets and financial liabilities, b) impairment methodology, and c) general hedge accounting. IFRS 9 (as revised in 2014) will supersede IAS 39 - Financial Instruments: Recognition and Measurement upon its effective date.

#### ***Phase 1: Classification and measurement of financial assets and financial liabilities***

With respect to classification and measurement, the number of categories of financial assets under IFRS 9 has been reduced; all recognized financial assets that are currently within the scope of IAS 39 will be subsequently measured at either amortized cost or fair value under IFRS 9.

IFRS 9 also contains requirements for the classification and measurement of financial liabilities and derecognition requirements.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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One major change from IAS 39 relates to the presentation of changes in the fair value of a financial liability designated as at FVTPL attributable to changes in the credit risk of that liability. Under IFRS 9, such changes are presented in other comprehensive income, unless the presentation of the effect of the change in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss.

### ***Phase 2: Impairment of financial assets***

The impairment model under IFRS 9 reflects expected credit losses, as opposed to incurred credit losses under IAS 39. Under the impairment approach in IFRS 9, it is no longer necessary for a credit event to have occurred before credit losses are recognized. Instead, an entity always accounts for expected credit losses and changes in those expected credit losses. The amount of expected credit losses should be updated at each reporting date to reflect changes in credit risk since initial recognition.

### ***Phase 3: Hedge accounting***

The general hedge accounting requirements of IFRS 9 retain the three types of hedge accounting mechanisms in IAS 39. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is no longer required. Far more disclosure requirements about an entity's risk management activities have been introduced.

### ***Transitional provisions***

IFRS 9 (as revised in 2014) is effective for reporting periods beginning on or after January 1, 2018 with earlier application permitted. Management has elected to adopt the standard as of the effective date and although the classification of existing financial instruments and related disclosures will change, there will be no material adjustments to the amounts reported in Nalcor's annual audited consolidated financial statements.

## **4.2 IFRS 15 Revenue from Contracts with Customers**

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. It will supersede the following revenue standards and interpretations upon its effective date:

- IAS 18 Revenue;
- IAS 11 Construction Contracts;
- IFRIC 13 Customer Loyalty Programs;
- IFRIC 15 Agreements for the Construction of Real Estate;
- IFRIC 18 Transfers of Assets from Customers; and
- SIC 31 Revenue-Barter Transactions Involving Advertising Services.

As suggested by the title of the new revenue standard, IFRS 15 will only cover revenue arising from contracts with customers. Under IFRS 15, a customer of an entity is a party that has contracted with the entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration. Unlike the scope of IAS 18, the recognition and measurement of interest income and dividend income from debt and equity investments are no longer within the scope of IFRS 15. Instead, they are within the scope of IAS 39 (or IFRS 9 if it is early adopted).

As mentioned above, the new standard has a single model to deal with revenue from contracts with customers. Its core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Specifically, the standard introduces a five-step approach to revenue recognition:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Extensive disclosures are also required by the new standard.

IFRS 15, together with clarifications thereto issued in April 2016, is effective for reporting periods beginning on or after January 1, 2018 with earlier application permitted. Management has elected to adopt the standard as of the effective date and although the related disclosures will change, there will be no material adjustments to the amounts reported in Nalcor's annual audited consolidated financial statements.

### 4.3 IFRIC 22 Foreign Currency Transactions and Advance Consideration

IFRIC 22 addresses how to determine the 'date of transaction' for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income, when consideration for that item has been paid or received in advance in a foreign currency which resulted in the recognition of a non-monetary asset or non-monetary liability (for example, a non-refundable deposit or deferred revenue).

The Interpretation is effective for reporting periods beginning on or after January 1, 2018 with earlier application permitted. Entities can apply the Interpretation either retrospectively or prospectively. Specific transition provisions apply to prospective application. The application of these amendments to IFRIC 22 will not have a material impact on Nalcor's annual audited consolidated financial statements.

### 4.4 IFRS 16 - Leases

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It will supersede the following lease standard and interpretations upon its effective date:

- IAS 17 Leases;
- IFRIC 4 Determining Whether an Arrangement contains a Lease;
- SIC-15 Operating Leases – Incentives; and
- SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

IFRS 16 applies a control model to the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer.

The standard introduces significant changes to lessee accounting: it removes the distinction between operating and finance leases under IAS 17 and requires a lessee to recognize a right-of-use asset and a lease liability at lease commencement for all leases, except for short-term leases and leases of low value assets.

In contrast to lessee accounting, the IFRS 16 lessor accounting requirements remain largely unchanged from IAS 17, which continue to require a lessor to classify a lease as either an operating lease or a finance lease.

A lessee can apply IFRS 16 either by a full retrospective approach or a modified retrospective approach. If the latter approach is selected, an entity is not required to restate the comparative information and the cumulative effect of initially applying IFRS 16 must be presented as an adjustment to opening retained earnings. Management anticipates that the application of IFRS 16 in the future may have a material impact on the amounts reported and disclosures made in Nalcor's annual audited consolidated financial statements. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until Management performs a detailed review.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 5. CASH AND CASH EQUIVALENTS

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Cash	143	130
Cash equivalents	-	13
	<b>143</b>	<b>143</b>

The effective interest rate on cash equivalents at December 31, 2017 was nil (2016 - 0.97%).

### 6. TRADE AND OTHER RECEIVABLES

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Trade receivables	199	148
Advances (a)	78	38
Other receivables (b)	135	124
Allowance for doubtful accounts	(17)	(16)
	<b>395</b>	<b>294</b>

(a) Advances relate to the current portion of long-term advances to suppliers in relation to construction of the Lower Churchill Project.

(b) Other receivables are comprised primarily of harmonized sales tax (HST) as well as interest on long-term investments.

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
0-60 days	365	247
60+ days	30	47
	<b>395</b>	<b>294</b>

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Allowance for doubtful accounts, beginning of year	(16)	(13)
Amounts provided for during the year	(1)	(3)
Allowance for doubtful accounts, end of year	<b>(17)</b>	<b>(16)</b>

As at December 31, 2017, trade and other receivables included balances of \$40.6 million (2016 - \$43.9 million) denominated in United States Dollars (USD).

### 7. INVENTORIES

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Materials and other	57	47
No. 6 fuel	48	35
Diesel fuel	4	4
Other fuel	4	5
Construction aggregates	3	2
	<b>116</b>	<b>93</b>

The cost of inventories recognized as an expense during the year is \$234.1 million (2016 - \$173.9 million) and is included in operating costs and fuels.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 8. PROPERTY, PLANT AND EQUIPMENT

<i>(millions of Canadian dollars)</i>	Generation Plant	Transmission and Distribution	Petroleum and Natural Gas Properties	Other	Construction in Progress	Total
<b>Cost</b>						
Balance at January 1, 2016	1,711	773	1,117	419	5,182	9,202
Additions	-	-	208	1	3,041	3,250
Disposals	(6)	(3)	-	(4)	-	(13)
Transfers	94	98	-	28	(220)	-
Decommissioning liabilities and revisions	(14)	1	(10)	-	-	(23)
Other adjustments	-	-	-	(2)	-	(2)
<b>Balance at December 31, 2016</b>	<b>1,785</b>	<b>869</b>	<b>1,315</b>	<b>442</b>	<b>8,003</b>	<b>12,414</b>
<b>Additions</b>	<b>-</b>	<b>1</b>	<b>123</b>	<b>22</b>	<b>3,227</b>	<b>3,373</b>
<b>Disposals</b>	<b>(3)</b>	<b>(4)</b>	<b>(13)</b>	<b>(4)</b>	<b>-</b>	<b>(24)</b>
<b>Transfers</b>	<b>69</b>	<b>335</b>	<b>-</b>	<b>26</b>	<b>(430)</b>	<b>-</b>
<b>Decommissioning liabilities and revisions</b>	<b>(1)</b>	<b>-</b>	<b>2</b>	<b>-</b>	<b>-</b>	<b>1</b>
<b>Other adjustments</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(2)</b>	<b>(13)</b>	<b>(15)</b>
<b>Balance at December 31, 2017</b>	<b>1,850</b>	<b>1,201</b>	<b>1,427</b>	<b>484</b>	<b>10,787</b>	<b>15,749</b>
<b>Depreciation, depletion and impairment</b>						
Balance at January 1, 2016	412	140	172	153	-	877
Depreciation and depletion	48	23	40	14	-	125
Disposals	(2)	(1)	-	(2)	-	(5)
<b>Balance at December 31, 2016</b>	<b>458</b>	<b>162</b>	<b>212</b>	<b>165</b>	<b>-</b>	<b>997</b>
<b>Depreciation and depletion</b>	<b>53</b>	<b>27</b>	<b>57</b>	<b>15</b>	<b>-</b>	<b>152</b>
<b>Disposals</b>	<b>(2)</b>	<b>(1)</b>	<b>-</b>	<b>(2)</b>	<b>-</b>	<b>(5)</b>
<b>Impairment</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>51</b>	<b>51</b>
<b>Balance at December 31, 2017</b>	<b>509</b>	<b>188</b>	<b>269</b>	<b>178</b>	<b>51</b>	<b>1,195</b>
<b>Carrying value</b>						
Balance at January 1, 2016	1,299	633	945	266	5,182	8,325
Balance at December 31, 2016	1,327	707	1,103	277	8,003	11,417
<b>Balance at December 31, 2017</b>	<b>1,341</b>	<b>1,013</b>	<b>1,158</b>	<b>306</b>	<b>10,736</b>	<b>14,554</b>

Capitalized interest for the year ended December 31, 2017, was \$268.0 million (December 31, 2016 - \$198.3 million) related to assets under development.

As at December 31, 2017, construction in progress includes \$140.3 million (2016 - \$186.3 million) of capitalized Gull Island Project costs. This is subsequent to an impairment of \$50.6 million as at December 31, 2017 of the Gull Island Project relating to older costs, previously capitalized, which Management has assessed as no longer having future economic benefit towards the project.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 9. INTANGIBLE ASSETS

<i>(millions of Canadian dollars)</i>	Computer Software	Feasibility Studies	Seismic Data Acquisitions	Intellectual Property	Assets Under Development	Total
<b>Cost</b>						
Balance at January 1, 2016	16	2	41	2	-	61
Additions	-	-	28	-	8	36
Balance at December 31, 2016	16	2	69	2	8	97
<b>Additions</b>	-	-	<b>37</b>	-	<b>14</b>	<b>51</b>
<b>Balance at December 31, 2017</b>	<b>16</b>	<b>2</b>	<b>106</b>	<b>2</b>	<b>22</b>	<b>148</b>
<b>Amortization and impairment</b>						
Balance at January 1, 2016	7	1	3	-	-	11
Amortization	2	-	8	-	-	10
Balance at December 31, 2016	9	1	11	-	-	21
<b>Amortization</b>	<b>2</b>	-	<b>14</b>	-	-	<b>16</b>
<b>Impairment</b>	-	-	<b>81</b>	-	-	<b>81</b>
<b>Balance at December 31, 2017</b>	<b>11</b>	<b>1</b>	<b>106</b>	-	-	<b>118</b>
<b>Carrying value</b>						
Balance at January 1, 2016	9	1	38	2	-	50
Balance at December 31, 2016	7	1	58	2	8	76
<b>Balance at December 31, 2017</b>	<b>5</b>	<b>1</b>	-	<b>2</b>	<b>22</b>	<b>30</b>

As at December 31, 2017, intangible assets included an impairment expense of \$81.0 million related to seismic and geoscientific data acquisition costs previously capitalized as Management assessed the costs as having no short or medium-term future economic benefit to Nalcor.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 10. LONG-TERM INVESTMENTS

In July 2017, Muskrat Falls, Labrador Transco, and the IT purchased six additional structured deposit notes using the proceeds from the issue of long-term debt. The investments are restricted in nature and subject to the provisions contained within the MF/LTA PFA and the LIL PFA.

