

Tabled by the  
Minister of Natural Resources  
2013-05-17

*Bearnes*

**NEWFOUNDLAND AND LABRADOR HYDRO –  
A NALCOR ENERGY COMPANY**

Consolidated Financial Statements  
December 31, 2012







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April 30, 2013

Honourable Tom Marshall, Q.C.  
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 Marshall:

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, 2012.

A detailed account of Hydro's activities during the year ended December 31, 2012 is included in the Nalcor Energy 2012 Business and Financial Report.


Sincerely,

Ed Martin  
President and CEO



**NEWFOUNDLAND AND LABRADOR HYDRO**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012**



**BOARD OF DIRECTORS**

**TERRANCE STYLES**  
Business Owner



**LEO ABBASS**  
Mayor, Happy Valley Goose Bay



**ALLAN HAWKINS**  
Mayor, Grand Falls Windsor



**ERIN BREEN**  
Lawyer



**ED MARTIN**  
President and Chief Executive Officer



**TOM CLIFT**  
Professor  
Memorial University - Faculty of Business Administration



**KEN MARSHALL**  
President - Atlantic Region  
Rogers Cable



**GERALD SHORTALL**  
Chartered Accountant  
Corporate Director

**OFFICERS**

**TERRANCE STYLES**  
Chairperson

**ED MARTIN**  
President and Chief Executive Officer

**GILBERT BENNETT**  
Vice President, Lower Churchill Project

**JIM HAYNES**  
Vice President, Regulated Operations

**DERRICK STURGE**  
Vice President, Finance and Chief Financial Officer

**GERARD McDONALD**  
Vice President, Human Resources and Organizational  
Effectiveness

**JOHN MacISAAC**  
Vice President, Project Execution and Technical Services

**WAYNE CHAMBERLAIN**  
General Counsel and Corporate Secretary

**PETER HICKMAN**  
Assistant Corporate Secretary

**JAMES MEANEY**  
Corporate Treasurer

**S. KENT LEGGE**  
General Manager, Finance and Corporate Services

**HEAD OFFICE**

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

## Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of Newfoundland and Labrador Hydro, which comprise the consolidated balance sheet as at December 31, 2012, and the consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Consolidated Financial Statements*

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

### *Auditor's Responsibility*

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

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

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



*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Newfoundland and Labrador Hydro as at December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*Deloitte LLP*

Chartered Accountants  
March 28, 2013

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**CONSOLIDATED BALANCE SHEET**

*As at December 31 (millions of dollars)*

Notes

2012

2011

**ASSETS**

Current assets

Cash and cash equivalents		11.8	15.7
Short-term investments		0.5	9.6
Accounts receivable		102.3	96.3
Current portion of regulatory assets	5	2.2	2.8
Inventory		62.1	63.5
Prepaid expenses		3.9	3.1
Derivative assets		-	0.2
		<u>182.8</u>	<u>191.2</u>
Property, plant and equipment	4	1,805.5	1,760.7
Other long-term assets	6	315.0	294.0
Regulatory assets	5	62.8	63.6
		<u>2,366.1</u>	<u>2,309.5</u>

**LIABILITIES**

Current liabilities

Short-term borrowings		52.0	-
Accounts payable and accrued liabilities	8	92.3	149.8
Current portion of long-term debt	8	8.2	8.2
Current portion of regulatory liabilities	5	169.0	137.6
Current portion of asset retirement obligations	10	0.3	-
Deferred credits		1.9	3.5
		<u>323.7</u>	<u>299.1</u>
Long-term debt	8	1,125.9	1,131.5
Regulatory liabilities	5	33.2	33.3
Asset retirement obligations	10	24.6	20.2
Long-term payables	9	2.6	6.2
Employee future benefits	11	69.3	63.0
		<u>1,579.3</u>	<u>1,553.3</u>

**SHAREHOLDER'S EQUITY**

Share capital	12	22.5	22.5
Contributed capital	12	116.7	116.4
		<u>139.2</u>	<u>138.9</u>
Accumulated other comprehensive income	12	42.8	46.4
Retained earnings		604.8	570.9
		<u>647.6</u>	<u>617.3</u>
		<u>786.8</u>	<u>756.2</u>
		<u>2,366.1</u>	<u>2,309.5</u>

Commitments and contingencies (Note 19)

Subsequent events (Note 21)

See accompanying notes

On behalf of the Board

  
 \_\_\_\_\_  
 DIRECTOR

  
 \_\_\_\_\_  
 DIRECTOR

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS**

<i>For the year ended December 31 (millions of dollars)</i>	Notes	2012	2011
Revenue			
Energy sales		641.9	610.2
Other revenue		6.0	5.9
		<u>647.9</u>	<u>616.1</u>
Expenses			
Fuels		182.4	154.9
Power purchased		60.8	52.9
Operating costs	13	177.2	170.8
Net finance expense	16	72.5	71.5
Amortization		60.2	55.4
Other income and expense		0.6	(4.9)
Regulatory adjustments	5	30.0	24.1
		<u>583.7</u>	<u>524.7</u>
Net income		64.2	91.4
Retained earnings at beginning of year		570.9	557.5
Dividends		30.3	78.0
Retained earnings at end of year		<u>604.8</u>	<u>570.9</u>

*See accompanying notes*

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

<i>For the year ended December 31 (millions of dollars)</i>	Notes	2012	2011
Net income		64.2	91.4
Other comprehensive (loss) income	12	(3.6)	19.1
Comprehensive income		<u>60.6</u>	<u>110.5</u>

