

# **NALCOR ENERGY**

2008 Annual Performance Report  
Transparency and Accountability

June 2009



## Message from the Board of Directors

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

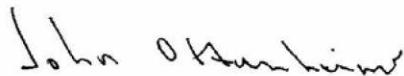
Dear Mr. Speaker:

In accordance with the *Transparency and Accountability Act*, I am pleased to submit the 2008 Annual Performance Report on behalf of the Board of Directors of Nalcor Energy.

The Strategic Plan 2008-2010 for the Energy Corporation of Newfoundland and Labrador outlined the direction for the corporation and all of its subsidiaries. During 2008, there were a number of changes in corporate structure as well as the introduction of the Nalcor Energy name and brand. At December 31, 2008, the subsidiaries of Nalcor Energy were Newfoundland and Labrador Hydro (NLH) and Nalcor – Oil and Gas Inc. Subsidiaries of NLH were Churchill Falls (Labrador) Corporation (Churchill Falls), Lower Churchill Development Corporation (LCDC) and Gull Island Power Corporation (GIPCo).

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

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



John Ottenheimer  
Chair  
Nalcor Energy

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## Overview of the Company

Newfoundland and Labrador has an immense and diverse energy warehouse. In 2007, guided by a long-term Energy Plan, the Government of Newfoundland and Labrador created a new provincial energy corporation to take a lead role in the development of the province's energy resources. In 2008, the Nalcor Energy name and brand were introduced.

Nalcor's foundation is built on its base business - the generation and transmission of electrical power. The company makes a strong commitment to provide safe, reliable and dependable electricity to its utility, industrial, residential and retail customers. Beyond the base business, Nalcor has expanded into the broader energy sector, including oil and gas, wind energy, and research and development. Nalcor is leading the development of the province's energy resources, including the Lower Churchill hydroelectric development and is focused on environmentally-responsible and sustainable growth.

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

## Vision

### ***Nalcor Energy***

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

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

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

### ***Churchill Falls***

To be recognized as a major world-class provider of efficient, renewable energy through the exceptional contribution of all employees.

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<sup>1</sup> Transferred to Nalcor on March 31, 2009.

<sup>2</sup> At December 31, 2008, the subsidiaries of Nalcor Energy were Newfoundland and Labrador Hydro (NLH) and Nalcor – Oil and Gas Inc. Subsidiaries of NLH were Churchill Falls (Labrador) Corporation (Churchill Falls), Lower Churchill Development Corporation (LCDC) and Gull Island Power Corporation (GIPCo). LCDC and GIPCo are not active operating companies. Churchill Falls maintains a 33% share in Twin Falls Power Corporation (TwinCo).

## Mission

### ***Nalcor Energy***

By 2011, Nalcor Energy will have enhanced its asset management processes to continuously improve the delivery of safe and reliable electricity to its customers, and expanded its energy sector involvement to include oil and gas, wind energy, and research and development to help build a strong economic future for Newfoundland and Labrador.

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

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

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

### ***Churchill Falls***

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

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

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

## Mandate

### ***Nalcor Energy***

The *Energy Corporation Act (2008)* mandates Nalcor to invest in, engage in, and carry out activities in all areas of the energy sector in the province and elsewhere, including:

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

- Manufacturing, producing, distributing and selling energy related products and services; and,
- Research and development.

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

The *Hydro Corporation Act* (2007) mandates NLH 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.

### **Values**

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

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

## Lines of Business

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

NLH is the primary generator of electricity in Newfoundland and Labrador with an installed generating capacity of 1,635 megawatts (MW). The activities of NLH include the operation of the regulated utility and non-regulated activities. The regulated utility delivers safe, reliable power to industrial, utility and over 35,000 direct customers in rural Newfoundland and Labrador. NLH operates nine hydroelectric generating stations, one oil-fired plant, four gas turbines, and 25 diesel plants. It maintains 54 high-voltage terminal stations, 25 lower-voltage interconnected distribution substations, 3,742 km of interconnected high-voltage transmission lines and 3,368 km of distribution lines. In 2008, non-regulated activities of NLH included the sale of power to Hydro-Québec and two industrial customers in Labrador.

### ***Churchill Falls***

The Churchill Falls Generating Station is one of the largest underground powerhouses in the world and is operated by the Churchill Falls (Labrador) Corporation. The plant has a rated capacity of 5,428 MW and generates over 34,000 gigawatt-hours (GWh) of energy annually. Churchill Falls operates the town of Churchill Falls, including a school, theatre, library, and recreational facilities. The majority of electricity from the Churchill Falls station is sold to Hydro-Québec under a long-term contract, though sufficient electricity is retained to supply all current energy requirements on the Labrador Interconnected System.

### ***Lower Churchill Project***

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

### ***Nalcor Energy – Oil and Gas***

In 2008, a new company, Nalcor Energy – Oil and Gas was formed and it holds and manages oil and gas interests. The company is currently a partner in two developments in the Newfoundland and Labrador offshore oil and gas industry – the Hebron oil field, the province's fourth offshore oil project, and the White Rose Growth Project. Nalcor Energy – Oil and Gas is also pursuing other investment opportunities.

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

Bull Arm is a valuable asset for the province in the development of the oil and gas industry in Newfoundland and Labrador and the advancement of the province's fabrication capability. In

August 2008, the Government announced the transfer of the Bull Arm Site Corporation to Nalcor Energy. Due diligence activities were undertaken and the transfer was completed on March 31, 2009.

#### ***Other Companies***

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

The Gull Island Power Corporation (GIPCo) is a wholly owned subsidiary of NLH. 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 2008, NLH owned 51 per cent of the shares of LCDC and the federal government owned 49 per cent. The LCDC is presently not an active operating company.

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

#### ***Nalcor Energy***

Nalcor, the province's energy corporation is leading the development of the province's energy resources. As of December 31, 2008, Nalcor and its lines of business employed 1,237 people.

Gender	Rural	Urban	Total	Per cent
Female	140	141	281	23%
Male	730	226	956	77%
<b>Total</b>	<b>870</b>	<b>367</b>	<b>1,237</b>	
<b>Per cent</b>	<b>70%</b>	<b>30%</b>		

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

Headquartered in St. John's, NLH is the province's main electrical energy provider. In December 2008, the company had a staffing level of 860 people located throughout the province including 581 people in rural areas.

Gender	Rural	Urban	Total	Per cent
Female	54	101	155	18%
Male	527	178	705	82%
<b>Total</b>	<b>581</b>	<b>279</b>	<b>860</b>	
<b>Per cent</b>	<b>68%</b>	<b>32%</b>		

### ***Churchill Falls***

Churchill Falls operates the second largest underground hydropower station in the world and provides municipal and community services in the town of Churchill Falls. In December 2008, there were 289 people employed by Churchill Falls.

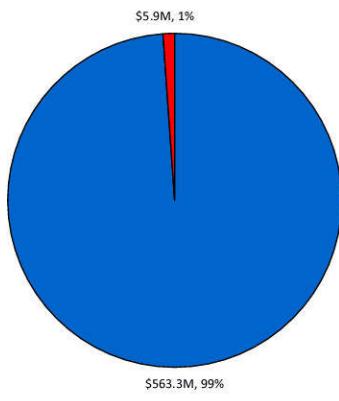
Gender	Rural	Per cent
Female	86	30%
Male	203	70%
<b>Total</b>	<b>289</b>	

### **2008 Consolidated Revenues and Expenses**

The following charts summarize the consolidated 2008 revenue and expenses for Nalcor Energy. The 2008 Consolidated Financial Statements for Nalcor Energy are appended to this document (See Appendix 1).

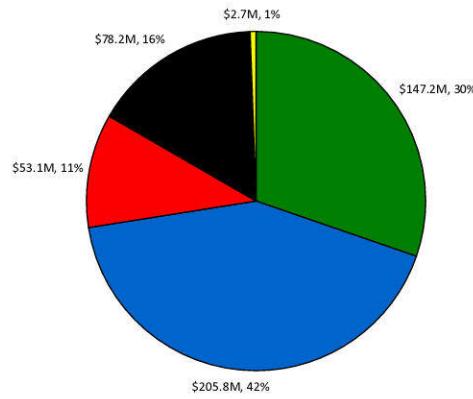
Nalcor Energy Consolidated Revenue and Expenses 2008

Total Revenue: \$569.2M



■ Energy Sales ■ Other

Total Expenses: \$487M

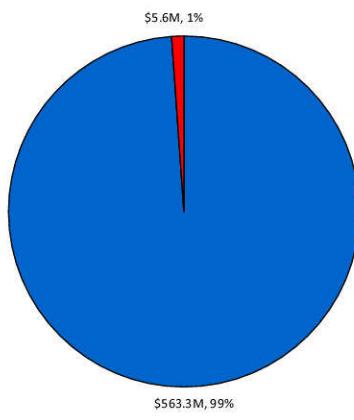


■ Operations and Administration  
■ Amortization  
■ Write-down of investment  
■ Fuels & Power Purchased  
■ Interest

The following charts summarize the consolidated 2008 revenue and expenses for NLH. NLH's audited consolidated financial statements are appended to this document (See Appendix 2).

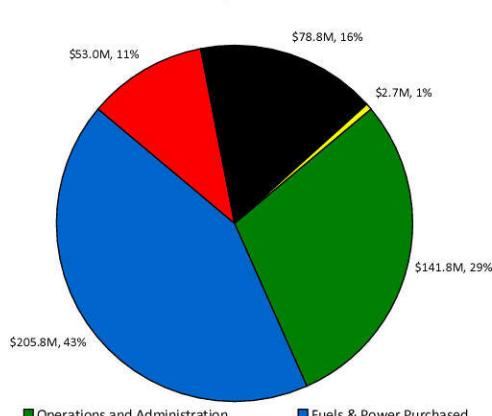
NLH Consolidated Revenue and Expenses 2008

Total Revenue:



■ Energy Sales ■ Other

Total Expenses:



■ Operations and Administration  
■ Amortization  
■ Write-down of investment  
■ Fuels & Power Purchased  
■ Interest

## Shared Commitments

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

### **Department of Natural Resources**

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

### **Department of Finance**

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

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

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

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

## Outcomes of Objectives

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

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

### Issue 1: Safety Leadership

**Issue:** To be a safety leader.

Achieving excellence in safety is Nalcor's number one priority. To fulfil this priority, the company established a safety framework built on leadership, procedures and equipment, competence, supportive culture, union/management alignment, responsibility and reporting.

In 2008, Nalcor implemented a number of safety strategies and initiatives aimed at changing behaviours and strengthening the company's safety culture. A two-day Safety Culture Workshop was delivered to nearly 40 per cent of the workforce, including 80 per cent of field employees. This workshop will continue in 2009 to ensure all employees participate. The company also established a new Safety Credo and embedded it into the corporate Safety Culture Workshop. The goal of the Safety Credo is to promote and foster personal responsibility for safety as a core employee value. In addition, an Internal Responsibility System (IRS) for safety was jointly developed with both International Brotherhood of Electrical Workers (IBEW) locals through Nalcor's Corporate Safety Advisory Committee (CSAC). An important success in Nalcor's safety journey in 2008 was the increase in reporting of incidents, near misses and safe practices. This demonstrates a clear commitment from employees to report and take action when they see unsafe conditions and behaviours.

**Objective:** In 2008, continue to improve or sustain safety performance by increasing the ratio of reports that identify conditions or behaviours that contribute to the number of disabling and medical-aid incidents to the number of disabling and medical-aid incidents.

**Measure:** Sustained improvement of safety performance.

INDICATORS	2008 ACCOMPLISHMENTS
	<b>Nalcor Energy</b> <p>In 2008, Nalcor maintained its momentum for reporting incidents, near misses and safe practices. Observations increased by 29 per cent over 2007 and the lead/lag ratio for the year was 252:1, slightly above the target of 250:1.</p>
Achieved annual safety lead/lag ratio targets	<b>NLH</b> <p>Performance was better than target. The safety lead/lag ratio was 337:1 reflecting 3,712 observations/ reports and 11 safety incidents.</p>
	<b>Churchill Falls</b> <p>Performance was lower than target with a safety lead/lag ratio of 169:1 compared to the target of 250:1. Despite the positive trend in reporting (2,023 observations/reports) the increased safety incidents (12) contributed to the lower than target performance for this indicator. As noted below, the majority of these incidents took place in one area of Churchill Falls. This area has focused significant attention on improvement activities.</p>
Achieved annual target reductions in the number and frequency of disabling injuries	<b>Nalcor Energy</b> <p>In 2008, most areas of the company maintained excellent safety performance with few or zero disabling incidents. However, both NLH and Churchill Falls had one area of their operations experience a significant number of incidents.</p> <p>Overall in 2008, Nalcor's disabling injury statistics were higher than target. The company experienced 13 lost-time injuries (lost-time injury frequency rate<sup>3</sup> of 1.17), significantly higher than the targeted reduction to three injuries (lost-time injury frequency rate of 0.30). The immediate cause for the majority of these incidents was failing to properly identify potential hazards or risks and take the appropriate mitigating measures.</p>

<sup>3</sup> Lost time injury frequency rate = [(Lost time injuries) x 200,000]/Exposure hours (hours worked)

INDICATORS	2008 ACCOMPLISHMENTS
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### **NLH**

In 2008, NLH's disabling injury statistics were higher than the targeted reduction to two injuries or less. NLH experienced six disabling injuries in 2008 (lost-time injury frequency rate of .78), an increase from five (lost-time injury frequency rate of .64) in 2007. A significant number of NLH's incidents took place in one area of operations and this area has focused significant attention on improvement activities.

### **Churchill Falls**

In 2008, Churchill Fall's disabling injury statistics were significantly higher than targeted reduction to one or no injuries. Churchill Falls experienced seven injuries in 2008 (lost-time injury frequency rate of 2.54) an increase from one (lost-time injury frequency rate of .36) in 2007. The majority of these disabling injuries occurred in one area of the Churchill Falls operation. A renewed focus on safety has become a key strategy for this area.

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### **Nalcor Energy**

Achieved annual target reductions in the number and frequency of medical-aid injuries

As noted, in 2008 most areas of the company maintained excellent safety performance with few or zero incidents. However, the same two operational areas that experienced a higher incidence of disabling injuries also faced the same challenge with respect to medical-aid injuries. These areas have focused significant attention on efforts to improve and sustain safety performance.

In 2008, Nalcor's medical-aid injury statistics were higher than target. The company experienced 10 medical-aid injuries (medical-aid frequency rate<sup>4</sup> of .90) compared to the targeted reduction to five injuries (medical-aid frequency rate of .45). The immediate cause for the majority of these incidents was failing to properly identify potential hazards or risks and take the appropriate mitigating measures such as using personal

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<sup>4</sup> Medical aid injury frequency rate = [(Medical aid injuries) x 200,000]/Exposure hours (hours worked)

INDICATORS	2008 ACCOMPLISHMENTS
protective equipment or appropriate equipment/tools.	

#### **NLH**

In 2008, NLH's medical-aid injury statistics were higher than the targeted reduction to less than four injuries. There were five medical-aid injuries in 2008 (medical-aid frequency rate of .65), a slight decrease from the six injuries in 2007 (medical-aid frequency rate of .76).

#### **Churchill Falls**

In 2008, Nalcor's medical-aid injury statistics were higher than the targeted reduction to one or no medical-aid injuries. There were five medical-aid injuries in 2008 (medical-aid frequency rate of 1.81) compared to four in 2007 (medical-aid frequency rate of 1.44). The majority of these medical-aid injuries occurred in same area of the Churchill Falls operation that experienced many disabling injuries in 2008. A focus on safety excellence for this area is intended to reduce all types of safety incidents.

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In 2008, most areas of the company maintained excellent safety performance with few or zero incidents however, for two specific areas of the company this past year was challenging with respect to safety incidents. These areas have focused significant attention on efforts to improve and sustain safety performance.

