

**NALCOR ENERGY
NEWFOUNDLAND AND LABRADOR HYDRO**

2012 Annual Performance Report
Transparency and Accountability

June 2013



Message from the Boards of Directors

Honourable Tom Marshall, Q.C.
Minister of Natural Resources
Government of Newfoundland and Labrador
P. O. Box 8700
St. John's, NL
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Dear Minister:

In accordance with the *Transparency and Accountability Act*, I am pleased to submit the 2012 Annual Performance Report on behalf of the Boards of Directors of Nalcor Energy and Newfoundland and Labrador Hydro.

To address all strategic issues outlined in the 2011-2013 Strategic Plan, this Performance Report will present results for all of Nalcor Energy and will also highlight the accomplishments of Hydro and other subsidiaries.

As the Boards of Directors of Nalcor Energy and Newfoundland and Labrador Hydro, we are accountable for the results outlined.



Terry Styles
Chair
Nalcor Energy
Newfoundland and Labrador Hydro

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1 OVERVIEW

Nalcor Energy

Nalcor Energy is Newfoundland and Labrador's energy company. The company's business includes the development, generation, transmission and sale of electricity; the exploration, development, production and sale of oil and gas; industrial fabrication; 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 that facilitates the prudent management of its assets while continuing an unwavering focus on the safety of its workers, contractors and the public.

Nalcor, a provincial Crown corporation, had seven wholly-owned subsidiaries at December 31, 2012, Newfoundland and Labrador Hydro (Hydro), Nalcor Energy – Oil and Gas, Nalcor Energy – Bull Arm Fabrication, Labrador Island Link General Partner Corporation, Labrador Island Link Holding Corporation, Labrador Island Link Limited Partnership¹ and Gull Island Power Corporation. Nalcor, through its subsidiary, Hydro, holds a 65.8 per cent interest in Churchill Falls (Labrador) Corporation (CF(L)Co) and 51 per cent of Lower Churchill Development Corporation².

Headquartered in St. John's, Nalcor's energy portfolio is located throughout the province (see Appendix 1). In 2012, Nalcor had over 1,300 employees, with nearly 70 per cent of these employees located in rural parts of the island and Labrador. The gender composition of Nalcor's employee group was 77 per cent male and 23 per cent female. Nalcor is currently implementing a multi-year action plan to support diversity and inclusion.

In 2012 Nalcor had revenues of \$726.1 million. The majority of Nalcor's revenues are currently generated from energy sales to utility, rural and industrial customers. Approximately 38 per cent of Nalcor's 2012 expenditures related to fuels and power purchases by Hydro with

¹ Nalcor ownership changed to 65 per cent in February 2013.

² Gull Island Power Corporation (GIPCo) and Lower Churchill Development Corporation (LCDC) are inactive subsidiaries. In 2012, Nalcor created new subsidiaries as part of advancing the Muskrat Falls Project. The new subsidiaries are associated with the development, construction, financing and operation the Labrador-Island Link and include the Labrador-Island Link General Partner Corporation (LIL GP) and the Labrador-Island Link Holding Corporation (LIL Holdco). Nalcor also created the Labrador-Island Link Partnership (LIL Partnership) in accordance with the Labrador-Island Link Limited Partnership Agreement to develop the Labrador-Island link. LIL Holdco holds 100% of the Class A Units.

operations and administration accounting for 33 per cent of expenses, amortization and depletion totalling 12 per cent and interest and finance charges accounting for 12 per cent.

Table 1: Nalcor Energy Consolidated Revenue and Expenses 2012

<i>For the year ended December 31 (millions of dollars)</i>	\$	%
Revenue		
Energy sales	710.4	97.8
Interest and finance income	-	-
Other revenue	15.7	2.2
	726.1	
Expenses		
Fuels	182.4	28.8
Power purchased	60.8	9.6
Operations and administration	206.9	32.7
Net finance expense	73.6	11.6
Amortization and depletion	79.3	12.5
Other income and expense	0.4	0.1
Regulatory Adjustments	30.0	4.7
	633.4	
Net Income	92.7	

Hydro

As the province's main electricity provider, Hydro is focused on providing a safe, reliable and cost-effective electricity supply to meet current energy needs and accommodate future growth. Hydro is involved in both regulated and non-regulated activities.

Hydro Regulated is regulated by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) and its electricity rates are set through periodic general rate applications. The regulated portion of the company includes the generation, transmission and distribution of electrical power and energy to utility, residential and commercial customers, as well as island industrial customers.

Hydro has an installed generating capacity of 1,637 megawatts (MW) and its generating assets include nine hydroelectric plants, one oil-fired plant, four gas turbines, and 25 diesel plants. These generating assets along with a network of transmission and distribution lines bring electricity to communities throughout Newfoundland and Labrador.

Under the Churchill Falls Power Contract, CF(L)Co has the right to recall 300 MW of power. CF(L)Co sells this power to Hydro under a long-term contract expiring in 2041. Hydro uses a

portion of this power to supply residential and commercial customer requirements under regulated service. Hydro's non-regulated activities include the sale of another portion of this power to mining operations in Labrador West and the remaining portion of recall power is exported into Canadian markets.

In 2012, Hydro directly employed 861 people. The location of these employees reflects Hydro's service area and the location of the company's electricity assets, with 70 per cent located in rural areas. The gender composition of Hydro's employee group is 82 per cent male and 18 per cent female. As a large employer within Nalcor, Hydro will play a key role in implementing the multi-year action plan to support diversity and inclusion.

In 2012, Hydro had revenues of \$647.9 million. The majority of Hydro's revenues are from energy sales to utility, rural and industrial customers with other revenues including preferred dividends from Hydro's subsidiary Churchill Falls. Consolidated energy sales also include CF(L)Co sales to Hydro Quebec as well as sales of recall power. In 2012, Hydro net income of \$64.2 million consisted of \$17.1 million from Hydro Regulated, \$28.3 million from Churchill Falls and \$18.8 million from recall power and other non-regulated activities. The following chart summarizes the consolidated 2012 revenue and expenses for Hydro.

Table 2: Hydro Consolidated Revenue and Expenses 2012

<i>For the year ended December 31 (millions of dollars)</i>	\$	%
Revenue		
Energy sales	641.9	99.1
Interest and finance income	-	
Other revenue	6.0	0.9
	647.9	
Expenses		
Fuels	182.4	31.2
Power purchased	60.8	10.4
Operations and administration	177.2	30.4
Net finance expense	72.5	12.4
Amortization	60.2	10.3
Other income and expenses	0.6	0.1
Regulatory adjustments	30.0	5.2
	583.7	
Net Income	64.2	

2 MANDATE

Nalcor

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

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

Hydro

The *Hydro Corporation Act* 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, coal, oil, wind, hydrogen 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.

3 LINES OF BUSINESS

Nalcor has six lines of business: Newfoundland and Labrador Hydro - Regulated, Churchill Falls, Oil and Gas, Lower Churchill Project, Bull Arm Fabrication and Energy Marketing.

Newfoundland and Labrador Hydro - Regulated

Hydro is the primary generator of electricity in Newfoundland and Labrador. The utility delivers safe, reliable power to utility, industrial, residential and commercial customers in more than 200 communities in the province. Hydro regulated activities can be grouped as follows:

- Electricity generation involves the operations of nine hydroelectric generating stations, one oil-fired plant, four gas turbines and 25 diesel plants. This line of business also includes Hydro's involvement in forecasting electricity requirements in the province and advancing options for generation expansion.
- Transmission, distribution and customer service activities include the operation and maintenance of over 3,700 kilometres of transmission lines and 3,300 kilometres of distribution lines. Customer service activities address the requirements of over 36,000 residential and commercial customers, Newfoundland Power, as well as our industrial customers.

Churchill Falls

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

The Churchill Falls generating station provides clean, renewable electricity to millions of consumers throughout North America. A significant portion of that electricity is being sold to Hydro-Québec under a long-term contract. Churchill Falls sells 300 MW (recall power), the maximum provided under the power contract, to Hydro for use in the province and for export sales. Churchill Falls also provides 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 White Rose Growth Project, and the Hibernia Southern extension. Through its multi-year exploration strategy, Nalcor Energy – Oil and Gas also supports efforts toward further exploration and development of the province’s potential offshore resources. The company also continues to pursue additional investment opportunities.

Lower Churchill Project

The lower Churchill River hydroelectric resource is one of the most attractive undeveloped hydroelectric projects in North America and is a key component of the province’s energy warehouse. The project’s two proposed installations at Gull Island and Muskrat Falls will have a combined capacity of over 3,000 MW. The clean, stable, renewable electricity will provide an opportunity for the province to meet its own domestic and industrial needs in an environmentally sustainable way, and also export excess electricity to other jurisdictions where the demand for clean, renewable energy continues to grow. In 2012, sanction was achieved for Phase One of the project - Muskrat Falls, Labrador transmission assets, Labrador-Island Link and the Maritime Link.

Bull Arm Fabrication

Bull Arm Fabrication, manages Atlantic Canada’s largest fabrication site. Close to international shipping lanes and Europe, this site has unobstructed, deep water access to the Atlantic Ocean. This facility spans over 2,560 hectares and has integrated and comprehensive infrastructure to support fabrication and assembly of three key project functions, simultaneously, in three separate theatres: Topsides Fabrication and Assembly, Dry-dock Fabrication and Construction, and Deepwater Construction and Integration Site. Currently, the Bull Arm site is fully leased by ExxonMobil for the construction and commissioning phases of the Hebron Project.

Energy Marketing

Nalcor is involved in energy marketing and other energy activities including non-regulated electricity generation, wind energy, and research and development. Nalcor’s current energy marketing portfolio will grow over the coming years and currently includes recall power³ that is not required by Hydro to meet demand in Labrador.

³Under the Churchill Falls Power Contract, Hydro has the right to recall 300 megawatts at the same price as Hydro-Québec pays Churchill Falls (Labrador) Corporation.

4 VALUES

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

- 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.

5 PRIMARY CLIENTS

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

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

The primary clients of Hydro, including its subsidiary CF(L)Co, are:

- Industrial electricity consumers
- Newfoundland Power
- Rural retail electricity customers
- Hydro-Québec
- Emera Energy
- Non-utility electricity generators (e.g. Corner Brook Pulp and Paper, wind generators)
- Government of Newfoundland and Labrador departments and agencies.

6 VISION

Nalcor

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

Hydro

To be recognized as an innovative provider of quality energy services.

7 MISSION

Nalcor

Nalcor is focused on sustainable growth and is leading the development of the province's energy resources to provide maximum benefit to Newfoundland and Labrador. Over the coming years, Nalcor will continue to manage its energy holdings including oil and gas interests, Hydro and upper Churchill assets, and the Bull Arm Fabrication site, and will advance plans for the development of the lower Churchill hydroelectric resource.

By December 31, 2016, Nalcor Energy will have further advanced its energy sector involvement in hydroelectric development, oil and gas, energy marketing and industrial site fabrication management to help build a strong economic future for Newfoundland and Labrador.

Measure: Advanced energy sector involvement

Indicators:

- Effectively managed upper Churchill resource to:
 - Maintain assets to ensure long-term reliable service and,
 - Pursue Power Contract adjustments.
- As an active partner in existing offshore oil developments, fulfilled all required obligations and worked to attain alignment between provincial interests and project partners.
- Advanced oil and gas exploration activity.
- Significantly advanced the Lower Churchill Development Phase One and continued efforts to progress Phase Two.
- Monitored asset management and environmental protection at the Bull Arm Fabrication site and planned for long-term site utilization.
- Enhanced energy marketing capabilities toward establishing a self-contained energy marketing line of business.

Hydro

Hydro is focused on providing a safe, reliable and cost-effective electricity supply to meet current and future energy needs. Hydro's strategy is focused on managing its assets in a manner that optimizes total cost of operation and maintenance. Diligence in the area of safety of employees, contractors and the public and a commitment to environmental sustainability and energy conservation drive the company. Over the coming years, Hydro will continue to enhance safety, asset management and environmental sustainability to improve the delivery of electricity to the people of the province.

By December 31, 2016, Hydro will have enhanced its safety, asset management and environmental sustainability processes to continuously improve the delivery of reliable and cost-effective electricity supply to its customers.

Measure: Enhanced safety, asset management and environmental sustainability processes

Indicators:

- Advanced efforts toward safety excellence with emphasis on employees, contractors, and the public.
- Enhanced asset management to ensure reliability of electricity assets (generation, transmission and distribution), as well as future capacity to accommodate power from the Lower Churchill Development (Muskrat Falls).
- Advanced efforts to secure power from Muskrat Falls for use in the province.
- Advanced research on renewable/alternative power generation options for the province with environmental sustainability in mind.
- Promoted energy conservation by electricity consumers as well as internal energy efficiency.

8 SHARED COMMITMENTS

Nalcor and Hydro work with a variety of agencies, departments and commissions to execute their mandates and support fulfillment of the strategic directions of the Minister of Natural Resources. Collectively, these groups influence the activities 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 and supports the company's efforts to progress all the strategic issues outlined. For example, activity related to the acquisition of working interests in offshore oil fields and efforts to promote exploration are co-ordinated efforts between the department and Nalcor Energy – Oil and Gas (Issue 4: Oil and gas interests, exploration and development – Nalcor). During 2012, the department was also involved in a range of activities to inform the Muskrat Falls Project sanction decision (Issue 5: Lower Churchill Development – Nalcor). The ongoing administration of issues related to the electrical system throughout the province and the execution of key policy actions outlined in the province's Energy Plan are areas of significant collaboration.

Department of Finance

The Department of Finance works with Nalcor to address requirements related to financial structure and dividend policies that support Nalcor's efforts related to all the strategic issues outlined. A specific example of working together during 2012 was the department's involvement in activities related to project financing to inform the Muskrat Falls Project sanction decision (Issue 5: Lower Churchill Development –Nalcor).

Newfoundland and Labrador Board of Commissioners of Public Utilities

The 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. Activities related to Issue 2: Electricity supply (Hydro), are impacted by the PUB. The role of the PUB is detailed in the *Public Utilities Act*.

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

9 ISSUES

Nalcor drives performance excellence in its lines of business and functional support areas through its planning and performance monitoring processes. Nalcor focuses on five key areas: safety leadership, environmental leadership, business excellence, people and community. These focus areas drive goals, objectives and operational activities throughout the company.

The strategic issues outlined below will be addressed by Nalcor and/or Hydro to realize their mandates and visions. Consistent with the underlying philosophy of the multi-year performance-based planning required under the provisions of the *Transparency and Accountability Act*, these issues are at a governance level and reflect the priorities of the Minister of Natural Resources. Other issues and focus areas, such as people excellence and corporate citizenship, will continue to drive operational activities of Nalcor and its lines of business and support efforts to address the issues outlined.

Issue 1: Safety leadership (Nalcor, Hydro)

Issue 2: Electricity supply (Hydro)

Issue 3: Upper Churchill asset management and Power Contract adjustments (Nalcor)

Issue 4: Oil and gas interests, exploration and development (Nalcor)

Issue 5: Lower Churchill development (Nalcor)

Issue 6: Bull Arm Fabrication site lease management and long-term strategy (Nalcor)

Issue 7: Energy marketing portfolio management and long-term strategy (Nalcor)

10 SUMMARY 2012 ACCOMPLISHMENTS AND HIGHLIGHTS

Outlined below is a summary of 2012 accomplishments related to Nalcor and Hydro's strategic plans and work plans.

Issue 1: Safety leadership (Nalcor, Hydro)

- Enhanced procedures for safely completing high-risk work activities through the preparation of a training program, delivery of training and development of work methods for critical tasks.
- Nalcor confined space entry program certified as Workplace, Health, Safety and Compensation Commission (WHSCC) compliant.
- Delivered a public education campaign on power line safety.
- *BeSafe*, a safety coaching training workshop, delivered to over 600 employees.
- Reported nearly 7,400 safety related observations through the Safe Workplace Observation Program (SWOP).