<i>As at December 31 (millions of Canadian dollars)</i>	Year of Maturity	2017	2016
<b>Muskrat Falls</b>			
\$75.0 million Floating Rate Deposit Note, with interest paid at the one-month Canadian Dollar Offered Rate (CDOR) plus 0.38%.	2017	-	49
\$75.0 million Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.20%.	2019	61	-
\$483.8 million Amortizing Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.20%.	2019	266	-
\$725.7 million Amortizing Fixed Rate Deposit Note, with interest paid at a rate of 1.679% per annum.	2019	400	-
<b>Labrador Transco</b>			
\$75.0 million Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.38%.	2017	-	13
\$75.0 million Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.20%.	2019	14	-
\$483.8 million Amortizing Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.20%.	2019	62	-
\$725.7 million Amortizing Fixed Rate Deposit Note, with interest paid at a rate of 1.679% per annum.	2019	94	-
<b>LIL</b>			
\$75.0 million Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.38%.	2017	-	29
\$75.0 million Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.20%.	2019	75	-
\$182.9 million Amortizing Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.20%.	2019	91	-
\$548.6 million Amortizing Fixed Rate Deposit Note, with interest paid at a rate of 1.644% per annum.	2019	273	-
<b>Churchill Falls</b>			
\$18.4 million Redeemable Guaranteed Investment Certificate (GIC), with interest paid at a rate of 1.40% per annum.	2019	18	18
\$15.5 million Redeemable GIC, with interest paid at a rate of 1.46% per annum.	2019	16	16
Total long-term investments		<b>1,370</b>	125
Less: redemptions to be received within the next year <sup>1</sup>		<b>(1,038)</b>	(91)
		<b>332</b>	34

<sup>1</sup>Redemptions to be received within one year have been reclassified to short-term investments.

As at December 31, 2017, Churchill Falls held a bank deposit note purchased on October 25, 2017 for \$22.1 million maturing April 25, 2018 with an interest rate of 1.52% per annum. Nalcor's 65.8% share of the short-term investment is \$14.5 million (2016 - \$nil).

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 11. OTHER LONG-TERM ASSETS

<i>As at December 31 (millions of Canadian dollars)</i>		2017	2016
Investment property	(a)	1	1
Investment in joint arrangement		1	1
Long-term receivables	(b)	-	28
Long-term prepayments		1	3
Reserve fund	(c)	-	15
Sinking funds	(d)	231	307
Other		1	1
Other long-term assets		235	356
Less: current portion		(2)	(82)
		233	274

- (a) As at December 31, 2017, the fair value measurement of the investment property is categorized as a Level 3 valuation. The fair value of the investment property at December 31, 2017 is estimated to be \$1.9 million (2016 - \$19.4 million). Due to the nature of the property and lack of comparable market data, the fair value of Nalcor's investment property is determined using the present value of future cash flows. Nalcor's 2017 estimate is based on cash flows estimated to occur between 2018 and 2022, discounted at a rate of 12.0%.
- (b) As at December 31, 2017, long-term receivables include \$nil (2016 - \$26.9 million) related to long-term advances to suppliers in relation to construction of the Lower Churchill Project. The current portion of \$77.6 million (2016 - \$38.2 million) is included in trade and other receivables. The non-current portion of receivables associated with customer payment plans and the long-term portion of employee purchase programs as at December 31, 2017 is \$0.3 million (2016 - \$0.5 million).
- (c) In 2007 Churchill Falls commenced the creation of a \$75.0 million segregated reserve fund pursuant to the terms of the Shareholders' Agreement to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested \$17.0 million in each of 2007, 2008 and 2009 and \$8.0 million in each of 2010, 2011 and 2012. In December 2017, \$22.5 million (2016 - \$23.4 million) was withdrawn to fund a portion of capital expenditures. As per the terms of the Shareholders' Agreement, these funds will be replaced over a five year period beginning in 2018.

This fund must remain in place until the end of the Shareholders' Agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holdings consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 and 2 Canadian Chartered Banks.

Nalcor's proportionate share of the reserve fund consists of the following:

<i>As at December 31 (millions of Canadian dollars)</i>		2017	2016
Reserve fund, beginning of year		15	31
Principal withdrawals		(15)	(16)
Reserve fund, end of year		-	15
Less: current portion		-	(5)
		-	10

Nalcor's proportionate share of reserve fund contributions for the next five years are as follows:

<i>(millions of Canadian dollars)</i>	2018	2019	2020	2021	2022
Reserve fund contributions	12	12	12	6	7

- (d) As at December 31, 2017, sinking funds include \$190.2 million (2016 - \$267.0 million) related to repayment of Hydro's long-term debt and \$40.9 million (2016 - \$40.1 million) related to funding of Nalcor's long-term payable under the Upper Churchill

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Redress Agreement (UCRA). Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2018 to 2041.

Hydro debentures, which are intended to be held to maturity, are deducted from debt while all other sinking fund investments are shown separately on the Consolidated Statement of Financial Position as assets. Annual contributions to the various sinking funds are in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 2.57% to 6.82% (2016 - 0.97% to 9.12%).

Nalcor's sinking funds are held to fund the annual payments to the Innu Nation as required under the UCRA.

The sinking funds consist of the following:

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Sinking funds, beginning of year	307	284
Contributions	7	8
Earnings	24	14
Disposals and maturities	(97)	(2)
Mark-to-market adjustment	(10)	3
Sinking funds, end of year	231	307
Less: current portion	(2)	(77)
	229	230

Sinking fund instalments due for the next five years are as follows:

<i>(millions of Canadian dollars)</i>	2018	2019	2020	2021	2022
Sinking fund instalments	7	7	7	7	7

## 12. REGULATORY DEFERRALS

<i>As at (millions of Canadian dollars)</i>	January 1 2017	Reclass and Disposition	Regulatory Activity	December 31 2017	Remaining Recovery Settlement Period (years)
<b>Regulatory asset deferrals</b>					
2014 cost deferral (a)	39	(38)	(1)	-	n/a
2015 cost deferral (b)	25	(28)	3	-	n/a
2016 cost deferral (c)	32	(36)	4	-	n/a
Deferred energy conservation costs (e)	8	-	1	9	n/a
Deferred foreign exchange on fuel (f)	-	-	(1)	(1)	n/a
Deferred lease costs (g)	5	-	(1)	4	3.4
Energy supply deferral (j)	-	31	21	52	n/a
Foreign exchange losses (k)	54	-	(2)	52	24.0
Phase Two hearing costs (p)	1	-	-	1	n/a
Other (d),(m)	-	-	-	-	n/a
	164	(71)	24	117	
<b>Regulatory liability deferrals</b>					
Insurance amortization and proceeds (n)	(4)	-	1	(3)	n/a
Labrador refund (o)	-	(1)	-	(1)	2.0
Rate stabilization plan (RSP) (q)	(344)	203	66	(75)	n/a
Other (h)	-	-	-	-	n/a
	(348)	202	67	(79)	

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 12.1 Regulatory Adjustments Recorded in the Consolidated Statement of Profit and Comprehensive (Loss) Income

The following table shows Hydro's regulatory deferrals which will be, or are expected to be, reflected in customer rates in future periods and have been established through the rate setting process. In the absence of rate regulation, these amounts would be reflected in operating results in the period and the profit for the period ended December 31, 2017 would have decreased by \$91.1 million (2016 - a decrease of \$0.8 million).

<i>For the year ended December 31 (millions of Canadian dollars)</i>		2017	2016
RSP amortization		(53)	(40)
RSP fuel deferral		(19)	42
RSP interest		9	25
Rural rate adjustment		(3)	(8)
<b>Total RSP activity</b>	<b>(q)</b>	<b>(66)</b>	<b>19</b>
2014 cost deferral	(a)	1	8
2015 cost deferral	(b)	(3)	2
2016 cost deferral	(c)	(4)	(32)
Deferred energy conservation	(e)	(1)	(1)
Deferred foreign exchange on fuel	(f)	1	1
Deferred lease costs	(g)	1	1
Energy supply deferral	(j)	(21)	-
Amortization of deferred foreign exchange losses	(k)	2	2
Fuel supply deferral	(l)	-	1
Insurance amortization and proceeds	(n)	(1)	(1)
Phase Two hearing costs	(p)	-	(1)
Other	(d),(h),(i),(m),(o)	-	-
		<b>(91)</b>	<b>(1)</b>

#### (a) 2014 Cost Deferral

In Board Order No. P.U. 22 (2017), the Board approved \$37.7 million of the \$38.7 million 2014 cost deferral, resulting in a loss in 2017 of \$1.0 million (2016 - \$8.0 million loss), and the disposition of the deferral balance from the RSP.

#### (b) 2015 Cost Deferral

In Board Order No. P.U. 22 (2017), the Board approved \$27.7 million of the 2015 cost deferral, resulting in a gain in 2017 of \$3.2 million (2016 - \$1.6 million loss), and the disposition of the deferral balance from the RSP.

#### (c) 2016 Cost Deferral

The 2016 cost deferral of \$32.4 million consisted of energy supply costs of \$31.0 million and other costs of \$1.4 million. As a result of Board Order No. P.U. 22 (2017), \$31.0 million was re-classified to the energy supply deferral. The Board also approved other 2016 costs of \$5.0 million, which resulted in an increase in profit of \$3.6 million in 2017, and the disposition of the deferral balance from the RSP.

#### (d) Asset Disposal

As per Board Order No. P.U. 49 (2016), the PUB Ordered that Hydro recognize a regulatory asset of \$0.4 million related to the Sunnyside transformer that was disposed of in 2014. Hydro is required to recover the deferred asset in rate base and amortize the asset for 22.4 years commencing in 2015. Hydro is required to exclude the new Sunnyside transformer from rate base until the Sunnyside Transformer Original Asset Deferral has been fully amortized.

#### (e) Deferred Energy Conservation

In 2017, Hydro deferred \$1.5 million (2016 - \$1.1 million) in the Energy Conservation Costs regulatory asset associated with an electrical conservation program for residential, industrial, and commercial sectors. In addition, as per Board Order No. P.U. 22 (2017), Hydro recovered \$0.5 million (2016 - \$nil) of the balance through a rate rider.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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- (f) **Deferred Foreign Exchange on Fuel**  
Hydro purchases a significant amount of fuel for Holyrood Thermal Generating Station (HTGS) in USD. The RSP allows Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2017, Hydro recognized in regulatory assets, foreign exchange gains on fuel purchases of \$0.4 million (2016 - \$0.9 million gain).
- (g) **Deferred Lease Costs**  
In 2017, pursuant to Board Order No. P.U. 38 (2013), Board Order No. P.U. 17 (2016) and Board Order No. P.U. 23 (2016), Hydro deferred lease costs of \$nil (2016 - \$1.6 million) for diesel units and other necessary infrastructure to ensure black start capability at HTGS. In Board Order No. P.U. 17 (2016), Board Order No. P.U. 23 (2016) and Board Order No. P.U. 49 (2016) the Board approved the amortization of diesel units at (HTGS) over a period of five years. In 2017, Hydro recorded amortization of \$1.3 million (2016 - \$2.2 million) of the deferred lease costs.
- (h) **Deferred Purchased Power Savings**  
In 1997, the PUB ordered Hydro to defer \$1.1 million related to reduced purchased power rates resulting from the interconnection of communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system and amortize the balance over a 30 year period. The remaining unamortized savings in the amount of \$0.4 million (2016 - \$0.4 million) are deferred as a regulatory liability.
- (i) **Employee Future Benefits Actuarial Loss**  
Pursuant to Board Order No. P.U. 36 (2015), Hydro has recognized the amortization of employee future benefit actuarial gains and losses in net income. During 2017, Hydro recorded \$0.1 million (2016 - \$0.2 million) employee future benefits losses as a regulatory adjustment. In the absence of rate regulation, IFRS would require Hydro to include employee future benefits actuarial gains and losses in other comprehensive loss. As a result, during 2017 Hydro also recorded a decrease of \$0.1 million (2016 - \$0.2 million) to other comprehensive loss to recognize the amount that was reclassified to profit or loss.
- (j) **Energy Supply Deferrals**  
Pursuant to Board Order No. P.U. 22(2017), the Board approved the deferral of Energy Supply deferrals which includes the Energy Supply, Holyrood Conversion and Isolated Systems Supply deferral. The recovery of the deferral is subject to a future Board order. In 2017, \$31.0 million relating to energy supply deferred for the periods 2015-2016 was re-classified from the 2016 Cost deferral to the Energy Supply deferral. The net increase to profit in 2017 was \$21.3 million.
- (k) **Foreign Exchange Losses**  
In 2002, the PUB ordered Hydro to defer realized foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt and amortize the balance over a 40 year period. Accordingly, these costs were recognized as a regulatory asset. During 2017, the amortization of \$2.2 million (2016 - \$2.2 million) reduced regulatory assets.
- (l) **Fuel Supply Deferral**  
Pursuant to Board Order No. P.U. 56 (2014), Hydro received approval in 2014 to defer \$9.6 million as a regulatory asset in additional capacity related supply costs incurred during the three months ended March 31, 2014. As per Board Order No. P.U. 13 (2016) and Board Order No. P.U. 49 (2016), Hydro recorded a reduction of \$1.5 million in 2016 based upon the results of a Prudence Review. In 2016, as per Board Order No. P.U. 49 (2016), the remaining balance of \$8.1 million was re-classified to the 2014 Cost Deferral.
- (m) **Hearing Costs**  
As per Board Order No. P.U. 49 (2016), the Board approved \$0.8 million in hearing costs to be deferred and amortized over a three year period commencing 2015. In 2017, Hydro recorded amortization of \$0.3 million (2016 - \$0.5 million).
- (n) **Insurance Amortization and Proceeds**  
Pursuant to Board Order No. P.U. 13 (2012), Hydro records net insurance proceeds against the capital costs and amortizes the balance over the life of the asset. Under IFRS, Hydro is required to recognize the insurance proceeds and corresponding

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

amortization in regulatory liabilities. During 2017, Hydro recorded a decrease to regulatory liabilities resulting from amortization of \$0.5 million (2016 - \$0.6 million) related to the assets.