While lost-time and medical-aid safety statistics were much higher than targeted in 2008, achieving and sustaining safety excellence is a long-term commitment. Targets for improvement in safety performance will continue to be set at a level that demonstrates the company's commitment to keeping employees, contractors and the general public safe.

**Objective:** Further enhance Nalcor's safety programs in 2008

**Measure:** Action on individual components of safety improvement programs

INDICATORS	2008 ACCOMPLISHMENTS
Developed and implemented an improved communications strategy for the safety and health program.	Complete. In 2008, the company developed and implemented an improved safety and health program communications strategy. Specific communications initiatives included the development and distribution of a comprehensive quarterly safety report targeted for senior management and supervisors as well as communications activities related to the Internal Responsibility System and Safety Credo.
Implemented a safety accountability framework (Internal Responsibility System).	Complete. In 2008, CSAC revised the safety accountability framework. The new IRS is based on the foundation that everyone in the workplace is responsible for his or her own safety and for the safety of co-workers. A joint promotion strategy for the IRS has been implemented including incorporating the IRS into the Safety Culture Workshop series and other communication efforts.
Implemented new safety rules (Safety Credo).	Complete. In 2008, the Safety Credo was embedded into the Safety Culture Workshop series and is promoted on an ongoing basis through various other channels.
Implemented detailed analysis overview and trending of Safe Workplace Observation Program (SWOP) reports.	Complete. In 2008, SWOP trending and analysis was incorporated into quarterly safety reports.
Reviewed the Safety Management System with a view to eventual auditing by external safety auditors.	Complete. In 2008, the decision was taken to be internally compliant with ISO 18001 within three years.

### 2009 OBJECTIVES, MEASURES AND INDICATORS

Safety continues to be the company's priority and a driver for Nalcor's business success. The direction contained in the 2008-2010 Strategic Plan outlines the company's ongoing commitment to improved and sustained safety performance. 2009 objectives, measures and indicators are as follows:

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

**Measure:** Improved safety performance.

**Indicators:**

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

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

**Measure:** Action on individual components of safety improvement programs.

**Indicators:**

- Completed planned activities for internal responsibility system rollout.
- Completed safety culture workshop training for select employees.

## Issue 2: Environmental Leadership

**Issue:** To be an environmental leader.

Every year, Nalcor invests significantly in environmental protection measures to limit its ecological footprint. Mitigation measures are built into the company's development projects to reduce environmental impacts, and follow-up programs assess the effectiveness of these measures. An ISO 14001 Certified Environmental Management System (EMS) governs the activities in Nalcor's base businesses, NLH and Churchill Falls, that affect the environment. These systems include specific performance targets and milestones that provide the basis for the indicators outlined below. Activities related to this issue support the Minister's strategic direction regarding sustainable resource development.

A focus area for NLH is the reduction of emissions from thermal generation. In 2006, NLH switched from two per cent to one per cent sulphur fuel at the Holyrood plant resulting in a 50 per cent reduction in sulphur dioxide and particulate emission rates. During 2008, additional options for reducing emissions were investigated and PUB approval will be sought in 2009 for NLH to switch to an even cleaner fuel with 0.7 per cent sulphur content, which will further reduce emissions from the Holyrood plant by 30 per cent.

In 2008, Nalcor Energy - Churchill Falls successfully completed 100 per cent of its EMS environmental targets and milestones. Key environmental initiatives completed in Churchill Falls included converting the last of 11 underground transformers to environmentally-friendly transformer oil (Luminol) and the clean-up of five large sites of construction debris in the Twin Falls and Churchill Falls areas.

The company continues exploring opportunities to incorporate alternative sources of energy into the province's energy supply. In 2008, NLH purchased wind power from the first commercial wind development in Newfoundland, located in St. Lawrence; power from a second wind site in Fermeuse became available in 2009.

Nalcor's Ramea Wind-Hydrogen-Diesel Project also began construction. This is one of the first projects in the world to integrate generation from wind, hydrogen and diesel in a remote, isolated electricity system. This research and development project has the potential to eventually replace diesel with zero-emission power and it has commercial prospects around the world.

With funding from the Provincial Government, NLH commenced two energy projects in select coastal Labrador communities in 2008 - an alternative energy study and an energy efficiency community pilot project. These two programs are important initiatives to identify technically-sound alternative energy options for coastal communities and meaningful ways for consumers to conserve energy.

NLH is committed to helping consumers use energy wisely. In 2008, NLH and Newfoundland Power, an investor-owned utility, filed a five-year joint Energy Conservation Plan with the Newfoundland and Labrador Board of Commissioners of Public Utilities. This plan outlines program priorities for future energy conservation and efficiency opportunities in the province. In November 2008, the companies launched a new provincial energy efficiency partnership and brand, takeCHARGE – Saving Energy Starts Here! takeCHARGE provides Newfoundlanders and Labradorians with information, tools and programs to assist them in using energy wisely and encourages people to take charge and action in their own homes and businesses to reduce their energy usage.

Nalcor and its lines of business are leading by example and have taken steps to reduce energy usage at its office buildings, generating stations and other facilities across the province. In 2008, these activities resulted in energy reductions of approximately 500 megawatt hours (MWh) of electricity.

**Objective:** In 2008, maintain or increase the number of Environmental Management System (EMS) targets and objectives accomplished to 95%.

**Measure:** Annual accomplishment of EMS milestones and targets

INDICATORS	2008 ACCOMPLISHMENTS
	<b>Nalcor Energy</b> In 2008, Nalcor completed 333 (96%) of EMS milestones for the year, slightly over the targeted 95%.
Annual EMS <i> milestone</i> tracking progress <sup>5</sup>	<b>NLH</b> Milestone completion level for 2008 was 94% slightly below the target of 95%. Several milestones will be completed in early 2009 pending resolution of software and resource issues that

<sup>5</sup> The Environmental Management Systems (EMS) include a number of environmental improvement targets or specific activities/initiatives to be completed in a given year: these targets are further divided into a series of tasks or milestones.

INDICATORS	2008 ACCOMPLISHMENTS
	prevented 2008 completion.
<b>Churchill Falls</b>	
	Milestone completion level for 2008 was 100%.
<b>Nalcor Energy</b>	
	In 2008, Nalcor completed 107 (94%) of EMS targets for the year, slightly less than the targeted 95% due to less than target performance of NLH.
<b>NLH</b>	
Annual EMS <i>target</i> tracking progress.	Of the 66 targets to be completed in 2008, 59 or (89%) were completed. Milestones associated with seven EMS targets were delayed due to software and resource issues. These milestones and targets will be completed in 2009.
<b>Churchill Falls</b>	
	Target completion level for 2008 was 100%.

**Objective:** In 2008, maintain EMS performance.

**Measure:** EMS performance

INDICATORS	2008 ACCOMPLISHMENTS
Achieved 95% or greater of EMS targets and milestones.	See above.

### 2009 OBJECTIVES, MEASURES AND INDICATORS

In 2009, Nalcor will maintain the direction contained in the 2008-2010 Strategic Plan.

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

**Measure:** Annual accomplishment of EMS targets

**Indicators:**

- Annual target tracking progress

## Issue 3: Finance and Corporate Governance

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

Nalcor is committed to excellence in its business activities and the processes that support and facilitate these activities. During 2008, the company completed corporate restructuring activities to support the pursuit of its vision and mandate.

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

**Measure:** Improved governance and financial structure

INDICATORS	2008 ACCOMPLISHMENTS
Completion of corporate restructuring plans elements to facilitate investment opportunities	During 2008, NLH was made a subsidiary of Nalcor Energy and the oil and gas entity (Nalcor Energy – Oil and Gas Inc.) was created. As well, some functions including the Lower Churchill Project were moved from NLH to Nalcor.
Annual targets for governance improvements	During 2008, a Corporate Governance Index was prepared for the Board of Directors of Nalcor to assess governance effectiveness. Governance Index targets for 2008 were attained.

**Objective:** By December 2008, complete key initiatives required to support financial and governance structure improvements.

**Measure:** Completion of initiatives

INDICATORS	2008 ACCOMPLISHMENTS
Formed new corporate entities as required.	Complete. During 2008, the oil and gas entity was created (Nalcor Energy – Oil and Gas).

INDICATORS	2008 ACCOMPLISHMENTS
Completed initiatives required under governance readiness plan.	Complete. Initiatives included the preparation of Corporate Governance Index for the Board of Directors of Nalcor and the identification of areas for improvement.

### 2009 OBJECTIVES, MEASURES AND INDICATORS

In 2009, Nalcor will maintain the direction contained in the 2008-2010 Strategic Plan.

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

**Measure:** Completion of initiatives.

**Indicators:**

- Completed identified initiatives.

## Issue 4: Growth

**Issue:** To grow a diversified and viable energy business.

In 2008, Nalcor continued to expand its operations into the broader energy sector, making significant progress in the oil and gas sector. In August 2008, Oil and Gas Corporation of Newfoundland and Labrador Inc. was incorporated under the Corporations Act of Newfoundland and Labrador and subsequently changed its name to Nalcor Energy – Oil and Gas. This company holds and manages the oil and gas interests of Nalcor. Activities related to this issue support the Minister's strategic direction regarding promoting natural resource development and diversification.

**Objective:** In 2008, acquire equity interests in oil and gas fields and/or pursue new development opportunities as appropriate.

**Measure:** Progress towards assuming equity positions.

INDICATORS	2008 ACCOMPLISHMENTS
Completion of equity agreements in oil and gas fields	Nalcor Energy – Oil and Gas completed the acquisition of a 4.9 per cent participating interest in the Significant Discovery Licenses and project assets for the Hebron Ben Nevis and West Ben Nevis fields. In cooperation with other partners, the company is pursuing development of the oil resources within the Hebron field.

**Objective:** In 2008, complete agreements for equity interests in the Hebron field and White Rose Growth areas.

**Measure:** Completion of required activities for equity position assumption.

INDICATORS	2008 ACCOMPLISHMENTS
Completed required activities.	See above.

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### 2009 OBJECTIVES, MEASURES AND INDICATORS

Nalcor's growth agenda for 2009 is consistent with the direction contained in the 2008-2010 Strategic Plan.

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

**Measures:** Progress toward assuming equity positions

**Indicators:**

- Completed required activities

## Issue 5: Operational Excellence

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

Nalcor Energy's commitment to operational excellence transcends across all lines of business. The foundation of the company is built on the strength and expertise of its base businesses – NLH and Churchill Falls. Both companies are focused on long-term asset management to ensure a continued safe and reliable source of electricity. Renewed investment in the provincial electricity infrastructure is a key priority for NLH. In 2008, the company filed a \$1.2 billion 20-year capital plan with the Public Utilities Board which focuses on identifying the investments needed to upgrade aging infrastructure. This was the first 20 year plan and it will continue to be revised and updated on a regular basis.

Churchill Falls focuses on operating, maintaining and investing in its assets to maximize long-term value while meeting contractual obligations. Key elements of its strategy include maintaining safety leadership, environmental stewardship and reliability. The company is taking steps to ensure the continued performance of the facilities so future generations benefit from this provincial resource.

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

Activities related to the regulated utility, NLH support the minister's strategic direction to provide a stable and competitively priced supply of electricity.

**Objective:** In 2008, improve or maintain corporate reliability indices while achieving capital and operating budget financial targets.

**Measure:** Annual reliability and operating cost performance.

INDICATORS	2008 ACCOMPLISHMENTS
Achieved annual reliability targets (winter availability	<b>NLH</b> <b>Winter Availability:</b> Overall performance of 90.3% compared to

INDICATORS	2008 ACCOMPLISHMENTS
and transmission reliability) <sup>6</sup> – NLH.	<p>a target of 97%. Holyrood thermal generating unit performance for the winter months ranged between 86.9% and 95.4% compared to the target of 97%. This performance was a result of outages required to complete repairs to generating equipment. Hydraulic generating plant performance for the winter months ranged between 92.8% and 99.7% compared to the target of 99%. Contributing factors to below target performance included delays in completing capital improvements as a result of a defective part.</p> <p><b>Transmission (Delivery Point) Reliability:</b> Achieved performance better than target with 93.5% reliability (8,875 megawatt minutes) compared to target of 87.3% (17,373 megawatt minutes).</p>
Achieved Guaranteed Winter Availability Contract (GWAC) targets <sup>7</sup> – Churchill Falls	<p><b>Churchill Falls</b></p> <p><b>GWAC:</b> During January, February and March, actual GWAC revenue averaged 99.3% of potential revenue compared to a target of 99%. On November 3, 2008, a fire in a cable shaft at the Churchill Falls generating plant caused extensive damage to two sets of power cables, resulting in two (of the 11) generation units being unavailable. The actual GWAC percentage for 2008 of 66.6% reflects the reduced amount of generation availability during November and December.</p>

<sup>6</sup> Winter availability is a measure of the reliability of the major generating facilities on the island interconnected system during the critical winter season. Transmission network reliability is measured through the delivery point reliability/unreliability index.

<sup>7</sup> GWAC tracks actual revenue as a percentage of maximum possible revenue under the provision of an agreement between Churchill Falls and Hydro-Québec. During key winter months, Churchill Falls receives GWAC revenue based upon plant availability. For the 2008 calendar year GWAC could be earned for January, February, March, November and December.

INDICATORS	2008 ACCOMPLISHMENTS
	<b>Nalcor Energy</b>
	2008 actual operating costs less than 1% over budget; within the <u>± 2%</u> target. Net income for 2008 was above budget.
	<b>NLH</b>
Achieved operating cost targets	Actual operating costs for 2008 were less than 1% over budget; within <u>± 2%</u> target.
	<b>Churchill Falls</b>
	Actual operating costs for 2008 were 4.3% over budget; in excess of the <u>± 2%</u> target. The primary factor contributing to this performance was the costs associated with the cable fire, specifically, the insurance policy deductible payment.
<b>Objective:</b>	Complete initiatives necessary to achieve targets for reliability, cost control and long-term asset management in 2008
<b>Measure:</b>	Completion of initiatives.
INDICATORS	2008 ACCOMPLISHMENTS
	<b>NLH</b>
Capital program delivery performance	2008 capital projects valued at \$36.8M were completed and an additional \$8.8M was spent to complete capital projects started in previous years. Capital projects involved upgrading and replacing generating equipment as well as transmission and distribution assets. In addition funds were invested to upgrade NLH properties and purchase technology, tools and equipment.
	2008 projects were completed within the project budget. For NLH, the actual costs were \$36.8M compared to the budget of \$36.9M. A variance of \$0.1M or less than 1% under budget.
	<b>Churchill Falls</b>
	2008 capital projects valued at \$3.0M were completed and an additional \$1.3M was spent to complete projects started in

INDICATORS	2008 ACCOMPLISHMENTS
	<p>prior years.</p> <p>2008 projects were completed substantially below budget with the actual cost \$1.0M or 25% under budget.</p>
Asset management plan	<p>Nalcor initiated a review of its asset management practices to ensure the company manages its equipment effectively and consistently to maximize availability and minimize cost. Asset management strategy is a key focus for NLH and Churchill Falls.</p> <p>In 2008, NLH completed a 20-year capital plan and filed this plan with the PUB. Substantial progress was also made in developing a long-term asset management plan for several critical systems including four gas turbines. As well, Churchill Falls completed a long-term maintenance plan for the powerhouse.</p> <p>Over the planning period, additional effort will focus on establishing a consistent asset management framework and process across the company.</p>

## 2009 OBJECTIVES, MEASURES AND INDICATORS

Efforts to achieve and sustain excellence in operations will continue in 2009 consistent with the direction contained in the 2008-2010 Strategic Plan. Specific plans for 2009 are as follows:

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

**Measure:** Annual reliability and financial performance.

**Indicators:**

- Achieved annual reliability performance (winter availability) – **NLH only**.
- Achieved Guaranteed Winter Availability Contract (GWAC) targets – **Churchill Falls only**.
- Achieved annual net income targets.