Issue 2: Electricity supply (Hydro)

- Achieved 99.97 per cent winter availability for key electricity generating assets, better than the target for the year and the five-year average.
- Invested over \$77 million to upgrade electricity generation, transmission and distribution assets as well as supporting technology and infrastructure and refreshed Hydro's long-term plan for capital investments.
- Formed internal technical councils to share knowledge and promote best practices as part of the company's asset management approach.
- Completed planned activities for Hydro to secure access to energy from Muskrat Falls and identify electricity system upgrades to support integration of Muskrat Falls energy.
- Produced approximately 230,000 kilowatt hours (kWh) of renewable energy from Ramea Wind-Hydrogen-Diesel Energy research and development project, continuing to offset diesel fuel consumption in the isolated community.
- Completed draft feasibility report regarding the feasibility of the hydroelectric potential of select coastal Labrador communities.
- Commissioned project to complete further analysis of potential wind generation in coastal Labrador communities.
- Completed the first three projects through Hydro's Industrial Energy Efficiency Program, resulting in energy savings of 3.2 gigawatt (GWh) per year.

- Approved 280 rebates for insulation upgrades, Energy Star windows and thermostats, and provided incentives for more than 4,800 efficient lighting technologies to Hydro customers through the takeCHARGE energy efficiency program.

Issue 3: Upper Churchill asset management and power contract adjustments

- Invested \$55 million as part of a long-term plan for renewal of assets and refreshed plan for future investments.
- Completed required preparations for the Upper Churchill Power Contract trial.

Issue 4: Oil and gas interests, exploration and development (Nalcor)

- Worked with partners in three offshore oil developments to support achievement of key project milestones:
 - Submitted North Amethyst (Hibernia reservoir) and South White Rose Extension development plan amendments (DPA)⁴ to the Canada-Newfoundland and Labrador Offshore Petroleum Board (C-NLOPB) for review and approval.
 - Hebron development plan approved and project sanctioned.
 - Completed planned fabrication and construction activities for Hibernia Southern Extension.
- Completed planned exploration activities:
 - Acquired remaining 11,400 kilometres of original two year 22,000 kilometres seismic data acquisition program offshore Labrador.
 - Acquired additional 7,500 kilometres of data over the Orphan Basin to the Flemish Pass.
 - Completed ranking of all Newfoundland and Labrador basins to inform future exploration activities.
- Discovered three new basins offshore Labrador.
- Promoted the province's oil and gas potential through participation in national and international industry conferences including the Offshore Technology Conference and Offshore Europe.

Issue 5: Lower Churchill Development (Nalcor)

- Achieved project sanction for Muskrat Falls, Labrador Transmission Assets, Labrador-Island Link and Maritime link.

⁴ A development plan details the approach that a particular company (operator), on behalf of its partners, proposes for the development of a particular pool or field which contains oil and/or gas resources.

- Negotiated Federal Loan Guarantee.
- Negotiated and executed Nalcor-Emera commercial agreements.
- Received release from the environmental assessment for the Lower Churchill Hydroelectric Generation Project from the governments of Newfoundland and Labrador and Canada.
- Submitted the Environmental Impact Statement for the Labrador-Island Transmission Link environmental assessment.
- Commenced implementation of the Impact and Benefits Agreement (IBA) with the Innu Nation including the formation of the Tshiashkueish committee which will oversee the implementation of the IBA.
- Reached completion in excess of 50 per cent of project engineering.
- Completed planned construction and procurement activities including completion of the south-side road access to enable mass excavation at Muskrat Falls and awarded contracts for long lead-time items including Strait of Belle Island cable and turbine and generator sets.

Issue 6: Bull Arm Fabrication Site lease management and long-term strategy (Nalcor)

- Created a baseline 20 year capital plan for the Bull Arm Site.
- Approved more than \$17 million in upgrades and site refurbishments to be completed by the site tenant.
- Continued stakeholder engagement to inform the development of a long-term strategy for the Site.
- Updated and tested an emergency response plan that will be in place for the duration of Hebron project construction.

Issue 7: Energy marketing portfolio management and long-term strategy (Nalcor)

- Completed planned activities to advance energy marketing operations.
- Identified and implemented measures to increase portfolio value and achieved revenue 52 per cent greater than market benchmark.

11 OUTCOMES OF OBJECTIVES

The 2011-2013 Strategic Plan for Nalcor Energy and Newfoundland and Labrador Hydro established goals and objectives for the seven strategic issues outlined. This section details performance in 2012 relative to these issues and presents objectives and indicators for each issue for 2013.

Issue 1: Safety leadership (Nalcor, Hydro)

Nalcor's relentless commitment to safety drives all the company's lines of business. Achieving excellence in safety is Nalcor's number one priority and safety is a shared core value. For Nalcor, safety excellence is more than a way of operating it is an integral part of Nalcor's identity and strategy for the future. By driving the company's strategy and operations in all lines of business, safety also supports the fulfillment of the strategic directions of the Minister of Natural Resources.

Nalcor's pursuit of safety excellence encompasses the safety of employees, contractors and the general public. The company has established a safety framework that drives its safety initiatives and is built on leadership, procedures and equipment, competence, supportive culture, union management alignment, responsibility and reporting.

Nalcor's safety journey is one of persistence and commitment. During 2012, Nalcor implemented many initiatives to move the company forward on its journey to safety excellence. The company advanced procedures for completing high-risk work, delivered safety training to maintain employee competence and completed planned employee communication and public education activities.

Since 2002, Nalcor has experienced a 65 per cent reduction in lost-time injury frequency rates. During 2012, many areas of Nalcor sustained excellent safety performance and the company is seeing its safety culture mature with Nalcor employees identifying and addressing unsafe conditions and behaviours and accepting personal responsibility for their safety and the safety of others. Achieving and maintaining excellent safety performance in all areas of the company however is an ongoing challenge. To meet this challenge and ensure nobody gets hurt, Nalcor completes investigations of all safety incidents and analyses safety performance information to identify areas for improving the design and delivery of its safety programs.

Unless otherwise specified, the goal, objectives, measures, indicators and accomplishments outlined below apply to both Nalcor and Hydro. Nalcor’s safety programs and initiatives are targeted to all its lines of business as well as support areas of the company. As a large electricity operation and the largest employer within Nalcor, Hydro’s accomplishments are a significant component of the safety achievements of Nalcor as a whole.

Issue 1: Safety leadership (Nalcor, Hydro)	
Goal 1	
By December 31, 2013, Nalcor and Hydro will have enhanced employee safety programs and strengthened initiatives towards enhanced contractor and public safety.	
Measure	Enhanced safety programs and initiatives.
Indicator	<ul style="list-style-type: none"> ▪ Refined existing employee, contractor, and public safety programs. ▪ Enhanced communication of safety programs and initiatives.
Objective	
By December 31, 2012, Nalcor and Hydro will have continued to strengthen employee, contractor and public safety programs.	
Measure	
<ul style="list-style-type: none"> ▪ Strengthened safety programs. 	
INDICATORS	2012 ACCOMPLISHMENTS
Further advanced development and implementation of work protection code and work methods procedures for completing high-risk work activities	<p>Nalcor’s and Hydro’s safety excellence approach recognizes the importance of technically sound, best-in-class procedures for safely completing high-risk work. The activities required to advance a specific procedure depends on the scope of the procedure and its level of maturity. For example, the work protection code⁵ was updated in 2009 and since that time advancement activities focused on code training and implementation with 2012 activities including improvement audits and refresher training.</p> <p>All planned activities to advance development and implementation of the work protection code and work methods⁶ were completed as planned in 2012.</p> <ul style="list-style-type: none"> ▪ Work protection code: The work protection code has been implemented in all electricity lines of business. During 2012, improvement audits were completed in several Hydro operations and required action plans were

⁵ Work protection code (WPC) establishes conditions which, when combined with appropriate work practices, procedures and work methods, will provide workers with a safe work area when working on or around electrical and other energized equipment.

⁶ Work methods outline the tools and equipment and standard procedures to complete work, particularly high-risk tasks, safely.

Issue 1: Safety leadership (Nalcor, Hydro)	
	<p>implemented. As well, introductory and refresher training and awareness sessions were completed as planned during the year.</p> <ul style="list-style-type: none"> ▪ Work methods: In 2012, Nalcor continued its strong progress in developing work methods for safety critical tasks. As planned, efforts to date have resulted in the completion of over 90 per cent of work methods, surpassing the 2012 target of 85 per cent.
<p>Completed planned activities to maintain and enhance the competence of employees working with energized equipment and other high-risk work activities:</p> <ul style="list-style-type: none"> ▪ Designed grounding and bonding training program and completed planned training for line operations staff ▪ Completed planned fall arrest training activities 	<p>Maintained and enhanced competence of employees by completing planned 2012 activities to ensure employees working with energized equipment and completing other high-risk work activities keep their skills and certifications current.</p> <ul style="list-style-type: none"> ▪ Grounding and bonding⁷: Developed the grounding and bonding training program and completed planned training. This included train-the-trainer sessions for internal trainers as well as planned training for line workers. ▪ Fall arrest: During 2012, Nalcor completed planned fall arrest/fall protection training for 292 employees. This training addressed: hazard recognition, evaluation and control, fall arrest, equipment inspection and emergency rescue techniques. Nalcor's fall protection training program is approved by the Workplace Health Safety and Compensation Commission (WHSCC).
<ul style="list-style-type: none"> ▪ Developed confined space entry training program, secured WHSCC approval of program and developed training plan for implementation 	<ul style="list-style-type: none"> ▪ Confined space entry: During 2012, Nalcor developed a confined space entry training program and secured WHSCC approval. The training program outlines responsibilities for confined space entry and safe entry requirements. It also identifies who must be trained, the type of training required, the frequency of training and the necessary equipment. This specific information is necessary to ensure that all workers understand the requirements for entering a confined space. During 2012 a training plan was developed and implementation was advanced with 47 employees completing confined space entry training during the year.

⁷ The grounding and bonding program identifies electrical grounding and bonding practices for temporary grounding of electricity transmission and distribution lines to provide maximum protection for workers performing de-energized work.

Issue 1: Safety leadership (Nalcor, Hydro)	
<p>Completed planned safety coaching training with employees</p>	<p>Completed planned safety coaching training with over 600 employees attending the BeSafe safety coaching workshops. The primary target group for 2011 training was supervisors, union shop stewards, occupational health and safety committee co-chairs and other safety leaders while in 2012 training was also offered to frontline employees.</p> <p>The BeSafe workshop helps build the skills required to take action on at-risk behaviours by outlining a consistent approach to safety interactions and providing an opportunity to practice the approach.</p>
<p>Reviewed safety orientation program for vulnerable employees and identified program improvements for implementation in 2012 and 2013</p>	<p>During 2012, the safety orientation program for vulnerable (new and temporary) employees was reviewed and an action plan was developed outlining program improvements for 2012 and 2013.</p> <p>The key improvement implemented in 2012 to promote safety of vulnerable workers was enhancing the safety component of employee orientations. A corporate standard was developed to ensure that all operational areas complete local orientations for vulnerable workers in a consistent manner. The standard outlines the company-wide safety and health information to be covered as well as the location and job specific safety topics to be addressed.</p>
<p>Executed planned employee safety communication activities</p>	<p>Completed planned employee safety communications activities including:</p> <ul style="list-style-type: none"> ▪ Electronic device use campaign: Electronic device use while working can cause serious safety concerns. To help address electronic device use while at work, Nalcor developed guidelines and a supporting information campaign to promote responsible use. The information campaign included internal newsletters, videos and emails. In addition, Nalcor partnered with the Royal Newfoundland Constabulary to share important messages about distracted driving due to electronic device use with the public. ▪ Family safety mail out: In June 2012 a mail out was sent to Nalcor employees' homes with topics related to family and child safety activities. Also during the year a safety calendar featuring artwork by employees' children was distributed to all employees and retirees.

Issue 1: Safety leadership (Nalcor, Hydro)	
	<ul style="list-style-type: none"> ▪ Safety stories: Stories related to a variety of health and safety topics were shared with employees through internal publications. During 2012, topics included ergonomic wellness, power line safety, and vulnerable workers. ▪ Safety summit: Annual conference focusing on safety involving frontline workers, union executive, supervisors, occupational health and safety committees and senior management from all Nalcor lines of business. ▪ Safety Week: North America Occupational Health and Safety Week was observed throughout Nalcor with safety-related training, information sessions and workplace inspections taking place throughout the company. The theme for 2012 was <i>Safety and Health: a Commitment for Life: Making it Work</i>.
Completed planned public safety communication activities through the Back it Up safety campaign (Hydro only)	<p>During 2012, Hydro completed planned public safety communication activities through the multi-year Back it Up safety campaign. The content of the HydroSafety.ca website that promotes electrical safety, recreational safety and safety at home was updated and Hydro employees continued to deliver safety presentations at schools throughout the province. Also, as part of its 2012 seasonal safety communication program, Hydro issued advisories regarding winter recreational safety and reservoir water levels to promote public safety around electricity facilities.</p> <p>In addition, in 2012 Hydro completed an assessment of the Back it Up safety campaign as input to a new three-year public safety communication strategy.</p>
Further promoted power line safety with the general public and targeted audiences	<p>During 2012, Nalcor continued to promote power line safety through the delivery of the Power Line Safety Campaign in partnership with Newfoundland Power, the Newfoundland and Labrador Construction Safety Association, and the WHSCC.</p> <p>A public campaign including print, radio and social media was delivered during the year. As well, Nalcor targeted power line hazard education to students training in the operation of heavy equipment.</p> <p>During 2012, Nalcor also conducted focus groups with</p>

Issue 1: Safety leadership (Nalcor, Hydro)

	contractors and the residential do-it-yourself target audience to identify messages, tone and advertising approaches to guide future communication efforts around power line safety.
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The objective, measure and indicators for 2013 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 1: Safety leadership (Nalcor, Hydro)

Objective	
By December 31, 2013, Nalcor and Hydro will have further strengthened employee, contractor and public safety programs.	
Measure	Strengthened safety programs
Indicators	<ul style="list-style-type: none"> ▪ Assessed implementation of work protection code and identified opportunities for improvement. ▪ Completed planned activities to maintain and enhance the competence of employees working with energized equipment and other high-risk work activities: <ul style="list-style-type: none"> • Delivered planned grounding and bonding training to electricity lines operations employees. • Completed fall protection and confined space entry programs training for target employees. ▪ Continued planned safety coaching training with employees. ▪ Completed three-year plan for employee safety communications. ▪ Completed planned 2013 activities in three-year public safety communication strategy focusing on children’s electrical safety and power line safety (Hydro).

Issue 2: Electricity supply (Hydro)

Nalcor’s subsidiary, Newfoundland and Labrador Hydro, ensures there is a safe, reliable and cost-effective electricity supply available to meet current demand and future growth. These activities support fulfillment of the strategic direction of the Minister of Natural Resources related to a stable and competitive energy supply for domestic use and export to market. More specifically, the initiatives outlined support focus areas related to alternative energy research and development, and advancement of renewable energy projects and related infrastructure.

Asset Management/Reliability

A key challenge in the Canadian utility industry is electricity infrastructure renewal. As with other utilities, many of Hydro's assets are over 40 years old and require significant investment to ensure a continued safe and reliable supply of electricity.

Asset management is the cornerstone of Hydro's approach for managing assets over their lifecycle and making the investments required for reliable, cost-effective electricity to meet the needs of customers. Keeping Hydro's electricity systems in reliable operating condition is accomplished through a combination of routine maintenance of existing assets, replacement or rehabilitation of assets that have reached the end of their useful life with new or renewed assets that result in lower life cycle costs or improved operational characteristics.

Hydro has developed a long-term capital plan outlining the major capital investments required in electricity generation, transmission and distribution assets and supporting infrastructure. This plan will be refreshed periodically as new information becomes available about the condition of Hydro's assets, the operating demands to be placed on them, and future load growth needs.

During 2012, Hydro invested \$77 million to upgrade or replace its assets. Key investments were made to upgrade electricity generation, transmission and distribution assets as well as supporting technology and infrastructure. As well, during 2012, additional planning was completed for the upgrades and modifications to the electricity system required to support integration of Muskrat Falls energy.

Hydro achieved excellent reliability in its electricity generating assets in 2012. A key measure of reliability is the availability of generation to meet demand during the winter months of January, February, March and December. In 2012, winter generation availability was over 99 per cent – better than the target for the year. As well, the duration of electricity transmission outages was better than target.

Long-term Least-cost Supply

Hydro has a responsibility to assess electricity requirements in the province and recommend supply options to meet growing energy needs. Hydro's 2012 Planning Load Forecast confirmed that by 2015 the utility will be challenged to reliably meet peak demand in the winter months and, post-2019, there will not be sufficient energy supply to reliably meet demand through the

year. Hydro's examination of available alternatives determined that an interconnection to Labrador via a High-Voltage direct current (HVdc)⁸ link bringing power from the Muskrat Falls hydroelectric generating station was the least-cost option for electricity customers. During the balance of the planning period, Hydro will continue to pursue arrangements to secure the energy required from Muskrat Falls for use in the province.