*See accompanying notes*

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

<i>For the year ended December 31 (millions of dollars)</i>	Notes	2012	2011
<b>Cash provided by (used in)</b>			
<b>Operating activities</b>			
Net income		64.2	91.4
Adjusted for items not involving a cash flow			
Amortization		60.2	55.4
Accretion		0.5	0.5
Loss (gain) on disposal of property, plant and equipment		3.6	(1.9)
Increase in employee future benefits		6.3	5.3
Other		0.7	0.3
		<u>135.5</u>	<u>151.0</u>
Changes in non-cash working capital balances	17	<u>(30.2)</u>	<u>(3.6)</u>
		<u>105.3</u>	<u>147.4</u>
<b>Financing activities</b>			
Dividends paid to Nalcor		(30.3)	(78.0)
Increase in contributed capital		0.3	0.4
Increase in short-term borrowings		52.0	-
Decrease in long-term receivables		0.8	24.4
Decrease in long-term payable		(3.6)	(23.7)
(Decrease) increase in deferred credits		(1.6)	3.4
		<u>17.6</u>	<u>(73.5)</u>
<b>Investing activities</b>			
Additions to property, plant and equipment		(107.7)	(87.9)
Increase in sinking fund		(26.1)	(24.7)
Decrease in short-term investments		9.1	2.3
Increase in reserve fund		(5.6)	(5.4)
Proceeds on disposal of property, plant and equipment		3.5	4.8
		<u>(126.8)</u>	<u>(110.9)</u>
Net decrease in cash		(3.9)	(37.0)
Cash position at beginning of year		15.7	52.7
Cash position at end of year		<u>11.8</u>	<u>15.7</u>
<b>Cash position is represented by:</b>			
Cash		11.8	15.7
Cash equivalents		-	-
		<u>11.8</u>	<u>15.7</u>
<b>Supplementary cash flow information (Note 17)</b>			

*See accompanying notes*

## **NEWFOUNDLAND AND LABRADOR HYDRO**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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#### **1. DESCRIPTION OF BUSINESS**

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

Hydro holds interests in the following subsidiary 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).

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.

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. LCDC is 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.

#### **2. SIGNIFICANT ACCOUNTING POLICIES**

##### **2.1 Basis of Presentation**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP).

##### **2.2 Principles of Consolidation**

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

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Quebec 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-Quebec 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-Quebec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has applied the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

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.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

**2.3 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.

**2.4 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% (2011 - 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 Consolidated Financial Statements are more fully disclosed in Note 5.

**2.5 Cash and Cash Equivalents and Short-Term Investments**

Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and Banker's Acceptances (BAs). 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 1.34% to 1.35% (2011 - 1.18% to 1.24%) per annum. Cash and cash equivalents and short-term investments are measured at fair value.

**2.6 Inventory**

Inventory is recorded at the lower of average cost and net realizable value.

**2.7 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 recorded as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

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

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

**2.7 Property, Plant and Equipment (cont'd.)**

Electricity Generation, Transmission and Distribution

Construction in progress includes the costs incurred in engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to Hydro's weighted average cost of debt.

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

<b>Generation Plant</b>	
Hydroelectric	45 to 100 years
Thermal	35 to 65 years
Diesel	25 to 55 years
<b>Transmission</b>	
Lines	30 to 65 years
Terminal stations	40 to 55 years
Distribution system	30 to 55 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

Other assets include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment which are carried at cost less accumulated amortization. Amortization is recognized in profit or loss on a straight-line basis over estimated useful lives ranging from 5 to 55 years. Amortization methods, useful lives and residual values are reviewed at each reporting date.

Churchill Falls

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

Hydroelectric generation plant	45 to 100 years
Transmission and terminals	30 to 65 years
Service facilities and other	7 to 45 years

**2.8 Capitalized Interest**

Interest is charged to construction in progress until the project is complete at rates equivalent to the weighted average cost of debt. Capitalized interest cannot exceed actual interest incurred.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

**2.9 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.

**2.10 Asset Retirement Obligations**

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, is 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. Accretion of asset retirement obligations is included in net income through Amortization. Differences between the recorded asset retirement obligation and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

**2.11 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.

**2.12 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, whereas export sales and sales to certain major industrial customers are either at rates under the terms of the applicable contracts, or at market rates.

A power contract with Hydro-Quebec (Power Contract), dated May 12, 1969, provides for the sale of a significant amount of 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-Quebec, under a guaranteed winter availability contract (GWAC) through 2041. The GWAC provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Quebec 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, is tracked over a four-year period and then either recovered from or refunded to Hydro-Quebec 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 (2011 - 7%).



**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

**2.13 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, except gains or losses on purchases of fuel which are included in the cost of fuel inventory.

**2.14 Financial Instruments and Hedging Activities**

Financial Instruments

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
Derivative assets	Held for trading
Sinking funds - investments in same Hydro issue	Held to maturity
Sinking funds - other investments	Available for sale
Reserve fund	Available for sale
Long-term receivables	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Short-term borrowings	Other liabilities
Derivative liabilities	Held for trading
Long-term debt	Other liabilities
Long-term payable	Other liabilities

Each of these financial instruments is measured at amortized cost, except for cash and cash equivalents and short-term investments, reserve fund, sinking fund – other investments, derivative assets and derivative liabilities 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 through interest and finance charges, 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.

## NEWFOUNDLAND AND LABRADOR HYDRO NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

#### 2.14 Financial Instruments and Hedging Activities (cont'd.)

##### Derivative Instruments and Hedging Activities

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. Hydro had no cash flow hedges or fair value hedges in place at December 31, 2012 (2011 - nil).

#### 2.15 Future Accounting Changes – International Financial Reporting Standards (IFRS)

The Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2015. Hydro is a qualifying entity and chose to use the deferral option for the year ended December 31, 2012.

Although IFRS and Canadian GAAP are based on a similar conceptual framework, there are a number of differences in recognition, measurement and disclosure. The areas with the highest potential impact on Hydro are property, plant and equipment and regulatory assets and liabilities.

Hydro continues to assess the financial reporting impacts of the adoption of IFRS; however, the impact of IFRS will depend on the IFRS standards in effect at the time of conversion and the accounting elections made.

### 3. CHANGE IN ACCOUNTING POLICY

During 2012, Hydro adopted new accounting policies as approved by the PUB in Order No P.U. 13( 2012). These policy changes were applied retroactive to January 1, 2011. The policy changes are as follows:

#### Capitalization of Property, Plant and Equipment

Previously, Hydro capitalized certain general overhead costs and training costs and included the costs of asset overhauls and major inspections as an operating expense. Hydro's revised policy is to expense general overheads and training costs as incurred and to capitalize costs associated with asset overhauls and major inspections. These changes resulted in a decrease in net income of \$1.3 million for the year ended December 31, 2011.