## Issue 6: Lower Churchill

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

The overarching process used by Nalcor in relation to the Lower Churchill Project (LCP) is called the Gateway Process. The Gateway Process provides a logical roadmap that ensures organized project planning and execution. A gateway is at the end of each project phase and readiness checkpoints occur throughout. There are five gates within the LCP lifecycle that mark important junctures of the project. The LCP is currently in Phase two, approaching Decision Gate Two which is essentially concept selection. Concept selection includes defining the project scope, front-end engineering and assessing the optimal return on investment.

In 2008, the Lower Churchill Project team made significant progress to support Decision Gate Two. Key accomplishments included the preparation for the submission of the Environmental Impact Statement (EIS) of the lower Churchill generation project in Labrador as well as the initiation of the Environmental Assessment (EA) process for the Labrador- Island Transmission Link. A significant milestone was also reached in negotiations with the Innu Nation of Labrador with the establishment of the New Dawn Agreement. Step-by-step, Nalcor Energy is obtaining the certainty needed to move forward with the project planning and further investment for the Lower Churchill Project.

**Goal:** By 2009 to have completed analysis necessary for the Provincial Government to consider a decision regarding sanction.

**Measure:** Progress in each of the seven key areas

INDICATORS	2008 ACCOMPLISHMENTS
Engineering	In 2008, Nalcor successfully completed the majority of preliminary engineering and field investigation activities associated with the Gull Island generation site and continued the field investigation work and baseline data gathering for the Labrador-Island Transmission Link.
Financing	Continued to work with financial advisors to assess financing alternatives.

INDICATORS	2008 ACCOMPLISHMENTS
Environment	Significant engineering and environmental activities took place during 2008 leading to the submission of the EIS for the generation project in Labrador as well as the initiation (registration) of the EA process for the Labrador-Island Transmission Link.
Commercial/Market Access	The Lower Churchill Project can generate sufficient energy to fulfill domestic and industrial needs in the province with additional energy available for export. Potential routing and market options continue to be analyzed.
Aboriginal Impacts and Benefits Agreement	In January 2008, a Memorandum of Understanding (MOU) was signed with Emera and Nova Scotia Power inc. to explore the possibility of bringing energy from the Lower Churchill Project to the Maritime and New England markets. As well, the application process for power routing through Québec continues to be progressed under the Open Access Transmission Tariff (OATT) process.
Project Execution Planning	In 2008, a significant milestone was reached in negotiations with the Innu Nation of Labrador with the signing of the New Dawn Agreement. The agreement covers three important areas: Innu land claims; Lower Churchill Project impacts and benefits agreement; and upper Churchill redress.
Operations	Project execution planning progressed significantly in 2008 with the achievement of a planned project readiness milestone known as Gate 2a.
	Preliminary operations philosophy and support strategy were developed.

**Objective:** Complete key milestones in the areas of activity per the overall project plan

**Measure:** Completion of analysis milestones

INDICATORS	2008 ACCOMPLISHMENTS
Progressed preparation of EIS submission for Generation Project	EIS submission was undergoing final review at 2008 year-end.
Completed draft of registration document for Labrador-Island transmission link	Registration document was prepared and undergoing final review at 2008 year-end.
Achieved Gate 2a	All key deliverables for Gate 2a were completed thus providing the basis for Gate 2a passage.
Progressed discussions to identify viable customer options for lower Churchill power	Discussions progressed with potential Labrador based industrial customers and potential off takers in the Maritimes, Ontario and New England markets.
Progressed transmission access decision	MOU signed with Emera and Nova Scotia Power Inc. Quebec OATT process continued to be pursued.
Progressed Innu Nation IBA	New Dawn Agreement was signed with the Innu Nation of Labrador providing a way forward to conclude an Impacts and Benefits Agreement (IBA) for ratification.
Commence Phase 3 engineering and design	Expression of Interest (EOI) prepared for detailed engineering and design work.

### 2009 OBJECTIVES, MEASURES AND INDICATORS

During 2009, Nalcor will continue to pursue the direction contained in the 2008-2010 Strategic Plan.

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

**Measure:** Progress in each of the seven key areas

**Indicators:**

- Engineering

- Financing
- Environment
- Commercial/market access
- Aboriginal Impacts and Benefits Agreement
- Project Execution Planning
- Operations

## Issue 7: People

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

Nalcor recognizes the vital role employees play in the company's success and future direction. The company is focused on a workplace where people feel valued for their contributions. Nalcor's employees share a set of core values: honesty and trust, open communication, accountability, safety, teamwork, respect and dignity, and leadership. Throughout 2008, the company worked to integrate these core values into employee recognition, leadership development, performance management, and recruitment and retention.

In 2008, Nalcor introduced a new Employee Recognition Program intended to foster an environment of shared recognition. The program contains three elements: renewed Service Awards, used to highlight milestones achieved by employees who have dedicated years of service to the company; and two new programs, the On the Spot Awards and the President's Awards. The On the Spot Awards facilitate day-to-day recognition of employees by highlighting behaviours and actions supporting Nalcor's core values. The President's Awards are awarded to employees for significant accomplishments related to one of Nalcor's corporate goals.

Another key initiative in 2008 focused on the development of employees and future leaders. Nalcor implemented a new Management Development program for senior managers with one third of the company's managers completing the program in 2008. Nalcor also continued its Leadership Fundamentals program, which provides both union and front-line supervisors with important management and leadership skills. More than 200 employees have participated in this program since it was introduced in 2006.

Nalcor continues to pursue opportunities for collaboration on key initiatives with its union partners, the IBEW. In 2008, a Corporate Labour Management Team was established, comprised of members from Nalcor's leadership team and senior union leadership. This is a forum to discuss high-level issues across the company. As well, similar teams are being established in key operating departments.

Measuring and managing the performance of employees is also important to help Nalcor achieve its long-term goals and vision. Nalcor's Performance Management Program was enhanced in 2008 through improvements such as online reporting tools. This performance management process for non-union employees provides a procedure and forum for ongoing dialogue between managers/supervisors and their employees and is an important approach to

motivating individual performance, providing employees with feedback on their work, and appropriately recognizing and rewarding employees for their performance.

**Goal:** By 2009 improve all elements to a level where Nalcor would qualify for recognition as one of Canada's best employers in reference to an acceptable external benchmark.

**Measure:** Progress towards ensuring alignment between employee and corporate goals

INDICATORS	2008 ACCOMPLISHMENTS
	<p>Nalcor uses an Employee Opinion Survey (EOS) to measure progress and identify required improvements to achieve its goal to be recognized as one of Canada's top employers. The survey gives employees the opportunity to provide feedback about their work experience at Nalcor.</p>
	<p><b>Nalcor</b></p> <p>The 2008 EOS was distributed to over 1,100 employees within Nalcor. A total of 924 surveys were completed, resulting in an overall response rate of 79% for 2008. This is significantly higher than the average participation rate in Atlantic Canada (71%) and almost identical to the 2007 response rate.</p>
Improved Employee Opinion Survey score	<p>The EOS score for 2008 was 3.6 out of five; consistent with the 2007 score. Areas identified for improvement include: recognition and compensation; employee development; and communication.</p>
	<p><b>NLH</b></p> <p>The EOS score for 2008 was 3.6 out of five, consistent with the 2007 score. Areas for improvement identified for NLH included communication and organizational commitment.<sup>8</sup></p>
	<p><b>Churchill Falls</b></p> <p>The EOS score for 2008 was 3.5 out of five; slightly less than the 2007 score of 3.6 (3.57). Areas identified for improvement include: organizational commitment, communication, and employee development.</p>

<sup>8</sup> This category includes questions related to job satisfaction/motivation/pride and the company's commitment to customer convenience and service.

**Objective:** Undertake activities required to enable closer business-employee alignment by December 2008

**Measure:** Completion of feedback and engagement activities

INDICATORS	2008 ACCOMPLISHMENTS
Developed recruitment and retention strategy aligned with the Energy Plan with a focus to securing sufficient qualified human resources as we move into the future.	Complete. A final report outlining the recruitment and retention strategy was completed in December 2008.
Established a Corporate Labour Management Committee to oversee strategic labour relations issues.	Complete. A Statement of Guiding Principles and Terms of Reference were jointly signed by all team members in March 2008; discussions are ongoing.

### 2009 OBJECTIVES, MEASURES AND INDICATORS

Objectives, measures and indicators for 2009 are consistent with the direction contained in the 2008-2010 Strategic Plan.

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

**Measure:** Completion of improvement activities

**Indicators:**

- Completed organization structure review and implemented any required adjustments according to plan.
- Completed plan for execution of recruitment and retention initiatives and plan implementation on target.
- Completed work improvement plans to address priority people issues identified in the employee opinion survey and plan execution initiated.
- Completed planned activities regarding employee communication.

## Issue 8: Community

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

Nalcor, through its subsidiary NLH, manages its corporate citizenship activities through its Community Investment Program, which supports hundreds of programs, events and charities annually. The company takes pride in its commitment to strengthen the communities where it operates and its employees live and work. Significant investments in the focus areas of safety and health, and environment and conservation, as well as employee volunteer time, exemplify this commitment.

In 2008, NLH started its safety and health partnership with the Seniors Resource Centre of Newfoundland and Labrador (SRC) to expand their safety, health and wellness initiatives for seniors across the province. NLH also supported the Single Parent's Association of Newfoundland and Labrador (SPAN). For over 20 years SPAN has provided support for single parents – delivering Crisis Intervention, Peer Support Group and Parent Effectiveness Training programs to single parents in the province.

NLH also supports community initiatives that promote environmental awareness and preservation of Newfoundland and Labrador's unique environment. During 2008, the company continued its 12-year partnership with the Conservation Corps of Newfoundland and Labrador by supporting Green Teams in three communities- Sheshatshiu, Flower's Cove and St. Alban's.

Nalcor believes that supporting local communities goes beyond financial investments. The company encourages volunteerism among its employees and supports their commitment to local activities through its Employee Matching and Volunteer Contribution Programs. Through these initiatives, charities where employees donate their time and expertise receive a financial contribution from the company in the name of the employee. In 2008, more than 30 organizations were supported through these two employee-driven programs.

As a major employer in Newfoundland and Labrador, Nalcor recognizes the need to play a strong role in the development of the company's future workforce by collaborating with local educational institutions. In 2008, the company completed a strategic review of its Scholarship Program to enhance it for students and align it with the corporate goals. Throughout the year, more than \$50,000 in scholarships and endowments were made by the company to students who are leaders and role models in their schools and communities. This includes the newly established Nalcor Energy endowment scholarship at Memorial University for women in engineering to help encourage and support women entering the engineering field.

**Objective:** In 2008, to have further strengthened Nalcor's reputation by means of excellence in safety, environment, conservation, community investment, business planning and execution.

**Measure:** Improvements in perception by the public

INDICATORS	2008 ACCOMPLISHMENTS
Increased performance on NLH's reputation index	Targets were not established for 2008. 2008 activities focused on implementation of NLH's Community Investment Program. Measurement, through a survey, will be completed in 2009.
Increased brand recognition (Nalcor)	The Nalcor name and brand was introduced in early December 2008. As a result of this timing, Nalcor name/brand recognition in Newfoundland and Labrador will not be measured until 2009.

**Objective:** In 2008, launch new name and brand for the "energy corporation of Newfoundland and Labrador".

**Measure:** Launched new name and brand

INDICATORS	2008 ACCOMPLISHMENTS
Completed the naming and branding of the new name energy corporation.	The Nalcor name and brand was introduced in December 2008. Additional information about the company and the brand can be found on the company's website at <a href="http://nalcorenergy.com">nalcorenergy.com</a> .

## 2009 OBJECTIVES, MEASURES AND INDICATORS

Objectives, measures and indicators for 2009 are consistent with the direction contained in the 2008-2010 Strategic Plan.

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

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

**Indicators:**

- Increased annual performance on NLH's reputation index
- Awareness of the Nalcor brand

## Opportunities and Challenges

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

### Energy Costs

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

### Workforce Changes

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

### Long-term Asset Management Plan

A significant portion of NLH's asset base is 30 to 40 years old, and is well into its original designed life expectancy. To continue to provide safe, cost-effective, reliable power, an asset management framework and organization is being developed. This framework will include a plan to address deteriorating or obsolete assets over the long term, identifying the key investments required to enable NLH to continue to deliver on its mandate. NLH anticipates continued and increasing investment will be required into the future as this plan evolves and is executed. The challenge of asset management is also faced by Churchill Falls as the company strives to ensure the continued performance of its facilities in order that future generations benefit from this resource. The costs, challenges and renewal opportunities that arise as a result of the execution of the long-term asset maintenance and management plan will be a key element of the 2008-2010 strategic plan.

### Implementation of the Energy Plan

The provincial Energy Plan identified the key role that the company will play in the development of the Province's energy sector. In addition to the core business of electrical utility operation, a key focus of the 2008-2010 strategic plan will be to capitalize upon opportunities emerging in the areas of oil and gas and new business, while continuing to

perform the analysis necessary to enable the Shareholder to make a decision regarding sanction of the Lower Churchill Project.

## **Financial Statements**

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

Appendix 1  
Nalcor Energy  
2008 Consolidated Financial Statements

**NALCOR ENERGY  
CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008**

## MANAGEMENT REPORT

The accompanying Consolidated Financial Statements of Nalcor Energy, and all information in the Annual 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 February 20, 2009. Financial information presented elsewhere in the Annual 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.



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ED MARTIN  
President and Chief Executive Officer



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DERRICK STURGE  
Vice-President, Finance and Chief Financial Officer

## Auditors' Report

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

We have audited the consolidated balance sheet of Nalcor Energy (the "Company") as at December 31, 2008 and the consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Energy Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year, except as disclosed in Note 2.

