

**NALCOR ENERGY  
NEWFOUNDLAND AND LABRADOR HYDRO**

2011 Annual Performance Report  
Transparency and Accountability

June 2012





## Message from the Boards of Directors

Honourable Jerome P. Kennedy, Q.C.  
Minister of Natural Resources  
Government of Newfoundland and Labrador  
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St. John's, NL  
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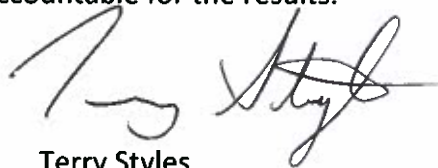
Dear Minister:

In accordance with the *Transparency and Accountability Act*, I am pleased to submit the 2011 Annual Performance Report on behalf of the Boards of Directors of Nalcor Energy and Newfoundland and Labrador Hydro.

Nalcor Energy's legal structure at December 31, 2011 included four wholly-owned subsidiaries, Newfoundland and Labrador Hydro (Hydro or NLH), Nalcor – Oil and Gas Inc., Nalcor Energy – Bull Arm Fabrication, and Gull Island Power Corporation (GIPCo). Subsidiaries of Hydro were Churchill Falls (Labrador) Corporation (Churchill Falls or CF(L)Co), and Lower Churchill Development Corporation (LCDC). Churchill Falls holds a minority interest in Twin Falls Power Corporation (TwinCo).

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 preparation of this report and are accountable for the results.



Terry Styles  
Chair  
Nalcor Energy  
Newfoundland and Labrador Hydro



## Table of Contents

1	Overview .....	1
2	Mandate.....	5
3	Lines of Business .....	6
4	Values.....	8
5	Primary Clients .....	9
6	Vision.....	10
7	Mission .....	11
8	Shared Commitments .....	13
9	Issues.....	14
10	Summary 2011 Accomplishments and Highlights .....	15
11	Outcomes of Objectives.....	18
12	Opportunities and Challenges .....	54
Appendix 1	Other Companies	
Appendix 2	Energy Portfolio	
Appendix 3	Nalcor Energy Consolidated Financial Statements	
Appendix 4	Newfoundland and Labrador Hydro Consolidated Financial Statements	



## 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, has four wholly-owned subsidiaries, Newfoundland and Labrador Hydro (Hydro), Nalcor Energy – Oil and Gas, Nalcor Energy – Bull Arm Fabrication, 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 Corporation (see Appendix 1).

Headquartered in St. John's, Nalcor's energy portfolio is located throughout the province (see Appendix 2). In 2011, Nalcor had over 1,300 employees, with 70 per cent of these employees located in rural parts of the island and Labrador. The gender composition of Nalcor's employee group was 78 per cent male and 22 per cent female. Nalcor is currently implementing a multi-year action plan to support diversity and inclusion.

In 2011 Nalcor had revenues of \$729.9 million. The majority of Nalcor's revenues are currently generated from energy sales to utility, rural and industrial customers. Nearly 35 per cent of Nalcor's 2011 expenditures related to fuels and power purchases by Hydro with operations and administration accounting for 33 per cent of expenses, amortization and depletion totalling 14 per cent and interest and finance charges accounting for 18 per cent.

**Table 1: Nalcor Energy Consolidated Revenue and Expenses 2011**

<i>For the year ended December 31 (millions of dollars)</i>	\$	%
Revenue		
Energy sales	695.6	95.3
Interest and finance income	20.2	2.8
Other revenue	14.1	1.9
	729.9	
Expenses		
Fuels	156.7	26.0
Power purchased	52.9	8.8
Operations and administration	199.9	33.1
Interest and finance charges	108.4	18.0
Amortization and depletion	87.7	14.5
Other income and expense	(2.4)	-0.4
	603.2	
Net Income	126.7	

## 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, Hydro has the right to recall 300 MW of power. Hydro's non-regulated activities include the sale of a portion of this power to mining operations in Labrador West. The remaining portion of recall power is sold on the Canadian side of the



United States/Canada border to a third-party energy marketer as well as directly into Atlantic Canada.

In 2011, Hydro directly employed 863 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 2011, Hydro had revenues of \$631.6 million. The majority of Hydro's revenues are from energy sales to utility, rural and industrial customers with other revenues from pole attachment revenues, and preferred dividends from Churchill Falls. The following charts summarize the consolidated 2011 revenue and expenses for Hydro.

**Table 2: Hydro Consolidated Revenue and Expenses 2011**

<i>For the year ended December 31 (millions of dollars)</i>	\$	%
Revenue		
Energy sales	605.8	95.9
Interest and finance income	19.9	3.2
Other revenue	5.9	0.9
	631.6	
Expenses		
Fuels	156.7	28.9
Power purchased	52.9	9.8
Operations and administration	170.6	31.5
Interest and finance charges	108.7	20.0
Amortization	57.9	10.7
Other income and expenses	(4.5)	-0.8
	542.3	
Net Income	89.3	



## 2 MANDATE

### Nalcor

The mandate of Nalcor, established in legislation under the *Energy Corporation Act (2008)*, 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 (2007)* mandates Hydro to be responsible for:

- Developing and purchasing power and energy on an economic and efficient basis.
- Engaging within the province and elsewhere in the development, generation, production, transmission, distribution, delivery, supply, sale, purchase and use of power from water, steam, gas and other products.
- Supplying power, at rates consistent with sound financial administration, for domestic, commercial, industrial or other uses in the province and subject to the prior approval of the Lieutenant-Governor in Council, outside of the province.

### 3 LINES OF BUSINESS

Nalcor has five lines of business: Newfoundland and Labrador Hydro, Churchill Falls, Oil and Gas, Lower Churchill Project and Bull Arm Fabrication.

#### ***Newfoundland and Labrador Hydro***

Hydro is the primary generator of electricity in Newfoundland. 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 in the following lines of business:

- 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.

As noted, Hydro's non-regulated line of business includes power sales to two industrial customers in Labrador and sales to other markets outside the province through energy marketing activities. As well, Hydro non-regulated operates the diesel plant in Natuashish, Labrador, on behalf of the Mushuau Innu First Nation.

#### ***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 to further exploration and development of the province's potential offshore resources. The company also continues to pursue other 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 provides an opportunity for the province to meet its own domestic and industrial needs in an environmentally sustainable way, and also export excess electricity to other jurisdictions where the demand for clean, renewable energy continues to grow. Nalcor is moving towards a sanction decision for Phase One of the development: Muskrat Falls and associated transmission links to the island portion of the province and Nova Scotia. Nalcor is also negotiating the formal agreements that will enable the development of the Maritime Link.

### ***Bull Arm Fabrication***

Nalcor's fifth line of business, 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 world-class 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. The Bull Arm site is fully leased by ExxonMobil for the construction and commissioning phases of the Hebron Project.

## 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
- New Brunswick Power
- 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 I and continued efforts to progress Phase II.
- 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. 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 also areas of significant collaboration.

### **Department of Finance**

The Department of Finance works with Nalcor to address requirements related to financial structure and dividend policies.

### **Newfoundland and Labrador Board of Commissioners of Public Utilities**

The Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) is responsible for regulatory oversight of Hydro's regulated utility activities. This responsibility covers a wide range of activities, including approval of its revenue requirements, rates, rate structure and capital program. Activities related to Issue 2: Electricity supply (Hydro), are impacted by PUB. The role of the PUB is detailed in the Public Utilities Act.

Nalcor also shares commitments with the Department of Environment and Conservation, the Department of Government Services, and the federal Department of Fisheries and Oceans in related 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. 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 2011 ACCOMPLISHMENTS AND HIGHLIGHTS

Outlined below is a summary of 2011 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.
- Implemented an enhanced approach for investigating workplace safety incidents and near misses.
- Delivered a public education campaign on power line safety.
- Launched *BeSafe*, a safety coaching framework, and delivered a workshop to approximately 150 employees.
- Reduced lost-time injuries by 50 per cent over 2010.
- Reduced days lost by 84 per cent over 2010.
- Reported 7,135 safety related observations through the Safe Workplace Observation Program (SWOP).

### Issue 2: Electricity supply (Hydro)

- Achieved over 98 per cent winter availability for key electricity generating assets, better than the target for the year and the five-year average.
- Invested \$63 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 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.
- Substantially completed final commissioning of the Wind-Hydrogen-Diesel Energy research and development project in Ramea.
- Issued a request for proposals to analyse the feasibility of the hydroelectric potential of select coastal Labrador communities.
- Commenced the first three projects through Hydro's Industrial Energy Efficiency Program, expected to result in energy savings of 3.6 GWh per year.

- Approved 344 rebates for insulation, Energy Star windows, high efficiency and programmable thermostats, and incentives were provided for nearly 9,000 efficient lighting products.

### **Issue 3: Upper Churchill asset management and power contract adjustments**

- Invested nearly \$30.2 million as part of a long-term 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)**

- Achieved first oil from the West White Rose project and Hibernia Southern Extension.
- Hebron development plan submitted and public hearings completed.
- Oil and gas exploration strategy completed, offering tremendous potential to develop new resources in the offshore.
- Acquired some 10,700 kilometers of seismic data with international data and exploration company, TGS, in partnership with the survey's operator, PGS.
- Completed other planned exploration activities related to Parsons Pond, regional satellite oil seep mapping, seismic data purchase and re-processing and the North Atlantic Petroleum plate reconstruction project.
- 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)**

- Participated in the Environmental Assessment process for the Lower Churchill Generation Project by presenting project information and potential impacts and clarifying information during the 45-day public hearings.
- Drafted Environmental Impact Statement for the Labrador-Island Transmission Link and submitted 14 component studies to the provincial and federal governments.
- Held over 50 public and Aboriginal consultations, presentations, open houses and information sessions across the province. Some of these sessions related to ongoing environmental assessments for components of the Muskrat Falls development, while supplier information sessions were held to prepare businesses for upcoming contract opportunities.
- The New Dawn Agreement, including an Impacts and Benefits Agreement, was ratified by

Labrador Innu.

- Secured commitment for Federal Loan Guarantee for Lower Churchill Project, Phase One.
- Commercial agreements with Emera neared completion.
- Independent review of Muskrat Falls development, conducted by Navigant Consulting based on decision gate 2 (concept selection) data, validated the proposed development of Muskrat Falls and the Labrador-Island Transmission Link as the long-term, least-cost supply option for electricity consumers on the island of Newfoundland.
- The engineering, procurement and construction management (EPCM) contract was awarded to SNC-Lavalin and team fully mobilized in St. John's.

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

- Entered into sublease agreement with ExxonMobil Canada Properties for Hebron Project construction at the Bull Arm Fabrication Site.
- Developed a multi-year stakeholder engagement strategy for progressing the long-term plan.

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

- Developed a long-term implementation plan for energy marketing operations.
- Identified and implemented measures to increase portfolio value and achieved revenue 18 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 2011 relative to these issues and presents objectives and indicators for each issue for 2012.

### Issue 1: Safety leadership (Nalcor, Hydro)

Nalcor's relentless commitment to safety drives all of our 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 the Nalcor identity and our 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 our employees, contractors and the general public. The company has established a safety framework that drives our 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 2011, Nalcor implemented many initiatives to move the company forward on its journey to safety excellence. The company completed planned activities to advance the development of high-risk work procedures, enhanced online training, implemented a new safety incident and near miss investigations protocol, and refreshed communication and education materials.

Nalcor's safety performance has improved over the last number of years. The total number of injuries has decreased and the severity of injuries has declined as well. Between 2005 and 2011, the total number of injuries declined by 52 per cent, with the number of lost-time injuries down 80 per cent during the same period. As well, 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.



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)	
<b>Goal 1</b>	
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"> <li>▪ Refined existing employee, contractor, and public safety programs.</li> <li>▪ Enhanced communication of safety programs and initiatives.</li> </ul>
<b>Objective</b>	
By December 31, 2011, Nalcor and Hydro will have strengthened employee, contractor and public safety programs.	
<b>Measure</b>	
<ul style="list-style-type: none"> <li>▪ Strengthened safety programs.</li> </ul>	
INDICATORS	2011 ACCOMPLISHMENTS
Advanced development of 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 specific activities required to advance development of a procedure depends on factors such as the scope and nature of the procedure and its level of maturity. For example, the work protection code<sup>1</sup> was updated in 2009 and since that time, activities have focused on code implementation, training and audit activities in electricity lines of business. Grounding and bonding<sup>2</sup> procedures are in the early stage of development with 2011 activities involving the development of a corporate standard.</p> <p>All planned 2011 activities to advance safety procedures were completed including:</p> <ul style="list-style-type: none"> <li>▪ Work protection code: Completed planned training,</li> </ul>

<sup>1</sup> 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.

<sup>2</sup> 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>implementation and audit activities.</p> <ul style="list-style-type: none"> <li>▪ Work methods<sup>3</sup>: Completed planned task-based risk assessments and confirmed work methods for critical tasks.</li> <li>▪ Grounding and bonding: Established working group and developed corporate standard that outlines roles, responsibilities and procedures.</li> <li>▪ Fall protection: Developed training program and received Workplace Health Safety and Compensation Commission (WHSCC) approval.</li> </ul>
Enhanced online training to maintain competence and certification for employees working with energized equipment	Enhanced training approach for employees working with energized equipment by supplementing the classroom training delivered in 2010 with an online training program. During 2011, the work protection code online refresher training program was developed and piloted with nearly 70 employees; in 2012 the online training will be delivered to other employees. This training will support efforts to ensure employees working with energized equipment keep their skills and certifications current.
Implemented enhanced safety incident and near miss investigations approach	<p>The safety incident and near miss investigations approach outlines the reporting, recording, investigation and communication procedures to be implemented when any employee, contractor, consultant or visitor experiences a workplace safety incident, near miss or dangerous occurrence during the course of their work.</p> <p>During 2011, an enhanced approach for investigating workplace safety incidents and near misses was implemented. The approach places increased emphasis on completing in-depth analyses of higher risk incidents to ensure that root causes and corrective actions are identified and can be used to focus preventative safety programming.</p>
Assessed contractor safety management program implementation and identified areas of focus for 2012	As part of their commitment to safety, Nalcor and Hydro have a contractor safety management program for work completed by external contractors. The program is dedicated to monitoring contractor safety performance and improvement. During 2011, the contractor safety management program was assessed and areas of focus were identified for 2011 and 2012. During 2011, refresher training

<sup>3</sup> 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>was provided to employees overseeing the work of contractors and an electronic evaluation tool was developed and implemented to better identify areas for improvement in all types of contracted work. The focus for 2012 will be to continue to utilize existing processes and electronic tools and build contractor knowledge of the program through supplier development sessions.</p>
<p>Refreshed communications and education materials focused on public safety around electricity equipment</p>	<p>During 2011, communication and education materials addressing contractor and general public safety around electricity equipment were refreshed. Power line safety was promoted through the Back it Up safety program and the “Look Up. Keep Back. Call Ahead.” tagline and communications materials. During 2011, the content on the HydroSafety.ca website was also updated to highlight power line safety and Hydro targeted a mailing campaign and safety presentations to contractors and heavy equipment operators. Safety personnel also delivered presentations to apprentice line workers at several campuses of the College of the North Atlantic. This focus on power line safety was supplemented by safety advisories about winter safety and other seasonal advisories guiding public safety around electricity facilities and equipment.</p>
<p>Developed employee safety communications plan to support focus on role of front-line supervisors and safety of vulnerable employee groups</p>	<p>An employee safety communications plan was developed and planned activities were completed. Activities to support a focus on role of front-line supervisors and the safety of vulnerable workers included:</p> <ul style="list-style-type: none"> <li>▪ Safety Summit involving approximately 130 participants. The Safety Summit theme, <i>Staying Connected: What's My Role?</i>, focused on the role of front-line supervisors and Occupational Health and Safety Committee members.</li> <li>▪ Planned training and education activities with front-line supervisors regarding the early and safe return to work process<sup>4</sup>.</li> <li>▪ A new <i>BeSafe</i> safety coaching framework and the delivery of <i>BeSafe</i> workshops to 150 participants. These participants were formal leaders, including front-line supervisors. The <i>BeSafe</i> workshop helps build the skills required to take action on at-risk behaviours. The</li> </ul>

<sup>4</sup> The early and safe return to work process involves working with employees who have been impacted by illness or injury to minimize the impacts by returning employees to safe and productive work as soon as it is medically appropriate.

Issue 1: Safety leadership (Nalcor, Hydro)	
	<p>workshop outlines a consistent approach to safety interactions and provides an opportunity to practice the approach.</p> <ul style="list-style-type: none"> <li>Implemented initiatives to promote safety of new and temporary workers including enhancing the safety component of corporate and regional employee orientations and introducing the New Worker Hard Hat program<sup>5</sup>.</li> </ul>
Distributed power line hazards booklet (Hydro only)	Distributed power line hazards booklet in partnership with the Newfoundland Power and Workplace Health, Safety and Compensation Commission (WHSCC) to all contractors in the WHSCC database. Other communication and education activities regarding power line safety were outlined above.
Completed updates to Back it Up safety campaign, including Hydrosafety.ca website, school safety presentations and seasonal safety communication programs (Hydro only)	Completed planned updates to Back it Up Safety campaign and Hydrosafety.ca website including development of power line safety communications materials. Hydro employees also delivered safety presentations at schools throughout the province. As part of its seasonal safety communication program, Hydro issued advisories regarding winter recreational safety and reservoir water levels to promote public safety around electricity facilities.

The objective, measure and indicators for 2012 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 1: Safety leadership (Nalcor, Hydro)	
<b>Objective</b>	
By December 31, 2012, Nalcor and Hydro will have continued to strengthen employee, contractor and public safety programs.	
Measure	Strengthened safety programs
Indicators	<ul style="list-style-type: none"> <li>Further advanced development and implementation of work protection code and work methods procedures for completing high-risk work activities.</li> <li>Completed planned activities to maintain and enhance the competence of employees working with energized equipment and other high-risk work activities:</li> </ul>

<sup>5</sup> The New Worker Hard Hat program easily identifies new workers at the worksite by the colour of their hard hat. The program is intended to encourage new workers to ask questions about job tasks especially as they relate to safety protocol, remind other employees about the presence of new workers and incorporate these new workers into job safety planning.