Environmental Sustainability

In addition to being the long-term least-cost alternative, the Muskrat Falls option is also more environmentally-acceptable than maintaining an isolated island power system, which is heavily reliant on thermal generation at the Holyrood Generating Station. With Muskrat Falls, the Newfoundland and Labrador electricity system will be run on 98 per cent renewable, emission-free energy.

In recent years, Hydro has also been involved in a number of activities to investigate renewable electricity generation and to help electricity consumers conserve energy. These activities support the intent and goals of the 2007 Energy Plan and the 2011 Energy Efficiency Action Plan to achieve energy savings and support education and awareness of opportunities to conserve energy. The Government of Newfoundland and Labrador and Hydro completed the Coastal Labrador Alternative Energy study to investigate the potential for the integration of alternative energy sources, including solar, wind and mini-hydroelectric facilities into isolated Labrador communities that rely on diesel generation as a primary means of electricity. Results of the study were positive and the Provincial Government announced additional funding to study small-scale hydroelectric projects for some Labrador coastal communities. During 2012, a draft feasibility study of the hydraulic potential of coastal Labrador was prepared and in 2013 the feasibility study will be completed with data collection continuing until 2015. The Provincial Government also provided Hydro with funding to complete further analysis of potential wind generation in some coastal Labrador communities. The Coastal Labrador Wind Monitoring Program will continue until 2015.

Since 2009, in an effort to reduce emissions from burning fossil fuels, Hydro has purchased wind energy from wind projects in St. Lawrence and Fermeuse. As well, the Wind-Hydrogen-Diesel Energy research and development project in Ramea uses wind and hydrogen technology

⁸ High Voltage Direct Current (HVdc) – direct current boosted up to higher voltages for long-distance transmission. This form is normally used to carry large amounts of power over long distances and for transmission under water.

to supplement the diesel requirements of this isolated community. This energy project offers an opportunity to increase renewable generation in isolated communities that rely on diesel power generation and reduce Hydro’s future use of fossil fuels and its carbon footprint as well as other emissions. During 2012, the Ramea Wind-Hydrogen-Diesel Energy Project successfully produced approximately 230,000 kWh of renewable energy reducing diesel fuel consumption in Ramea.

Hydro is also committed to helping consumers use energy wisely. In addition to taking active steps to create energy savings in its own facilities, the company partners with Newfoundland Power to deliver the takeCHARGE program. takeCHARGE offers rebate programs to encourage residential and commercial customers to reduce their electricity usage. During 2012 Hydro also introduced an energy efficiency program to help residential and commercial customers in isolated communities save energy.

Issue 2: Electricity supply (Hydro)	
Goal By December 31, 2013, Hydro will have progressed milestones towards a reliable and cost-effective electricity supply for the province.	
Measure	Progressed milestones
Indicators	<ul style="list-style-type: none"> ▪ Enhanced asset management ▪ Completed milestones to facilitate access to Muskrat Falls energy ▪ Enhanced programs to support environmental sustainability
Objective By December 31, 2012, Hydro will have continued to enhance its asset management activities, completed additional planning activities to support access to Muskrat Falls energy and progressed select environmental sustainability initiatives.	
INDICATORS	2012 ACCOMPLISHMENTS
Measure 1 Completed planned initiatives to support enhanced asset reliability	
Completed required updates to long-term plan for capital investments	<p>During 2012 the required updates to the long-term plan for capital investments were completed to address updated asset condition data and risk assessments. Within the long term asset management plan the first five years of the plan is refreshed annually by utilizing the latest condition data to optimize project timing and cost by identifying the right work, on the right assets, at the right time. This information is the basis of the annual capital budget for Hydro.</p> <p>An example of an update to Hydro’s long-term plan for</p>

Issue 2: Electricity supply (Hydro)	
	capital investments was advancing a project to upgrade steel tower foundations on two transmission lines. A 2012 inspection of the condition of the tower foundations revealed that the foundations had deteriorated to a point where it was necessary to complete the upgrades three years earlier than originally planned (2015 versus 2018).
Completed planned investments in Hydro assets	In 2012, Hydro invested \$77 million to upgrade electricity generation, transmission and distribution assets, as well as supporting technology and infrastructure. This expenditure was below the \$94 million budgeted for 2012. The variance in budget versus actual expenditures resulted when not all planned work for the year was completed. A number of projects were delayed when bids far exceeded estimated costs and had to be re-tendered resulting in carryover of some planned 2012 work into 2013. Other planned work was deferred when electricity system constraints prevented the equipment outages required to complete work without impacting safety and system reliability.
Further enhanced asset management approach by completing 2012 priorities outlined in asset management implementation plan	Completed all planned 2012 priorities outlined in the asset management implementation plan and advanced some planned 2013 activities. Key accomplishments included: <ul style="list-style-type: none"> ▪ Completed planned work to refresh and document asset operating parameters, standards, service level requirements and other technical asset information. ▪ Developed and communicated an approach to complete asset condition assessments. ▪ Reviewed and validated metrics to measure asset management effectiveness. ▪ Developed approach to identify critical spare parts required for equipment/assets. ▪ Existing technical and functional councils that share knowledge and best practices continued to mature and new councils were initiated as planned.
Measure 2	
Completed planned activities related to accessing power from Muskrat Falls pending project sanction decision	
Further advanced arrangements to secure access to Muskrat Falls energy	During 2012, Hydro further advanced arrangements to secure access to Muskrat Falls energy. Specifically, drafting of the commercial agreements for the purchase of energy and capacity from the Muskrat Falls generating plant was

Issue 2: Electricity supply (Hydro)	
	initiated.
Measure 3	
Completed planned environmental sustainability initiatives	
Commenced demonstration phase of Ramea Wind-Hydrogen-Diesel Energy Project	<p>During 2012, the Ramea Wind-Hydrogen-Diesel Energy Project successfully produced approximately 230,000 kWh of renewable energy continuing to reduce diesel fuel consumption in Ramea.</p> <p>The demonstration phase of the project did not begin as planned in 2012 because the commissioning phase of the project was not fully completed due to delays testing full site automation resulting from issues with the hydrogen generating set. Despite Hydro maintenance activities and ongoing efforts to secure support from the manufacturer to correct mechanical deficiencies, the hydrogen generating set issues were not resolved in 2012. All other aspects of the commissioning phase have been completed and data collection and analysis from the project has commenced.</p>
Further advanced analysis of potential hydroelectric projects for Labrador coastal communities	The analysis of potential hydroelectric projects in Labrador coastal communities continued to advance during 2012. The contract to conduct a feasibility study into the potential for hydraulic development in coastal Labrador communities was awarded and a draft feasibility report was completed.
Progressed energy savings feasibility studies for industrial customers through the Industrial Energy Efficiency Program (IEEP)	<p>The IEEP provides Hydro's industrial electricity customers with financial assistance to complete feasibility studies and capital upgrades to achieve energy savings. Hydro also provides technical support to assist industrial customers in identifying and assessing energy saving projects.</p> <p>In 2012, three energy savings projects were completed resulting in annual savings of 3.2 GWh of electricity. As well, additional projects were proposed by industrial customers during the year and feasibility studies were progressed, or in some cases completed with work planning and implementation started. These studies included reviews of energy savings opportunities related to compressed air system optimization and pump sizing assessment and consolidation. Hydro also held an employee engagement partnership event with one of its industrial customers to encourage energy efficiency in that workplace.</p>
Continued residential and	Hydro and Newfoundland Power continued to work in

Issue 2: Electricity supply (Hydro)	
<p>commercial customer rebate programs in partnership with Newfoundland Power</p>	<p>partnership to develop and implement the takeCHARGE energy efficiency program. In 2012 this program continued to be very successful with 280 rebates for insulation upgrades and Energy Star windows and thermostats for residential customers of Hydro and more than 4,800 efficient lighting technologies purchased by Hydro’s commercial customers.</p> <p>Also during the year, Hydro and Newfoundland Power completed a new Five Year Conservation and Demand Management (CDM) Plan and filed the plan with the PUB seeking approval of additional energy efficiency rebate programs for both residential and commercial customers as well as continued energy efficiency education activities.</p>
<p>Implemented a new Isolated System Community Program to promote energy efficiency to residential and commercial customers in Hydro’s isolated systems</p>	<p>Hydro’s Isolated Systems Energy Efficiency Program is a new program launched in 2012. It is a three-year energy efficiency program that engages the full community and helps residential and commercial customers served by Hydro’s isolated systems save energy and money. Homeowners, renters and small businesses in communities served by diesel systems in Labrador and the island are eligible to participate. During 2012, 1,355 home and business customers benefitted from the installation of energy efficient technologies free of charge.</p> <p>The Isolated Systems Business Efficiency Program (ISBEP) was also launched in 2012 providing facility audits and technical support to identify energy efficiency opportunities and assess their economics. ISBEP also provides financial support for capital upgrades. More than 40 commercial facility audits were completed to inform customers of opportunities for incentives and one project was completed in 2012 resulting in annual savings of three MWh.</p> <p>In addition, a block heater timer (BHT) rebate program was developed and launched in late 2012. This program provides both free and discounted BHTs to customers in the Labrador Interconnected System where block heaters are frequently used.</p>

The objective, measures and indicators outlined for 2013 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 2: Electricity supply (Hydro)

Objective

By December 31, 2013, Hydro will have further enhanced its asset management activities, completed additional planning activities to support access to Muskrat Falls energy and progressed select environmental sustainability initiatives.

Measure 1	Completed planned initiatives to support enhanced asset reliability
Indicators	<ul style="list-style-type: none"> ▪ Completed required updates to five-year plan for capital investments. ▪ Completed 2013 priorities outlined in the asset management implementation plan. ▪ Completed planned investments in Hydro assets.
Measure 2	Completed planned activities related to accessing power from Muskrat Falls
Indicators	<ul style="list-style-type: none"> ▪ Further advanced commercial arrangements to secure access to Muskrat Falls energy. ▪ Completed required electricity system engineering and design activities to support integration of Muskrat Falls energy.
Measure 3	Completed planned environmental sustainability initiatives
Indicators	<ul style="list-style-type: none"> ▪ Continued collection and analysis of data collected from the Ramea Wind-Hydrogen Diesel Energy Project. ▪ Completed feasibility study of potential hydroelectric projects for Labrador coastal communities. ▪ Completed planned site selection and approvals process to advance Coast Labrador Wind Monitoring Program. ▪ Completed an evaluation of the Industrial Energy Efficiency Program (IEEP) and determined next steps for gaining energy efficiency savings with industrial customers. ▪ Delivered residential and commercial customer rebate programs pending PUB approval of the proposed Five Year Conservation and Demand Management (CDM) Plan. ▪ Continued delivery of the Isolated Systems Community Energy Efficiency Program to promote energy efficiency to residential and commercial customers in Hydro's isolated systems.

Issue 3: Upper Churchill asset management and Power Contract adjustments (Nalcor)

Asset Management

The Churchill Falls Generating Station is one of the largest underground hydroelectric powerhouses in the world with 5,428 MW of capacity used by millions of consumers in North America.

In 2011, Churchill Falls celebrated 40 years since first power. With the plant and related infrastructure aging, asset management is critical to keeping assets in reliable operating condition to provide reliable service to customers for the long-term and to ensure assets are fully functional well beyond the expiry of current commitments in 2041.

Taking steps to ensure the continued performance of the Churchill Falls facilities through planning and strategic investment drives the company's strategy. A long-term asset plan that informs capital investments has been developed. This plan is based on comprehensive assessments of asset condition, operating and maintenance experience and other key inputs, and reflects the operating requirements the plant should meet. Nalcor Energy-Churchill Falls will refresh its five-year capital plan as required and complete planned asset investments.

Upper Churchill Power Contract

A power contract with Hydro-Québec dated May 12, 1969, provides for the sale of almost 90 per cent of the energy from the Churchill Falls facility to Hydro-Québec. Presently, the purchase price under the Power Contract is one-quarter of one cent per kilowatt hour and the automatic renewal clause fixes the purchase price at one-fifth of one cent for a 25 year period beginning in 2016. This will mean, for the remainder of the Power Contract, power will be sold to Hydro- Québec for less than five per cent of its present commercial value.

In 2009, CF(L)Co formally requested that Hydro-Québec enter into discussions to amend the pricing terms for the remainder of the 1969 Power Contract. Hydro-Québec did not respond and therefore, in early 2010, CF(L)Co filed a motion against Hydro-Québec in Quebec Superior Court seeking to change, as of November 2009, the pricing terms for the remaining term of the Power Contract. It is the position of CF(L)Co that the circumstances since the original contract was signed have changed in ways that could not have been anticipated by the parties, and have resulted in an inequitable distribution of the contractual benefits in favour of Hydro-Québec. This situation, combined with the obligation under the Quebec Civil Code to act in good faith throughout the term of a contract, CF(L)Co believes obliges Hydro-Québec to renegotiate the pricing terms of the contract to re-establish the equilibrium of benefits.

Fall 2013 has been fixed as the commencement date for the trial and during 2013 CF(L)Co will complete necessary preparations.

Activities and accomplishments related to this issue support the fulfillment of the strategic direction of the Minister of Natural Resources related to a stable and competitive energy supply for domestic use and export to market. The energy supplied by the Churchill Falls asset relates to the focus area of export of surplus energy.

Issue 3: Upper Churchill asset management and Power Contract adjustments (Nalcor)	
Goal By December 31, 2013, Nalcor will have advanced long-term asset renewal and completed preparations for Upper Churchill Power Contract trial.	
Measure	Pursued opportunities for the Upper Churchill to make a greater economic contribution to the province
Indicators	<ul style="list-style-type: none"> ▪ Advanced long-term asset renewal ▪ Completed preparations for the Upper Churchill Power Contract trial
Objective By December 31, 2012, Nalcor will have completed planned 2012 capital investments to support long-term asset reliability and continued to advance preparations for Upper Churchill Power Contract trial.	
INDICATORS	2012 ACCOMPLISHMENTS
Measure 1 Completed planned capital investments	
Refreshed five year capital plan as required	<p>During 2012 the five year capital plan was refreshed to address changes in market conditions, updated asset condition data and risk assessments. An example of an update to the plan was the change in timing for the replacement of high voltage air-blast breakers⁹ in the Churchill Falls switchyard. Asset condition monitoring identified issues with air leakage that increased the risk of outages and the replacement program originally intended to start in 2025 was advanced to be completed by 2016.</p> <p>Planned projects in the five year capital plan remain aligned with the scope of the Churchill Falls Long Term Asset Management Plan and utilize the latest data to optimize timing and cost by identifying the right work, on the right assets, at the right time. Refreshing of the five year capital plan in alignment with the Churchill Falls Long Term Asset Management Plan will occur annually.</p>
Completed planned 2012 capital investments	During 2012, Churchill Falls completed capital investments of over \$55 million. This compares to \$68 million budgeted for the year. There are several factors contributing to this variance including improved pricing

⁹ Circuit breakers protect transformers and transmission lines from overloading. The breakers operate automatically to sense excessive current and open the breaker contacts and cut off the power flow to the circuit. This protects the electrical equipment from damage caused by high currents that occur during an electrical fault.

Issue 3: Upper Churchill asset management and Power Contract adjustments (Nalcor)	
INDICATOR	2012 ACCOMPLISHMENTS
	and associated cost savings resulting from a multi-year contract strategy and value added scope changes realized as project engineering progressed.
Measure 2	
Prepared for Upper Churchill Power Contract trial	
Completed required preparations for the Upper Churchill Power Contract trial	Completed required preparations for Fall 2013 commencement date for trial. The Discovery of witnesses was completed in 2012 and all of the pre-trial documents have been filed, including an Answer to the Defence filed by CF(L)Co in August of 2012 and the filing of the final expert reports by the parties. As well, the parties have each filed a Certificate of Readiness for Trial.

The objective, measures and indicators outlined for 2013 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 3: Upper Churchill asset management and Power Contract adjustments (Nalcor)	
Objective	
By December 31, 2013, Nalcor will have completed planned 2013 capital investments to support long-term asset reliability and began Upper Churchill Power Contract trial scheduled for fall 2013.	
Measure	Completed planned capital investments
Indicators	<ul style="list-style-type: none"> ▪ Refreshed five-year capital plan as required. ▪ Completed planned 2013 capital investments.
Measure	Prepared for Upper Churchill Power Contract trial
Indicator	<ul style="list-style-type: none"> ▪ Completed required preparations for the Upper Churchill Power Contract trial and began trial scheduled for fall 2013.

