NALCOR ENERGY

2009 Annual Performance Report
Transparency and Accountability

June 2010

Message from the Board of Directors

Hon. Roger Fitzgerald, M.H.A.
Speaker of the House of Assembly
East Block
Confederation Building

Dear Mr. Speaker:

In accordance with the *Transparency and Accountability Act*, I am pleased to submit the 2009 Annual Performance Report on behalf of the Board of Directors of Nalcor Energy.

The Strategic Plan 2008-2010 for the Energy Corporation of Newfoundland and Labrador outlined the direction for the corporation and the subsidiaries that existed in March 2008. During 2008, there were a number of changes in corporate structure as well as the introduction of the Nalcor Energy name and brand.

Nalcor Energy's legal structure at December 31, 2009 included three wholly-owned subsidiaries, Newfoundland and Labrador Hydro (Hydro or NLH), Nalcor – Oil and Gas Inc and Nalcor Energy – Bull Arm Fabrication. Subsidiaries of Hydro were Churchill Falls (Labrador) Corporation (Churchill Falls), Lower Churchill Development Corporation (LCDC) and Gull Island Power Corporation (GIPCo). Churchill Falls holds a minority interest in Twin Falls Power Corporation.

Currently, the *Transparency and Accountability Act* requires that Hydro and Churchill Falls table annual performance reports. Nalcor Energy and Nalcor – Oil and Gas Inc. have not yet been categorized under the *Transparency and Accountability Act* and are therefore not required to report. In order to address all components of the Strategic Plan 2008-2010, this Annual Performance Report will present results for all of Nalcor Energy and will also highlight the accomplishments of Hydro and its subsidiary Churchill Falls. The reporting period for the performance report is the calendar year 2009.

As the Board of Directors of Nalcor Energy, we are accountable for the preparation of this report and are accountable for the actual results.

John Ottenheimer
Chair
Nalcor Energy

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Overview of the Company

Newfoundland and Labrador has an immense and diverse energy warehouse. In 2007, guided by a long-term Energy Plan, the Government of Newfoundland and Labrador created a new provincial energy corporation to take a lead role in the development of the province's energy resources. In 2009, the Nalcor Energy name and brand were introduced.

Nalcor Energy'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 marketing. Focused on sustainable growth, the company is leading the development of the province's energy resources and has a corporate-wide framework which facilitates prudent management of its assets while continuing an unwavering focus on the safety of its workers and the public.

Nalcor Energy has five lines of business: Newfoundland and Labrador Hydro (Hydro or NLH), Churchill Falls, Oil and Gas, Lower Churchill Project, and Bull Arm Fabrication[1]. The activities of these lines of business are undertaken by Nalcor Energy and its subsidiaries Newfoundland and Labrador Hydro[2] (Hydro) and Nalcor Energy – Oil and Gas.

Vision

Nalcor Energy
To build a strong economic future for successive generations of Newfoundlanders and Labradorians.

Newfoundland and Labrador Hydro
To be recognized as an innovative provider of quality energy services.

Churchill Falls
To be a safe, reliable and efficient plant operating in 2041 and beyond. There are three key elements of our vision:

[1] Transferred to Nalcor on March 31, 2009.

[2] The subsidiaries of Nalcor Energy are Newfoundland and Labrador Hydro (Hydro) and Nalcor – Oil and Gas Inc. Subsidiaries of Hydro were Churchill Falls (Labrador) Corporation (Churchill Falls), Lower Churchill Development Corporation (LCDC) and Gull Island Power Corporation (GIPCo). LCDC and GIPCo are not active operating companies. Churchill Falls maintains a 33 per cent share in Twin Falls Power Corporation (TwinCo).

- Safety – maintain a relentless focus on safety.
- Environment – reduce the environmental footprint of our operations.
- Asset management – reliable, cost-effective operations led by the right people, built on a foundation of excellence in long-term asset planning, short-term planning and scheduling, work execution, operations, and support services.

Mission

Nalcor Energy
By 2010, Nalcor Energy will have enhanced its asset management processes to continuously improve the delivery of safe and reliable electricity to its customers, and expanded its energy sector involvement to include oil and gas, wind energy, and research and development to help build a strong economic future for Newfoundland and Labrador.

Newfoundland and Labrador Hydro
Hydro is a Crown corporation committed to providing cost-effective and reliable energy services to our customers for the benefit of all people of the province.

Our skilled and committed employees will use innovative methods and technologies, and will maintain high standards of safety and health, and environmental responsibility.

Churchill Falls
Churchill Falls is committed to providing cost-effective and reliable energy services to our customers.

Our skilled and committed employees will maintain high standards of safety and health, and environmental responsibility.

We will promote innovative technologies and enhance the assets of the corporation for the benefit of future generations.

Mandate

Nalcor Energy
The *Energy Corporation Act* (2008) mandates Nalcor 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 of 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.

Newfoundland and Labrador Hydro

The *Hydro Corporation Act* (2007) mandates Hydro to be responsible for:

- Developing and purchasing power and energy on an economic and efficient basis.

- Engaging within the province and elsewhere, in the development, generation, production, transmission, distribution, delivery, supply, sale, purchase and use of power from water, steam, gas and other products.

- Supplying power, at rates consistent with sound financial administration, for domestic, commercial, industrial or other uses in the province, and, subject to the prior approval of the Lieutenant-Governor in Council, outside of the province.

Churchill Falls

The Articles of Incorporation for the Churchill Falls (Labrador) Corporation state that the business of the Corporation be limited to the following:

- Producing or otherwise acquiring and transmitting and selling electricity;

- Harnessing or otherwise making use of water for the purpose of producing hydroelectric and hydraulic power and for any other purpose.

Values

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

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

Lines of Business

Newfoundland and Labrador Hydro

Hydro is the primary generator of electricity in Newfoundland and Labrador with an installed generating capacity of 1,637 megawatts (MW). The activities of Hydro include the operation of the regulated utility and non-regulated activities. The regulated utility delivers safe, reliable power to utility, industrial, residential and commercial customers in more than 200 communities in Newfoundland and Labrador. Hydro operates nine hydroelectric generating stations, one oil-fired plant, four gas turbines and 25 diesel plants. In 2009, non-regulated activities of Hydro included the operation of the Menihek Generating Station and power sales to two industrial customers in Labrador.

Churchill Falls

The Churchill Falls Generating Station is one of the largest underground powerhouses in the world and is operated by the Churchill Falls (Labrador) Corporation. The plant has a rated capacity of 5,428 MW and generates over 34,000 gigawatt-hours (GWh) of energy annually. Churchill Falls operates the town of Churchill Falls, including a school, theatre, library, and recreational facilities. The majority of electricity from the Churchill Falls station is sold to Hydro-Québec under a long-term contract. Churchill Falls sells 300 MW (recall power), the maximum provided under the power contract, to Hydro for use in Labrador and for export sales. Churchill Falls also sells 225 MW to Twin Falls to service the mining industry in Labrador West.

Nalcor Energy – Oil and Gas

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 province's fourth offshore oil project; the White Rose Growth Project; and, the Hibernia Southern Extension. In addition, during 2009 Nalcor Energy – Oil and Gas acquired a majority interest in three onshore exploration permits on the west coast of the Island. Nalcor Energy – Oil and Gas continues to pursue other investment opportunities.

Lower Churchill Project

The lower Churchill River hydroelectric resource is one of the key elements of the province's energy warehouse. The Lower Churchill Project (LCP) includes the development of two hydroelectric sites on the lower Churchill River – Gull Island (2,250 MW) and Muskrat Falls (824MW). The LCP is currently undertaking environmental assessments, preliminary field work, market assessment, transmission routes assessment and economic analysis to support concept selection for the project.

Bull Arm Fabrication

The Bull Arm Fabrication Site is Atlantic Canada's largest industrial fabrication site. This world-class facility spans over 2,560 hectares and has comprehensive infrastructure to support fabrication and assembly in three project areas simultaneously. In August 2008, the Government announced the transfer of the Bull Arm Site Corporation to Nalcor Energy. Due diligence activities were undertaken and the transfer was completed on March 31, 2009.

Other Companies

The Twin Falls Power Corporation (TwinCo) was incorporated on February 18, 1960 to construct and operate the Twin Falls power plant which provided power to the mines of Labrador West. The Twin Falls power plant has been shut down and TwinCo purchases power from Churchill Falls to supply to the mines. Churchill Falls maintains a 33 per cent share in TwinCo and holds two-thirds voting shares in the company. Wabush Mines Incorporated, HLE Mining GP Incorporated, Wabush Iron Company Ltd. (collectively Wabush Mines) and the Iron Ore Company of Canada are the other shareholders in TwinCo. The operational activities of TwinCo are minimal.

The Gull Island Power Corporation (GIPCo) is a wholly owned subsidiary of Hydro. GIPCo was incorporated on September 21, 1970, as an organizational vehicle for the possible development of the lower Churchill. GIPCo is not presently an active operating company.

The Lower Churchill Development Corporation (LCDC) was incorporated on December 15, 1978. At that time it was considered as a possible organizational entity for the development of the lower Churchill hydroelectric development. At the end of December 2009, Hydro owned 51 per cent of the shares of LCDC and the federal government owned 49 per cent. The LCDC is presently not an active operating company.

Number of Employees, Physical Location and Other Key Statistics

Nalcor Energy

Nalcor Energy, the province's energy corporation, is leading the development of the province's energy resources. As of December 31, 2009, Nalcor and its lines of business employed 1,299 people.

Gender	Rural	Urban	Total	Per cent
Female	133	154	287	22%
Male	759	253	1012	78%
Total	892	407	1299	
Per cent	69%	31%		

Newfoundland and Labrador Hydro

Headquartered in St. John's, Hydro is the province's main electrical energy provider. In December 2009, the company had a staffing level of 883 people located throughout the province including 583 people in rural areas.

Gender	Rural	Urban	Total	Per cent
Female	47	108	155	18%
Male	536	192	728	82%
Total	583	300	883	
Per cent	66%	34%		

Churchill Falls

Churchill Falls operates the second largest underground hydropower station in the world and provides municipal and community services in the town of Churchill Falls. In December 2009, there were 289 people employed by Churchill Falls.

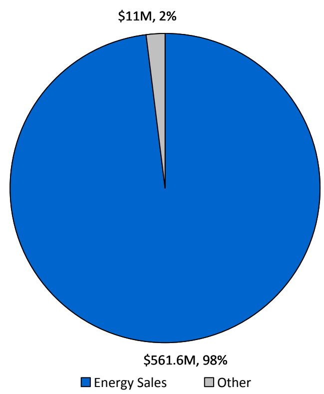
Gender	Rural	Per cent
Female	86	30%
Male	203	70%
Total	289	

2009 Consolidated Revenues and Expenses

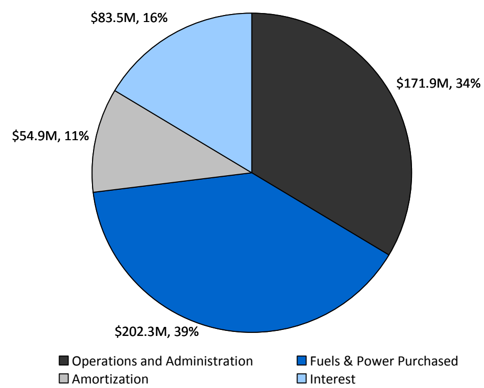
The following charts summarize the consolidated 2009 revenue and expenses for Nalcor Energy. The 2009 Consolidated Financial Statements for Nalcor Energy are appended to this document (See Appendix 1). The majority of Nalcor's revenues are from energy sales to utility, rural and industrial customers with other revenues including lease revenue from the Bull Arm Fabrication Site, Hydro pole attachment revenues, and preferred dividends from Churchill Falls.

Nalcor Energy Consolidated Revenue and Expenses 2009

Total Revenue: $572.6M



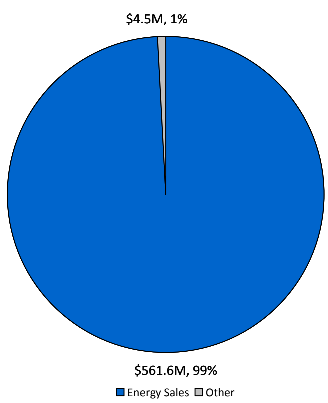
Total Expenses: $512.6M



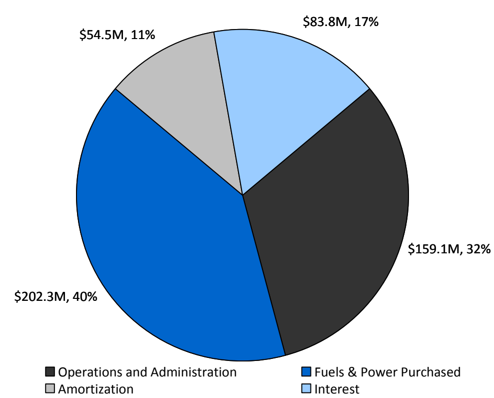
The following charts summarize the consolidated 2009 revenue and expenses for Hydro. Hydro’s audited Consolidated Financial Statements are appended to this document (See Appendix 2). The majority of Hydro’s revenues are from energy sales to utility, rural and industrial customers with other revenues from pole attachment revenues, and preferred dividends from Churchill Falls.

Hydro Consolidated Revenue and Expenses 2009

Total Revenue: $566.1M



Total Expenses: $499.7M



Shared Commitments

Nalcor works with a variety of agencies, departments and commissions to execute its mandate. Collectively these groups influence the activities that are reported herein.

Department of Natural Resources
The Department of Natural Resources works with Nalcor in policy-related areas for the various energy sector activities in which Nalcor engages. Activity related to the acquisition of working interests in offshore oil fields was a coordinated effort between the department and Nalcor Energy – Oil and Gas, as is the ongoing administration of issues related to the electrical system throughout the province.

Department of Finance
The Department of Finance works with Nalcor in relation to addressing requirements related to financial structure, as well as providing guarantees for the company's debt financing activities.

Newfoundland and Labrador Board of Commissioners of Public Utilities
The Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) is responsible for regulatory oversight of Hydro's regulated utility activities. This responsibility covers a wide range of activities, including approval of its revenue requirements, rates, rate structure and capital program. The role of the PUB is detailed in the *Public Utilities Act*.

Nalcor also shares commitments with the Department of Environment and Conservation, the Department of Government Services, and the federal Department of Fisheries and Oceans in relation to the environmental aspects of Nalcor's activities.

Outcomes of Objectives

The 2008-2010 Strategic Plan for the Energy Corporation of Newfoundland and Labrador, highlighted eight strategic issues around which goals and objectives were established. These issues encompass the activities of Nalcor and its subsidiaries. In general, the accomplishments outlined are for Nalcor; accomplishments specific to Hydro and Churchill Falls are noted.

The following section details performance in 2009 relative to goals, objectives, measures and indicators. For each strategic issue, the information provided in the 2008-2010 Strategic Plan is reproduced, followed by an assessment of performance in 2009.

Issue 1: Safety Leadership

Issue: To be a safety leader.

Nalcor's relentless commitment to safety excellence drives all of our lines of business. To achieve safety excellence, the company established a safety framework built on leadership, procedures and equipment, competence, supportive culture, union/management alignment, responsibility and reporting.

During 2009, the company implemented many initiatives to achieve best-in-class safety performance. Nalcor introduced the Internal Responsibility System (IRS) which was developed with both of our International Brotherhood of Electrical Workers locals. The IRS promotes personal responsibility for safety regardless of where we work in the company, from the front lines to the boardroom. Enhancements were also made to other elements of our safety program as well, including the Work Protection Code, safety culture training for employees, and the contractor safety management program.

We are also very proud of a major safety milestone achieved in 2009: our Holyrood Generating Station reached one million hours without a lost-time injury. Holyrood was also presented with a safety award at the Boilermaker's Eastern Canada Tripartite Conference for their participation in the Nalcor-wide Safe Workplace Observation Program.

Objective: In 2009, continue to improve or sustain safety performance by increasing the ratio of reports that identify conditions or behaviours that contribute to the number of lost-time[3] and medical-aid incidents to the number of lost-time and medical-aid incidents.

Measure: Improved safety performance.

INDICATORS	2009 ACCOMPLISHMENTS
Achieved annual safety lead/lag ratio targets.	**Nalcor Energy**[4] In 2009, Nalcor maintained its momentum for increased reporting of incidents, near misses and safe practices. Observations increased by 15 per cent over 2008 and the lead/lag ratio for the year was 369:1, better than the target of 350:1. **Hydro** Performance was less than target. The safety lead/lag ratio was 341:1 reflecting 3750 observations/reports and 11 safety incidents. Overall reporting was up slightly from 2008 (one per cent) however, the higher than targeted number of incidents (see explanation on page 12) resulted in a lead/lag ratio below target. **Churchill Falls** Performance was better than target with a safety lead/lag ratio of 378:1 compared to the target of 350:1. The positive trend in reporting (up 12 per cent to 2267 observations/reports) and the reduced number of incidents (down 50 per cent from 2008) drove this significant improvement in performance.
Achieved annual improvements in the all injury (medical-aid and lost-time) frequency rate.	**Nalcor Energy** In 2009, most areas of the company maintained excellent safety performance with few or zero medical-aid and lost-time incidents. As well, overall performance improved over 2008. However, in both Hydro and Churchill Falls one area of

[3] Lost-time injuries (also referred to as disabling injuries) include injuries/illness resulting in lost days beyond the date of injury as a direct result of an occupational injury/illness incident.
[4] The performance data for Nalcor includes Hydro and Churchill Falls performance.

INDICATORS	2009 ACCOMPLISHMENTS
	operations experienced a disproportionate number of incidents and as a result, the all injury frequency rate (AIFR)[5] was higher than target. In 2009, Nalcor experienced 18 incidents compared to a targeted reduction to 11 on the path to zero incidents. Nalcor's medical-aid incidents were slightly better than target with only five incidents compared to the target of six. This better than target performance was offset by higher lost-time injury incidents. The company experienced 13 lost-time injuries higher than the targeted reduction to five injuries. The resulting AIFR was 1.58, significantly better than 2008 performance of 2.08 but higher than the target of less than or equal to one. If the two operational areas experiencing safety challenges in 2009 are removed from the calculations, the adjusted AIFR is 0.83, better than target and close to world class performance of less than or equal to 0.50. The immediate cause for the majority of the 2009 incidents was failing to properly identify potential hazards or risks and take the appropriate mitigating measures such as following proper procedures and wearing appropriate personal protective equipment. **Hydro** In 2009, Hydro experienced 11 injury incidents, the same as 2008. Medical-aid incidents decreased from five to four and lost-time incidents increased from six to seven. Hydro's AIFR for 2009 stayed the same as 2008 at 1.44, above the target of less than or equal to one. Over half of Hydro's incidents took place in one area of operations and this area has focused significant attention on improvement activities. **Churchill Falls** In 2009, Churchill Falls did not experience any medical-aid

[5] All injury frequency rate = [(Medical-aid + lost-time incidents)x 200,000]/Exposure hours (hours worked)

INDICATORS	2009 ACCOMPLISHMENTS
	incidents compared to five incidents in 2008. However, lost-time injury statistics were slightly higher than 2008 and higher than the target for the year. Churchill Falls experienced a total of six incidents in 2009 for an AIFR of 2.22, almost 50 per cent better than 2008 but still above the AIFR target of less than or equal to one. The majority of these lost-time injuries occurred in one area of the Churchill Falls operation. A renewed focus on safety has become a key strategy for this area.
Achieved annual improvements in the lost-time injury frequency rate.	**Nalcor Energy** As noted, in 2009 most areas of the company maintained excellent safety performance with few or zero lost-time incidents. However, Nalcor's total lost-time incident statistics were higher than target. The company experienced 13 lost-time incidents or a lost-time frequency rate (LTIFR)[6] of 1.14. This compared to the targeted reduction to five injuries or a LTIFR of less than or equal to 0.50. The immediate cause for the majority of these incidents was failing to properly identify potential hazards or risks and take the appropriate mitigating measures such as following proper procedures. **Hydro** In 2009, Hydro's lost-time injury statistics were slightly higher than 2008 (seven compared to six) and higher than target for 2009. The resulting LTIFR of 0.92 was higher than the target of less than or equal to 0.50. **Churchill Falls** In 2009, Churchill Falls experienced six lost-time incidents resulting in a LTIFR of 2.22, a reduction from the 2008 rate of 2.54 but higher than the target of 0.50. The majority of the Churchill Falls incidents occurred in one area of the operation.