**Issue 1: Safety leadership (Nalcor, Hydro)**

	<ul style="list-style-type: none"><li>• Designed grounding and bonding training program and completed planned training for line operations staff.</li><li>• Completed planned fall arrest training activities.</li><li>• Developed confined space entry training program, secured WHSCC approval of program and developed training plan for implementation.</li><li>▪ Completed planned safety coaching training with employees.</li><li>▪ Reviewed safety orientation program for vulnerable employees and identified program improvements for implementation in 2012 and 2013.</li><li>▪ Executed planned employee safety communication activities.</li><li>▪ Completed planned public safety communication activities through the Back it Up safety campaign (Hydro only).</li><li>▪ Further promoted power line safety with the general public and targeted audiences.</li></ul>
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## 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<sup>6</sup> 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 20-year capital plan outlining the major capital investments required in electricity generating, 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 2011, Hydro invested \$63 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 2011, additional planning was completed for the upgrades and modifications to the electricity system required to support

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<sup>6</sup> Asset management is the comprehensive management of asset requirements, planning, procurement, operations, maintenance, and evaluation in terms of life extension or rehabilitation, replacement or retirement to achieve maximum value for the stakeholders based on the required standard of service to current and future generations.

integration of Muskrat Falls energy.

Hydro achieved excellent reliability in its electricity generating assets in 2011. A key measure of reliability is the availability of generation to meet demand during the winter months of January, February, March and December. In 2011, availability was over 98 per cent – significantly better than the target for the year and the five-year average. However, the reliability of electricity transmission was lower than planned performance as a result of equipment issues and several severe weather events.

#### *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. In 2010, the company confirmed new generation would be required to meet a capacity shortfall in 2015 and an energy shortfall by 2021.<sup>7</sup> Hydro's examination of available alternatives determined that an interconnection to Labrador via an HVdc<sup>8</sup> link bringing power from the Muskrat Falls Generating Station was the least-cost option for electricity customers. During the planning period, Hydro will 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 consumers conserve energy. The Government of Newfoundland and Labrador and Hydro completed a study to investigate the potential for the integration of alternative energy sources, including solar, wind and mini-hydroelectric facilities

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<sup>7</sup> Capacity refers to the highest level of electricity that the utility can supply at any one time; energy refers to the total amount of electricity that the utility supplies throughout the year. Hydro must be able to supply the electricity required during peak demand times as well as the total amount of electricity that customers want over the year.

<sup>8</sup> High voltage direct current (HVdc) - direct current boosted up to high voltages for long distance transmission. This form is normally used to carry large amounts of power over long distances and for transmission under water.

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 2011, Hydro issued a request for proposals for a feasibility study of hydraulic potential of coastal Labrador. During the 2011-2013 planning period, the feasibility study will be completed with data collection continuing 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 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. The final commissioning<sup>9</sup> of this project was substantially completed in 2011 with the multi-year demonstration phase scheduled to begin in 2012. The demonstration phase involves studying the operation of the facility, analyzing collected data, and optimizing operations. The results of the demonstration phase will answer key questions around the role this technology could play in an isolated electricity system.

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 – Saving Energy Starts Here! Program. takeCHARGE offers rebate programs to encourage residential and commercial customers to reduce their electricity usage. In 2011, Hydro also approved the first three projects under the Industrial Energy Efficiency Program (IEEP) to support Hydro's industrial customers' efforts to improve electrical energy efficiency in a variety of industrial processes.

## 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

<sup>9</sup> Commissioning is a process by which equipment, a facility, or a plant (which is installed, or is complete or near completion) is tested to verify if it functions according to its design objectives or specifications.



Issue 2: Electricity supply (Hydro)	
Indicators	<ul style="list-style-type: none"> <li>▪ Enhanced asset management</li> <li>▪ Completed milestones to facilitate access to Muskrat Falls energy</li> <li>▪ Enhanced programs to support environmental sustainability</li> </ul>
<p><b>Objective</b> By December 31, 2011, Hydro will have enhanced its asset management activities, advanced planning activities to support access to Muskrat Falls energy and progressed select environmental sustainability initiatives.</p>	
INDICATORS	2011 ACCOMPLISHMENTS
<p><b>Measure 1</b> Completed planned initiatives to support enhanced asset reliability</p>	
Completed any required updates to long-term plan for capital investments	Required updates to long-term plan completed, focusing on refresh and prioritization of the 2012-2016 portion of Hydro's long-term plan for capital investments to confirm the timing and scope of required investments. This information supported the preparation of Hydro's 2012 capital budget.
Completed planned investments in Hydro assets	In 2011, Hydro invested \$63 million to upgrade electricity generation, transmission and distribution assets, as well as supporting technology and infrastructure. This expenditure was below the \$67 million budgeted for 2011. The variance in planned versus actual expenditures resulted from not completing all planned work for the year. A number of projects were delayed when no bids were received or bids far exceeded estimated costs and had to be re-tendered, resulting in carryover of some planned 2011 work to 2012.
Enhanced asset management approach, including long-term asset planning and work execution	Completed planned activities to enhance the approach to asset management to support managing assets over their useful life. All elements of the asset management implementation plan for 2011 related to long-term asset planning and work execution were completed as planned, including the following enhancements: documenting asset design standards, planning criteria and operating parameters; establishing technical councils; and assessing critical spares. In addition, some planned 2012 activities were advanced and completed. These activities included completing organization structure changes and supporting implementation of key asset management roles through education and mentoring.
<p><b>Measure 2</b> Completed planned activities related to accessing power from Muskrat Falls</p>	
Advanced arrangements to secure access to Muskrat Falls	To secure access to Muskrat Falls energy, Hydro is working with Nalcor to identify commercial terms for the purchase of

<b>Issue 2: Electricity supply (Hydro)</b>	
energy	<p>electricity including schedule for delivery, payment, pricing and performance standards.</p> <p>During 2011, Hydro completed planned activities to secure access to Muskrat Falls energy. These activities focused on identifying the guiding principles and the structure of contract arrangements for the purchase of Muskrat Falls energy by Hydro.</p>
Completed initial phase of planning and budgeting activities to identify electricity system upgrades/modifications to support integration of Muskrat Falls energy	<p>Thorough planning is required to ensure that Muskrat Falls energy is integrated into Hydro's existing electricity system in a manner that addresses system reliability.</p> <p>During 2011, Hydro completed the initial phase of planning and budgeting activities to identify electricity system upgrades/modifications to support integration of Muskrat Falls energy. These activities included:</p> <ul style="list-style-type: none"> <li>• Identifying upgrades/modifications to electricity system infrastructure.</li> <li>• Completing scopes of work for these upgrades/modifications.</li> <li>• Preparing feasibility or screening level cost estimates for the required investments.</li> </ul>
<b>Measure 3</b>	
Completed planned environmental sustainability initiatives	
Continued demonstration phase of Ramea Wind-Hydrogen-Diesel Energy Project	<p>Activities scheduled for 2011 were not fully completed as planned. The commissioning phase of Ramea Wind-Hydrogen-Diesel Energy Project, which must be completed in before the demonstration phase begins, was substantially completed in 2011 and renewable energy generated from all components has been used to offset some diesel fuel consumption. However, issues with full site automation and testing delayed the completion of the commissioning phase in 2011 and the demonstration phase of the project is now scheduled to commence in 2012.</p>
Advanced analysis of potential hydroelectric projects for Labrador coastal communities	<p>During 2011, Hydro completed planned activities to advance the analysis of hydroelectric potential in the coastal Labrador communities of Charlottetown, Hopedale, Makkovik, Mary's Harbour and Port Hope Simpson. A request for proposals to complete a feasibility study into the potential for hydraulic development to supplement or replace existing diesel electricity generation in these communities was developed</p>

Issue 2: Electricity supply (Hydro)	
	during 2011 and closed for proposals in early December. This project will continue through the planning period and includes the collection of certain hydrology data until 2015.
Implemented Industrial Energy Efficiency Program (IEEP)	The IEEP provides Hydro's industrial electricity customers with assistance to complete feasibility studies and capital upgrades to achieve energy savings. In 2011, the IEEP was implemented and three energy efficiency projects were approved. One project, a lighting retrofit, was completed and two other projects were progressed as planned. When all three projects are completed, energy savings will total 3.6 gigawatt hours (GWh), equivalent to reducing oil usage at the Holyrood Generating Station by approximately 5,800 barrels of oil per year. Also during 2011, progress was made in planning and prioritizing energy savings opportunities for several other industrial customers.
Implemented new residential and commercial customer rebate programs in partnership with Newfoundland Power	<p>Hydro and Newfoundland Power continue to work in partnership to develop and implement the takeCHARGE energy efficiency program. This indicator was based on completion and approval of a Joint Utility Five-Year Conservation and Demand Management Plan by mid-year 2011. Due to other priorities of our utility partner, the plan could not be completed as anticipated and the partners decided to complete the Joint Utility Conservation and Demand Management Plan in 2012 to guide future programming. During 2011, Hydro did conduct its own planning to ensure the expansion of initiatives targeted to Hydro's rural residential and commercial customers in 2012.</p> <p>In 2011, under existing programs, 344 rebates for Hydro customers were approved for insulation, Energy Star windows, high efficiency and programmable thermostats, and Energy Star rated appliances. As well, a program to support commercial customers to make more energy efficient lighting choices provided incentives for nearly 9,000 lighting products used by Hydro customers.</p>
Implemented new community-based energy efficiency program for Hydro customers	Hydro implemented several new community-based energy efficiency initiatives under existing programs, designed to promote energy efficiency and discussion around the many ways to conserve. Hydro determined that the most appropriate way to deliver these new initiatives was under existing programs rather than introducing new programs.

Issue 2: Electricity supply (Hydro)	
	<p>The initiatives were delivered through Phase II of the Coastal Labrador Energy Efficiency Program that Hydro administered on behalf of the provincial Department of Natural Resources. In 2011, in addition to education and energy walkthroughs for homes, a new element of the program was the promotion of provincial home retrofit programs and the direct installation of energy savings technologies, including lighting and water heating savings items. Also, in 2011, additional value was provided to commercial customers by completing an analysis of their electricity use and suggestions for savings.</p>

The objective, measures and indicators outlined for 2012 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 2: Electricity supply (Hydro)	
<b>Objective</b>	
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.	
Measure 1	Completed planned initiatives to support enhanced asset reliability
Indicators	<ul style="list-style-type: none"> <li>▪ Completed required updates to long-term plan for capital investments.</li> <li>▪ Completed planned investments in Hydro assets.</li> <li>▪ Further enhanced asset management approach by completing 2012 priorities outlined in asset management implementation plan.</li> </ul>
Measure 2	Completed planned activities related to accessing power from Muskrat Falls pending project sanction decision
Indicators	<ul style="list-style-type: none"> <li>▪ Further advanced arrangements to secure access to Muskrat Falls energy.</li> </ul>
Measure 3	Completed planned environmental sustainability initiatives
Indicators	<ul style="list-style-type: none"> <li>▪ Commenced demonstration phase of Ramea Wind-Hydrogen-Diesel Energy Project.</li> <li>▪ Further advanced analysis of potential hydroelectric projects for Labrador coastal communities.</li> <li>▪ Progressed energy savings feasibility studies for industrial customers through the Industrial Energy Efficiency Program (IEEP).</li> <li>▪ Continued residential and commercial customer rebate programs in partnership with Newfoundland Power.</li> </ul>

**Issue 2: Electricity supply (Hydro)**

	<ul style="list-style-type: none"><li>▪ Implemented a new Isolated System Community Program to promote energy efficiency to residential and commercial customers in Hydro’s isolated systems.</li></ul>
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### 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.

On December 6, 2011, the generating station 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 develop and refresh its five year capital plan and complete planned asset investments over the planning period.

#### *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 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 Québec 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 Québec 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 the planning period, CF(L)Co will continue to 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)	
<b>Goal</b> 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"> <li>▪ Advanced long-term asset renewal</li> <li>▪ Completed preparations for the Upper Churchill Power Contract trial</li> </ul>
<b>Objective</b> By December 31, 2011, Nalcor will have completed planned 2011 capital investments to support long-term asset reliability and prepared for Upper Churchill Power Contract trial.	
INDICATORS	2011 ACCOMPLISHMENTS
<b>Measure 1</b> Completed planned capital investments	
Refreshed five year capital plan	During 2011, the five year capital plan for 2012-2016 was refreshed based on revised market conditions and information gathered from asset inspections, condition and risk assessments. This information resulted in some adjustments to the required timing and cost estimates for certain projects.
Completed planned 2011 capital investments	During 2011, Churchill Falls completed nearly \$30.2 million in capital investments, compared to an approved 2011 budget of \$31.8 million; a variance of \$1.6 million. This variance resulted when the increased costs of two projects was more than offset with the deferral of planned expenditures on a number of other projects. The largest cost change resulted when the planned 2011 project scope and budget for the major

Issue 3: Upper Churchill asset management and Power Contract adjustments (Nalcor)	
	inspection of two generating units had to be increased. While completing planned activity, difficulties encountered required the complete removal of one generating unit for the first time since its commissioning in 1971. Although the original project scope did not require a complete disassembly of the unit, it provided a unique opportunity for detailed inspection and lessons learned for employees and contractors.
INDICATOR	2011 ACCOMPLISHMENTS
<b>Measure 2</b>	
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. Preparations included commencement of discovery of Hydro-Québec personnel.

The objective, measures and indicators outlined for 2012 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 3: Upper Churchill asset management and Power Contract adjustments (Nalcor)	
<b>Objective</b>	
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.	
Measure	Completed planned capital investments
Indicators	<ul style="list-style-type: none"> <li>▪ Refreshed five year capital plan as required.</li> <li>▪ Completed planned 2012 capital investments.</li> </ul>
Measure	Prepared for Upper Churchill Power Contract trial
Indicator	<ul style="list-style-type: none"> <li>▪ Completed required preparations for the Upper Churchill Power Contract trial.</li> </ul>



#### 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. 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 and is a co-venturer in the Hebron oil field, holding a 4.9 per cent working interest in the province's fourth offshore oil project. 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.

In 2011, Nalcor announced first oil from both the Hibernia South Extension and the White Rose Extension. Beyond investments in existing developments, Nalcor is advancing exploration opportunities in Newfoundland and Labrador's offshore. Oil and gas exploration represents the first piece 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. 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. The seismic data from the survey will build 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 through the provincial government's Offshore Geoscience Data Program.

The company was also directly involved in exploration activity on Newfoundland's west coast through its Parsons Pond drilling program. The information obtained from the two Nalcor Parsons Pond wells is critical in determining the next steps required to understand the region's potential – both onshore and offshore. The data and analysis resulting from these exploration programs will be used to advance our understanding of the prospectivity of existing basins and will also help target future data acquisition programs for frontier exploration areas and unlock the prospectivity of new areas. This information will also support the province's efforts to plan new activities that will encourage exploration and production companies to explore in Newfoundland and Labrador.

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*<sup>10</sup> 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*. Nalcor also initiated an examination of other policy issues including land tenure and access to infrastructure.

Over the planning period, Nalcor will continue to exercise its rights under joint venture

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<sup>10</sup> 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.

agreements to pursue issues of interest to Nalcor and the province and to establish work plans and budgets that 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)	
<b>Goal</b>	
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"> <li>▪ Managed offshore interests</li> <li>▪ Advanced efforts to support exploration activity</li> </ul>
<b>Objective 1</b>	
By December 31, 2011, Nalcor Energy - Oil and Gas will have promoted project work plans and budgets to preserve key project milestones and advanced its exploration strategy.	
<b>Measure</b>	
Promoted work plans and budgets and advanced exploration strategy	
INDICATORS	2011 ACCOMPLISHMENTS
<p>Worked with partners to support achievement of key project milestones:</p> <ul style="list-style-type: none"> <li>▪ West White Rose (Phase 1) - first production in 2011</li> <li>▪ Hebron Project - first oil currently targeted for 2017</li> <li>▪ Hibernia Southern Extension - first production in 2011</li> </ul>	<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 2011:</p> <ul style="list-style-type: none"> <li>▪ West White Rose first oil in September 2011.</li> <li>▪ Hebron Project development plan submitted in April 2011 and public hearings completed. First oil currently targeted for 2017.</li> <li>▪ Hibernia South Extension first oil in June 2011.</li> <li>▪ In addition, the North Amethyst Hibernia Formation (North Amethyst Field, White Rose Growth Project) development plan<sup>11</sup> amendment was submitted in December 2011.</li> </ul>
	<p>Nalcor's main objective for the Parsons Pond exploration program was to gain information from this basin to allow further insight and assessment of the geology and petroleum potential. Planned drilling of the first two wells was completed in 2010, and in February 2011, Nalcor and its partners announced their intention not to pursue drilling of the third well. The first two wells encountered gas shows while drilling and analysis of the data showed that drilling in the third location, which is located directly between the first</p>

<sup>11</sup> 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>two wells, would likely show similar results and provide limited additional information about the area's oil potential.</p> <p>During 2011, the company assessed collected data and evaluated future regional exploration activities as planned. Results of drilling, testing and seismic analysis enhanced understanding of both the onshore and offshore parts of the West Coast basin and will help inform targeting of future exploration work in the basin.</p>
Completed regional satellite oil seeps mapping and interpretation study and have data added to a database that can be licensed by oil exploration companies worldwide	Completed planned 2011 activities. Regional satellite oil seep mapping started in late 2010 and completed in 2011. Data collection covered over 1.5 million square kilometers of the offshore area of Newfoundland and Labrador linking into southwest Greenland. Following the study of data, interpreted seeps <sup>12</sup> were added to a database with other exploration data that can be licensed by oil exploration companies.
Advanced North Atlantic Petroleum plate reconstruction project to better understand the evaluation of our offshore basins to identify areas of higher prospectivity	The North Atlantic Plate Reconstruction Project is jointly funded by the Irish Shelf Petroleum Studies Group (ISPSG) and Nalcor (on behalf of the Offshore Geoscience Data Program with the Government of Newfoundland and Labrador). The North Atlantic Petroleum plate reconstruction project <sup>13</sup> was advanced in 2011 with the completion of a planned workshop and technical reviews and will conclude as planned in 2012. Through this project, new insights will be gained to enhance the understanding of what areas may be prospective for hydrocarbon exploration.
Identified priority regional seismic data purchases and acquired data	Nalcor has developed an integrated Exploration Strategy System (NESS) that provides systematic scoring of Newfoundland and Labrador's frontier basins on both the potential for new discoveries and the level of industry knowledge about the basin's petroleum potential (ranges from very little known, e.g. St. Anthony Basin; to extensive knowledge, e.g. Jeanne d'Arc Basin). The NESS system approach was used in 2011 to help identify priority basins to make targeted data purchases during the year. These purchases, made from multi-client data companies, are

<sup>12</sup> Interpreted seeps are deemed to be natural oil seeps as opposed to oil resulting from ship traffic or other man-made spills.