**(o) Labrador Refund**

Pursuant to Board Order No. P.U. 22 (2017), during 2017 Hydro refunded Labrador Industrial Transmission customers' excess revenues relating to the period of 2014 to 2017. The PUB also ordered that Hydro apply a rate reduction for a 30-month period to address excess revenues relating to Hydro's rural customers on the Labrador Interconnected System. In July 2017, Hydro began the amortization of excess revenues which resulted in a decrease to profit of \$0.5 million (2016 - \$nil).

**(p) Phase Two Hearing Costs**

Pursuant to Board Order No. P.U. 13 (2016), Hydro received approval to defer consulting fees, salary transfers and overtime relating to Phase Two of the investigation into the reliability and adequacy of power on the Island Interconnected system after the interconnection with the Muskrat Falls generating station. As a result, Hydro recorded a regulatory asset of \$0.3 million (2016 - \$0.9 million).

**(q) RSP**

In 1986, the PUB ordered Hydro to implement the RSP which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, hydrology and load and associated interest. Additionally, the RSP also includes costs associated with the island interconnected and isolated systems. Adjustments required in utility rates to cover the amortization of the balance are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year. On June 30, 2017, the PUB approved rates for Hydro's Island Interconnected and Rural customers in Board Order No. P.U. 25 (2017).

During 2017, Hydro recorded a net decrease in regulatory liabilities of \$269.4 million (2016 - increase of \$19.0 million) resulting in an RSP ending balance for 2017 of \$74.2 million (2016 - \$343.6 million). The decrease in the RSP balance is primarily caused by the RSP surplus payout, the disposition of the 2014-2016 Cost Deferrals and GRA related payments, and the normal operation of the RSP. As per Board Order P.U. 36 (2016), the RSP was reduced by \$130.8 million relating to the refund of the utility surplus balance. The reduction was comprised of \$128.8 million refund to customers and \$2.0 million in administrative costs. The remaining portion of the utility surplus balance is \$12.6 million (2016 - \$143.4 million). As per Board Order No. P.U. 22 (2017) and Board Order No. P.U. 24 (2017), the Board approved a \$72.4 million recovery of the 2014-2016 Cost Deferrals and other GRA related payments through the RSP. The normal operation of the RSP resulted in an increase to net income of \$66.2 million (2016 - decrease of \$19.0 million).

### 13. TRADE AND OTHER PAYABLES

<i>As at December 31 (millions of Canadian dollars)</i>	<b>2017</b>	2016
Trade payables and accruals	<b>491</b>	1,089
Accrued interest payable	<b>55</b>	44
Rent and royalty payable	<b>4</b>	5
Other payables	<b>34</b>	24
	<b>584</b>	1,162

As at December 31, 2017, trade and other payables included balances of \$23.5 million (2016 - \$34.2 million) denominated in USD, \$nil (2016 - \$0.1 million) denominated in Great British Pounds and \$0.9 million (2016 - \$45.0 million) denominated in Euros.

### 14. DEBT

#### 14.1 Short-term Borrowings

Nalcor maintains a \$250.0 million CAD or USD equivalent committed revolving term credit facility with its banker, with a maturity

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

date of January 31, 2019. There were no amounts drawn on this facility as at December 31, 2017 (2016 - \$nil), however \$34.3 million of the borrowing limit has been used to issue 15 irrevocable letters of credit (2016 - \$34.1 million). Borrowings in CAD may take the form of Prime Rate Advances, Bankers' Acceptances (BAs) and letters of credit. Borrowings in USD may take the form of Base Rate Advances, London Interbank Offer Rate (LIBOR) Advances and letters of credit. The facility also provides coverage for overdrafts on Nalcor's bank accounts, with interest calculated at the Prime Rate.

Two letters of credit, totaling \$25.7 million, are on behalf of Oil and Gas to ensure compliance with regulations relating to petroleum and natural gas exploration and production activities. Another 12 letters, totaling \$7.8 million, are on behalf of Energy Marketing and relate to power purchases and sale contracts with various independent system operators, transmission providers and bilateral counterparties. One irrevocable letter of credit for \$0.8 million was issued by Nalcor in July 2017 as bid security for a Request for Proposal (RFP) for the supply of energy.

In December 2017, Nalcor, on behalf of Energy Marketing, issued an unconditional guarantee in the amount of \$10.0 million, in order to guarantee amounts under a power purchase and sale contract with a bilateral counterparty.

On September 29, 2017, Nalcor refinanced the \$225.0 million promissory note to the Province dated March 31, 2017. The new promissory note matures March 30, 2018 and carries an interest rate of 1.845%.

On July 27, 2017, Hydro converted its \$50.0 million demand operating facility, to a \$200.0 million CAD or USD equivalent committed revolving term credit facility, with a maturity date of July 27, 2019. As at December 31, 2017, there were no amounts drawn on the facility (2016 - \$nil). Borrowings in CAD may take the form of Prime Rate Advances, BAs and letters of credit, with interest calculated at the Prime Rate or prevailing Government BA fee. Borrowings in USD may take the form of Base Rate Advances, LIBOR Advances and letters of credit. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate.

In addition, Hydro utilized its government guaranteed promissory note program to fulfil its short-term funding requirements. As at December 31, 2017, there were \$144.0 million in promissory notes outstanding with a maturity date of January 3, 2018 bearing an interest rate of 1.13% (2016 - \$210.0 million bearing an interest rate of 0.63%). Upon maturity, a promissory note was reissued in the amount of \$155.0 million with a maturity date of January 16, 2018 bearing an interest rate of 1.17%.

<i>As at December 31 (millions of Canadian dollars)</i>	<b>2017</b>	<b>2016</b>
Promissory notes - borrowed from the Province	<b>225</b>	<b>225</b>
Promissory notes - borrowed from external markets	<b>144</b>	<b>210</b>
	<b>369</b>	<b>435</b>

Churchill Falls maintains a \$10.0 million Canadian or US equivalent unsecured operating credit facility with its banker. Advances may take the form of a Prime Rate advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA Fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate. There were no amounts drawn on this facility as at December 31, 2017 (2016 - \$nil).

Churchill Falls has issued three irrevocable letters of credit totaling \$2.0 million (2016 - \$2.0 million), \$1.0 million of which does not impact the borrowing limit of the operating credit facility (2016 - \$1.0 million). The letters of credit ensure satisfactory management of its waste management system and compliance with a certificate of approval for the transportation of special and hazardous wastes, granted by the Provincial Department of Environment and Conservation.

Oil and Gas maintains a \$30.0 million CAD or USD equivalent unsecured credit facility with its banker and as at December 31, 2017, there were no amounts drawn on this facility (2016 - \$nil), however \$5.4 million of the borrowing limit has been used to issue two irrevocable letters of credit (2016 - \$0.5 million). Borrowings in CAD may take the form of Prime Rate Advances and letters of credit. Borrowings in USD may take the form of Base Rate Advances and letters of credit. In April 2017, Oil and Gas issued an irrevocable letter of credit in the amount of \$4.9 million to the Canada-Newfoundland and Labrador Offshore Petroleum Board (C-NLOPB). The purpose of the letter was to provide proof of financial responsibility with respect to the Hebron project.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Energy Marketing maintains a \$20.0 million CAD or USD equivalent demand operating credit facility with its banker, and as at December 31, 2017, there were no amounts drawn on this facility (2016 - \$nil). This facility has an unconditional and irrevocable guarantee from Nalcor. Borrowings in CAD may take the form of Prime Rate Advances, BAs and letters of credit. Borrowings in USD may take the form of Base Rate Advances, LIBOR Advances and letters of credit.

### 14.2 Long-term Debt

The following table represents the value of long-term debt measured at amortized cost:

<i>As at December 31 (millions of Canadian dollars)</i>	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2017	2016
<b>Hydro</b>						
X*	-	10.25	1992	2017	-	150
Y*	300	8.40	1996	2026	295	295
AB*	300	6.65	2001	2031	305	306
AD*	125	5.70	2003	2033	124	124
AF	500	3.60	2014/2017	2045	480	197
1A	300	3.70	2017	2048	330	-
<b>LIL LP</b>						
Tranche A	725	3.76	2013	2033	726	726
Tranche B	600	3.86	2013	2045	600	600
Tranche C	1,075	3.85	2013	2053	1,075	1,075
Tranche 1-10	105	1.14-1.75	2017	2020-2025	105	-
Tranche 11-20	105	1.84-2.37	2017	2025-2030	105	-
Tranche 21-30	105	2.41-2.64	2017	2030-2035	105	-
Tranche 31-40	105	2.66-2.80	2017	2035-2040	105	-
Tranche 41-50	105	2.81-2.86	2017	2040-2045	105	-
Tranche 51-60	105	2.84-2.86	2017	2045-2050	105	-
Tranche 61-70	105	2.85	2017	2050-2055	105	-
Tranche 71-74	315	2.85	2017	2055-2057	316	-
<b>Lab Transco/Muskrat Falls</b>						
Tranche A	650	3.63	2013	2029	650	650
Tranche B	675	3.83	2013	2037	675	675
Tranche C	1,275	3.86	2013	2048	1,275	1,275
Tranche 1-10	205	1.14-1.75	2017	2020-2025	205	-
Tranche 11-20	224	1.84-2.37	2017	2025-2030	224	-
Tranche 21-30	253	2.41-2.64	2017	2030-2035	253	-
Tranche 31-40	288	2.66-2.80	2017	2035-2040	289	-
Tranche 41-50	331	2.81-2.86	2017	2040-2045	331	-
Tranche 51-60	381	2.84-2.86	2017	2045-2050	382	-
Tranche 61-64	168	2.85	2017	2050-2052	168	-
<b>Total</b>	<b>9,425</b>				<b>9,438</b>	<b>6,073</b>
Less: Sinking fund investments in own debentures					45	57
					<b>9,393</b>	<b>6,016</b>
Less: maturities of debt within one year					-	150
Less: sinking fund payments within one year					7	7
Less: maturities of sinking funds in own debentures					-	(14)
					<b>9,386</b>	<b>5,873</b>

\*Sinking funds have been established for these issues.

Hydro's promissory notes and long-term debt are unsecured and unconditionally guaranteed as to principal and interest and,

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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where applicable, sinking fund payments, by the Province, with the exception to Series 1A. The Province charges Hydro a guarantee fee of 25 basis points annually on the total debt (net of sinking funds) with a remaining term to maturity of less than or equal to 10 years and 50 basis points annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years for debt outstanding as of December 31, 2010. For debt issued subsequent to December 31, 2010, the guarantee rate is 25 basis points annually on the total debt (net of sinking funds) with an original term to maturity of less than or equal to 10 years and 50 basis points annually on total debt (net of sinking funds) with an original term to maturity greater than 10 years. The guarantee fee charged by the Province for the year ended December 31, 2017 was \$4.1 million (2016 - \$4.5 million).