[6] Lost-time frequency rate = [(Lost-time incidents) x 200,000]/Exposure hours (hours worked)

INDICATORS	2009 ACCOMPLISHMENTS
	This area has focused on driving safety excellence to reduce all types of safety incidents.

Nalcor's safety journey is one of persistence and commitment. In 2009, our safety performance yielded mixed results. On a positive note, Nalcor met the lead/lag ratio target and most areas of the company achieved sustained safety performance with zero incidents. Although we reduced the number of workplace incidents in 2009, we had targeted greater improvement. We will continue to push for improvement. We are striving for sustained safety performance and recognize this takes time, significant effort and a relentless commitment. Our safety programs are in place and our commitment to safety is unwavering.

Objective: Further enhance Nalcor's safety programs in 2009.

Measure: Action on individual components of safety improvement programs.

INDICATORS	2009 ACCOMPLISHMENTS
Completed planned activities for internal responsibility system rollout.	Completed. Internal Responsibility System (IRS) rollout completed at company-wide Checkpoint in April and Safety Summit in May. IRS being reinforced on an ongoing basis.
Completed safety culture workshop training for select employees.	Completed. Thirteen safety culture workshops conducted in 2009 with approximately 400 participants.

2010 OBJECTIVES, MEASURES AND INDICATORS

Safety continues to be a core value and Nalcor's first priority. The direction contained in the 2008-2010 Strategic Plan outlines the company's ongoing commitment to improved and sustained safety performance. Our safety programs are in place and are growing, and our commitment to safety continues in 2010 and beyond. 2010 objectives, measures and indicators are as follows:

Objective: In 2010, continue to improve or sustain safety performance by increasing the ratio of reports that identify conditions or behaviours that contribute to the number of lost-time and medical-aid incidents to the number of lost-time and medical-aid incidents.

Measure: Improved safety performance.

Indicators:

- Achieved annual safety lead/lag ratio targets.
- Achieved annual improvements in the all injury (medial-aid and lost-time) frequency rate.
- Achieved annual improvements in the lost-time injury frequency rate.

Objective: Further enhance Nalcor's safety programs in 2010.

Measure: Action on individual components of safety improvement programs.

Indicators:

- Completed planned activities related to safety procedures including work methods and work protection code.
- Completed planned activities related to employee wellness program.

Issue 2: Environmental Leadership

Issue: To be an environmental leader.

Nalcor helps sustain a diverse and healthy environment for present and future Newfoundlanders and Labradorians by maintaining a high standard of environmental responsibility and performance. Every year, the company invests significantly in environmental protection measures to limit its ecological footprint. Mitigation measures are built into the company's development projects to reduce environmental impacts, and follow-up programs assess the effectiveness of these measures. Activities related to this issue support the Minister's strategic direction regarding sustainable resource development.

A well-established ISO 14001 Certified Environmental Management System (EMS) governs the activities in Nalcor's electricity businesses, Hydro and Churchill Falls that affect the environment. These systems include specific performance targets and milestones that provide the basis for continuous improvement and the indicators outlined below. Nalcor is investigating the use of the EMS for other lines of business.

Hydro continues its environmental leadership efforts. A focus area for Hydro is the reduction of emissions from thermal generation. In 2009, Hydro switched from the one per cent sulphur fuel introduced in 2006 to an even cleaner fuel (0.7% sulphur) at the Holyrood Generating station which will further reduce some emissions by 30 per cent. Hydro also has power purchase agreements for 54 megawatts of clean, renewable wind energy. Newfoundland's two wind farms produced enough green energy in 2009 to power over 8,100 homes - that's equivalent to burning 245,000 barrels of oil at the Holyrood Plant, and is a reduction of more than 122,000 tonnes of greenhouse gas emissions.

To complement Hydro's environmental efforts, the company is educating customers about energy conservation. Hydro, with its energy efficiency partner and utility customer Newfoundland Power, strengthened its takeCHARGE energy efficiency program in 2009. In June, new rebates for programmable thermostats, insulation, ENERGY STAR® windows and commercial lighting were introduced.

Environmental leadership is also a key element of Churchill Falls' vision. In 2009, Churchill Falls successfully completed 95 per cent of its EMS environmental targets and milestones. During the year, the company also continued the clean-up of construction debris on five large sites in the Twin Falls and Churchill Falls areas.

Significant progress was made on Nalcor's Wind-Hydrogen-Diesel Project in Ramea. This research and development project is one of the first in the world to integrate generation from wind and hydrogen components in a small, diesel powered community. The project will use wind and hydrogen technology to supplement the diesel requirements of this isolated community.

Objective: In 2009, maintain or increase the number of Environmental Management System (EMS) targets and objectives accomplished to 95 per cent.

Measure: Annual accomplishment of EMS targets.

INDICATORS	2009 ACCOMPLISHMENTS
Annual target tracking progress.	**Nalcor Energy** In 2009, Nalcor completed 105 (94 per cent) of EMS targets for the year, slightly less than the targeted 95 per cent due to the slightly below target performance of Hydro. Of the seven targets not completed, significant progress was achieved and milestone[7] completion was 97 per cent – better than the objective of 95 per cent. **Hydro** Of the 71 targets planned for completion in 2009, 66 or (93 per cent) were completed or only one less than the target of 67. There were five targets not completed in 2009 however, significant progress was made (98 per cent of milestones achieved) and these targets will be completed in 2010. Reasons for not completing targets included reallocation of resources to other priorities and delays resulting from troubleshooting a software program used in energy forecasting. **Churchill Falls** Target and milestone completion levels for 2009 were on target at 95 per cent.

[7] Each EMS target has one or more milestones (steps or key deliverables).

2010 OBJECTIVES, MEASURES AND INDICATORS

In 2010, Nalcor will maintain the direction contained in the 2008-2010 Strategic Plan.

Objective: In 2010, maintain or increase the number of Environmental Management System (EMS) targets and objectives accomplished to 98 per cent.

Measure: Annual accomplishment of EMS targets.

Indicators:

- Accomplished 98 per cent of Environmental Management System (EMS) targets.

Issue 3: Finance and Corporate Governance

Issue: To strengthen our financial and governance structure to enable Nalcor's mandate.

Nalcor is committed to excellence in its business activities and the processes that facilitate these activities. During 2008, the company completed corporate restructuring activities to support the pursuit of its vision and mandate. In 2009, the company continued to enhance its financial position and governance model to support existing operations and position Nalcor for growth.

The province has approved significant equity investment in Nalcor during 2008-2010. This equity has been directed to renewable energy activities, including the Lower Churchill Project, and oil and gas investments that will generate future revenues. As well in 2009, Nalcor contributed $100 million, that it received as an equity contribution from the Shareholder to Hydro to strengthen its financial position. This action combined with the higher return on equity will provide a strong foundation for future financial performance.

Nalcor's Board of Directors has made a firm commitment to best governance practices. The Board continues to demand transparency, accountability and the highest level of ethical conduct from all operations and activities. Continuing into the future, reinforcing Nalcor's strong governance foundation will be a priority for the Board of Directors.

Goal: By the end of 2009 to have completed a corporate restructuring that facilitates financing requirements and appropriate risk and cost allocation.

Measure: Improved governance and financial structure.

Nalcor has successfully completed the corporate restructuring required to facilitate investment opportunities. During 2008, Hydro was made a subsidiary of Nalcor Energy and the oil and gas entity (Nalcor Energy – Oil and Gas Inc.) was created. As well, some functions including the Lower Churchill Project were moved from Hydro to Nalcor. These changes resulted in the separation of regulated and non-regulated activities and supported appropriate cost and risk allocation. During 2009, Nalcor Energy assumed ownership of the Bull Arm Fabrication Site and established a team to manage site operations.

To identify and achieve governance improvements, a Corporate Governance Index was prepared for the Board of Directors of Nalcor in 2008. As noted in the 2008 Annual Performance Report, Governance index targets for 2008 were attained.

Objective: In 2009, complete identified initiatives required to support continuous improvements to financial and governance structure.

Measure: Completion of initiatives.

INDICATORS	2009 ACCOMPLISHMENTS
Completed identified initiatives	To maintain its commitment to continuous improvement, a number of initiatives were successfully completed in 2009. **Completed review of Board of Directors and committees mandates (Nalcor)**. The Nalcor Corporate Governance Committee has reviewed and approved current Board of Directors' and Board committee mandates. In addition, mandates have been drafted for subsidiary Boards and committees for review and approval. **Completed planned risk management discussions with Board of Directors (Nalcor)**. Risk management presentation made to Nalcor Board of Directors outlining current and desired future state risk management approaches and preliminary business unit risk assessment. As well, during 2009 a formal Financial Risk Management Policy outlining the company's approach to the management of credit risk and risks emanating from movements in interest rates, foreign exchange and commodity prices was approved by the Nalcor Board. **Completed annual public meeting (Nalcor)**. On June 24, 2009, Nalcor held its first Annual General Meeting.

INDICATORS	2009 ACCOMPLISHMENTS
	Achieved approval to earn improved return on equity (Hydro). In 2009, the Government of Newfoundland and Labrador issued an Order in Council which provided Hydro with the ability to earn a return on equity (ROE) on its regulated operations equal to that of Newfoundland Power, effective with the next general rate application. Hydro has not yet filed a general rate application to reflect the new ROE; however, it is under consideration. **Secured equity contribution (Hydro)**. In 2009, Nalcor contributed $100 million that it received as an equity contribution from its Shareholder to Hydro to strengthen its balance sheet.

2010 OBJECTIVES, MEASURES AND INDICATORS

Nalcor's goal of completing a corporate restructuring that facilitates financing requirements and appropriate risk and cost allocations has been completed. In 2010, Nalcor will focus on continuous improvement.

Objective: In 2010, complete identified initiatives required to support continuous improvements to financial and governance structure.

Measure: Completion of initiatives.

Indicators:

- Completed identified initiatives.

Issue 4: Growth

Issue: To grow a diversified and viable energy business.

Over the past three years, Nalcor Energy has experienced tremendous growth in its oil and gas business. In January 2009, the company finalized the purchase of a five per cent working interest in the oil resources contained within the White Rose Growth Project. The project includes the North Amethyst Field, West White Rose and South White Rose Extension.

Nalcor also signed an memorandum of understanding (MOU) to acquire a 10 per cent working interest in the Hibernia Southern Extension in 2009 (agreements signed in February 2010). In addition to the Hibernia and White Rose projects, Nalcor is also a co-venturer in the Hebron oil field, holding a 4.9 per cent working interest in the province's fourth offshore oil project.

Nalcor's near-term strategy for growth in the oil and gas sector is to obtain equity positions in various stages of development. The company also recognizes that another key to advancing the province's oil and gas sector is to encourage additional exploration activity.

In August 2009, Oil and Gas marked a significant step for the future development of the province's oil and gas resources when it acquired an average of 67 per cent gross working interest in three onshore exploration permits in the Parsons Pond area on the Great Northern Peninsula.

Nalcor Energy's exploration program on Newfoundland's west coast will provide access to new, valuable information about the province's natural resources. The program will also provide a unique opportunity to better understand both the onshore and offshore potential in western Newfoundland. Nalcor hopes that improved prospectivity resulting from increased exploration activity in the region will stimulate other interest in the province's oil and gas potential in the west coast basin.

The company's participation in the three offshore projects will contribute significantly to its production and cash flow objectives. Through investments of the nature and magnitude required in the oil and gas industry, Nalcor will see proportionate returns, allowing further expansion and growth of the company.

Activities related to this issue support the Minister's strategic direction regarding promoting natural resource development and diversification.

Objective: In 2009, acquire equity interests in oil and gas fields and/or pursue new development opportunities as appropriate.

Measure: Progress towards assuming equity positions.

INDICATORS	2009 ACCOMPLISHMENTS
Completed required activities.	During 2009, Nalcor Energy – Oil and Gas completed the acquisition of a five per cent working interest in the White Rose Growth project. This project includes the North Amethyst Field, West White Rose and the South White Rose Extension. Also during 2009, a memorandum of understanding (MOU) was signed to acquire a working interest in the Hibernia Southern Extension. The province, through Nalcor Energy – Oil and Gas, will have a 10 per cent equity stake in the Hibernia Southern Extension subsea tie-back project. In 2009 Nalcor Energy – Oil and Gas acquired an average 67 per cent working interest in three onshore exploration permits in Parsons Pond on province's west coast. Nalcor will be operator of this project and plans to drill three wells in its first onshore drilling program.

2010 OBJECTIVES, MEASURES AND INDICATORS

Nalcor's growth agenda for 2010 is consistent with the direction contained in the 2008-2010 Strategic Plan.

Objective: In 2010 acquire equity interests in oil and gas fields and/or pursue new development opportunities as appropriate.

Measures: Progress toward assuming equity positions.

Indicators:

- Completed required discussions and due diligence activities for any identified opportunities.

Issue 5: Operational Excellence

Issue: Through operational excellence to provide value to all consumers of our energy.

Nalcor Energy's commitment to excellence drives all lines of business. The foundation of the company is built on the strength and expertise of its electricity businesses – Hydro and Churchill Falls. These companies are leading Nalcor's asset management efforts to ensure our assets provide service and value for generations to come.

In 2009, Hydro invested over $54 million in capital to enhance reliability and ensure safe operation of the provincial electricity system. Activities related to the regulated utility, Hydro support the Minister's strategic direction to provide a stable and competitively priced supply of electricity.

Operational excellence is the keystone of Churchill Falls, with a focus on safety excellence, reliability and managing the asset to provide long-term value.

Nalcor Energy will continue to strive for business excellence across the company with an approach to maximizing benefits from renewable and non-renewable energy resources to help build a stronger economy in Newfoundland and Labrador.

Objective: In 2009, improve or maintain corporate reliability indices while achieving capital and operating budget financial targets.

Measure: Annual reliability and financial performance.

INDICATORS	2009 ACCOMPLISHMENTS
	Hydro
Achieved annual reliability targets (winter availability)[8] – **NLH only**.	**Winter Availability**: Overall performance of 97.7 per cent significantly better than the target of 93 per cent. Holyrood thermal generating unit performance for the winter months ranged between 86.3 per cent and 97.1 per cent with a total winter season availability of 94.2 per cent. Hydraulic generating

[8] Winter availability is a measure of the reliability of the major generating facilities on the island interconnected system during the critical winter season (January, February, March, and December).

INDICATORS	2009 ACCOMPLISHMENTS
	plant performance for the winter months ranged between 98.8 per cent and 100 per cent with a total winter season availability of 99.5 per cent.
Achieved Guaranteed Winter Availability Contract (GWAC) targets[9] – **Churchill Falls only.**	**Churchill Falls** **GWAC:** Actual GWAC revenue averaged 54 per cent of potential revenue, better than the target of greater than or equal to 45 per cent. The target for 2009 reflected the loss of electricity production resulting from the November 3, 2008, fire in a cable shaft at the Churchill Falls facility. The fire at the generating plant caused extensive damage to two sets of power cables and resulted in two (of the 11) generating units being unavailable. Repairs resulting from the cable fire were completed on-time allowing the plant to return to full operation before the end of 2009.

[9] GWAC tracks actual revenue as a percentage of maximum possible revenue under the provision of an agreement between Churchill Falls and Hydro-Québec. During key winter months, Churchill Falls receives GWAC revenue based upon plant availability. For the 2009 calendar year GWAC could be earned for January, February, March, November and December.

INDICATORS	2009 ACCOMPLISHMENTS
Achieved annual net income targets.	**Nalcor Energy** 2009 actual net income was $60.0 million this was below budget by $5.3 million. Lower than budget performance for Churchill Falls and energy marketing activities was partially offset by higher than budget net income in the regulated business. Churchill Falls net income was impacted by lower than budget energy sales and energy marketing earnings were below budget primarily due to low pricing in North American energy markets combined with the change in strategic direction for this activity. Despite the condition of energy markets, Nalcor was able to realize revenues higher than market benchmarks. **Hydro** Regulated net income was better than budget primarily due to a decrease in power purchases and operating costs. **Churchill Falls** As noted, Churchill Falls segment earnings were below budget primarily due to a reduction in energy sales to Hydro-Québec.

2010 OBJECTIVES, MEASURES AND INDICATORS

Efforts to achieve and sustain excellence in operations will continue in 2010 consistent with the direction contained in the 2008-2010 Strategic Plan. Specific plans for 2010 are as follows:

Objective: In 2010, improve or maintain corporate reliability indices while achieving capital and operating budget financial targets.

Measure: Annual reliability and financial performance.

Indicators:

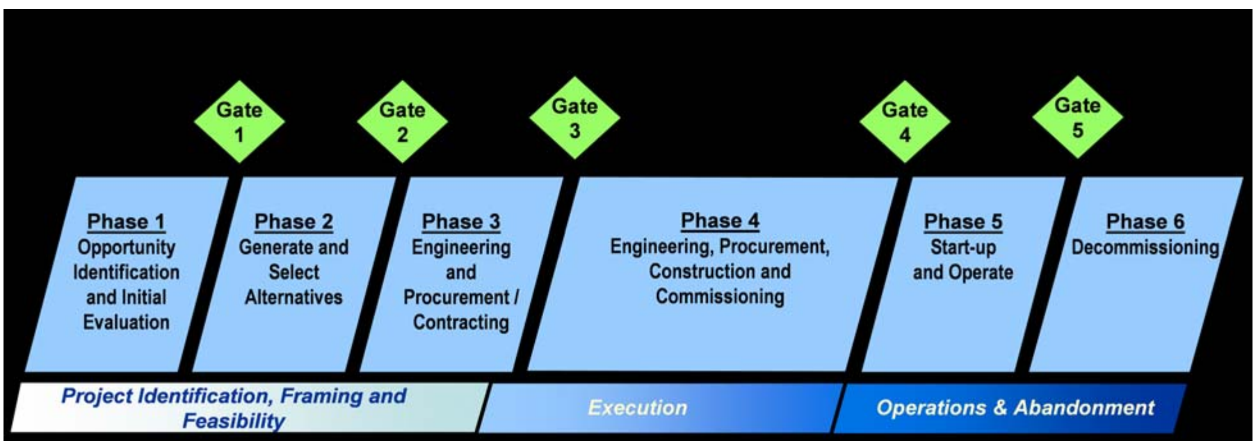
- Achieved annual reliability performance (winter availability) – **Hydro only.**
- Achieved Guaranteed Winter Availability Contract (GWAC) targets – **Churchill Falls only.**
- Achieved capital structure target (debt/equity).