*Deloitte & Touche LLP*

Chartered Accountants  
February 20, 2009

**BOARD OF DIRECTORS**

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Lawyer and Corporate Director

**EDMUND J. MARTIN**  
President and Chief Executive Officer  
Nalcor Energy

**TOM CLIFT**  
Associate Dean Academic Programs  
Faculty of Business  
Memorial University of Newfoundland

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

**CATHY BENNETT**  
Owner / Operator  
Bennett Restaurants Ltd.

**GERALD SHORTALL**  
Chartered Accountant and Corporate Director

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Vice-President, Human Resources and  
Organizational Effectiveness

**GILBERT J. BENNETT**  
Vice-President, Lower Churchill Project

**WAYNE D. CHAMBERLAIN**  
General Counsel and Corporate Secretary

**PETER A. HICKMAN**  
Assistant Corporate Secretary

**MARK G.S. BRADBURY**  
Corporate Treasurer

**GLENN H. MITCHELL**  
Corporate Controller

**HEAD AND CORPORATE OFFICE**

P.O. Box 12800  
St. John's, Newfoundland and Labrador

**NALCOR ENERGY**  
**CONSOLIDATED BALANCE SHEET**

*As at December 31 (millions of dollars)*

	<b>2008</b>	<b>2007</b>		
	(Note 1)			
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	55.2	7.2		
Short-term investments	24.6	11.5		
Accounts receivable	77.1	80.2		
Current portion of long-term receivable	-	0.5		
Current portion of regulatory assets (Note 5)	5.0	17.2		
Fuel and supplies	52.7	69.7		
Prepaid expenses	1.6	1.2		
	<b>216.2</b>	<b>187.5</b>		
Property, plant and equipment (Note 3)	1,862.8	1,825.7		
Oil and gas properties (Note 4)	112.1	-		
Sinking funds (Notes 8 and 14)	163.9	151.8		
Regulatory assets (Note 5)	74.6	81.3		
Reserve fund (Note 18(b))	23.4	11.5		
Other long-term assets (Note 6)	26.7	28.5		
	<b>2,479.7</b>	<b>2,286.3</b>		
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>				
Current liabilities				
Bank indebtedness (Note 8)	5.7	9.1		
Accounts payable and accrued liabilities	56.4	75.9		
Accrued interest	28.7	30.7		
Current portion of long-term debt (Note 8)	9.1	209.1		
Current portion of regulatory liabilities (Note 5)	22.3	23.5		
Deferred capital contribution (Note 19(e))	0.5	-		
Promissory notes (Note 8)	163.0	7.0		
	<b>285.7</b>	<b>355.3</b>		
Long-term debt (Notes 8 and 14)	1,175.7	1,187.8		
Regulatory liabilities (Note 5)	31.5	15.5		
Employee future benefits (Note 10)	51.6	47.4		
Long-term payable (Note 9)	0.7	-		
	<b>83.8</b>	<b>62.9</b>		
Non-controlling interest in Lower Churchill Development Corporation (Note 6)	-	2.5		
Shareholder's equity				
Share capital (Note 11)	122.5	22.5		
Contributed capital (Note 11)	191.5	114.0		
Accumulated other comprehensive income (Notes 13 and 14)	16.5	19.5		
Retained earnings	604.0	521.8		
	<b>934.5</b>	<b>677.8</b>		
	<b>2,479.7</b>	<b>2,286.3</b>		

Commitments and contingencies (Note 18)

Subsequent event (Note 23)

*See accompanying notes*

On behalf of the Board:

  
 DIRECTOR

  
 DIRECTOR

**NALCOR ENERGY**  
**CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS**

<i>Year ended December 31 (millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Revenue		(Note 1)
Energy sales (Notes 1 and 21)	<b>563.3</b>	567.5
Other	<b>5.9</b>	<b>5.9</b>
	<b>569.2</b>	<b>573.4</b>
Expenses		
Operations and administration	<b>147.2</b>	143.1
Fuels	<b>164.8</b>	159.2
Power purchased	<b>41.0</b>	38.4
Amortization	<b>53.1</b>	50.7
Interest (Note 15)	<b>78.2</b>	100.4
Write-down of investment (Note 6(a))	<b>2.7</b>	-
	<b>487.0</b>	<b>491.8</b>
Net income	<b>82.2</b>	81.6
Retained earnings, beginning of year	<b>521.8</b>	437.9
Add: adjustment to long-term debt (Note 14)	-	2.3
Retained earnings, end of year	<b>604.0</b>	<b>521.8</b>

*See accompanying notes*

**NALCOR ENERGY**  
**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

<i>Year ended December 31 (millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Net income	<b>82.2</b>	81.6
Other comprehensive income		
Change in fair value of sinking fund and reserve fund investments	<b>(3.0)</b>	0.2
Comprehensive income	<b>79.2</b>	<b>81.8</b>

*See accompanying notes*

**NALCOR ENERGY**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

<i>Year ended December 31 (millions of dollars)</i>	<b>2008</b>	<b>2007</b>
		(Note 1)
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net income	<b>82.2</b>	81.6
Adjusted for items not involving a cash flow		
Amortization	<b>53.1</b>	50.7
Accretion of long-term debt	<b>0.5</b>	0.8
Loss on disposal of property, plant and equipment	<b>2.5</b>	1.0
Foreign exchange gain	-	(0.3)
Write-down of investments	<b>2.7</b>	-
Other	-	(0.1)
	<b>141.0</b>	133.7
Changes in non-cash working capital balances (Note 16)	<b>33.9</b>	42.5
	<b>174.9</b>	176.2
<b>Financing activities</b>		
Increase (decrease) in promissory notes	<b>156.0</b>	(51.8)
Long-term debt retired	<b>(207.5)</b>	(13.1)
Foreign exchange loss recovered	-	0.1
Increase in contributed capital	<b>77.5</b>	-
Issue of common shares	<b>100.0</b>	-
Increase in deferred capital contribution	<b>0.5</b>	-
	<b>126.5</b>	(64.8)
<b>Investing activities</b>		
Additions to property, plant and equipment	<b>(93.4)</b>	(86.5)
Additions to oil and gas properties	<b>(112.1)</b>	-
Increase in sinking funds	<b>(20.8)</b>	(19.6)
(Increase) decrease in short-term investments	<b>(13.1)</b>	0.2
Increase in reserve fund	<b>(11.3)</b>	(11.5)
Proceeds on disposal of property, plant and equipment	<b>0.7</b>	0.6
	<b>(250.0)</b>	(116.8)
Net increase (decrease) in cash	<b>51.4</b>	(5.4)
Cash position, beginning of year	<b>(1.9)</b>	3.5
Cash position, end of year	<b>49.5</b>	(1.9)
<b>Cash position is represented by</b>		
Cash and cash equivalents	<b>55.2</b>	7.2
Bank indebtedness	<b>(5.7)</b>	(9.1)
	<b>49.5</b>	(1.9)
<b>Supplementary disclosure of cash flow information</b>		
Income taxes paid	<b>0.1</b>	0.2
Interest income received	<b>0.9</b>	1.2
Interest paid	<b>101.6</b>	105.4

*See accompanying notes*

## NALCOR ENERGY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. SIGNIFICANT ACCOUNTING POLICIES

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

On October 11, 2007, the Province of Newfoundland and Labrador ("Province") proclaimed the Energy Corporation Act, creating a new Crown corporation, Nalcor Energy ("Nalcor"), to hold its investments in the energy sector. The Consolidated Financial Statements include the financial statements of Nalcor and its subsidiary companies, Newfoundland and Labrador Hydro ("Hydro"), Churchill Falls (Labrador) Corporation Limited ("Churchill Falls"), Nalcor Energy - Oil and Gas ("Oil and Gas"), Twin Falls Power Corporation ("Twin Falls"), Gull Island Power Corporation ("GIPCo") and Lower Churchill Development Corporation ("LCDC"). Nalcor was inactive until January 1, 2008; therefore the comparative figures included in these Consolidated Financial Statements are those of Hydro consolidated for the year ended December 31, 2007. The transfer of the Province's shares in Hydro to Nalcor was accounted for using the continuity of interests method.

Nalcor and Hydro are incorporated under special acts of the Legislature of the Province as Crown corporations and their core business is the development, generation and sale of electricity. Nalcor has also expanded into the broader energy sector, including oil and gas, wind energy, and research and development.

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

Oil and Gas was incorporated August 12, 2008, 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.

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

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.

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

##### **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% (2007 - 7.4%). Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 5.

## NALCOR ENERGY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

##### **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), GIPCo (100% owned) and LCDC (51% owned). Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

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

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

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

Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and bankers' acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than 12 months are classified as short-term investments. Both are stated at cost, which approximates market value. The short-term investments bear interest rates of 1.58% to 3.60% (2007 - 4.12% to 5.00%) per annum.

##### **Fuel and Supplies**

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

##### **Property, Plant and Equipment**

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

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

##### **Nalcor and Hydro**

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

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

**NALCOR ENERGY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**1. 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 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 kV. Switching station assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

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

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

**Churchill Falls**

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

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

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

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

**Oil and Gas**

Property, plant and equipment includes office equipment and software. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. Amortization is calculated on a straight-line basis over the useful life of five years.

## **NALCOR ENERGY**

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

#### **1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)**

##### **Oil and Gas Properties**

Nalcor employs the full cost method of accounting for oil and gas interests whereby all costs associated with acquisition, exploration for and development of oil and gas reserves are capitalized. Such costs include land acquisition, geological and geophysical activity, drilling of wells and administrative costs directly related to exploration and development activities.

Under the full cost method, oil and gas properties are depleted using the unit-of-production method based upon estimated proved petroleum and natural gas reserves. Projects currently in development or construction are not depleted.

##### **Asset Retirement Obligations**

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Nalcor's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Nalcor is legally required to remove, an asset retirement obligation will be recognized at that time.

##### **Impairment of Long-lived Assets**

Nalcor reviews the carrying value of its oil and gas properties and development projects at the end of each accounting period. Nalcor reviews the carrying value of its other property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

##### **Revenue Recognition**

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

A power contract with Hydro-Québec ("Power Contract"), dated May 12, 1969, provides for the sale of substantially all the energy from 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 base rate is predetermined in the Power Contract and decreases from the existing rate of 2.5425 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 additional availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base ("AEB"), as defined in the Power Contract, are tracked over a four-year period and then either recovered from or refunded to Hydro-Québec over the subsequent four-year period, unless the balance is less than \$1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2007 - 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.

**NALCOR ENERGY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**Foreign Currency Translation (cont'd.)**

- (b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.
- (c) Foreign exchange gains and losses are included in income in the current year except for unrealized gains and losses related to First Mortgage Bonds which were recoverable under the Power Contract.

**Employee Future Benefits**

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

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

**2. CHANGES IN ACCOUNTING POLICIES**

Effective January 1, 2008, Nalcor adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA").

**Inventories**

Section 3031, Inventory requires inventories to be measured at the lower of cost or net realizable value; disallows the use of last-in-first-out inventory costing methodology; and requires that, when circumstances which previously caused inventories to be written down no longer exist, the amount of the write-down is to be reversed. This new standard did not have any impact on Nalcor's financial results or disclosures.

**Disclosure and Presentation of Financial Instruments**

Section 3862, Financial Instruments, Disclosures and Section 3863, Financial Instruments, Presentation sets out new accounting recommendations for disclosure and presentation of financial instruments. The new recommendations require disclosure of both quantitative and qualitative information that enables users of financial statements to evaluate the nature and extent of exposure to risks from financial instruments. These new standards did not have any impact on Nalcor's financial results. The additional disclosure is included in Note 14 to these financial statements.

**Capital Disclosures**

Section 1535, Capital Disclosures requires Nalcor to include additional information in the notes to the financial statements about its capital and the manner in which it is managed. This additional disclosure includes quantitative and qualitative information regarding objectives, policies and processes for managing capital. The additional required disclosure is provided in Note 12 to these financial statements.

**NALCOR ENERGY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**3. PROPERTY, PLANT AND EQUIPMENT**

		Contributions in aid of Construction	Accumulated Amortization	Net Book Value
<i>millions of dollars</i>			2008	
Electric - generation	1,678.5	27.3	547.8	1,103.4
Electric - transmission and distribution	785.4	60.2	245.3	479.9
Development projects	157.0	-	-	157.0
Other	346.2	32.4	191.3	122.5
	<b>2,967.1</b>	<b>119.9</b>	<b>984.4</b>	<b>1,862.8</b>
<i>millions of dollars</i>			2007	
Electric - generation	1,670.5	27.2	531.2	1,112.1
Electric - transmission and distribution	768.0	60.7	229.2	478.1
Development projects	113.8	-	-	113.8
Other	332.3	32.0	178.6	121.7
	<b>2,884.6</b>	<b>119.9</b>	<b>939.0</b>	<b>1,825.7</b>

As at December 31, 2008, the cost of assets under construction and therefore excluded from costs subject to amortization were \$169.5 million (2007 - \$120.4 million).

**4. OIL AND GAS PROPERTIES**

	2008	2007
<i>millions of dollars</i>		
Acquisition costs		
Balance - beginning of year	-	-
Discovery licenses	<b>110.0</b>	-
Balance - end of year	<b>110.0</b>	-
Development costs		
Balance - beginning of year	-	-
Project development costs	<b>2.1</b>	-
Balance - end of year	<b>2.1</b>	-
Total - end of year	<b>112.1</b>	-

## NALCOR ENERGY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

##### Hydro

<i>millions of dollars</i>	2008	2007	Remaining Recovery Settlement Period (years)
<b>Regulatory assets</b>			
Long-term receivable	-	12.1	-
Foreign exchange losses	<b>71.1</b>	73.3	34
Deferred regulatory costs	0.2	0.4	1
Deferred major extraordinary repairs	7.6	12.3	4
Deferred study costs	0.2	0.4	1
Deferred wind power costs	0.5	-	1
<b>Total regulatory assets</b>	<b>79.6</b>	<b>98.5</b>	
Less current portion	<b>5.0</b>	<b>17.2</b>	
	<b>74.6</b>	<b>81.3</b>	
 <b>Regulatory liabilities</b>			
Rate stabilization plan	53.2	38.3	n/a
Deferred purchased power savings	0.6	0.7	19
<b>Total regulatory liabilities</b>	<b>53.8</b>	<b>39.0</b>	
Less current portion	<b>22.3</b>	<b>23.5</b>	
	<b>31.5</b>	<b>15.5</b>	

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

##### Rate Stabilization Plan and Related Long-term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence 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 are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

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

## NALCOR ENERGY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

##### **Rate Stabilization Plan and Related Long-term Receivable (cont'd.)**

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2008, \$9.1 million was recognized (2007 - \$31.5 million) in the RSP and \$14.9 million (2007 - \$8.9 million) was recovered through rates and included in energy sales, with a corresponding cost amortized in fuels expenses.

##### **Foreign Exchange Losses**

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

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a 40-year period. This amortization, of \$2.2 million annually, is included in interest expense (Note 15).

##### **Deferred Regulatory Costs**

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

##### **Deferred Major Extraordinary Repairs**

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of \$500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station ("HTGS"). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset which will be amortized over the subsequent five-year period. In 2006, Hydro incurred \$2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007, \$2.0 million of expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, has been expensed in 2008 (Note 20). In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year in which they were incurred. In 2008, \$2.7 million (2007 - \$2.1 million) of amortization was recognized in operations and administration expense.

##### **Deferred Wind Power Costs**

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

**NALCOR ENERGY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)****Deferred Study Costs**

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

**Deferred Purchased Power Savings**

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of \$0.6 million (2007 - \$0.7 million) are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were 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 2008, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.3% and the amount capitalized is higher and interest expense is lower by \$0.4 million than that which would be permitted in the absence of rate regulation. In 2007, Hydro's AFUDC of 7.6% was lower than its cost of debt of 8.0%, the amount capitalized was lower and interest expense was higher by \$0.3 million than that which would be permitted in the absence of rate regulation (Note 15).

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

During 2005, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately \$170.0 - \$180.0 million lower than it would otherwise be, and annual amortization expense is \$10.0 - \$11.0 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets. An update to this study began in 2008 and is presently ongoing.

**6. OTHER LONG-TERM ASSETS**

<i>millions of dollars</i>	<b>2008</b>	<b>2007</b>
Investment in Lower Churchill Development Corporation Limited	-	5.2 (a)
Long-term receivable	<b>26.7</b>	<b>23.3 (b)</b>
	<b>26.7</b>	<b>28.5</b>

## NALCOR ENERGY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

##### (a) Investment in LCDC

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

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

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

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

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

##### (b) Long-term Receivable

Included in long-term receivables are two refundable deposits in the amount of \$25.4 million (2007 - \$23.3 million) associated with an application for transmission service into Québec, bearing interest at prime until April 2007 at one-year Guaranteed Income Certificate ("GIC") rates thereafter. The remaining portion of \$1.3 million (2007 - nil) is a long-term receivable from Hydro-Québec.

#### 7. 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, 2008, and its proportionate interest in Churchill Falls' operations for the year ended December 31, 2008.

## NALCOR ENERGY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 7. JOINT VENTURE (cont'd.)

<i>millions of dollars</i>	2008	2007
Current assets	37.0	39.5
Long-term assets	334.2	328.9
Current liabilities	10.5	12.5
Long-term liabilities	29.3	36.6
Revenues	65.3	70.6
Expenses	50.3	51.0
Net income	<u>15.0</u>	<u>19.6</u>
Cash provided by (used in)		
Operating activities	30.4	40.4
Financing activities	(12.9)	(19.7)
Investing activities	(20.0)	(16.3)

Income tax expense in the amount of \$0.2 million (2007 - \$0.2 million) related to a jointly controlled subsidiary, Twin Falls, has been grouped with operating expenses.