Issue 4: Oil and gas interests, exploration and development (Nalcor)

The mandate of Nalcor, established under the *Energy Corporation Act (2008)* includes exploring for, developing, producing, refining, marketing and transporting hydrocarbons and products from hydrocarbons. These activities support fulfillment of the strategic direction of the Minister of Natural Resources related to increased exploration and development of energy resources and the focus areas of acquisition and promotion of geoscience data and increased exploration and development.

Nalcor's subsidiary, Nalcor Energy-Oil and Gas, currently manages oil and gas interests in three developments offshore Newfoundland and Labrador. These ownership positions provide significant economic value to Nalcor and also provide the company with knowledge and information to help ensure better alignment between the provincial interest and the partners in the various projects.

The company holds a five per cent working interest in the White Rose Growth project, which includes the North Amethyst Field, West White Rose, and South White Rose Extension. The company also has a 10 per cent working interest in the Hibernia South Extension Unit subsea tie-back project. In addition to its working interest in the project, Nalcor has also acquired a significant amount of high-quality geoscience data for the entire Hibernia field that will be useful in identifying possible future expansion. Nalcor is also a partner in the Hebron oil field, holding a 4.9 per cent working interest in the province's fourth offshore oil project. In 2012, Nalcor and its partner companies approved project sanction for the Hebron project.

Beyond investments in existing developments, Nalcor is advancing exploration opportunities in Newfoundland and Labrador's offshore. Oil and gas exploration represents the initial stage of the petroleum value chain that, when successful, can lead to significant discoveries and new developments. To date, the amount of geoscientific data collected and the number of exploratory wells drilled in offshore Newfoundland and Labrador are significantly lower than in areas such as offshore United Kingdom or Norway. While Newfoundland and Labrador has over 20 offshore basins, the province has oil production in only the Jeanne d'Arc Basin, with the remaining basins largely underexplored or unexplored.

Nalcor has developed a multi-year exploration strategy that outlines priorities for data acquisition, including partnering arrangements and technical activities such as basin evaluations

and other research projects. In addition, Nalcor's expertise can help inform policies aimed at enhancing the province's global competitiveness and encouraging new entrants and existing exploration and production companies to explore in Newfoundland and Labrador's basins.

Nalcor Energy-Oil and Gas has been actively completing the priorities outlined in its exploration strategy over the last several years. In September 2011, Nalcor announced a partnership and strategic investment in a large-scale multi-client 2D seismic survey of offshore Newfoundland and Labrador. To date, nearly 30,000 kilometres of seismic data has been acquired, making the province's program one of the largest by area globally. The seismic data from the survey builds on data received by Nalcor from a satellite seeps study initiated in 2010 to enhance understanding of the petroleum potential in a number of basins. The Nalcor investment in the seismic survey and the satellite seeps study was funded in part through the provincial government's Offshore Geoscience Data Program. Seismic data is critical to early stage exploration and is the primary data used in exploration drilling decisions. In addition to Nalcor receiving the survey data, the new data will also be available to oil companies around the world with the goal of increasing exploration interest and activity in Newfoundland and Labrador's underexplored offshore.

In early 2013, Nalcor announced the discovery of three newly defined basins in the Labrador Sea. In addition to the new basins, a fourth previously established basin was discovered to be much larger than previously understood. The redefined Hawke basin and the new Henley, Chidley and Holton basins, named for nearby place names in Labrador, more than double the basin area offshore Labrador. The structures being imaged in the new basins has led to an increase in the industry interest in the new data and Nalcor anticipates data licensing to exploration companies will occur over the next year.

In addition to the exploration activities noted, Nalcor has also provided its expertise to support efforts to ensure the province is an attractive location for exploration activity. During 2011, the company developed a position paper on the federal *Coasting Trade Act*¹⁰ and presented it to key provincial and federal officials. The paper outlined Nalcor's position that seismic data acquisition in Canada has been adversely impacted by objections launched under the *Coasting Trade Act*. In July 2012, the Act was amended to be more favourable to exploration. During

¹⁰ The Act is intended to support domestic marine interests by reserving the coasting trade of Canada to Canadian registered ships, with limited exemptions. The legislation provides an administrative process to temporarily import a foreign vessel under a coasting trade licence when a suitable Canadian registered vessel is not available.

2012, Nalcor also completed additional analysis of other policy issues, including land tenure and access to infrastructure, and completed international benchmarking studies on these issues.

Over the planning period, Nalcor will continue to exercise its rights under joint venture agreements to pursue issues of interest to Nalcor and the province and to establish work plans and budgets that maximize resource recovery and preserve key project milestones. Nalcor will also work to continually refresh its exploration strategy and complete priority initiatives.

Issue 4: Oil and gas interests, exploration and development (Nalcor)	
Goal By December 31, 2013, Nalcor Energy-Oil and Gas, will have maximized opportunities for oil and gas development and exploration.	
Measure	Maximized oil and gas development and exploration opportunities
Indicators	<ul style="list-style-type: none"> ▪ Managed offshore interests ▪ Advanced efforts to support exploration activity
Objective 1 By December 31, 2012, Nalcor Energy-Oil and Gas will have worked with its partners to advance project milestones, including the Hebron development plan process, and progressed seismic data and analysis activities.	
Measure Promoted work plans and budgets and further advanced exploration strategy	
INDICATORS	2012 ACCOMPLISHMENTS
<p>Worked with partners in the three offshore developments that Nalcor holds working interest to support achievement of key project milestones:</p> <ul style="list-style-type: none"> ▪ West White Rose (North Amethyst Hibernia) development plan review and approval ▪ Hebron – first oil currently targeted for 2017. ▪ Hibernia Southern Extension – advanced planned fabrication and construction activities. 	<p>Worked with partners in the three offshore oil developments that Nalcor holds working interests in to support achievement of key project milestones as planned in 2012:</p> <ul style="list-style-type: none"> ▪ White Rose: Development plan amendments (DPA)¹¹ for both the North Amethyst (Hibernia reservoir) and South White Rose Extension were submitted to the C-NLOPB for review and approval during 2012. At year-end, the C-NLOPB completeness review process was ongoing. ▪ Hebron project – Development plan approval received and project sanctioned in 2012, first oil currently targeted for 2017. ▪ Hibernia Southern Extension – completed planned fabrication and construction activities including completion of the excavated drill centre.

¹¹ A development plan details the approach that a particular company (operator), on behalf of its partners, proposes for the development of a particular pool or field which contains oil and/or gas resources.

Issue 4: Oil and gas interests, exploration and development (Nalcor)	
<p>Completed planned 2012 activities outlined in the multi-year exploration strategy, including completing Phase I of the offshore seismic survey and ranking of Newfoundland and Labrador basins to evaluate future exploration opportunities.</p>	<p>Completed planned activities outlined in the multi-year exploration strategy including:</p> <ul style="list-style-type: none"> ▪ Successfully completed original scope of Phase I of offshore seismic survey with collection of remaining 11,400 kilometres of two-year 22,000 kilometre seismic data acquisition program offshore Labrador. ▪ Initiated an expansion of the Phase I seismic survey (covering the Labrador Sea) to the south east to extend over the Orphan Basin to the Flemish Pass and acquired initial 7,500 kilometres of data. ▪ Completed ranking of all Newfoundland and Labrador basins based on prospectivity and knowledge level. This information will be used to plan future exploration activities to close identified knowledge gaps and facilitate new industry exploration. ▪ Discovered three new basins offshore Labrador.

The objective, measure and indicators outlined for 2013 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 4: Oil and gas interests, exploration and development (Nalcor)	
<p>Objective 1 By December 31, 2013, Nalcor Energy-Oil and Gas will have worked with its partners to advance project milestones, including the Hebron construction process, and progressed seismic data acquisition and analysis activities.</p>	
<p>Measure</p>	<p>Promoted work plans and budgets and further advanced exploration strategy</p>
<p>Indicators</p>	<ul style="list-style-type: none"> ▪ Worked with partners in the three offshore developments that Nalcor holds working interest to support achievement of key project milestones: <ul style="list-style-type: none"> ▪ White Rose – Determination of concept for field extension. ▪ Hebron project – Advanced detailed engineering and began GBS and topsides construction. ▪ Hibernia Southern Extension – Subsea equipment Installation. ▪ Completed planned 2013 activities outlined in the multi-year exploration strategy: data acquisition including completion of the north-east Newfoundland slope 2012-2013 regional seismic program, data assessment including continuation of basin analysis activities for offshore Labrador and north-east Newfoundland slope, and exploration policy support to attract and accelerate global exploration investment in Newfoundland and Labrador.

Issue 5: Lower Churchill development (Nalcor)

The lower Churchill River is one of the most attractive undeveloped hydroelectric sites in North America and is a key component of the province's energy warehouse. The Lower Churchill development's two proposed installations at Muskrat Falls and Gull Island will have a combined capacity of over 3,000 MW.

Phase One of the Lower Churchill development includes an 824 MW hydroelectric generating facility at Muskrat Falls, over 1,500 kilometres of associated transmission lines in Newfoundland and Labrador and the Maritime Link between the island of Newfoundland and Cape Breton, Nova Scotia. Phase Two of the Lower Churchill development includes the Gull Island generating facility and associated transmission.

The development of the Muskrat Falls Project will provide a clean, renewable source of electricity to meet the province's growing energy demands. It will provide Newfoundland and Labrador homes and businesses with stable electricity rates well into the future, and will be a valuable power-producing asset for the province for more than 100 years.

With the sanction of the Muskrat Falls Project by the Government of Newfoundland and Labrador in late 2012, procurement and employment benefits from the project are already being realized across the province. Construction is underway and will take approximately five years to complete.

The Muskrat Falls Project will meet the province's energy needs, provide electricity for future developments and promote jobs and benefits for the people of Newfoundland and Labrador. In addition to providing long-term stable electricity rates, the development will help Canada's efforts to reduce greenhouse gas emissions.

This development will also generate economic benefits in every corner of the province, including \$1.9 billion in income to labour and business, with approximately \$500 million of this to be earned by Labradorians and Labrador-based businesses. The provincial economy will also benefit from employment associated with building the Muskrat Falls Hydroelectric Generating facility and the transmission links, with 9,100 person-years of direct employment, including 5,800 person-years in Labrador.

The Lower Churchill development plays a key role in supporting the fulfillment of several strategic directions of the Minister of Natural Resources. The development of clean, renewable energy through the Lower Churchill Project and activities to support social license through adequate stakeholder consultation are focus areas of the Minister's strategic direction related to responsible resource development. As well, increased participation in energy developments supports the outcome of ensuring maximum benefits to the province through the strategic development of the province's resources, while providing a stable and competitive energy supply for domestic use and export to markets are key attributes of this development.

Aboriginal Affairs

Following execution and ratification of the Tshash Petapen (New Dawn) Agreement¹², Nalcor commenced implementation of the Impact and Benefits Agreement (IBA) with the Innu Nation. A key event was the formation of the Tshiashkueish committee which is overseeing the implementation of the IBA. This committee continues to meet on a regular basis. Another oversight committee that has been active over 2012 and critical to the IBA is the joint Nalcor-Innu Nation Environmental Management Committee.

Environmental Assessment

Environmental Assessment is a regulatory review and planning process administered by the federal and provincial governments for identifying the potential environmental and socioeconomic effects of proposed development projects and to inform project planning and decision making.

Nalcor received release from the environmental assessment for the Lower Churchill Hydroelectric Generation Project from the governments of Newfoundland and Labrador and Canada on March 15, 2012. Nalcor is incorporating the terms and conditions outlined in the governments' responses into the Muskrat Falls Hydroelectric Generating Project design and planning work.

In April, Nalcor submitted the required Environmental Impact Statement (EIS) for the Labrador-Island Transmission Link environmental assessment. Nalcor's submission of the EIS is an important part of the environmental assessment process for the Labrador-Island Transmission

¹² The Tshash Petapen (New Dawn) Agreement includes three elements: the Upper Churchill Redress Agreement, the land claims agreement-in-principle and the Lower Churchill Impacts and Benefits Agreement (IBA).

Link. Prior to the submission of the EIS, Nalcor completed significant analysis of the likely environmental effects of the transmission line and Strait of Belle Isle crossing which was incorporated into the EIS prior to submitting it to the provincial and federal governments; Nalcor anticipates a response in 2013.

Engineering, Procurement and Construction

Following a competitive selection process, Nalcor engaged SNC-Lavalin as the engineering, procurement and construction management (EPCM) consultant for the Muskrat Falls generating facility and the Labrador-Island Transmission Link. By the end of 2012, detailed engineering had progressed with more than 50 per cent of the detailed engineering for the Muskrat Falls Project completed.

In late April 2012, Nalcor announced the award of several contracts for early works at the Muskrat Falls Hydroelectric Generating facility site. Between June and December, Nalcor advanced site construction early works to ensure the construction site was ready upon sanction of the project.

Market Access/Commercial Arrangements

Access to both domestic and export markets is essential to realizing the full economic and environmental benefits of the Lower Churchill development. In Newfoundland and Labrador, Hydro is mandated to forecast electricity requirements and evaluate alternate generation sources to identify the least-cost, long-term option for meeting electricity requirements. Through its detailed decision gate 3 analyses completed in 2012, Nalcor confirmed the Muskrat Falls Project, with a transmission link between Labrador and the island, to be the lowest-cost alternative to meet the province's growing need for electricity. This analysis was validated through external review. The Provincial Government sanctioned the Muskrat Falls Project in December 2012.

Nalcor's partnership with Emera Inc. to construct the Maritime Link will help leverage financial opportunities for export sales of surplus electricity. In July 2012, Nalcor and Emera Inc. signed formal agreements for the development and transmission of hydroelectric power from Muskrat Falls. The Maritime Link will allow Nalcor to access the Maritime and New England markets thereby gaining a fair and competitive price for clean, renewable power that is not required to meet the domestic energy needs. It will also facilitate the development of the province's energy warehouse. A critical element of the Muskrat Falls Project is the strategic partnerships with industry and

government. The completion of the federal loan guarantee in 2012 was an important negotiation with the Government of Canada. The loan guarantee is a significant economic investment in the province and Atlantic Canada, and will result in lower project costs through reduced interest rates. This in turn, will lower electricity prices for consumers.

In addition to efforts to develop the Maritime Link for the Muskrat Falls development, Nalcor has also worked to advance market access via the Hydro-Québec transmission system for Phase Two Gull Island. A legal case for a judicial review was initiated in 2011 following regulatory decisions made by the Régie de l'énergie in relation to a dispute with Hydro-Québec regarding a Lower Churchill Project transmission service request. During 2012, legal work was undertaken to complete all necessary court filings and prepare for the Quebec Superior Court hearing scheduled for January 2013. In addition, Nalcor continues its monitoring, assessment and engagement in electricity markets for market opportunities for the development of Gull Island.