Issue 6: Lower Churchill

Issue: To complete analysis required to consider a sanction decision on the Lower Churchill Project.

The development of the lower Churchill River hydroelectric resource is an exciting opportunity for Nalcor Energy and the Province of Newfoundland and Labrador. The Lower Churchill Project (Project or LCP) is comprised of the Gull Island and Muskrat Falls installations which combined will have generating capacity of over 3,000 megawatts.

Large projects like the Lower Churchill Project have long lead times and require thorough planning and timely execution. The stage-by-stage process used by Nalcor to advance the Project from identification through to operations and abandonment is called the Gateway Process. The process includes a series of stages or phases of activities with structured decision points or gate reviews at the end of each phase. At the gate review, a decision must be made whether to: hold further activity pending receipt of some final clarifications or supporting information; move to the next phase of the process; or terminate all project activity.



The LCP is currently in Phase two, approaching Decision Gate Two which is essentially concept selection.

In 2009, the Lower Churchill Project team made significant progress to support Decision Gate Two. Negotiations were well advanced towards the finalization of the agreements contemplated in the Tshash Petapen (New Dawn) Agreement reached with the Innu Nation of Labrador and many of the key issues were resolved. These agreements include a provincial Innu

Rights Agreement, the Lower Churchill Impacts and Benefits Agreement and the Upper Churchill Redress Agreement.

The submission of the Environmental Impact Statement for the Generation Project was another significant step forward in 2009. As well, in early 2009 Nalcor registered the Labrador-Island Transmission Link for environmental assessment.

Access to both domestic and export markets is essential to realize the full economic and environmental benefits of the lower Churchill development. Utilizing the power for industrial growth in the province is a key focus, as well two market access alternatives for exporting excess power continue to be advanced: access to the Hydro-Québec transmission system and development of a maritime transmission route. Nalcor has filed complaints regarding fair and reasonable access to Hydro-Québec's transmission system and further clarity on this routing option is expected when the Regié de l'énergie announces a ruling related to Nalcor's transmission applications later in 2010.

As well in 2009, in preparation for future development activities, Nalcor issued an Expression of Interest to six engineering and project management companies. These companies are worldwide specialists in hydroelectric, transmission and civil construction. Extensive field work was also conducted in the Strait of Belle Isle to determine how to best transport electricity across the Strait.

The proposed lower Churchill development shares the Churchill River with the Churchill Falls hydroelectric generation plant. The *Electrical Power Control Act* requires Nalcor to enter into a water management agreement to coordinate production among all facilities on the Churchill River. A tentative agreement reached between Nalcor and Churchill Falls was not approved by the Churchill Falls Board of Directors. As a result in late 2009, Nalcor applied to the Public Utilities Board (PUB) to establish the terms of the agreement.

There are numerous developments which signal important steps on the road to the advancement of the Lower Churchill Project. Step-by-step in accordance with a long-term plan, Nalcor Energy is achieving progress on many fronts towards obtaining the certainty needed to move forward with the Project.

While earlier plans established 2009 as a target for considering a sanction decision, Nalcor prudently deferred this decision in order to further progress key elements of the Project and gain the additional clarity required to inform the sanction decision. A particular challenge in this regard has been the timing of the application and complaints process regarding access to Hydro-Québec transmission.

Objective: In 2009 to have completed analysis necessary for the Provincial Government to consider a decision regarding sanction.

Measure: Progress in each of the seven key areas

INDICATORS	2009 ACCOMPLISHMENTS
Engineering	Completed extensive field work in the Strait of Belle Isle in 2009. Engineering analysis focused on two potential methods of transporting electricity across the Strait. In 2009, Nalcor also issued an Expression of Interest to six engineering and project management companies to determine their interest in bidding for the Project's detailed engineering design work.
Financing	Continued preliminary discussions with financial advisors to assess financing alternatives. Additional activity deferred pending progress on market access and power sales options.
Environment	During 2009, the Environmental Impact Statement (EIS) for the Generation Project was submitted in February 2009. As well, in January 2009 the Labrador-Island Transmission Link was registered for environmental assessment under the *Newfoundland and Labrador Environmental Protection Act* and the *Canadian Environmental Assessment Act*.
Commercial/Market Access	Access to both domestic and export markets is essential to realize the full economic and environmental benefits of the lower Churchill development. Utilizing the power for industrial growth in the province is a key focus, as well two market access alternatives continue to be advanced: access to the Hydro-Québec transmission system and development of a maritime transmission route. Nalcor has filed complaints with the Regié de l'énergie, Québec's independent regulator, regarding fair and reasonable access to Hydro-Québec's transmission system. During 2009 preparation for the Regié hearings was a key focus for Nalcor.

INDICATORS	2009 ACCOMPLISHMENTS
Aboriginal Impacts and Benefits Agreement	During 2009, discussions with the Innu Nation of Labrador centered on finalizing the agreements contemplated in the Tshash Petapen (New Dawn) Agreement and many key issues were resolved. In addition, consultation efforts were continued with the Nunatsiavut Government, the Labrador Metis Nation (LMN) and Quebec Innu groups.
Project Execution Planning	Following confirmation of the basis of design and the Gull Island configuration, the project capital cost, schedule and risk analysis was updated. The Labrador-Island Transmission Link design was also decided and capital cost, schedule and risk analysis for this portion of the Project was also updated. The technical assessment of a transmission line through the Long Range Mountains was completed and this route became the preferred option, thereby avoiding transmission through Gros Morne National Park.
Operations	An operations and maintenance strategy for the Lower Churchill Project facilities was developed.

2010 OBJECTIVES, MEASURES AND INDICATORS

During 2010, Nalcor will continue to pursue the direction contained in the 2008-2010 Strategic Plan.

Objective: In 2010, to have completed analysis necessary for the Provincial Government to consider a decision regarding sanction.

Measure: Progress in each of the seven key areas to inform a decision regarding sanction.

Indicators:

- Engineering
- Financing
- Environment
- Commercial/Market Access
- Aboriginal Impacts and Benefits Agreement
- Project Execution Planning
- Operations

Issue 7: People

Issue: To ensure a highly skilled and motivated team of employees who are strongly committed to Nalcor's success and future direction.

Nalcor recognizes the vital role employees play in the company's success and future direction. The company is focused on a workplace where people feel highly engaged and valued for their contributions.

Nalcor's employees share a set of core values: honesty and trust, open communication, accountability, safety, teamwork, respect and dignity and leadership. Throughout 2009, the company continued to integrate these core values into employee recognition, leadership development, performance management, and recruitment and retention programs and processes.

During 2009, Nalcor held its fourth annual Checkpoint with employees to celebrate the successes of 2008 and share plans for the coming year. Checkpoint is held across all lines of business and discussions include corporate and local achievements and plans.

Also during the year, employees continued to support the new employee recognition programs introduced in 2008. Over 2,000 On-the-Spot peer recognitions were given by employees and nine employees were selected for the President's Awards to acknowledge their contribution to the company's vision and goals.

Leadership development activities continued during 2009 as well. Some 50 front-line supervisors and managers participated in the Leadership Fundamentals Program and the Management Development Program. The company's senior management group also participated in two Leadership Development workshops during the year.

Nalcor uses an Employee Opinion Score (EOS) to measure progress and identify required improvements to achieve its goal to be recognized as one of Canada's top employers. The EOS survey gives employees the opportunity to provide feedback about their work experience at Nalcor. An EOS survey was not planned or completed in 2009. A survey is planned for 2010 and results will be available for the 2010 Annual Report.

Objective: In 2009, work to improve all elements of employee engagement to a level where Nalcor would qualify for recognition as one of Canada's best employers in reference to an acceptable external benchmark.

Measure: Completion of improvement activities.

INDICATORS	2009 ACCOMPLISHMENTS
Completed organization structure review and implemented any required adjustments according to plan.	Completed organization structure review in 2009 and identified adjustments to Nalcor's organizational design. These adjustments reflect Nalcor's increased emphasis on asset management and project execution. Organizational charts and role descriptions were completed as planned in 2009. The decision was made to defer filling positions to 2010, in order to fully engage senior leadership as well as operations and engineering management in the proposed changes.
Completed plan for execution of recruitment and retention initiatives and plan implementation on target.	Completed all 2009 action items including: revised corporate recognition program; new on-line orientation program; revised maternity leave policy; new employee wellness program; total compensation statements; revised salary administration structure; and on-line pay stubs. In addition, a review of recruitment and retention issues in rural/remote areas was started.
Completed work improvement plans to address priority people issues identified in the employee opinion survey and plan execution initiated.	Completed. 2008 EOS results communicated in March 2009 and incorporated into corporate action plan that was communicated to all employees in August 2009. Various improvement initiatives at corporate and local levels initiated as planned.
Completed planned activities regarding employee communications.	Completed. Activities focused on reinforcing vision, values and Nalcor's commitment to employee engagement. Specific activities planned and completed included: Checkpoint sessions; performance management process enhancements; corporate recognition program enhancements; supervisor orientation programs; behaviour based interviews; and Leadership Development Series.

2010 OBJECTIVES, MEASURES AND INDICATORS

Objectives, measures and indicators for 2010 are consistent with the direction contained in the 2008-2010 Strategic Plan.

Objective: In 2010, work to improve all elements of employee engagement to a level where Nalcor would qualify for recognition as one of Canada's best employers in reference to an acceptable external benchmark.

Measure: Completion of improvement activities.

Indicators:

- Completed planned implementation and change management related to asset management framework, project execution structure and matrix organization design.
- Developed strategy for recruitment & retention in rural/remote areas and execute planned 2010 activities.
- Completed diversity strategy for executive approval.
- Completed current state assessment of mandatory safety and technical skills training.
- Completed 2010 Employee Opinion Score (EOS) survey.

Issue 8: Community

Issue: To be a valued corporate citizen and an active member of the communities in which we operate.

Giving back to communities in Newfoundland and Labrador is a priority for Nalcor Energy and the company strives to be a valued corporate citizen and to improve the quality of life for people throughout the province. This means actively supporting organizations in the communities where Nalcor operates and where our employees live. Through our Community Investment Program, Nalcor and its subsidiary company Hydro, support, educate and strengthen communities through charitable donations, youth scholarships and support of employee volunteerism.

In 2009, Nalcor Energy supported Ronald McDonald House's Capital Campaign for the development of Newfoundland and Labrador's first Ronald McDonald House. For children with serious illnesses, it will play a powerful role in helping them lead happier and healthier lives.

Safety and health is a key area of focus for Hydro's Community Investment Program. In 2009, Hydro continued its safety and health partnership with the Seniors Resource Centre of Newfoundland and Labrador (SRC). This newly formed partnership is helping the SRC expand and deliver their safety, health and wellness initiatives for seniors across the province. Since 2008, over 500 seniors have attended Safety and Health Days organized by the SRC.

Each year, Nalcor and Hydro support educational and academic achievements by providing scholarships to students who achieve high academic standings and are leaders and role models in their schools and communities. The scholarship program represents Nalcor's commitment to help the province's youth further their educational studies. In 2009, more than $40,000 was awarded through scholarships and endowments to Newfoundland and Labrador students. This includes scholarships for women in engineering, trades and technology to help encourage and support women entering these fields of study.

Volunteerism is part of the corporate culture at Nalcor Energy. By partnering with employees through our company-wide Employee Matching and Volunteer Contribution Program, Nalcor reaches out to a broader range of community partners. In 2009, these two employee-driven programs supported more than 30 organizations including the Community Food Sharing Association, Young Adult Cancer, CIBC Run for the Cure, and many other community organizations and charity events throughout the province.

Nalcor's Community Investment Program reinforces the corporate vision by enhancing community service, investing in local communities, demonstrating good corporate citizenship and empowering employees in their community service.

Objective: In 2009, to have further strengthened Nalcor's reputation by means of excellence in safety, environment, conservation, community investment, business planning and execution.

Measure: Improvements in awareness/perception of Nalcor by the public.

INDICATORS	2009 ACCOMPLISHMENTS
Increased annual performance on NLH's reputation index.	The results of the public reputation index review indicate an increase over the 2007 review from 77.24 to 77.55. A significant increase was realized in the Conception Bay South area and is attributed to actions taken with respect to Holyrood emissions.
Awareness of the Nalcor brand.	Corporate reputation research on name/brand recognition in Newfoundland and Labrador demonstrated awareness of 64 per cent.

2010 OBJECTIVES, MEASURES AND INDICATORS

Objectives, measures and indicators for 2010 are consistent with the direction contained in the 2008-2010 Strategic Plan.

Objective: In 2010, to have further strengthened Nalcor's reputation by means of excellence in safety, environment, conservation, community investment, business planning and execution.

Measure: Improvements in awareness/perception of Nalcor by the public.

Indicators:

- Completed phase two brand implementation of signage and vehicles.
- Updated and produced Nalcor Energy Corporate video.
- Completed collateral package for Churchill Falls.

Opportunities and Challenges

Four key areas have emerged as providing opportunities and challenges as Nalcor progresses through the 2008-2010 planning horizon. Addressing these areas will play a central role in the execution of the 2008-2010 plan.

Energy Costs

Trends in energy costs have had a profound impact on the provincial and global economies. These costs translate into opportunities in the areas of development of new energy supplies, use of alternate energy supplies and an increased emphasis on conservation. These costs also present a challenge affecting the cost of supply to energy consumers in the province. Accordingly, addressing both the challenges and opportunities associated with energy costs will be a focus in the execution of the 2008-2010 strategic plan.

Workforce Changes

Attracting and retaining qualified, skilled staff poses a significant challenge. In Hydro and Churchill Falls, retirements continue to draw upon the pool of experienced workers and the rural nature of many of our needs add additional challenges to recruiting efforts. In growth and development areas of the company, there is intense competition for workers in a variety of fields. Addressing the challenges of the changing workforce and the company's requirements will be a key element in the execution of the 2008-2010 strategic plan.

Asset Management

A significant portion of Hydro's asset base is 30 to 40 years old, and is well into its original designed life expectancy. To continue to provide safe, cost-effective, reliable power, an asset management framework and organization has been developed. The asset management framework is a holistic, lifecycle view on how assets are managed. It addresses key processes including: long-term asset planning; short-term planning; work execution; asset operations; and support services. The challenge of asset management is also faced by Churchill Falls as the company strives to ensure the continued performance of its facilities in order that future generations benefit from this resource. The costs, challenges and renewal opportunities that arise as a result of the execution of Nalcor's asset management framework will be a key element of the 2008-2010 strategic plan.

Implementation of the Energy Plan

The provincial Energy Plan identified the key role that Nalcor will play in the development of the province's energy sector. In addition to the core business of electrical utility operation, a key focus of the 2008-2010 strategic plan will be to capitalize upon opportunities emerging in the areas of oil and gas and new business, while continuing to perform the analysis necessary to enable the Shareholder to make a decision regarding sanction of the Lower Churchill Project.

Financial Statements

Attached are Nalcor's audited consolidated financial statements (see Appendix 1) and the audited consolidated financial statements for Hydro (see Appendix 2).

APPENDIX 1

Nalcor Energy
2009 Consolidated Financial Statements

2009 BUSINESS AND FINANCIAL REPORT

boundlessenergy

nalcor energy

Consolidated Financial Statements

NEWFOUNDLAND AND LABRADOR HYDRO   CHURCHILL FALLS   OIL AND GAS   LOWER CHURCHILL PROJECT   BULL ARM FABRICATION

Management Report

The accompanying Consolidated Financial Statements of Nalcor Energy, and all information in the Business and Financial Report, are the responsibility of Management and have been approved by the Board of Directors.

The Consolidated Financial Statements have been prepared by Management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on Management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to March 9, 2010. Financial information presented elsewhere in the Business and Financial Report is consistent with that in the Consolidated Financial Statements.

Management maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for the appropriate delegation of authority and segregation of responsibilities. An internal audit department independently evaluates the effectiveness of these internal controls on an ongoing basis, and reports its findings to Management and to the Audit Committee of the Board of Directors.

The responsibility of the external auditor, Deloitte & Touche LLP, is to express an independent, professional opinion on whether the Consolidated Financial Statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditors' Report outlines the scope of their examination and their opinion.

The Board of Directors, through its Audit Committee, is responsible for ensuring that Management fulfils its responsibility for financial reporting and internal controls. The Audit Committee meets regularly with Management, the internal auditors and the external auditors to satisfy itself that each group has properly discharged its respective responsibility and to review the Consolidated Financial Statements before recommending approval by the Board of Directors. The internal and external auditors have full and free access to the Audit Committee, with and without the presence of Management.

Ed Martin
President and Chief Executive Officer

Derrick Sturge
Vice President, Finance and Chief Financial Officer

Auditors' Report

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

We have audited the consolidated balance sheet of Nalcor Energy (the Company) as at December 31, 2009, and the consolidated statements of income and retained earnings and comprehensive income and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Energy Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Deloitte & Touche LLP

Chartered Accountants
St. John's, NL
Canada
March 9, 2010

Consolidated Balance Sheet

As at December 31 (millions of dollars)	**2009**	2008
		(Note 1)
ASSETS		
Current assets		
Cash and cash equivalents	**14.0**	49.8
Short-term investments	**49.2**	24.6
Accounts receivable	**88.9**	77.2
Current portion of regulatory assets (Note 6)	**4.8**	5.0
Fuel and supplies	**59.5**	52.7
Prepaid expenses	**3.3**	1.6
	219.7	210.9
Property, plant and equipment (Note 4)	**1,901.7**	1,863.4
Petroleum and natural gas properties (Note 5)	**193.8**	112.1
Regulatory assets (Note 6)	**69.3**	74.6
Other long-term assets (Note 7)	**246.2**	214.0
	2,630.7	2,475.0
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	**124.4**	85.1
Current portion of long-term debt (Note 9)	**37.5**	9.1
Current portion of regulatory liabilities (Note 6)	**89.8**	22.3
Deferred credits	**3.1**	0.5
Promissory notes	**-**	163.0
	254.8	280.0
Long-term debt (Notes 9 and 15)	**1,141.6**	1,175.7
Regulatory liabilities (Note 6)	**32.8**	31.5
Other long-term liabilities (Note 10)	**5.1**	1.7
Employee future benefits (Note 11)	**54.4**	51.6
	1,488.7	1,540.5
SHAREHOLDER'S EQUITY		
Share capital (Note 12)	**122.5**	122.5
Contributed capital (Note 12)	**333.5**	191.5
	456.0	314.0
Accumulated other comprehensive income (Notes 14 and 15)	**22.0**	16.5
Retained earnings	**664.0**	604.0
	686.0	620.5
	1,142.0	934.5
	2,630.7	2,475.0

Commitments and contingencies (Note 19)

Subsequent events (Note 24)

See accompanying notes

On Behalf of the Board

John Ottenheimer
Director

Gerald Shortall
Director

Consolidated Statement of Income and Retained Earnings

Year ended December 31 (millions of dollars)	**2009**	2008
		(Note 1)
Revenue		
Energy sales (Notes 2 and 21)	**561.6**	563.3
Other	**11.0**	7.0
	572.6	570.3
Expenses		
Operations and administration	**171.9**	148.2
Fuels	**155.2**	164.8
Interest (Note 16)	**83.5**	78.2
Amortization	**54.9**	53.2
Power purchased	**47.1**	41.0
Write-down of investment	**-**	2.7
	512.6	488.1
Net income	**60.0**	82.2
Retained earnings, beginning of year	**604.0**	521.8
Retained earnings, end of year	**664.0**	604.0

See accompanying notes

Consolidated Statement of Comprehensive Income

Year ended December 31 (millions of dollars)	**2009**	2008
		(Note 1)
Net income	**60.0**	82.2
Other comprehensive income		
Change in fair value of sinking fund and reserve fund investments (Note 14)	**(0.7)**	(3.0)
Unrealized gain on derivatives designated as cash flow hedges (Note 14)	**6.2**	-
Comprehensive income	**65.5**	79.2

See accompanying notes

Consolidated Statement of Cash Flows

Year ended December 31 (millions of dollars)	**2009**	2008
		(Note 1)
Cash provided by (used in)		
Operating activities		
Net income	**60.0**	82.2
Adjustments for items not involving cash		
Amortization	**54.9**	53.2
Accretion of long-term debt	**0.4**	0.5
Loss on disposal of property, plant and equipment	**1.8**	2.5
Unrealized gain on derivative instruments	**(0.8)**	-
Write-down of investments	**-**	2.7
	116.3	141.1
Changes in non-cash operating working capital balances (Note 17)	**96.2**	36.1
	212.5	177.2
Financing activities		
(Decrease) increase in promissory notes	**(163.0)**	156.0
Repayment of long-term debt	**(0.9)**	(207.5)
Contributed capital	**142.0**	77.5
Issue of common shares	**-**	100.0
Increase in deferred credits	**2.6**	0.5
Increase in other liabilities	**3.4**	0.6
	(15.9)	127.1
Investing activities		
Additions to property, plant and equipment	**(96.4)**	(93.4)
Additions to oil and gas properties	**(81.7)**	(112.1)
Increase in other long-term assets	**(31.1)**	(35.0)
Increase in short-term investments	**(24.6)**	(13.1)
Proceeds on disposal of property, plant and equipment	**1.4**	0.7
	(232.4)	(252.9)
Net (decrease) increase in cash	**(35.8)**	51.4
Cash position, beginning of year	**49.8**	(1.6)
Cash position, end of year	**14.0**	49.8
Cash position is represented by		
Bank indebtedness	**(3.0)**	(5.1)
Cash equivalents	**17.0**	54.9
	14.0	49.8
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**0.8**	0.9
Interest paid	**92.8**	101.6

See accompanying notes

Notes to Consolidated Financial Statements

1. DESCRIPTION OF BUSINESS

Nalcor Energy (Nalcor) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and its business includes the development, generation and sale of electricity, oil and gas, wind energy, industrial fabrication and energy marketing.