#### Employee Future Benefits

Previously, Hydro accounted for employee future benefits under the corridor method whereby the excess of gains and losses over 10% of the accrued benefit obligation is amortized to income over the expected average remaining service life of the employee group. Hydro's revised policy is to defer the amortization of actuarial gains and losses recognized in employee future benefits expense through regulatory adjustments. This change resulted in an increase in net income of \$1.2 million for the year ended December 31, 2011.

#### Depreciation of Property, Plant and Equipment

Previously, Hydro amortized hydroelectric generating assets and transmission assets using the sinking fund method. Hydro's new policy is to calculate amortization using the straight-line methodology. As part of the methodology change, Hydro also changed its estimate of service lives effective January 1, 2011. In the absence of regulatory approval, this change would have been applied retroactively resulting in a decrease in retained earnings as at January 1, 2011 of \$210.7 million. Pursuant to Order No. P.U. 13 (2012), the PUB approved the use of the carrying value of property, plant and equipment under Canadian GAAP as deemed cost at January 1, 2011. As the deemed cost of Hydro's regulated property, plant and equipment is recoverable through future rates, no adjustment to opening retained earnings is necessary. These changes resulted in an increase in net income of \$2.2 million for the year ended December 31, 2011.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. PROPERTY, PLANT AND EQUIPMENT**

	Property Plant and Equipment in Service	Contributions in Aid of Construction	Accumulated Amortization	Construction in Progress	Net Book Value
<i>(millions of dollars)</i>			<b>2012</b>		
Generation plant					
Hydroelectric	1,349.6	2.4	356.5	6.6	997.3
Thermal	98.1	-	12.5	8.5	94.1
Diesel	37.9	-	2.7	0.3	35.5
Transmission and distribution	644.2	18.5	92.7	21.5	554.5
Other	189.3	23.1	48.4	6.3	124.1
	<u>2,319.1</u>	<u>44.0</u>	<u>512.8</u>	<u>43.2</u>	<u>1,805.5</u>
<i>(millions of dollars)</i>			<b>2011</b>		
Generation plant					
Hydroelectric	1,337.6	2.4	334.5	6.7	1,007.4
Thermal	81.5	-	5.5	6.4	82.4
Diesel	35.9	-	1.2	0.5	35.2
Transmission and distribution	589.4	7.6	76.0	18.8	524.6
Other	160.4	15.5	41.1	7.3	111.1
	<u>2,204.8</u>	<u>25.5</u>	<u>458.3</u>	<u>39.7</u>	<u>1,760.7</u>

As at December 31, 2012, the cost of assets under construction and therefore excluded from costs subject to amortization was \$43.2 million (2011 - \$39.7 million).

**5. REGULATORY ASSETS AND LIABILITIES**

<i>(millions of dollars)</i>	2012	2011	Remaining Recovery Settlement Period (years)
Regulatory assets			
Foreign exchange losses	62.6	64.7	29.0
Deferred major extraordinary repairs	-	0.6	-
Deferred energy conservation costs	2.4	1.1	n/a
Total regulatory assets	<u>65.0</u>	<u>66.4</u>	
Less current portion	<u>2.2</u>	<u>2.8</u>	
	<u>62.8</u>	<u>63.6</u>	
Regulatory liabilities			
Rate stabilization plan (RSP)	201.7	170.3	n/a
Deferred purchased power savings	0.5	0.6	14.5
Total regulatory liabilities	<u>202.2</u>	<u>170.9</u>	
Less current portion	<u>169.0</u>	<u>137.6</u>	
	<u>33.2</u>	<u>33.3</u>	

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. REGULATORY ASSETS AND LIABILITIES (cont'd.)**

**5.1 Regulatory Adjustments Recorded in the Consolidated Statement of Income**

<i>(millions of dollars)</i>	<b>2012</b>	<b>2011</b>
RSP recovery	60.4	25.4
Rural rate adjustment	7.0	4.4
RSP fuel deferral	(49.3)	(20.9)
RSP interest	13.2	12.2
Amortization of deferred foreign exchange losses	2.1	2.1
Deferred foreign exchange (losses) gains on fuel	(0.4)	0.2
Employee future benefit actuarial losses	(2.3)	(1.2)
Amortization of deferred major extraordinary repairs	0.6	1.7
Deferred energy conservation	(1.4)	(0.5)
Insurance proceeds	0.2	0.8
Deferred purchased power savings	(0.1)	(0.1)
	<u>30.0</u>	<u>24.1</u>

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. Amounts deferred as regulatory assets and liabilities are subject to PUB approval. 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.

**5.2 Rate Stabilization Plan**

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.

Balances accumulating in the RSP, including financing charges, are to be recovered or refunded 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. A portion of the RSP balance totaling approximately \$135.0 million (2011 - \$102.0 million) has been set aside by the PUB and will be subject to a future regulatory ruling on the allocation between the industrial customers and retail customers. This balance is mainly due to fuel savings at the Holyrood Thermal Generating Station (HTGS) as a result of the shutdown of a portion of the pulp and paper industry in the Province since 2007.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**5. REGULATORY ASSETS AND LIABILITIES (cont'd.)**

**5.2 Rate Stabilization Plan (cont'd.)**

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 2012, \$49.3 million was deferred (2011 - \$20.9 million) in the RSP and \$60.4 million (2011 - \$25.4 million) was recovered through rates and included in energy sales.

Hydro's rural rates on the Island Interconnected and Isolated systems are primarily based upon retail electricity rates. Therefore, when a rate adjustment for retail rates has been approved by the PUB, Hydro's rural customers receive the same rate change. In 2012, the rural rate adjustment reduced income and increase the RSP liability by \$7.0 million (2011 - \$4.4 million). In the absence of rate regulation, the rate adjustment would have been recorded in income.

Hydro is required to charge or pay interest on balances accumulating in the RSP at a rate equal to Hydro's weighted average cost of capital. As a result, Hydro recognized interest expense of \$13.2 million (2011 - \$12.2 million).

**5.3 Deferred 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 \$2.1 million annually, is included in regulatory adjustments.

**5.4 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 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 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 2012, \$0.6 million (2011 - \$1.7 million) of amortization was recognized in Operations and administration expense.

**5.5 Deferred Energy Conservation Costs**

Pursuant to Order No. P.U. 14 (2009), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors. 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 2012, \$1.4 million (2011 - \$0.5 million) was deferred.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. REGULATORY ASSETS AND LIABILITIES (cont'd.)**

**5.6 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 and amortize the benefits of a reduced initial purchased power rate over a 30 year period. The remaining unamortized savings in the amount of \$0.5 million (2011 - \$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.