Issue 5: Lower Churchill development (Nalcor)	
Goal By December 31, 2013, Nalcor will have progressed milestones to advance the sanction decisions for Lower Churchill development Phase One projects (Muskrat Falls, Labrador-Island Transmission Link, Maritime Link) and advanced Phase Two (Gull Island) of the development.	
Measure	Progressed Phase One and Phase Two milestones
Indicator	<ul style="list-style-type: none"> ▪ Advanced sanction decisions for projects ▪ Completed approved engineering, procurement and construction activities for each project ▪ Advanced activities to secure transmission access to external electricity markets for Gull Island power
Objective By December 31, 2012, Nalcor will have continued to advance the Lower Churchill Development Phase One and will have progressed efforts to secure additional access to electricity markets outside Newfoundland and Labrador for Phase Two (Gull Island) power.	
Measure Completed required activities to support gate 3 decisions for the Muskrat Falls (Phase One Generation Project), Labrador-Island Transmission Link Project, and Maritime Link Project and related to market access for Phase Two.	
INDICATORS	2012 ACCOMPLISHMENTS
Adhered to the terms and conditions outlined by the federal and provincial governments for the Environmental Assessment	Nalcor received release from the environmental assessment for the Lower Churchill Hydroelectric Generation Project from the governments of Newfoundland and Labrador and Canada on March 15, 2012. The terms and conditions outlined are being

Issue 5: Lower Churchill development (Nalcor)	
release of the Lower Churchill Hydroelectric Generation Project	incorporated into the project design and planning work. Appropriate Environmental Monitoring Systems were implemented in 2012 and all necessary permits were acquired to allow site activities to proceed according to plan.
Filed Environmental Impact Statement (EIS) for the Labrador-Island Transmission Link	<p>On April 9, 2012, Nalcor submitted the required EIS for the Labrador-Island Transmission Link environmental assessment to the governments of Newfoundland and Labrador and Canada.</p> <p>The environmental assessment process emphasizes consultation with public, stakeholder and aboriginal groups and the EIS reflected consultation input and included significant analysis of the likely environmental effects of the transmission line and Strait of Belle Isle crossing. Nalcor submitted necessary component studies to Governments and answered Information Requests related to project planning; an addendum to the EIS was submitted on December 10, 2012.</p>
Began executing the Lower Churchill Impacts and Benefits Agreement (IBA) with the Innu Nation of Labrador, as appropriate	Nalcor commenced implementation of the IBA with the Innu Nation. A key event was the formation of the Tshiashkueish committee which will oversee the implementation of the IBA. The committee has been meeting on a regular basis. The joint Nalcor-Innu Nation Environmental Management Committee has also been active. Other key milestones include the commencement of implementation funding payments and the award of Innu-preferred contracts.
Completed the conversion of the Nalcor-Emera term sheet into formal legal agreements	<p>The conversion of the term sheet into formal legal agreements was completed and on July 31, 2012, Nalcor and Emera signed formal agreements for the development and transmission of hydroelectric power from Muskrat Falls.</p> <p>On December 17, 2012, the sanction of the Muskrat Falls development was announced.</p>
Completed planned engineering activities for the Muskrat Falls Generating Project, the Labrador-Island Transmission Link, and the Maritime Link	<p>During 2012, planned engineering activities for the Muskrat Falls Generating Project, the Labrador-Island Transmission Link and the Maritime Link were completed.</p> <p>Key accomplishments include:</p> <ul style="list-style-type: none"> ▪ Completed in excess of 50 per cent of project engineering. ▪ Completed Strait of Belle Isle horizontal direct drilling pilot bore program.

Issue 5: Lower Churchill development (Nalcor)	
	<ul style="list-style-type: none"> Prepared, evaluated and awarded numerous procurement packages including Strait of Bell Isle cable, tower steel and turbine and generator sets and progressed other procurement packages as planned.
Identified and progressed next steps to secure non-discriminatory transmission service from Hydro-Québec TransÉnergie, as appropriate.	A legal case for a judicial review was initiated in 2011 in relation to a dispute with Hydro-Québec regarding a Lower Churchill Project transmission service request. During 2012, Nalcor completed all filings for the Superior court judicial review and preparations for the 2013 hearing.

The objective, measure and indicators outlined for 2013 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 5: Lower Churchill development (Nalcor)	
<p>Objective</p> <p>By December 31, 2013, Nalcor will have further advanced the Lower Churchill development Phase One and will have continued efforts to secure additional access to electricity markets outside Newfoundland and Labrador for Phase Two (Gull Island) power.</p>	
Measure	Completed planned activities to advance Lower Churchill development Phase One (Muskrat Falls generating facility, Labrador-Island Transmission Link, Maritime Link) and progressed to market access for Phase Two.
Indicators	<p>Lower Churchill Development Phase One</p> <ul style="list-style-type: none"> Completed planned engineering/procurement activities in accordance with the project construction schedule. Continued to adhere to the terms and conditions outlined by the federal and provincial governments in the Environmental Assessment release of the Lower Churchill Hydroelectric Generation Project. Continued implementation and monitoring of all IBA commitments, including regular meetings of the Tshiashkueish committee. <p>Lower Churchill Development Phase Two</p> <ul style="list-style-type: none"> Participated in Québec Superior court judicial review hearing and as appropriate, identified appropriate course of action following court decision. Advanced planned market assessment and engagement activities.

Issue 6: Bull Arm Fabrication site lease management and long-term strategy (Nalcor)

The Bull Arm Fabrication site is an important asset for industrial development in Newfoundland and Labrador and the advancement of the province’s fabrication capability. Bull Arm has capabilities for steel fabrication and concrete construction, outfitting installation, at-shore hook-up and deep water commissioning. The site has facilitated the advancement of the province’s fabrication capability through participation in the Hibernia, Terra Nova and White Rose oil projects. The Bull Arm Fabrication site supports fulfillment of the strategic direction of the Minister of Natural Resources related to ensuring maximum benefits to the province through the strategic development of our resources. More specifically, the site accommodates the focus area related to supporting increased local industrial and employment benefits.

The Bull Arm site is now leased to ExxonMobil Canada Properties for the construction and fabrication of the Hebron project. During 2012, the early works phase of the project began at the site in preparation for the construction of the gravity based structure and the living quarters module. Since the execution of the site lease, more than \$17 million in site upgrades and refurbishments by the tenant have been approved by Nalcor.

Nalcor is focused on utilization of the Bull Arm site during the short to medium-term for the Hebron project, while planning for a competitive operation with a sustained workforce in the long-term. In addition to obtaining value from the site during the lease period, Nalcor will also align its long-term strategy for Bull Arm to facilitate a seamless transition to other site operations at the conclusion of the Hebron project construction. The strategy is intended to position the site to maximize the benefits to the province from construction and fabrication projects in Newfoundland and Labrador and from around the world. In 2012, Nalcor conducted stakeholder engagement sessions to support the development of the long-term strategy. As well, the company developed a preliminary 20-year capital plan for the site to inform post-Hebron project investment priorities.

Issue 6: Bull Arm Fabrication site lease management and long-term strategy (Nalcor)

Goal 1

By December 31, 2013, Nalcor will have progressed milestones toward a competitive, successful fabrication site.

Measure	Progressed milestones
Indicators	<ul style="list-style-type: none"> ▪ Advanced the long-term strategy

Issue 6: Bull Arm Fabrication site lease management and long-term strategy (Nalcor)	
	<ul style="list-style-type: none"> ▪ Executed lease and implemented lease monitoring activities
<p>Objective By December 31, 2012, Nalcor will have continued to advance engagement and research activities to inform long-term planning, and monitored the key lease provisions and acted on issues and opportunities.</p>	
INDICATORS	2012 ACCOMPLISHMENTS
<p>Measure 1 Gathered additional information to inform long-term strategy for Bull Arm Fabrication site</p>	
Completed planned engagement activities outlined in the multi-year engagement strategy	During 2012, Nalcor completed planned engagement sessions with internal, government and industry stakeholders. These early phases of engagement were intended to build knowledge, create alignment and inform the long-term strategy for the Bull Arm Fabrication Site. The sessions were outlined in the multi-year engagement strategy approved in 2011 that identified key stakeholders and consultation activities.
Completed additional secondary research to support identification and analysis of alternate business models for the Bull Arm Fabrication site	Secondary research to investigate the business models in place at various fabrication yards throughout the world was completed as planned during 2012. This information will support the identification and analysis of alternate business models for the Bull Arm Fabrication site as part of the long-term strategy.
<p>Measure 2 Continued lease monitoring activities</p>	
Continued management of change process for approval and monitoring of all site infrastructure modifications	Nalcor's management of change process for the Bull Arm Fabrication site governs all upgrades and modifications to site infrastructure. In 2012, Nalcor continued the management of change process and reviewed and approved 277 change requests submitted by the tenant. These requests include more than \$17 million in site improvements to be made by the tenant.
Participated in tenant safety and environment meetings and shared information regarding investigations of incidents and high-potential near misses	During 2012, Nalcor participated in monthly safety and environment meetings with the tenant. These meetings focused on site safety and environmental performance and provided an opportunity for both Nalcor and the tenant to discuss incident investigations, high-potential near misses as well as safety coaching and communications programs.
Completed planned reviews and implementation of the key elements of Nalcor's	During 2012, Nalcor completed planned reviews and implementation of key environmental initiatives. The company updated and tested the Bull Arm Emergency

Issue 6: Bull Arm Fabrication site lease management and long-term strategy (Nalcor)	
environmental emergency response plan and environmental management framework	Response Plan, which includes response to an environmental emergency. Also during the year, Nalcor implemented the environmental management framework which provides operational direction regarding oversight of the environmental terms of the lease.

The objective, measures and indicators outlined for 2013 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 6: Bull Arm Fabrication Site lease management and long-term strategy (Nalcor)	
Objective By December 31, 2013, Nalcor will have advanced engagement activities and completed preliminary evaluation of alternate business models to inform long-term strategy, and monitored the key lease provisions and acted on issues and opportunities.	
Measure	Advanced engagement and evaluation activities to inform long-term strategy for Bull Arm Fabrication site
Indicators	<ul style="list-style-type: none"> ▪ Completed planned 2013 engagement activities outlined in the multi-year engagement strategy. ▪ Completed preliminary evaluation of alternate business models for the Bull Arm Fabrication site.
Measure	Continued lease monitoring activities
Indicators	<ul style="list-style-type: none"> ▪ Continued management of change process for approval and monitoring of all site infrastructure modifications. ▪ Continued participation in tenant safety and environment meetings to share Nalcor and tenant lessons learned and best practices. ▪ Completed planned review and update of Nalcor's emergency response plan and completed development of procedures to support environmental management framework.

Issue 7: Energy marketing portfolio management and long-term strategy (Nalcor)

In 2009, Nalcor established an energy marketing team to sell energy from existing and future developments and build expertise as a participant in competitive energy markets in Canada and the United States. The current portfolio includes recall power that is not required by Hydro to meet demand in Labrador. Nalcor’s energy marketing activities support fulfillment of the strategic direction of the Minister of Natural Resources related to energy supply and more specifically the focus area related to the export of surplus energy.

In March 2009, Nalcor, through its subsidiary, Hydro, signed a Transmission Service Agreement with Hydro-Québec TransÉnergie (HQT) under HQT’s Open Access Transmission Tariff. The agreement is for long-term power transmission capacity from Labrador through Quebec to the New York border with the ability to transmit electricity to other markets. Under this arrangement power is sold on the Canadian side of the border to a third-party energy marketer, and directly into Atlantic Canada.

During 2012, Nalcor continued to develop its energy marketing capability and successfully pursued opportunities to increase the value of its current energy portfolio. This portfolio will continue to grow over the coming years with the development of the lower Churchill River hydroelectric resource and increased production from Nalcor Energy-Oil and Gas’ offshore interests. Nalcor also completed planned activities to grow and develop the energy marketing organization and policy and procedures to position the company to extract value from an even larger energy portfolio.

Issue 7: Energy marketing portfolio management and long-term strategy (Nalcor)

Goal

By December 31, 2013, Nalcor will have enhanced its energy marketing capability.

Measure

Enhanced energy marketing capability

Indicators

- Completed planned implementation activities for long-term energy marketing operations.
- Increased value of current energy marketing portfolio.

Objective

By December 31, 2012, Nalcor will have continued to advance its long-term implementation plan for energy marketing operations and pursued opportunities to increase the value of the current portfolio.

INDICATORS	2012 ACCOMPLISHMENTS
Measure 1	
Completed planned implementation activities for long-term energy marketing operations.	
Completed planned 2012 activities outlined in the long-term implementation plan for energy marketing operations.	In 2011, a long-term implementation plan for energy marketing operations was developed and approved. This plan outlined risk management, regulatory and organizational activities for energy marketing operations. During 2012, Nalcor completed planned activities including the creation of an Energy Marketing division dedicated to energy trading activities. Also during 2012, Nalcor completed an Energy Marketing Operations Manual that outlines policies and procedures governing energy trading activities to effectively manage operational risk.
Measure 2	
Pursued opportunities to increase portfolio value	
Identified and implemented measures to increase portfolio value.	<p>During 2012, Nalcor identified and implemented measures to increase the value of its energy portfolio by delivering energy to the market during times of higher prices. Specifically, the company implemented an approach to enhance energy supply flexibility that provides Nalcor with the ability to supply greater volumes of energy to markets during periods of higher pricing rather than delivering it during lower priced periods. Also, Nalcor took steps to mitigate transmission congestion risk in New York thereby achieving high overall prices for the energy that it delivers to the New York market.</p> <p>As a result of these measures, Nalcor achieved revenues 52 per cent, or slightly more than \$6 million, above the market benchmark.</p>

The objective, measures and indicators outlined for 2013 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 7: Energy marketing portfolio management and long-term strategy (Nalcor)	
Objective	
By December 31, 2013, Nalcor will have further advanced its long-term implementation plan for energy marketing operations and pursued opportunities to increase the value of the current portfolio.	
Measure	Completed planned implementation activities for long-term energy marketing operations

Indicators	▪ Completed planned 2013 activities outlined in the long-term implementation plan for energy marketing operations.
Measure	Pursued opportunities to increase portfolio value
Indicators	▪ Implemented measures to increase portfolio value.

12 OPPORTUNITIES AND CHALLENGES

Implementing the remaining portion of the 2011-2013 Strategic Plan will require that Nalcor and Hydro build on accomplishments of the past and address future challenges and opportunities. Key challenges and opportunities are summarized below.

Safety Leadership

Nalcor's relentless commitment to safety drives all its lines of business. Achieving excellence in safety is Nalcor's number one priority and safety is also a shared core value. For Nalcor and Hydro, safety excellence is more than a way of operating; it is an integral part of the companies' strategy for the future. In 2013, Nalcor and Hydro will continue to address the challenge of being a safety leader and will strengthen and promote safety initiatives aimed at enhancing the safety of employees, contractors and the public.

Electricity Supply

Nalcor's subsidiary, Hydro, ensures there is a safe, reliable and cost-effective electricity supply available to meet current demand and future growth. During 2013, Hydro will finalize arrangements to secure the energy required from Muskrat Falls for use in the province, enhance asset management and implement programs to support environmental sustainability. Hydro will also complete required asset investments including refurbishment of a generating unit (Unit One) at the Holyrood Generating Station that was damaged during a severe winter storm on January 11, 2013.

Upper Churchill

The Churchill Falls power station is a world class facility and one of the largest underground power stations in the world. The generating plant and related infrastructure are now beyond 40 years in service and for the balance of the planning period, Churchill Falls will address this challenge and refresh its five year capital plan as required and complete planned asset investments. As well, CF(L)Co will complete preparations for the Upper Churchill Power Contract trial scheduled to commence in fall 2013.¹³

¹³ A power contract with Hydro-Québec dated May 12, 1969, provides for the sale of the majority of the energy from the Churchill Falls facility to Hydro-Québec. Presently the purchase price under the Power Contract is one-quarter of one cent per kilowatt hour and the automatic renewal clause fixes the purchase price at one-fifth of one cent for a 25 year period beginning in 2016. This will mean, for the remainder of the Contract, power will be sold to Hydro-Québec for less than five per cent of its recent commercial value.

In 2009, CF(L)Co formally requested that Hydro-Québec enter into discussions to amend the pricing terms for the remainder of the 1969 Power Contract. Hydro-Québec did not respond and therefore, in early 2010 CF(L)Co filed

Oil and Gas Interests, Exploration and Development

Nalcor's subsidiary, Nalcor Energy-Oil and Gas, currently manages oil and gas interests in three developments offshore Newfoundland and Labrador. During 2013, Nalcor will continue to exercise its rights under joint venture agreements to pursue issues of interest to Nalcor and the province and to establish work plans and budgets that preserve key project milestones. As well, the company will continually refresh its exploration strategy and invest a portion of its revenues in exploration activities. The data and analysis resulting from these exploration activities offers the opportunity to advance our understanding of prospectivity of existing basins and unlock the prospectivity of new areas.

Lower Churchill Development

The Lower Churchill development includes two generating facilities, Muskrat Falls and Gull Island, which can provide 16.7 terawatt hours of electricity per year. This energy can supply power to hundreds of thousands of households annually and contribute significantly to the reduction of air emissions from thermal, coal and fossil fuel power generation. During 2013, Nalcor will complete planned activities to deliver Phase One (Muskrat Falls, Labrador Transmission Assets, Labrador-Island Transmission Link and Maritime Transmission Link) of the Development. The Muskrat Falls Project provides the opportunity to achieve long-term stable rates, provide electricity for future development and promote jobs and benefits for the people of Newfoundland and Labrador.