Nalcor holds interests in the following subsidiaries and jointly controlled companies:

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province. The principal activity of Hydro is the generation, transmission and sale of electricity. Hydro's activities include both regulated and non-regulated activities.

Churchill Falls (Labrador) Corporation Limited (Churchill Falls) is incorporated under the laws of Canada and owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW).

Twin Falls Power Corporation (Twin Falls) is incorporated under the laws of Canada and has developed a 225 MW hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Nalcor Energy - Oil and Gas Inc. (Oil and Gas) is incorporated under the Corporations Act of Newfoundland and Labrador. Oil and Gas has a broad mandate to engage in upstream and downstream sectors of the oil and gas industry including exploration, development, production, transportation and processing.

Nalcor Energy - Bull Arm Fabrication Inc. (Bull Arm Fabrication) is incorporated under the Corporations Act of Newfoundland and Labrador. Bull Arm Fabrication is Atlantic Canada's largest industrial fabrication site and has a fully integrated infrastructure to support large-scale fabrication and assembly. Its facilities include onshore fabrication halls and shops, a dry-dock, and a deepwater site. The Province transferred its shares in Bull Arm Fabrication to Nalcor effective March 31, 2009. The transfer has been accounted for using the continuity of interests method which resulted in a restatement of 2008 comparative figures to include Bull Arm Fabrication's financial position, results of operations and cash flows as if Bull Arm Fabrication had been combined since its inception.

Gull Island Power Corporation (GIPCo) is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland. Lower Churchill Development Corporation (LCDC) is incorporated under the laws of Newfoundland and Labrador with the objective of developing all or part of the hydroelectric potential of the lower Churchill River (Lower Churchill Development). Both GIPCo and LCDC are inactive. All current Lower Churchill Development activities are being conducted in Nalcor.

Nalcor and its subsidiaries and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

Notes to Consolidated Financial Statements

2. SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles.

Principles of Consolidation

The Consolidated Financial Statements include the financial statements of Nalcor and its subsidiary companies: Hydro (100% owned), Oil and Gas (100% owned), Bull Arm Fabrication (100% owned), GIPCo (100% owned) and LCDC (51% owned). Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Québec entered into a 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 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 venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

A portion of Hydro's shareholding in Churchill Falls was deposited in a voting trust pursuant to an agreement with Hydro Québec, in relation to Churchill Falls' General Mortgage Bonds. Effective February 25, 2008, the bonds were retired, removing the requirement for the shares to be held in trust.

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 by the proportionate consolidation method.

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

Use of Estimates

Preparation of these Consolidated Financial Statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, environmental and asset retirement obligations, amortization, property, plant and equipment and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), and these differences could be material.

Rates and Regulations

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 (COS) methodology. The allowed rate of return on rate base is 7.4% (2008 - 7.4%). 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 will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 6.

Cash and Cash Equivalents and Short-term Investments

Cash and cash equivalents and short-term investments consist primarily of Canadian Treasury Bills and Bankers' Acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than 12 months are classified as short-term investments. The short-term investments bear interest rates of 0.26% to 0.65% (2008 – 1.58% to 3.60%) per annum. Cash and cash equivalents and short-term investments are measured at fair value.

Fuel and Supplies

Fuel and supplies inventories are recorded at the lower of average cost or net realizable value.

Property, Plant and Equipment

Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment, or the fair value of assets contributed. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

Gains or losses on the disposal of property, plant and equipment are recognized in income as incurred.

<u>Nalcor, Oil and Gas and Bull Arm Fabrication</u>

Amortization is calculated on a straight-line basis over service lives ranging from five to 27 years.

<u>Hydro</u>

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on distribution system and other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dykes, 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, dykes 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). Switching station assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators and conductors.

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

Churchill Falls

Churchill Falls uses the group amortization method for certain property, plant and equipment, other than the generation plant, transmission and terminals and service facilities.

Amortization is calculated on a straight-line basis over the following estimated useful lives:

Hydroelectric generation plant	67 years
Transmission and terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Petroleum and Natural Gas Properties

Nalcor employs the full cost method of accounting for oil and gas interests whereby all costs related to the acquisition, exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical costs, carrying charges of non-producing properties, drilling of productive and non-productive wells, the cost of petroleum and natural gas production equipment and administrative costs directly related to exploration and development activities.

Under the full cost method, capitalized costs, together with estimated future capital costs associated with proved reserves, are depleted and depreciated using the unit-of-production method based on estimated gross proved reserves at future prices and costs as determined by independent reservoir engineers.

Costs of acquiring and evaluating unproved properties and certain costs associated with major development projects are not subject to depletion until proved reserves are attributable to the property, production commences or impairment occurs. The carrying value of petroleum and natural gas properties is assessed annually or as circumstances dictate.

Impairment losses are recognized when the carrying value exceeds the sum of:

- the undiscounted future net cash flows from production of proved reserves based on forecast prices and costs;
- the costs of unproved properties, less impairment; and
- the costs of major development projects, less impairment.

The amount of impairment loss is the amount by which the carrying value exceeds the sum of:

- the fair value of proved and probable reserves; and
- the cost, less impairment, of unproved properties and major development projects.

Capitalized Interest

Interest is charged to construction in progress until the project is complete at rates equivalent to the weighted average cost of debt or the last approved weighted average cost of capital for regulated assets. Capitalized interest cannot exceed actual interest incurred.

Asset Retirement Obligations

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. 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 asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Nalcor is legally required to remove, an asset retirement obligation will be recognized at that time.

Impairment of Long-lived Assets

Nalcor reviews the carrying value of its oil and gas properties and development projects at the end of each accounting period. Nalcor reviews the carrying value of its other property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Revenue Recognition

Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB. Sales to other markets are at rates or at market prices under the terms of applicable contracts.

A power contract with Hydro-Québec (Power Contract), dated May 12, 1969, provides for the sale of substantially all the energy from Churchill Falls until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The rate is predetermined in the Power Contract and decreases from the existing rate of 2.5426 mills per kilowatt hour (kWh) to 2.0 mills per kWh upon renewal in 2016.

Churchill Falls receives revenues from Hydro-Québec, under a guaranteed winter availability contract (GWAC) through 2041. The GWAC 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 the end of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, are tracked over a four-year period and then either recovered from or refunded to Hydro-Québec over the subsequent four-year period, unless the balance is less than $1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2008 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

(c) Foreign exchange gains and losses are included in income except for unrealized gains and losses related to First Mortgage Bonds which were recoverable under the Power Contract.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Nalcor provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

Financial Instruments and Hedging Activities

<u>Financial Instruments</u>

Financial assets and financial liabilities are recognized on the balance sheet 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. Nalcor has classified each of its financial instruments into the following categories:

financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

Nalcor has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Short-term investments	Available-for-sale
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available-for-sale
Reserve fund	Available-for-sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities

Each of these financial instruments is measured at amortized cost, except for the reserve fund, sinking fund – other investments, cash and cash equivalents, and short-term investments which are measured at fair value.

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities

Derivative instruments are utilized by Nalcor to manage market risk. Nalcor's policy is not to utilize derivative instruments for speculative purposes. Nalcor may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Nalcor formally documents all hedges and the 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.

Nalcor has designated forward foreign exchange contracts as cash flow hedges (Notes 7 (d) and 15). In a cash flow hedge relationship, the portion of gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income.

Nalcor had no fair value hedges in place at December 31, 2009 or 2008.

3. CHANGES IN ACCOUNTING POLICIES

New Accounting Policies

Effective January 1, 2009, Nalcor adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA):

Goodwill and Intangible Assets

Section 3064, Goodwill and Intangible Assets establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and provides more comprehensive guidance particularly with respect to internally developed intangible assets. This new standard did not have any impact on Nalcor's financial results or disclosures.

Financial Instruments

EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities issued by the Emerging Issues Committee. This abstract requires that an entity's own credit risk (for financial liabilities) and the credit risk of the counterparty (for financial assets) should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not have a material impact on Nalcor's Consolidated Financial Statements.

Nalcor also adopted the changes made by CICA to Section 3862, Financial instruments – Disclosures whereby an entity shall classify and disclose fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have 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. The required disclosures are included in Note 15.

Future Accounting Changes

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

In January 2009, the CICA issued the following new Handbook sections: Section 1582, Business Combinations, Section 1601, Consolidated Financial Statements and Section 1602, Non-controlling Interests which replace Section 1581, Business Combinations and Section 1600, Consolidated Financial Statements. These new Sections will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. Early adoption is permitted to the extent the three new Sections are adopted simultaneously. Together, the new Sections establish standards for the accounting for a business combination, the preparation of consolidated financial statements and the accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. Nalcor does not expect that the adoption of these new Sections will have a material impact on its Consolidated Financial Statements.

International Financial Reporting Standards (IFRS)

In October 2009, the Accounting Standards Board (AcSB) issued a third and final Omnibus Exposure Draft confirming that publically accountable enterprises in Canada will be required to apply IFRS in full and without modification, for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Accordingly, starting in 2011, Nalcor will present its financial statements in accordance with IFRS, and will be required to present restated comparative information for its year-ended December 31, 2010 balances, and will also restate its opening balance sheet as at January 1, 2010.

Nalcor is continuing to assess the financial reporting impacts of the adoption of IFRS, however, the impact of these differences on Nalcor's future financial position and results of operations are not reasonably estimable or determinable at this time. Nalcor does anticipate a significant increase in disclosure resulting from the adoption of IFRS and is continuing to assess the level of disclosure required as well as any system changes that may be necessary to compile and process the information.

The International Accounting Standards Board (IASB) project schedule had indicated that a final standard on rate-regulated activities would be released in the second quarter of 2010. Commentary received on the Exposure Draft, and the resulting activities now planned by the IASB, creates uncertainty as to if and when a final standard will be released. If a final standard is released, it may not be until late 2011. Accordingly, Nalcor is unable to conclude on the impact, if any, of differences that will apply to accounting for rate-regulated activities under IFRS versus Canadian GAAP.

4. PROPERTY, PLANT AND EQUIPMENT

	Cost	Contributions in aid of Construction	Accumulated Amortization	Net Book Value
(millions of dollars)		**2009**		
Electric – generation	**1,722.1**	**29.6**	**581.7**	**1,110.8**
Electric – transmission and distribution	**822.9**	**67.7**	**263.3**	**491.9**
Development projects	**194.2**	**-**	**-**	**194.2**
Other	**295.5**	**23.5**	**167.2**	**104.8**
	3,034.7	**120.8**	**1,012.2**	**1,901.7**
(millions of dollars)		2008		
Electric – generation	1,721.1	27.3	573.9	1,119.9
Electric – transmission and distribution	798.7	60.2	248.2	490.3
Development projects	157.0	-	-	157.0
Other	291.6	32.4	163.0	96.2
	2,968.4	119.9	985.1	1,863.4

As at December 31, 2009, the cost of assets under construction and therefore excluded from costs subject to amortization was $200.9 million (2008 - $169.5 million).

5. PETROLEUM AND NATURAL GAS PROPERTIES

(millions of dollars)	**2009**	2008
Petroleum and natural gas properties	**193.8**	112.1
Accumulated depletion	**-**	-
	193.8	112.1

Internal costs directly related to acquisition, exploration and development activities capitalized in 2009 were $0.2 million (2008 - $0.2 million).

As at December 31, 2009 and December 31, 2008 all costs of petroleum and natural gas properties were not subject to depletion and depreciation.

Petroleum and natural gas properties include Nalcor's acquisition costs and proportionate share of exploration and development costs. Nalcor has a 4.9% working interest in the Hebron oil field, a 5.0% working interest in the White Rose Growth Project and an average working interest of 67% in three onshore exploration permits. On February 16, 2010, Nalcor acquired a 10% working interest in the Hibernia Southern Extension.

Acquisitions

On January 30, 2009, Oil and Gas signed an agreement to purchase a 5% working interest in the oil resources contained within the White Rose Growth Project which includes the North Amethyst Field, West White Rose and the South White Rose Extension. The purchase price was a maximum of $30.0 million, to be paid in two instalments. The first instalment of $7.0 million was paid on January 30, 2009; the remaining payment will be made upon the determination of the West White Rose Extension oil reserves. This payment will be dependent on the extent of these oil reserves but will be no more than $23.0 million.

On August 7, 2009, Oil and Gas announced its operatorship in three exploration permits in Western Newfoundland acquiring an average of 67% gross working interest in the three permits. Oil and Gas acquired the permits from Leprechaun Resources for a purchase price of $0.6 million. Oil and Gas has also assumed its proportionate share of Leprechaun Resources' work commitments valued at $0.6 million, which is refundable upon completion of the drilling program.

6. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

(millions of dollars)	**2009**	2008	Remaining Recovery Settlement Period (years)
Regulatory assets			
Foreign exchange losses	**68.9**	71.1	32.0
Deferred regulatory costs	**-**	0.2	-
Deferred major extraordinary repairs	**4.9**	7.6	2.8
Deferred study costs	**0.1**	0.2	2.0
Deferred wind power costs	**-**	0.5	-
Deferred energy conservation costs	**0.2**	-	n/a
Total regulatory assets	**74.1**	79.6	
Less current portion	**4.8**	5.0	
	69.3	74.6	
Regulatory liabilities			
Rate stabilization plan	**122.0**	53.2	n/a
Deferred purchased power savings	**0.6**	0.6	17.5
Total regulatory liabilities	**122.6**	53.8	
Less current portion	**89.8**	22.3	
	32.8	31.5	

Nalcor's subsidiary, Hydro, has operations that are regulated by the PUB.

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities are no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

Rate Stabilization Plan and Related Long-term Receivable

On January 1, 1986, Hydro, having received the approval of the PUB, implemented a Rate Stabilization Plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to December 31, 2003, were converted to a long-term receivable bearing interest at the weighted average cost of capital to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007, and for the utility customers on June 30, 2008, and any remaining balances were transferred to the current plan. Any subsequent balances accumulating in the RSP, including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of 25% of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian generally accepted accounting principles require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2009, $42.3 million was recognized (2008 - $9.1 million) in the RSP and $18.3 million (2008 - $14.9 million) was recovered through rates and included in energy sales, with a corresponding cost amortized in fuel expenses.

Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro’s deferred realized foreign exchange losses be amortized over a 40-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 16).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include these costs in operating costs in the year incurred. In 2009, $0.2 million (2008 - $0.2 million) of amortization was recognized in operations and administration expense.

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007, $2.0 million of expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, was expensed in 2008. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2009, $2.7 million (2008 - $2.7 million) of amortization was recognized in operations and administration expense.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004), the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three-year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year incurred. In 2009, there were no additions (2008 - nil) and $0.1 million (2008 - $0.2 million) of amortization was recognized in operations and administration expense.

Deferred Wind Power Costs

Pursuant to Order No. P.U. 20 (2008), the PUB agreed to allow Hydro to defer $0.5 million in costs associated with connecting the wind farms at St. Lawrence and Fermeuse to the Island Interconnected Grid through Newfoundland Power's transmission system and accordingly, these costs have been recognized as a regulatory asset. These costs were expensed in 2009. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include these costs in operating costs in the year incurred.

Deferred Energy Conservation Costs

Pursuant to Order No. P.U. 8 (2007), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors and, accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include this program as operating costs in the year incurred. In 2009, $0.2 million (2008 – nil) was deferred.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec electricity system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of $0.6 million (2008 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2009, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.2% and the amount capitalized is higher and interest expense is lower by $0.1 million than that which would be permitted in the absence of rate regulation. In 2008, Hydro's AFUDC of 7.6% was higher than its cost of debt of 7.3%, the amount capitalized was lower and interest expense was higher by $0.4 million than that which would have been permitted in the absence of rate regulation (Note 16).

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

During 2005, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately $170.0-$180.0 million lower than it would otherwise be and annual amortization expense is $10.0-$11.0 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets. A more recent study indicated that the amounts could be significantly higher. An update to this study is to be completed in 2010.

7. OTHER LONG-TERM ASSETS

(millions of dollars)		**2009**	2008
Long-term receivable	(a)	**24.8**	26.7
Sinking funds	(b)	**179.6**	163.9
Reserve fund	(c)	**34.8**	23.4
Derivative instruments	(d)	**7.0**	-
Lower Churchill Development Corporation Limited	(e)	**-**	-
		246.2	214.0

(a) Included in long-term receivables are two refundable deposits in the amount of $23.9 million (2008 - $25.4 million) associated with an application for transmission service into Québec, bearing interest at one-year Guaranteed Income Certificate (GIC) rates and a $0.1 million deposit associated with an application for transmission service in New Brunswick. The remaining portion of $0.8 million (2008 – $1.3 million) is a long-term receivable from Hydro-Québec bearing interest at 7.0%.

(b) Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures, which management intends to hold to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2008 - 4.50% to 9.86%).