<sup>13</sup> Plate reconstruction provides data to support oil and gas exploration. The Plate Reconstruction Project provides a structural image of the early stages of basin evolution and shows the history of a basin's structural development.

Issue 4: Oil and gas interests, exploration and development (Nalcor)	
	aiding the Nalcor basin evaluation technical work program and will allow for the optimized planning of future Nalcor exploration investments and new data surveys to close material knowledge gaps. Once addressed, the closure of these knowledge gaps could accelerate the opening of new areas/basins to industry exploration activity.
Completed planned seismic data re-processing and updated regional geological models	Completed seismic data re-processing and updated regional geological models as planned. The latest seismic technologies were used to reprocess legacy seismic data from both Western Newfoundland and the Grand Banks. Seismic re-processing applies modern computing power and scientific methods to enhance the data to bring out more geological features compared to what could be seen previously with earlier legacy processing. Reprocessing helps improve the subsurface image and allows for a more accurate understanding of the petroleum potential of a basin.
Completed area prioritization for planned direct or partnered 2012 seismic data acquisition	Completed area prioritization and initiated large-scale, multi-client 2D seismic survey of offshore Newfoundland and Labrador. The survey, commenced by international data and exploration company, TGS <sup>14</sup> , in partnership with the survey's operator, PGS, will provide data to enhance the understanding of the petroleum potential in a number of offshore basins. Planned 2012 seismic data acquisition was advanced to begin in 2011 with some 10,700 kilometers of data acquired.

The objective, measure and indicators outlined for 2012 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 4: Oil and gas interests, exploration and development (Nalcor)	
<b>Objective 1</b>	
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

<sup>14</sup> TGS provides multi-client geoscience data and services to oil and gas Exploration and Production companies; Petroleum Geo-Services (PGS) offers seismic and electromagnetic services, data acquisition, processing, reservoir analysis/interpretation and multi-client library data.

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

Indicators	<ul style="list-style-type: none"><li>▪ 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"><li>▪ West White Rose (North Amethyst Hibernia) development plan amendment review and approval.</li><li>▪ Hebron Project – first oil currently targeted for 2017.</li><li>▪ Hibernia Southern Extension – advanced planned fabrication and construction activities.</li></ul></li><li>▪ 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.</li></ul>
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## Issue 5: Lower Churchill development (Nalcor)

The lower Churchill River is one of the most attractive undeveloped hydroelectric site 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 the Muskrat Falls generating facility and associated Labrador transmission: the Labrador-Island Transmission Link and the Maritime Link. Phase Two of the Lower Churchill Development includes the Gull Island generating facility and associated transmission. Phase One of the Lower Churchill Development will meet the province's capacity and 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.

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 our resources, while providing a stable and competitive energy supply for domestic use and export to markets are key attributes of this Development.

Large projects like the Lower Churchill Development have long lead times and require thorough planning and timely execution. Nalcor uses a staged gate process to advance the development from identification through to completion. This decision gate or staged process is an industry accepted best practice approach for decision making for major capital projects that provides the checks and balances decision makers require to demonstrate that an acceptable level of readiness has been achieved to progress the project through a decision gate.

There are four decision gates in Phase One of the Lower Churchill Development. Decision gate 1 provided approval to proceed with concept selection and decision gate 2 provided approval of

the development scenario and to commence detailed design. To date, Nalcor has made significant progress in key areas to support the process, including: Aboriginal affairs, environmental assessment, engineering and market access/commercial arrangements. Nalcor is currently progressing toward decision gate 3 or project sanction (approval to commence full construction).

### *Aboriginal Affairs*

In February 2010, representatives of the Government of Newfoundland and Labrador, Innu Nation, Innu Band Councils and Nalcor initialled the Upper Churchill Redress Agreement and the Lower Churchill Project Impacts and Benefits Agreement (IBA). At the same time, representatives of the Province, Innu Nation and each Innu Band Council initialled the bilateral Newfoundland and Labrador-Innu Nation land claims agreement-in-principle. On June 30, 2011, the Innu of Labrador voted in favour of ratifying the Tshash Petapen (New Dawn) Agreement<sup>15</sup>; in November, 2011 the official signing occurred. These agreements will introduce benefits to the Innu people of Labrador and the acceptance represents a major step forward for the development of Muskrat Falls.

### *Environmental Assessment*

Environmental Assessment (EA) 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 consider and incorporate these into project planning and decision making.

The registration of the Lower Churchill Hydroelectric Generation Project in December 2006 began the environmental assessment process for the generation project. In February 2009, following consultations with communities and groups throughout the province, Nalcor submitted the required Environmental Impact Statement (EIS) for the Lower Churchill Hydroelectric Generation Project. Public hearings were completed in April 2011 and the Environmental Assessment Joint Review Panel released its report to the federal and provincial ministers of environment in August 2011.<sup>16</sup>

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<sup>15</sup> 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).

<sup>16</sup> On March 15, 2012, the Governments of Canada and Newfoundland and Labrador released the Lower Churchill Hydroelectric Generation Project from the environmental assessment process.



The Labrador-island transmission link project was registered under the *Newfoundland and Labrador Environmental Protection Act* and the *Canadian Environmental Assessment Act* in January 2009, in order to formally initiate the provincial and federal EA reviews. During 2011, significant progress was made in drafting the EIS for the Labrador-island Transmission Link project and this document will be filed in 2012.<sup>17</sup>

#### *Engineering, Procurement and Construction*

In late 2010, Nalcor selected SNC-Lavalin as the engineering, procurement and construction management (EPCM) contractor for the Muskrat Falls generating facility and the Labrador-island transmission link and this contract was formally awarded in March 2011. SNC-Lavalin specializes in hydroelectric developments, transmission, HVdc and civil works, all of which are critical to successful project construction. During the planning period, further detailed engineering will move in parallel with other key project activities as Nalcor progresses through to a project sanction decision for the project.

In 2010, the province released the Lower Churchill Construction Projects Benefits Strategy, outlining the activities and procedures to be followed by Nalcor, its contractor and subcontractors regarding employment and business benefits. Gender equity and diversity programs are critical components of this strategy. During the planning period, the Lower Churchill Construction Projects Benefits Strategy will guide Nalcor as it advances engineering, procurement and construction activities.

#### *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. Based on data available from decision gate 2, Hydro has identified the Muskrat Falls project, with a transmission link between Labrador and the island, to be the least cost alternative to meet the province's growing need for electricity.

Over the last number of years, Nalcor has also advanced two primary market access alternatives for exporting excess power: access to the Hydro-Québec transmission system and

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<sup>17</sup> Filed April 9, 2012.

development of a maritime transmission link.

In November 2010, the development of a maritime transmission link passed a significant milestone when the Governments of Newfoundland and Labrador and Nova Scotia announced an agreement between Nalcor and Emera Inc. The arrangement will result in the development of Muskrat Falls, with a transmission link between Labrador and the island of Newfoundland. In addition to meeting domestic electricity needs, power will also be available for use for industrial development in Labrador. Surplus power will be transmitted through the Maritime Link and access will be available for Nalcor to sell this power into other markets including Atlantic Canada and the Northeastern United States. During the planning period, the Nalcor and Emera Inc. term sheet signed in 2010 will be converted into final legal agreements. Nalcor's efforts to export power across the Québec transmission system resulted in a 2006 application to Hydro-Québec TransÉnergie for transmission service from the Labrador/Québec border to markets in Québec, Ontario, the Maritime Provinces and the Northeastern United States. As a result of the subsequent refusal by Hydro-Québec to provide fair access, Nalcor filed complaints with the Régie de l'énergie for a hearing based on the principles of open access and non-discrimination. In May 2010, the Régie ruled solely in favour of Hydro-Québec and dismissed all legitimate arguments presented by Nalcor. The following month, Nalcor filed an Application for Administrative Revision<sup>18</sup> with the Régie, the first step to appeal the decision. In April 2011, the Régie upheld its May 2010 decision to deny transmission access across the Québec transmission system to Newfoundland and Labrador. In May 2011, Nalcor filed an application for judicial review of the Régie decisions with the Superior Court of Québec; a hearing is scheduled for January 2013.

A significant commercial milestone was achieved in August 2011 when the Government of Canada committed to a federal loan guarantee for the Muskrat Falls project. The loan guarantee is an important 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.

Over the planning period, Nalcor will work to inform the sanction decision for Phase One of the Lower Churchill River hydroelectric development by advancing activities in the following areas:

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<sup>18</sup> Under section 37 of "the Act Respecting the Régie de l'énergie ", the Régie may on its own initiative or on application revise or revoke a previous decision. Upon application for a revision a new panel is appointed to review the decision on specific grounds; no new evidence is filed.

Aboriginal affairs, environmental assessment, engineering, financing and, market access/commercial arrangements.

Issue 5: Lower Churchill development (Nalcor)	
<b>Goal</b> By December 31, 2013, Nalcor will have progressed milestones to advance the sanction decisions for Lower Churchill Development Phase I projects (Muskrat Falls, Labrador-island transmission link, Maritime link) and advanced Phase II (Gull Island) of the Development.	
Measure	Progressed Phase I and Phase II milestones
Indicator	<ul style="list-style-type: none"> <li>▪ Advanced sanction decisions for projects</li> <li>▪ Completed approved engineering, procurement and construction activities for each project</li> <li>▪ Advanced activities to secure transmission access to external electricity markets for Gull Island power</li> </ul>
<b>Objective</b> By December 31, 2011, Nalcor will have advanced Lower Churchill Development Phase I and advanced efforts to secure additional access to electricity markets outside Newfoundland and Labrador.	
<b>Measure</b> Completed required activities to support gate 3 decisions for Muskrat Falls (Phase I Generation Project), Labrador-island transmission link project and Maritime link project, and related to market access for Phase II.	
INDICATORS	2011 ACCOMPLISHMENTS
Participated in the Environmental Assessment process to secure release of the Muskrat Falls generation project	<p>Lower Churchill Generation Project Environmental Impact Statement (EIS) and Nalcor's responses to Information Requests submitted by the joint Federal and Provincial Review Panel were assessed by the Panel and determined to be sufficient, and in January 2011 public hearings were announced. These public hearings were completed in April 2011 and the Environmental Assessment Joint Review Panel released its report to the federal and provincial ministers of environment in August 2011.</p> <p>Nalcor presented the project and its potential impacts and clarified information as required during the 45 day public hearings. In addition to participating in the public hearing process during 2011, Nalcor reviewed the Panel's <i>Response to Environmental Assessment</i> and developed a response strategy.</p>
Advanced Environmental Impact Statement (EIS) for the	During 2011, Nalcor completed planned work to draft the Environmental Impact Statement (EIS) for the Labrador-Island

Issue 5: Lower Churchill development (Nalcor)	
Labrador-Island Transmission Link	Transmission Link in preparation for filing in 2012. Also during 2011, Nalcor completed and filed a series of component studies outlining baseline data required to support the evaluation of environmental effects and/or the development of mitigation measures as well as monitoring programs. These component studies were submitted to both the federal and provincial governments.
Supported Emera's efforts to file environmental registration for the Maritime link	<p>The Maritime Link Project was registered with Canadian Environmental Assessment Agency (CEA Agency) and Newfoundland and Labrador's Department of Environment and Conservation in December 2011.</p> <p>Nalcor supported Emera's efforts to complete the activities required to file environmental registration for the Maritime Link. In addition to providing advice and lessons learned for the completion of baseline studies to support the environmental assessment process, Nalcor completed a review of the Maritime Link Project Description.</p>
Supported efforts to attain final ratification of the Lower Churchill Impact and Benefits Agreement and Churchill Falls Redress Agreement	On June 30, 2011, the Innu of Labrador voted in favour of the Agreement-in-Principle. In November 2011, the official signing of the Innu Land Claims Agreement in Principle, the Lower Churchill Impacts and Benefits Agreement, and the Upper Churchill Redress Agreement occurred. Nalcor supported efforts to develop agreement language.
Advanced the conversion of the Nalcor/Emera term sheet into formal legal agreements	<p>The Governments of Newfoundland and Labrador and Nova Scotia announced on November 18, 2010 that Nalcor and Emera Inc. had signed a term sheet to partner on the development of the Muskrat Falls Generating Station, the Labrador-Island Transmission Link and the Maritime Link.</p> <p>In 2011, significant progress was achieved in converting the Nalcor/Emera term sheet into formal legal and commercial agreements. Both parties are committed to the principles of the term sheet and will work to complete the conversion of the term sheet into formal agreements over the planning period.</p>
Signed agreement for engineering, procurement and construction management (EPCM)	Engineering, procurement and construction management (EPCM) contract for components of Phase One of the Lower Churchill Project, Muskrat Falls was awarded to SNC-Lavalin. The contract includes the Muskrat Falls Generating Facility and the Labrador-Island Transmission Link.

Issue 5: Lower Churchill development (Nalcor)	
Engaged with potential financiers and refined financing strategy as appropriate	<p>During 2011, Nalcor continued to refine the financing strategy for the Muskrat Falls phase of the Lower Churchill Development based on information received from financial and legal advisers, including market requirements for successful project financing structures.</p> <p>Key financing activities completed during the year included establishing a data room containing detailed project and financial information, completion of deliverables required to support the Federal Loan Guarantee and the execution of a Federal Loan Guarantee memorandum of agreement.</p>
Completed planned engineering activities for the Muskrat Falls generation project, the Labrador-island transmission link and the Maritime link	<p>Complete planned engineering and procurement activities for Muskrat Falls, the Labrador-island transmission link and the Maritime link. Key accomplishments include:</p> <ul style="list-style-type: none"> <li>▪ Commenced a horizontal direct drilling pilot bore study well program for the Strait of Belle Isle.</li> <li>▪ Issued a request for proposals for Strait of Belle Isle cable and received responses.</li> <li>▪ Completed sea bed data collection program activities.</li> <li>▪ Received responses to requests for proposals for construction power and road construction.</li> <li>▪ Worked with world-class engineering companies to complete both a physical hydraulic model of the site and models of the generating turbines.</li> <li>▪ Commenced procurement process for long lead times items, including turbines and generators.</li> </ul>
Supported challenge of the Régie de l'énergie ruling regarding complaints filed by Newfoundland and Labrador Hydro, a subsidiary of Nalcor Energy, against Hydro-Québec TransÉnergie via an administrative revision	<p>Nalcor filed an application for revision of the Régie de l'énergie's ruling in 2010, however, in April 2011, the Régie upheld its May 2010 decision against Nalcor's complaints and denied the application for revision. Subsequent to the April 2011 decision by the Régie de l'énergie, Nalcor filed an application with the Superior Court of Québec for the judicial review of the Régie de l'énergie decisions to decline the complaints against Hydro-Québec TransÉnergie and Nalcor's subsequent application for revision of these decisions. Nalcor is continuing to assess all options to obtain non-discriminatory transmission service from Hydro-Québec TransÉnergie.</p>
Identified and progressed next steps pending the outcome of the administrative revision process	<p>As noted above, subsequent to the April 2011 decision by the Régie de l'énergie, Nalcor filed an application with the Superior Court of Québec for the judicial review of the Régie de l'énergie decisions to decline the complaints against</p>

**Issue 5: Lower Churchill development (Nalcor)**

	Hydro-Québec TransÉnergie and Nalcor’s subsequent application for revision of these decisions. Nalcor is continuing to asses all options to obtain non-discriminatory transmission service from Hydro-Québec TransÉnergie.
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The objective, measure and indicators outlined for 2012 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

**Issue 5: Lower Churchill development (Nalcor)**

<b>Objective</b>	
By December 31, 2012, Nalcor will have continued to advance the Lower Churchill Development Phase I and will have progressed efforts to secure additional access to electricity markets outside Newfoundland and Labrador for Phase II (Gull Island) power.	
Measure	Completed required activities to support gate 3 decisions for Muskrat Falls (Phase I Generation Project), Labrador-island transmission link project, and Maritime link project and related to market access for Phase II
Indicators	<ul style="list-style-type: none"> <li>▪ Adhered to the terms and conditions outlined by the federal and provincial governments for the Environmental Assessment release of the Lower Churchill Hydroelectric Generation Project.</li> <li>▪ Filed Environmental Impact Statement (EIS) for the Labrador-island transmission link.</li> <li>▪ Began executing the Lower Churchill Impacts and Benefits Agreement with the Innu Nation of Labrador, as appropriate.</li> <li>▪ Completed the conversion of the Nalcor-Emera term sheet into formal legal agreements.</li> <li>▪ Completed planned engineering activities for the Muskrat Falls generating project, the Labrador-island transmission link, and the Maritime link.</li> <li>▪ Identified and progressed next steps to secure non-discriminatory transmission service from Hydro-Québec TransÉnergie, as appropriate.</li> </ul>

**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 is a world-class facility with 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.

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 2011, Nalcor executed a site lease with ExxonMobil Properties Canada and worked to ensure a smooth transition of the site. Commencing in the fall of 2011, work began to prepare the site for construction related to the Hebron Project. Also during 2011, Nalcor worked to establish processes to monitor all site infrastructure modifications to ensure asset and environmental protection during and beyond the lease period.

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 2011, Nalcor developed a stakeholder engagement process and continued gathering information to inform the long-term strategy for the Bull Arm Fabrication Site.

**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
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Issue 6: Bull Arm Fabrication Site lease management and long-term strategy (Nalcor)	
Indicators	<ul style="list-style-type: none"> <li>▪ Advanced the long-term strategy</li> <li>▪ Executed lease and implemented lease monitoring activities</li> </ul>
<p><b>Objective</b> By December 31, 2011, Nalcor will have completed planned engagement and research activities to inform long-term planning, executed the lease with ExxonMobil and established processes to monitor lease provisions.</p>	
INDICATORS	2011 ACCOMPLISHMENTS
<p><b>Measure 1</b> Gathered information to inform long-term strategy for Bull Arm Fabrication Site</p>	
Developed engagement strategy to inform long-term planning and completed planned engagement activities	Engagement strategy developed and approved. This strategy identifies key stakeholders and consultation activities to ensure that stakeholder ideas and opinions are considered in long-term planning activities. Also during 2011, Nalcor completed planned 2011 engagement activities including discussions with other Nalcor lines of business and meetings with potential customers and local communities.
Advanced research activities to support identification and analysis of alternate business models for the Bull Arm Fabrication Site	Completed planned secondary research to investigate alternate business models in place at various fabrication yards throughout the world. This information will be fully assessed and incorporated in the long-term strategy for the Bull Arm Fabrication Site.
<p><b>Measure 2</b> Executed lease and implemented lease monitoring</p>	
Completed development of lease with ExxonMobil Properties Canada for construction of the Hebron project	Lease negotiations concluded and the lease was executed with ExxonMobil Canada Properties (EMCP) in Fall 2011. The Bull Arm Site will be leased by EMCP for the duration of the construction and commissioning phases of the Hebron Project.
Established and implemented process to monitor key lease provisions related to asset management and environmental protection	Processes established and implemented to monitor key lease provisions, including asset management and environmental protection. Through the management of change process, a key component of Nalcor's approach to asset management, Nalcor monitors all site infrastructure modifications. As well, in 2011, Nalcor established a framework to guide the review of the environmental management systems of EMCP and its contractors and their reporting of significant environmental incidents at Bull Arm during the lease duration.