#### 8. LONG-TERM DEBT

<i>Summary of long-term debt</i> <i>millions of dollars</i>	Churchill			Churchill		
	Hydro	Falls	Total	Hydro	Falls	Total
Long-term debt	1,154.7	30.1	1,184.8	1,359.4	37.5	1,396.9
Less current portion	8.3	0.8	9.1	208.3	0.8	209.1
	<u>1,146.4</u>	<u>29.3</u>	<u>1,175.7</u>	<u>1,151.1</u>	<u>36.7</u>	<u>1,187.8</u>

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

<i>millions of dollars</i>	2009	2010	2011	2012	2013
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayments	0.9	29.3	-	-	-
	<u>9.1</u>	<u>37.5</u>	<u>8.2</u>	<u>8.2</u>	<u>8.2</u>

#### Nalcor

Nalcor maintains an unsecured revolving term credit facility with its banker in the amount of \$150.0 million Canadian or US equivalent. Borrowings in Canadian dollars may take the form of Prime Rate advances, Bankers' Acceptances ("BAs"), and Letters of Credit. Borrowings in US dollars may take the form of Base Rate advances, LIBOR Advances, and Letters of Credit. The facility also provides coverage for overdrafts on Nalcor's bank accounts, with interest calculated at the Prime Rate. The terms of the credit facility provide for the expansion of the facility up to \$300.0 million Canadian or US equivalent as a non-revolving term credit facility, secured by the guarantee of the Province. At year-end, the only drawing on the facility was one irrevocable letter of credit issued on behalf of Nalcor's subsidiary, Oil and Gas. This letter of credit, in the amount of \$1.5 million, was issued to The Canada-Newfoundland and Labrador Offshore Petroleum Board ("CNLOPB") to satisfy certain financial responsibility requirements specified in the Accords Acts with respect to the issuance of authorizations for petroleum-related work or activities within the Newfoundland and Labrador offshore area.

**NALCOR ENERGY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**Hydro**

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2008	2007
<i>millions of dollars</i>						
AA	200.0	5.50	1998	2008	-	199.9
V *	125.0	10.50	1989	2014	<b>124.5</b>	124.4
X *	150.0	10.25	1992	2017	<b>149.1</b>	149.0
Y *	300.0	8.40	1996	2026	<b>292.9</b>	292.7
AB *	300.0	6.65	2001	2031	<b>306.9</b>	307.1
AD *	125.0	5.70	2003	2033	<b>123.5</b>	123.5
AE	225.0	4.30	2006	2016	<b>223.5</b>	223.3
Total debentures	1,425.0				<b>1,220.4</b>	1,419.9
Less sinking fund investments in own debentures					<b>65.9</b>	60.8
Other					<b>1,154.5</b>	1,359.1
Less payments due within one year					<b>0.2</b>	0.3
					<b>1,154.7</b>	1,359.4
					<b>8.3</b>	208.3
					<b>1,146.4</b>	1,151.1

\* Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures, which management intends to hold to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2007 - 4.50% to 9.86%).

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

Hydro uses promissory notes to fulfill its short-term funding requirements. At year-end the promissory notes outstanding were at interest rates ranging from 1.40% to 2.90% (2007 - 4.30% to 4.45%).

Hydro maintains a \$50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end, there were no amounts drawn on the facility (2007 - nil). Advances may take the form of a prime rate advance or the issuance of a BA with interest calculated at the prime rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the prime rate. At year-end, Hydro had two letters of credit outstanding (Note 18(f)) reducing the availability of the credit facility by \$7.5 million.

**NALCOR ENERGY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****8. LONG-TERM DEBT (cont'd.)****Churchill Falls**

<i>millions of dollars</i>	2008	2007
<b>General Mortgage Bonds</b>		
7.5% due December 15, 2010	-	37.5
Less: current portion	-	0.8
Total long-term debt	<u>-</u>	<u>36.7</u>
 <b>Bank of Nova Scotia Credit Agreement</b>		
4.4% due December 15, 2010	30.1	-
Less: current portion	0.8	-
Total long-term debt	<u>29.3</u>	<u>-</u>

**Refinancing**

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

Churchill Falls exercised its prepayment privileges under the new credit agreement by prepaying \$10.0 million principal on March 25, 2008. Nalcor's share of this repayment was \$6.6 million.

**Dividend Restriction**

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

**Operating Credit Facility**

Churchill Falls maintains a \$10.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end, there were no amounts drawn on the facility (2007 - \$0.3 million). Advances may take the form of a Prime Rate advance or the issuance of BAs with interest calculated at the Prime Rate or prevailing Government BA fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate. At year-end, Churchill Falls had two letters of credit outstanding (Note 18(f)) reducing the availability of the credit facility by \$1.4 million.

**9. LONG-TERM PAYABLE**

The long-term payable to Hydro-Québec as of December 31, 2008, is the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, the full amount of \$0.7 million (2007 - nil) is long-term. The final amount will be determined on August 31, 2012, and will be paid/collected monthly beginning September 2012 and ending August 2016.

**NALCOR ENERGY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**10. EMPLOYEE FUTURE BENEFITS**

**Pension Plan**

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$4.9 million (2007 - \$4.6 million) are expensed as incurred.

**Other Benefits**

Additionally, Nalcor provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2008, cash payments to beneficiaries for its unfunded other employee future benefits was \$3.0 million (2007 - \$2.3 million). The most recent actuarial valuation was performed as at December 31, 2006, with an extrapolation of the December 31, 2006 valuation to December 31, 2008. The next actuarial valuation will be performed as at December 31, 2009.

<i>millions of dollars</i>	<b>2008</b>	<b>2007</b>
<b>Accrued benefit obligation</b>		
Balance at beginning of year	<b>68.6</b>	67.8
Current service cost	2.2	2.3
Interest cost	3.8	3.6
Actuarial gain	(19.3)	(2.8)
Benefits paid	(3.0)	(2.3)
Balance at end of year	<b>52.3</b>	<b>68.6</b>
Plan deficit	<b>52.3</b>	68.6
Unamortized actuarial loss	(0.4)	(20.9)
Unamortized past-service cost	(0.3)	(0.3)
Accrued benefit liability at end of year	<b>51.6</b>	<b>47.4</b>
<i>millions of dollars</i>	<b>2008</b>	<b>2007</b>
<b>Components of benefit cost</b>		
Current service cost	2.2	2.3
Interest cost	3.8	3.6
Actuarial gain	(19.3)	(2.8)
	<b>(13.3)</b>	3.1
Adjustments		
Difference between actual actuarial gain and amount recognized	<b>20.4</b>	4.3
Benefit expense	<b>7.1</b>	<b>7.4</b>
The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:		
<b>2008</b>	<b>2007</b>	
Discount rate	7.5%	5.5%
Rate of compensation increase	3.5%	3.5%
Assumed health care trend rates:		
<b>2008</b>	<b>2007</b>	
Initial health care expense trend rate	7.0%	8.0%
Cost trend decline to	5.0%	5.0%
Year that rate reaches the rate it is assumed to remain at	<b>2011</b>	<b>2011</b>

**NALCOR ENERGY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

<i>millions of dollars</i>	<b>2008</b>	<b>2007</b>
Current service and interest cost	<b>1.2</b>	0.8
Accrued benefits obligation	<b>7.2</b>	5.7

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

<i>millions of dollars</i>	<b>2008</b>	<b>2007</b>
Current service and interest cost	<b>(0.8)</b>	(0.8)
Accrued benefit obligation	<b>(5.5)</b>	(9.2)

**11. SHAREHOLDER'S EQUITY**

**Share Capital**

<i>millions of dollars</i>	<b>2008</b>	<b>2007</b>
Common shares		
Authorized: unlimited; issued 122,500,000 (2007 - 22,503,924)	<b>122.5</b>	<b>22.5</b>

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

**Contributed Capital**

<i>millions of dollars</i>	<b>2008</b>	<b>2007</b>
Total contributed capital	<b>191.5</b>	<b>114.0</b>

During 2008, the Province contributed capital in the amount of \$77.5 million.

**12. CAPITAL MANAGEMENT**

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

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

**NALCOR ENERGY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****12. CAPITAL MANAGEMENT (cont'd.)**

A summary of the capital structure is outlined below:

<i>millions of dollars</i>	2008	2007
<b>Debt</b>		
Long-term debt	1,175.7	1,187.8
Current portion of long-term debt	9.1	209.1
Promissory notes	163.0	7.0
Sinking funds	(163.9)	(151.8)
	<u>1,183.9</u>	<u>1,252.1</u>
	55.9%	64.9%
<b>Equity</b>		
Share capital	122.5	22.5
Contributed capital	191.5	114.0
Accumulated other comprehensive income	16.5	19.5
Retained earnings	604.0	521.8
	<u>934.5</u>	<u>677.8</u>
	<u>44.1%</u>	<u>35.1%</u>
<b>Total debt and equity</b>	<b><u>2,118.4</u></b>	<b><u>1,929.9</u></b>
	<b><u>100.0%</u></b>	<b><u>100.0%</u></b>

**Hydro**

Hydro requires access to capital due to the capital intensive nature of the business which is required to ensure the continued delivery of safe and reliable service to its customers. Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its earnings before interest and taxes ("EBIT") coverage of interest. Adjustments to the capital structure are accomplished through adjustments to the amount of dividends paid to the shareholder, cash infusion via contributed equity and new debt issuance or debt issuance with differing characteristics. Hydro's goal is to achieve a capital structure and cash flows to support debt.

**Churchill Falls**

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

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

**NALCOR ENERGY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****12. CAPITAL MANAGEMENT (cont'd.)****Oil and Gas**

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

**13. ACCUMULATED OTHER COMPREHENSIVE INCOME**

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

<i>millions of dollars</i>	2008	2007
Balance, beginning of year	<b>19.5</b>	-
Adjustment due to the adoption of new accounting policies	-	19.3
Change in fair value of sinking fund investments	<b>(3.6)</b>	0.2
Change in fair value of reserve fund investments	<b>0.6</b>	-
Balance, end of year	<b><u>16.5</u></b>	<b><u>19.5</u></b>

**14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

Nalcor has classified its financial instruments as follows:

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

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

**Fair Value**

The estimated fair values of financial instruments as at December 31, 2008, are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Nalcor might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Nalcor as a whole.

In 2007, Nalcor recognized an increase to opening retained earnings of \$2.3 million resulting from the measurement of outstanding long-term debt at amortized cost, using the effective interest method. As well, Nalcor recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of \$19.3 million.

**NALCOR ENERGY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)****Fair Value (cont'd.)**

<i>millions of dollars</i>	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Carrying Value</b>	<b>Fair Value</b>
	<b>2008</b>		<b>2007</b>	
<b>Financial liabilities</b>				
Long-term debt including current portion	1,184.8	1,484.8	1,396.9	1,731.2

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 which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

**Risk Management**

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

**Credit Risk**

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

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

**Liquidity Risk**

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

**Market Risk**

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

**NALCOR ENERGY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

***Interest Rates***

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

Within Hydro, exposure to changes in interest rates on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios, creates risk. Hydro estimates that an increase of 100 basis points from the actual average yield on the short-term debt portfolio in 2008 would have resulted in a change in interest expense of \$1.3 million (2007 - \$0.2 million). Similarly, an increase of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2008 would have resulted in a change in interest income of \$2.0 million (2007 - \$1.8 million) and a decrease in other comprehensive income of \$16.1 million (2007 - \$16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

Within Churchill Falls, interest rate risk is mitigated on the company's long-term debt by virtue of a fixed interest rate to maturity. Exposure to changes in interest rates exists on investment income related to the short-term and reserve fund investment portfolios. Churchill Falls estimates that an increase of 100 basis points from the actual average yield earned on the short-term investment portfolio in 2008 would have resulted in a change in interest income of \$0.2 million (2007 - \$0.2 million). Similarly, an increase of 100 basis points from the actual average yield earned on the reserve fund investment portfolio in 2008 would have resulted in a change in interest income of \$0.2 million (2007 - \$0.1 million) and an increase in other comprehensive income of \$0.5 million (2007 - \$0.2 million). Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated.

***Foreign Currency and Commodity Exposure***

Fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Nalcor's primary exposure to both foreign exchange and commodity price risk arises within Hydro from its purchases of No. 6 fuel for consumption at the HTGS. During 2008, Hydro had total purchases of No. 6 fuel of \$103.9 million (2007 - \$122.0 million). These purchases are denominated in US dollars.

Nalcor's exposure to both the foreign exchange and commodity price risk associated with these purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates as compared to that approved in Hydro's most recent COS used to set rates, are captured in the RSP and are either refunded to or collected from customers via automatic rate adjustments. Nalcor also employs the periodic use of forward currency contracts as a means by which exposure to exchange rates on a particular day can be avoided. As at December 31, 2008, there were no forward contracts outstanding.

## NALCOR ENERGY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 15. INTEREST EXPENSE

<i>millions of dollars</i>	2008	2007
<b>Gross interest</b>		
Long-term debt	<b>96.0</b>	105.0
Promissory notes	<b>4.2</b>	0.9
	<b>100.2</b>	105.9
Accretion of long-term debt	<b>0.5</b>	0.8
Provision for foreign exchange losses	<b>2.2</b>	2.2
	<b>102.9</b>	108.9
<b>Less</b>		
Recovered from Hydro-Québec	<b>0.1</b>	1.0
Interest capitalized during construction	<b>9.6</b>	6.3
Interest earned	<b>15.0</b>	14.3
Net interest expense	<b>78.2</b>	87.3
Debt guarantee fee	<b>-</b>	13.1
Net interest and guarantee fee	<b>78.2</b>	<b>100.4</b>

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

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

#### 16. CHANGE IN NON-CASH WORKING CAPITAL BALANCES

<i>millions of dollars</i>	2008	2007
Accounts receivable	<b>3.1</b>	(7.8)
Fuel and supplies	<b>17.0</b>	(15.3)
Prepaid expenses	<b>(0.4)</b>	0.3
Accounts payable and accrued liabilities	<b>(19.5)</b>	26.7
Regulatory assets	<b>18.9</b>	49.7
Regulatory liabilities	<b>14.8</b>	(11.3)
Accrued interest	<b>(2.0)</b>	(0.1)
Employee future benefits	<b>4.2</b>	5.1
Long-term receivable	<b>(2.9)</b>	(4.5)
Long-term payable	<b>0.7</b>	(0.3)
	<b>33.9</b>	<b>42.5</b>

## NALCOR ENERGY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 17. SEGMENT INFORMATION

Nalcor operates in four business segments. Regulated operations encompass sales of power and energy to most customers within the Province while Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. Other energy activities are primarily engaged in sales to markets outside the province and development activities. Oil and Gas activities include exploration, development, production, transportation and processing sectors of the oil and gas industry. The designation of segments has been based on a combination of regulatory status and management accountability. The segment's accounting policies are the same as those described in Note 1.

	Regulated	Other Energy Activities	Churchill Falls	Oil and Gas	Inter- segment	Total
<i>millions of dollars</i>	<b>2008</b>					
<b>Revenue</b>						
Energy sales	<b>440.1</b>	<b>58.2</b>	<b>68.9</b>	-	(3.9)	<b>563.3</b>
Other	<b>2.2</b>	-	<b>0.3</b>	<b>0.3</b>	<b>3.1</b>	<b>5.9</b>
	<b>442.3</b>	<b>58.2</b>	<b>69.2</b>	<b>0.3</b>	<b>(0.8)</b>	<b>569.2</b>
<b>Expenses</b>						
Operations and administration	<b>99.1</b>	<b>8.9</b>	<b>38.8</b>	<b>0.4</b>	-	<b>147.2</b>
Fuels	<b>164.8</b>	-	-	-	-	<b>164.8</b>
Power purchased	<b>41.4</b>	<b>3.5</b>	-	-	(3.9)	<b>41.0</b>
Amortization	<b>40.4</b>	<b>0.1</b>	<b>11.4</b>	-	<b>1.2</b>	<b>53.1</b>
Interest	<b>87.6</b>	(9.5)	<b>0.1</b>	-	-	<b>78.2</b>
Write-down of investment	-	<b>2.7</b>	-	-	-	<b>2.7</b>
	<b>433.3</b>	<b>5.7</b>	<b>50.3</b>	<b>0.4</b>	<b>(2.7)</b>	<b>487.0</b>
Net income before equity in Churchill Falls	<b>9.0</b>	<b>52.5</b>	<b>18.9</b>	(0.1)	<b>1.9</b>	<b>82.2</b>
Equity in Churchill Falls	-	<b>11.8</b>	-	-	(11.8)	-
Preferred dividends	-	<b>9.0</b>	-	-	(9.0)	-
Net income	<b>9.0</b>	<b>73.3</b>	<b>18.9</b>	(0.1)	<b>(18.9)</b>	<b>82.2</b>
Capital expenditures	<b>45.6</b>	<b>43.2</b>	<b>4.3</b>	<b>112.4</b>	-	<b>205.5</b>
<b>Total assets</b>	<b>1,711.5</b>	<b>723.0</b>	<b>371.2</b>	<b>112.7</b>	<b>(438.7)</b>	<b>2,479.7</b>

During 2008, sales to Nalcor's three largest customers amounted to 90% of total energy sales revenue (2007 – 90%).