**5.7 Property, Plant and Equipment**

Pursuant to Order No P.U. 13 (2012), the PUB approved the use of the carrying amount of property, plant and equipment under Canadian GAAP as the deemed cost at January 1, 2011.

During 2010, 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, 2009. Based on the results of this study and PUB approval, amortization previously calculated using the 'sinking fund' method under Canadian GAAP is now calculated on a straight-line basis. In addition, the service lives for certain assets have also been revised.

The PUB permits major inspections to be included in the cost of capital and amortized over the average expected period of the next major inspection. In 2012, \$6.8 million (2011 - \$0.9 million) was recognized as property, plant and equipment. In the absence of rate regulation, Canadian GAAP would require that Hydro include the major inspections as operating costs in the year incurred.

**5.8 Foreign Exchange Gains and Losses**

Hydro purchases a significant amount of fuel in US dollars. The RSP allows Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2012, Hydro deferred foreign exchange losses on fuel purchases of \$0.4 million (2011 - gain of \$0.2 million). In the absence of rate regulation, Canadian GAAP would require that Hydro include gains and losses on foreign currencies in Net finance expense in the period incurred.

**5.9 Insurance Proceeds**

Pursuant to Order No. P.U. 13 (2012), Hydro records net insurance proceeds in excess of \$50,000 against the capital costs of the related assets. Hydro recorded net insurance proceeds of \$0.2 million (2011 - \$0.8 million) against costs of the related assets.

**5.10 Employee Future Benefits**

Pursuant to Order No. P.U. 13 (2012), Hydro defers the amortization of actuarial gains and losses. During 2012, Hydro deferred actuarial gains and losses of \$2.3 million (2011 - \$1.2 million).

**6. OTHER LONG-TERM ASSETS**

<i>(millions of dollars)</i>		<b>2012</b>	<b>2011</b>
Long-term receivables	(a)	0.8	1.6
Sinking funds	(b)	263.3	247.0
Reserve fund	(c)	50.9	45.4
		<u>315.0</u>	<u>294.0</u>

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**6. OTHER LONG-TERM ASSETS (cont'd.)**

- (a) The balance of \$0.8 million (2011 - \$1.6 million) includes the non-current portion of receivables associated with customer time payment plans and the long-term portion of employee purchase programs of \$0.2 million (2011 - \$0.2 million). During 2012, refundable deposits associated with applications for transmission service into Nova Scotia and New Brunswick were settled (2011 - \$1.4 million). During 2011, Hydro-Quebec refunded two deposits totaling \$24.1 million associated with applications for transmission service through Quebec. The remaining balance of \$0.6 million (2011 - nil) relates to differences between the Annual Energy Base (AEB) in the Churchill Falls Power contract and energy delivered accumulating over the four-year period from September 2012 to August 2016.
- (b) As at December 31, 2012, sinking funds include \$263.3 million (2011 - \$247.0 million) related to repayment of Hydro's long-term debt. Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2013 to 2033.

Hydro debentures, which are intended to be held 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 in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 2.57% to 9.86% (2011 - 3.12% to 9.86%).

<i>(millions of dollars)</i>	2012	2011
Sinking funds at beginning of year	247.0	208.2
Contributions	8.2	8.2
Earnings	11.7	11.0
Valuation adjustment	(3.6)	19.6
Sinking funds at end of year	<u>263.3</u>	<u>247.0</u>

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

<i>(millions of dollars)</i>	2013	2014	2015	2016	2017
Sinking fund instalments	8.2	8.2	8.2	8.2	6.7

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

<i>(millions of dollars)</i>	2012	2011
Opening balance	45.4	39.3
Contribution	5.3	5.3
Net interest	0.3	0.1
Mark-to-market adjustment	(0.1)	0.7
Fair value of reserve fund	<u>50.9</u>	<u>45.4</u>

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**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 and its proportionate interest in Churchill Falls' operations for the year then ended.

<i>(millions of dollars)</i>	<b>2012</b>	<b>2011</b>
Current assets	<b>39.9</b>	41.8
Long-term assets	<b>383.2</b>	394.8
Current liabilities	<b>20.5</b>	19.0
Long-term liabilities	<b>15.6</b>	16.2
Revenues	<b>73.5</b>	64.2
Expenses	<b>48.6</b>	43.1
Net income	<b>24.9</b>	21.1
Cash provided by (used in)		
Operating activities	<b>33.1</b>	32.3
Financing activities	<b>(2.5)</b>	0.9
Investing activities	<b>(23.8)</b>	(32.6)

Income tax expense in the amount of \$0.1 million (2011 - \$0.2 million) related to a jointly controlled subsidiary, Twin Falls, has been included in expenses.

**8. LONG-TERM DEBT**

Details of long-term debt are as follows:

<b>Series</b>	<b>Face Value</b>	<b>Coupon Rate %</b>	<b>Year of Issue</b>	<b>Year of Maturity</b>	<b>2012</b>	<b>2011</b>
<i>(millions of dollars)</i>						
V *	125.0	10.50	1989	2014	124.8	124.7
X *	150.0	10.25	1992	2017	149.4	149.4
Y *	300.0	8.40	1996	2026	293.8	293.5
AB *	300.0	6.65	2001	2031	306.3	306.5
AD *	125.0	5.70	2003	2033	123.7	123.6
AE	225.0	4.30	2006	2016	224.2	224.0
Total debentures	1,225.0				1,222.2	1,221.7
Less sinking fund investments in own debentures					88.1	82.0
					1,134.1	1,139.7
Less: payments due within one year					8.2	8.2
					1,125.9	1,131.5

\* 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 25 basis points annually on the total debt (net of sinking funds) with a remaining term to maturity less than 10 years and 50 basis points annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years. The fee for 2012 was \$3.7 million (2011 - \$3.9 million).

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2012, there was \$52.0 million in promissory notes outstanding (2011 - nil).



**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

Hydro maintains a \$50.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2011 - 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 24 letters of credit outstanding, reducing the availability of the credit facility by \$18.9 million (2011 - \$18.9 million).