The objective, measures and indicators outlined for 2012 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)	
<p><b>Objective</b> 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>	
Measure	Gathered additional information to inform long-term strategy for Bull Arm Fabrication Site
Indicators	<ul style="list-style-type: none"> <li>▪ Completed planned engagement activities outlined in the multi-year engagement strategy.</li> <li>▪ Completed additional secondary research to support identification and analysis of alternate business models for the Bull Arm Fabrication Site.</li> </ul>
Measure	Continued lease monitoring activities
Indicators	<ul style="list-style-type: none"> <li>▪ Continued management of change process for approval and monitoring of all site infrastructure modifications.</li> <li>▪ Participated in tenant safety and environment meetings and shared information regarding investigations of incidents and hi-potential near misses.</li> <li>▪ Completed planned reviews and implementation of the key elements of Nalcor's environmental emergency response plan and environmental management framework.</li> </ul>

**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<sup>19</sup> 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 Québec to the Canada-United States border. 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 2011, 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. Extracting value from these activities and positioning Nalcor for an even larger portfolio requires consideration of options to market its energy. During 2011, the company completed further evaluation of marketing options and completed, and began implementing, a long-term implementation plan to grow and develop the energy marketing business.

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

<b>Goal</b>	
By December 31, 2013, Nalcor will have enhanced its energy marketing capability.	
Measure	Enhanced energy marketing capability
Indicators	<ul style="list-style-type: none"> <li>▪ Completed planned implementation activities for long-term energy marketing operations.</li> <li>▪ Increased value of current energy marketing portfolio.</li> </ul>
<b>Objective</b>	

<sup>19</sup> Under 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.

Issue 7: Energy marketing portfolio management and long-term strategy (Nalcor)	
By December 31, 2011, Nalcor will have advanced its long-term implementation plan for energy marketing operations and pursued opportunities to increase the value of the current portfolio.	
INDICATORS	2011 ACCOMPLISHMENTS
<b>Measure 1</b> Completed planned implementation activities for long-term energy marketing operations	
Developed long-term implementation plan for energy marketing operations and completed 2011 planned activities	During 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 2011, Nalcor completed the planned development of a risk management guide for trading operations.
<b>Measure 2</b> Pursued opportunities to increase portfolio value	
Identified and implemented measures to increase portfolio value	Identified and implemented measures to increase portfolio value including successfully negotiating an energy supply contract with New Brunswick Power to provide electricity at mutually beneficial prices. Largely as a result of this measure, Nalcor achieved revenues 18 per cent above benchmark. Also, Nalcor identified measures to enhance energy supply flexibility to enable the delivery of energy to the market during times of higher prices.

The objective, measures and indicators outlined for 2012 are consistent with the direction outlined in the 2011-2013 Strategic Plan.

Issue 7: Energy marketing portfolio management and long-term strategy (Nalcor)	
<b>Objective</b> 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.	
Measure	Completed planned implementation activities for long-term energy marketing operations
Indicators	<ul style="list-style-type: none"> <li>▪ Completed planned 2012 activities outlined in the long-term implementation plan for energy marketing operations.</li> </ul>
Measure	Pursued opportunities to increase portfolio value
Indicators	<ul style="list-style-type: none"> <li>▪ Identified and implemented measures to increase portfolio value.</li> </ul>

## 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 2012, Nalcor and Hydro will continue address the challenge of being a world-class 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 the balance of the 2011-2013 planning period, Hydro will pursue arrangements to secure the energy required from Muskrat Falls for use in the province, enhance asset management and implement programs to support environmental sustainability.

### **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 approaching 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, Churchill Falls (Labrador) Corporation will advance preparations for the Upper Churchill Power Contract trial, scheduled to commence in fall 2013.<sup>20</sup>

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<sup>20</sup> 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 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.

### **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 2012 and 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 hundreds of thousands to households annually and contribute significantly to the reduction of air emissions from thermal, coal and fossil fuel power generation. During the balance of the 2011-2013 planning period, Nalcor will progress milestones to advance the sanction decisions for Phase One (Muskrat Falls, 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 the balance of 2011-2012 planning period, 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 River hydroelectric resource and increased production from Nalcor Energy - Oil and Gas' offshore oil interests. Taking advantage of this opportunity to extract value from these activities requires consideration of options to market this energy. During the remainder of the planning period, Nalcor will continue to advance its long-term implementation plan to grow and develop the energy marketing business.

## ***Appendix 1***

### Other Companies

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

The Lower Churchill Development Corporation (LCDC) was incorporated on December 15, 1978. At that time it was considered as a possible organizational entity for the development of the lower Churchill hydroelectric development. At the end of December 2011, Hydro owned 51 per cent of the shares of LCDC and the federal government owned 49 per cent. The LCDC is presently not an active operating company.

*TRANSPARENCY AND ACCOUNTABILITY ACT  
2011 ANNUAL PERFORMANCE REPORT*

**Appendix 2**  
Energy Portfolio



NALCOR ENERGY  
NEWFOUNDLAND AND LABRADOR HYDRO



*TRANSPARENCY AND ACCOUNTABILITY ACT  
2011 ANNUAL PERFORMANCE REPORT*

***Appendix 3***

**NALCOR ENERGY  
CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2011**

## MANAGEMENT REPORT

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

The Consolidated Financial Statements have been prepared by management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to March 23, 2012. Financial information presented elsewhere in the Business and Financial Report is consistent with that in the Consolidated Financial Statements.

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

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

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



**Ed Martin**

President and Chief Executive Officer



**Derrick Sturge**

Vice President, Finance and Chief Financial Officer

## 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, 2011 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 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, 2011, and the results of its operations and its cash flows for the year then ended, in accordance with Canadian generally accepted accounting principles.

*Deloitte & Touche LLP*


Chartered Accountants  
St. John's, NL  
Canada  
March 23, 2012

## CONSOLIDATED BALANCE SHEET

<i>As at December 31 (millions of dollars)</i>	2011	2010
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	18.7	44.5
Short-term investments	16.9	15.7
Accounts receivable (Note 21 p)	163.6	93.6
Current portion of regulatory assets (Note 6)	2.8	3.8
Inventory	63.5	63.0
Prepaid expenses	4.8	4.7
Derivative assets	0.2	2.0
	270.5	227.3
Property, plant and equipment (Note 4)	2,108.6	1,968.7
Petroleum and natural gas properties (Note 5)	304.2	269.2
Regulatory assets (Note 6)	63.6	65.9
Other long-term assets (Note 7)	294.0	273.7
	3,040.9	2,804.8
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued liabilities	156.1	152.1
Current portion of long-term debt (Note 9)	8.2	8.2
Current portion of regulatory liabilities (Note 6)	137.6	118.9
Deferred credits (Note 21)	11.3	2.6
Derivative liabilities	0.2	0.3
	313.4	282.1
Long-term debt (Note 9)	1,131.5	1,136.7
Regulatory liabilities (Note 6)	33.3	40.9
Asset retirement obligations (Note 10)	24.8	14.8
Long-term payables (Note 11)	42.7	4.6
Employee future benefits (Note 12)	67.6	60.3
	1,613.3	1,539.4
<b>SHAREHOLDER'S EQUITY</b>		
Share capital (Note 13)	122.5	122.5
Contributed capital (Note 13)	390.5	374.1
	513.0	496.6
Accumulated other comprehensive income (Note 14)	46.4	27.3
Retained earnings	868.2	741.5
	914.6	768.8
	1,427.6	1,265.4
	3,040.9	2,804.8
Commitments and contingencies (Note 20)		

See accompanying notes

On Behalf of the Board



**Ed Martin**  
Director



**Gerald Shortall**  
Director

## CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

<i>For the year ended December 31 (millions of dollars)</i>	2011	2010
<b>Revenue</b>		
Energy sales	695.6	588.8
Interest and finance income (Note 17)	20.2	18.0
Other revenue	14.1	13.3
	<b>729.9</b>	<b>620.1</b>
<b>Expenses</b>		
Fuels	156.7	140.4
Power purchased	52.9	44.4
Operations and administration	199.9	181.9
Interest and finance charges (Note 17)	108.4	105.1
Amortization and depletion	87.7	67.5
Other income and expense	(2.4)	3.3
	<b>603.2</b>	<b>542.6</b>
<b>Net income</b>	<b>126.7</b>	<b>77.5</b>
Retained earnings, beginning of year	741.5	664.0
Retained earnings, end of year	<b>868.2</b>	<b>741.5</b>

See accompanying notes

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

<i>For the year ended December 31 (millions of dollars)</i>	2011	2010
<b>Net income</b>	<b>126.7</b>	<b>77.5</b>
<b>Other comprehensive income</b>		
Change in fair value of available for sale financial instruments	31.6	20.6
Change in fair value of derivatives designated as cash flow hedges	0.1	1.1
Amounts recognized in net income	(12.6)	(16.4)
<b>Comprehensive income</b>	<b>145.8</b>	<b>82.8</b>

See accompanying notes

## CONSOLIDATED STATEMENT OF CASH FLOWS

<i>For the year ended December 31 (millions of dollars)</i>	2011	2010
Cash provided by (used in)		
Operating activities		
Net income	126.7	77.5
Adjusted for items not involving a cash flow		
Amortization and depletion	87.7	67.5
Accretion of long-term debt	0.5	0.4
(Gain) loss on disposal of property, plant and equipment	(2.7)	0.7
Unrealized loss on derivative instruments	0.5	0.3
	212.7	146.4
Changes in non-cash working capital balances (Note 18)	(44.9)	64.8
	167.8	211.2
Financing activities		
Increase in contributed capital	16.4	40.6
Increase (decrease) in deferred credits	8.7	(0.5)
Long-term debt retired	-	(29.3)
Increase in long-term payables	38.1	0.3
	63.2	11.1
Investing activities		
Additions to property, plant and equipment	(191.4)	(113.6)
Additions to petroleum and natural gas properties	(63.2)	(82.7)
Increase in other long-term assets	(5.7)	(29.5)
(Increase) decrease in short-term investments	(1.2)	33.5
Proceeds on disposition of property, plant and equipment	4.7	0.5
	(256.8)	(191.8)
Net (decrease) increase in cash	(25.8)	30.5
Cash position, beginning of year	44.5	14.0
Cash position, end of year	18.7	44.5
Cash position is represented by		
Cash	18.7	44.3
Cash equivalents	-	0.2
	18.7	44.5

Supplementary cash flow information (Note 18)

See accompanying notes

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. DESCRIPTION OF BUSINESS

Nalcor Energy (Nalcor) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (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 holds interests in the following subsidiaries and jointly controlled companies:

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

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

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.

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

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

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.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### BASIS OF PRESENTATION

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



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### PRINCIPLES OF CONSOLIDATION

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

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-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.

### 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, 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.

### 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% (2010 - 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 more fully disclosed in Note 6.

#### CASH AND CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash and cash equivalents and short-term investments consist primarily of Canadian Treasury Bills and 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 0.74% to 1.24% (2010 - 0.40% to 1.35%) per annum. Cash and cash equivalents and short-term investments are measured at fair value.

#### INVENTORY

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

#### PROPERTY, PLANT AND EQUIPMENT

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

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment or the fair value of assets contributed. Contributions are 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 capital.

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Estimated service lives of the major assets are as follows:

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

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

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

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

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

### Churchill Falls

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

Hydroelectric generation plant	10-101 years
Transmission and terminals	14-74 years
Service facilities and other	3-79 years

### CAPITALIZED INTEREST

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

### 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.

#### 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.

#### 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 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.

#### 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

### 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 (2010 - 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 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.

#### 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.

#### 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
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
Derivative liabilities	Held for trading
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, 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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.

During the year, Nalcor had foreign exchange forward contracts designated as cash flow hedges (Note 16). In a cash flow hedge relationship, the portion of unrealized gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income. Nalcor had no cash flow hedges in place at December 31, 2011.

Nalcor had no fair value hedges in place at December 31, 2011 or 2010.

### **FUTURE ACCOUNTING CHANGES – INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)**

In October 2010, 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, 2012. Nalcor is a qualifying entity and chose to use the deferral option.

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.

The International Accounting Standards Board (IASB) has deferred its work on rate-regulated activities accounting project and has not provided interim guidance for the recognition and measurement of regulatory assets and liabilities. Accordingly, Nalcor continues to assess existing IFRS guidance to determine the impact of differences that will apply to accounting for rate-regulated activities upon adoption of IFRS. In December 2011, Hydro applied to the PUB for approval to use IFRS as the basis for regulatory reporting.

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 on January 1, 2012 and the accounting elections made.

### **3. CHANGE IN ESTIMATE**

In 2010, Churchill Falls engaged a depreciation specialist to review the service lives of its property, plant and equipment. Based on the analysis performed, the service lives of Churchill Falls' property, plant and equipment were revised effective January 1, 2011. This change is treated as a change in estimate in accordance with CICA Section 1506, "Accounting Changes" and as such has been applied prospectively from January 1, 2011.

#### 4. PROPERTY, PLANT AND EQUIPMENT

	Cost	Contributions		Net Book Value
		In Aid of Construction	Accumulated Amortization	
<i>(millions of dollars)</i>				
<b>2011</b>				
Electric – generation	1,798.0	29.3	636.2	1,132.5
Electric – transmission and distribution	889.7	68.2	298.4	523.1
Development projects	337.5	-	-	337.5
Other	330.3	24.7	190.1	115.5
	<b>3,355.5</b>	<b>122.2</b>	<b>1,124.7</b>	<b>2,108.6</b>
<i>(millions of dollars)</i>				
<b>2010</b>				
Electric – generation	1,767.6	29.5	615.9	1,122.2
Electric – transmission and distribution	849.0	67.9	280.4	500.7
Development projects	240.1	-	-	240.1
Other	309.4	24.0	179.7	105.7
	<b>3,166.1</b>	<b>121.4</b>	<b>1,076.0</b>	<b>1,968.7</b>

As at December 31, 2011 the cost of assets under construction and therefore excluded from costs subject to amortization was \$384.8 million (2010 - \$257.7 million).

Included in Development projects is \$329.0 million related to the lower Churchill hydroelectric development. On November 18, 2010, a term sheet was executed between Nalcor and Emera Inc. (Emera) to develop Muskrat Falls, a hydroelectric development on the lower Churchill River in Labrador, and related transmission assets. The agreement 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. The project has a total estimated cost of \$6.2 billion (excluding financing costs). 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. During 2011, Nalcor continued to work towards sanction as well as finalizing commercial agreements with Emera.

#### 5. PETROLEUM AND NATURAL GAS PROPERTIES

	2011	2010
<i>(millions of dollars)</i>		
Petroleum and natural gas properties	344.0	279.8
Less: accumulated depletion	39.8	10.6
	<b>304.2</b>	<b>269.2</b>



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Internal costs directly related to acquisition, exploration and development activities capitalized in 2011 were \$0.5 million (2010 - \$0.6 million).

As at December 31, 2011, \$139.1 million (2010 - \$174.7 million) of accumulated costs of petroleum and natural gas properties were not subject to depletion and depreciation.

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 71% 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 have been included in the calculation of 2011 depletion.

### 6. REGULATORY ASSETS AND LIABILITIES

<i>(millions of dollars)</i>	2011	2010	Remaining Recovery Settlement Period (years)
<b>Regulatory assets</b>			
Foreign exchange losses	64.7	66.8	30.0
Deferred major extraordinary repairs	0.6	2.3	0.8
Deferred energy conservation costs	1.1	0.6	n/a
<b>Total regulatory assets</b>	<b>66.4</b>	<b>69.7</b>	
Less current portion	2.8	3.8	
	<b>63.6</b>	<b>65.9</b>	
<b>Regulatory liabilities</b>			
Rate stabilization plan	170.3	159.2	n/a
Deferred purchased power savings	0.6	0.6	15.5
<b>Total regulatory liabilities</b>	<b>170.9</b>	<b>159.8</b>	
Less current portion	137.6	118.9	
	<b>33.3</b>	<b>40.9</b>	

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.

#### 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 twenty-five percent of the outstanding balance at year end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to, or subtracted from, the rates that would otherwise be in effect. A portion of the RSP balance totalling approximately \$100 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 reduced use of the Holyrood Thermal Generating Station (HTGS) leading to fuel savings at the HTGS as a result of the shut down 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 2011, \$20.9 million was deferred (2010 - \$23.3 million recognized) in the RSP and \$25.4 million (2010 - \$2.3 million) was recovered through rates and included in energy sales, with the corresponding cost amortized in fuel expenses.

#### 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 40-year period. This amortization, of \$2.1 million annually, is included in interest expense (Note 17).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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 2011, \$1.7 million (2010 - \$2.6 million) of amortization was recognized in Operations and administration expense.

### 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 2011, \$0.5 million (2010 - \$0.4 million) was deferred.

### DEFERRED PURCHASED POWER SAVINGS

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-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. These savings in the amount of \$0.6 million (2010 - \$0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

### PROPERTY, PLANT AND EQUIPMENT

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2011, Hydro's AFUDC of 7.6% is lower than its cost of debt of 8.4% and the amount capitalized is lower and interest expense is higher by \$0.2 million than that which would be permitted under Canadian GAAP in the absence of rate regulation. In 2010, Hydro's AFUDC of 7.6% was higher than its cost of debt of 7.2% and the amount capitalized was higher and interest expense was lower by \$0.1 million than that which would be permitted under Canadian GAAP in the absence of rate regulation.

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

currently estimates that switching from the use of sinking fund to straight-line amortization for hydroelectric and transmission assets, as well as changing from unit based amortization to a group based method on a remaining life basis and implementing the recommended service lives, would have resulted in an estimated decrease of \$1.0 million in the annual amortization expense. In December 2011, Hydro applied to the PUB requesting approval of these recommended changes. Approval has not yet been received.