(c) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a $75.0 million segregated reserve fund 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. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2010	$8.0 million
January 1, 2011	$8.0 million
January 1, 2012	$8.0 million

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 Canadian Chartered Banks. Nalcor's share of this commitment is 65.8%.

A summary of Nalcor's 65.8% share of the reserve fund is as follows:

(millions of dollars)	**2009**	2008
Opening balance	**23.4**	11.2
Contribution	**11.2**	11.2
Total contribution to reserve fund	**34.6**	22.4
Net interest	**(0.2)**	0.4
Mark-to-market adjustment	**0.4**	0.6
Fair value of reserve fund	**34.8**	23.4

(d) During 2009, Nalcor entered into a series of 24 foreign exchange forward contracts to manage exchange rate risk on US dollar (USD) electricity sales. The nominal contract values range from $2.4 million to $6.0 million with an average exchange rate of $1.17 Canadian to USD. During the year, eight of these contracts were settled with the effective portion of the gain, in the amount of $2.4 million, reported as energy sales and the ineffective portion as other income. The $7.0 million represents the fair value of the remaining 16 contracts outstanding as at December 31, 2009. These contracts have been designated as part of a hedging relationship (Note 15).

(e) LCDC was incorporated in 1978 pursuant to the provisions of an agreement (Principal Agreement), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as closely as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Pursuant to the provisions of the Principal Agreement, the Province agreed to enter into an Option Agreement, dated November 24, 1978, with LCDC in respect of the GIPCo assets and the hydroelectric development rights to the Lower Churchill River, (the Water Rights). In consideration of the option granted from the Province, LCDC issued 520 Class A common shares to Hydro valued at $5.2 million.

The option provided that, upon agreement to continue with the lower Churchill hydroelectric development, LCDC would have acquired the GIPCo assets for $94.8 million ($100.0 million less the amount of $5.2 million representing the shares issued pursuant to the signing of the Option Agreement). A 10% convertible demand debenture in the amount of $94.8 million would have been issued as consideration for the GIPCo assets, and LCDC would have acquired the Water Rights from the Province with the consideration having been the issue of 3,000 Class B common shares without nominal or par value.

On November 20, 2008, LCDC was advised by the Province that it would not be extending the Option Agreement. As a consequence, LCDC's option expired on November 24, 2008, which had the effect of terminating the Option Agreement. Hydro's share of the option in the amount of $2.7 million was expensed as an asset write-down in 2008 and the liability to the Government of Canada for non-controlling interest in the amount of $2.5 million was eliminated.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $0.01 million each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

8. JOINT VENTURE

The following amounts included in the Consolidated Financial Statements represent Nalcor's proportionate share of Churchill Falls' assets and liabilities at December 31, 2009, and its proportionate interest in Churchill Falls' operations for the year then ended.

(millions of dollars)	**2009**	2008
Current assets	**45.7**	35.1
Long-term assets	**374.5**	372.8
Current liabilities	**38.8**	10.2
Long-term liabilities	**12.7**	38.0
Revenues	**57.4**	65.4
Expenses	**50.9**	51.6
Net income	**6.5**	13.8
Cash provided by (used in)		
Operating activities	**15.3**	31.4
Financing activities	**0.9**	(15.7)
Investing activities	**(17.4)**	(18.7)

Income tax expense in the amount of $0.2 million (2008 - $0.2 million) related to a jointly controlled subsidiary, Twin Falls, has been included in expenses.

9. LONG-TERM DEBT

	Hydro	Churchill Falls	Total	Hydro	Churchill Falls	Total
(millions of dollars)		**2009**			2008	
Long-term debt	**1,149.8**	**29.3**	**1,179.1**	1,154.7	30.1	1,184.8
Less current portion	**8.2**	**29.3**	**37.5**	8.3	0.8	9.1
	1,141.6	**-**	**1,141.6**	1,146.4	29.3	1,175.7

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

(millions of dollars)	2010	2011	2012	2013	2014
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayment	29.3	-	-	-	125.0
	37.5	8.2	8.2	8.2	133.2

Nalcor

Nalcor maintains an unsecured revolving term credit facility with its banker in the amount of $150.0 million Canadian or US equivalent. Borrowings in Canadian dollars 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, 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. The terms of the credit facility provide for the expansion of the facility up to $300.0 million Canadian or US equivalent as a non-revolving term credit facility, secured by the guarantee of the Province. At year-end, the only drawing on the facility was one irrevocable letter of credit issued on behalf of Nalcor's subsidiary, Oil and Gas. This letter of credit, in the amount of $1.5 million, was issued to the Canada-Newfoundland and Labrador Offshore Petroleum Board (C-NLOPB) to satisfy certain financial responsibility requirements specified in the Accords Acts with respect to the issuance of authorizations for petroleum-related work or activities within the Newfoundland and Labrador offshore area.

Hydro

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity		
(millions of dollars)					**2009**	2008
V *	125.0	10.50	1989	2014	**124.5**	124.5
X *	150.0	10.25	1992	2017	**149.2**	149.1
Y *	300.0	8.40	1996	2026	**293.1**	292.9
AB *	300.0	6.65	2001	2031	**306.8**	306.9
AD *	125.0	5.70	2003	2033	**123.6**	123.5
AE	225.0	4.30	2006	2016	**223.7**	223.5
Total debentures	1,225.0				**1,220.9**	1,220.4
Less sinking fund investments in own debentures					**71.1**	65.9
					1,149.8	1,154.5
Other					**-**	0.2
					1,149.8	1,154.7
Less payments due within one year					**8.2**	8.3
					1,141.6	1,146.4

* Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest, and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1.0% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. During 2008 and 2009 the Province waived the payment of this fee.

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2009, no promissory notes were outstanding (2008 - $163.0 million).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end, there were no amounts drawn on the facility (2008 - nil). 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 also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year-end, Hydro had two letters of credit outstanding (Note 19(g)) reducing the availability of the credit facility by $7.5 million. In February 2010 Hydro issued 22 additional letters of credit, see Note 24.

Churchill Falls

(millions of dollars)	**2009**	2008
Bank of Nova Scotia Credit Agreement		
4.4% due December 15, 2010		
Outstanding	**29.3**	30.1
Due within one year	**29.3**	0.8
Total long-term debt	**-**	29.3

Refinancing

On February 25, 2008, Churchill Falls completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds, bearing an interest rate of 7.5% (6.0% net of subsidies) were retired and replaced with a 4.4% fixed rate credit agreement with The Bank of Nova Scotia. Principal repayment terms of the new credit agreement are the same as those required by the General Mortgage Bonds which provided for semi-annual payments in an amount equal to 1.0% of the aggregate principal amount outstanding on January 1 preceding each payment date with a final principal payment due in 2010.

Dividend Restriction

Under the terms of the long-term debt instruments, Churchill Falls may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June 1999 places additional restrictions on common dividends based on cash flow.

Operating Credit Facility

Churchill Falls maintains a $10.0 million Canadian unsecured operating credit facility with its banker and at year-end, there were no amounts drawn on the facility (2008 - nil). Advances may take the form of a Prime Rate advance or the issuance of BAs 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. At year-end, Churchill Falls has one letter of credit outstanding (Note 19(g)) reducing the availability of the credit facility by $0.7 million.

10. OTHER LONG-TERM LIABILITIES

(millions of dollars)		**2009**	2008
Long-term payable	(a)	**4.3**	0.7
Distribution payable to Province	(b)	**0.8**	1.0
		5.1	1.7

(a) The long-term payable to Hydro-Québec as at December 31, 2009, represents the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, the full amount of $4.3 million (2008 - $0.7 million) is long-term bearing interest of 7.0%. The final amount will be determined on August 31, 2012, and will be paid/collected monthly beginning September 2012 and ending August 2016.

(b) Prior to January 1, 2009, the Provincial Minister of Finance was authorized to invest any surplus from Bull Arm Fabrication's operations. Each year, the surplus or deficit from operations was credited or charged to the Distribution payable to the Province, however, there are no set terms of payment. This balance contains the accumulated results of operations of Bull Arm Fabrication since inception up to January 1, 2009, less any distributions paid to the Province. Effective January 1, 2009, rental revenues are to be retained and are reflected in retained earnings.

11. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $5.3 million (2008 - $4.9 million) are expensed as incurred.

Other Benefits

Additionally, Nalcor provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2009, cash payments to beneficiaries for its unfunded other employee future benefits was $2.7 million (2008 - $3.0 million). An actuarial valuation was performed on December 31, 2009.

(millions of dollars)	**2009**	2008
Accrued benefit obligation		
Balance at beginning of year	**52.3**	68.6
Current service cost	**1.6**	2.2
Interest cost	**3.9**	3.8
Actuarial loss (gain)	**17.6**	(19.3)
Benefits paid	**(2.7)**	(3.0)
Balance at end of year	**72.7**	52.3
Plan deficit	**72.7**	52.3
Unamortized actuarial loss	**(18.1)**	(0.4)
Unamortized past-service cost	**(0.2)**	(0.3)
Accrued benefit liability at end of year	**54.4**	51.6

(millions of dollars)	**2009**	2008
Components of benefit cost		
Current service cost	**1.6**	2.2
Interest cost	**3.9**	3.8
Actuarial loss (gain)	**17.6**	(19.3)
	23.1	(13.3)
Difference between actual actuarial (gain) loss and amount recognized	**(17.6)**	20.4
Benefit expense	**5.5**	7.1

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

	2009	2008
Discount rate – benefit cost	**7.5%**	5.5%
Discount rate – accrued benefit obligation	**6.5%**	7.5%
Rate of compensation increase	**3.5%**	3.5%

Assumed health care trend rates:

	2009	2008
Initial health care expense trend rate	**7.5%**	7.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2014**	2011

A 1% increase in assumed health care trend rates would have had the following effect:

(millions of dollars)	2009	2008
Current service and interest cost	**0.8**	1.2
Accrued benefit obligation	**11.1**	7.2

A 1% decrease in assumed health care trend rates would have had the following effect:

(millions of dollars)	2009	2008
Current service and interest cost	**(0.6)**	(0.8)
Accrued benefit obligation	**(8.7)**	(5.5)

12. SHAREHOLDER'S EQUITY

Share Capital

(millions of dollars)	2009	2008
Common shares		
Authorized: unlimited; Issued and outstanding 122,500,000 (2008 – 122,500,000)	**122.5**	122.5

In 2007, the Province held 22,503,924 shares in Hydro with a value of $22.5 million and pursuant to the Hydro Corporation Act, 2007 these shares were transferred to Nalcor. This transfer of shares was accounted for using the continuity of interests method. During 2008, Nalcor issued an additional 99,996,076 shares with a value of $100.0 million.

Contributed Capital

(millions of dollars)	2009	2008
Total contributed capital	**333.5**	191.5

During 2009, the Province contributed capital in the amount of $142.0 million (2008 - $77.5 million).

13. CAPITAL MANAGEMENT

Nalcor's primary objectives when managing capital are to minimize Nalcor's cost of capital within the confines of established risk parameters, and to safeguard Nalcor's ability to continue as a going concern. Nalcor's approach to capital management is performed on a consolidated basis. Management monitors the capital requirement for each subsidiary individually.

The capital managed by Nalcor is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

A summary of the capital structure is outlined below:

(*millions of dollars*)	**2009**		2008	
Debt				
Long-term debt	**1,141.6**		1,175.7	
Current portion of long-term debt	**37.5**		9.1	
Promissory notes	**-**		163.0	
Sinking funds	**(179.6)**		(163.9)	
	999.5	**46.7%**	1,183.9	55.9%
Equity				
Share capital	**122.5**		122.5	
Contributed capital	**333.5**		191.5	
Accumulated other comprehensive income	**22.0**		16.5	
Retained earnings	**664.0**		604.0	
	1,142.0	**53.3%**	934.5	44.1%
Total debt and equity	**2,141.5**	**100.0%**	2,118.4	100.0%

Hydro

Hydro requires access to capital due to the capital intensive nature of the business which is required to ensure the continued delivery of safe and reliable service to its customers. 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 earnings before interest and taxes (EBIT) coverage of interest. Adjustments to the capital structure are accomplished through adjustments to the amount of dividends paid to the Shareholder, cash infusion via contributed equity and new debt issuance or debt issuance with differing characteristics. Hydro's goal is to achieve a capital structure and cash flows to support debt.

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 increase, coincident with the aging of the plant and related infrastructure. 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 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 weighted heavily toward equity capital (share capital and retained earnings). The only remaining long-term debt at the end of the year consisted of a loan from the Bank of Nova Scotia, the balance of which comprised less than 10% of the Churchill Falls capital structure. This loan carries the same terms of repayment as the former General Mortgage Bonds and will mature in December of 2010, with any remaining principal due at that time. Churchill Falls has the right to prepay under certain conditions and has already taken advantage of the opportunity to do so. On March 19, 2008, Churchill Falls exercised its prepayment rights under the Credit Agreement to prepay $10.0 million in principal effective March 25, 2008. The corporate strategy is to ensure that funding is in place to extinguish the entire debt by the end of 2010 without re-financing. The capital structure is adjusted through the amount of dividends paid to shareholders.

Oil and Gas

Future requirements for capital are expected to increase, coincident with the increase in projects in development. Capital costs to date have been financed by equity. Once projects reach the production stage, Oil and Gas' cash from operations will contribute to funding its capital requirements.

14. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in the fair value of sinking fund and reserve fund investments comprise the items in other comprehensive income.

(millions of dollars)	**2009**	2008
Balance, beginning of year	**16.5**	19.5
Change in fair value of sinking fund investments	**(1.1)**	(3.6)
Change in fair value of reserve fund investments	**0.4**	0.6
Unrealized gains on derivatives designated as cash flow hedges	**6.2**	-
Balance, end of year	**22.0**	16.5

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

The estimated fair values of financial instruments as at December 31, 2009 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. 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, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments. The fair value estimates below do not reflect the fair value of Nalcor as a whole.

	Carrying Value	Fair Value	Carrying Value	Fair Value
(millions of dollars)	**2009**		2008	
Long-term debt including amount due within one year	**1,179.1**	**1,471.0**	1,184.8	1,484.8

Establishing Fair Value

The fair value of cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness and accounts payable and accrued liabilities approximates their carrying values due to their short-term maturity.

The fair value of long-term debt is determined using the present value of future cash flows under current financing agreements, based on the Nalcor's current estimated borrowing rate for loans with similar terms and conditions.

Fair Value Hierarchy

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the significance 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.

Financial instruments included in Level 1 are cash and cash equivalents and short-term investments. Financial instruments included in Level 2 are the derivative instruments, the reserve fund and sinking funds - other investments. There are no financial instruments in Level 3.

Risk Management

Exposure to credit risk, liquidity risk and market risk arises in the normal course of Nalcor's business.

Credit Risk

Nalcor is exposed to credit risk in the event of non performance by counterparties to its financial instruments. The majority of the receivables are from regulated utilities which minimizes credit risk. There is risk that Nalcor will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Nalcor manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers.

Nalcor manages its investment credit risk exposure by restricting its investments to high-quality securities such as Canada Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks. Additionally, the investments held within the portfolios of Churchill Falls do not exceed 10% with any one institution, with the exception of the Government of Canada.

Liquidity Risk

Nalcor is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. This risk is managed by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cash flows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300.0 million promissory note program and credit facilities. Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues. In addition, the reserve fund in Churchill Falls and the dividend management policy are used to meet long-term liquidity requirements associated with debt retirement and capital expenditure programs.

Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. During 2009, the Board of Directors of Nalcor approved a formal financial risk management policy that outlined the risks associated with the operations of Nalcor and its subsidiaries and approaches and guidelines to be followed in the management of those risks. This policy will be reviewed by the Board annually, or more frequently if there is a material change to Nalcor's financial risks, and outlines a formal approval process for various hedging instruments used. The Audit Committee will provide oversight on behalf of the Board with the exception of any items that specifically require Board approval.

Interest Rates

Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast 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 net income resulting from an unexpected change in interest rates.

Within Hydro, exposure to changes in interest rates on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios, creates risk. Hydro estimates that a change of 100 basis points from the actual average yield on the short-term debt portfolio in 2009 would have resulted in a change in interest expense of $0.5 million (2008 - $1.3 million). Similarly, a change of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2009 would have resulted in a change in interest income of $2.3 million (2008 - $2.0 million) and a change in other comprehensive income of $16.6 million (2008 - $16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

Within Churchill Falls, interest rate risk is mitigated on the company's long-term debt by virtue of a fixed interest rate to maturity. Exposure to changes in interest rates exists on investment income related to the short-term and reserve fund investment portfolios. Churchill Falls estimates that a change of 100 basis points from the actual average yield earned on the short-term investment portfolio in 2009 would have resulted in a change in interest income of $0.1 million (2008 - $0.2 million). Similarly, a change of 100 basis points from the actual average yield earned on the reserve fund investment portfolio in 2009 would have resulted in a change in interest income of $0.3 million (2008 - $0.2 million) and a change in other comprehensive income of $0.8 million (2008 - $0.5

million). Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated.

Foreign Currency and Commodity Exposure

Fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Nalcor's primary exposure to both foreign exchange and commodity price risk arises within Hydro from its purchases of No. 6 fuel for consumption at the HTGS and certain electricity sales both of which are denominated in USD.

During 2009, Hydro had total purchases of No. 6 fuel of $87.5 million (2008 - $103.9 million), denominated in USD. Nalcor's exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates, as compared to that approved in Hydro's most recent cost of service study used to set rates, are captured in the RSP and are either refunded to or collected from customers through automatic rate adjustments. Nalcor also employs the periodic use of forward currency contracts to avoid exposure to exchange rates on a particular day.

During 2009, total electricity sales denominated in USD were $42.5 million. Nalcor mitigates this risk through the use of forward contracts. During 2009, Nalcor entered into a series of 24 monthly foreign currency forward contracts, in the amount of $87.8 million USD at an average exchange rate of 1.17 to hedge 75% of Nalcor's forecasted USD sales, the last of which expires in April 2011. These contracts have been designated as part of a hedging relationship.

Effect of Hedge Accounting on Financial Statements

(millions of dollars)	Net Gains Included in Net Income	Unrealized Gains Included in OCI
Ineffective portion	0.5	-
Effective portion	2.4	6.2

16. INTEREST EXPENSE

(millions of dollars)	**2009**	2008
Gross Interest		
Long-term debt	**92.0**	96.0
Promissory notes	**0.6**	4.2
	92.6	100.2
Accretion of long-term debt	**0.4**	0.5
Amortization of foreign exchange losses	**2.2**	2.2
Other	**7.2**	2.8
	102.4	105.7
Less		
Recovered from Hydro-Québec	**-**	0.1
Interest capitalized during construction	**0.8**	9.6
Interest earned	**18.1**	17.8
Net interest expense	**83.5**	78.2

Under the terms of the Power Contract, Churchill Falls recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt. In addition, Churchill Falls is required to share with Hydro-Québec any benefits resulting from the refinancing of the General Mortgage Bonds.