On January 20, 2017, Hydro issued new long-term debt through the reopening and sale of \$300.0 million of Series AF debentures to its underwriting syndicate. The debentures mature on December 1, 2045 with a coupon rate of 3.60% paid semi-annually.

On July 14, 2017 Hydro's \$150.0 million long-term debt, Series X, matured. Sinking fund disposals during the year in the amount of \$95.1 million were used to offset the Series X maturity.

On December 20, 2017, Hydro issued new long-term debt, Series 1A, with a face value of \$300.0 million. The Province of Newfoundland and Labrador issued debt specifically on Hydro's behalf and lent the proceeds to Hydro. The debt matures on October 17, 2048 with a coupon rate of 3.70% paid semi-annually.

On January 3, 2018, Hydro reissued a promissory note in the amount of \$155.0 million with a maturity date of January 16, 2018 bearing an interest rate of 1.17%. Upon maturity, the promissory note was reissued.

On May 10, 2017, Muskrat Falls, Labrador Transco, the MF/LTA Funding Trust and the Collateral Agent executed a second amendment to the MF/LTA PFA. Under the terms and conditions of the second amended MF/LTA PFA, the MF/LTA Funding Trust agreed to provide an additional non-revolving credit facility in the amount of \$1.85 billion available in a series of 64 bonds with maturities every six months beginning in December 2020. On May 25, 2017, the second construction facility was fully drawn down by way of a single advance to an account administered by a Collateral Agent. The Company draws funds from this account on a monthly basis in accordance with procedures set out in the MF/LTA PFA.

On May 10, 2017, the IT, LIL Funding Trust, LIL LP, LIL Opco and the Collateral Agent executed second amendments to the IT Project Finance Agreement (IT PFA) and LIL PFA. Under the terms and conditions of the second amended IT PFA, the LIL Funding Trust agreed to provide an additional non-revolving credit facility in the amount of \$1.05 billion to the IT. These facilities, available in a series of 74 bonds with maturities every six months beginning in December 2020, were fully drawn down on May 25, 2017 by way of a single advance to an account administered by a Collateral Agent. LIL LP draws funds from this account on a monthly basis in accordance with procedures set out in the LIL PFA.

The financing of the MF/LTA Funding Trust and LIL Funding Trust benefits from a direct, absolute, unconditional and irrevocable guarantee from the Government of Canada, and thereby carries its full faith and credit (AAA rating or equivalent). Under the terms of the additional guarantee from the Government of Canada, Muskrat Falls, Labrador Transco and LIL LP agree to pay an annual guarantee fee starting in May 2018 equal to 0.5% of the average balance outstanding on LIL LP Tranches 1 through 74 and Labrador Transco/Muskrat Falls Tranches 1 through 64 for the prior twelve months.

As security for these debt obligations, Muskrat Falls, Labrador Transco and LIL LP have granted to the Collateral Agent first ranking liens on all present and future assets. Sinking funds, beginning in December 2020, are required to be set up for Tranche A, B and C debentures and are to be held in a sinking fund account under the control of the Collateral Agent.

### 15. CLASS B LIMITED PARTNERSHIP UNITS

Debt and equity instruments issued by LIL LP are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

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The Class B limited partnership units represent Emera NL's ownership interest in the Partnership. As described in the Partnership Agreement, these units have certain rights and obligations, including mandatory distributions, that indicate that the substance of the units represent a financial liability and are measured at amortized cost using the effective interest method. The return on the units is classified as a finance expense. All finance expenses associated with the units have been capitalized.

<i>As at December 31 (millions of Canadian dollars)</i>	Units	2017	Units	2016
Class B limited partnership units, beginning of year	25	399	25	207
Contributions	-	55	-	168
Accrued interest	-	37	-	24
Class B limited partnership units, end of year	25	491	25	399

### 16. DEFERRED CREDITS

Deferred credits consist of funding from the Province, deferred energy sales to Emera NL and deferred lease revenue related to Menihek lease assets for the sale of energy to Hydro-Québec.

<i>As at December 31, 2017 (millions of Canadian dollars)</i>	Government Funding	Oil and Gas Over-lift	Deferred Energy Sales	Deferred Lease Revenue	Total
Deferred credits, beginning of year	2	1	1,145	16	1,164
Additions	1	-	588	5	594
Amortization	(2)	-	-	(3)	(5)
Deferred credits, end of year	1	1	1,733	18	1,753
Less: current portion	(1)	-	-	-	(1)
	-	1	1,733	18	1,752

Nalcor has received funding from the Province for wind feasibility studies in Labrador. The funding is recognized as other revenue when the related expenditures are incurred.

Nalcor has also received funding from the Province towards two Oil and Gas initiatives. The first is the Petroleum Exploration Enhancement Program (PEEP) which is designed to boost new petroleum exploration in Western Newfoundland through acquisition and assessment of seismic data. The second is the Offshore Geoscience Data Project (OGDP) which is designed to encourage new offshore petroleum exploration in Newfoundland and Labrador through the acquisition and assessment of seismic data. The funding is recognized as other revenue when the related expenditures are incurred. Deferred revenue also includes the over-lift position associated with Nalcor's net working interest of petroleum and natural gas produced, and the fair value of oil inventory held at the Newfoundland Transshipment site.

Nalcor has recorded deferred energy sales of \$1,732.9 million (2016 - \$1,144.5 million) which equals the construction costs to date incurred by Emera related to the Maritime Link. Nalcor has determined that it controls the Maritime Link asset for financial reporting purposes, and as such, has recorded the costs as a component of property, plant and equipment under construction.

Deferred lease revenue includes deferred lease revenue related to the Menihek plant.

### 17. DEFERRED CONTRIBUTIONS

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Deferred contributions, beginning of year	12	12
Additions	1	1
Amortization	(1)	(1)
Deferred contributions, end of year	12	12
Less: current portion	(1)	(1)
	11	11

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 18. DECOMMISSIONING LIABILITIES

Nalcor has recognized liabilities associated with the retirement of portions of the HTGS, disposal of Polychlorinated Biphenyls (PCB) and decommissioning liabilities resulting from its net ownership interests in petroleum and natural gas properties and related well sites.

The reconciliation of beginning and ending carrying amounts of decommissioning liabilities as at December 31, 2017 and December 31, 2016 are as follows:

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Decommissioning liabilities, beginning of year	83	103
Liabilities settled	(1)	(1)
Accretion	3	4
Revisions	1	(23)
<u>Decommissioning liabilities, end of year</u>	<u>86</u>	<u>83</u>
<u>Less: current portion</u>	<u>-</u>	<u>(1)</u>
	<u>86</u>	<u>82</u>

The total estimated undiscounted cash flows required to settle the HTGS obligations as at December 31, 2017 are \$15.2 million (2016 - \$15.2 million). In 2016, the HTGS decommissioning obligation decreased primarily due to an updated assumption that Holyrood will be used as an industrial site for the foreseeable future because of the operation of assets such as the Holyrood CT and the black start diesels. Payments to settle the liabilities are expected to occur between 2020 and 2023. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at Hydro's credit adjusted risk free rate of 2.6% (2016 - 2.5%). Nalcor has recorded \$13.5 million (2016 - \$13.4 million) related to HTGS obligations.

The total estimated undiscounted cash flows required to settle the PCB obligations as at December 31, 2017 are \$1.8 million (2016 - \$2.7 million). Payments to settle the liabilities are expected to occur between 2018 and 2025. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at Hydro's and Churchill Falls' credit adjusted risk free rates of 2.8% to 3.2%, respectively, (2016 - 2.9% to 3.7%). Nalcor has recorded \$1.5 million (2016 - \$2.4 million) related to PCB obligations.

Oil and Gas' decommissioning liabilities result from net ownership interests in petroleum and natural gas properties and related well sites. The total undiscounted estimated cash flows required to settle the obligations, including a rate of inflation of 2%, at December 31, 2017 are \$131.3 million (2016 - \$116.8 million). Payments to settle the liabilities are expected to occur between 2028 and 2033. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at rates ranging from 3.9% to 4.2% (December 31, 2016 - 4.0% to 4.3%).

A significant number of Nalcor's assets include generation plants, transmission assets and distribution systems. These assets can continue to run indefinitely with ongoing maintenance activities. As it is expected that Nalcor's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related decommissioning liability cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Nalcor is required to remove, a decommissioning liability for those assets will be recognized at that time.

### 19. LONG-TERM PAYABLES

As at December 31, 2017, long-term payables consist of a payable to the Innu Nation under the UCRA, a payable to the Innu Nation under the Impact and Benefits Agreement (IBA) and a payable to the NunatuKavut Community Council under the Community Development Agreement (CDA).

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Long-term payables, beginning of year	65	77
Payments	(7)	(15)
Additions and revisions	(1)	-
Accretion	4	3
	61	65
Less: current portion	(9)	(7)
Long-term payables, end of year	52	58

Under the UCRA, Nalcor is required to pay to the Innu Nation \$2.0 million annually, escalating by 2.5% annually until 2041. At December 31, 2017, \$2.4 million (2016 - \$2.2 million) of the amount is current and is recorded in trade and other payables. Nalcor has sinking funds in the amount of \$40.9 million (2016 - \$40.1 million) to fund these future obligations.

Under the IBA, Nalcor is required to make annual implementation payments to the Innu Nation that commenced upon sanction of the Muskrat Falls hydroelectric plant. The Muskrat Falls hydroelectric plant was sanctioned in December 2012 and the first IBA payment was made at that time. The IBA requires annual payments of \$5.0 million escalating by an annual consumer price index from sanction until the earlier of first commercial power or ten years. The present value of the remaining payments using a discount rate of 2.9% (2016 - 2.7%) is \$13.2 million (2016 - \$27.9 million). The current portion of the payable at December 31, 2017 is \$5.0 million (2016 - \$5.0 million) and is recorded in trade and other payables.

Under the CDA signed on December 1, 2017, Nalcor is required to pay the NunatuKavut Community Council for the obligations as outlined in the agreement. At December 31, 2017, the present value of the payable is \$7.5 million. The current portion of the payable as at December 31, 2017 is \$1.5 million and is recorded in trade and other payables.

## 20. EMPLOYEE FUTURE BENEFITS

### 20.1 Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$13.1 million (2016 - \$12.0 million) are expensed as incurred.

### 20.2 Other Benefits

Nalcor provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a retirement allowance. In 2017, cash payments to beneficiaries for its unfunded other employee future benefits were \$4.5 million (2016 - \$8.9 million). An actuarial valuation was performed as at December 31, 2017.

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Accrued benefit obligation, beginning of year	117	116
Current service cost	5	5
Interest cost	5	5
Benefits paid	(4)	(9)
Actuarial loss	3	-
Accrued benefit obligation, end of year	126	117

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Component of benefit cost		
Current service cost	5	5
Interest cost	5	5
Total benefit expense for the year	10	10

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The significant actuarial assumptions used in measuring the accrued benefit obligations and benefit expenses are as follows:

	2017	2016
Discount rate - benefit cost	3.90%	4.10%
Discount rate - accrued benefit obligation	3.55%	3.90%
Rate of compensation increase	3.50%	3.50%

Assumed healthcare trend rates:

	2017	2016
Initial health care expense trend rate	6.00%	5.85%
Cost trend decline to	4.50%	4.50%
Year that rate reaches the rate it is assumed to remain at	2028	2025

A 1% change in assumed health care trend rates would have had the following effects:

<i>Increase (millions of Canadian dollars)</i>	2017	2016
Current service and interest cost	2.5	2.1
Accrued benefit obligation	21.4	19.3
<i>Decrease (millions of Canadian dollars)</i>	2017	2016
Current service and interest cost	(1.8)	(1.5)
Accrued benefit obligation	(16.2)	(14.8)

## 21. SHAREHOLDER'S EQUITY

### 21.1 Share Capital

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Common shares of par value \$1 each		
Authorized - unlimited		
Issued and outstanding - 122,500,000	123	123

### 21.2 Shareholder Contributions

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Total shareholder contributions	3,693	2,861

During 2017, Nalcor's shareholder contributed capital in the amount of \$832.3 million (2016 - \$656.1 million) in relation to Nalcor's capital expenditures.