Bull Arm Fabrication Site Lease Management and Long-term Strategy

During 2013 and until 2017, the Bull Arm Fabrication Site will be leased to ExxonMobil Canada Properties, who will use the site for Hebron project construction. As well, Nalcor will align its long-term strategy for Bull Arm to transition to other site opportunities at the conclusion of the Hebron project construction.

Energy Marketing

Nalcor's energy portfolio will continue to grow over the coming years with the development of the Lower Churchill Project and increased production from Nalcor Energy-Oil and Gas' offshore oil interests. During 2013, Nalcor will continue to advance its long-term implementation plan to grow and develop the energy marketing business.

a motion against Hydro-Québec in Québec Superior Court seeking to change, as of November 2009, the pricing terms for the remaining term of the Power Contract.

Appendix 1

Energy Portfolio



NALCOR ENERGY
NEWFOUNDLAND AND LABRADOR HYDRO

Appendix 2

Nalcor Energy Consolidated Financial Statements

NALCOR ENERGY
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
Partner, Simmons + Partners Defence

ED MARTIN
President and CEO

TOM CLIFT
Associate Professor
Memorial University - Faculty of Business Administration

KEN MARSHALL
President – Atlantic Region
Rogers Communications Inc.

GERALD SHORTALL
Chartered Accountant
Corporate Director

OFFICERS

TERRANCE STYLES
Chairperson

ED MARTIN
President and Chief Executive Officer

DERRICK STURGE
Vice President, Finance and Chief Financial Officer

CHRIS KIELEY
Vice President, Strategic Planning
and Business Development

JIM KEATING
Vice President, Oil and Gas

GERARD McDONALD
Vice President, Human Resources
and Organizational Effectiveness

JOHN MacISAAC
Vice President, Project Execution and Technical Services

GILBERT BENNETT
Vice President, Lower Churchill Project

DAWN DALLEY
Vice President, Corporate Relations

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary

PETER HICKMAN
Assistant Corporate Secretary

ROBERT HULL
General Manager, Commercial and Financing

S. KENT LEGGE
General Manager, Finance and Corporate Services

HEAD OFFICE

Nalcor Energy
P.O. Box 12800
Hydro Place, 500 Columbus Drive
St. John's, NL
Canada A1B 0C9

Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of Nalcor Energy, which comprise the consolidated 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 Nalcor Energy 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.

NALCOR ENERGY
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)

	Notes	2012	2011
ASSETS			
Current assets			
Cash and cash equivalents		12.1	18.7
Short-term investments		11.5	16.9
Accounts receivable		125.0	163.6
Current portion of regulatory assets	6	2.2	2.8
Inventory		62.1	63.5
Prepaid expenses		5.6	4.8
Derivative assets		0.1	0.2
		<u>218.6</u>	<u>270.5</u>
Property, plant and equipment	4	2,435.0	2,109.5
Petroleum and natural gas properties	5	376.0	304.2
Regulatory assets	6	62.8	63.6
Other long-term assets	7	354.5	294.0
		<u>3,446.9</u>	<u>3,041.8</u>
LIABILITIES			
Current liabilities			
Short-term borrowings	10	125.0	-
Accounts payable and accrued liabilities		198.1	156.1
Current portion of long-term debt	10	8.2	8.2
Current portion of regulatory liabilities	6	169.0	137.6
Current portion of deferred credits	9	7.2	11.3
Current portion of asset retirement obligations	11	1.4	-
Derivative liabilities		-	0.2
		<u>508.9</u>	<u>313.4</u>
Long-term debt	10	1,125.9	1,131.5
Regulatory liabilities	6	33.2	33.3
Asset retirement obligations	11	30.0	24.8
Deferred credits	9	28.0	-
Long-term payables	12	82.4	42.7
Employee future benefits	13	73.6	66.4
		<u>1,882.0</u>	<u>1,612.1</u>
SHAREHOLDER'S EQUITY			
Share capital	14	122.5	122.5
Contributed capital	14	435.8	390.5
		<u>558.3</u>	<u>513.0</u>
Accumulated other comprehensive income	14	43.6	46.4
Retained earnings		963.0	870.3
		<u>1,006.6</u>	<u>916.7</u>
		<u>1,564.9</u>	<u>1,429.7</u>
		<u>3,446.9</u>	<u>3,041.8</u>

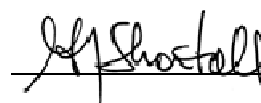
Commitments and contingencies (Note 22)
Subsequent events (Note 24)

See accompanying notes

On behalf of the Board:



DIRECTOR



DIRECTOR

NALCOR ENERGY
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

<i>For the year ended December 31 (millions of dollars)</i>	Notes	2012	2011
Revenue			
Energy sales	15	710.4	700.0
Other revenue	15	<u>15.7</u>	<u>14.1</u>
		<u>726.1</u>	<u>714.1</u>
Expenses			
Fuels		182.4	154.9
Power purchased		60.8	52.9
Operating costs	16	206.9	200.1
Net finance expense	19	73.6	70.9
Amortization and depletion		79.3	85.2
Other income and expense		0.4	(2.8)
Regulatory adjustments	6	<u>30.0</u>	<u>24.1</u>
		<u>633.4</u>	<u>585.3</u>
Net income		92.7	128.8
Retained earnings at beginning of year		<u>870.3</u>	<u>741.5</u>
Retained earnings at end of year		<u>963.0</u>	<u>870.3</u>

See accompanying notes

NALCOR ENERGY
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

<i>For the year ended December 31 (millions of dollars)</i>	Notes	2012	2011
Net income		92.7	128.8
Other comprehensive (loss) income	14	<u>(2.8)</u>	<u>19.1</u>
Comprehensive income		<u>89.9</u>	<u>147.9</u>

See accompanying notes

NALCOR ENERGY
CONSOLIDATED STATEMENT OF CASH FLOWS

<i>For the year ended December 31 (millions of dollars)</i>	Notes	2012	2011
Cash provided by (used in)			
Operating activities			
Net income		92.7	128.8
Adjusted for items not involving a cash flow			
Amortization and depletion		79.3	85.2
Accretion		2.7	0.5
Increase in employee future benefits		7.2	6.0
Loss (gain) on disposal of property, plant and equipment		3.6	(1.9)
Other		0.4	0.6
		<u>185.9</u>	<u>219.2</u>
Changes in non-cash working capital balances	20	<u>113.9</u>	<u>(52.2)</u>
		<u>299.8</u>	<u>167.0</u>
Financing activities			
Increase in contributed capital		45.3	16.4
Increase in deferred credits		23.9	8.7
Increase in short-term borrowings		125.0	-
Increase in long-term payables		37.5	38.1
		<u>231.7</u>	<u>63.2</u>
Investing activities			
Additions to property, plant and equipment		(389.1)	(190.7)
Additions to petroleum and natural gas properties		(88.3)	(63.2)
Increase in other long-term assets		(69.6)	(5.7)
Decrease (increase) in short-term investments		5.4	(1.2)
Proceeds on disposal of property, plant and equipment		3.5	4.8
		<u>(538.1)</u>	<u>(256.0)</u>
Net decrease in cash		<u>(6.6)</u>	<u>(25.8)</u>
Cash position at beginning of year		<u>18.7</u>	<u>44.5</u>
Cash position at end of year		<u>12.1</u>	<u>18.7</u>
Cash position is represented by			
Cash		12.1	18.7
Cash equivalents		-	-
		<u>12.1</u>	<u>18.7</u>

Supplementary cash flow information (Note 20)

See accompanying notes

NALCOR ENERGY
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 (the Province) as a Crown corporation and its business includes the development, generation and sale of electricity, oil and gas, industrial fabrication and energy marketing. Nalcor's head office is located in St. John's, Newfoundland and Labrador.

1.1 Subsidiaries

Nalcor holds interests in the following subsidiaries:

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 operations include both regulated and non-regulated activities.

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.

In 2012, Nalcor created new subsidiaries as part of advancing the Muskrat Falls Project. The new subsidiaries are associated with the development, construction, financing and operation of the Labrador-Island Link and include the Labrador-Island Link General Partner Corporation (LIL GP) and the Labrador-Island Link Holding Corporation (LIL Holdco). Nalcor also created the Labrador-Island Link Partnership (LIL Partnership) in accordance with the Labrador-Island Link Limited Partnership Agreement to develop the Labrador-Island link. LIL Holdco holds 100% of the Class A Units.

Nalcor also has two inactive subsidiaries, Gull Island Power Corporation (GIPCo) and Lower Churchill Development Corporation (LCDC).

1.2 Jointly Controlled Entities

Nalcor holds interests in the following jointly controlled entities:

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). Nalcor owns 65.8% of Churchill Falls.

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. Churchill Falls owns 33.33% of Twin Falls.

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.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 Nalcor and its subsidiary companies: Hydro (100% owned), Oil and Gas (100% owned), Bull Arm Fabrication (100% owned), LIL GP (100% owned), LIL Holdco (100% owned), LIL Partnership (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-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.

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.

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 and depletion, property, plant and equipment, the valuation of oil and gas reserves and related depletion 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

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 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 Consolidated Financial Statements are disclosed in Note 6.

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 12 months are classified as short-term investments. The short-term investments bear interest rates of 1.26% to 1.35% (2011 - 0.74% to 1.24%) per annum. Cash and cash equivalents and short-term investments are measured at fair value.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

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.

Nalcor, Oil and Gas and Bull Arm Fabrication

Amortization is calculated on a straight-line basis over service lives ranging from four to 30 years.

Hydro

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:

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

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

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

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

Hydro (cont'd.)

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 calculated 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 following estimated useful lives:

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.

2.9 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.

2.10 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.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.11 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 at fair value, with a corresponding increase to property, plant and equipment. Accretion of asset retirement obligations is included in net income through Amortization and depletion. Differences between the recorded asset retirement obligation and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

2.12 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 is amortized over the expected average remaining service life of the employee group.

2.13 Revenue Recognition

Electricity Sales

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 dated May 12, 1969 (the Power Contract) 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 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 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%).

Oil Sales

Revenue from the sale of crude oil is recognized under the accrual method when the significant risks and rewards of ownership have passed and collection is reasonably assured. The transfer of risks and rewards is considered to have occurred when title to the product passes to the customer.

Revenue from properties in which Oil and Gas has an interest with other producers is recognized on the basis of the net working interest using the entitlement method. Under this method, crude oil produced and sold below or above the Oil and Gas' net working interest results in an underlift or overlift position. Underlift or overlift positions are measured at market value and recorded as an asset or liability respectively.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.13 Revenue Recognition (cont'd.)

Lease Revenue

Lease revenue is recognized when services have been rendered; recovery of the consideration is probable; and the amount of revenue can be reliably estimated.

2.14 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.

2.15 Financial Instruments and Hedging Activities

Financial Instruments

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
Derivatives	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
Short-term borrowings	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Long-term debt	Other liabilities
Long-term payables	Other liabilities

Each of these financial instruments is measured at amortized cost, except for cash and cash equivalents, short-term investments, sinking funds – other investments, reserve fund, short-term borrowings, 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.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.15 Financial Instruments and Hedging Activities (cont'd.)

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 had no derivatives designated as hedges at December 31, 2012 (2011 – nil).

2.16 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. Nalcor 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 Nalcor are property, plant and equipment, regulatory assets and liabilities and petroleum and natural gas properties.

Nalcor 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 POLICIES

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.

Amortization 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.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. PROPERTY, PLANT AND EQUIPMENT

	Cost	Contributions In Aid of Construction	Accumulated Amortization	Net Book Value
<i>(millions of dollars)</i>				
2012				
Electric – generation	1,501.0	2.4	371.7	1,126.9
Electric – transmission and distribution	672.8	18.5	92.9	561.4
Development projects	618.0	-	-	618.0
Other	202.5	23.1	50.7	128.7
	<u>2,994.3</u>	<u>44.0</u>	<u>515.3</u>	<u>2,435.0</u>
<i>(millions of dollars)</i>				
2011				
Electric – generation	1,468.7	2.4	341.2	1,125.1
Electric – transmission and distribution	615.3	7.6	76.0	531.7
Development projects	337.5	-	-	337.5
Other	173.6	15.5	42.9	115.2
	<u>2,595.1</u>	<u>25.5</u>	<u>460.1</u>	<u>2,109.5</u>

As at December 31, 2012 the cost of assets under construction and therefore excluded from costs subject to amortization was \$661.2 million (2011 - \$384.3 million).

Included in Development projects is \$609.3 million related to the Lower Churchill Project (2011 - \$329.0 million). Phase 1 of the Project, which was sanctioned in December 2012, will result in the development of the 824 MW Muskrat Falls site, with power being transmitted over a new transmission line (the Labrador-Island Transmission Link) to be constructed from Labrador across the Strait of Belle Isle to the Avalon Peninsula on the island of Newfoundland, and the development of a new transmission system (the Maritime Transmission Link) from Newfoundland to Nova Scotia, for the provision of power to Emera in Nova Scotia and the provision of market access to Nalcor. Nalcor will also obtain transmission access in Nova Scotia, New Brunswick and Maine from Emera. Nalcor will own and finance 100% of Muskrat Falls and the Labrador Transmission Assets. Nalcor and Emera, through a partnership in which Nalcor has the majority interest, will finance the Labrador-Island Transmission Link. The Maritime Transmission Link will be 100% owned and financed by Emera.

5. PETROLEUM AND NATURAL GAS PROPERTIES

<i>(millions of dollars)</i>		2012	2011
Petroleum and natural gas properties		434.0	344.0
Less: accumulated depletion		<u>58.0</u>	<u>39.8</u>
		<u>376.0</u>	<u>304.2</u>

Internal costs directly related to acquisition, exploration and development activities capitalized in 2012 were \$0.1 million (2011 - \$0.5 million).

As at December 31, 2012, \$187.1 million (2011 - \$139.1 million) of accumulated costs of petroleum and natural gas properties were not subject to depletion and depreciation.

NALCOR ENERGY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. PETROLEUM AND NATURAL GAS PROPERTIES (cont'd.)

Oil and 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 a 10% working interest in the Hibernia Southern Extension. Nalcor also has an average working interest of 99% in two onshore exploration permits in Parson's Pond on the Great Northern Peninsula. A third exploration permit, in which Nalcor had a 62% interest, has expired.

On February 17, 2011, Oil and Gas announced that it will not drill the third of a three well drilling program related to its exploration licenses in Parson's Pond on the West Coast of Newfoundland. The two drilled exploration wells are currently in a suspended state. The costs capitalized for Parson's Pond were included in the depletion base in December 2011.

6. 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	65.0	66.4	
Less current portion	2.2	2.8	
	<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	202.2	170.9	
Less current portion	169.0	137.6	
	<u>33.2</u>	<u>33.3</u>	

6.1 Regulatory Adjustments Recorded in the Consolidated Statement of Income

<i>(millions of dollars)</i>	2012	2011
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>

6. REGULATORY ASSETS AND LIABILITIES (cont'd.)

6.1 Regulatory Adjustments Recorded in the Consolidated Statement of Income (cont'd.)

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. 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.

6.2 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.

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 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 increased 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 in 2012 (2011 - \$12.2 million).

6. REGULATORY ASSETS AND LIABILITIES (cont'd.)

6.3 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.

6.4 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 Operating costs.

6.5 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.

6.6 Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Quebec 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 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.

6.7 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.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. REGULATORY ASSETS AND LIABILITIES (cont'd.)

6.7 Property, Plant and Equipment (cont'd.)

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.

6.8 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 purchase of \$0.4 million (2011 - \$0.2 million gain). 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.

6.9 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. In 2012, Hydro recorded net insurance proceeds of \$0.2 million (2011- \$0.8 million) against costs of the related assets.

6.10 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).

7. OTHER LONG-TERM ASSETS

<i>(millions of dollars)</i>		2012	2011
Long-term receivables	(a)	0.8	1.6
Sinking funds	(b)	302.8	247.0
Reserve fund	(c)	50.9	45.4
		<u>354.5</u>	<u>294.0</u>

(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) related to repayment of Hydro's long-term debt and \$39.5 million (2011 - nil) related to funding of Nalcor's long-term payable under the UCRA.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2013 to 2041.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. OTHER LONG-TERM ASSETS (cont'd.)

(b) (cont'd.)

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 1.38% to 9.86% (2011 - 3.12% to 9.86%).

Nalcor sinking funds are held to fund the annual payments to the Innu Nation as required under the Upper Churchill Redress Agreement (UCRA).