## NALCOR ENERGY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 17. SEGMENT INFORMATION (cont'd.)

	Regulated	Other Energy Activities	Churchill Falls	Oil and Gas	Inter-segment	Total
<i>millions of dollars</i>						
						2007
<b>Revenue</b>						
Energy sales	438.7	58.5	74.2	-	(3.9)	567.5
Other	2.0	-	0.3	-	3.6	5.9
	<u>440.7</u>	<u>58.5</u>	<u>74.5</u>	<u>-</u>	<u>(0.3)</u>	<u>573.4</u>
<b>Expenses</b>						
Operations and administration	98.5	6.0	38.6	-	-	143.1
Fuels	159.2	-	-	-	-	159.2
Power purchased	38.5	3.9	-	-	(4.0)	38.4
Amortization	38.4	-	11.2	-	1.1	50.7
Interest	103.2	(5.0)	2.1	-	0.1	100.4
	<u>437.8</u>	<u>4.9</u>	<u>51.9</u>	<u>-</u>	<u>(2.8)</u>	<u>491.8</u>
Net income before equity in Churchill Falls	2.9	53.6	22.6	-	2.5	81.6
Equity in Churchill Falls	-	14.7	-	-	(14.7)	-
Preferred dividends	-	10.4	-	-	(10.4)	-
Net income	<u>2.9</u>	<u>78.7</u>	<u>22.6</u>	<u>-</u>	<u>(22.6)</u>	<u>81.6</u>
Capital expenditures	36.0	45.7	4.8	-	-	86.5
Total assets	<u>1,733.3</u>	<u>498.9</u>	<u>368.4</u>	<u>-</u>	<u>(314.3)</u>	<u>2,286.3</u>

#### Geographic Information

##### Revenues by geographic area:

	2008	2007
Newfoundland and Labrador	447.6	445.1
Québec	121.6	128.3
	<u>569.2</u>	<u>573.4</u>

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

#### 18. COMMITMENTS AND CONTINGENCIES

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

**NALCOR ENERGY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**(a) (cont'd.)**

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

**(b)** 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 and 2008. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2009	\$17.0 million
January 1, 2010	\$8.0 million
January 1, 2011	\$8.0 million
January 1, 2012	\$8.0 million

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

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

<i>millions of dollars</i>	<b>2008</b>	<b>2007</b>
Opening balance	<b>11.2</b>	-
Contribution	<b>11.2</b>	<b>11.2</b>
Total contribution to reserve fund	<b>22.4</b>	<b>11.2</b>
Net interest earned	<b>0.4</b>	<b>0.3</b>
Mark-to-market adjustment	<b>0.6</b>	-
Fair value of reserve fund	<b>23.4</b>	<b>11.5</b>

**(c)** Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be \$0.2 million (2007 - \$1.2 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately \$22.2 million (2007 - \$21.8 million) related to outages and plant shutdowns. Hydro is defending this claim and management believes that this claim will not be successful.

**(d)** Outstanding commitments for capital projects total approximately \$13.6 million (2007 - \$16.8 million).

**NALCOR ENERGY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****18. COMMITMENTS AND CONTINGENCIES (cont'd.)**

(e) 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

During 2008, the enactment of the Abitibi-Consolidated Rights and Assets Act resulted in the cancelation of two long-term power purchase agreements (Note 21(a)).

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

<i>millions of dollars</i>	2009	2010	2011	2012	2013
Power purchases	25.6	26.4	29.6	30.0	30.6

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

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

Churchill Falls has issued two irrevocable letters of credit, in the amount of \$0.7 million each 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.

**19. RELATED PARTY TRANSACTIONS**

The Province, Nalcor, Hydro, Churchill Falls, Oil and Gas, LCDC and GIPCo are related parties. In addition, the PUB is related to Nalcor by virtue of its status as an agency of the Province.

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of \$6.0 million (2007 - \$6.1 million) of the power produced by Churchill Falls and Nalcor's 65.8% share is eliminated upon consolidation.

(b) For the year ended December 31, 2008, approximately \$2.2 million (2007 - \$2.2 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties and Nalcor's 65.8% share is eliminated upon consolidation.

**NALCOR ENERGY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

- (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 2008, Hydro incurred \$0.6 million in costs related to the PUB (2007 - \$1.2 million) of which \$0.1 million (2007 - \$0.1 million) was included in accrued liabilities.
- (d) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually.
- (e) During 2008, Hydro received contribution in aid of construction from the Province related to wind feasibility studies. As at December 31, 2008, the full amount of \$0.5 million has been recorded as deferred capital contribution.
- (f) During 2008, Hydro received \$0.4 million (2007 - nil) as a rate subsidy for rural isolated customers from the Province and \$1.5 million (2007 - \$0.6 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 \$0.1 million (2007 - \$0.6 million) recorded as accounts receivable at year-end.

**20. CHANGE IN ESTIMATE**

In 2007, Hydro incurred \$2.0 million in expenses to repair a turbine at HTGS and these costs were deferred as a major extraordinary repair. Pursuant to Order No. P.U. 31 (2008), the PUB denied Hydro's request to treat the repair of the turbine as a major extraordinary repair and therefore, the full cost of the repair, net of insurance proceeds of \$0.8 million, was recorded in operations and administration expense during 2008.

**21. SIGNIFICANT OCCURRENCES**

**Hydro**

In late 2008, Abitibi-Consolidated announced the shut-down of the Grand Falls Pulp and Paper Mill resulting in the loss of a major industrial customer. Revenue from this customer for the year ended December 31, 2008, was \$5.1 million (2007 - \$4.9 million). The Abitibi-Consolidated Rights and Assets Act was enacted on December 16, 2008, resulting in the cancellation of two power purchase agreements from two non-utility generators in which Abitibi was a partner.

**Churchill Falls**

On November 3, 2008, a fire occurred in a cable shaft at Churchill Falls causing extensive damage to two sets of high voltage cables in two units of the cable shaft.

Repair work has begun on one unit with work expected to be completed in February 2009. The second unit will be repaired in the summer of 2009 once the necessary cables have been obtained. Nalcor's estimated share of the cost of the repair to the cables in the amount of \$6.6 million is covered by an insurance policy with a \$1.3 million deductible. As at December 31, 2008, Nalcor's share of expenses totaling \$1.5 million have been incurred in relation to this repair and insurance proceeds of \$0.2 million have been accrued. Churchill Falls will accrue the expenses and related insurance proceeds as incurred.

**NALCOR ENERGY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****21. SIGNIFICANT OCCURRENCES (cont'd.)****Churchill Falls (cont'd)**

Nalcor's 65.8% share of the total impact of the fire on net income for the year ended December 31, 2008, including lost revenue is estimated to be as follows:

<i>millions of dollars</i>	<b>2008</b>
Lost revenue - guaranteed winter availability	(8.4)
Lost revenue - power sales	(2.1)
Repair costs (net of insurance proceeds)	(1.3)
Net decrease in rental and other costs	0.8
<b>Total impact on net income</b>	<b>(11.0)</b>

**22. OIL AND GAS INTERESTS**

In 2008, Oil and Gas purchased a 4.9% participating interest in the Significant Discovery Licences ("SDL") and project assets for the Hebron Ben Nevis and West Ben Nevis fields for a purchase price of \$110.0 million. In co-operation with the other partners, Oil and Gas is pursuing development of the oil resources within the Hebron field.

**23. SUBSEQUENT EVENT**

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

Appendix 2  
Newfoundland and Labrador Hydro  
Consolidated Financial Statements  
December 31, 2008

**NEWFOUNDLAND AND LABRADOR HYDRO  
CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2008**



## Auditors' Report

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

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro (the "Company") as at December 31, 2008 and the consolidated statements of income and retained earnings and comprehensive income and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year, except as disclosed in Note 2.

*Deloitte & Touche LLP*

Chartered Accountants  
February 20, 2009



**BOARD OF DIRECTORS**

JOHN OTTENHEIMER (Chair)  
Lawyer and Corporate Director

EDMUND J. MARTIN  
President and Chief Executive Officer  
Nalcor Energy

TOM CLIFT  
Associate Dean Academic Programs  
Faculty of Business  
Memorial University of Newfoundland

KEN MARSHALL  
President  
Rogers Cable - Atlantic Region

CATHY BENNETT  
Owner/Operator  
Bennett Restaurants Ltd.

**OFFICERS**

JOHN OTTENHEIMER  
Chairman

EDMUND J. MARTIN  
President and Chief Executive Officer

DERRICK F. STURGE  
Vice-President, Finance and Chief Financial Officer

JAMES R. HAYNES  
Vice-President, Regulated Operations

JOHN E. MALLAM  
Vice-President, Engineering Services

JIM M. KEATING  
Vice-President, Nalcor Energy – Oil and Gas

ANDREW E. MacNEILL  
Vice-President, Nalcor Energy – Churchill Falls

GERARD V. McDONALD  
Vice-President, Human Resources and  
Organizational Effectiveness

GILBERT J. BENNETT  
Vice-President, Lower Churchill Project

WAYNE D. CHAMBERLAIN  
General Counsel and Corporate Secretary

PETER A. HICKMAN  
Assistant Corporate Secretary

MARK G.S. BRADBURY  
Corporate Treasurer

GLENN H. MITCHELL  
Corporate Controller

**HEAD AND CORPORATE OFFICE**

P.O. Box 12400  
St. John's, Newfoundland and Labrador  
A1B 4K7

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

*As at December 31 (millions of dollars)*

	<b>2008</b>	<b>2007</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	4.1	7.2
Short-term investments	14.6	11.5
Accounts receivable	76.6	80.2
Current portion of long-term receivable	-	0.5
Current portion of regulatory assets (Note 4)	5.0	17.2
Fuel and supplies	52.7	69.7
Prepaid expenses	1.6	1.2
	<u>154.6</u>	<u>187.5</u>
Property, plant and equipment (Notes 3 and 19(e))	1,702.4	1,829.7
Long-term receivables (Note 5)	26.7	23.3
Sinking funds (Notes 8 and 14)	163.9	151.8
Regulatory assets (Note 4)	74.6	81.3
Investments (Note 6)	-	5.2
Reserve fund (Note 18(b))	23.4	11.5
	<u>2,145.6</u>	<u>2,286.3</u>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
Current liabilities		
Bank indebtedness (Note 8)	5.7	9.1
Accounts payable and accrued liabilities	55.1	75.9
Accrued interest	28.7	30.7
Current portion of long-term debt (Note 8)	9.1	209.1
Current portion of regulatory liabilities (Note 4)	22.3	23.5
Deferred capital contribution (Note 19(f))	2.2	-
Promissory notes (Note 8)	163.0	7.0
Due to related parties (Notes 14 and 19)	2.9	-
	<u>289.0</u>	<u>355.3</u>
Long-term debt (Notes 8 and 14)	1,175.7	1,187.8
Regulatory liabilities (Note 4)	31.5	15.5
Employee future benefits (Notes 10 and 19(e))	49.9	47.4
Long-term payable (Note 9)	0.7	-
	<u>82.1</u>	<u>62.9</u>
Non-controlling interest in Lower Churchill Development Corporation (Note 6)	-	2.5
Shareholder's equity		
Share capital (Note 11)	22.5	22.5
Contributed capital (Notes 11 and 19(e))	111.8	114.0
Accumulated other comprehensive income (Notes 13 and 14)	16.5	19.5
Retained earnings (Note 19(e))	448.0	521.8
	<u>598.8</u>	<u>677.8</u>
Commitments and contingencies (Note 18)	<u>2,145.6</u>	<u>2,286.3</u>

*See accompanying notes*

On behalf of the Board:



JOHN OTTENHEIMER  
 DIRECTOR

  
 ED MARTIN  
 DIRECTOR

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

<i>Year ended December 31 (millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Revenue		
Energy sales (Notes 1 and 21)	<b>563.3</b>	567.5
Other	<b>5.6</b>	5.9
	<b>568.9</b>	<b>573.4</b>
Expenses		
Operations and administration	<b>141.8</b>	143.1
Fuels	<b>164.8</b>	159.2
Power purchased	<b>41.0</b>	38.4
Amortization	<b>53.0</b>	50.7
Interest (Note 15)	<b>78.8</b>	100.4
Write-down of investment (Note 6)	<b>2.7</b>	-
	<b>482.1</b>	<b>491.8</b>
Net income	<b>86.8</b>	81.6
Retained earnings, beginning of year	<b>521.8</b>	437.9
Add: adjustment to long-term debt (Note 14)	-	2.3
Deduct: adjustment to retained earnings (Note 19(e))	<b>160.6</b>	-
Retained earnings, end of year	<b>448.0</b>	<b>521.8</b>

*See accompanying notes*

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

<i>Year ended December 31 (millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Net income	<b>86.8</b>	81.6
Other comprehensive income		
Change in fair value of sinking fund and reserve fund investments	<b>(3.0)</b>	0.2
Comprehensive income	<b>83.8</b>	<b>81.8</b>

*See accompanying notes*

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

<i>Year ended December 31 (millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Cash provided by (used in)		
Operating activities		
Net income	<b>86.8</b>	81.6
Adjusted for items not involving a cash flow		
Amortization	<b>53.0</b>	50.7
Accretion of long-term debt	<b>0.5</b>	0.8
Loss on disposal of property, plant and equipment	<b>2.5</b>	1.0
Foreign exchange gain	-	(0.3)
Write-down of investments	<b>2.7</b>	-
Other	-	(0.1)
	<b>145.5</b>	133.7
Changes in non-cash working capital balances (Note 16)	<b>31.7</b>	42.5
	<b>177.2</b>	176.2
Financing activities		
Increase (decrease) in promissory notes	<b>156.0</b>	(51.8)
Long-term debt retired	<b>(207.5)</b>	(13.1)
Advance to Nalcor (Note 19(e))	<b>(3.0)</b>	-
Foreign exchange loss recovered	-	0.1
Increase in deferred capital contribution	<b>2.2</b>	-
	<b>(52.3)</b>	(64.8)
Investing activities		
Additions to property, plant and equipment	<b>(90.1)</b>	(86.5)
Increase in sinking funds	<b>(20.8)</b>	(19.6)
(Increase) decrease in short-term investments	<b>(3.1)</b>	0.2
Increase in reserve fund	<b>(11.3)</b>	(11.5)
Proceeds on disposal of property, plant and equipment	<b>0.7</b>	0.6
	<b>(124.6)</b>	(116.8)
Net increase (decrease) in cash	<b>0.3</b>	(5.4)
Cash position, beginning of year	<b>(1.9)</b>	3.5
Cash position, end of year	<b>(1.6)</b>	(1.9)
Cash position is represented by		
Cash and cash equivalents	<b>4.1</b>	7.2
Bank indebtedness	<b>(5.7)</b>	(9.1)
	<b>(1.6)</b>	(1.9)
Supplementary disclosure of cash flow information		
Income taxes paid	<b>0.1</b>	0.2
Interest income received	<b>0.9</b>	1.2
Interest paid	<b>101.6</b>	105.4

*See accompanying notes*

## **NEWFOUNDLAND AND LABRADOR HYDRO**

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

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#### **1. SIGNIFICANT ACCOUNTING POLICIES**

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

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

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

Churchill Falls (Labrador) Corporation Limited (“Churchill Falls”) is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (“Churchill Falls Project”). Twin Falls Power Corporation (“Twin Falls”) is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

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.