During 2017, the Churchill Falls (Labrador) Corporation Trust (the Trust) contributed capital in the amount of \$0.2 (2016 - \$0.3 million).

## 22. CAPITAL MANAGEMENT

Nalcor's principal business requires ongoing access to capital in order to maintain assets and ensure the continuity of its operations as a going concern. Nalcor also requires access to capital to fund its various development activities relating to Oil and Gas and the Lower Churchill Project. Therefore, Nalcor's primary objective when managing capital is to ensure ready access to capital at a reasonable cost, to minimize its cost of capital within the confines of established risk parameters, and to safeguard Nalcor's ability to continue as a going concern.

The capital managed by Nalcor is comprised of debt (long-term debentures, promissory notes, bank credit facilities and Class B limited partnership units) and equity (share capital, shareholder contributions, reserves and retained earnings).

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

A summary of the consolidated capital structure is outlined below:

<i>As at December 31 (millions of Canadian dollars)</i>	2017		2016	
<b>Debt</b>				
Sinking funds (Hydro portion only)	(190)		(267)	
Short-term borrowings	369		435	
Current portion of long-term debt	7		143	
Long-term debt	9,386		5,873	
Class B limited partnership units	491		399	
	<b>10,063</b>	<b>66.4%</b>	6,583	60.7%
<b>Equity</b>				
Share capital	123		123	
Shareholder contributions	3,693		2,861	
Reserves	(71)		7	
Retained earnings	1,336		1,273	
	<b>5,081</b>	<b>33.6%</b>	4,264	39.3%
<b>Total Debt and Equity</b>	<b>15,144</b>	<b>100.0%</b>	10,847	100.0%

Nalcor's committed operating facility has covenants restricting the issuance of debt such that the unconsolidated debt to total capitalization ratio cannot exceed 70.0%. The covenants further stipulate that the debt service coverage ratio should at all times be greater than 1.5 on an unconsolidated basis. As at December 31, 2017, Nalcor was in compliance with these covenants.

### 22.1 Hydro

Hydro's principal business requires ongoing access to capital in order to maintain assets to ensure the continued delivery of safe and reliable service to its customers. Therefore, Hydro's primary objective when managing capital is to ensure ready access to capital at a reasonable cost, to minimize its cost of capital within the confines of established risk parameters, and to safeguard Hydro's ability to continue as a going concern.

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity, and its interest coverage.

For the regulated portion of Hydro's operations, Management targets a capital structure comprised of 75% debt and 25% equity, a ratio which Management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, shareholder contributions and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of the PUB. Hydro's committed operating facility has a covenant restricting the issuance of debt such that consolidated debt to total capitalization ratio cannot exceed 85%. As at December 31, 2017, Hydro was in compliance with this covenant.

Legislation stipulates that the total of the Government guaranteed short-term loans issued by Hydro and outstanding at any time shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at \$300.0 million and \$144.0 million is outstanding as at December 31, 2017 (2016 - \$210.0 million). Issuance of short term borrowings and long-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both short term and long-term debt, to \$2.1 billion at any point in time.

Historically, Hydro addressed longer-term capital funding requirements by issuing government guaranteed long-term debt in the domestic capital markets. However, in December 2017, the process changed to one whereby the Province issues debt specifically on Hydro's behalf and lends the proceeds to Hydro. The Province authorized funding up to \$700.0 million, which includes \$225.0 million to repay an outstanding promissory note to the Province through Nalcor, due March 31, 2018. As at December 31, 2017, \$300.0 million of the \$700.0 million authorized has been issued.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 22.2 Oil and Gas

Oil and Gas' objective when managing capital is to maintain its ability to fund operating costs and expenditures related to development and production assets, on a timely basis. Oil and Gas maintains a \$30 million unsecured demand credit facility, which is used to finance operations in the short-term. Long-term capital includes share capital, shareholder contributions and retained earnings. Oil and Gas' future requirements for capital are expected to decline as construction on existing joint venture projects decreases. During this time, it is expected that Oil and Gas' cash flow from operations will be sufficient to fund its capital needs. Additional requirements will be funded through Oil and Gas' credit facility.

### 22.3 Energy Marketing

Energy Marketing's objective when managing capital is to maintain its ability to continue as a going concern. Energy Marketing's capital consists of shareholders' equity, specifically, share capital, reserves and retained earnings. Capital resource requirements are limited to working capital needs, which are funded through cash from operations, support from its parent, and a \$20.0 million demand operating facility with its primary banker.

### 22.4 Bull Arm

Bull Arm Fabrication's objective when managing capital is to maintain its ability to continue as a going concern. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. In 2013, Bull Arm Fabrication implemented its Board approved dividend policy of paying dividends to Nalcor when, together, cash and short-term investment balances exceed \$1.0 million.

### 22.5 Churchill Falls

Churchill Falls' objective when managing capital is to maintain its ability to continue as a going concern. Churchill Falls' requirements for capital in the future are expected to remain constant, coincident with the aging of the plant and related infrastructure and the execution of the long-term asset management plan. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Managing the level of common dividend payments is a key aspect of ensuring the availability of funding to maintain the plant and infrastructure.

At present, the capital position of Churchill Falls is comprised entirely of equity capital (issued capital, shareholder contributions, reserves and retained earnings). The capital structure is adjusted through the amount of dividends paid to shareholders.

### 22.6 Muskrat Falls

The capital structure of Muskrat Falls includes long-term debt, share capital and shareholder contributions. The objectives for managing capital are to maintain its ability to continue as a going concern and to ensure timely payment of its contractual obligations as they relate to the construction of the Muskrat Falls hydroelectric facility. Muskrat Falls' future requirements for capital are expected to increase commensurate with progress on the construction. During this time, it is expected that proceeds from the Muskrat/LTA Construction Facility and shareholder contributions will be sufficient to fund the development of the Muskrat Falls hydroelectric facility. The Province of Newfoundland and Labrador has provided a guarantee of equity support in relation to the construction of the Muskrat Falls hydroelectric facility. These guarantees, together with the proceeds from long-term debt, will ensure sufficient funds are available to finance construction.

### 22.7 LCP Transmission (LIL LP and Labrador Transco)

The capital structure of the LIL LP is comprised of partner capital (issued units, cash calls and deficit) and long-term debt. The capital structure is adjusted through the amount of distributions paid to the Partners as well as capital contributions.

LIL LP's objective when managing capital is to fund the construction of the LIL while providing its partners a required return. LIL LP's requirements for capital in the future are expected to increase, coincident with the development of the LIL. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Managing cash calls from the limited partners is a key aspect of ensuring the availability of funding to develop the LIL. The Province of Newfoundland and Labrador have provided guarantees of partner contributions in relation to the construction of the LIL. These partner contributions, together with the proceeds from long-term debt, will be sufficient to fund the development and construction of the LIL.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The capital structure of Labrador Transco includes long-term debt, share capital and shareholder contributions. The objectives for managing capital are to maintain its ability to continue as a going concern and to ensure timely payment of its contractual obligations as they relate to the construction of the LTA. It is expected that proceeds from the Muskrat/LTA Construction Facility and shareholder contributions will be sufficient to fund the development of the LTA. The Province of Newfoundland and Labrador has provided guarantees of equity support in relation to the construction of the LTA. These guarantees, together with the proceeds from long-term debt will ensure sufficient funds are available to finance construction.

### 23. REVENUE

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Electricity sales	616	624
GWAC revenue	24	24
Petroleum and natural gas sales	228	137
Royalty expense	(10)	(6)
Total energy sales	858	779
Lease revenue	49	21
Government funding	1	2
Preferred dividends	2	4
Other	20	18
Total other revenue	72	45

### 24. OPERATING COSTS

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Salaries and benefits	135	130
Maintenance and materials	39	35
Professional services	15	18
Advertising, donations and community involvement	10	1
Insurance	7	6
Travel and transportation	7	6
Rental and royalty	4	5
Other operating costs	2	6
	219	207

### 25. PRODUCTION, MARKETING AND TRANSPORTATION COSTS

Production, marketing and transportation costs include costs incurred related to the operating, processing and transportation of oil.

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Project operating costs	22	16
Processing and marketing	9	6
Transportation and transshipment	5	4
	36	26

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 26. TRANSMISSION RENTAL AND MARKET FEES

Transmission rental and market fees are related to the sale and transmission of energy to export markets.

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Transmission rental	24	21
Market fees	1	1
	25	22

### 27. NET FINANCE EXPENSE

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Finance income		
Interest on sinking fund	13	15
Interest on reserve fund	-	1
Interest on investments	13	8
Interest on restricted cash	14	15
Other interest income	5	2
	45	41
Finance expense		
Long-term debt	314	273
Class B limited partnership units	37	24
Debt guarantee fees	13	4
Accretion	7	7
Other	8	3
	379	311
Interest capitalized during construction	(268)	(198)
	111	113
Net finance expense	66	72

The effective interest rate on short-term investments at December 31, 2017 was 1.52% per annum (2016 - 1.00%).

### 28. OTHER EXPENSE (INCOME)

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Settlement of commodity swaps	2	(10)
Settlement of foreign exchange forward contracts	(1)	-
Financial transmission rights income and amortization	(1)	(2)
Cash flow hedge ineffectiveness	1	-
Loss on disposal of property, plant and equipment	20	7
Asset disposal costs	-	1
Unrealized foreign exchange loss	-	1
Realized foreign exchange loss	3	-
Other	(1)	(1)
Other expense (income)	23	(4)

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 29. ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of, and changes in, accumulated other comprehensive loss are as follows:

*Items that may or have been reclassified to profit or loss:*

<i>(millions of Canadian dollars)</i>	2017	2016
Employee future benefits		
Balance at January 1	(27)	(27)
Net actuarial loss on defined benefit plans	(3)	-
Balance at December 31	(30)	(27)
<i>(millions of Canadian dollars)</i>	2017	2016
Available-for-sale financial instruments		
Balance at January 1	48	45
Fair value (loss) gain during the year	(2)	13
Amounts reclassified to profit or loss	(8)	(10)
Balance at December 31	38	48
<i>(millions of Canadian dollars)</i>	2017	2016
Cash flow hedges		
Balance at January 1	(14)	(6)
Fair value loss during the year	(66)	(2)
Amounts reclassified to profit or loss	1	(6)
Balance at December 31	(79)	(14)

### 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

#### 30.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2017 and December 31, 2016 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Nalcor might receive or incur in actual market transactions.

As a significant number of Nalcor's assets and liabilities do not meet the definition of a financial instrument, the fair value estimates below do not reflect the fair value of Nalcor as a whole.

#### Establishing Fair Value

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the nature of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. For assets and liabilities that are recognized at fair value on a recurring basis, Nalcor determines whether transfers have occurred between

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

levels in the hierarchy by reassessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. There were no transfers between Level 1, 2 and 3 for the years ended December 31, 2017 and December 31, 2016.

<i>As at (millions of Canadian dollars)</i>	Level	Category	Carrying Value December 31, 2017	Fair Value December 31, 2017	Carrying Value December 31, 2016	Fair Value December 31, 2016
<b>Financial assets</b>						
Derivative assets	2,3	FVTPL <sup>1</sup>	3	3	1	1
Sinking funds - investments in Hydro debt issue	2	HTM <sup>2</sup>	45	56	57	71
Sinking funds - other investments	2	AFS <sup>3</sup>	231	231	307	307
Long-term investments	1,2	HTM <sup>2</sup>	332	332	34	34
Reserve fund	2	AFS <sup>3</sup>	-	-	15	15
Long-term receivables	2	L&R <sup>4</sup>	-	-	28	28
<b>Financial liabilities</b>						
Derivative liabilities	2	FVTPL <sup>1</sup>	8	8	5	5
Long-term debt including amount due within one year (before sinking funds)	2	OFL <sup>5</sup>	9,438	10,500	6,073	6,965
Class B limited partnership units	3	OFL <sup>5</sup>	491	491	399	399
Long-term payables	2	OFL <sup>5</sup>	52	56	58	75

1. Fair value through profit or loss
2. Held-to-maturity investments
3. Available-for-sale financial assets
4. Loans and receivables
5. Other financial liabilities

The fair value of cash and cash equivalents, restricted cash, short-term investments, trade and other receivables, short-term borrowings and trade and other payables approximates their carrying values due to their short-term maturity.