<i>(millions of dollars)</i>	2012	2011
Sinking funds at beginning of year	247.0	208.2
Contributions	48.1	8.2
Earnings	12.6	11.0
Redemptions	(2.0)	-
Valuation adjustment	(2.9)	19.6
Sinking funds at end of year	302.8	247.0

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 Nalcor'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	50.9	45.4

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

9. DEFERRED CREDITS

Deferred credits consist of funding from the Government of Newfoundland and Labrador, deferred revenue from Emera Inc., deferred lease revenue and oil production.

Hydro has received funding from the Province for wind feasibility studies in Labrador. Oil and Gas has received funding from the Province for oil and gas exploration initiatives. Funding related to studies and programs are amortized to income directly against the related expenditures as the costs are incurred.

In July 2012, Nalcor entered into agreements with Emera Inc. related to the Muskrat Falls project. Under these agreements, Emera is constructing the Maritime Link in exchange for the provision of power by Nalcor for a 35-year period. Nalcor has recorded deferred revenue of \$28.0 million which equals the construction costs to date incurred by Emera. Nalcor controls the Maritime Link asset and as such has recorded the costs as a component of property, plant and equipment under construction.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. DEFERRED CREDITS (cont'd.)

Other includes deferred lease revenue and over-lift on oil production. The following is a schedule of the deferred credits for the year:

<i>(millions of dollars)</i>	Hydro Wind Credits	Oil and Gas Program Funding	Deferred Energy Sales	Other	Total
Balance at January 1, 2011	-	2.2	-	0.3	2.5
Additions	3.5	8.0	-	0.6	12.1
Amortization	-	(3.3)	-	-	(3.3)
Balance at December 31, 2011	<u>3.5</u>	<u>6.9</u>	<u>-</u>	<u>0.9</u>	<u>11.3</u>
Additions	-	2.3	28.0	0.5	30.8
Amortization	(1.6)	(4.4)	-	(0.9)	(6.9)
Balance at December 31, 2012	<u>1.9</u>	<u>4.8</u>	<u>28.0</u>	<u>0.5</u>	<u>35.2</u>
Less: current portion	<u>1.9</u>	<u>4.8</u>	<u>-</u>	<u>0.5</u>	<u>7.2</u>
	<u>-</u>	<u>-</u>	<u>28.0</u>	<u>-</u>	<u>28.0</u>

10. DEBT

10.1 Short-Term Borrowings

Nalcor maintains a \$100.0 million unsecured demand operating credit facility with its banker. Borrowings in Canadian dollars may take the form of Prime Rate Advances, BAs and Letters of Credit. Borrowings in USD may take the form of Base Rate Advances, LIBOR Advances and Letters of Credit. The facility also provides coverage for overdrafts on Nalcor's bank accounts, with interest calculated at the Prime Rate. At year end, the drawings on the facility were four irrevocable letters of credit. One was issued to the Department of Fisheries and Oceans (DFO), two were issued to the Newfoundland Labrador Offshore Petroleum Board, and one was issued to Newfoundland Transshipment. The letter of credit issued to DFO in the amount of \$0.3 million was in connection with the operation of hydroelectric assets on the Exploits River. The remaining letters of credit totaled \$4.8 million and relate to Oil and Gas to ensure compliance with regulations relating to petroleum and natural gas exploration and production activities.

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).

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 and compliance with a certificate of approval for the transportation of special hazardous wastes granted by the Department of Environment and Conservation.

Oil and Gas maintains a \$5.0 million unsecured credit facility. As at December 31, 2012, \$3.7 million was drawn on the facility (2011 - nil).

Short-term borrowings consist of promissory notes in Hydro totalling \$52.0 million and bankers' acceptances in Nalcor totalling \$73.0 million. There were no short-term borrowings at December 31, 2011.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. DEBT (cont'd.)

10.2 Long-Term Debt

Details of long-term debt are as follows:

	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2012	2011
<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
					<u>1,125.9</u>	<u>1,131.5</u>

* 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 ten 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).

Required repayments of long-term debt 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

11. ASSET RETIREMENT OBLIGATIONS

Nalcor has recognized liabilities associated with the retirement of portions of the HTGS, disposal of polychlorinated biphenyls (PCB) and retirement obligations associated with Nalcor's net interest in petroleum and natural gas properties. The reconciliation of the beginning and ending carrying amount of asset retirement obligations is as follows:

<i>(millions of dollars)</i>	2012	2011
Obligations at beginning of year	24.8	14.8
Liabilities incurred	1.4	3.7
Accretion	1.0	0.7
Revisions	4.3	5.6
Settlements	(0.1)	-
Obligations at end of year	31.4	24.8
Less current portion:	1.4	-
	<u>30.0</u>	<u>24.8</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

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

value of the asset retirement obligations was determined using the present value of future cash flows discounted at a
11. ASSET RETIREMENT OBLIGATIONS (cont'd.)

credit adjusted risk free rate of 2.8% (2011 - 2.9%).

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 credit adjusted risk free rates ranging between 3.1% and 5.5% (2011 - 3.1% and 5.6%).

Oil and Gas asset retirement obligations result from net ownership interests in petroleum and natural gas properties and related well sites. The total undiscounted estimated cash flows required to settle the obligations at December 31, 2012 is \$10.7 million (2011 - \$8.9 million). Payments to settle the liability are expected to occur between 2020 and 2030. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at credit adjusted risk free rates ranging between 4.7% and 6.3% (2011 - 5.0% to 6.2%).

A significant number of Nalcor's assets include generation plants, transmission assets and distribution systems. These assets can continue to run indefinitely with ongoing maintenance activities. As it is expected that Nalcor's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related 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 for those assets will be recognized at that time.

12. LONG-TERM PAYABLES

<i>(millions of dollars)</i>	2012	2011
Balance at beginning of year	45.1	4.6
Additions and revisions	43.2	40.5
Accretion	2.2	-
Balance at end of year	90.5	45.1
Less: current portion	(8.1)	(2.4)
	82.4	42.7

The long-term payables consist of a payable to the Innu Nation under the UCRA, a payable to the Innu Nation under the Impact and Benefits Agreement (IBA), a payable to Hydro-Quebec related to the AEB and a penalty payment regarding the Hebron Oil and Gas project.

Under the UCRA, Nalcor is required to pay to the Innu Nation, \$2.0 million annually escalated by 2.5% annually until 2041. Currently, \$2.1 million (2011 - \$2.0 million) of the amount is current and is recorded in trade and other payables. Nalcor has sinking funds in the amount of \$40.0 million to fund these future obligations.

Under the IBA, Nalcor is required to make annual payments to the Innu Nation commencing on sanction of the Muskrat Falls Project. The Muskrat Falls Project was sanctioned in December 2012 and the first IBA payment was made at that time. The IBA requires annual payments of \$5.0 million escalated by the annual consumer price index from sanction until first commercial power. The present value of the payments using a discount rate of 3.7% is \$40.4 million (2011 - nil). The current portion of the payable at December 31, 2012 is \$5.0 million.

In September 2012, the joint venture partners in the Hebron project executed the Benefits Agreement Drilling Equipment Set (DES) Settlement Agreement. This Agreement allowed the Hebron partners to adjust the Hebron Benefits Agreement such that the Hebron Project DES could be constructed at a geographic location outside of Newfoundland and Labrador in exchange for a one-time payment to the Province. The total payment was agreed to be \$150.0 million payable on June 30, 2016. Nalcor's proportionate 4.9% share of the payment will be \$7.3 million. Oil and Gas has recognized the present value of its payable of \$6.4 million determined using a discount rate of 3.4%.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. LONG-TERM PAYABLES (cont'd.)

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 Accounts payable and accrued liabilities. The long-term portion is \$2.6 million (2011 - \$4.8 million).

13. EMPLOYEE FUTURE BENEFITS

13.1 Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$6.8 million (2011 - \$6.4 million) are expensed as incurred.

13.2 Other Benefits

Nalcor provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2012, cash payments to beneficiaries for its unfunded other employee future benefits was \$3.0 million (2011 - \$2.6 million). An actuarial valuation was performed at December 31, 2012.

<i>(millions of dollars)</i>	2012	2011
Accrued benefit obligation		
Balance at beginning of year	113.1	87.5
Current service cost	4.6	3.3
Interest cost	5.0	5.1
Actuarial (gain) loss	(1.0)	21.0
Regulatory adjustments	(2.3)	(1.2)
Benefits paid	(3.0)	(2.6)
Balance at end of year	116.4	113.1
Plan deficit	116.4	113.1
Unamortized actuarial loss	(42.6)	(46.5)
Unamortized past-service cost	(0.2)	(0.2)
Accrued benefit liability at end of year	73.6	66.4
<i>(millions of dollars)</i>	2012	2011
Component of benefit cost		
Current service cost	4.6	3.3
Interest cost	5.0	5.1
Actuarial (gain) loss	(1.0)	21.0
	8.6	29.4
Difference between actuarial gain or loss and amount recognized	3.9	(19.6)
Benefit expense	12.5	9.8

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%

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. EMPLOYEE FUTURE BENEFITS (cont'd.)

13.2 Other Benefits (cont'd.)

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	2.3	1.7
Accrued benefit obligation	23.1	23.1
<i>Decrease</i>	2012	2011
Current service and interest cost	(1.7)	(1.3)
Accrued benefit obligation	(17.5)	(17.6)

14. SHAREHOLDER'S EQUITY

14.1 Share Capital

<i>(millions of dollars)</i>	2012	2011
Common shares of par value \$1 each		
Authorized: unlimited		
Issued and outstanding 122,500,000	122.5	122.5

14.2 Contributed Capital

<i>(millions of dollars)</i>	2012	2011
Total contributed capital	435.8	390.5

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 Power Contract. During 2012, the Province contributed capital in the amount of \$45.0 million (2011 - \$16.0 million) and the Trust contributed \$0.3 million (2011 - \$0.4 million).

14.3 Accumulated Other Comprehensive Income

<i>(millions of dollars)</i>	2012	2011
Balance at beginning of year	46.4	27.3
Other comprehensive (loss) income	(2.8)	19.1
Balance at end of year	43.6	46.4

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

15. REVENUE

<i>(millions of dollars)</i>	2012	2011
Electricity sales	627.5	598.5
GWAC revenue	16.0	13.0
Oil sales	68.7	90.1
Royalties	(1.8)	(1.6)
Total energy sales	<u>710.4</u>	<u>700.0</u>
Lease revenue	5.2	4.3
Government funding	4.4	3.7
Preferred dividends	3.4	3.3
Other	2.7	2.8
Total other revenue	<u>15.7</u>	<u>14.1</u>

16. OPERATING COSTS

<i>(millions of dollars)</i>	2012	2011
Salaries and benefits	114.8	107.7
Maintenance and materials	36.8	37.5
Transmission rental	19.7	18.7
Professional services	15.7	12.9
Oil and gas production costs	10.4	9.0
Other operating costs	9.5	14.3
Total	<u>206.9</u>	<u>200.1</u>

17. CAPITAL MANAGEMENT

Nalcor'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, Nalcor's primary objective when managing capital is to ensure ready access to capital at a reasonable cost, to minimize its cost of capital within the confines of established risk parameters, and to safeguard Nalcor's ability to continue as a going concern.

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

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. CAPITAL MANAGEMENT (cont'd.)

A summary of the capital structure is outlined below:

<i>(millions of dollars)</i>	2012		2011	
Debt				
Long-term debt	1,125.9		1,131.5	
Short-term borrowings	125.0		-	
Current portion of long-term debt	8.2		8.2	
Sinking funds	(263.3)		(247.0)	
	<u>995.8</u>	38.9%	<u>892.7</u>	38.4%
Equity				
Share capital	122.5		122.5	
Contributed capital	435.8		390.5	
Accumulated other comprehensive income	43.6		46.4	
Retained earnings	963.0		870.3	
	<u>1,564.9</u>	61.1%	<u>1,429.7</u>	61.6%
Total Debt and Equity	<u>2,560.7</u>	100.0%	<u>2,322.4</u>	100.0%

Nalcor's unsecured demand operating facility has covenants restricting the issuance of debt such that the unconsolidated 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 on an unconsolidated basis. As at December 31, 2012, Nalcor was in compliance with these covenants.

17.1 Hydro

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.

17.2 Oil and Gas

Oil and Gas' objective when managing capital is to maintain the ability to fund operating costs and expenditures related to development and production assets, on a timely basis. Oil and Gas maintains an unsecured demand credit facility, which is used to finance operations in the short-term. Long-term capital includes share capital, contributed capital and retained earnings. Oil and Gas' future requirements for capital are expected to increase, as construction begins on new development assets. During this time, it is expected that Oil and Gas' cash from operations will be sufficient to fund a portion of its capital needs. Additional requirements will be funded entirely through contributed capital.

17. CAPITAL MANAGEMENT (cont'd.)

17.3 Bull Arm Fabrication

Bull Arm Fabrication's objective when managing capital is to maintain its ability to continue as a going concern. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Commencing in January 2009, earnings are retained by Bull Arm Fabrication and reported in retained earnings. Prior to this, net earnings received were payable to the Province.

17.4 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.

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

18.1 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 Nalcor might receive or incur in actual market transactions.

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

Establishing Fair Value

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

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

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

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

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

NALCOR ENERGY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

18.1 Fair Value (cont'd.)

	Level	Carrying Value	Fair Value	Carrying Value	Fair Value
		December 31, 2012		December 31, 2011	
<i>(millions of dollars)</i>					
Financial assets					
Cash and cash equivalents	1	12.1	12.1	18.7	18.7
Short-term investments	1	11.5	11.5	16.9	16.9
Accounts receivable	1	125.0	125.0	163.6	163.6
Derivative assets	2	0.1	0.1	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	302.8	302.8	247.0	247.0
Reserve fund	2	50.9	50.9	45.4	45.4
Long-term receivable	2	0.8	0.8	1.6	1.6
Financial liabilities					
Accounts payable and accrued liabilities	1	198.1	198.1	156.1	156.1
Short-term borrowings	1	125.0	125.0	-	-
Derivative liabilities	2	-	-	0.2	0.2
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 payables	2	82.4	82.6	42.7	43.2

The fair value of cash and cash equivalents, short-term investments, accounts receivable, short-term borrowings and accounts payable and accrued liabilities 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.

18.2 Risk Management

Nalcor 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 Nalcor's expected future cash flows.

Credit Risk

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

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

18.2 Risk Management (cont'd.)

Credit Risk (cont'd.)

Credit risk on cash and cash equivalents is considered to be minimal, as Nalcor'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 the Federal and Provincial governments, as well as Bankers' Acceptances and term deposits issued by Canadian Schedule 1 Chartered Banks.

Credit exposure on Nalcor's sinking funds is limited by restricting the holdings to long-term debt instruments issued by the Government of Canada or any province of Canada, crown corporations and 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 Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value of Portfolio (%)
<i>(millions of dollars)</i>	2012		2011	
Provincial Governments	AA- to AAA	4.71%	AA- to AAA	4.19%
Provincial Governments	A- to A+	52.75%	A- to A+	57.75%
Provincially owned utilities	A- to A+	37.31%	A- to A+	32.43%
Schedule 1 Canadian banks	A- to A+	1.64%	A- to A+	1.31%
Provincially owned utilities	BBB+	3.59%	BBB+	4.32%
		100.00%		100.00%

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 the 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:

	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%
		100.00%		100.00%

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.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

18.2 Risk Management (cont'd.)

Credit Risk (cont'd.)

Nalcor's exposure to credit risk on its energy sales and associated accounts receivable is determined by the credit quality of its customers. Nalcor's three largest customers are not covered by the credit policies outlined in the Financial Risk Management Policy. These customers account for 83.8% (2011 - 72.3%) of total energy sales and 57.9% (2011 - 63.4%) of accounts receivable. These customers are comprised of rate regulated entities and/or organizations with investment grade credit ratings.

Nalcor 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

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

Short-term liquidity for Nalcor and its subsidiaries is mainly provided through cash and cash equivalents on hand, funds from operations and a \$100.0 million (2011 - \$100.0 million) demand operating credit facility which Nalcor maintains with its banker. In addition Hydro has access to a \$300.0 million promissory note program and a \$50.0 million (2011 - \$50.0 million) unsecured demand operating credit facility. Oil and Gas and Churchill Falls also maintain small demand operating facilities of \$5.0 million (2011 - \$5.0 million) and \$10.0 million (2011 - \$10.0 million) respectively. Churchill Falls also maintains a \$10.0 million minimum cash balance.