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. 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, 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”).

##### **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% (2007 - 7.4%). Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 4.

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

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, GIPCo., (100% owned) and LCDC, (51% owned). Intercompany transactions and balances have been 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. Although Hydro retains its 65.8%

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

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

**Principles of Consolidation (cont'd.)**

ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

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

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

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

Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and bankers' acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. The short-term investments bear interest rates of 1.58% to 3.60% (2007 - 4.12% to 5.00%) per annum.

**Fuel and Supplies**

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

**Property, Plant and Equipment**

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

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

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

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

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

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

**Hydro**

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

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

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on 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 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 would include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment.

**Churchill Falls**

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

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

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

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

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

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

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

**Impairment of Long-Lived Assets**

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

**Revenue Recognition**

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

A power contract with Hydro-Québec, dated May 12, 1969 ("Power Contract") provides for the sale of substantially all the energy from the Churchill Falls Project until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The base rate is predetermined in the Contract and decreases from the existing rate of 2.5425 mills per 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 additional availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base ("AEB"), as defined in the Power Contract, are tracked over a four year period and then either recovered from or refunded to Hydro-Québec over the subsequent four year period, unless the balance is less than \$1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2007 - 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.

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

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

**Foreign Currency Translation (cont'd.)**

- (b) At the date of settlement and at each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.
- (c) Foreign exchange gains and losses are included in income in the current year except for unrealized gains and losses related to First Mortgage Bonds which were recoverable under the Power Contract.

**Employee Future Benefits**

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

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 are amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

**2. CHANGES IN ACCOUNTING POLICIES**

Effective January 1, 2008, Hydro adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA").

**Inventories**

Section 3031, Inventory requires inventories to be measured at the lower of cost or net realizable value; disallows the use of last-in-first-out inventory costing methodology; and requires that, when circumstances which previously caused inventories to be written down no longer exist, the amount of the write-down is to be reversed. This new standard did not have any impact on Hydro's financial results or disclosures.

**Disclosure and Presentation of Financial Instruments**

Section 3862, Financial Instruments, Disclosures and Section 3863, Financial Instruments, Presentation sets out new accounting recommendations for disclosure and presentation of financial instruments. The new recommendations require disclosure of both quantitative and qualitative information that enables users of financial statements to evaluate the nature and extent of exposure to risks from financial instruments. These new standards did not have any impact on Hydro's financial results. The additional disclosure is included in Note 14.

**Capital Disclosures**

Section 1535, Capital Disclosures requires Hydro to include additional information in the notes to the financial statements about its capital and the manner in which it is managed. This additional disclosure includes quantitative and qualitative information regarding objectives, policies and processes for managing capital. The additional required disclosure is provided in Note 12 to these financial statements.

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

**3. 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>2008</b>				
Generation plant					
Hydroelectric	1,364.7	20.5	325.5	1.5	1,020.2
Thermal	247.5	0.8	190.6	1.9	58.0
Diesel	62.1	6.0	31.7	0.8	25.2
Transmission and distribution	781.2	60.2	245.3	4.2	479.9
Service facilities	22.0	-	11.4	-	10.6
Other	316.6	32.4	179.8	4.1	108.5
	<b>2,794.1</b>	<b>119.9</b>	<b>984.3</b>	<b>12.5</b>	<b>1,702.4</b>
<i>(millions of dollars)</i>	<b>2007</b>				
Generation plant					
Hydroelectric	1,363.5	20.5	313.2	114.4	1,144.2
Thermal	244.2	0.8	188.3	0.8	55.9
Diesel	61.3	5.9	29.7	0.1	25.8
Transmission and distribution	767.2	60.7	229.2	0.8	478.1
Service facilities	22.0	-	11.1	-	10.9
Other	306.0	32.0	167.5	4.3	110.8
	<b>2,764.2</b>	<b>119.9</b>	<b>939.0</b>	<b>120.4</b>	<b>1,825.7</b>

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

**4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION**

		<b>2008</b>	<b>2007</b>	<b>Remaining Recovery Settlement Period (years)</b>
<i>(millions of dollars)</i>				
Regulatory assets				
Long-term receivable		-	12.1	-
Foreign exchange losses		<b>71.1</b>	73.3	34.0
Deferred regulatory costs		0.2	0.4	1.0
Deferred major extraordinary repairs		7.6	12.3	4.0
Deferred study costs		0.2	0.4	1.0
Deferred wind power costs		0.5	-	1.0
Total regulatory assets		<b>79.6</b>	98.5	
Less current portion		<b>5.0</b>	17.2	
		<b>74.6</b>	81.3	
Regulatory liabilities				
Rate stabilization plan		<b>53.2</b>	38.3	n/a
Deferred purchased power savings		<b>0.6</b>	0.7	19.0
Total regulatory liabilities		<b>53.8</b>	39.0	
Less current portion		<b>22.3</b>	23.5	
		<b>31.5</b>	15.5	

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

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

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

**Rate Stabilization Plan and Related Long-Term Receivable**

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence 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 are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

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

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2008, \$9.1 million was recognized (2007 - \$31.5 million) in the RSP and \$14.9 million (2007 - \$8.9 million) was recovered through rates and included in energy sales, with a corresponding cost amortized in fuels expenses.

**Foreign Exchange Losses**

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

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

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

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

**Deferred Regulatory Costs**

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

**Deferred Major Extraordinary Repairs**

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of \$500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station ("HTGS"). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset which will be amortized over the subsequent five-year period. In 2006, Hydro incurred \$2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007 \$2.0 million of expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, has been expensed in 2008 (Note 20). In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year in which they were incurred. In 2008, \$2.7 million (2007 - \$2.1 million) of amortization was recognized in operating costs.

**Deferred Wind Power Costs**

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

**Deferred Study Costs**

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

**Deferred Purchased Power Savings**

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of \$0.6 million (2007 - \$0.7 million) are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred.

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

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

**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 2008, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.3% the amount capitalized is higher and interest expense is lower by \$0.4 million than that which would be permitted in the absence of rate regulation. In 2007, Hydro's AFUDC of 7.6% is lower than its cost of debt of 8.0%, the amount capitalized is lower and interest expense is higher by \$0.3 million than that which would be permitted in the absence of rate regulation (Note 15).

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

During 2005, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately \$170.0 - \$180.0 million lower than it would otherwise be, and annual amortization expense is \$10.0 - \$11.0 million lower, primarily due to the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets. An update to this study began in 2008 and is presently ongoing.

**5. LONG-TERM RECEIVABLES**

Included in long-term receivables are two refundable deposits in the amount of \$25.4 million (2007 - \$23.3 million) associated with an application for transmission service into Québec, bearing interest at prime until April, 2007 and at one year Guaranteed Income Certificate ("GIC") rates thereafter. The remaining portion of \$1.3 million (2007 - nil) is a long-term receivable from Hydro- Québec.

**6. INVESTMENTS**

<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Lower Churchill Development Corporation Limited	-	5.2

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

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

The option provided that upon agreement to continue with the Project, LCDC would have acquired the GIPCo. assets for the amount of \$94.8 million (\$100.0 million less the amount of \$5.2 million representing the shares issued pursuant to the signing of the Option Agreement). A 10% convertible demand debenture in the amount of \$94.8 million would

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

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**6. INVESTMENTS (cont'd.)**

have been issued as consideration for the GIPCo. assets and LCDC would have acquired the Water Rights from the Province with the consideration having been the issue of 3,000 Class B common shares without nominal or par value. On November 20, 2008, LCDC was advised by the Province that it would not be extending the Option Agreement. As a consequence, LCDC's option expired on November 24, 2008, which had the effect of terminating the Option Agreement and Hydro's share of the option in the amount of \$2.7 million was expensed as an asset write-down in 2008 and the liability to the Government of Canada for non controlling interest in the amount of \$2.5 million was eliminated.

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

**7. JOINT VENTURE**

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of Churchill Falls' assets and liabilities at December 31, 2008, and its proportionate interest in Churchill Falls' operations for the year ended December 31, 2008.

<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Current assets	<b>37.0</b>	39.5
Long-term assets	<b>334.2</b>	328.9
Current liabilities	<b>10.5</b>	12.5
Long-term liabilities	<b>29.3</b>	36.6
Revenues	<b>65.3</b>	70.6
Expenses	<b>50.3</b>	51.0
<b>Net Income</b>	<b>15.0</b>	19.6
Cash provided by (used in)		
Operating activities	<b>30.4</b>	40.4
Financing activities	<b>(12.9)</b>	(19.7)
Investing activities	<b>(20.0)</b>	(16.3)

Income tax expense in the amount of \$0.2 million (2007 - \$0.2 million) related to a jointly controlled subsidiary, Twin Falls has been grouped with operating expenses.

**8. LONG-TERM DEBT**

<b>Summary of long-term debt</b>	<b>Churchill</b>			<b>Churchill</b>		
	<b>Hydro</b>	<b>Falls</b>	<b>Total</b>	<b>Hydro</b>	<b>Falls</b>	<b>Total</b>
<i>(millions of dollars)</i>	<b>2008</b>			<b>2007</b>		
Long-term debt	<b>1,154.7</b>	<b>30.1</b>	<b>1,184.8</b>	1,359.4	37.5	1,396.9
Less current portion	<b>8.3</b>	<b>0.8</b>	<b>9.1</b>	208.3	0.8	209.1
	<b>1,146.4</b>	<b>29.3</b>	<b>1,175.7</b>	<b>1,151.1</b>	<b>36.7</b>	<b>1,187.8</b>

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

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

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

<i>(millions of dollars)</i>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayments	0.9	29.3	-	-	-
	<b>9.1</b>	<b>37.5</b>	<b>8.2</b>	<b>8.2</b>	<b>8.2</b>

Details of long-term debt are as follows:

**Hydro**

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2008	2007
(millions of dollars)						
AA	200.0	5.50	1998	2008	-	199.9
V	125.0	10.50	1989	2014	<b>124.5</b>	124.4 (a)
X	150.0	10.25	1992	2017	<b>149.1</b>	149.0 (a)
Y	300.0	8.40	1996	2026	<b>292.9</b>	292.7 (a)
AB	300.0	6.65	2001	2031	<b>306.9</b>	307.1 (a)
AD	125.0	5.70	2003	2033	<b>123.5</b>	123.5 (a)
AE	225.0	4.30	2006	2016	<b>223.5</b>	223.3
Total debentures	<b>1,425.0</b>				<b>1,220.4</b>	1,419.9
Less sinking fund investments in own debentures					<b>65.9</b>	60.8
Other					<b>1,154.5</b>	1,359.1
Less payments due within one year					<b>0.2</b>	0.3
					<b>1,154.7</b>	1,359.4
					<b>8.3</b>	208.3
					<b>1,146.4</b>	1,151.1

(a) Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2007 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. During 2008, the Province waived the payment of this fee.

Hydro uses promissory notes to fulfill its short-term funding requirements. At year-end the promissory notes outstanding were at interest rates ranging from 1.40% to 2.90% (2007 - 4.30% to 4.45%).

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

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

**Hydro (cont'd.)**

Hydro maintains a \$50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year end, there were no amounts drawn on the facility (2007 - nil). Advances may take the form of a prime rate advance or the issuance of a Bankers' Acceptance ("BA") with interest calculated at the prime rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the prime rate. At year end, Hydro had two letters of credit outstanding (Note 18(f)) reducing the availability of the credit facility by \$7.5 million.

**Churchill Falls**

<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
General Mortgage Bonds		
7.5% due December 15, 2010	-	37.5
Less: current portion	-	0.8
Total long-term debt	<b>-</b>	<b>36.7</b>
Bank of Nova Scotia Credit Agreement		
4.4% due December 15, 2010	<b>30.1</b>	-
Less: current portion	<b>0.8</b>	-
Total long-term debt	<b>29.3</b>	-

**Refinancing**

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

Churchill Falls exercised its prepayment privileges under the new credit agreement by prepaying \$10.0 million principal on March 25, 2008. Hydro's share of this repayment was \$6.6 million.

**Dividend Restriction**

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

**Operating Credit Facility**

Churchill Falls maintains a \$10.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year end, there were no amounts drawn on the facility (2007 - \$0.3 million). Advances may take the form of a Prime Rate advance or the issuance of a BA's with interest calculated at the Prime Rate or prevailing Government BA fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate. At year end, Churchill Falls had two letters of credit outstanding (Note 18(f)) reducing the availability of the credit facility by \$1.4 million.

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

**9. LONG-TERM PAYABLE**

The long-term payable to Hydro-Québec as of December 31, 2008 is the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, the full amount of \$0.7 million (2007 - nil) is long-term. The final amount will be determined on August 31, 2012 and will be paid/collected monthly beginning September 2012 and ending August 2016.

**10. EMPLOYEE FUTURE BENEFITS**

**Pension Plan**

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$4.6 million (2007 - \$4.6 million) are expensed as incurred.

**Other Benefits**

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2008, cash payments to beneficiaries for its unfunded other employee future benefits was \$3.0 million (2007 - \$2.3 million). The most recent actuarial valuation was performed as at December 31, 2006 with an extrapolation of the December 31, 2006 valuation to December 31, 2008. The next actuarial valuation will be performed as at December 31, 2009.

<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Accrued benefit obligation		
Balance at beginning of year	<b>68.6</b>	67.8
Transfer to Nalcor (Note 19)	(1.4)	-
Current service cost	<b>2.1</b>	2.3
Interest cost	<b>3.7</b>	3.6
Actuarial gain	(18.9)	(2.8)
Benefits paid	(3.0)	(2.3)
Balance at end of year	<b>51.1</b>	<b>68.6</b>
Plan deficit	<b>51.1</b>	68.6
Unamortized actuarial loss	(0.5)	(20.9)
Unamortized past service cost	(0.2)	(0.3)
Transfer to Nalcor (Note 19)	(0.5)	-
Accrued benefit liability at end of year	<b>49.9</b>	<b>47.4</b>
<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Components of benefit cost		
Current service cost	<b>2.1</b>	2.3
Interest cost	<b>3.7</b>	3.6
Actuarial gain	(18.9)	(2.8)
	<b>(13.1)</b>	3.1
Adjustments		
Difference between actual actuarial gain and amount recognized	<b>20.0</b>	4.3
Benefit expense	<b>6.9</b>	<b>7.4</b>

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

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

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

	<b>2008</b>	2007
Discount rate	7.5%	5.5%
Rate of compensation increase	3.5%	3.5%
Assumed health care trend rates:		
	<b>2008</b>	2007
Initial health care expense trend rate	7.0%	8.0%
Cost trend decline to	5.0%	5.0%
Year that rate reaches the rate it is assumed to remain at	2011	2011

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

<i>(millions of dollars)</i>	<b>2008</b>	2007
Current service and interest cost	1.2	1.2
Accrued benefits obligation	6.9	11.9
A 1% decrease in assumed health care trend rates would have had the following effect:		
<i>(millions of dollars)</i>	<b>2008</b>	2007
Current service and interest cost	(0.8)	(0.8)
Accrued benefits obligation	(5.5)	(9.2)

**11. SHAREHOLDER'S EQUITY**

**Share Capital**

<i>(millions of dollars)</i>	<b>2008</b>	2007
Common shares of par value \$1 each Authorized 25,000,000 shares; issued 22,503,942 shares	<u>22.5</u>	<u>22.5</u>

**Contributed Capital**

<i>(millions of dollars)</i>	<b>2008</b>	2007
Total contributed capital	<u>111.8</u>	<u>114.0</u>

The contributed capital related to the Muskrat Falls project was transferred to Nalcor as at December 31, 2008 pursuant to the Transfer Agreement (Note 19(e)).