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

<i>(millions of dollars)</i>	2013	2014	2015	2016	2017
Long-term debt repayment	-	125.0	-	225.0	150.0

Churchill Falls maintains a \$10.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2011 - 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.

Churchill Falls has issued two irrevocable letters of credit totaling \$2.0 million to ensure satisfactory management of its waste management system and compliance with a certificate of approval for the transportation of special and hazardous wastes, granted by the Provincial Department of Environment and Conservation.

**9. LONG-TERM PAYABLES**

The long-term payable to Hydro-Quebec as at December 31, 2012 is the accumulation of differences between energy delivered and the AEB energy base billed during the four-year period from September 1, 2008 to August 31, 2012. Monthly repayments commenced in September 2012 and will terminate on August 31, 2016. The current portion of \$1.0 million (2011 - \$0.4 million) is included in Trade and other payables. The long-term portion is \$2.6 million (2011 - \$4.9 million). As at December 31, 2011, long-term payables also included a \$1.3 million note payable to Nalcor which was repaid in full during 2012. The note was non-interest bearing and had no set terms for repayment.

**10. ASSET RETIREMENT OBLIGATIONS**

Hydro has recognized liabilities associated with the retirement of portions of the HTGS and disposal of Polychlorinated Biphenyls (PCB). The reconciliation of the beginning and ending carrying amount of asset retirement obligations is as follows:

<i>(millions of dollars)</i>	2012	2011
Asset retirement obligations at beginning of year	20.2	11.4
Liabilities incurred	0.3	2.8
Revisions	3.7	5.5
Accretion	0.8	0.5
Settlements	(0.1)	-
Asset retirement obligations at end of year	24.9	20.2
Less: current portion	0.3	-
	<u>24.6</u>	<u>20.2</u>

The total undiscounted estimated cash flows required to settle the HTGS obligations at December 31, 2012 are \$32.1 million (2011 - \$27.0 million). Payments to settle the liability are expected to occur between 2020 and 2024. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 2.8% (2011 - 2.9%).

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**10. ASSET RETIREMENT OBLIGATIONS (cont'd.)**

The total undiscounted estimated cash flows required to settle the PCB obligations at December 31, 2012 are \$3.6 million (2011 - \$3.6 million). Payments to settle the liability are expected to occur between 2013 and 2025. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rates ranging between 3.1% and 5.5% (2011 - 3.1% and 5.6%).

A significant number of Hydro's assets include generation plants, transmission assets and distribution systems. These assets can continue to run indefinitely with ongoing maintenance activities. As it is expected that 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 for those assets will be recognized at that time.

**11. EMPLOYEE FUTURE BENEFITS**

**11.1 Pension Plan**

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$5.4 million (2011 - \$5.2 million) are expensed as incurred.

**11.2 Other Benefits**

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2012, cash payments to beneficiaries for its unfunded other employee future benefits were \$2.8 million (2011 - \$2.5 million). An actuarial valuation was performed as at December 31, 2012.

<i>(millions of dollars)</i>	<b>2012</b>	<b>2011</b>
Accrued benefit obligation		
Balance at beginning of year	106.9	83.3
Current service cost	3.8	2.7
Interest cost	4.7	4.9
Actuarial (gain) loss	(4.7)	19.7
Regulatory adjustments	(2.3)	(1.2)
Benefits paid	(2.8)	(2.5)
Balance at end of year	<u>105.6</u>	<u>106.9</u>
Plan deficit	105.6	106.9
Unamortized actuarial loss	(36.1)	(43.7)
Unamortized past-service cost	(0.2)	(0.2)
Accrued benefit liability at end of year	<u>69.3</u>	<u>63.0</u>
<i>(millions of dollars)</i>	<b>2012</b>	<b>2011</b>
Component of benefit cost		
Current service cost	3.8	2.7
Interest cost	4.7	4.9
Actuarial (gain) loss	(4.7)	19.7
	<u>3.8</u>	<u>27.3</u>
Difference between actuarial gain or loss and amount recognized	7.6	(18.3)
Benefit expense	<u>11.4</u>	<u>9.0</u>

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**11. EMPLOYEE FUTURE BENEFITS (cont'd.)**

**11.2 Other Benefits (cont'd.)**

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

	2012	2011
Discount rate – benefit cost	4.55%	5.75%
Discount rate – accrued benefit obligation	4.00%	4.55%
Rate of compensation increase	3.50%	3.50%
Assumed health care trend rates:		
	2012	2011
Initial health care expense trend rate	6.00%	7.50%
Cost trend decline to	4.50%	5.00%
Year that rate reaches the rate it is assumed to remain at	2020	2016

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

<i>Increase</i>	2012	2011
Current service and interest cost	2.0	1.5
Accrued benefit obligation	20.6	21.6
<i>Decrease</i>	2012	2011
Current service and interest cost	(1.5)	(1.1)
Accrued benefit obligation	(15.7)	(16.5)

**12. SHAREHOLDER'S EQUITY**

**12.1 Share Capital**

<i>(millions of dollars)</i>	2012	2011
Common shares of par value \$1 each		
Authorized: 25,000,000		
Issued and outstanding 22,503,942	<u>22.5</u>	<u>22.5</u>

**12.2 Contributed Capital**

<i>(millions of dollars)</i>	2012	2011
Total contributed capital	<u>116.7</u>	<u>116.4</u>

On February 3, 2010, the Province established the Churchill Falls (Labrador) Corporation Trust (the Trust) with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses incurred in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. During 2012 the Trust contributed capital of \$0.3 million (2011 - \$0.4 million).

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**12. SHAREHOLDER'S EQUITY (cont'd.)**

**12.3 Accumulated Other Comprehensive Income**

<i>(millions of dollars)</i>	<b>2012</b>	<b>2011</b>
Balance at beginning of year	46.4	27.3
Other comprehensive (loss) income	(3.6)	19.1
Balance at end of year	<u>42.8</u>	<u>46.4</u>

**13. OPERATING COSTS**

<i>(millions of dollars)</i>	<b>2012</b>	<b>2011</b>
Salaries and benefits	100.1	95.2
Maintenance and materials	28.8	28.8
Transmission rental	19.7	18.7
Professional services	12.4	9.9
Rental and royalty	4.3	3.6
Other operating costs	11.9	14.6
Total	<u>177.2</u>	<u>170.8</u>

**14. CAPITAL MANAGEMENT**

**14.1 Hydro**

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

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).