## 7. OTHER LONG-TERM ASSETS

<i>(millions of dollars)</i>		2011	2010
Long-term receivables	(a)	1.6	26.0
Sinking funds	(b)	247.0	208.4
Reserve fund	(c)	45.4	39.3
		<b>294.0</b>	<b>273.7</b>

(a) Included in long-term receivables are two refundable deposits, one in the amount of \$1.3 million (2010 - \$1.2 million) associated with an application for transmission service into Nova Scotia, bearing interest at the Prime Rate less 1% and a second in the amount of \$0.1 million (2010 - \$0.1 million) associated with an application for transmission service in New Brunswick, bearing interest at the Prime Rate. During 2011, Hydro-Quebec refunded two deposits totalling \$24.1 million associated with applications for transmission service through Quebec. The remaining balance of \$0.2 million (2010 - \$0.3 million) is the non-current portion of receivables associated with customer time payment plans and the long-term portion of employee purchase programs.

(b) 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 3.12% to 9.86% (2010 - 3.86% to 9.86%).

(c) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a \$75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement [Note 20(j)]. A summary of Nalcor's 65.8% share of the reserve fund is as follows:

<i>(millions of dollars)</i>		2011	2010
Opening balance		39.3	34.8
Contribution		5.3	5.3
Net interest		0.1	(0.4)
Mark-to-market adjustment		0.7	(0.4)
Fair value of reserve fund		<b>45.4</b>	<b>39.3</b>

## 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>	2011	2010
Current assets	41.8	39.2
Long-term assets	394.8	375.8
Current liabilities	19.0	15.6
Long-term liabilities	16.2	14.0
Revenues	64.2	74.1
Expenses	43.1	50.8
Net income	21.1	23.3
Cash provided by (used in)		
Operating activities	32.3	48.3
Financing activities	0.9	(27.9)
Investing activities	(32.6)	(0.4)

Income tax expense in the amount of \$0.2 million (2010 - \$0.2 million) related to a jointly controlled subsidiary, Twin Falls, has been included in expenses.

### 9. LONG-TERM DEBT

<i>(millions of dollars)</i>	2011	2010
Long-term debt	1,139.7	1,144.9
Less current portion	8.2	8.2
	1,131.5	1,136.7

#### NALCOR

In March 2011, Nalcor renegotiated the terms of its credit facility with its banker in order to achieve alignment with its revised short-term working capital needs. The facility was converted to a demand operating facility with a limit of \$100.0 million, with no change in the financial covenants. 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 only drawing on the facility was one irrevocable letter of credit issued to the Department of Fisheries and Oceans. This letter of credit, in the amount of \$0.3 million [Note 20(g)], was issued in connection with the operation of hydroelectric assets on the Exploits River.

HYDRO

	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2011	2010
<i>(millions of dollars)</i>						
V *	125.0	10.50	1989	2014	124.7	124.6
X *	150.0	10.25	1992	2017	149.4	149.3
Y *	300.0	8.40	1996	2026	293.5	293.3
AB *	300.0	6.65	2001	2031	306.5	306.7
AD *	125.0	5.70	2003	2033	123.6	123.6
AE	225.0	4.30	2006	2016	224.0	223.8
Total debentures	1,225.0				1,221.7	1,221.3
Less: sinking fund investments in own debentures					82.0	76.4
					1,139.7	1,144.9
Less: payments due within one year					8.2	8.2
					1,131.5	1,136.7

\* 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 was waived for 2010. The fee for 2011 was \$3.9 million.

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2011 there were no promissory notes outstanding (2010 - nil).

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 (2010 - 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 [Note 20(g)] reducing the availability of the credit facility by \$18.9 million (2010 - \$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>	2012	2013	2014	2015	2016
Sinking fund requirement	8.2	8.2	8.2	8.2	8.2
Long-term debt repayment	-	-	125.0	-	225.0
	8.2	8.2	133.2	8.2	233.2

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### CHURCHILL FALLS

#### Operating Credit Facility

Churchill Falls maintains a \$10.0 million Canadian or US equivalent unsecured operating credit facility with its banker. Advances may take the form of a Prime Rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the Prime Rate or prevailing Government BA Fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate.

Churchill Falls has issued three irrevocable letters of credit totalling \$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 Department of Environment and Conservation [Note 20(g)].

### 10. ASSET RETIREMENT OBLIGATIONS

<i>(millions of dollars)</i>	2011	2010
Asset retirement obligations, beginning of year	14.8	-
Liabilities incurred	3.7	15.2
Accretion	0.7	0.1
Revisions	5.6	(0.5)
Asset retirement obligations, end of year	24.8	14.8

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 total undiscounted estimated cash flows required to settle the HTGS obligations at December 31, 2011 are \$27.0 million (2010 - \$20.5 million). Payments to settle the liability are expected to occur between 2021 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 2.9% (2010 - 4.1%).

The total undiscounted estimated cash flows required to settle the PCB obligations at December 31, 2011 are \$3.6 million. Payments to settle the liability are expected to occur between 2012 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 5.6%.

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, 2011 is \$8.9 million (2010 -\$4.8 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 Nalcor's credit adjusted risk free rates ranging between 5.0% and 6.2% (2010 - 4.7%).

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.

## 11. LONG-TERM PAYABLES

The long-term payables consist of a payable to Hydro-Quebec and a payable to the Innu Nation.

The long-term payable to Hydro-Quebec as at December 31, 2011 represents the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which is being tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, \$0.4 million of the amount is current and is recorded in Accounts payable and accrued liabilities while the remaining \$4.8 million (2010 - \$4.6 million) is long-term. The final amount will be determined on August 31, 2012 and will be paid or collected monthly beginning September 2012 and ending August 2016.

The long-term payable to the Innu Nation relates to the Upper Churchill Redress Agreement that was ratified in November 2011. Under this agreement, Nalcor is required to pay, to the Innu Nation, \$2.0 million annually escalated by 2.5% until 2041. Currently, \$2.0 million of the amount is current and is recorded in Accounts payable and accrued liabilities while the remaining \$37.9 million is long-term. Nalcor has also recorded funding receivable from the Province in relation to the Upper Churchill Redress Agreement as outlined in Note 21(p).

## 12. EMPLOYEE FUTURE BENEFITS

### PENSION PLAN

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$6.4 million (2010 - \$5.8 million) are expensed as incurred.

### OTHER BENEFITS

Nalcor provides group life insurance and healthcare benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2011, cash payments to beneficiaries for its unfunded other employee future benefits was \$2.6 million (2010 - \$2.4 million). The most recent actuarial valuation was performed as at December 31, 2009 and extrapolated to December 31, 2011. The next actuarial valuation will be performed as at December 31, 2012.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

<i>(millions of dollars)</i>	2011	2010
Accrued benefit obligation		
Balance at beginning of year	87.5	72.7
Current service cost	3.3	2.6
Interest cost	5.1	4.8
Actuarial loss	21.0	9.8
Benefits paid	(2.6)	(2.4)
Balance at end of year	114.3	87.5
Plan deficit	114.3	87.5
Unamortized actuarial loss	(46.5)	(27.0)
Unamortized past-service cost	(0.2)	(0.2)
Accrued benefit liability at end of year	67.6	60.3

<i>(millions of dollars)</i>	2011	2010
Component of benefit cost		
Current service cost	3.3	2.6
Interest cost	5.1	4.8
Actuarial loss	21.0	9.8
	29.4	17.2
Difference between actuarial loss and amount recognized	(19.5)	(8.9)
Benefit expense	9.9	8.3

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

	2011	2010
Discount rate – benefit cost	5.75%	6.50%
Discount rate – accrued benefit obligation	4.55%	5.75%
Rate of compensation increase	3.50%	3.50%

Assumed healthcare trend rates:

	2011	2010
Initial health care expense trend rate	7.50%	7.50%
Cost trend decline to	5.00%	5.00%
Year that rate reaches the rate it is assumed to remain at	2016	2016

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

<i>Increase</i>	2011	2010
Current service and interest cost	1.7	1.3
Accrued benefit obligation	23.1	15.1
<i>Decrease</i>	2011	2010
Current service and interest cost	(1.3)	(1.0)
Accrued benefit obligation	(17.6)	(11.7)

### 13. SHAREHOLDER'S EQUITY

#### SHARE CAPITAL

<i>(millions of dollars)</i>	2011	2010
Common shares of par value \$1 each		
Authorized: unlimited		
Issued and outstanding 122,500,000 (2010 - 122,500,000)	122.5	122.5

#### CONTRIBUTED CAPITAL

<i>(millions of dollars)</i>	2011	2010
Total contributed capital	390.5	374.1

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 2011, the Province contributed capital in the amount of \$16.0 million (2010 - \$40.0 million) and the Trust contributed \$0.4 million (2010 - \$0.6 million).

### 14. ACCUMULATED OTHER COMPREHENSIVE INCOME

<i>(millions of dollars)</i>	2011	2010
Balance, beginning of year	27.3	22.0
Change in fair value of available for sale financial instruments	31.6	20.6
Change in fair value of derivatives designated as cash flow hedges	0.1	1.1
Amount recognized in net income	(12.6)	(16.4)
Balance, end of year	46.4	27.3

### 15. CAPITAL MANAGEMENT

Nalcor's primary objectives when managing capital are 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. Nalcor's approach to capital management is performed on a consolidated basis. Management monitors the capital requirement for each subsidiary individually.

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the capital structure is outlined below:

<i>(millions of dollars)</i>	2011	2010		
Debt				
Long-term debt	1,131.5	1,136.7		
Current portion of long-term debt	8.2	8.2		
Sinking funds	(247.0)	(208.4)		
	892.7	936.5	38.5%	42.5%
Equity				
Share capital	122.5	122.5		
Contributed capital	390.5	374.1		
Accumulated other comprehensive income	46.4	27.3		
Retained earnings	868.2	741.5		
	1,427.6	1,265.4	61.5%	57.5%
Total debt and equity	2,320.3	2,201.9	100.0%	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, 2011, Nalcor was in compliance with these covenants.

### HYDRO

Hydro's principal business requires ongoing access to capital in order to maintain 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.

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

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% common 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 million. There was no balance outstanding as at December 31, 2011 or 2010. 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.

#### 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 (share capital, contributed capital and retained earnings). The capital structure is adjusted through the amount of dividends paid to shareholders.

#### OIL AND GAS

The capital managed by Oil and Gas is composed of share capital, contributed capital and retained earnings. Oil and Gas' objective, when managing capital, is to maintain its ability to continue as a going concern. Oil and Gas' future requirements for capital are expected to increase, coincident with the increase in development projects. This increased demand for capital is expected to be temporary and will abate as projects under development move into the production stage. Due to the temporary nature of the capital requirement, these requirements will be funded entirely through contributed capital as well as internal cash flows. A balanced approach to dividends will ensure maximum return to the shareholder while ensuring liquidity levels adequate to address normal business risk.

Future requirements for capital are expected to increase to fund Oil and Gas' share of project development costs. Capital costs to date have been financed by equity. As projects reach the production stage, Cash flow generated from operations contributes toward funding its capital requirements by reducing the reliance on Nalcor to finance growth.

#### 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 ensure the availability of sufficient cash to satisfy capital requirements.

### 16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

#### FAIR VALUE

The estimated fair values of financial instruments as at December 31, 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Carrying Value	Fair Value	Carrying Value	Fair Value
(millions of dollars)	2011		2010	
<b>Financial assets</b>				
Cash and cash equivalents	18.7	18.7	44.5	44.5
Short-term investments	16.9	16.9	15.7	15.7
Accounts receivable	163.6	163.6	93.6	93.6
Derivative assets	0.2	0.2	2.0	2.0
Sinking funds – investments in same Hydro issue	82.0	103.7	76.4	93.6
Sinking funds – other investments	247.0	247.0	208.4	208.4
Reserve fund	45.4	45.4	39.3	39.3
Long-term receivable <sup>(1)</sup>	1.6	n/a	26.0	n/a
<b>Financial liabilities</b>				
Accounts payable and accrued liabilities	156.1	156.1	152.1	152.1
Derivative liabilities	0.2	0.2	0.3	0.3
Long-term debt including amount due within one year (before sinking funds)	1,221.7	1,695.3	1,221.3	1,589.7
Long-term payables	42.7	43.2	4.6	4.7

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

<sup>(1)</sup> The fair value of the long-term receivable subject to uncertainty regarding the timing of future cash flows and as such, the fair value of the long-term receivable could not be determined as at December 31, 2011 and 2010.

### 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.

**TRANSPARENCY AND ACCOUNTABILITY ACT  
2011 ANNUAL PERFORMANCE REPORT**

The following table presents Nalcor's fair value hierarchy for financial assets and liabilities as at December 31. There were no transfers between Level 1 and Level 2 during the year:

	Level 1	Level 2	Total
<i>(millions of dollars)</i>	<b>2011</b>		
<b>Financial assets</b>			
Cash and cash equivalents	18.7	-	18.7
Short-term investments	16.9	-	16.9
Accounts receivable	163.6	-	163.6
Derivative assets	-	0.2	0.2
Sinking funds – investments in same Hydro issue	-	103.7	103.7
Sinking funds – other investments	-	247.0	247.0
Reserve fund	-	45.4	45.4
<b>Financial liabilities</b>			
Accounts payable and accrued liabilities	156.1	-	156.1
Derivative liabilities	-	0.2	0.2
Long-term debt including amount due within one year (before sinking funds)	-	1,695.3	1,695.3
Long-term payables	-	43.2	43.2
	<b>2010</b>		
<b>Financial assets</b>			
Cash and cash equivalents	44.5	-	44.5
Short-term investments	15.7	-	15.7
Accounts receivable	93.6	-	93.6
Derivative assets	-	2.0	2.0
Sinking funds – investments in same Hydro issue	-	93.6	93.6
Sinking funds – other investments	-	208.4	208.4
Reserve fund	-	39.3	39.3
<b>Financial liabilities</b>			
Accounts payable and accrued liabilities	152.1	-	152.1
Derivative liabilities	-	0.3	0.3
Long-term debt including amount due within one year (before sinking funds)	-	1,589.7	1,589.7
Long-term payables	-	4.7	4.7

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2011 and 2010.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### RISK MANAGEMENT

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

#### Credit Risk

Nalcor is exposed to credit risk in the event of non performance by counterparties to its financial instruments. The majority of the receivables are from regulated utilities which minimizes credit risk. There is risk that Nalcor will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments arise in the normal course of business and do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Nalcor manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers. As at December 31, 2011 security deposits of \$0.7 million (2010 - \$0.1 million) are included in accounts payable and accrued liabilities.

Nalcor's three largest customers account for 72.3% (2010 - 78.3%) of total energy sales and 63.4% (2010 - 59.6%) of accounts receivable. These customers are comprised of rate regulated entities 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, 2011.

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

#### Liquidity Risk

Nalcor is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. This risk is managed by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cash flows.

Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a \$300.0 million promissory note program and credit facilities.

Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues, with the exception of Series AE.

The following are the contractual maturities of Nalcor's financial liabilities, including principal and interest, as at December 31, 2011:

<i>(millions of dollars)</i>	<1 Year	1-3 Years	3-5 Years	>5 Years	Total
Accounts payable and accrued liabilities	156.1	-	-	-	156.1
Derivative liabilities	0.2	-	-	-	0.2
Long-term debt including amount					
due within one year	-	125.0	225.0	875.0	1,225.0
Long-term payables	-	6.9	6.7	78.3	91.9
Interest	61.9	174.2	152.7	649.2	1,038.0
	218.2	306.1	384.4	1,602.5	2,511.2

#### Market Risk

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

#### Interest Rates

Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management includes the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Nalcor attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Nalcor is exposed to interest rate risk related to the short-term debt portfolio, the sinking fund investment portfolios and reserve fund investment portfolios. Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

The following table illustrates Nalcor's exposure to a 50 basis points (0.5%) change in interest rates:

<i>(millions of dollars)</i>	Net Income		Other Comprehensive Income	
	0.5% decrease	0.5% increase	0.5% decrease	0.5% increase
Interest on short-term investments	(0.1)	0.1	-	-
Interest on sinking fund	-	-	20.0	(2.7)
Interest on reserve fund	-	-	1.0	(1.0)
	(0.1)	0.1	21.0	(3.7)



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### *Foreign Currency and Commodity Exposure*

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

During 2011, Hydro had total purchases of No. 6 fuel of \$135.1 million (2010 - \$104.1 million) denominated in USD. Exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in fuel prices including exchange rates, as compared to that approved in Hydro's most recent cost of service study, are captured in the RSP and are either refunded to, or collected from, customers through rate adjustments. Hydro also employs the periodic use of forward currency contracts to manage exposure to exchange rates on a particular day.

During 2011, total electricity sales denominated in USD were \$67.9 million (2010 - \$72.8 million). In 2011 Hydro mitigated this risk through the use of commodity swaps and foreign currency forward contracts.

During 2011, total oil energy sales denominated in USD were \$90.4 million (2010 - \$15.2 million). Oil and Gas has sales denominated in USD that are based on prevailing market oil prices. Market risk associated with fluctuations in oil prices and foreign exchange rates is managed consistent with Nalcor's financial risk management policy. Oil and Gas has exposure to fluctuations in the USD/CAD exchange rate based on its sales, which are denominated in USD. However, a significant portion of Oil and Gas' planned capital expenditures are denominated in USD, which mitigates this exposure. Oil and gas also mitigates its commodity risk exposure through the use of commodity swaps.

During 2009, Hydro entered into a series of 24 monthly foreign exchange forward contracts with a notional value of \$87.9 million USD to hedge foreign exchange risk on 75% of Hydro's USD electricity sales. These contracts had an average exchange rate of \$1.17 CAD per USD. These contracts were designated as part of a hedging relationship. The last of these contracts expired in April 2011.

During 2011, Hydro entered into a series of nine monthly foreign exchange forward contracts with a notional value of \$35.7 million USD to hedge foreign exchange risk on 75% of Hydro's USD electricity sales. These contracts had an average exchange rate of \$1.00 CAD per USD.

In 2011, Hydro also entered into 20 commodity swap contracts with a notional value of \$27.8 million USD to hedge commodity price risk on electricity sales. These contracts swapped floating market rates for fixed rates, with Hydro receiving an average fixed rate of \$35.37 USD/MWh (2010 - \$36.01 USD/MWh). During 2011, \$1.9 million in losses from these contracts were included in Other income and expense (2010 - \$3.4 million).