Long-term liquidity risk for Nalcor 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.

The following are contractual maturities of Nalcor'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	198.1	-	-	-	198.1
Short-term borrowings	125.0				125.0
Long-term debt	-	125.0	375.0	725.0	1,225.0
Interest	61.8	160.6	135.7	588.7	946.8
Long-term payables	15.3	156.1	406.7	796.1	1,374.2
	<u>400.2</u>	<u>441.7</u>	<u>917.4</u>	<u>2,109.8</u>	<u>3,869.1</u>

Market Risk

In the course of carrying out its operating, financing and investing activities, Nalcor is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities. Market price movements to which Nalcor has significant exposure include those relating to prevailing interest rates, foreign exchange rates, most notably USD/CAD, and current commodity prices, most notably the spot prices for diesel fuel, electricity, No. 6 fuel and oil. These exposures were addressed as part of the 2012 Financial Risk Management Strategy.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

18.2 Risk Management (cont'd.)

Market Risk (cont'd.)

Interest Rates

Changes in prevailing interest rates will impact the fair value of financial assets and liabilities classified as held for trading or available for sale, which includes Nalcor's 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 and reserve fund at the balance sheet date:

	Net Income		Other Comprehensive Income	
	0.5% Decrease	0.5% Increase	0.5% Decrease	0.5% Increase
<i>(millions of dollars)</i>				
Interest on sinking funds	(0.1)	0.1	11.0	(10.3)
Interest on reserve fund	-	-	1.1	(0.7)
	<u>(0.1)</u>	<u>0.1</u>	<u>12.1</u>	<u>(11.0)</u>

The impact of interest rates on the expected future cash outflows related to short-term debt, which includes promissory notes and banker's acceptances issued under Nalcor's credit lines and long-term debt, are managed within the corporate financing strategy, and 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.

Foreign Currency and Commodity Exposure

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

During 2012, total electricity sales denominated in USD were \$33.8 million (2011 - \$67.9 million). In 2012, Hydro mitigated foreign exchange risk on a portion of these sales through the use of foreign currency forward contracts. In March 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).

NALCOR ENERGY**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)****18.2 Risk Management (cont'd.)**Market Risk (cont'd.)

During 2012, total oil sales denominated in USD were \$69.2 million (2011 - \$90.4 million). While Oil and Gas had exposure to fluctuations in the USD/CAD exchange rate on those sales, a significant portion of Oil and Gas' planned capital expenditures for 2012 were denominated in USD, which mitigated this exposure. In 2012, Oil and Gas entered into a series of three commodity price swaps with a notional value of \$2.8 million USD to mitigate price exposure on 10% of remaining budgeted production for the year. During 2012, \$0.2 million in gains from these contracts were included in other income and expense (2011 - \$2.0 million).

During 2012, total rental revenues at Bull Arm denominated in USD were \$4.9 million (2011 - \$3.9 million). In March 2012, Bull Arm entered into a series of nine monthly foreign exchange forward contracts with a notional value of \$3.6 million USD to hedge foreign exchange risk on rental revenue. These contracts had an average exchange rate of \$1.00 CAD per USD.

19. NET FINANCE EXPENSE

<i>(millions of dollars)</i>	2012	2011
Finance income		
Interest on sinking fund	18.8	16.6
Interest on reserve fund	1.6	1.5
Other interest income	1.6	5.0
	<u>22.0</u>	<u>23.1</u>
Finance expense		
Long-term debt	90.5	90.5
Accretion	2.7	0.5
Debt guarantee fee	3.7	3.9
Other	1.4	0.7
	<u>98.3</u>	<u>95.6</u>
Interest capitalized during construction	<u>(2.7)</u>	<u>(1.6)</u>
	<u>95.6</u>	<u>94.0</u>
Net finance expense	<u>73.6</u>	<u>70.9</u>

20. SUPPLEMENTARY CASH FLOW INFORMATION

<i>(millions of dollars)</i>	2012	2011
Accounts receivable	38.6	(70.0)
Inventory	1.4	(0.5)
Prepaid expenses	(0.8)	(0.1)
Regulatory assets	1.4	3.3
Regulatory liabilities	31.3	11.1
Accounts payable and accrued liabilities	42.0	4.0
Changes in non-cash working capital balances	<u>113.9</u>	<u>(52.2)</u>
Income taxes paid	0.1	0.2
Interest received	3.3	2.5
Interest paid	92.0	90.9

NALCOR ENERGY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21. SEGMENT INFORMATION

Nalcor operates in seven 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. Oil and Gas activities include exploration, development, production, transportation and processing sectors of the oil and gas industry. Bull Arm Fabrication consists of an industrial fabrication site which is leased for major construction of development projects. Energy Marketing includes the sale of electricity to markets outside the province and other non-regulated electricity sales. Muskrat Falls includes the development of a new hydroelectricity facility and related infrastructure in the province. Corporate and other activities encompass development activities including Phase 2 of the lower Churchill hydroelectric development 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 described in Note 2.

	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Corporate and Other Activities	Muskrat Falls	Bull Arm	Inter- Segment	Total
<i>(millions of dollars)</i>									
2012									
Revenue									
Energy sales	520.7	73.0	66.9	53.6	0.2	-	-	(4.0)	710.4
Other revenue	2.1	0.5	4.5	-	-	-	5.2	3.4	15.7
	<u>522.8</u>	<u>73.5</u>	<u>71.4</u>	<u>53.6</u>	<u>0.2</u>	<u>-</u>	<u>5.2</u>	<u>(0.6)</u>	<u>726.1</u>
Expenses									
Fuels	182.4	-	-	-	-	-	-	-	182.4
Power purchased	57.0	0.1	-	7.7	-	-	-	(4.0)	60.8
Operations and administration	109.5	42.0	20.4	24.7	9.3	-	1.0	-	206.9
Net finance expense	74.0	(1.6)	(0.3)	0.1	1.4	-	-	-	73.6
Amortization	47.5	12.7	18.7	-	0.3	-	0.1	-	79.3
Other income and expense	5.3	(4.6)	(0.1)	(0.1)	-	-	(0.1)	-	0.4
Regulatory adjustments	30.0	-	-	-	-	-	-	-	30.0
	<u>505.7</u>	<u>48.6</u>	<u>38.7</u>	<u>32.4</u>	<u>11.0</u>	<u>-</u>	<u>1.0</u>	<u>(4.0)</u>	<u>633.4</u>
Net income (loss) from operations	17.1	24.9	32.7	21.2	(10.8)	-	4.2	3.4	92.7
Preferred dividends	-	3.4	-	-	-	-	-	(3.4)	-
Net income (loss)	<u>17.1</u>	<u>28.3</u>	<u>32.7</u>	<u>21.2</u>	<u>(10.8)</u>	<u>-</u>	<u>4.2</u>	<u>-</u>	<u>92.7</u>
Capital expenditures	77.6	30.1	88.8	-	5.6	275.3	-	-	477.4
Total assets	1,906.4	456.2	392.7	3.5	252.5	443.3	13.6	(21.3)	3,446.9

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
21. SEGMENT INFORMATION (cont'd.)

	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Corporate and Other Activities	Muskrat Falls	Bull Arm	Inter- Segment	Total
<i>(millions of dollars)</i>									
2011									
Revenue									
Energy sales	473.6	66.2	88.5	75.6	-	-	-	(3.9)	700.0
Other revenue	2.3	0.3	3.5	-	-	-	4.7	3.3	14.1
	<u>475.9</u>	<u>66.5</u>	<u>92.0</u>	<u>75.6</u>	<u>-</u>	<u>-</u>	<u>4.7</u>	<u>(0.6)</u>	<u>714.1</u>
Expenses									
Fuels	154.9	-	-	-	-	-	-	-	154.9
Power purchased	52.2	-	-	4.6	-	-	-	(3.9)	52.9
Operations and administration	104.4	41.8	21.4	22.7	8.8	-	1.0	-	200.1
Net finance expense	73.5	(1.4)	(0.1)	(0.6)	(0.5)	-	-	-	70.9
Amortization	43.2	12.2	29.6	-	0.2	-	-	-	85.2
Other income and expense	0.5	(7.2)	2.0	1.8	0.1	-	-	-	(2.8)
Regulatory adjustments	24.1	-	-	-	-	-	-	-	24.1
	<u>452.8</u>	<u>45.4</u>	<u>52.9</u>	<u>28.5</u>	<u>8.6</u>	<u>-</u>	<u>1.0</u>	<u>(3.9)</u>	<u>585.3</u>
Net income (loss) from operations	23.1	21.1	39.1	47.1	(8.6)	-	3.7	3.3	128.8
Preferred dividends	-	3.3	-	-	-	-	-	(3.3)	-
Net income (loss)	<u>23.1</u>	<u>24.4</u>	<u>39.1</u>	<u>47.1</u>	<u>(8.6)</u>	<u>-</u>	<u>3.7</u>	<u>-</u>	<u>128.8</u>
Capital expenditures	62.3	25.6	63.3	-	13.5	89.2	-	-	253.9
Total assets	1,867.5	436.6	329.5	3.9	277.0	168.2	9.2	(50.1)	3,041.8

All of Nalcor's physical assets are located in the province and all revenues are generated in Canada.

22. 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. 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.
- (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 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.
- (c) Hydro has entered into power sales agreements with third parties. To facilitate market access, Hydro has entered into a transmission service agreement with Hydro-Quebec TransEnergie which concludes in 2014, 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

- (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 \$0.3 million (2011 - \$0.4 million).

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.

- (e) Outstanding commitments for capital projects total approximately \$531.8 million as at December 31, 2012 (2011 - \$54.0 million). In addition, Oil and Gas has committed to fund 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

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

22. COMMITMENTS AND CONTINGENCIES (cont'd.)

(f) (cont'd.)

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

(g) Nalcor has issued four irrevocable letters of credit. One was issued to the Department of Fisheries and Oceans (DFO), two were issued to the Newfoundland Labrador Offshore Petroleum Board and one was issued to Newfoundland Transshipment. The letter of credit issued to DFO in the amount of \$0.3 million was in connection to the operation of the hydroelectric assets on the Exploits River. The remaining letters of credit totaled \$4.8 million and relate to Oil and Gas to ensure compliance with regulations relating to petroleum and natural gas exploration and production activities.

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.

(h) 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 and development project. 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.

(i) 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 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.

23. RELATED PARTY TRANSACTIONS

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

Related Party	Relationship
The Province	100% shareholder of Nalcor Energy.
Churchill Falls	Jointly controlled subsidiary of Hydro.
Twin Falls	Jointly controlled subsidiary of Churchill Falls.
The Trust	Created by the Province with Churchill Falls as the beneficiary.
Board of Commissioners of Public Utilities (PUB)	Agency of the Province.

Routine operating transactions with related parties are settled at prevailing market prices under normal trade terms.

(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.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

23. RELATED PARTY TRANSACTIONS (cont'd.)

- (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) The 2012 debt guarantee fee payable to the Province was \$3.7 million (2011 - \$3.9 million). Both the 2012 and 2011 debt guarantee fees were paid in full in March 2012.
- (d) The Petroleum Exploration Enhancement Program (PEEP) was established as part of the Newfoundland and Labrador Energy Plan. PEEP is designed to boost new petroleum exploration in Western Newfoundland through the acquisition and assessment of seismic data. Funding for PEEP is provided by the Province and the program is administered by Oil and Gas. Total funding available under PEEP is \$5.0 million over five years. There was no funding provided in 2012 (2011 - \$4.5 million) and \$1.8 million is included in Deferred credits (2011 - \$2.5 million).
- (e) The Offshore Geoscience Data Project (OGDP) was established as part of the Newfoundland and Labrador Energy Plan. OGDP is designed to boost new offshore petroleum exploration in Newfoundland through the acquisition and assessment of seismic data. Funding for OGDP is provided by the Province and the program is administered by Oil and Gas. Total funding available under OGDP is \$20.0 million over two years. In 2012, funding of \$2.3 million was received from the Province (2011 - \$10.5 million) of which \$3.0 million has been recorded as Deferred credits (2011 - \$4.4 million).
- (f) 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. The 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, earnings are to be retained and are reflected in retained earnings. As at December 31, 2012, \$0.8 million (2011 - \$0.8 million) of distributions payable to the Province are included in Accounts payable and accrued liabilities.
- (g) During 2010, Bull Arm Fabrication received \$1.0 million in funding from the Province of which \$0.3 million was recognized as revenue in 2011. No grant revenue was received or recognized during 2012.
- (h) Nalcor, as the operator of the Exploits assets, has a net payable to the Province of \$17.4 million (2011 - \$9.9 million) which is included in Accounts payable and accrued liabilities. Nalcor operates these assets on behalf of the Province on a cost recovery basis.
- (i) 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 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.
- (j) 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.

NALCOR ENERGY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

23. RELATED PARTY TRANSACTIONS (cont'd.)

- (k) 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.
- (l) In relation to Nalcor's financial obligations with respect to the Upper Churchill Redress Agreement, the Province provided funding in the amount of \$39.9 million which is recorded as Other long-term assets. This funding will be used to offset payments to the Innu Nation.

24. SUBSEQUENT EVENTS

Forward Contracts

In January 2013, Oil and Gas entered into a total of 11 commodity price swap contracts with a notional value of USD \$25.3 million to mitigate commodity price exposure on energy sales. These contracts provide Oil and Gas with an average fixed price of \$107.45 per barrel on approximately 36.0% of the estimated production for 2013.

In January 2013, Hydro entered into a total of 12 forward contracts with a notional value of US \$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.

In January 2013, Bull Arm Fabrication entered into a total of 22 forward contracts with a notional value of US \$10.1 million to mitigate a USD/CAD currency exposure on a portion of its USD denominated lease revenue. The average rate on these forward contracts was \$1.01 CAD per USD.

Cancellation of letters of credit

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

Demand Operating Facility

Subsequent to the year end, Nalcor increased the credit available under its demand operating facility from \$100 million to \$150 million.

Equity Contribution

In each of January and March 2013, Nalcor received contributed capital of \$100.0 million from the Province.

Change in Ownership

On February 11, 2013, Emera Newfoundland & Labrador Holdings Inc. contributed \$67.7 million to the LIL Partnership in exchange for 25 Class B Limited Units in accordance with the terms and conditions of the Labrador-Island Link Limited Partnership Agreement. As a result, Nalcor's ownership in the LIL Partnership changed from 100% to 65%.

Capital Commitments

Subsequent to year end, Nalcor entered into new commitments totaling \$434.8 million related to the Muskrat Falls project.

25. COMPARATIVE FIGURES

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

Appendix 3

Newfoundland and Labrador Hydro Consolidated Financial Statements

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

<i>As at December 31 (millions of dollars)</i>	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

For the year ended December 31 (millions of dollars)

	Notes	2012	2011
Cash provided by (used in)			
Operating activities			
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>
Financing activities			
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>
Investing activities			
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		<u>(3.9)</u>	<u>(37.0)</u>
Cash position at beginning of year		15.7	52.7
Cash position at end of year		<u>11.8</u>	<u>15.7</u>
Cash position is represented by:			
Cash		11.8	15.7
Cash equivalents		-	-
		<u>11.8</u>	<u>15.7</u>
Supplementary cash flow information (Note 17)			

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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:

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

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

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

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

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>					
			2012		
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>					
			2011		
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	65.0	66.4	
Less current portion	2.2	2.8	
	<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	202.2	170.9	
Less current portion	169.0	137.6	
	<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>	2012	2011
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

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

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2012	2011
<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>	2012	2011
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>	2012	2011
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>	2012	2011
Balance at beginning of year	46.4	27.3
Other comprehensive (loss) income	(3.6)	19.1
Balance at end of year	42.8	46.4

13. OPERATING COSTS

<i>(millions of dollars)</i>	2012	2011
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	177.2	170.8

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>	2012		2011	
Debt				
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)	
	922.8	54.0%	892.7	54.1%
Equity				
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	
	786.8	46.0%	756.2	45.9%
Total debt and equity	1,709.6	100.0%	1,648.9	100.0%

NEWFOUNDLAND AND LABRADOR HYDRO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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
Financial assets					
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
Financial liabilities					
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 Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value 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%
		<u>100.00%</u>		<u>100.00%</u>

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%
		100.00%		100.00%

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>	2012	2011
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>	2012	2011
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>						2012
Revenue						
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>
Expenses						
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>						2011
Revenue						
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>
Expenses						
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

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.