Also, Churchill Falls can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such requests fail to attract sufficient advances, Churchill Falls can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

17. CHANGES IN NON-CASH OPERATING WORKING CAPITAL BALANCES

(*millions of dollars*)	**2009**	2008
Accounts receivable	**(11.7)**	3.1
Fuel and supplies	**(6.8)**	17.0
Prepaid expenses	**(1.7)**	(0.4)
Regulatory assets	**5.5**	18.9
Regulatory liabilities	**68.8**	14.8
Accounts payable and accrued liabilities	**39.3**	(21.5)
Employee future benefits	**2.8**	4.2
	96.2	36.1

18. SEGMENT INFORMATION

Nalcor operates in five business segments. Hydro Regulated encompasses sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. Energy Marketing activities include the sale of electricity to markets outside the Province. Oil and Gas activities include exploration, development, production, transportation and processing sectors of the oil and gas industry. Other encompasses industrial fabrication, some non-regulated electricity sales, development activities including the Lower Churchill Project and corporate activities. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 2.

	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Other	Inter-Segment	Total
(millions of dollars)				**2009**			
Revenue							
Energy sales	**443.8**	**61.0**	**-**	**54.7**	**6.0**	**(3.9)**	**561.6**
Other	**2.2**	**0.3**	**0.4**	**0.7**	**6.1**	**(1.3)**	**11.0**
	446.0	**61.3**	**0.4**	**55.4**	**12.1**	**(2.6)**	**572.6**
Expenses							
Operations and administration	**100.9**	**37.7**	**2.7**	**17.2**	**13.4**	**-**	**171.9**
Fuels	**155.2**	**-**	**-**	**-**	**-**	**-**	**155.2**
Interest	**83.5**	**0.4**	**-**	**-**	**(0.4)**	**-**	**83.5**
Amortization	**41.7**	**12.8**	**0.1**	**-**	**0.3**	**-**	**54.9**
Power purchased	**46.8**	**-**	**-**	**4.2**	**-**	**(3.9)**	**47.1**
	428.1	**50.9**	**2.8**	**21.4**	**13.3**	**(3.9)**	**512.6**
Net income (loss) from operations	**17.9**	**10.4**	**(2.4)**	**34.0**	**(1.2)**	**1.3**	**60.0**
Preferred dividends	**-**	**1.3**	**-**	**-**	**-**	**(1.3)**	**-**
Net income (loss)	**17.9**	**11.7**	**(2.4)**	**34.0**	**(1.2)**	**-**	**60.0**
Capital expenditures	**54.1**	**3.7**	**82.6**	**-**	**37.7**	**-**	**178.1**
Total assets	**1,766.0**	**420.5**	**198.3**	**10.2**	**286.2**	**(50.5)**	**2,630.7**
				2008			
Revenue							
Energy sales	440.1	68.9	-	51.3	6.9	(3.9)	563.3
Other	2.2	0.3	0.3	-	1.1	3.1	7.0
	442.3	69.2	0.3	51.3	8.0	(0.8)	570.3
Expenses							
Operations and administration	99.1	38.8	0.4	-	9.9	-	148.2
Fuels	164.8	-	-	-	-	-	164.8
Interest	87.6	0.1	-	-	(9.5)	-	78.2
Amortization	40.4	12.6	-	-	0.2	-	53.2
Power purchased	41.4	-	-	3.5	-	(3.9)	41.0
Write-down of investment	-	-	-	-	2.7	-	2.7
	433.3	51.5	0.4	3.5	3.3	(3.9)	488.1
Net income (loss) from operations	9.0	17.7	(0.1)	47.8	4.7	3.1	82.2
Preferred dividends	-	3.1	-	-	-	(3.1)	-
Net income (loss)	9.0	20.8	(0.1)	47.8	4.7	-	82.2
Capital expenditures	45.6	4.3	112.4	-	43.2	-	205.5
Total assets	1,711.4	414.4	112.7	3.7	250.4	(27.6)	2,475.0

Revenues by geographic area:

(millions of dollars)	**2009**	2008
Newfoundland and Labrador	**459.6**	448.7
Québec	**69.8**	121.6
Nova Scotia	**39.7**	-
New Brunswick	**3.5**	-
	572.6	570.3

All of Nalcor's assets are located in the Province.

19. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, Churchill Falls is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of Twin Falls will revert to Churchill Falls, and Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

(b) The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out. Further monitoring is recommended for 2010 and every five years thereafter.

(c) Effective March 31, 2009, Hydro's five-year power sales agreement to sell energy to Hydro-Québec expired. Effective April 1, 2009, Hydro entered into a power sales agreement with a third party with respect to the energy previously sold to Hydro-Québec. To facilitate market access, Hydro has entered into a five-year transmission service agreement with Hydro-Québec TransÉnergie to acquire access to 265 MW of transmission capacity from Labrador through Québec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing service request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that of the competing request.

Pursuant to Hydro's five-year transmission service agreement with Hydro-Québec TransÉnergie, the transmission rental payments for the next five years are as follows:

2010	$19.2 million
2011	$19.2 million
2012	$19.2 million
2013	$19.2 million
2014	$4.8 million

(d) Nalcor and its subsidiaries have received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Nalcor's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.1 million (2008 - $0.2 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.9 million (2008 - $22.2 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate effect of such an action cannot be ascertained at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(e) Outstanding commitments for capital projects total approximately $22.4 million (2008 - $13.6 million). In addition, Oil and Gas has committed to funding its share of all exploration and development projects.

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

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

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

(*millions of dollars*)	2010	2011	2012	2013	2014
Power purchases	27.0	27.6	28.5	29.5	30.2

On December 16, 2008, the Province licensed Nalcor Energy to manage and operate hydro facilities on behalf of the Province. Nalcor is operating the Star Lake, Grand Falls and Bishop's Falls facilities on a cost recovery basis. The power purchase agreements that previously applied to these facilities have been cancelled through Legislation.

(g) Nalcor has issued an irrevocable letter of credit, in the amount of $1.5 million, to the C-NLOPB to satisfy certain financial responsibility requirements specified in the Accords Acts with respect to the issuance of authorizations for petroleum-related work or activities within the Newfoundland and Labrador offshore area.

Hydro has issued two irrevocable letters of credit, one in the amount of $7.2 million to New Brunswick System Operator as credit support related to an application for point-to-point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

Churchill Falls has issued an irrevocable letter of credit, in the amount of $0.7 million, for waste management and compliance with a Certificate of Approval for the transportation of special hazardous wastes, granted by the Department of Environment and Conservation.

(h) Hydro has received funding in the amount of $2.5 million from the Atlantic Canada Opportunities Agency in relation to a Wind-Hydrogen-Diesel research and development project; this funding is repayable by annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2009, there have been no commercial implementations.

20. RELATED PARTY TRANSACTIONS

The Province, Hydro, Churchill Falls, Bull Arm Fabrication, LCDC, GIPCo and Oil and Gas are related parties of Nalcor. In addition, the PUB is related to Nalcor by virtue of its status as an agency of the Province. Related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $5.9 million (2008 - $6.0 million) of the power produced by Churchill Falls and Nalcor's 65.8% share is eliminated upon consolidation.

(b) For the year ended December 31, 2009, approximately $2.3 million (2008 - $2.2 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. Nalcor's 65.8% share is eliminated upon consolidation.

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2009, Hydro incurred $0.6 million in costs related to the PUB (2008 - $0.6 million) of which $0.1 million (2008 - $0.1 million) was included in accrued liabilities.

(d) Nalcor, and its subsidiaries, have a net payable to the Province of $9.5 million (2008 - $4.3 million). This payable consists of various transactions including rentals and royalties, power purchases, cost recoveries and amounts related to the acquisition of Bull Arm Fabrication. Of the $9.5 million, $8.7 million is included in Accounts payable and accrued liabilities (2008 - $3.3 million).

(e) During 2009, Hydro received $0.4 million (2008 - $0.4 million) as a rate subsidy for rural isolated customers from the Province and $1.6 million (2008 - $1.5 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.1 million (2008 - $0.1 million) recorded as accounts receivable at year-end.

(f) During 2009, Bull Arm Fabrication received $2.0 million (2008 - $0.5 million) in funding from the Province. As at December 31, 2009, $0.5 million is included in deferred credits.

(g) Oil and Gas administers the Petroleum Exploration Enhancement Program (PEEP), established as part of the Newfoundland and Labrador Energy Plan, on behalf of the Province. PEEP is designed to boost new petroleum exploration in western Newfoundland through the acquisition and assessment of seismic data. Total funding available under PEEP is $5.0 million over five years. During 2009, $1.0 million (2008 – nil) in funding was received of which $0.4 million is included in deferred credits at December 31, 2009 (2008 – $0.3 million included in receivables).

21. SIGNIFICANT OCCURRENCE

On November 3, 2008, a fire occurred in a cable shaft at Churchill Falls causing extensive damage to two sets of high voltage cables in two units of the cable shaft. This resulted in Nalcor's 65.8% share of lost GWAC revenue and power sales of approximately $7.7 million and $2.5 million in 2009 and $8.4 million and $2.1 million in 2008.

Nalcor's share of total repair costs of $5.3 million as of December 31, 2009 was covered by insurance with the exception of a $1.3 million deductible. Repair work was completed on the first unit in February 2009 and the second unit in October 2009.

22. ACQUISITION

On March 31, 2009, Nalcor acquired 100% of the shares of Bull Arm Fabrication from the Province for cash consideration of one dollar. At the time of acquisition, Nalcor and Bull Arm Fabrication were subject to common control. As a result, the acquisition was accounted for using the continuity of interests method and the assets and liabilities acquired were recorded at their carrying values. Accordingly, these financial statements have been prepared to reflect the financial position and results of operations and cash flows as if Nalcor and Bull Arm Fabrication had been combined since inception.

23. WATER MANAGEMENT AGREEMENT

In June 2007, the Province passed an amendment to the Electrical Power Control Act, 1994 (EPCA). The amendment requires parties, that utilize a common water resource in the province for power production, enter into a water management agreement. If the parties cannot reach an agreement, the PUB has the authority to impose an agreement on the parties. Nalcor's proposed hydroelectric development shares the Churchill River with Churchill Falls' hydroelectric generation plant. The amendment provides that any resulting water management agreement will not adversely affect existing power contracts.

A tentative agreement reached between management of Nalcor and Churchill Falls was not approved by the Churchill Falls Board of Directors. As a result, on November 10, 2009, Nalcor applied to the PUB to establish the terms of the agreement. In March 2010, the PUB established an agreement, see Note 24.

24. SUBSEQUENT EVENTS

(a) In January 2010, Hydro entered into 28 swap contracts to hedge the commodity price risk on electricity sales in the amount of $24.7 million.

(b) On February 16, 2010, Oil and Gas signed formal agreements to purchase a 10% working interest in the Hibernia Southern Extension for $30.0 million.

(c) On February 23, 2010, Churchill Falls filed a motion against Hydro-Québec in the Québec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The outcome of this motion is not determinable at this time.

On February 3, 2010, the Province established a trust with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses incurred in relation to this matter.

(d) In February 2010, Hydro issued 22 letters of credit, for transmission bookings, reducing the availability of its credit facility by $11.5 million.

(e) On March 2, 2010, Nalcor received notification that a $40.0 million equity contribution from the Province was approved.

(f) On March 9, 2010, the PUB issued a board order establishing the water management agreement proposed by Nalcor in November 2009.


nalcor energy
nalcorenergy.com
NEWFOUNDLAND AND LABRADOR HYDRO
CHURCHILL FALLS
OIL AND GAS
LOWER CHURCHILL PROJECT
BULL ARM FABRICATION

APPENDIX 2

Newfoundland and Labrador Hydro
2009 Consolidated Financial Statements

NEWFOUNDLAND AND LABRADOR HYDRO – A NALCOR ENERGY COMPANY

Consolidated Financial Statements

December 31, 2009

newfoundland labrador
hydro
a nalcor energy company

Hydro Place. 500 Columbus Drive.
P.O. Box 12400. St. John's. NL
Canada A1B 4K7
t. 709.737.1400 f. 709.737.1800
www.nlh.nl.ca

April 30, 2010

Honourable Kathy Dunderdale
Minister of Natural Resources

Minister's Office (Headquarters)
7th Floor, Natural Resources Building
50 Elizabeth Avenue
P.O. Box 8700
St. John's, NL A1B 4J6

Dear Minister Dunderdale:

Pursuant to Section 33 of the Hydro Corporation Act, 2007, please find attached the audited Consolidated Financial Statements of Newfoundland and Labrador Hydro (Hydro) for the year ended December 31, 2009.

A detailed account of Hydro's activities during the year ended December 31, 2009 is included in the Nalcor Energy 2009 Business and Financial Report.

Sincerely,

John Ottenheimer
Chair, Board of Directors

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

Deloitte & Touche LLP
10 Factory Lane
Fort William Building
St. John's NL A1C 6H5
Canada

Tel: (709) 576-8480
Fax: (709) 576-8460
www.deloitte.ca

Auditors' Report

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

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro (the "Company") as at December 31, 2009 and the consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Deloitte & Touche LLP

Chartered Accountants
March 9, 2010

BOARD OF DIRECTORS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

CATHY BENNETT
Owner/Operator
Bennett Restaurants Ltd.

TOM CLIFT
Associate Dean, Academic Programs
Memorial University - Faculty of Business

KEN MARSHALL
President
Rogers Cable - Atlantic Region

GERRY SHORTALL
Chartered Accountant
Corporate Director

OFFICERS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

MARK BRADBURY
Corporate Treasurer
Nalcor Energy

GILBERT BENNETT
Vice President
Lower Churchill Project

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary
Nalcor Energy

JIM HAYNES
Vice President Regulated Operations
Newfoundland and Labrador Hydro

PETER HICKMAN
Assistant Corporate Secretary
Nalcor Energy

ANDY MACNEILL
Vice President
Churchill Falls

JOHN MALLAM
Vice President Engineering Services
Newfoundland and Labrador Hydro

GERARD MCDONALD
Vice President Human Resources and
Organizational Effectiveness
Nalcor Energy

GLENN H. MITCHELL
Corporate Controller
Nalcor Energy

DERRICK STURGE
Vice President Finance and Chief Financial Officer
Nalcor Energy

HEAD OFFICE
Newfoundland and Labrador Hydro
Hydro Place. 500 Columbus Drive
P.O. Box 12400. St. John's, NL
Canada A1B 4K7

NEWFOUNDLAND AND LABRADOR HYDRO

CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2009**	2008
ASSETS		
Current assets		
Cash and cash equivalents	**12.7**	-
Short-term investments	**37.4**	14.6
Accounts receivable	**85.6**	76.6
Current portion of regulatory assets (Note 4)	**4.8**	5.0
Fuel and supplies	**59.5**	52.7
Prepaid expenses	**2.2**	1.6
	202.2	150.5
Property, plant and equipment (Notes 3 and 19 (f))	**1,703.1**	1,702.4
Long-term receivables (Note 5)	**24.7**	26.7
Sinking funds (Notes 8 and 14)	**179.6**	163.9
Regulatory assets (Note 4)	**69.3**	74.6
Derivative instruments	**7.0**	-
Reserve fund (Note 18 (c))	**34.8**	23.4
	2,220.7	2,141.5
LIABILITIES		
Current liabilities		
Bank indebtedness (Note 8)	-	1.6
Accounts payable and accrued liabilities	**62.4**	55.1
Accrued interest	**28.7**	28.7
Current portion of long-term debt (Note 8)	**37.5**	9.1
Current portion of regulatory liabilities (Note 4)	**89.8**	22.3
Deferred capital contribution (Note 19 (g))	**0.2**	2.2
Promissory notes (Note 8)	-	163.0
Due to related parties (Notes 14 and 19)	**20.9**	2.9
	239.5	284.9
Long-term debt (Notes 8 and 14)	**1,141.6**	1,175.7
Regulatory liabilities (Note 4)	**32.8**	31.5
Employee future benefits (Notes 10 and 19 (f))	**52.4**	49.9
Long-term payable (Note 9)	**4.3**	0.7
Long-term related party note payable	**23.9**	-
	1,494.5	1,542.7
SHAREHOLDER'S EQUITY		
Share capital (Note 11)	**22.5**	22.5
Contributed capital (Notes 11 and 19 (f))	**211.8**	111.8
	234.3	134.3
Accumulated other comprehensive income (Notes 13 and 14)	**22.0**	16.5
Retained earnings (Note 19 (f))	**469.9**	448.0
	491.0	464.5
	726.2	598.8
	2,220.7	2,141.5

Commitments and contingencies (Note 18)

Subsequent events (Note 22)

See accompanying notes

On behalf of the Board:

John Ottenheimer
Director

Gerald Shortall
Director

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2009**	2008
Revenue		
Energy sales	**561.6**	563.3
Other	**4.5**	5.6
	566.1	568.9
Expenses		
Operations and administration	**159.1**	141.8
Fuels	**155.2**	164.8
Interest (Note 15)	**83.8**	78.8
Amortization	**54.5**	53.0
Power purchased	**47.1**	41.0
Write-down of investment (Note 6)	**-**	2.7
	499.7	482.1
Net income	**66.4**	86.8
Retained earnings, beginning of year	**448.0**	521.8
Equity transfer (Note 19 (f))	**-**	(160.6)
Dividends	**44.5**	-
Retained earnings, end of year	**469.9**	448.0

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31 (millions of dollars)	**2009**	2008
Net income	**66.4**	86.8
Other comprehensive income		
Change in fair value of sinking fund and reserve fund investments	**(0.7)**	(3.0)
Unrealized gain on derivatives designated as cash flow hedges	**6.2**	-
Comprehensive income	**71.9**	83.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2009**	2008
Cash provided by (used in)		
Operating activities		
Net income	**66.4**	86.8
Adjustments for items not involving cash		
Amortization	**54.5**	53.0
Accretion of long-term debt	**0.4**	0.5
Loss on disposal of property, plant and equipment	**1.3**	2.5
Unrealized gain on derivative assets	**(0.8)**	-
Write-down of investments	**-**	2.7
	121.8	145.5
Changes in non-cash operating working capital balances (Note 16)	**115.2**	31.7
	237.0	177.2
Financing activities		
(Decrease) increase in promissory notes	**(163.0)**	156.0
Repayment of long-term debt	**(0.9)**	(207.5)
Dividends paid to Nalcor Energy	**(44.5)**	-
Advance to Nalcor Energy (Note 19(f))	**-**	(3.0)
(Decrease) increase in deferred capital contribution	**(2.0)**	2.2
Contributed capital	**100.0**	-
	(110.4)	(52.3)
Investing activities		
Additions to property, plant and equipment	**(57.8)**	(90.1)
Increase in sinking funds	**(22.0)**	(20.8)
Increase in short-term investments	**(22.8)**	(3.1)
Increase in reserve fund	**(11.0)**	(11.3)
Proceeds on disposal of property, plant and equipment	**1.3**	0.7
	(112.3)	(124.6)
Net increase in cash	**14.3**	0.3
Cash position, beginning of year	**(1.6)**	(1.9)
Cash position, end of year	**12.7**	(1.6)
Cash position is represented by		
Bank indebtedness	**(4.3)**	(5.5)
Cash equivalents	**17.0**	3.9
	12.7	(1.6)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**0.4**	0.9
Interest paid	**92.8**	101.6

See accompanying notes

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Newfoundland and Labrador Hydro (Hydro), a Nalcor Energy company, is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and its principal activity is the development, generation and sale of electricity.

Hydro holds interests in the following subsidiaries and jointly controlled companies:

Churchill Falls (Labrador) Corporation Limited (Churchill Falls) is incorporated under the laws of Canada and owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW) (Churchill Falls Project).