In February 2011, Oil and Gas entered into 11 commodity swap contracts with a notional value of \$17.4 million USD to hedge a portion of its commodity price risk on sales. In exchange for paying the market rate over the term of the contract, Oil and Gas received an average fixed price of \$100.53 USD/BBL. These contracts have not been designated as part of a hedging relationship. During 2011, \$2.0 million in losses from these contracts were included in Other income and expense.

#### EFFECT OF HEDGE ACCOUNTING ON FINANCIAL STATEMENTS

	Net Gains Included in Net Income	Unrealized Gains Included in OCI	Net Gains Included in Net Income	Unrealized Gains Included in OCI
<i>(millions of dollars)</i>	2011		2010	
Ineffective portion	(0.1)	-	0.2	-
Effective portion	1.5	-	5.9	1.3

The ineffective portion of hedging gains and losses is included in net income through Other income and expense.

#### 17. INTEREST AND FINANCE INCOME/CHARGES

<i>(millions of dollars)</i>	2011	2010
Interest and finance income		
Interest on sinking fund	16.6	15.2
Interest on reserve fund	1.5	1.4
Other interest income	2.1	1.4
	20.2	18.0
Interest and finance charges		
Long-term debt	90.5	91.7
Interest on rate stabilization plan	12.2	10.2
Accretion of long-term debt	0.5	0.4
Amortization of deferred foreign exchange losses	2.1	2.1
Debt guarantee fee	3.9	-
Other	0.7	1.9
	109.9	106.3
Interest capitalized during construction	(1.5)	(1.2)
	108.4	105.1

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 18. SUPPLEMENTARY CASH FLOW INFORMATION

<i>(millions of dollars)</i>	2011	2010
Accounts receivable	(70.0)	(4.7)
Inventory	(0.5)	(3.5)
Prepaid expenses	(0.1)	(1.4)
Regulatory assets	3.3	4.4
Regulatory liabilities	11.1	37.2
Accounts payable and accrued liabilities	4.0	26.9
Employee future benefits	7.3	5.9
Changes in non-cash working capital balances	(44.9)	64.8
Income taxes paid	0.2	0.2
Interest received	2.5	2.2
Interest paid	90.9	92.4

### 19. SEGMENT INFORMATION

Nalcor operates in five business segments. Hydro Regulated encompasses sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Quebec. Oil and Gas activities include exploration, development, production, transportation and processing sectors of the oil and gas industry. Energy Marketing activities include the sale of electricity to markets outside the province. Other encompasses industrial fabrication, some non-regulated electricity sales, development activities including 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.

TRANSPARENCY AND ACCOUNTABILITY ACT  
2011 ANNUAL PERFORMANCE REPORT

	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Other	Inter- Segment	Total
<i>(millions of dollars)</i>							
<b>2011</b>							
<b>Revenue</b>							
Energy sales	469.2	66.2	88.5	69.7	5.9	(3.9)	695.6
Interest and finance income	17.6	1.7	0.1	0.6	0.7	(0.5)	20.2
Other revenue	2.3	0.3	3.5	-	4.7	3.3	14.1
	489.1	68.2	92.1	70.3	11.3	(1.1)	729.9
<b>Expenses</b>							
Fuels	156.7	-	-	-	-	-	156.7
Power purchased	52.2	-	-	4.6	-	(3.9)	52.9
Operations and administration	104.2	41.8	21.4	20.6	11.9	-	199.9
Interest and finance charges	108.4	0.3	-	-	0.2	(0.5)	108.4
Amortization	45.7	12.2	29.6	-	0.2	-	87.7
Other income and expense	0.9	(7.2)	2.0	1.8	0.1	-	(2.4)
	468.1	47.1	53.0	27.0	12.4	(4.4)	603.2
Net income (loss) from operations	21.0	21.1	39.1	43.3	(1.1)	3.3	126.7
Preferred dividends	-	3.3	-	-	-	(3.3)	-
Net income (loss)	21.0	24.4	39.1	43.3	(1.1)	-	126.7
Capital expenditures	63.1	25.6	63.3	-	102.6	-	254.6
Total assets	1,866.6	436.6	329.5	3.9	454.4	(50.1)	3,040.9

	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Other	Inter- Segment	Total
<i>(millions of dollars)</i>							
<b>2010</b>							
<b>Revenue</b>							
Energy sales	417.1	76.0	15.3	77.5	6.8	(3.9)	588.8
Interest and finance income	16.1	1.7	-	-	0.5	(0.3)	18.0
Other revenue	2.3	0.3	3.9	-	3.3	3.5	13.3
	435.5	78.0	19.2	77.5	10.6	(0.7)	620.1
<b>Expenses</b>							
Fuels	140.3	-	-	-	0.1	-	140.4
Power purchased	44.2	-	-	4.1	-	(3.9)	44.4
Operations and administration	97.1	40.5	10.7	21.4	12.2	-	181.9
Interest and finance charges	102.9	1.6	0.1	0.5	0.3	(0.3)	105.1
Amortization	43.8	12.6	10.9	-	0.2	-	67.5
Other income and expense	0.7	-	-	2.6	-	-	3.3
	429.0	54.7	21.7	28.6	12.8	(4.2)	542.6
Net income (loss) from operations	6.5	23.3	(2.5)	48.9	(2.2)	3.5	77.5
Preferred dividends	-	3.5	-	-	-	(3.5)	-
Net income (loss)	6.5	26.8	(2.5)	48.9	(2.2)	-	77.5
Capital expenditures	55.5	9.9	82.8	-	48.1	-	196.3
Total assets	1,831.5	417.0	278.3	7.4	324.7	(54.1)	2,804.8

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### GEOGRAPHIC INFORMATION

Revenues by geographic area:

<i>(millions of dollars)</i>	2011	2010
Newfoundland and Labrador	599.6	476.4
Quebec	62.1	71.9
New Brunswick	56.7	60.7
Nova Scotia	11.5	11.1
	<b>729.9</b>	<b>620.1</b>

All of Nalcor's physical assets are located in the province.

### 20. 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 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:

2012	\$19.0 million
2013	\$19.0 million
2014	\$4.8 million

- (d) Nalcor and its subsidiaries have received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Nalcor's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be \$0.4 million (2010 - \$0.1 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately \$21.9 million (2010 - \$21.8 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this action is not determinable 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 \$54.0 million (2010 - \$41.6 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

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

(millions of dollars)	2012	2013	2014	2015	2016
Power purchases	24.8	25.5	26.1	26.8	27.3

- (g) Nalcor has issued an irrevocable letter of credit, in the amount of \$0.3 million, to the Department of Fisheries and Oceans. This letter of credit was issued connection with the operation of the hydroelectric assets on the Exploits River.

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 three 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Oil and Gas has issued two irrevocable letters of credit, totaling \$4.7 million, to ensure compliance with regulations relating to petroleum and natural gas exploration and production activities.

- (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, 2011 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 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.
- (j) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a \$75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested \$17.0 million in each of 2007, 2008 and 2009, and \$8.0 million in 2010 and 2011. The remaining investments were acquired in January 2012.

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holdings consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 Canadian Chartered Banks. Nalcor's share of this commitment is 65.8%.

### 21. RELATED PARTY TRANSACTIONS

Nalcor 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 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.

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

		The Province	Other Affiliates	Total
<i>(millions of dollars)</i>		2011		
Revenue	(e)(f)(g)(h)(o)(q)	4.2	-	4.2
Expenses	(b)(c)(d)(i)(j)(k)(l)(n)(p)	(18.0)	1.9	(16.1)
Accounts receivable	(c)(e)(o)(p)	40.5	0.6	41.1
Accounts payable and accrued liabilities	(b)(d)(i)(j)(k)(l)(n)	19.4	0.6	20.0
Deferred credits	(f)(g)(h)(m)	10.4	-	10.4
<i>(millions of dollars)</i>		2010		
Revenue	(e)(f)(g)(h)(o)(q)	7.1	-	7.1
Expenses	(b)(c)(d)(i)(j)(k)(l)(n)	16.3	1.3	17.6
Accounts receivable	(c)(e)(o)	0.9	1.8	2.7
Accounts payable and accrued liabilities	(b)(d)(i)(j)(k)(l)(n)	10.5	0.1	10.6
Deferred credits	(f)(g)(h)(m)	2.5	-	2.5

- (a) On January 19, 2011, the PUB issued Board Order No. P.U. 1 (2011) approving a modification to the RSP rules to reduce the balance owing to industrial customers by \$10.0 million. The order also approved Hydro's reimbursement of the amount to the Province. The payment was made to the Province on January 27, 2011.
- (b) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of \$6.0 million (2010 - \$6.0 million) of the power produced by Churchill Falls.
- (c) For the year ended December 31, 2011, approximately \$4.1 million (2010 - \$3.7 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. At December 31, 2011, \$0.5 million (2010 - \$1.7 million) was receivable from Churchill Falls.
- (d) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2011, Hydro incurred \$1.2 million in costs related to the PUB (2010 - \$0.6 million) of which \$0.6 million (2010 - \$0.1 million) was included in Accounts payable and accrued liabilities.
- (e) During 2011, Hydro received \$0.4 million (2010 - \$0.4 million) as a rate subsidy for rural isolated customers from the Province and \$1.7 million (2010 - \$1.6 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with \$0.3 million (2010 - \$0.3 million) recorded as Accounts receivable at year end.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (f) During 2010, Bull Arm Fabrication received \$1.0 million from the Province. As at December 31, 2010, \$0.3 million was included in Deferred credits. No amount remains in Deferred credits at December 31, 2011.
- (g) 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. As at December 31, 2011, \$4.5 million of funds have been received (2010 - \$1.0 million) and \$2.5 million is included in Deferred credits (2010 - \$0.6 million receivable).
- (h) 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. As at December 31, 2011, \$10.5 million has been received from the Province (2010 - \$5.0 million) of which \$4.4 million has been recorded in Deferred credits (2010 - \$2.1 million).
- (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 1969 Power Contract. To date, \$1.4 million (2010 - \$0.8 million) has been received and \$0.2 million (2010 - \$0.2 million) has been accrued as due from the Trust.
- (j) 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 reported as retained earnings. As at December 31, 2011, \$0.8 million (2010 - \$0.8 million) of distributions payable to the Province are included in Accounts payable and accrued liabilities. Bull Arm Fabrication also has a payable to the Province of \$0.3 million (2010 - \$0.3 million) related to costs incurred prior to the transfer of Bull Arm Fabrication to Nalcor.
- (k) Nalcor, as the operator of the Exploits assets, has a net payable to the Province of \$9.9 million (2010 - \$5.7 million) which is included in Accounts payable and accrued liabilities. Nalcor operates these assets on behalf of the Province on a cost recovery basis.
- (l) 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, 2011, \$5.3 million (2010 - \$5.6 million) was payable.
- (m) Hydro received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2011, \$3.5 million (2010 - \$0.1 million) has been recorded in Deferred credits.

- (n) During 2011, Hydro incurred a debt guarantee fee from the Province of \$3.9 million (2010 - nil). This amount remains payable at December 31, 2011.
- (o) Hydro has a receivable owing from the Department of Natural Resources of \$0.3 million (2010 - nil) related to a Coastal Labrador Efficiency Project established as part of energy conservation activities.
- (p) In relation to Nalcor's financial obligations with respect to the Upper Churchill Redress Agreement (Note 11), the Province has agreed to provide funding in the amount of \$39.9 million which is recognized in Accounts receivable. As this funding will be used to offset payments to the Innu Nation, the \$39.9 million has been netted against the expenses related to Nalcor's obligation under the Upper Churchill Redress Agreement.
- (q) Oil and Gas pays royalties on production from its petroleum and natural gas properties to the Province. During 2011, Oil and Gas recognized royalty expense of \$1.6 million (2010 - \$0.1 million). As at December 31, 2011, \$1.0 million (2010 - nil) was included in Accounts payable and accrued liabilities.

## **22. COMPARATIVE FIGURES**

The comparative figures have been reclassified to conform with the 2011 financial statement presentation including Accounts receivable, Long-term receivables, Operating costs and Other income and expense.

***Appendix 4***

**NEWFOUNDLAND AND LABRADOR HYDRO  
CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2011**

**BOARD OF DIRECTORS**

CATHY BENNETT (Chairperson)  
Chief Executive Officer  
Bennett Group of Companies

ED MARTIN  
President and Chief Executive Officer  
Nalcor Energy

TOM CLIFT  
Professor  
Memorial University - Faculty of Business

KEN MARSHALL  
President  
Rogers Cable - Atlantic Region

GERALD SHORTALL  
Chartered Accountant  
Corporate Director

**HEAD OFFICE**

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

**OFFICERS**

CATHY BENNETT (Chairperson)

ED MARTIN  
President and Chief Executive Officer

GILBERT BENNETT  
Lower Churchill Project Vice President

WAYNE CHAMBERLAIN  
General Counsel and Corporate Secretary

JIM HAYNES  
Regulated Operations Vice President

ANDY MACNEILL  
Churchill Falls Vice President

JOHN MacISAAC  
Project Execution and Technical Services Vice President

GERARD MCDONALD  
Human Resources and  
Organizational Effectiveness Vice President

DERRICK STURGE  
Finance Vice President and Chief Financial Officer

PETER HICKMAN  
Assistant Corporate Secretary

JAMES MEANEY  
Corporate Treasurer

S. KENT LEGGE  
Finance and Corporate Services General Manager


**NEWFOUNDLAND AND LABRADOR HYDRO  
CONSOLIDATED BALANCE SHEET**

*As at December 31 (millions of dollars)*

	<b>2011</b>	<b>2010</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	15.7	52.7
Short term investments	9.6	11.9
Accounts receivable	96.3	81.0
Current portion of regulatory assets (Note 5)	2.8	3.8
Inventory	63.5	62.9
Prepaid expenses	3.1	3.1
Derivative assets (Note 15)	0.2	2.0
	<u>191.2</u>	<u>217.4</u>
Property, plant and equipment (Note 4)	1,759.8	1,722.3
Sinking funds	247.0	208.4
Regulatory assets (Note 5)	63.6	65.9
Long term receivables (Note 6)	1.6	26.0
Reserve fund (Note 19 (d))	45.4	39.3
	<u>2,308.6</u>	<u>2,279.3</u>
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued liabilities	121.1	123.2
Accrued interest	28.7	28.7
Current portion of long term debt (Note 8)	8.2	8.2
Current portion of regulatory liabilities (Note 5)	137.6	118.9
Deferred capital contribution (Note 20(f))	3.5	0.1
Derivative liabilities	-	0.3
	<u>299.1</u>	<u>279.4</u>
Long term debt (Note 8)	1,131.5	1,136.7
Regulatory liabilities (Note 5)	33.3	40.9
Asset retirement obligations (Note 10)	20.2	11.4
Employee future benefits (Note 11)	64.2	57.7
Long term payable (Note 9)	4.9	4.6
Long term related party note payable (Note 20 (i))	1.3	25.3
	<u>1,554.5</u>	<u>1,556.0</u>
<b>SHAREHOLDER'S EQUITY</b>		
Share capital (Note 12)	22.5	22.5
Contributed capital (Note 12)	116.4	116.0
	<u>138.9</u>	<u>138.5</u>
Accumulated other comprehensive income (Note 13)	46.4	27.3
Retained earnings	568.8	557.5
	<u>615.2</u>	<u>584.8</u>
	<u>754.1</u>	<u>723.3</u>
Commitments and contingencies (Note 19)		
	<u>2,308.6</u>	<u>2,279.3</u>

*See accompanying notes*

On behalf of the Board:

  
ED MARTIN

  
GERRY SHORTALL

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

<i>For the year ended December 31 (millions of dollars)</i>	<b>2011</b>	2010
Revenue		
Energy sales	<b>605.8</b>	572.2
Interest and finance income (Note 16)	<b>19.9</b>	17.8
Other revenue	<b>5.9</b>	6.1
	<u><b>631.6</b></u>	<u>596.1</u>
Expenses		
Fuels	<b>156.7</b>	140.4
Power purchased	<b>52.9</b>	44.4
Operations and administration	<b>170.6</b>	162.9
Interest and finance charges (Note 16)	<b>108.7</b>	105.0
Amortization	<b>57.9</b>	56.4
Other income and expense	<b>(4.5)</b>	3.3
	<u><b>542.3</b></u>	<u>512.4</u>
Net income	<b>89.3</b>	83.7
Retained earnings, beginning of year	<b>557.5</b>	566.2
Dividends	<b>78.0</b>	92.4
Retained earnings, end of year	<u><b>568.8</b></u>	<u>557.5</u>

*See accompanying notes*

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

<i>For the year ended December 31 (millions of dollars)</i>	<b>2011</b>	2010
Net income	<b>89.3</b>	83.7
Other comprehensive income		
Change in fair value of available for sale financial instruments	<b>31.6</b>	20.6
Change in fair value of derivatives designated as cash flow hedges	<b>0.1</b>	1.1
Amounts recognized in net income	<b>(12.6)</b>	(16.4)
Comprehensive income	<u><b>108.4</b></u>	<u>89.0</u>

*See accompanying notes*

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

<i>For the year ended December 31 (millions of dollars)</i>	<b>2011</b>	2010
Cash provided by (used in)		
Operating activities		
Net income	<b>89.3</b>	83.7
Adjusted for items not involving a cash flow		
Amortization	<b>57.9</b>	56.4
Accretion of long term debt	<b>0.5</b>	0.4
Unrealized losses on derivative instruments	<b>0.3</b>	0.3
(Gain) loss on disposal of property, plant and equipment	<b>(2.7)</b>	0.7
	<b>145.3</b>	141.5
Changes in non-cash working capital balances (Note 17)	<b>2.9</b>	87.1
	<b>148.2</b>	228.6
Financing activities		
Long term debt retired	-	(29.3)
Dividends paid to Nalcor	<b>(78.0)</b>	(92.4)
Increase in contributed capital	<b>0.4</b>	0.6
Decrease (increase) in long term receivables	<b>24.4</b>	(1.3)
Increase in long term payable	<b>0.3</b>	0.3
(Decrease) increase in long term related party note payable	<b>(24.0)</b>	1.4
Increase (decrease) in deferred capital contribution	<b>3.4</b>	(0.1)
	<b>(73.5)</b>	(120.8)
Investing activities		
Additions to property, plant and equipment	<b>(88.7)</b>	(65.4)
Increase in sinking fund	<b>(24.7)</b>	(23.4)
Decrease in short term investments	<b>2.3</b>	25.4
Increase in reserve fund	<b>(5.4)</b>	(4.9)
Proceeds on disposal of property, plant and equipment	<b>4.8</b>	0.5
	<b>(111.7)</b>	(67.8)
Net (decrease) increase in cash	<b>(37.0)</b>	40.0
Cash position, beginning of year	<b>52.7</b>	12.7
Cash position, end of year	<b>15.7</b>	52.7
Cash position is represented by:		
Cash	<b>15.7</b>	52.5
Cash equivalents	-	0.2
	<b>15.7</b>	52.7
Supplementary cash flow information (Note 17)		

See accompanying notes

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

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**1. DESCRIPTION OF BUSINESS**

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

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**

**Basis of Presentation**

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

**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-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec on the Board of Directors of Churchill Falls. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has applied the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

Churchill Falls holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives Churchill Falls joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.