A summary of the capital structure is outlined below:

<i>(millions of dollars)</i>	<b>2012</b>		<b>2011</b>	
<b>Debt</b>				
Long-term debt	1,125.9		1,131.5	
Short-term borrowings	52.0		-	
Current portion of long-term debt	8.2		8.2	
Sinking funds	(263.3)		(247.0)	
	<u>922.8</u>	54.0%	<u>892.7</u>	54.1%
<b>Equity</b>				
Share capital	22.5		22.5	
Contributed capital	116.7		116.4	
Accumulated other comprehensive income	42.8		46.4	
Retained earnings	604.8		570.9	
	<u>786.8</u>	46.0%	<u>756.2</u>	45.9%
<b>Total debt and equity</b>	<u>1,709.6</u>	<u>100.0%</u>	<u>1,648.9</u>	<u>100.0%</u>

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**14. CAPITAL MANAGEMENT (cont'd.)**

**14.1 Hydro (cont'd.)**

Hydro's unsecured demand operating facility has covenants restricting the issuance of debt such that the debt to total capitalization ratio cannot exceed 70%. The covenants further stipulate that the Debt Service Coverage Ratio should at all times be greater than 1.5 to 1.0. As at December 31, 2012, Hydro was in compliance with these covenants.

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

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% equity is maintained, a ratio which management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, contributed equity and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of the PUB.

Legislation stipulates that the total of the short-term loans issued by Hydro and outstanding at any time shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at \$300.0 million. There was \$52.0 million outstanding as at December 31, 2012 (2011 - nil). Issuance of long-term and short-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both long and short-term debt, to \$1.6 billion at any point in time.

**14.2 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 and the execution of the long-term asset management plan. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Managing the level of dividend payments is a key aspect of ensuring the availability of funding to maintain the plant and infrastructure.

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

**15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

**15.1 Fair Value**

The estimated fair values of financial instruments as at December 31, 2012 and 2011 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)**

**15.1 Fair Value (cont'd.)**

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

**Establishing Fair Value**

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

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

<i>(millions of dollars)</i>	Level	Carrying Value 2012	Fair Value	Carrying Value 2011	Fair Value
<b>Financial assets</b>					
Cash and cash equivalents	1	11.8	11.8	15.7	15.7
Short-term investments	1	0.5	0.5	9.6	9.6
Accounts receivable	1	102.3	102.3	96.3	96.3
Derivative assets	2	-	-	0.2	0.2
Sinking funds – investments in same Hydro issue	2	88.1	107.3	82.0	103.7
Sinking funds – other investments	2	263.3	263.3	247.0	247.0
Long-term receivable	2	0.8	0.8	1.6	1.6
Reserve fund	2	50.9	50.9	45.4	45.4
<b>Financial liabilities</b>					
Accounts payable and accrued liabilities	1	92.3	92.3	149.8	149.8
Short-term borrowings	1	52.0	52.0	-	-
Long-term debt including amount due within one year (before sinking funds)	2	1,222.2	1,668.6	1,221.7	1,695.3
Long-term payable	2	2.6	2.8	6.2	6.7

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

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2012 and 2011.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)**

**15.2 Risk Management**

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

**Credit Risk**

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

Credit risk on cash and cash equivalents is minimal, as Hydro's cash deposits are held by a Canadian Schedule 1 Chartered Bank with a rating of A+ (Standard and Poor's).

Credit risk on short-term investments is minimized by limiting holdings to high-quality, investment grade securities issued by Federal and Provincial governments, as well as Bankers' Acceptances and term deposits issued by Canadian Schedule 1 Chartered Banks.

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

	Issuer	Fair Value	Issuer	Fair Value
	Credit Rating	of Portfolio (%)	Credit Rating	of Portfolio (%)
	2012		2011	
Provincial Governments	AA- to AAA	4.07%	AA- to AAA	4.19%
Provincial Governments	A- to A+	55.95%	A- to A+	57.75%
Provincially owned utilities	A- to A+	33.96%	A- to A+	32.43%
Schedule 1 Canadian banks	A- to A+	1.89%	A- to A+	1.31%
Provincially owned utilities	BBB+	4.13%	BBB+	4.32%
		<b>100.00%</b>		<b>100.00%</b>

Credit exposure on the reserve fund is mitigated by adhering to an investment policy which restricts the holdings to long-term debt instruments issued or guaranteed by the Government of Canada or any province of Canada. Investment in the long-term debt instruments of Canadian banks are also permitted, provided the bank is rated A or higher by Standard and Poor's. With the exception of Government of Canada, holdings of any one issuer are limited to 10% of the total principal amount of the portfolio. The following credit risk table provides information on credit exposures according to issuer type and credit rating for the reserve fund:

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)**

**15.2 Risk Management (cont'd.)**

Credit Risk (cont'd.)

	Issuer Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value of Portfolio (%)
	2012		2011	
Provincial Governments	AA- to AAA	13.19%	AA- to AAA	17.03%
Canadian Schedule 1 banks	AA- to AAA	12.70%	AA- to AAA	17.94%
Provincial Governments	A- to A+	20.86%	A- to A+	23.12%
Provincially owned utilities	A- to A+	13.39%	A- to A+	14.65%
Canadian Schedule 1 banks	A- to A+	39.86%	A- to A+	27.26%
		<u>100.00%</u>		<u>100.00%</u>

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

Hydro's exposure to credit risk on its energy sales and associated accounts receivable is determined by the credit quality of its customers. Hydro's three largest customers account for 89.9% (2011 - 76.6%) of total energy sales and 58.6% (2011 - 65.8%) of accounts receivable. These customers are comprised of rate regulated entities and/or organizations with investment grade credit ratings.

Hydro does not have any significant amounts that are past due and uncollectable, for which a provision has not been recognized at December 31, 2012.

Liquidity Risk

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

Short-term liquidity is mainly provided through cash and cash equivalents on hand, funds from operations, and a \$300.0 million promissory note program. In addition, Hydro maintains a \$50.0 million (2011 - \$50.0 million) unsecured demand operating facility with its primary banker in order to meet any requirements beyond those forecasted for a given period. Churchill Falls also maintains a \$10.0 million minimum cash balance.