The fair values of Level 2 financial instruments are determined using quoted prices in active markets, which in some cases are adjusted for factors specific to the asset or liability. Level 2 derivative instruments are valued based on observable commodity future curves, broker quotes or other publicly available data. Level 2 fair values of other risk management assets and liabilities and long-term debt are determined using observable inputs other than unadjusted quoted prices, such as interest rate yield curves and currency rates.

Level 3 financial instruments include financial transmission rights and Class B limited partnership units.

Financial transmission rights are purchased contracts used to mitigate risk associated with congestion in export markets. The following table summarizes quantitative information about the valuation techniques and unobservable inputs used in the fair value measurement of financial transmission rights as at December 31, 2017.

<i>(millions of Canadian dollars)</i>	Carrying Value	Valuation Techniques	Significant Unobservable Input(s)	Range
Derivative assets (Financial transmission rights)	0.3	Modelled pricing	Price, seasonality and market factors	-10% to 2%

Methodologies for calculating the fair values of financial transmission rights are determined by using underlying contractual data as well as observable and unobservable inputs. Fair value methodologies are reviewed by Management on a quarterly basis to assess the reasonability of the assumptions made and models are adjusted as necessary for significant expected changes in fair

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

value due to changes in key inputs. As at December 31, 2017, the effect of using reasonably possible alternative assumptions regarding the unobservable implied volatilities may have resulted in -\$32,900 to \$7,700 change in the carrying value of the financial transmission rights.

The Class B limited partnership units are carried at amortized cost calculated using the effective interest method. The effective interest rate of 8.5% (2016 – 8.8%) is defined in the Newfoundland and Labrador Development Agreement as Emera NL's rate of return on equity (RROE), and is equal to the rate approved by the PUB for privately-owned regulated electrical utilities. Due to the unobservable nature of the effective interest rate and cash flows associated with the units, the fair value is assumed to approximate carrying value and the instruments have therefore been classified as Level 3.

The table below sets forth a summary of changes in fair value of the Class B limited partnership units given a one percent change in the discount rate while holding other variables constant:

<i>(millions of Canadian dollars)</i>	1% Increase	1% Decrease
Class B limited partnership units	(10.5)	10.3

### 30.2 Risk Management

Nalcor is exposed to certain credit, liquidity and market price risks through its operating, financing and investing activities. Financial risk is managed in accordance with a Board approved policy, which outlines the objectives and strategies for the management of financial risk, including the use of derivative contracts. Permitted financial risk management strategies are aimed at minimizing the volatility of Nalcor's expected future cash flows.

#### Credit Risk

Nalcor's expected future cash flows are exposed to credit risk through its operating activities, primarily due to the potential for non-performance by its customers, and through its financing and investing activities, based on the risk of non-performance by counterparties to its financial instruments. The degree of exposure to credit risk on cash and cash equivalents, short-term investments, long-term investments and derivative assets as well as from the sale of electricity to customers, including the associated accounts receivable, is determined by the financial capacity and stability of those customers and counterparties. The maximum exposure to credit risk on these financial instruments is represented by their carrying values on the Consolidated Statement of Financial Position at the reporting date.

Credit risk on cash and cash equivalents is considered to be minimal, as Nalcor's cash deposits are held by a Schedule 1 Canadian Chartered bank with a rating of A+ (Standard and Poor's). Credit risk on restricted cash is considered to be minimal, as Nalcor's restricted cash deposits are held by Schedule 1 Canadian Chartered banks with a rating of AA- (Standard and Poor's). Credit risk on short-term investments is minimized by limiting holdings to high-quality, investment grade securities issued by the Federal and Provincial governments, as well as BAs and term deposits issued by Schedule 1 Canadian Chartered banks.

Credit exposure on Nalcor's sinking funds is limited by restricting the holdings to long-term debt instruments issued by the Government of Canada or any province of Canada, Crown corporations and Schedule 1 Canadian Chartered banks. The following credit risk table provides information on credit exposures according to issuer type and credit rating for the remainder of the sinking fund's portfolio:

	Issuer Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value of Portfolio (%)
	2017		2016	
Provincial governments	AA- to AAA	-	AA- to AAA	0.37%
Provincial governments	A- to A+	46.14%	A- to A+	44.29%
Provincially owned utilities	A- to A+	53.86%	A- to A+	49.22%
Schedule 1 Canadian banks	A- to A+	-	A- to A+	6.12%
		<b>100.00%</b>		<b>100.00%</b>

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Credit exposure on the reserve fund is mitigated by adhering to an investment policy which restricts the holdings to long-term debt instruments issued or guaranteed by the Government of Canada or any province of Canada. Investments in the long-term debt instruments of Canadian banks are also permitted, provided the bank is rated A or higher by Standard and Poor's. With the exception of the Government of Canada, holdings of any one issuer are limited to 10.0% of the total principal amount of the portfolio. The following credit risk table provides information on credit exposures according to issuer type and credit rating for the reserve fund:

	Issuer Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value of Portfolio (%)
	2017		2016	
Provincial governments	AA- to AAA	-	AA- to AAA	7.32%
Provincial governments	A- to A+	-	A- to A+	30.63%
Schedule 1 Canadian banks	AA- to AAA	-	AA- to AAA	9.07%
Schedule 1 or 2 Canadian banks	A- to A+	-	A- to A+	52.98%
		-		100.00%

As at December 31, 2017, the reserve fund balance was fully withdrawn.

Credit exposure on Nalcor's long-term investments is considered to be limited as the investments are held by Schedule 1 Canadian Chartered banks and Provincially owned utilities investment grade ratings of A- or higher (Standard and Poor's). The following credit risk table provides information on credit exposures according to issuer type and credit rating for the long-term investments:

	Issuer Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value of Portfolio (%)
	2017		2016	
Provincially owned utilities	A- to A+	0.01%	A- to A+	0.08%
Schedule 1 Canadian Banks	AA- to AAA	-	AA- to AAA	72.65%
Schedule 1 Canadian Banks	A- to A+	99.99%	A- to A+	27.27%
		100.00%		100.00%

Credit exposure on derivative assets is limited by a Financial Risk Management Policy as approved by the Board, which restricts available counterparties for hedge transactions to Schedule 1 Canadian Chartered banks and Federally Chartered US banks.

Nalcor does not have any significant amounts that are past due and uncollectable, for which a provision has not been recognized at December 31, 2017.

### Liquidity Risk

Nalcor is exposed to liquidity risk with respect to its contractual obligations and financial liabilities, including any derivative liabilities related to hedging activities. Liquidity risk management is aimed at ensuring cash is available to meet those obligations as they become due.

Short-term liquidity for Nalcor and its subsidiaries is mainly provided through cash and cash equivalents on hand, funds from operations, an operating credit facility which Nalcor maintains with its banker, and shareholder contributions. Nalcor maintains a \$250.0 million (2016 - \$250.0 million) committed revolving term credit facility, with a maturity date of January 31, 2019. There were no amounts drawn on this facility at December 31, 2017 (2016 - \$nil). In addition, Hydro has access to a \$300.0 million promissory note program and a \$200.0 million (2016 - \$50.0 million) revolving term credit facility. Oil and Gas and Churchill Falls also maintain demand operating facilities of \$30.0 million (2016 - \$30.0 million) and \$10.0 million (2016 - \$10.0 million), respectively. Churchill Falls maintains a \$23.0 million minimum cash balance (2016 - \$22.0 million). Energy Marketing maintains a demand operating facility of \$20.0 million (2016 - \$20.0 million).

Liquidity risk for Muskrat Falls and Labrador Transco is considered to be minimal, as both companies can access the funds drawn down from the MF/LTA construction facility for the payment of construction costs as well as interest payments. The LIL LP has

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access to the funds drawn down from the LIL construction facility for the payment of construction costs as well as interest payments.

Long-term liquidity risk for Hydro is managed by the issuance of a portfolio of debt with maturity dates ranging from 2026 to 2048. Sinking funds have been established for these issues, with the exception of the issues maturing in 2045 and 2048. For Churchill Falls, long-term liquidity risk is managed by maintenance of the reserve fund in accordance with the Shareholders' Agreement and a dividend management policy that meets long-term liquidity requirements associated with Churchill Falls' capital expenditure program.

The following are contractual maturities of Nalcor's financial liabilities, including principal and interest as at December 31, 2017:

<i>(millions of Canadian dollars)</i>	< 1 Year	1-3 Years	3-5 Years	> 5 Years	Total
Trade and other payables	584	-	-	-	584
Short-term borrowings	369	-	-	-	369
Derivative liabilities	8	-	-	-	8
Long-term debt (including sinking funds)	353	801	1,083	15,272	17,509
Class B partnership units	-	-	162	2,666	2,828
Long-term payables	9	20	10	58	97
	1,323	821	1,255	17,996	21,395

### Market Risk

In the course of carrying out its operating, financing and investing activities, Nalcor is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities. Market price movements to which Nalcor has significant exposure include those relating to prevailing interest rates, foreign exchange rates, most notably USD/CAD, and current commodity prices, most notably the spot prices for diesel fuel, electricity, No. 6 fuel and oil. These exposures are addressed as part of the Financial Risk Management Strategy.

### Interest Rates

Changes in prevailing interest rates will impact the fair value of financial assets and liabilities classified as held for trading or available-for-sale, which includes Nalcor's short-term investments, sinking funds and reserve fund. Expected future cash flows associated with those financial instruments can also be impacted. The impact of a 0.5% change in interest rates on the Consolidated Statement of Profit and Comprehensive (Loss) Income associated with cash and cash equivalents and short-term investments was immaterial throughout 2017 due to the short time period to maturity.

The table below shows the impact of a 0.5% change in interest rates on other comprehensive (loss) income associated with the sinking funds as at December 31, 2017:

<i>(millions of Canadian dollars)</i>	0.5% Decrease	0.5% Increase
Interest on sinking funds	12.0	(11.3)

The impact of interest rates on the expected future cash outflows related to short-term borrowings (which includes promissory notes and BAs issued under Nalcor's credit lines) and long-term debt are managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecasted and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management includes the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Nalcor attempts to minimize the likelihood of a material impact on profit or loss resulting from an unexpected change in interest rates.

In May 2017, Muskrat Falls, jointly with Labrador Transco, entered into six bond forward contracts to hedge the interest rate risk on the forecasted issue of the additional long-term debt. These contracts were designated as part of a cash flow hedging

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

relationship and the resulting change in fair value of \$65.9 million was recorded in other comprehensive (loss) income with the ineffective portion of \$1.1 million recognized immediately in other expense (income). The amortization of the other comprehensive (loss) income related to the effective portion of the cash flow hedge is capitalized in line with treatment of the interest expense related to the long-term debt that it is hedging, until the Muskrat Falls hydroelectric facility and LTA are ready for their intended use. At that point, amortization on the remainder of the effective portion will be recognized in profit or loss over the same period as the related debt instruments mature. The total amount amortized as at December 31, 2017 including the previous cash flow hedge initiated in December 2013 was \$1.8 million (2016 - \$0.8 million).

### *Foreign Currency and Commodity Exposure*

Nalcor's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS, capital purchases, USD denominated electricity sales, rental revenues and the sale of crude oil. For the purchase of No.6 fuel, these risks are mitigated through the operation of the RSP. Exposures to USD denominated electricity sales are addressed in accordance with the Board-approved Financial Risk Management Policy. Tactics include the use of forward rate agreements and fixed price commodity swaps.

The table below shows the impact of a 0.5% change in foreign exchange rates on trade and other payables as at December 31, 2017:

<i>(millions of Canadian dollars)</i>	0.5% Decrease	0.5% Increase
Trade and other payables	(2.0)	2.0

During 2017, total energy sales denominated in USD were \$35.3 million (2016 - \$31.7 million). To mitigate foreign exchange risk on these sales, Energy Marketing used foreign currency forward contracts. In December 2016, Energy Marketing entered into a series of foreign exchange forward contracts with a notional value of \$20.2 million USD and an average exchange rate of \$1.32 CAD per USD to hedge foreign exchange risk on 58% of planned USD energy sales for 2017.