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

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

**Use of Estimates**

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

**Rates and Regulations (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% (2010 - 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.

**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 investment bears an interest rate of 1.18% to 1.24% (2010 - 0.85% to 1.35%) per annum. Cash and cash equivalents and short term investments are measured at fair value.

**Inventory**

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

**Property, Plant and Equipment**

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

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

**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 capital.

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

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

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

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

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

Estimated service lives of the major assets are as follows:

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

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

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

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

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

**Churchill Falls**

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

Hydroelectric generation plant	10-101 years
Transmission and terminals	14-74 years
Service facilities and other	3-79 years

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

**Capitalized Interest**

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

**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.

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

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

**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.

**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.

**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-Québec (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-Québec, under a guaranteed winter availability contract (GWAC) through 2041. The GWAC provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, is tracked over a four-year period and then either recovered from or refunded to Hydro-Québec over the subsequent four-year period, unless the balance is less than \$1.0 million in which case it is recovered or refunded immediately. These long term receivables or long term payables are subject to interest at 7% per annum (2010 - 7%).

**Foreign Currency Translation**

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

- (a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.
- (b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income, except gains or losses on purchases of fuel which are included in the cost of fuel inventory.

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

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

**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
Accrued interest	Other liabilities
Derivative liabilities	Held for trading
Long term debt	Other liabilities
Long term payable	Other liabilities
Long term related party note 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.

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.

During the year, Hydro had foreign exchange forward contracts designated as cash flow hedges (Note 15). In a cash flow hedge relationship, the portion of unrealized gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income. Hydro had no cash flow hedges in place on December 31, 2011.

Hydro had no fair value hedges in place at December 31, 2011 or 2010.

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

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

**Future Accounting Changes – International Financial Reporting Standards (IFRS)**

In October 2010, the Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 of the CICA Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2012. Hydro is a qualifying entity and chose to use the deferral option.

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

The IASB has deferred its work on rate-regulated activities accounting project and has not provided interim guidance for the recognition and measurement of regulatory assets and liabilities. Accordingly, Hydro continues to assess existing IFRS guidance to determine the impact of differences that will apply to accounting for rate-regulated activities upon adoption of IFRS. In December 2011, Hydro applied to the PUB for approval to use IFRS as the basis for regulatory reporting.

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 on January 1, 2012 and the accounting elections made.

**3. CHANGE IN ESTIMATE**

In 2010, Churchill Falls engaged a depreciation specialist to review the service lives of its property, plant and equipment. Based on the analysis performed, the service lives of Churchill Falls' property, plant and equipment were revised effective January 1, 2011. This change is treated as a change in estimate in accordance with CICA Section 1506, "Accounting Changes" and as such has been applied prospectively from January 1, 2011.

**4. PROPERTY, PLANT AND EQUIPMENT**

	<b>Property Plant and Equipment In Service</b>	<b>Contributions In Aid of Construction</b>	<b>Accumulated Amortization</b>	<b>Construction In Progress</b>	<b>Net Book Value</b>
<i>(millions of dollars)</i>					
<b>2011</b>					
Generation plant					
Hydroelectric	<b>1,424.5</b>	<b>22.9</b>	<b>390.2</b>	<b>6.8</b>	<b>1,018.2</b>
Thermal	<b>284.0</b>	<b>0.8</b>	<b>209.1</b>	<b>6.5</b>	<b>80.6</b>
Diesel	<b>75.6</b>	<b>5.7</b>	<b>36.8</b>	<b>0.5</b>	<b>33.6</b>
Transmission and distribution	<b>870.5</b>	<b>68.2</b>	<b>298.3</b>	<b>19.2</b>	<b>523.2</b>
Other	<b>309.9</b>	<b>24.6</b>	<b>188.4</b>	<b>7.3</b>	<b>104.2</b>
	<b><u>2,964.5</u></b>	<b><u>122.2</u></b>	<b><u>1,122.8</u></b>	<b><u>40.3</u></b>	<b><u>1,759.8</u></b>

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

**4. PROPERTY, PLANT AND EQUIPMENT (cont'd.)**

	<b>Property Plant and Equipment In Service</b>	<b>Contributions In Aid of Construction</b>	<b>Accumulated Amortization</b>	<b>Construction In Progress</b>	<b>Net Book Value</b>
<i>(millions of dollars)</i>			2010		
Generation plant					
Hydroelectric	1,417.1	22.9	379.0	3.3	1,018.5
Thermal	273.8	0.8	201.6	3.2	74.6
Diesel	68.0	5.8	35.3	2.2	29.1
Transmission and distribution	838.2	67.9	280.4	10.8	500.7
Other	297.8	24.0	178.2	3.8	99.4
	<u>2,894.9</u>	<u>121.4</u>	<u>1,074.5</u>	<u>23.3</u>	<u>1,722.3</u>

**5. REGULATORY ASSETS AND LIABILITIES**

<i>(millions of dollars)</i>	2011	2010	Remaining Recovery Settlement Period (Years)
Regulatory assets			
Foreign exchange losses	64.7	66.8	30.0
Deferred major extraordinary repairs	0.6	2.3	0.8
Deferred energy conservation costs	1.1	0.6	n/a
Total regulatory assets	66.4	69.7	
Less current portion	2.8	3.8	
	<u>63.6</u>	<u>65.9</u>	
Regulatory liabilities			
Rate stabilization plan	170.3	159.2	n/a
Deferred purchased power savings	0.6	0.6	15.5
Total regulatory liabilities	170.9	159.8	
Less current portion	137.6	118.9	
	<u>33.3</u>	<u>40.9</u>	

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.

**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.

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

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

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

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 twenty five percent of the outstanding balance at year end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect. A portion of the RSP balance totaling approximately \$100 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 shut down 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 2011, \$20.9 million was deferred (2010 - \$23.3 million recognized) in the RSP and \$25.4 million (2010 - \$2.3 million) was recovered through rates and included in energy sales, with the corresponding cost amortized in fuels expenses.

**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 interest expense (Note 16).

**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 2011, \$1.7 million (2010 - \$2.6 million) of amortization was recognized in Operations and administration expense.

**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 2011, \$0.5 million (2010 - \$0.4 million) was deferred.

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

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

**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. These savings in the amount of \$0.6 million (2010 - \$0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

**Property, Plant and Equipment**

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2011, Hydro's AFUDC of 7.6% is lower than its cost of debt of 8.4% and the amount capitalized is lower and interest expense is higher by \$0.2 million than that which would be permitted under Canadian GAAP in the absence of rate regulation. In 2010, Hydro's AFUDC of 7.6% was higher than its cost of debt of 7.2% and the amount capitalized was higher and interest expense was lower by \$0.1 million than that which would be permitted under Canadian GAAP in the absence of rate regulation.

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight line method. During 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, management currently estimates that switching from the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets, as well as changing from unit based amortization to a group based method on a remaining life basis and implementing the recommended service lives; would have resulted in an estimated decrease of \$1.0 million in the annual amortization expense. In December 2011, Hydro applied to the PUB requesting approval of these recommended changes. Approval has not yet been received.

**6. LONG TERM RECEIVABLES**

Included in long term receivables are two refundable deposits in the amount of \$1.3 million (2010 - \$1.2 million) associated with an application for transmission service into Nova Scotia, bearing interest at the Prime Rate less 1% and a \$0.1 million (2010 - \$0.1 million) deposit associated with an application for transmission service in New Brunswick, bearing interest at the Prime Rate. During 2011, Hydro-Québec refunded two deposits totalling \$24.1 million associated with applications for transmission service through Québec. The remaining balance of \$0.2 million (2010 - \$0.3 million) is the non-current portion of receivables associated with customer time payment plans and the long term portion of employee purchase programs.



**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, 2011, and its proportionate interest in Churchill Falls' operations for the year then ended.

<i>(millions of dollars)</i>	<b>2011</b>	2010
Current assets	<b>41.8</b>	39.2
Long term assets	<b>394.8</b>	375.8
Current liabilities	<b>19.0</b>	15.6
Long term liabilities	<b>16.2</b>	14.0
Revenues	<b>64.2</b>	74.1
Expenses	<b>43.1</b>	50.8
Net income	<b>21.1</b>	23.3
Cash provided by (used in)		
Operating activities	<b>32.3</b>	48.3
Financing activities	<b>0.9</b>	(27.9)
Investing activities	<b>(32.6)</b>	(0.4)

Income tax expense in the amount of \$0.2 million (2010 - \$0.2 million) related to a jointly controlled subsidiary, Twin Falls has been included in expenses.

**8. LONG TERM DEBT**

Details of long term debt are as follows:

<b>Series</b>	<b>Face Value</b>	<b>Coupon Rate %</b>	<b>Year of Issue</b>	<b>Year of Maturity</b>	<b>2011</b>	2010
<i>(millions of dollars)</i>						
V *	125.0	10.50	1989	2014	<b>124.7</b>	124.6
X *	150.0	10.25	1992	2017	<b>149.4</b>	149.3
Y *	300.0	8.40	1996	2026	<b>293.5</b>	293.3
AB *	300.0	6.65	2001	2031	<b>306.5</b>	306.7
AD *	125.0	5.70	2003	2033	<b>123.6</b>	123.6
AE	225.0	4.30	2006	2016	<b>224.0</b>	223.8
Total debentures	1,225.0				<b>1,221.7</b>	1,221.3
Less sinking fund investments in own debentures					<b>82.0</b>	76.4
					<b>1,139.7</b>	1,144.9
Less: payments due within one year					<b>8.2</b>	8.2
					<b>1,131.5</b>	1,136.7

\* Sinking funds have been established for these issues.

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

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

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 3.12% to 9.86% (2010 - 3.86% to 9.86%).

Promissory notes, debentures and long term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments by the Province. The Province charges Hydro a guarantee fee of 25 bps annually on total debt (net of sinking funds) with a remaining term to maturity less than ten years and 50 bps annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years. This fee was waived for 2010. The fee for 2011 was \$3.9 million.

Hydro uses promissory notes to fulfill its short term funding requirements. As at December 31, 2011 there were no promissory notes outstanding (2010 - nil).

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 (2010 - 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 (Note 19(h)) reducing the availability of the credit facility by \$18.9 million (2010 - \$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>	2012	2013	2014	2015	2016
Sinking fund requirement	8.2	8.2	8.2	8.2	8.2
Long term debt repayment	-	-	125.0	-	225.0
	<u>8.2</u>	<u>8.2</u>	<u>133.2</u>	<u>8.2</u>	<u>233.2</u>

**Churchill Falls**

Operating Credit Facility

Churchill Falls maintains a \$10.0 million Canadian or US equivalent unsecured operating credit facility with its banker. Advances may take the form of a Prime Rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the Prime Rate or prevailing Government BA Fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate.

Churchill Falls has issued three irrevocable letters of credit totalling \$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 Department of Environment and Conservation (Note 19(h)).

**9. LONG TERM PAYABLE**

The long term payable to Hydro-Québec as at December 31, 2011 represents the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, \$0.4 million of the amount is current while the remaining \$4.9 million (2010 - \$4.6 million) is long term. The final amount will be determined on August 31, 2012 and will be paid or collected monthly beginning September 2012 and ending August 2016.

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

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**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>	<b>2011</b>	2010
Asset retirement obligations, beginning of year	<b>11.4</b>	-
Liabilities incurred	<b>2.8</b>	11.4
Revisions	<b>5.5</b>	-
Accretion	<b>0.5</b>	-
Asset retirement obligations, end of year	<b>20.2</b>	11.4

The total undiscounted estimated cash flows required to settle the HTGS obligations at December 31, 2011 are \$27.0 million (2010 - \$20.5 million). Payments to settle the liability are expected to occur between 2021 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 2.9% (2010 - 4.1%).

The total undiscounted estimated cash flows required to settle the PCB obligations at December 31, 2011 are \$3.6 million. Payments to settle the liability are expected to occur between 2012 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 5.6%.

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**

**Pension Plan**

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$5.2 million (2010 - \$4.9 million) are expensed as incurred.

**Other Benefits**

Hydro provides group life insurance and healthcare benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2011, cash payments to beneficiaries for its unfunded other employee future benefits were \$2.5 million (2010 - \$2.3 million). An actuarial valuation was performed as at December 31, 2009 and extrapolated to December 31, 2011. The next actuarial valuation will be performed as at December 31, 2012.

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

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

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

<i>(millions of dollars)</i>	<b>2011</b>	2010
Accrued benefit obligation		
Balance at beginning of year	<b>83.3</b>	69.6
Current service cost	<b>2.7</b>	2.2
Interest cost	<b>4.9</b>	4.6
Actuarial loss	<b>19.7</b>	9.2
Benefits paid	<b>(2.5)</b>	(2.3)
Balance at end of year	<b><u>108.1</u></b>	<u>83.3</u>
Plan deficit	<b>108.1</b>	83.3
Unamortized actuarial loss	<b>(43.7)</b>	(25.4)
Unamortized past-service cost	<b>(0.2)</b>	(0.2)
Accrued benefit liability at end of year	<b><u>64.2</u></b>	<u>57.7</u>
<i>(millions of dollars)</i>	<b>2011</b>	2010
Component of benefit cost		
Current service cost	<b>2.7</b>	2.2
Interest cost	<b>4.9</b>	4.6
Actuarial loss	<b>19.7</b>	9.2
	<b><u>27.3</u></b>	<u>16.0</u>
Difference between actuarial loss and amount recognized	<b>(18.3)</b>	(8.4)
Benefit expense	<b><u>9.0</u></b>	<u>7.6</u>

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

	<b>2011</b>	2010
Discount rate – benefit cost	<b>5.75%</b>	6.50%
Discount rate – accrued benefit obligation	<b>4.55%</b>	5.75%
Rate of compensation increase	<b>3.50%</b>	3.50%
Assumed healthcare trend rates:		
	<b>2011</b>	2010
Initial health care expense trend rate	<b>7.50%</b>	7.50%
Cost trend decline to	<b>5.00%</b>	5.00%
Year that rate reaches the rate it is assumed to remain at	<b>2016</b>	2016

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

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

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

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

<i>Increase</i>	<b>2011</b>	2010
Current service and interest cost	<b>1.5</b>	1.2
Accrued benefit obligation	<b>21.6</b>	14.2
<i>Decrease</i>	<b>2011</b>	2010
Current service and interest cost	<b>(1.1)</b>	(0.9)
Accrued benefit obligation	<b>(16.5)</b>	(11.1)

**12. SHAREHOLDER'S EQUITY**

**Share Capital**

<i>(millions of dollars)</i>	<b>2011</b>	2010
Common shares of par value \$1 each		
Authorized: 25,000,000		
Issued and outstanding 22,503,942	<b>22.5</b>	22.5

**Contributed Capital**

<i>(millions of dollars)</i>	<b>2011</b>	2010
Total contributed capital	<b>116.4</b>	116.0

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 2011 the Trust contributed capital of \$0.4 million (2010 - \$0.6 million).

**13. ACCUMULATED OTHER COMPREHENSIVE INCOME**

<i>(millions of dollars)</i>	<b>2011</b>	2010
Balance, beginning of year	<b>27.3</b>	22.0
Change in fair value of available for sale financial instruments	<b>31.6</b>	20.6
Change in fair value of derivatives designated as cash flow hedges	<b>0.1</b>	1.1
Amount recognized in net income	<b>(12.6)</b>	(16.4)
Balance, end of year	<b>46.4</b>	27.3

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

**14. CAPITAL MANAGEMENT**

**Hydro**

Hydro's principal business requires ongoing access to capital in order to maintain 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.

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

A summary of the capital structure is outlined below:

<i>(millions of dollars)</i>	<b>2011</b>		<b>2010</b>	
<b>Debt</b>				
Long term debt	<b>1,131.5</b>		1,136.7	
Current portion of long term debt	<b>8.2</b>		8.2	
Sinking funds	<b>(247.0)</b>		(208.4)	
	<b>892.7</b>	<b>54.2%</b>	936.5	56.4%
<b>Equity</b>				
Share capital	<b>22.5</b>		22.5	
Contributed capital	<b>116.4</b>		116.0	
Accumulated other comprehensive income	<b>46.4</b>		27.3	
Retained earnings	<b>568.8</b>		557.5	
	<b>754.1</b>	<b>45.8%</b>	723.3	43.6%
<b>Total debt and equity</b>	<b>1,646.8</b>	<b>100.0%</b>	1,659.8	100.0%

Hydro's principal business requires ongoing access to capital in order to maintain 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.

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

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% common 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 Hydro's regulator, the PUB.

Per legislation, 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 million. There was no balance outstanding as at December 31, 2011 or 2010. 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.

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

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

**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 (share capital, contributed capital and retained earnings). The capital structure is adjusted through the amount of dividends paid to shareholders.

**15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

**Fair Value**

The estimated fair values of financial instruments as at December 31, 2011 and 2010 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.

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.

	Carrying Value	Fair Value	Carrying Value	Fair Value
<i>(millions of dollars)</i>	2011		2010	
<b>Financial assets</b>				
Cash and cash equivalents	15.7	15.7	52.7	52.7
Short term investments	9.6	9.6	11.9	11.9
Accounts receivable	96.3	96.3	81.0	81.0
Derivative assets	0.2	0.2	2.0	2.0
Sinking funds – investments in same Hydro issue	82.0	103.7	76.4	93.6
Sinking funds – other investments	247.0	247.0	208.4	208.4
Long term receivable <sup>(1)</sup>	1.6	n/a	26.0	n/a
Reserve fund	45.4	45.4	39.3	39.3
<b>Financial liabilities</b>				
Accounts payable and accrued liabilities	121.1	121.1	123.2	123.2
Accrued interest	28.7	28.7	28.7	28.7
Derivative liabilities	-	-	0.3	0.3
Long term debt including amount due within one year (before sinking funds)	1,221.7	1,695.3	1,221.3	1,589.7
Long term payable	4.9	5.3	4.6	4.7
Long term related party note payable <sup>(1)</sup>	1.3	n/a	25.3	n/a

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

<sup>(1)</sup> The fair value of the long term receivable and long term related party note payable is subject to uncertainty regarding the timing of future cash flows and as such, the fair value of the long term receivable cannot be determined at December 31, 2011 and 2010.