Long-term liquidity risk for Hydro is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2013 to 2033. Sinking funds have been established for these issues, with the exception of the issue maturing in 2016.

For Churchill Falls, long-term liquidity risk is managed by maintenance of the reserve fund in accordance with the June 1999 shareholders' agreement and a dividend management policy that meets long-term liquidity requirements associated with Churchill Falls capital expenditure program.



**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)**

**15.2 Risk Management (cont'd.)**

Liquidity Risk (cont'd.)

The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2012:

<i>(millions of dollars)</i>	<1 Year	1-3 Years	3-5 years	> 5 Years	Total
Accounts payable and accrued liabilities	92.3	-	-	-	92.3
Short-term borrowings	52.0	-	-	-	52.0
Long-term payable	-	2.0	0.6	-	2.6
Long-term debt including amount due within one year	-	125.0	375.0	725.0	1,225.0
Interest	61.8	160.6	135.7	588.7	946.8
	<u>206.1</u>	<u>287.6</u>	<u>511.3</u>	<u>1,313.7</u>	<u>2,318.7</u>

Market Risk

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

Interest Rates

Changes in prevailing interest rates will impact the fair value of financial assets and liabilities classified as held for trading or available for sale, which includes Hydro's cash and cash equivalents, short-term investments, sinking funds and reserve fund. Expected future cash flows associated with those financial instruments can also be impacted. The impact of a 0.5% change in interest rates on net income and other comprehensive income associated with cash and cash equivalents, short-term investments and debt and short-term debt was negligible throughout 2012 due to the short time period to maturity.

The table below shows the impact of a 50 basis point change in interest rates on net income and other comprehensive income associated with the sinking funds at the balance sheet date:

<i>(millions of dollars)</i>	Net Income		Other Comprehensive Income	
	0.5% Decrease	0.5% Increase	0.5% Decrease	0.5% Increase
Interest on sinking fund	-	-	10.9	(10.2)
Interest on reserve fund	-	-	1.1	(0.7)
	<u>-</u>	<u>-</u>	<u>12.0</u>	<u>(10.9)</u>

Foreign Currency and Commodity Exposure

Hydro's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS and USD denominated electricity sales. These exposures are addressed in accordance with the board-approved Financial Risk Management Policy. Tactics to address these exposures include the use of forward rate agreements and fixed price commodity swaps.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)**

**15.2 Risk Management (cont'd.)**

Market Risk (cont'd.)

*Foreign Currency and Commodity Exposure*

During 2012, total electricity sales denominated in USD were \$33.8 million (2011 - \$67.9 million). In 2012 Hydro mitigated foreign exchange risk on these sales through the use of foreign currency forward contracts. In March of 2012, Hydro entered into a series of ten monthly foreign exchange forward contracts with a notional value of \$39.1 million USD to hedge foreign exchange risk on 75% of Hydro's planned USD electricity sales for the year. These contracts had an average exchange rate of \$1.00 CAD per USD. In 2012, management elected not to implement commodity price hedges aimed at addressing electricity price risk due to depressed market pricing conditions. During 2012, \$0.1 million in gains from these derivative contracts were included in other income and expense (2011 - \$1.9 million loss).

**16. NET FINANCE EXPENSE**

<i>(millions of dollars)</i>	<b>2012</b>	<b>2011</b>
Finance income		
Interest on sinking fund	18.0	16.6
Interest on reserve fund	1.6	1.5
Other interest income	0.9	4.7
	<u>20.5</u>	<u>22.8</u>
Finance expense		
Long-term debt	90.5	90.5
Accretion	0.5	0.5
Debt guarantee fee	3.7	3.9
Other	1.0	1.0
	<u>95.7</u>	<u>95.9</u>
Interest capitalized during construction	<u>(2.7)</u>	<u>(1.6)</u>
	<u>93.0</u>	<u>94.3</u>
Net finance expense	<u>72.5</u>	<u>71.5</u>

**17. SUPPLEMENTARY CASH FLOW INFORMATION**

<i>(millions of dollars)</i>	<b>2012</b>	<b>2011</b>
Accounts receivable	(6.0)	(15.3)
Inventory	1.4	(0.6)
Prepaid expenses	(0.8)	-
Regulatory assets	1.4	3.3
Regulatory liabilities	31.3	11.1
Accounts payable and accrued liabilities	(57.5)	(2.1)
Changes to non-cash working capital balances	<u>(30.2)</u>	<u>(3.6)</u>
Interest received	1.9	2.3
Interest paid	91.4	90.6
Income taxes paid	0.1	0.2

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**18. 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-Quebec. Hydro'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 2.

Segments	Hydro Regulated	Churchill Falls	Energy Marketing	Other	Inter- segment	Total
<i>(millions of dollars)</i>						<b>2012</b>
<b>Revenue</b>						
Energy sales	520.7	73.0	52.2	-	(4.0)	641.9
Other revenue	2.1	0.5	-	-	3.4	6.0
	<u>522.8</u>	<u>73.5</u>	<u>52.2</u>	<u>-</u>	<u>(0.6)</u>	<u>647.9</u>
<b>Expenses</b>						
Fuels	182.4	-	-	-	-	182.4
Power purchased	57.0	0.1	7.7	-	(4.0)	60.8
Operations and administration	109.5	42.0	25.1	0.6	-	177.2
Net finance expense	74.0	(1.6)	0.1	-	-	72.5
Amortization	47.5	12.7	-	-	-	60.2
Other income and expense	5.3	(4.6)	(0.1)	-	-	0.6
Regulatory adjustments	30.0	-	-	-	-	30.0
	<u>505.7</u>	<u>48.6</u>	<u>32.8</u>	<u>0.6</u>	<u>(4.0)</u>	<u>583.7</u>
Net income from operations	17.1	24.9	19.4	(0.6)	3.4	64.2
Preferred dividends	-	3.4	-	-	(3.4)	-
Net income	<u>17.1</u>	<u>28.3</u>	<u>19.4</u>	<u>(0.6)</u>	<u>-</u>	<u>64.2</u>
Capital expenditures	77.6	30.1	-	-	-	107.7
Total assets	1,906.4	456.2	3.5	-	-	2,366.1
<i>(millions of dollars)</i>						<b>2011</b>
<b>Revenue</b>						
Energy sales	473.6	66.2	74.3	-	(3.9)	610.2
Other revenue	2.3	0.3	-	-	3.3	5.9
	<u>475.9</u>	<u>66.5</u>	<u>74.3</u>	<u>-</u>	<u>(0.6)</u>	<u>616.1</u>
<b>Expenses</b>						
Fuels	154.9	-	-	-	-	154.9
Power purchased	52.2	-	4.6	-	(3.9)	52.9
Operations and administration	104.4	41.8	23.3	1.3	-	170.8
Net finance expense	73.5	(1.4)	(0.6)	-	-	71.5
Amortization	43.2	12.2	-	-	-	55.4
Other income and expense	0.5	(7.2)	1.8	-	-	(4.9)
Regulatory adjustments	24.1	-	-	-	-	24.1
	<u>452.8</u>	<u>45.4</u>	<u>29.1</u>	<u>1.3</u>	<u>(3.9)</u>	<u>524.7</u>
Net income from operations	23.1	21.1	45.2	(1.3)	3.3	91.4
Preferred dividends	-	3.3	-	-	(3.3)	-
Net income	<u>23.1</u>	<u>24.4</u>	<u>45.2</u>	<u>(1.3)</u>	<u>-</u>	<u>91.4</u>
Capital expenditures	62.3	25.6	-	-	-	87.9
Total assets	1,867.5	436.6	3.9	1.5	-	2,309.5