In November 2017, Energy Marketing entered into a series of foreign exchange forward contracts with a notional value of \$9.7 million USD on 36% of 2018 budgeted USD sales at an average rate of \$1.28 CAD per USD.

As the foreign exchange forward contracts have been designated as hedging instruments, changes in fair value have been recorded in other comprehensive (loss) income. During 2017, \$0.4 million in gains from foreign exchange forward contracts were included in other expense (income) (2016 - \$0.1 million losses) and \$0.2 million in gains (2016 - \$0.3 million in losses) remain in other comprehensive (loss) income.

Also, in November 2017, Energy Marketing entered into commodity contracts with a notional value of \$4.4 million USD on 11% of 2018 budgeted Recapture volume at an average rate of \$43.84 USD/MWh. These commodity contracts were entered into to mitigate price fluctuations on export market sales.

The commodity contracts have also been designated as hedging instruments and at December 31, 2017, \$1.3 million in unrealized losses have been recorded in other comprehensive (loss) income (2016 - \$nil).

During 2017, additional financial transmission rights with notional values of \$0.9 million USD were purchased to mitigate risk on congestion for the remainder of 2017 and a significant portion of 2018. As the rights have not been designated as hedging instruments, changes in fair value have been recorded in other expense (income).

During 2017, total oil sales denominated in USD were \$168.6 million (2016 - \$93.6 million). While Oil and Gas has exposure to fluctuations in the USD/CAD exchange rate on those sales, a significant portion of Oil and Gas' planned capital expenditures for 2017 were denominated in USD, which mitigated this exposure.

On November 30, 2016, Oil and Gas entered into a series of commodity price swap contracts to hedge commodity price risk on approximately 25% of anticipated 2017 production. These contracts had a notional value of \$32.3 million USD and an average

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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fixed price of \$52.09 USD per barrel. During 2017, \$1.9 million in realized losses (2016 - \$6.2 million in gains) from commodity price swaps contracts, designated under hedge accounting, were included in other expense (income). As these contracts have been designated as hedging instruments, changes in fair value have been recorded in other comprehensive (loss) income.

In December 2016, Oil and Gas entered into series of foreign exchange forward contracts to hedge foreign exchange risk on approximately 23% of anticipated USD oil sales in 2017. These contracts had a notional value of \$32.3 million USD and an average fixed rate of \$1.33 CAD per USD. During 2017, \$0.7 million in realized gains from foreign exchange forward contracts, designated under hedge accounting, were included in other expense (income). As these contracts have been designated as hedging instruments, changes in fair value have been recorded in other comprehensive (loss) income.

On November 27, 2017, Oil and Gas entered into a series of commodity price swaps to hedge commodity price risk on approximately 50% of anticipated 2018 production. These contracts have a notional value of \$97.9 million USD, and provide an average fixed price of \$61.36 USD per barrel.

On November 28, 2017 Oil and Gas entered into series of foreign exchange forward contracts to hedge foreign exchange risk on USD oil sales in 2018. These contracts have a notional value of \$97.9 million USD, and an average fixed rate of \$1.28 CAD per USD. Combined with one remaining contract already in place, Oil and Gas have hedged \$100.6 million in USD energy sales at an average fixed rate of \$1.28 CAD per USD.

As these contracts have been designated as hedging instruments, changes in fair value have been recorded in other comprehensive (loss) income. For the year ended December 31, 2017, \$4.6 million in losses (2016 - \$4.8 million in losses) remain in other comprehensive (loss) income.

During 2017, total rental revenue denominated in USD was \$36.6 million (2016 - \$16.1 million). In December 2016, Bull Arm entered into a series of foreign exchange contracts with a total notional value of \$16.1 million USD and a weighted average fixed exchange rate of \$1.32 CAD per USD. Combined with hedge contracts previously entered into during 2015, 100% of budgeted USD revenue for 2017 and the first two months of 2018 was hedged at a weighted average fixed change rate of \$1.32 CAD per USD.

As at December 31, 2017, Bull Arm Fabrication had no remaining foreign exchange forward contracts. The contracts for January and February 2018, with a notional value of \$2.7 million USD and a weighted average fixed exchange rate of \$1.32 CAD per USD, were settled in December 2017 as the sublease concluded during the month. As these contracts were all designated as hedging instruments, changes in fair value were recorded in other comprehensive (loss) income. For the year ended December 31, 2017, \$0.4 million in gains (2016 - \$0.2 million in losses) have been included in other expense (income) related to the forward contracts. As at December 31, 2017, there are no derivative instruments remaining.

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The components of change impacting the carrying value of derivative assets and liabilities for the years ended December 31, 2017 and 2016 are as follows:

	Commodity and forward contracts		Other derivatives		Total
	Level II	Level II	Level III	Level II	Level III
<i>(millions of Canadian dollars)</i>					
<b>Balance at January 1, 2017</b>	(5)	-	1	(5)	1
<b>Purchases</b>	-	-	1	-	1
	(5)	-	2	(5)	2
<b>Changes to profit</b>					
<b>Amortization</b>	-	-	(2)	-	(2)
<b>Total</b>	-	-	(2)	-	(2)
<b>Changes in other comprehensive loss</b>					
<b>Mark-to-market</b>	-	-	-	-	-
<b>Settlements realized in profit or loss</b>	-	-	-	-	-
<b>Total</b>	-	-	-	-	-
<b>Balance at December 31, 2017</b>	(5)	-	-	(5)	-
Balance at January 1, 2016	2	2	-	4	-
Purchases	-	-	2	-	2
	2	2	2	4	2
<b>Changes to profit</b>					
<b>Amortization</b>	-	-	(1)	-	(1)
<b>Mark-to-market</b>	4	-	-	4	-
<b>Settlements</b>	(1)	(2)	-	(3)	-
<b>Total</b>	3	(2)	(1)	1	(1)
<b>Changes in other comprehensive loss</b>					
<b>Mark-to-market</b>	(3)	-	-	(3)	-
<b>Settlements realized in profit or loss</b>	(7)	-	-	(7)	-
<b>Total</b>	(10)	-	-	(10)	-
<b>Balance at December 31, 2016</b>	(5)	-	1	(5)	1

### 31. RELATED PARTY TRANSACTIONS

Nalcor enters into various transactions with its shareholder and other affiliates. These transactions occur within the normal course of operations and are measured at the exchange amount, which is the amount of consideration agreed to by the related parties. Related parties with which Nalcor transacts are as follows:

Related Party	Relationship
The Province	100% shareholder of Nalcor
Churchill Falls	Joint arrangement of Hydro
Hydro-Québec	34.2% shareholder of Churchill Falls
Twin Falls	Joint venture of Churchill Falls
Churchill Falls (Labrador) Corporation Trust (The Trust)	Created by the Province with Churchill Falls as the beneficiary
LIL LP	Partnership in which Nalcor holds 75 Class A Partnership Units, 1 Class C Partnership Unit and 1 General Partner Unit
PUB	Agency of the Province

Routine operating transactions with related parties are settled at prevailing market prices under normal trade terms. Outstanding balances due to or from related parties are non-interest bearing with no set terms of repayment, unless otherwise stated.

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- (a) Hydro is required to incur the costs of operations, hearings and application costs of the PUB, including costs of any experts and consultants engaged by the PUB. During 2017, Hydro incurred \$1.8 million (2016 - \$1.3 million) in costs related to the PUB and has included \$3.0 million (2016 - \$2.1 million) in trade and other payables.
- (b) The Hydro debt guarantee fee for 2017 was \$4.1 million (2016 - \$4.5 million). It was paid to the Province on March 27, 2017.
- (c) For the year ended December 31, 2017, Hydro has purchased \$26.3 million (2016 - \$25.2 million) of power generated from assets related to Exploits Generation, which are held by the Province.
- (d) Hydro recorded \$nil (2016 - \$0.2 million) as a rate subsidy for rural isolated customers from the Province and \$1.8 million (2016 - \$1.8 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan. As at December 31, 2017, there is a balance of \$0.6 million (2016 - \$1.3 million) outstanding in trade and other receivables.
- (e) During 2017, Churchill Falls generated revenue from Hydro-Québec of \$94.6 million (2016 - \$102.4 million) and Nalcor has recognized its share of \$62.2 million (2016 - \$67.4 million).
- (f) Under the terms of the Churchill Falls (Labrador) Corporation Limited (Lease) Act, 1961 (the Lease) and amendments thereto, Churchill Falls is required to pay the Province an annual rental of 8% of the consolidated net profits before income taxes and an annual royalty of \$0.50 per horsepower year generated, as defined in the Lease. At December 31, 2017, \$6.4 million (2016 - \$7.5 million) was payable to the Province. Nalcor has recognized its share of \$4.2 million (2016 - \$4.9 million).
- (g) In February 3, 2010, the Province established the Trust with Churchill Falls as the beneficiary. The purpose of the Trust is to fund the external costs and expenses incurred in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. To date, \$5.6 million (2016 - \$5.3 million) has been received and \$nil (2016 - \$13.0 thousand) has been accrued as receivable from the Trust. Nalcor has recognized its share of \$3.7 million (2016 - \$3.5 million) as received and \$nil (2016 - \$8.6 thousand) accrued as receivable from the Trust.
- (h) As at December 31, 2017, Churchill Falls capacity penalty payable was \$0.4 million (2016 - \$0.4 million), of which Nalcor has recorded its share of \$0.3 million (2016 - \$0.3 million). The capacity penalty relates to the supply of power to Hydro-Québec. Churchill Falls did not incur a capacity penalty in 2017 (2016 - \$nil).
- (i) For the year ended December 31, 2017, Oil and Gas expensed \$10.3 million (2016 - \$6.4 million) to the Province for royalties on its oil and gas operations.
- (j) On December 20, 2017, Hydro issued new long-term debt, Series 1A, with face value of \$300.0 million. The Province of Newfoundland and Labrador issued debt specifically on Hydro's behalf and lent the proceeds to Hydro.

### 31.1 Key Management Personnel

Compensation for key management personnel, which Nalcor defines as its executives who have the primary authority and responsibility in planning, directing and controlling the activities of the entity, includes compensation for senior executives. Salaries and employee benefits include base salaries, performance contract payments, vehicle allowances and contributions to employee benefit plans. Post-employment benefits include contributions to the Province's Public Service Pension Plan.

<i>For the year ended December 31 (millions of Canadian dollars)</i>	<b>2017</b>	<b>2016</b>
Salaries and employee benefits*	6	10
Post-employment benefits	-	1
	<b>6</b>	<b>11</b>

\*2016 includes severance and related costs incurred in the second quarter.

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### 32. COMMITMENTS AND CONTINGENCIES

- (a) Nalcor and its subsidiaries have received claims instituted by various companies and individuals with respect to power delivery claims and other miscellaneous matters. Although the outcome of such matters cannot be predicted with certainty, Management believes Nalcor's exposure to such claims and litigation, to the extent not covered by insurance or otherwise provided for, is not expected to materially affect its financial position or results of operations.
- (b) Outstanding commitments for capital projects, excluding those related to Oil and Gas, total approximately \$1.0 billion as at December 31, 2017 (December 31, 2016 - \$2.1 billion). Prefunded equity requirements associated with Project Finance Agreements in Muskrat Falls and LCP Transmission total approximately \$1.0 billion as at December 31, 2017 (December 31, 2016 - \$2.8 billion).
- (c) Nalcor and its subsidiaries have issued 20 irrevocable letters of credit with a total value of \$41.7 million as per Note 14.1.
- (d) LCP has the following sinking fund instalments due for the next five years:

<i>(millions of Canadian dollars)</i>	2018	2019	2020	2021	2022
Sinking fund instalments	-	-	64.0	128.0	128.0

- (e) Oil and Gas has the following commitments as a result of its joint venture partnerships:

<i>(millions of Canadian dollars)</i>	Operating	Capital	Total Commitments
2018	15.9	7.2	23.1
2019	9.3	-	9.3
2020	9.3	-	9.3
2021	8.7	-	8.7
2022	8.5	-	8.5
Thereafter	6.3	-	6.3

- (f) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	Effective Date	Term
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 MW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years
Wind	300 kW	2010	Continual
Hydroelectric	175 kW	2017	15 years

Estimated payments due in each of the next five years are as follows:

<i>(millions of Canadian dollars)</i>	2018	2019	2020	2021	2022
Power purchases	30.7	31.9	32.5	32.6	32.7

- (g) In 2014, Hydro entered into three Capacity Assistance Agreements, one with Vale Newfoundland & Labrador Limited (Vale) and two with Corner Brook Pulp and Paper Limited (CBPP) for the purchase of relief power during the winter period. In 2016, Hydro also entered into two new Capacity Assistance Agreements, one with Praxair and a second agreement with Vale for the purchase of relief power. The agreements with Vale and Praxair have a supply period defined as December 1 to March 31 for each contract year, concluding March 2018. In November 2017, Hydro entered into a revised agreement with CBPP that

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expires the earlier of April 30, 2022 or the commissioning of the Muskrat Falls plant. Payment for services will be dependent on the successful provision of capacity assistance for the winter period by Vale, CBPP and Praxair.