Twin Falls Power Corporation (Twin Falls) is incorporated under the laws of Canada and has developed a 225 MW hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Gull Island Power Corporation (GIPCo) is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland. Lower Churchill Development Corporation (LCDC) is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the lower Churchill River (lower Churchill Development). Both GIPCo and LCDC are inactive.

Hydro and its subsidiary and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

Principles of Consolidation

The Consolidated Financial Statements include the financial statements of Hydro and its subsidiary companies, GIPCo, (100% owned) and LCDC, (51% owned). Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Québec entered into a 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 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 venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

A portion of Hydro's shareholding in Churchill Falls was deposited in a voting trust pursuant to an agreement with Hydro-Québec, in relation to Churchill Falls' General Mortgage Bonds. Effective February 25, 2008, the bonds were retired, removing the requirement for the shares to be held in trust.

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 by the proportionate consolidation method.

Use of Estimates

The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). Preparation of these Consolidated Financial Statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, environmental and asset retirement obligations, amortization,

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Use of Estimates (cont'd.)
property, plant, and equipment and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), and these differences could be material.

Rates and Regulations (Excluding Sales by Subsidiaries)
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 (COS) methodology. The allowed rate of return on rate base is 7.4% (2008 - 7.4%). Hydro applies certain 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 will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 4.

Cash and Cash Equivalents and Short-term Investments
Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and bankers' acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. The short-term investments bear interest rates of 0.26% to 1.57% (2008 – 1.58% to 3.60%) per annum. Cash and cash equivalents are measured at fair value and short-term investments are measured at amortized cost.

Fuel and Supplies
Fuel and supplies inventories are recorded at the lower of average cost or net realizable value.

Property, Plant and Equipment
Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro'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 asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment, or the fair value of assets contributed. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Hydro

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Gains or losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on distribution system and other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dykes, 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, dykes 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). Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators and conductors.

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

Churchill Falls

Churchill Falls uses the group amortization method for certain property, plant and equipment, other than the generation plant, transmission and terminals and service facilities.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Churchill Falls (cont'd.)
Amortization is calculated on a straight-line basis over the following estimated useful lives:

Hydroelectric generation plant	67 years
Transmission and terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to amortization expense.

Impairment of Long-lived Assets
Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Revenue Recognition
Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB. Sales to Hydro-Québec and certain major industrial customers are at rates under the terms of applicable contracts.

A power contract with Hydro-Québec (Power Contract), dated May 12, 1969, provides for the sale of substantially all the energy from the Churchill Falls Project until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The rate is predetermined in the Power Contract and decreases from the existing rate of 2.5426 mills per kilowatt hour (kWh) to 2.0 mills per kWh upon renewal in 2016.

Churchill Falls receives revenues from Hydro-Québec, under a guaranteed winter availability contract (GWAC) through 2041. The GWAC 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 the end of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, are tracked over a four-year period and then either recovered from or refunded to Hydro-Québec over the subsequent four-year period, unless the balance is less than $1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2008 - 7%).

Foreign Currency Translation
Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

(c) Foreign exchange gains and losses are included in income except for unrealized gains and losses related to First Mortgage Bonds which were recoverable under the Power Contract.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Employee Future Benefits
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation is amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

Financial Instruments and Hedging Activities

<u>Financial Instruments</u>
Financial assets and financial liabilities are recognized on the balance sheet when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Hydro has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Short-term investments	Available-for-sale
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available for sale
Reserve fund	Available for sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities
Due to related parties	Other liabilities

Each of these financial instruments is measured at amortized cost, except for the reserve fund, sinking fund – other investments, cash and cash equivalents and short-term investments which are measured at fair value.

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

<u>Derivative Instruments and Hedging Activities</u>
Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Hydro may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Hydro formally documents all hedges and the 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.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Financial Instruments and Hedging Activities (cont'd.)

Derivative Instruments and Hedging Activities (cont'd.)
Hydro has designated forward foreign exchange contracts as cash flow hedges (Note 14). In a cash flow hedge relationship, the portion of gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income.

Hydro had no fair value hedges in place at December 31, 2009 or 2008.

2. CHANGES IN ACCOUNTING POLICIES

New Accounting Policies
Effective January 1, 2009, Hydro adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA):

Goodwill and Intangible Assets
Section 3064, Goodwill and Intangible Assets establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and provides more comprehensive guidance particularly with respect to internally developed intangible assets. This new standard did not have any impact on Hydro's financial results or disclosures.

Financial Instruments
EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities issued by the Emerging Issues Committee. This abstract requires that an entity's own credit risk (for financial liabilities) and the credit risk of the counterparty (for financial assets) should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not have a material impact on Hydro's Consolidated Financial Statements.

Hydro also adopted the changes made by the CICA to Section 3862, Financial instruments – Disclosures whereby an entity shall classify and disclose fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have 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. The required disclosures are included in Note 14.

2. CHANGES IN ACCOUNTING POLICIES (cont'd.)

Future Accounting Changes

International Financial Reporting Standards (IFRS)
In October 2009, the Accounting Standards Board (AcSB) issued a third and final Omnibus Exposure Draft confirming that publically accountable enterprises in Canada will be required to apply IFRS in full and without modification, for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Accordingly, starting in 2011, Hydro will present its financial statements in accordance with IFRS, and will be required to present restated comparative information for its year-ended December 31, 2010 balances, and will also restate its opening balance sheet as at January 1, 2010.

Hydro is continuing to assess the financial reporting impacts of the adoption of IFRS, however, the impact of these differences on Hydro's future financial position and results of operations are not reasonably estimable or determinable at this time. Hydro does anticipate a significant increase in disclosure resulting from the adoption of IFRS and is continuing to assess the level of disclosure required as well as any system changes that may be necessary to compile and process the information.

The International Accounting Standards Board (IASB) project schedule had indicated that a final standard on rate-regulated activities would be released in the second quarter of 2010. Commentary received on the Exposure Draft, and the resulting activities now planned by the IASB, creates uncertainty as to if and when a final standard will be released. If a final standard is released, it may not be until late 2011. Accordingly, Hydro is unable to conclude on the impact, if any, of differences that will apply to accounting for rate-regulated activities under IFRS versus Canadian GAAP.

3. PROPERTY, PLANT AND EQUIPMENT

(millions of dollars)	Plant and Equipment in Service	Contributions in aid of Construction	Accumulated Amortization	Construction in Progress	Net Book Value
			2009		
Generation plant					
Hydroelectric	**1,397.5**	**22.9**	**352.3**	**1.1**	**1,023.4**
Thermal	**255.8**	**0.8**	**196.0**	**0.2**	**59.2**
Diesel	**64.6**	**5.9**	**33.5**	**2.8**	**28.0**
Transmission and distribution	**820.8**	**67.7**	**263.3**	**2.2**	**492.0**
Service facilities and other	**284.7**	**23.5**	**166.1**	**5.4**	**100.5**
	2,823.4	**120.8**	**1,011.2**	**11.7**	**1,703.1**
(millions of dollars)			**2008**		
Generation plant					
Hydroelectric	1,407.3	20.5	351.6	1.5	1,036.7
Thermal	247.5	0.8	190.6	1.9	58.0
Diesel	62.1	6.0	31.7	0.8	25.2
Transmission and distribution	794.5	60.2	248.2	4.2	490.3
Service facilities and other	282.7	32.4	162.2	4.1	92.2
	2,794.1	119.9	984.3	12.5	1,702.4

At the end of 2008, pursuant to an asset transfer agreement (the Transfer Agreement) between Hydro and Nalcor Energy (Nalcor), Hydro's parent company, $157.2 million of property, plant and equipment was transferred from Hydro to Nalcor for consideration equal to net book value (Note 19(f)).

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

(millions of dollars)	**2009**	2008	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Foreign exchange losses	**68.9**	71.1	32.0
Deferred regulatory costs	**-**	0.2	-
Deferred major extraordinary repairs	**4.9**	7.6	2.8
Deferred study costs	**0.1**	0.2	2.0
Deferred wind power costs	**-**	0.5	-
Deferred energy conservation costs	**0.2**	-	N/A
Total regulatory assets	**74.1**	79.6	
Less: current portion	**4.8**	5.0	
	69.3	74.6	
Regulatory liabilities			
Rate stabilization plan	**122.0**	53.2	N/A
Deferred purchased power savings	**0.6**	0.6	17.5
Total regulatory liabilities	**122.6**	53.8	
Less: current portion	**89.8**	22.3	
	32.8	31.5	

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

Rate Stabilization Plan and Related Long-term Receivable

On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003), RSP balances which accumulated prior to December 31, 2003, were converted to a long-term receivable bearing interest at the weighted average cost of capital to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007 and for the utility customers on June 30, 2008. Any remaining balances were transferred to the current plan. Any subsequent balances accumulating in the RSP, including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2009, $42.3 million was recognized (2008 - $9.1 million) in the RSP and $18.3 million (2008 - $14.9 million) was recovered through rates and included in energy sales, with the corresponding cost amortized in fuels expenses.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 15).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include these costs in operating costs in the year incurred. In 2009, $0.2 million (2008 - $0.2 million) of amortization was recognized in operations and administration expense.

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007, $2.0 million of expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, was expensed in 2008. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2009, $2.7 million (2008 - $2.7 million) of amortization was recognized in operations and administration expense.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004), the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the cost of these studies in operating costs in the year incurred. In 2009 there were no additions (2008 – nil) and $0.1 million (2008 - $0.2 million) of amortization was recognized in operating and administration expense.

Deferred Wind Power Costs

Pursuant to Order No. P.U. 20 (2008), the PUB agreed to allow Hydro to defer $0.5 million in costs associated with connecting the wind farms at St. Lawrence and Fermeuse to the Island Interconnected Grid through Newfoundland Power's transmission system and, accordingly, these costs have been recognized as a regulatory asset. These costs were expensed in 2009. In the absence of rate regulation, Canadian GAAP would require that Hydro include these costs in operating costs in the year incurred.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Deferred Energy Conservation Costs
Pursuant to Order No. P.U. 8 (2007), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors and , accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2009, $0.2 million (2008 – nil) was deferred.

Deferred Purchased Power Savings
In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of $0.6 million (2008 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

Property, Plant and Equipment
The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2009, Hydro's AFUDC of 7.6% was higher than its cost of debt of 7.2%, the amount capitalized higher and interest expense lower by $0.1 million than that which would have been permitted in the absence of rate regulation. In 2008, Hydro's AFUDC of 7.6% was higher than its cost of debt of 7.3%, the amount capitalized higher and interest expense lower by $0.4 million than that which would have been permitted in the absence of rate regulation (Note 15).

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method. During 2005, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately $170.0-$180.0 million lower than it would otherwise be and annual amortization expense is $10.0-$11.0 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets. A more recent study indicated that the amounts could be significantly higher. An update to this study is to be completed in 2010.

5. LONG-TERM RECEIVABLES

Long-term receivables consist of two refundable deposits in the amount of $23.9 million (2008 - $25.4 million) associated with an application for transmission service into Québec, bearing interest at one year Guaranteed Income Certificate (GIC) rates. The remaining portion of $0.8 million (2008 – $1.3 million) is a long-term receivable from Hydro-Québec, bearing interest at 7.0%.

6. INVESTMENTS

(millions of dollars)	**2009**	2008
Lower Churchill Development Corporation Limited	**-**	-

6. INVESTMENTS (cont'd.)

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (Principal Agreement), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as closely as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Pursuant to the provisions of the Principal Agreement, the Province agreed to enter into an Option Agreement, dated November 24, 1978, with LCDC in respect of the GIPCo assets and the hydroelectric development rights to the lower Churchill River, (the Water Rights). In consideration of the option granted from the Province, LCDC issued 520 Class A common shares to Hydro valued at $5.2 million.

The option provided that, upon agreement to continue with the Project, LCDC would have acquired the GIPCo assets for $94.8 million ($100.0 million less the amount of $5.2 million representing the shares issued pursuant to the signing of the Option Agreement). A 10% convertible demand debenture in the amount of $94.8 million would have been issued as consideration for the GIPCo assets, and LCDC would have acquired the Water Rights from the Province with the consideration having been the issue of 3,000 Class B common shares without nominal or par value.

On November 20, 2008, LCDC was advised by the Province that it would not be extending the Option Agreement. As a consequence, LCDC's option expired on November 24, 2008, which had the effect of terminating the Option Agreement. Hydro's share of the option in the amount of $2.7 million was expensed as an asset write-down in 2008 and the liability to the Government of Canada for non-controlling interest in the amount of $2.5 million was eliminated.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

7. JOINT VENTURE

The following amounts included in the Consolidated Financial Statements represent Hydro's proportionate share of Churchill Falls' assets and liabilities at December 31, 2009, and its proportionate interest in Churchill Falls' operations for the year then ended.

(millions of dollars)	**2009**	2008
Current assets	**45.7**	35.1
Long-term assets	**374.5**	372.8
Current liabilities	**38.8**	10.2
Long-term liabilities	**12.7**	38.0
Revenues	**57.4**	65.4
Expenses	**50.9**	51.6
Net income	**6.5**	13.8
Cash provided by (used in)		
Operating activities	**14.6**	31.1
Financing activities	**0.9**	(15.7)
Investing activities	**(17.4)**	(18.7)

Income tax expense in the amount of $0.2 million (2008 - $0.2 million) related to a jointly controlled subsidiary, Twin Falls has been included in expenses.

8. LONG-TERM DEBT

(millions of dollars)	**2009**			2008		
	Hydro	**Churchill Falls**	**Total**	Hydro	Churchill Falls	Total
Long-term debt	**1,149.8**	**29.3**	**1,179.1**	1,154.7	30.1	1,184.8
Less current portion	**8.2**	**29.3**	**37.5**	8.3	0.8	9.1
	1,141.6	**-**	**1,141.6**	1,146.4	29.3	1,175.7

Details of long-term debt are as follows:

Hydro

Series	**Face Value**	**Coupon Rate %**	**Year of Issue**	**Year of Maturity**		
(millions of dollars)					**2009**	2008
V *	125.0	10.50	1989	2014	**124.5**	124.5
X *	150.0	10.25	1992	2017	**149.2**	149.1
Y *	300.0	8.40	1996	2026	**293.1**	292.9
AB *	300.0	6.65	2001	2031	**306.8**	306.9
AD *	125.0	5.70	2003	2033	**123.6**	123.5
AE	225.0	4.30	2006	2016	**223.7**	223.5
Total debentures	1,225.0				**1,220.9**	1,220.4
Less sinking fund investments in own debentures					**71.1**	65.9
					1,149.8	1,154.5
Other					**-**	0.2
					1,149.8	1,154.7
Less: payments due within one year					**8.2**	8.3
					1,141.6	1,146.4

* Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2014 to 2033. Hydro debentures, which management intends to hold to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2008 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. During 2008 and 2009, the guarantee fee was waived by the Province.

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2009 there were no promissory notes outstanding (2008 – $163.0 million).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end there were no amounts drawn on the facility (2008 – nil). Advances may take the form of a Prime Rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year-end, Hydro had two letters of credit outstanding (Note 18(g)) reducing the availability of the credit facility by $7.5 million. In February 2010, Hydro issued 22 additional letters of credit, see Note 21.

8. LONG-TERM DEBT (cont'd.)

Hydro (cont'd.)
Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

(millions of dollars)	2010	2011	2012	2013	2014
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayment	-	-	-	-	125.0
	8.2	8.2	8.2	8.2	133.2

Churchill Falls

(millions of dollars)	**2009**	2008
Bank of Nova Scotia Credit Agreement		
4.4% due December 15, 2010		
Outstanding	**29.3**	30.1
Due within one year	**29.3**	0.8
Total long-term debt	**-**	29.3

Refinancing
On February 25, 2008 Churchill Falls completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds, bearing an interest rate of 7.5% (6.0% net of subsidies) were retired and replaced with a 4.4% fixed rate credit agreement with The Bank of Nova Scotia. Principal repayment terms of the new credit agreement are the same as those required by the General Mortgage Bonds which provided for semi-annual payments in an amount equal to 1.0% of the aggregate principal amount outstanding on January 1 preceding each payment date with a final principal payment due in 2010.

Repayment of Long-term Debt
Long-term debt repayments over the next five years are as follows:

(millions of dollars)	2010	2011	2012	2013	2014
	29.3	-	-	-	-

Dividend Restriction
Under the terms of the long-term debt instruments, Churchill Falls may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June 1999 places additional restrictions on dividends based on cash flow.

Operating Credit Facility
Churchill Falls maintains a $10.0 million Canadian 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. At year-end, Churchill Falls had a letter of credit outstanding (Note 18(g)) reducing the availability of the credit facility by $0.7 million.

9. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec as at December 31, 2009 represents the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, the full amount of $4.3 million (2008 – $0.7 million) is long-term. The final amount will be determined on August 31, 2012 and will be paid/collected monthly beginning September 2012 and ending August 2016.

10. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $4.6 million (2008 - $4.6 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2009, cash payments to beneficiaries for its unfunded other employee future benefits was $2.7 million (2008 - $3.0 million). An actuarial valuation was performed December 31, 2009.

(millions of dollars)	**2009**	2008
Accrued benefit obligation		
Balance at beginning of year	**51.1**	68.6
Transfer to Nalcor Energy	**(0.5)**	(1.4)
Current service cost	**1.4**	2.1
Interest cost	**3.8**	3.7
Actuarial loss (gain)	**16.5**	(18.9)
Benefits paid	**(2.7)**	(3.0)
Balance at end of year	**69.6**	51.1
Plan deficit	**69.6**	51.1
Unamortized actuarial loss	**(17.0)**	(0.5)
Unamortized past service cost	**(0.2)**	(0.2)
Transfer to Nalcor Energy	**-**	(0.5)
Accrued benefit liability at end of year	**52.4**	49.9

(millions of dollars)	**2009**	2008
Components of benefit cost		
Current service cost	**1.4**	2.1
Interest cost	**3.8**	3.7
Actuarial loss (gain)	**16.5**	(18.9)
	21.7	(13.1)
Difference between actual actuarial (gain) loss and amount recognized	**(16.5)**	20.0
Benefit expense	**5.2**	6.9

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

	2009	2008
Discount rate – benefit cost	**7.5%**	5.5%
Discount rate – accrued benefit obligations	**6.5%**	7.5%
Rate of compensation increase	**3.5%**	3.5%

Assumed healthcare trend rates:

	2009	2008
Initial healthcare expense trend rate	**7.5%**	7.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2014**	2011

10. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

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

Increase	**2009**	2008
Current service and interest cost	**0.8**	1.2
Accrued benefits obligation	**10.7**	6.9

Decrease	**2009**	2008
Current service and interest cost	**(0.6)**	(0.8)
Accrued benefits obligation	**(8.4)**	(5.5)

11. SHAREHOLDER'S EQUITY

Share Capital

(millions of dollars)	**2009**	2008
Common shares of par value $1 each		
Authorized 25,000,000 shares;		
Issued and outstanding 22,503,942 shares	**22.5**	22.5

Contributed Capital

(millions of dollars)	**2009**	2008
Total contributed capital	**211.8**	111.8

During 2009, Nalcor contributed capital of $100.0 million (2008 – nil).

12. CAPITAL MANAGEMENT

Hydro

Hydro's primary objectives when managing capital are to minimize Hydro's cost of capital within the confines of established risk parameters, and to safeguard Hydro's ability to continue as a going concern. Hydro requires access to capital due to the capital intensive nature of the business which is required to ensure the continued delivery of safe and reliable service to its customers .