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

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

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

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.

The following table presents Hydro's fair value hierarchy for financial assets and liabilities as at December 31. There were no transfers between Level 1 and Level 2 during the year:

	Level 1	Level 2	Total
<i>(millions of dollars)</i>	<b>2011</b>		
Financial assets			
Cash and cash equivalents	15.7	-	15.7
Short term investments	9.6	-	9.6
Accounts receivable	96.3	-	96.3
Derivative assets	-	0.2	0.2
Sinking funds – investments in same Hydro issue	-	103.7	103.7
Sinking funds – other investments	-	247.0	247.0
Reserve fund	-	45.4	45.4
Financial liabilities			
Accounts payable and accrued liabilities	121.1	-	121.1
Accrued interest	28.7	-	28.7
Derivative liabilities	-	-	-
Long term debt including amount due within one year (before sinking funds)	-	1,695.3	1,695.3
Long term payable	-	5.3	5.3



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

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

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

Establishing Fair Value (cont'd.)

	Level 1	Level 2	Total
	2010		
Financial assets			
Cash and cash equivalents	52.7	-	52.7
Short term investments	11.9	-	11.9
Accounts receivable	81.0	-	81.0
Derivative assets	-	2.0	2.0
Sinking funds – investments in same Hydro issue	-	93.6	93.6
Sinking funds – other investments	-	208.4	208.4
Reserve fund	-	39.3	39.3
Financial liabilities			
Accounts payable and accrued liabilities	123.2	-	123.2
Accrued interest	28.7	-	28.7
Derivative liabilities	-	0.3	0.3
Long term debt including amount			
due within one year	-	1,589.7	1,589.7
Long term payable	-	4.7	4.7

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2011 and 2010.

**Risk Management**

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

Credit Risk

Hydro is exposed to credit risk in the event of non-performance by counterparties to its financial instruments. The majority of the receivables are from regulated utilities which minimizes credit risk. There is risk that Hydro will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Hydro manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers. As at December 31, 2011 security deposits of \$0.3 million (2010 - \$0.1 million) are included in accounts payable and accrued liabilities.

Hydro's three largest customers account for 76.6% (2010 - 80.3%) of total energy sales and 65.8% (2010 - 69.0%) of accounts receivable. These customers are comprised of rate regulated organizations or organizations with an investment grade credit rating.

Hydro does not have any significant amounts that are past due and uncollectable for which a provision has not been recognized at December 31, 2011.

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

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

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

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

Liquidity Risk

Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. This risk is managed by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cash flows.

Short term liquidity is provided through cash and cash equivalents on hand, funds from operations, a \$300.0 million promissory note program and credit facilities.

Long term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues with the exception of Series AE.

The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2011:

<i>(millions of dollars)</i>	<b>&lt;1 Year</b>	<b>1-3 Years</b>	<b>3-5 years</b>	<b>&gt; 5 Years</b>	<b>Total</b>
Accounts payable and accrued liabilities	<b>121.1</b>	-	-	-	<b>121.1</b>
Accrued interest	<b>28.7</b>	-	-	-	<b>28.7</b>
Long term debt including amount					
due within one year	-	<b>125.0</b>	<b>225.0</b>	<b>875.0</b>	<b>1,225.0</b>
Long term payable	-	<b>2.6</b>	<b>2.3</b>	-	<b>4.9</b>
Interest	<b>61.9</b>	<b>174.2</b>	<b>152.7</b>	<b>649.2</b>	<b>1,038.0</b>
	<b>211.7</b>	<b>301.8</b>	<b>380.0</b>	<b>1,524.2</b>	<b>2,417.7</b>

Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. Hydro has a formal financial risk management policy that outlines the risks associated with the operations of Hydro and its subsidiaries outlining approaches and guidelines to be followed in the management of those risks. This policy is reviewed by the Board annually or more frequently if there is a material change to Hydro's financial risks. The Audit Committee provides oversight on behalf of the Board with the exception of any items that specifically require Board approval.

Interest Rates

Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management includes the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Hydro attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

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

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

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

Market Risk (cont'd.)

Hydro is exposed to interest rate risk related to the short term debt portfolio, the sinking fund investment portfolios and reserve fund investment portfolios. Interest rate risk on the long term debt portfolio is mitigated through the use of fixed rate debentures. The following table illustrates Hydro's exposure to a 50 basis point (0.5%) change in interest rates:

	Net Income		Other Comprehensive Income	
	0.5% Decrease	0.5% Increase	0.5% Decrease	0.5% Increase
<i>(millions of dollars)</i>				
Interest on short term investments	(0.1)	0.1	-	-
Interest on sinking fund	-	-	20.0	(2.7)
Interest on reserve fund	-	-	1.0	(1.0)
	(0.1)	0.1	21.0	(3.7)

*Foreign Currency and Commodity Exposure*

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

During 2011, Hydro had total purchases of No. 6 fuel of \$135.1 million (2010 - \$104.1 million) denominated in USD. Exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in fuel prices including exchange rates, as compared to that approved in Hydro's most recent cost of service study, are captured in the RSP and are either refunded to or collected from customers through rate adjustments. Hydro also employs the periodic use of forward currency contracts to manage exposure to exchange rates on a particular day.

During 2011, total electricity sales denominated in USD were \$67.9 million (2010 - \$72.8 million). Hydro mitigates the foreign exchange and commodity price risk through the use of commodity swaps and foreign currency forward contracts.

During 2009, Hydro entered into a series of 24 monthly foreign exchange forward contracts with a notional value of \$87.9 million USD to hedge foreign exchange risk on approximately 75% of Hydro's USD electricity sales. These contracts had an average exchange rate of \$1.17 CAD per USD. These contracts were designated as part of a hedging relationship. The last of these contracts expired in April 2011.

During 2011, Hydro entered into a series of 9 monthly foreign exchange forward contracts with a notional value of \$35.7 million USD to hedge foreign exchange risk on approximately 75% of Hydro's USD electricity sales. These contracts had an average exchange rate of \$1.00 CAD per USD.

In 2011, Hydro also entered into 20 commodity swap contracts with a notional value of \$27.8 million USD to hedge commodity price risk on electricity sales. These contracts swapped floating market rates for fixed rates, with Hydro receiving an average fixed rate of \$35.37 USD/MWh (2010 - \$36.01 USD/MWh). During 2011, \$1.9 million in losses from these commodity contracts were included in Other income and expense (2010 - \$3.4 million).

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

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

**Effect of Hedge Accounting on Financial Statements**

	<b>Net Gains Included in Net Income</b>	<b>Unrealized Gains Included in OCI</b>	<b>Net Gains Included in Net Income</b>	<b>Unrealized Gains Included in OCI</b>
<i>(millions of dollars)</i>	<b>2011</b>		2010	
Ineffective portion	<b>(0.1)</b>	-	0.2	-
Effective portion	<b>1.5</b>	-	5.9	1.3

The ineffective portion of hedging gains and losses is included in net income through Other income and expense.

**16. INTEREST AND FINANCE INCOME /CHARGES**

<i>(millions of dollars)</i>	<b>2011</b>	2010
Interest and finance income		
Interest on sinking fund	<b>16.6</b>	15.2
Interest on reserve fund	<b>1.4</b>	1.4
Other interest income	<b>1.9</b>	1.2
	<b>19.9</b>	17.8
Interest and finance charges		
Long term debt	<b>90.5</b>	91.7
Interest on RSP	<b>12.2</b>	10.2
Accretion of long term debt	<b>0.5</b>	0.4
Amortization of deferred foreign exchange losses	<b>2.1</b>	2.1
Debt guarantee fee	<b>3.9</b>	-
Other	<b>1.0</b>	1.8
	<b>110.2</b>	106.2
Interest capitalized during construction	<b>(1.5)</b>	(1.2)
	<b>108.7</b>	105.0

**17. SUPPLEMENTARY CASH FLOW INFORMATION**

<i>(millions of dollars)</i>	<b>2011</b>	2010
Accounts receivable	<b>(15.3)</b>	5.2
Inventory	<b>(0.6)</b>	(3.4)
Prepaid expenses	-	(0.9)
Regulatory assets	<b>3.3</b>	4.4
Regulatory liabilities	<b>11.1</b>	37.2
Accounts payable and accrued liabilities	<b>(2.1)</b>	39.3
Employee future benefits	<b>6.5</b>	5.3
Changes to non-cash working capital balances	<b>2.9</b>	87.1
Interest received	<b>2.3</b>	2.1
Interest paid	<b>90.6</b>	92.1
Income taxes paid	<b>0.2</b>	0.2

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

**18. SEGMENT INFORMATION**

Hydro operates in four business segments. Hydro Regulated encompass sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. 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.

<b>Segments</b>	<b>Hydro Regulated</b>	<b>Churchill Falls</b>	<b>Energy Marketing</b>	<b>Other</b>	<b>Inter- segment</b>	<b>Total</b>
<i>(millions of dollars)</i>						<b>2011</b>
Revenue						
Energy sales	469.2	66.2	69.7	4.6	(3.9)	605.8
Interest and finance income	17.6	1.7	0.6	-	-	19.9
Other revenue	2.3	0.3	-	-	3.3	5.9
	<u>489.1</u>	<u>68.2</u>	<u>70.3</u>	<u>4.6</u>	<u>(0.6)</u>	<u>631.6</u>
Expenses						
Fuels	156.7	-	-	-	-	156.7
Power purchased	52.2	-	4.6	-	(3.9)	52.9
Operations and administration	104.2	41.8	20.6	4.0	-	170.6
Interest and finance charges	108.4	0.3	-	-	-	108.7
Amortization	45.7	12.2	-	-	-	57.9
Other income and expense	0.9	(7.2)	1.8	-	-	(4.5)
	<u>468.1</u>	<u>47.1</u>	<u>27.0</u>	<u>4.0</u>	<u>(3.9)</u>	<u>542.3</u>
Net income from operations	21.0	21.1	43.3	0.6	3.3	89.3
Preferred dividends	-	3.3	-	-	(3.3)	-
Net income	<u>21.0</u>	<u>24.4</u>	<u>43.3</u>	<u>0.6</u>	<u>-</u>	<u>89.3</u>
Capital expenditures	63.1	25.6	-	-	-	88.7
Total assets	1,866.6	436.6	3.9	1.5	-	2,308.6

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

**18. SEGMENT INFORMATION (cont'd.)**

<b>Segments</b>	<b>Hydro Regulated</b>	<b>Churchill Falls</b>	<b>Energy Marketing</b>	<b>Other</b>	<b>Inter- segment</b>	<b>Total</b>
<i>(millions of dollars)</i>						2010
<b>Revenue</b>						
Energy sales	417.1	76.0	77.5	5.5	(3.9)	572.2
Interest and finance income	16.1	1.7	-	-	-	17.8
Other revenue	2.3	0.3	-	-	3.5	6.1
	<u>435.5</u>	<u>78.0</u>	<u>77.5</u>	<u>5.5</u>	<u>(0.4)</u>	<u>596.1</u>
<b>Expenses</b>						
Fuels	140.3	-	-	0.1	-	140.4
Power purchased	44.2	-	4.1	-	(3.9)	44.4
Operations and administration	97.1	40.5	21.4	3.9	-	162.9
Interest and finance charges	102.9	1.6	0.5	-	-	105.0
Amortization	43.8	12.6	-	-	-	56.4
Other income and expense	0.7	-	2.6	-	-	3.3
	<u>429.0</u>	<u>54.7</u>	<u>28.6</u>	<u>4.0</u>	<u>(3.9)</u>	<u>512.4</u>
Net income from operations	6.5	23.3	48.9	1.5	3.5	83.7
Preferred dividends	-	3.5	-	-	(3.5)	-
Net income	<u>6.5</u>	<u>26.8</u>	<u>48.9</u>	<u>1.5</u>	<u>-</u>	<u>83.7</u>
Capital expenditures	55.5	9.9	-	-	-	65.4
Total assets	1,831.5	417.0	7.4	25.4	(2.0)	2,279.3

**Geographic Information**

Revenues by geographic area:

<i>(millions of dollars)</i>	<b>2011</b>	<b>2010</b>
Newfoundland and Labrador	<b>502.6</b>	453.8
Québec	<b>60.8</b>	70.5
New Brunswick	<b>56.7</b>	60.7
Nova Scotia	<b>11.5</b>	11.1
	<u><b>631.6</b></u>	<u>596.1</u>

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

**19. COMMITMENTS AND CONTINGENCIES**

- (a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, Churchill Falls is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. 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) 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

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

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

- (b) (cont'd.)  
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 (2010 - \$0.1 million).
- (c) 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.
- (d) Pursuant to the terms of the 1999 shareholders' agreement Churchill Falls, in 2007, commenced the creation of a \$75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested \$17.0 million in each of 2007, 2008 and 2009 and \$8.0 million in 2010 and 2011. The remaining investment of \$8.0 million was acquired during the 30-day period commencing on January 1, 2012.

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holdings consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 Canadian Chartered Banks. Hydro's share of this commitment is 65.8%.

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

<i>(millions of dollars)</i>	<b>2011</b>	2010
Opening balance	<b>39.3</b>	34.8
Contribution	<b>5.3</b>	5.3
Net interest	<b>0.1</b>	(0.4)
Mark-to-market adjustment	<b>0.7</b>	(0.4)
Fair value of reserve fund	<b>45.4</b>	39.3

- (e) One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately \$21.9 million (2010 - \$21.8 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.
- (f) Outstanding commitments for capital projects total approximately \$29.2 million (2010 - \$17.6 million).
- (g) Hydro has entered into a number of long term power purchase agreements as follows:

<u>Type</u>	<u>Rating</u>	<u>In-service Date</u>	<u>Term</u>
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

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

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

(g) (cont'd.)

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

<i>(millions of dollars)</i>	2012	2013	2014	2015	2016
Power purchases	24.8	25.5	26.1	26.8	27.3

(h) 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 3 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.

(i) 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-Québec TransÉnergie to acquire access to 265 MW of transmission capacity from Labrador through Québec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that competing request.

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

2012	\$ 19.0 million
2013	\$ 19.0 million
2014	\$ 4.8 million

(j) 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, 2011 there have been no commercial implementations.

(k) 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.

**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:



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

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

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	Province owned trust with Churchill Falls as the beneficiary.
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:

		Nalcor	Other Affiliates	Total
<i>(millions of dollars)</i>		<b>2011</b>		
Revenue	(f)(g)(h)(l)	-	2.1	2.1
Expenses	(a)(b)(c)(e)(k)	25.7	9.2	34.9
Accounts receivable	(d)(g)(h)(l)	-	1.0	1.0
Accounts payable and accrued liabilities	(c)(d)(e)(k)	49.9	8.0	57.9
Deferred capital contribution	(f)	-	3.5	3.5
Long term related party note payable	(i)	1.3	-	1.3
<i>(millions of dollars)</i>		<b>2010</b>		
Revenue	(f)(g)(h)(l)	-	2.0	2.0
Expenses	(a)(b)(c)(e)(k)	20.2	4.8	25.0
Accounts receivable	(d)(g)(h)(l)	-	1.9	1.9
Accounts payable and accrued liabilities	(c)(d)(e)(k)	40.9	3.8	44.7
Deferred capital contribution	(f)	-	0.1	0.1
Long term related party note payable	(i)	25.3	-	25.3

- (a) Hydro has entered into a long term power contract with Churchill Falls for the purchase of \$6.0 million (2010 - \$6.0 million) of the power produced by Churchill Falls.
- (b) For the year ended December 31, 2011, approximately \$2.8 million (2010 - \$2.5 million) of operating costs were recovered from Nalcor and \$3.5 million (2010 - \$3.4 million) from other affiliates for engineering, technical, management and administrative services. During 2011, Hydro incurred \$2.9 million (2010 - \$2.7 million) of operating costs from Nalcor for engineering, technical, management and administrative services.
- (c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2011, Hydro incurred \$1.2 million (2010 - \$0.6 million) in costs related to the PUB of which \$0.6 million (2010 - \$0.1 million) was included in Accounts payable and accrued liabilities.
- (d) As at December 31, 2011, Hydro has a payable to Nalcor of \$49.9 million (2010 - \$40.9 million) and a receivable from other affiliates for \$0.3 million (2010 - \$1.5 million). This payable/receivable consists of various intercompany operating costs and power purchases.

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

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

- (e) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually. As at December 31, 2011, \$5.3 million (2010 - \$5.6 million) was payable.
- (f) During 2011, Nalcor advanced \$0.7 million (2010 - \$2.3 million) as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. Hydro received contributions in aid of construction from the Province related to wind feasibility studies and as at December 31, 2011, \$3.5 million (2010 - \$0.1 million) has been recorded as a Deferred capital contribution.
- (g) During 2011, Hydro received \$0.4 million (2010 - \$0.4 million) as a rate subsidy for rural isolated customers from the Province and \$1.7 million (2010 - \$1.6 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with \$0.3 million (2010 - \$0.3 million) recorded as Accounts receivable at year end.
- (h) 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, \$1.4 million (2010 - \$0.8 million) has been received and \$0.2 million (2010 - \$0.2 million) has been accrued as due from the Trust.
- (i) Hydro has a long term related party note payable to Nalcor for \$1.3 million (2010 - \$25.3 million). The note is non-interest bearing and has no set terms of repayment.
- (j) On January 19, 2011, the PUB issued Board Order No. P.U. 1(2011) approving a modification to the RSP rules to reduce the balance owing to industrial customers by \$10.0 million. The order also approved Hydro's reimbursement of the amount to the Province. The payment was made to the Province on January 27, 2011.
- (k) During 2011, the Province required payment on the debt guarantee of \$3.9 million (2010 - nil). This amount remains payable at December 31, 2011.
- (l) Hydro has an amount receivable from the Department of Natural Resources of \$0.3 million (2010 - nil) related to a Coastal Labrador Efficiency Project.

**21. COMPARATIVE FIGURES**

The comparative figures have been reclassified to conform with the 2011 financial statement presentation including Operations and administration, Other income and expense, Accounts receivable and Long term receivables.