- (h) Energy Marketing holds firm transmission rights with a number of counterparties in order to gain access to export markets. As at December 31, 2017, commitments for transmission rights total \$22.6 million for 2018. No transmission rights held by Energy Marketing extend beyond 2019.
- (i) As part of the LIL PFA, LIL LP has pledged its current and future assets as security to the Collateral Agent. Under the terms and conditions of the IT PFA, LIL LP has also provided a guarantee of the IT's payment obligations to the Collateral Agent for the benefit of the LIL Funding Trust.
- (j) As part of the MF/LTA PFA, Muskrat Falls and Labrador Transco have pledged its present and future assets as security to the Collateral Agent.
- (k) Under the terms of the Newfoundland and Labrador Development Agreement (NLDA), LIL GP has certain responsibilities and provisions of duty with which it must comply in its role as the general partner. Any failure of LIL GP to comply with the NLDA will result in Nalcor indemnifying Emera NL for any losses sustained.
- (l) In July 2012, Nalcor entered into the Energy and Capacity Agreement with Emera Inc. (Emera) providing for the sale and delivery of the Nova Scotia Block, 0.986 TWh of energy annually for a term of 35 years which will commence in 2020.
- (m) On November 29, 2017, Nalcor signed a CDA with the NunatuKavut Community Council, which came into effect December 1, 2017. The CDA is a six year agreement which provides tangible benefits to South Inuit and communities throughout NunatuKavut. Under the CDA there are contingent liabilities with an estimated value of \$1.1 million.
- (n) Under the IBA, Nalcor is required to make implementation payments to the Innu Nation that commenced upon sanction of the Muskrat Falls hydroelectric plant of \$5 million annually escalating by an annual consumer price index. Post first commercial power, when Nalcor begins earning revenue from the sale and delivery of capacity and energy from the facility, Nalcor is required to continue to make annual payments of the greater of \$5 million escalating by an annual consumer price index and 5% of after debt net cash flow, as defined by the agreement.

### 33. SUPPLEMENTARY CASH FLOW INFORMATION

<i>For the year ended December 31 (millions of Canadian dollars)</i>	<b>2017</b>	2016
Trade and other receivables	<b>(101)</b>	(23)
Prepayments	<b>(2)</b>	4
Inventories	<b>(23)</b>	(15)
Trade and other payables	<b>(578)</b>	165
Changes in non-cash working capital balances	<b>(704)</b>	131
Related to:		
Operating activities	<b>(81)</b>	(46)
Investing activities	<b>(623)</b>	177
	<b>(704)</b>	131

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### 34. SEGMENT INFORMATION

The operating structure as at December 31, 2017 reflects organizational changes that resulted in revised operating segments effective January 1, 2017. The designation of segments is based on a combination of regulatory status and management accountability. Previously reported segmented information has been presented to conform with the current operating structure. The following summary provides a brief overview of the nature of the operations included in each of the Company's six business segments.

**Hydro** - is comprised of both regulated and non-regulated activities.

- **Hydro Regulated** activities encompass sales of electricity to customers within the Province that are regulated by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).
- **Hydro Non-Regulated** activities include the sale of power, purchased from Churchill Falls, to mining operations in Labrador West as well as costs related to operations that Hydro manages that are not subject to rate regulation by the PUB.

**Power Development** - includes the development activities of the 824 MW **Muskrat Falls** hydroelectric generating facility currently under construction in Labrador on the Lower Churchill River. Once construction is complete this asset and its operating results will become part of the Power Supply segment.

**Power Supply** - is comprised of the following:

- **LCP Transmission** includes the construction and operation of the LIL and LTA, which consists of transmission lines connecting the Muskrat Falls hydroelectric plant, the Churchill Falls hydroelectric facility, and certain portions of the transmission system in Labrador to the island of Newfoundland.
- **Churchill Falls** owns and operates a hydroelectric generating facility which sells electricity to Hydro-Québec and Hydro.
- **Other** includes revenues and costs recovered from Hydro-Québec associated with Nalcor's operation of the Menihek Generating Station, the Maritime Link (which is owned by Emera, but consolidated by Nalcor), administration and community development costs related to Power Supply, and costs associated with the management of LCP construction.

**Energy Markets** - includes energy trading activities and commercial activities related to the development of energy markets.

- **Energy Trading** includes the sale of available excess energy, primarily Recapture, to export markets in eastern Canada and the northeastern United States. Recapture refers to excess energy from the 300 MW block of electricity which Churchill Falls has agreed to sell and deliver to Hydro to service its residential, commercial and industrial Labrador Interconnected customers.
- **Commercial and Other** includes costs associated with Gull Island and business development activities related to exploring additional markets and sources for future energy generation and transmission.

**Offshore Development** - includes the following:

- **Oil and Gas** activities include Nalcor's share of exploration, development, production, transportation and processing sectors of the oil and gas industry.
- **Bull Arm Fabrication** consists of an industrial fabrication site which is subleased to third parties.

**Corporate** - includes corporate support and shared services functions.

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<i>(millions of Canadian dollars)</i>	Hydro		Power Development	Power Supply			Energy Markets		Offshore Development			Inter-Segment	Total
	Regulated	Non-Regulated	Muskkrat Falls	LCP Transmission	Churchill Falls	Other	Energy Trading	Commercial and Other	Oil and Gas	Bull Arm	Corporate		
For the year ended December 31, 2017													
Energy sales	506	40	-	-	91	-	47	-	217	-	-	(43)	858
Other revenue	5	-	-	-	1	9	1	-	7	48	-	1	72
Revenue	511	40	-	-	92	9	48	-	224	48	-	(42)	930
Fuels	226	-	-	-	-	-	-	-	-	-	-	-	226
Power purchased	62	39	-	-	-	-	4	-	-	-	-	(43)	62
Operating costs	130	1	1	3	44	13	5	1	8	1	12	-	219
Production, marketing and transportation costs	-	-	-	-	-	-	-	-	36	-	-	-	36
Transmission rental and market fees	-	-	-	-	-	-	25	-	-	-	-	-	25
Depreciation, depletion, amortization and impairment****	78	-	-	-	18	-	-	51	152	-	1	-	300
Exploration and evaluation	-	-	-	-	-	-	-	-	1	-	-	-	1
Net finance expense (income)	65	-	-	(2)	(1)	-	-	-	3	-	1	-	66
Other expense (income)	6	-	1	-	-	-	(1)	-	15	-	1	1	23
Preferred dividends	-	-	-	-	(2)	-	-	-	-	-	-	2	-
Expenses	567	40	2	1	59	13	33	52	215	1	15	(40)	958
(Loss) profit before regulatory adjustments	(56)	-	(2)	(1)	33	(4)	15	(52)	9	47	(15)	(2)	(28)
Regulatory adjustments	(92)	-	-	-	-	-	-	-	-	-	-	1	(91)
Profit (loss) for the year	36	-	(2)	(1)	33	(4)	15	(52)	9	47	(15)	(3)	63
Capital expenditures*	344	-	1,137	1,140	46	593	-	1	161	-	4	(2)	3,424
Total assets**	2,605	48	5,679	5,841	592	1,773	23	144	1,246	2	406	(325)	18,034
Total debt***	1,668	-	3,606	4,789	-	-	-	-	-	-	-	-	10,063

\*Capital expenditures (inclusive of property, plant and equipment and intangible assets) include non-cash additions of \$588.4 million related to the Maritime Link and \$37.2 million related to Class B Limited Partnership Unit accrued interest.

\*\*Total assets include \$1,734.9 million related to the Maritime Link and \$82.0 million related to Class B Limited Partnership Unit accrued interest.

\*\*\*Total debt includes short-term borrowings, long-term debt including current portion less Hydro's sinking funds of \$190.2 million, and Class B Limited Partnership Units.

\*\*\*\*Included in depreciation, depletion, amortization and impairment is an impairment expense of \$50.6 million in Commercial and Other related to the Gull Island Project in addition to an impairment expense of \$81.0 million in Oil and Gas related to seismic and geoscientific data acquisition costs.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

	Hydro		Power Development	Power Supply			Energy Markets		Offshore Development		Corporate	Inter-Segment	Total
	Regulated	Non-Regulated	Muskrat Falls	LCP Transmission	Churchill Falls	Other	Energy Trading	Commercial and Other	Oil and Gas	Bull Arm			
<i>(millions of Canadian dollars)</i>													
For the year ended December 31, 2016													
Energy sales	511	40	-	-	96	-	43	-	131	-	-	(42)	779
Other revenue	4	-	-	-	1	6	-	-	9	21	-	4	45
Revenue	515	40	-	-	97	6	43	-	140	21	-	(38)	824
Fuels	168	-	-	-	-	-	-	-	-	-	-	-	168
Power purchased	60	39	-	-	-	-	4	-	-	-	-	(42)	61
Operating costs	124	4	-	2	44	3	5	-	8	1	13	3	207
Production, marketing and transportation costs	-	-	-	-	-	-	-	-	26	-	-	-	26
Transmission rental and market fees	-	-	-	-	-	-	22	-	-	-	-	-	22
Depreciation, depletion, amortization and impairment	68	-	-	-	17	-	-	1	48	-	1	-	135
Exploration and evaluation	-	-	-	-	-	-	-	-	2	-	-	-	2
Net finance expense (income)	71	-	-	(2)	(1)	-	-	-	3	-	1	-	72
Other expense (income)	6	-	1	(1)	-	-	(5)	-	(5)	-	-	-	(4)
Preferred dividends	-	-	-	-	(4)	-	-	-	-	-	-	4	-
Expenses	497	43	1	(1)	56	3	26	1	82	1	15	(35)	689
Profit (loss) before regulatory adjustments	18	(3)	(1)	1	41	3	17	(1)	58	20	(15)	(3)	135
Regulatory adjustments	(1)	-	-	-	-	-	-	-	-	-	-	-	(1)
Profit (loss) for the year	19	(3)	(1)	1	41	3	17	(1)	58	20	(15)	(3)	136
Capital expenditures*	221	1	976	1,315	41	491	-	1	236	-	6	(2)	3,286
Total assets**	2,442	51	3,598	4,731	560	1,183	8	187	1,243	4	384	(328)	14,063
Total debt***	1,182	-	2,055	3,346	-	-	-	-	-	-	-	-	6,583

\*Capital expenditures (inclusive of property, plant and equipment and intangible assets) include non-cash additions of \$485.2 million related to the Maritime Link and \$23.6 million related to Class B Limited Partnership Unit accrued interest.

\*\*Total assets include \$1,146.5 million related to the Maritime Link and \$37.4 million related to Class B Limited Partnership Unit accrued interest.

\*\*\*Total debt includes short-term borrowings, long-term debt including current portion less Hydro's sinking funds of \$267.0 million, and Class B Limited Partnership Units.

# NALCOR ENERGY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 35. SUBSEQUENT EVENT

On March 8, 2018, the Province of Newfoundland and Labrador issued long-term debt with a face value of \$300.0 million, specifically on Hydro's behalf. The debt matures on October 17, 2048 with a coupon rate of 3.70% paid semi-annually. Nalcor expects to use a portion of the proceeds to repay the \$225.0 million promissory note to the Province.