**12. CAPITAL MANAGEMENT**

**Hydro**

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

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

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

**Hydro (cont'd.)**

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

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its earnings before interest and taxes ("EBIT") coverage of interest. Adjustments to the capital structure are accomplished through adjustments to the amount of dividends paid to the shareholder, cash infusion via contributed equity and new debt issuance or debt issuance with differing characteristics. Hydro's goal is to achieve a capital structure and cash flow to support debt.

A summary of the capital structure is outlined below:

<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
<b>Debt</b>		
Long-term debt	<b>1,175.7</b>	1,187.8
Current portion of long-term debt	9.1	209.1
Promissory notes	163.0	7.0
Sinking funds	<b>(163.9)</b>	<b>(151.8)</b>
	<b>1,183.9</b>	66.4%
	<b>1,183.9</b>	64.9%
<b>Equity</b>		
Share capital	22.5	22.5
Contributed capital	111.8	114.0
Accumulated other comprehensive income	16.5	19.5
Retained earnings	<b>448.0</b>	<b>521.8</b>
	<b>598.8</b>	33.6%
	<b>598.8</b>	677.8
<b>Total debt and equity</b>	<b>1,782.7</b>	35.1%
	<b>1,782.7</b>	100.0%
	<b>1,782.7</b>	1,929.9
	<b>1,782.7</b>	100.0%

**Churchill Falls**

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

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

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

**13. ACCUMULATED OTHER COMPREHENSIVE INCOME**

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

<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Balance, beginning of year	<b>19.5</b>	-
Adjustment due to the adoption of new accounting policies	-	19.3
Change in fair value of sinking fund investments	(3.6)	0.2
Change in fair value of reserve fund investments	0.6	-
Balance, end of year	<b>16.5</b>	<b>19.5</b>

**14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

Hydro has classified its financial instruments as follows:

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

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

In 2007, Hydro recognized an increase to opening retained earnings of \$2.3 million resulting from the measurement of outstanding long-term debt at amortized cost, using the effective interest method. As well, Hydro recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of \$19.3 million.

**Fair Value**

The estimated fair values of financial instruments as at December 31, 2008 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

<i>(millions of dollars)</i>	<b>Carrying Value 2008</b>	<b>Carrying Value 2007</b>	<b>Carrying Fair Value 2008</b>	<b>Carrying Fair Value 2007</b>
Long-term debt including current portion	<b>1,184.8</b>	<b>1,484.8</b>	1,396.9	1,731.2

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

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

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

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 which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

**Risk Management**

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

**Hydro**

**(a) Credit Risk**

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

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

**(b) Liquidity Risk**

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

**(c) Market Risk**

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

**Interest Rates**

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

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

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

**Hydro (cont'd.)**

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

**Interest Rates (cont'd.)**

Exposure to changes in interest rates exists on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios. Hydro estimates that an increase of 100 basis points from the actual average yield on the short-term debt portfolio in 2008 would have resulted in a change in interest expense of \$1.3 million (2007 - \$0.2 million). Similarly, an increase of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2008 would have resulted in a change in interest income of \$2.0 million (2007 - \$1.8 million) and a decrease in other comprehensive income of \$16.1 million (2007 - \$16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

**Foreign Currency and Commodity Exposure**

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

During 2008, Hydro had total purchases of No. 6 fuel of \$103.9 million (2007 - \$122.0 million). These purchases are denominated in U.S. dollars.

Hydro's exposure to both the foreign exchange and commodity price risk associated with these purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates as compared to that approved in Hydro's most recent COS used to set rates, are captured in the RSP and are either refunded to or collected from customers via automatic rate adjustments. Hydro also employs the periodic use of forward currency contracts as a means by which exposure to exchange rates on a particular day can be avoided. As at December 31, 2008 there were no forward contracts outstanding.

**Churchill Falls**

**(a) Liquidity Risk**

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

**(b) Market Risk**

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

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

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

**Churchill Falls (cont'd.)**

**(b) Market Risk (cont'd.)**

**Interest Rates**

Interest rate risk is mitigated on the company's long-term debt by virtue of a fixed interest rate to maturity. Exposure to changes in interest rates exists on investment income related to the short-term and reserve fund investment portfolios. Churchill Falls estimates that an increase of 100 basis points from the actual average yield earned on the short-term investment portfolio in 2008 would have resulted in a change in interest income of \$0.2 million (2007 - \$0.2 million). Similarly, an increase of 100 basis points from the actual average yield earned on the reserve fund investment portfolio in 2008 would have resulted in a change in interest income of \$0.2 million (2007 - \$0.1 million) and an increase in other comprehensive income of \$0.5 million (2007 - \$0.2 million). Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated.

**Foreign Currency Exposure**

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

**Commodity**

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

**15. INTEREST EXPENSE**

<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Gross interest		
Long-term debt	<b>96.0</b>	105.0
Promissory notes	<b>4.2</b>	0.9
	<b>100.2</b>	105.9
Accretion of long-term debt	<b>0.5</b>	0.8
Provision for foreign exchange losses	<b>2.2</b>	2.2
	<b>102.9</b>	108.9
Less		
Recovered from Hydro-Québec	<b>0.1</b>	1.0
Interest capitalized during construction	<b>9.6</b>	6.3
Interest earned	<b>14.4</b>	14.3
Net interest expense	<b>78.8</b>	87.3
Debt guarantee fee	<b>-</b>	13.1
Net interest and guarantee fee	<b>78.8</b>	<b>100.4</b>

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

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

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**15. INTEREST EXPENSE (cont'd.)**

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

**16. CHANGE IN NON-CASH WORKING CAPITAL BALANCES**

<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Accounts receivable	<b>3.6</b>	(7.8)
Fuel and supplies	<b>17.0</b>	(15.3)
Prepaid expenses	<b>(0.4)</b>	0.3
Accounts payable and accrued liabilities	<b>(20.8)</b>	26.7
Regulatory assets	<b>18.9</b>	49.7
Regulatory liabilities	<b>14.8</b>	(11.3)
Accrued interest	<b>(2.0)</b>	(0.1)
Employee future benefits	<b>3.0</b>	5.1
Long-term receivable	<b>(2.9)</b>	(4.5)
Long-term payable	<b>0.7</b>	(0.3)
Due from related parties	<b>(0.2)</b>	-
	<b><u>31.7</u></b>	<b><u>42.5</u></b>

**17. SEGMENT INFORMATION**

Hydro operates in three business segments. Regulated operations encompass sales of power and energy to most customers within the province of Newfoundland and Labrador while Churchill Falls operates a hydro-electric generating facility and sells electricity primarily to Hydro-Québec. Other energy activities are primarily engaged in sales to markets outside the province. The designation of segments has been based on a combination of regulatory status and management accountability. The segment's accounting policies are the same as those described in Note 1.

**Geographic Information**

Revenues by geographic area:

<i>(millions of dollars)</i>	<b>2008</b>	<b>2007</b>
Newfoundland and Labrador	<b>447.3</b>	445.1
Québec	<b>121.6</b>	128.3
	<b><u>568.9</u></b>	<b><u>573.4</u></b>

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

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

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

**Segments**

	Regulated	Other Energy Activities	Churchill Falls	Inter- segment	Total
<i>(millions of dollars)</i>				2008	
Revenue					
Energy sales	440.1	58.2	68.9	(3.9)	563.3
Other	2.2		0.3	3.1	5.6
	<u>442.3</u>	<u>58.2</u>	<u>69.2</u>	<u>(0.8)</u>	<u>568.9</u>
Expenses					
Operations and administration	99.1	3.9	38.8	-	141.8
Fuels	164.8	-	-	-	164.8
Power purchased	41.4	3.5	-	(3.9)	41.0
Amortization	40.4	-	11.4	1.2	53.0
Interest	87.6	(8.9)	0.1	-	78.8
Write-down of investment	-	2.7	-	-	2.7
	<u>433.3</u>	<u>1.2</u>	<u>50.3</u>	<u>(2.7)</u>	<u>482.1</u>
Net income before equity in Churchill Falls	9.0	57.0	18.9	1.9	86.8
Equity in Churchill Falls	-	11.8	-	(11.8)	-
Preferred dividends	-	9.0	-	(9.0)	-
Net income	<u>9.0</u>	<u>77.8</u>	<u>18.9</u>	<u>(18.9)</u>	<u>86.8</u>
Capital expenditures	45.6	40.2	4.3	-	90.1
Total assets	<u>1,711.5</u>	<u>385.2</u>	<u>371.2</u>	<u>(322.3)</u>	<u>2,145.6</u>
<i>(millions of dollars)</i>				2007	
Revenue					
Energy sales	438.7	58.5	74.2	(3.9)	567.5
Other	2.0		0.3	3.6	5.9
	<u>440.7</u>	<u>58.5</u>	<u>74.5</u>	<u>(0.3)</u>	<u>573.4</u>
Expenses					
Operations and administration	98.5	6.0	38.6	-	143.1
Fuels	159.2	-	-	-	159.2
Power purchased	38.5	3.9	-	(4.0)	38.4
Amortization	38.4	-	11.2	1.1	50.7
Interest	103.2	(5.0)	2.1	0.1	100.4
Write-down of investment	-	-	-	-	-
	<u>437.8</u>	<u>4.9</u>	<u>51.9</u>	<u>(2.8)</u>	<u>491.8</u>
Net income before equity in Churchill Falls	2.9	53.6	22.6	2.5	81.6
Equity in Churchill Falls	-	14.7	-	(14.7)	-
Preferred dividends	-	10.4	-	(10.4)	-
Net income	<u>2.9</u>	<u>78.7</u>	<u>22.6</u>	<u>(22.6)</u>	<u>81.6</u>
Capital expenditures	36.0	45.7	4.8	-	86.5
Total assets	<u>1,733.3</u>	<u>498.9</u>	<u>368.4</u>	<u>(314.3)</u>	<u>2,286.3</u>

During 2008, sales to Hydro's two largest customers amounted to 60% and 10% of total energy sales revenue (2007 - 60% and 10%). At December 31, 2008 approximately 63.2% (2007 - 59.7%) of the total accounts receivable balance outstanding is due from one customer.

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

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**18. COMMITMENTS AND CONTINGENCIES**

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

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

(b) 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 and 2008. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2009	\$17.0 million
January 1, 2010	\$8.0 million
January 1, 2011	\$8.0 million
January 1, 2012	\$8.0 million

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holding consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 Canadian Chartered Accounts. 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>2008</b>	<b>2007</b>
Opening balance	<b>11.2</b>	-
Contribution	<b>11.2</b>	11.2
Total contribution to reserve fund	<b>22.4</b>	11.2
Net interest earned	<b>0.4</b>	0.3
Mark-to-market adjustment	<b>0.6</b>	-
Fair value of reserve fund	<b>23.4</b>	11.5

(c) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be \$0.2 million (2007 - \$1.2 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately \$22.2 million (2007 - \$21.8 million) related to outages and plant shutdowns. Hydro is defending this claim and management believes that this claim will not be successful.

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

(d) Outstanding commitments for capital projects total approximately \$7.1 million (2007 - \$16.8 million).

(e) 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

During 2008, the enactment of the Abitibi - Consolidated Rights and Assets Act resulted in the cancelation of two long-term power purchase agreements (Note 21).

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

<i>(millions of dollars)</i>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Power purchases	25.6	26.4	29.6	30.0	30.6

(f) Hydro has issued two irrevocable letters of credit, one in the amount of \$7.2 million to New Brunswick System Operator as credit support related to an application for point to point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of \$0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement. Churchill Falls has issued two irrevocable letters of credit, in the amount of \$0.7 million each 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.

**19. RELATED PARTY TRANSACTIONS**

The Province, Nalcor, Churchill Falls, LCDC and GIPCo. are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

- (a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of \$6.0 million (2007 - \$6.1 million) of the power produced by Churchill Falls and Hydro's 65.8% share is estimated upon consolidation.
- (b) For the year ended December 31, 2008, approximately \$1.8 million (2007 - \$2.2 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties and Hydro's 65.8% share is eliminated upon consolidation.
- (c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2008, Hydro incurred \$0.6 million in costs related to the PUB (2007 - \$1.2 million) of which \$0.1 million (2007 - \$0.1 million) was included in accrued liabilities.
- (d) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually.

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

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

(e) As at December 31, 2008, certain non-regulated assets and liabilities and the related debt and equity were transferred from Hydro to Nalcor. Details of the transactions are noted below which resulted in a payable of \$6.1 million by Hydro to Nalcor. In June, 2008, an advance payment was made by Hydro to Nalcor resulting in a \$3.1 million liability as at December 31, 2008 which is recorded in Due to related parties.

<i>(millions of dollars)</i>	<b>2008</b>
Capital assets	157.2
Contributed capital	(2.2)
Employee future benefits	(0.5)
Retained earnings from non-regulated activity in Hydro	<u>(160.6)</u>
Sub total	(6.1)
Payment made in 2008	3.0
Total due to Nalcor	<u><u>(3.1)</u></u>

In addition to the \$0.5 million transfer for employee future benefits noted above, in January, 2008, there was a transfer of a \$0.9 million liability from Hydro to Nalcor for a total transferred amount of \$1.4 million (Note 10).

(f) During 2008, Nalcor advanced \$4.5 million as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. As at December 31, 2008, \$1.7 million of this funding has not been utilized to cover the costs of the associated capital project and has been recorded as a deferred contribution. Hydro also received contribution in aid of construction from the Province related to wind feasibility studies. As at December 31, 2008, the full amount of \$0.5 million has been recorded as a deferred capital contribution.

(g) During 2008, Hydro received \$0.4 million (2007 - nil) as a rate subsidy for rural isolated customers from the Province and \$1.5 million (2007 - \$0.6 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 \$0.1 million (2007 - \$0.6 million) recorded as accounts receivable at year end.

**20. CHANGE IN ESTIMATE**

In 2007, Hydro incurred \$2.0 million in expenses to repair a turbine at HTGS and these costs were deferred as a major extraordinary repair. Pursuant to Order No. P.U. 31 (2008) the PUB denied Hydro's request to treat the repair of the turbine as a major extraordinary repair and therefore, the full cost of the repair, net of insurance proceeds of \$0.8 million, was recorded in operations and administration expense during 2008.

**21. SIGNIFICANT OCCURRENCES**

(a) In late 2008, Abitibi Consolidated announced a shut down of the Grand Falls Pulp and Paper Mill resulting in a loss of a major industrial customer. Revenue from Abitibi Grand Falls for the year ended December 31, 2008 was \$5.1 million (2007 - \$4.9 million). The Abitibi - Consolidated Rights and Assets Act was enacted on December 16, 2008 resulting in the cancellation of two power purchase agreements from two non-utility generator in which Abitibi was a partner.

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**21. SIGNIFICANT OCCURRENCES (cont'd.)**

(b) On November 3, 2008, a fire occurred in a cable shaft at Churchill Falls causing extensive damage to two sets of high voltage cables in two units of the cable shaft.

Repair work has begun on one unit with work expected to be completed in February 2009. The second unit will be repaired in the summer of 2009 once the necessary cables have been obtained. Hydro's estimated share of the cost of the repair to the cables in the amount of \$6.6 million is covered by an insurance policy with a \$1.3 million deductible. As at December 31, 2008, Hydro's share of expenses totaling \$1.5 million have been incurred in relation to this repair and insurance proceeds of \$0.2 million have been accrued. Churchill Falls will accrue the expenses and related insurance proceeds as incurred.

Hydro's 65.8% share of the total impact of the fire on net income for the year ended December 31, 2008 including lost revenue is estimated to be as follows:

<i>(millions of dollars)</i>	<b>2008</b>
Lost revenue - guaranteed winter availability	(8.4)
Lost revenue - power sales	(2.1)
Repair costs (net of insurance proceeds)	(1.3)
Net decrease in rental and other costs	0.8
<b>Total impact on net income</b>	<b><u>(11.0)</u></b>

**22. COMPARATIVE FIGURES**

Certain of the 2007 comparative figures have been reclassified to conform with the 2008 financial statement presentation.