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**19. COMMITMENTS AND CONTINGENCIES**

- (a) 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 \$0.3 million (2011 - \$0.3 million).
- (b) One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately \$21.9 million (2011 - \$21.9 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this 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.
- (c) Outstanding commitments for capital projects total approximately \$18.5 million (2011 - \$29.2 million).
- (d) 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:

<i>(millions of dollars)</i>	2013	2014	2015	2016	2017
Power purchases	24.9	24.5	24.7	24.9	25.2

- (e) Hydro has issued 23 irrevocable letters of credit to the New Brunswick System Operator totaling \$18.6 million as credit support related to applications for point to point transmission services. In addition Hydro has issued one letter of credit 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 two irrevocable letters of credit, totaling \$2.0 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.
- (f) Hydro entered into power sales agreements with third parties. To facilitate market access, Hydro has entered into a five year transmission service agreement with Hydro-Quebec TransEnergie to acquire access to 265 MW of transmission capacity from Labrador through Quebec. 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-Quebec TransEnergie, the transmission rental payments to contract maturity are as follows:

2013	\$ 18.9 million
2014	\$ 4.7 million

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**19. COMMITMENTS AND CONTINGENCIES (cont'd.)**

- (g) Hydro has received funding, in the amount of \$3.0 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 in annual installments of \$25,000 per commercial implementation of the resulting product. As at December 31, 2012 there have been no commercial implementations.
- (h) 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 trial is scheduled for the fall of 2013. The outcome of this motion is not determinable at this time.
- (i) 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. Beginning in 2015, Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.
- (j) 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 that further monitoring be carried out. Monitoring was performed throughout 2010 with no remediation required. However, the 2010 sampling did indicate some increase in PCB concentrations in sediment and fish flesh in specific locations, and an increased frequency of monitoring was recommended. Further sampling has now been scheduled for 2013.

**20. RELATED PARTY TRANSACTIONS**

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

Related Party	Relationship
Nalcor Energy (Nalcor)	100% shareholder of Hydro
The Province	100% shareholder of Nalcor
Churchill Falls	Jointly controlled subsidiary of Hydro
Twin Falls	Jointly controlled subsidiary of Churchill Falls
Churchill Falls (Labrador) Corporation Trust	Created by the Province with Churchill Falls as the beneficiary
Nalcor Energy – Bull Arm Fabrication	Wholly owned subsidiary of Nalcor
Nalcor Energy – Oil and Gas	Wholly owned subsidiary of Nalcor
Board of Commissioners of Public Utilities	Agency of the Province

Intercompany transactions and balances have been eliminated upon consolidation. The amounts included in the financial statements for related party transactions are as follows:

- (a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of \$6.1 million (2011 - \$6.0 million) of the power produced by Churchill Falls.
- (b) Hydro is required to contribute to the cost of operations of the PUB as well as the cost of hearings and applications costs. During 2012, Hydro incurred \$1.5 million (2011 - \$1.2 million) in costs related to the PUB of which \$0.6 million (2011 - \$0.6 million) was included in Accounts payable and accrued liabilities.
- (c) As at December 31, 2012, Hydro has a payable to Nalcor of \$2.3 million (2011 - \$49.9 million) and a receivable from other affiliates for \$0.7 million (2011 - \$0.3 million). This payable/receivable consists of various intercompany operating costs and power purchases.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**20. RELATED PARTY TRANSACTIONS (cont'd.)**

- (d) 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, 2012, \$6.2 million (2011 - \$5.3 million) was payable.
- (e) Hydro received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2012, \$1.9 million (2011 - \$3.5 million) has been recorded in Deferred credits.
- (f) On February 3, 2010, the Province established the Trust with Churchill Falls as the beneficiary. The purpose of this Trust is to fund the external costs and expenses in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. To date, \$1.8 million (2011 - \$1.4 million) has been received and \$0.2 million (2011 - \$0.2 million) has been accrued as due from the Trust.
- (g) During 2012, Hydro repaid the \$1.3 million long-term related party note payable to Nalcor in full. The note was non-interest bearing and had no set terms of repayment.
- (h) The 2012 debt guarantee fee payable to the Province was \$3.7 million (2011 - \$3.9 million). Both the 2011 and 2012 debt guarantee fees were paid in full in March 2012.

**21. SUBSEQUENT EVENTS**

*Forward Contracts*

On January 29, 2013, Hydro entered into a total of 12 forward contracts with a notional value of USD \$23.0 million to mitigate a portion of the USD exposure on recall sales through to the end of 2013. The average rate on these forward contracts was \$1.01 CAD per USD.

*Cancellation of letters of credit*

On February 15, 2013, Hydro cancelled 23 letters of credit related to the New Brunswick System Operator totaling \$18.6 million.

**22. COMPARATIVE FIGURES**

The comparative figures have been reclassified to conform with the 2012 financial statement presentation of regulatory accounting adjustments.