The capital managed by Hydro is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

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 earnings before interest and taxes (EBIT) coverage of interest. Adjustments to the capital structure are accomplished through adjustments to the amount of dividends paid to the Shareholder, cash infusion via contributed equity and new debt issuance or debt issuance with differing characteristics. Hydro's goal is to achieve a capital structure and cash flow to support debt.

12. CAPITAL MANAGEMENT (cont'd.)

Hydro (cont'd.)
A summary of the capital structure is outlined below:

(millions of dollars)	**2009**		2008	
Debt				
Bank Indebtedness	-		1.6	
Long-term debt	**1,141.6**		1,175.7	
Current portion of long-term debt	**37.5**		9.1	
Promissory notes	**-**		163.0	
Sinking funds	**(179.6)**		(163.9)	
	999.5	**57.9%**	1,185.5	66.4%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**211.8**		111.8	
Accumulated other comprehensive income	**22.0**		16.5	
Retained earnings	**469.9**		448.0	
	726.2	**42.1%**	598.8	33.6%
Total debt and equity	**1,725.7**	**100.0%**	1,784.3	100.0%

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 increase, coincident with the aging of the plant and related infrastructure. 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 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 weighted heavily toward equity capital (share capital and retained earnings). The only remaining long-term debt at the end of the year consisted of a loan from the Bank of Nova Scotia, the balance of which comprised less than 10% of Churchill Falls' capital structure. This loan carries the same terms of repayment as the former General Mortgage Bonds and will mature in December of 2010, with any remaining principal due at that time. Churchill Falls has the right to prepay under certain conditions and has already taken advantage of the opportunity to do so. On March 19, 2008, Churchill Falls exercised its prepayment rights under the Credit Agreement to prepay $10.0 million in principal effective March 25, 2008. The corporate strategy is to ensure that funding is in place to extinguish the entire debt by the end of 2010 without re-financing. The capital structure is adjusted through the amount of dividends paid to shareholders.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in the fair value of sinking fund and reserve fund investments comprise the items in other comprehensive income.

(millions of dollars)	**2009**	2008
Balance, beginning of year	**16.5**	19.5
Change in fair value of sinking fund investments	**(1.1)**	(3.6)
Change in fair value of reserve fund investments	**0.4**	0.6
Unrealized gains on derivatives designated as cash flow hedges	**6.2**	-
Balance, end of year	**22.0**	16.5

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

The estimated fair values of financial instruments as at December 31 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	**2009**		2008	
Financial liabilities				
Long-term debt including amount due within one year	**1,179.1**	**1,471.0**	1,184.8	1,484.8

Establishing Fair Value

The fair value of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities and due to related parties approximates their carrying values due to their short-term maturity.

The fair value of long-term debt, long-term receivables, and long-term payables are determined using the present value of future cash flows under current financing agreements, based on Hydro's current estimated borrowing rate for loans with similar terms and conditions.

Fair Value Hierarchy

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the significance 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.

Financial instruments included in Level 1 are cash and cash equivalents and short-term investments. Financial instruments included in Level 2 are the derivative instruments, the reserve fund and sinking funds – other investments. There are no financial instruments in Level 3.

Risk Management

Exposure to credit risk, liquidity risk and market risk arises in the normal course of Hydro's business.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Hydro

(a) Credit Risk
Hydro is exposed to credit risk in the event of non performance by counterparties to its financial instruments. The majority of Hydro's receivables are from regulated utilities which minimizes credit risk. There is risk that Hydro will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Hydro manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers.

Hydro manages its investment credit risk exposure by restricting its investments to high quality securities such as Canada Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks.

(b) Liquidity Risk
Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Hydro manages this risk by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cashflows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300.0 million promissory note program and a $50.0 million operating credit facility. Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues.

(c) Market Risk
Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. During 2009, the Board of Directors of Nalcor, approved a formal financial risk management policy that outlined the risks associated with the operations of Nalcor and its subsidiaries and approaches and guidelines to be followed in the management of those risks. This policy will be reviewed by the Board annually or more frequently if there is a material change to Nalcor's financial risks and outlines a formal approval process for various hedging instruments used. The Audit Committee will provide oversight on behalf of the Board with the exception of any items that specifically require Board approval.

Interest Rates
Interest rate risk is managed within the corporate financing strategy where floating rate debt exposures and interest rate scenarios are forecast 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 are 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, Hydro attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Exposure to changes in interest rates exists on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios. Hydro estimates that a change of 100 basis points from the actual average yield on the short-term debt portfolio in 2009 would have resulted in a change in interest expense of $0.5 million (2008 – $1.3 million). Similarly, a change of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2009 would have resulted in a change in interest income of $2.3 million (2008 – $2.0 million) and a change in other comprehensive income of $16.6 million (2008 - $16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Hydro (cont'd)

(c) Market Risk (cont'd.)

Foreign Currency and Commodity Exposure
Fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Hydro's primary exposure to both foreign exchange and commodity price risk arise from its purchases of No. 6 fuel for consumption at the HTGS and certain electricity sales both of which are denominated in US dollars.

During 2009, Hydro had total purchases of No. 6 fuel of $87.5 million (2008 - $103.9 million) denominated in US dollars. Hydro's exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates, as compared to that approved in Hydro's most recent cost of service study used to set rates, are captured in the RSP and are either refunded to or collected from customers through automatic rate adjustments. Hydro also employs the periodic use of forward currency contracts to avoid exposure to exchange rates on a particular day can be avoided.

During 2009, total electricity sales denominated in US dollars were $42.5 million. Hydro mitigates this risk through the use of forward contracts. During 2009, Hydro entered into a series of 24 monthly foreign currency forward contracts, the last of which matures April 2011, in the amount of $87.8 million US dollars at an average exchange rate of 1.17 to hedge 75% of Hydro's forecasted US dollars sales. The nominal contract value range from $2.4 million to $6.0 million. During the year, eight of the contracts were settled with the effective portion of the gain reported as energy sales and the ineffective portion as other income. The fair value of the 16 contracts outstanding as at December 31, 2009 is $7.0 million. These contracts have been designated as part of a hedging relationship.

Effect of Hedge Accounting on Financial Statements

(millions of dollars)	**Net Gains Included in Net Income**	**Unrealized Gains Included in OCI**
Ineffective portion	0.5	-
Effective portion	2.4	6.2

Churchill Falls

(a) Liquidity Risk
Churchill Falls is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Churchill Falls manages this risk by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within its operations and by continuously monitoring cash flows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations and the $10.0 million unsecured credit facility. Long-term liquidity risk is managed by maintenance of the reserve fund in accordance with the June 1999 shareholders' agreement and dividend management policy to meet long-term liquidity requirements associated with debt retirement and the company's capital expenditure program.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Churchill Falls (cont'd)

(b) Market Risk
Market risk refers primarily to the risk of loss resulting from changes in interest rates, foreign exchange rates and commodity prices.

Interest Rates
Interest rate risk is mitigated on Churchill Falls' long-term debt by virtue of a fixed interest rate to maturity. Exposure to changes in interest rates exists on investment income related to the short-term and reserve fund investment portfolios. Churchill Falls estimates that a change of 100 basis points from the actual average yield earned on the short-term investment portfolio in 2009 would have resulted in a change in interest income of $0.1 million (2008 – $0.2 million). Similarly, a change of 100 basis points from the actual average yield earned on the reserve fund investment portfolio in 2009 would have resulted in a change in interest income of $0.3 million (2008 – $0.2 million) and a change in other comprehensive income of $0.8 million (2008 - $0.5 million). Interest rate risk is managed within the corporate financing strategy where floating rate debt exposures and interest rate scenarios are forecast and evaluated.

Foreign Currency Exposure
The fair value or future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rate between a foreign currency and the Canadian dollar. Churchill Falls is exposed to foreign exchange risk when it enters into transactions to procure goods and services denominated in a foreign currency however this exposure to foreign exchange rate fluctuations is immaterial.

Commodity
Churchill Falls does not hold any financial instrument whose value would vary due to changes in a commodity price.

15. INTEREST EXPENSE

(millions of dollars)	**2009**	2008
Gross Interest		
Long-term debt	**92.0**	96.0
Promissory notes	**0.6**	4.2
	92.6	100.2
Accretion of long-term debt	**0.4**	0.5
Amortization of foreign exchange losses	**2.2**	2.2
Other	**7.0**	2.8
	102.2	105.7
Less		
Recovered from Hydro-Québec	**-**	0.1
Interest capitalized during construction	**0.8**	9.6
Interest earned	**17.6**	17.2
Net interest expense	**83.8**	78.8

With the refinancing of the General Mortgage Bonds in February 2008, Churchill Falls is required to share with Hydro-Québec any benefits it receives resulting from the respective change in interest rates. Prior to the refinancing, Churchill Falls recovered the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

15. INTEREST EXPENSE (cont'd.)

Also, Churchill Falls can request Hydro and Hydro-Québec to make advances, against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such requests fail to attract sufficient advances, Churchill Falls can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

16. CHANGES IN NON-CASH OPERATING WORKING CAPITAL BALANCES

(millions of dollars)	**2009**	2008
Accounts receivable	**(9.0)**	3.6
Fuel and supplies	**(6.8)**	17.0
Prepaid expenses	**(0.6)**	(0.4)
Accounts payable and accrued liabilities	**7.3**	(20.8)
Regulatory assets	**5.5**	18.9
Regulatory liabilities	**68.8**	14.8
Accrued interest	**-**	(2.0)
Employee future benefits	**2.5**	3.0
Long-term receivables	**2.0**	(2.9)
Long-term payable	**3.6**	0.7
Due to related parties	**18.0**	(0.2)
Long-term related party note payable	**23.9**	-
	115.2	31.7

17. SEGMENT INFORMATION

Hydro operates in four business segments. Hydro Regulated encompasses sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. Nalcor's energy marketing activities include the sale of electricity to markets outside the Province. Other encompasses other non-regulated activities. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 1.

Segments

(millions of dollars)	**Hydro Regulated**	**Energy Marketing**	**Churchill Falls**	**Other**	**Inter-Segment**	**Total**
			2009			
Revenue						
Energy sales	**443.8**	**54.7**	**61.0**	**6.0**	**(3.9)**	**561.6**
Other	**2.2**	**0.7**	**0.3**	**-**	**1.3**	**4.5**
	446.0	**55.4**	**61.3**	**6.0**	**(2.6)**	**566.1**
Expenses						
Operations and administration	**100.9**	**17.2**	**37.7**	**3.3**	**-**	**159.1**
Fuels	**155.2**	**-**	**-**	**-**	**-**	**155.2**
Power purchased	**46.8**	**4.2**	**-**	**-**	**(3.9)**	**47.1**
Amortization	**41.7**	**-**	**12.8**	**-**	**-**	**54.5**
Interest	**83.5**	**-**	**0.4**	**(0.1)**	**-**	**83.8**
	428.1	**21.4**	**50.9**	**3.2**	**(3.9)**	**499.7**
Net income from operations	**17.9**	**34.0**	**10.4**	**2.8**	**1.3**	**66.4**
Preferred dividends	**-**	**-**	**1.3**	**-**	**(1.3)**	**-**
Net income	**17.9**	**34.0**	**11.7**	**2.8**	**-**	**66.4**
Capital expenditures	**54.1**	**-**	**3.7**	**-**	**-**	**57.8**
Total assets	**1,766.0**	**10.2**	**420.5**	**24.8**	**(0.8)**	**2,220.7**

17. SEGMENT INFORMATION (cont'd.)

Segments (cont'd.)

(millions of dollars)	Hydro Regulated	Energy Marketing	Churchill Falls	Other	Inter-Segment	Total
			2008			
Revenue						
Energy sales	440.1	51.3	68.9	6.9	(3.9)	563.3
Other	2.2	-	0.3	-	3.1	5.6
	442.3	51.3	69.2	6.9	(0.8)	568.9
Expenses						
Operations and administration	99.1	-	38.8	3.9	-	141.8
Fuels	164.8	-	-	-	-	164.8
Power purchased	41.4	3.5	-	-	(3.9)	41.0
Amortization	40.4	-	12.6	-	-	53.0
Interest	87.6	-	0.1	(8.9)	-	78.8
Write-down of investments	-	-	-	2.7	-	2.7
	433.3	3.5	51.5	(2.3)	(3.9)	482.1
Net income from operations	9.0	47.8	17.7	9.2	3.1	86.8
Preferred dividends	-	-	3.1	-	(3.1)	-
Net income	9.0	47.8	20.8	9.2	-	86.8
Capital expenditures	45.6	-	4.3	40.2	-	90.1
Total assets	1,711.4	3.7	414.4	21.7	(9.7)	2,141.5

During 2009, sales to Hydro's three largest customers amounted to over 80% of total energy sales.

Geographic Information

Revenues by geographic area:

(millions of dollars)	**2009**	2008
Newfoundland and Labrador	**453.1**	447.3
Québec	**69.8**	121.6
Nova Scotia	**39.7**	-
New Brunswick	**3.5**	-
	566.1	568.9

All of Hydro's assets are located in the Province.

18. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, Churchill Falls is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of Twin Falls will revert to Churchill Falls, and Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

18. COMMITMENTS AND CONTINGENCIES (cont'd.)

(b) The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out. Further monitoring is recommended for 2010 and every five years thereafter.

(c) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a $75.0 million segregated reserve fund 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. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2010	$8.0	million
January 1, 2011	$8.0	million
January 1, 2012	$8.0	million

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 Canadian Chartered Banks.

A summary of Hydro's 65.8% share of the reserve fund is as follows:

(millions of dollars)	**2009**	2008
Opening balance	**23.4**	11.2
Contribution	**11.2**	11.2
Total contribution to reserve fund	**34.6**	22.4
Net interest earned	**(0.2)**	0.4
Mark-to-market adjustment	**0.4**	0.6
Fair value of reserve fund	**34.8**	23.4

(d) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.1 million (2008 - $0.2 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.9 million (2008 - $22.2 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate effect of such an action cannot be ascertained at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(e) Outstanding commitments for capital projects total approximately $13.3 million (2008 - $7.1 million).

18. COMMITMENTS AND CONTINGENCIES (cont'd.)

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

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

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

(millions of dollars)	2010	2011	2012	2013	2014
Power purchases	27.0	27.6	28.5	29.5	30.2

On December 16, 2008, the Province introduced legislation cancelling two power purchase agreements related to hydro facilities.

(g) Hydro has issued two irrevocable letters of credit, one in the amount of $7.2 million to the New Brunswick System Operator as credit support related to an application for point to point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement. Churchill Falls has issued an irrevocable letter of credit, in the amount of $0.7 million to ensure satisfactory management of its waste management and compliance with a certificate of approval for the transportation of special hazardous wastes, granted by the Department of Environment and Conservation.

(h) Effective March 31, 2009, Hydro's five-year power sales agreement to sell energy to Hydro-Québec expired. Effective April 1, 2009, Hydro has entered into a power sales agreement with a third party with respect to the energy previously sold to Hydro-Québec. To facilitate market access, Hydro has entered into a five-year transmission service agreement with Hydro-Québec TransÉnergie to acquire access to 265 MW of transmission capacity from Labrador through Québec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that competing request.

Pursuant to Hydro's five-year transmission service agreement with Hydro-Québec TransÉnergie, the transmission rental payments for the next five years are as follows:

2010	$ 19.2 million
2011	$ 19.2 million
2012	$ 19.2 million
2013	$ 19.2 million
2014	$ 4.8 million

(i) Hydro has received funding in the amount of $2.5 million from the Atlantic Canada Opportunities Agency in relation to a wind-hydrogen-diesel research development project in the community of Ramea; this funding is repayable by annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2009, there have been no commercial implementations.

19. RELATED PARTY TRANSACTIONS

The Province, Nalcor, Churchill Falls, Nalcor Energy – Oil and Gas, Nalcor Energy – Bull Arm Fabrication, LCDC and GIPCo are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $5.9 million (2008 - $6.0 million) of the power produced by Churchill Falls and Hydro's 65.8% share is eliminated upon consolidation.

(b) For the year ended December 31, 2009, approximately $1.9 million (2008 - $1.8 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. Hydro's 65.8% share is eliminated upon consolidation.

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2009, Hydro incurred $0.6 million in costs related to the PUB (2008 - $0.6 million) of which $0.1 million (2008 - $0.1 million) was included in accrued liabilities.

(d) As at December 31, 2009 Hydro has a payable to Nalcor of $20.8 million (2008- $2.9 million) and a payable to Churchill Falls of $0.1 million (2008 – nil). This payable consists of various intercompany operating costs.

(e) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually. As at December 31, 2009 $2.4 million (2008 - $3.3 million) was payable.

(f) During 2008, certain assets and liabilities and their related debt and equity were transferred from Hydro to Nalcor Energy. Details of the transactions are noted below:

(millions of dollars)	2008
Property, plant and equipment	157.2
Contributed capital	(2.2)
Employee future benefits	(0.5)
Retained earnings from non-regulated activity in Hydro	(160.6)
Total	(6.1)

(g) During 2009, Nalcor advanced $1.1 million (2008 - $4.5 million) as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. Hydro also received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2009, the full amount of $0.2 million has been recorded as a deferred capital contribution.

(h) During 2009, Hydro received $0.4 million (2008 - $0.4 million) as a rate subsidy for rural isolated customers from the Province and $1.6 million (2008 - $1.5 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.1 million (2008 - $0.1 million) recorded as accounts receivable at year-end.

20. SIGNIFICANT OCCURRENCES

On November 3, 2008, a fire occurred in a cable shaft at Churchill Falls causing extensive damage to two sets of high-voltage cables in two units of the cable shaft. This resulted in lost GWAC revenue and power sales of approximately $7.7 million and $2.5 million in 2009 and $8.4 million and $2.1 million in 2008.

Hydro's share of total repair costs of $5.3 million as of December 31, 2009 were covered by insurance with the exception of a $1.3 million deductible. Repair work was completed on the first unit in February 2009 and the second unit in October 2009.

21. WATER MANAGEMENT AGREEMENT

In June 2007, the Province passed an amendment to the Electrical Power Control Act, 1994 ("EPCA"). The amendment requires parties, that utilize a common water resource in the province for power production, enter into a water management agreement. If the parties cannot reach an agreement, the Board of Commissioners of Public Utilities ("PUB") has the authority to impose an agreement on the parties. Churchill Falls shares the Churchill River with a Nalcor proposed hydroelectrical generation development, downstream from Churchill Falls. The amendment provides that any resulting water management agreement will not adversely affect existing power contracts.

A tentative agreement reached between management of Nalcor and Churchill Falls was not approved by the Churchill Falls Board of Directors. As a result, on November 10, 2009 Nalcor applied to the PUB to establish the terms of the agreement.

22. SUBSEQUENT EVENTS

(a) In January 2010, Hydro entered into 28 swap contracts to hedge the commodity price risk on electricity sales in the amount of $24.7 million.

(b) On February 23, 2010, Churchill Falls filed a motion against Hydro-Quebec in the Quebec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The outcome of this motion is not determinable at this time.

On February 3, 2010, the Province established a trust with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses incurred in relation to this matter.

(c) In February 2010, Hydro issued 22 letters of credit, for transmission bookings, reducing the availability of its credit facility by $11.5 million.

(d) On March 9, 2010, the PUB issued a board order establishing the water management agreement proposed by Nalcor in November 2009.