

NEWFOUNDLAND AND LABRADOR HYDRO

2017 Annual Performance Report Transparency and Accountability

June 2018



Message from the Boards of Directors

In accordance with the *Transparency and Accountability Act*, I am pleased to provide the 2017 Annual Performance Report for Newfoundland and Labrador Hydro (Hydro), on behalf of the Board of Directors.

The 2017-2019 Strategic Plan for Hydro outlined how the corporation would address the applicable strategic directions of the Provincial Government in relation to Hydro's role in the energy sector as communicated by the Minister of Natural Resources.

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



John Green
Chair
Newfoundland and Labrador Hydro

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1. Overview

As the main generator and transmitter of electricity for use in the province, Newfoundland and Labrador Hydro (Hydro) is focused on providing a safe, reliable and least-cost electricity supply to meet current energy demand and future growth of its customers.

The majority of Hydro's business is regulated by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) and its electricity rates are set through periodic general rate applications. The regulated portion of the company includes the generation, transmission and distribution of electrical power and energy to utility, residential and commercial customers, as well as island industrial customers. The non-regulated activities of Hydro include electricity sales to industrial customers in Labrador west. Hydro is a 100 per cent owned subsidiary of Nalcor Energy (Nalcor). In 2016 Hydro regulated and non-regulated activities were separated from Nalcor's other lines of business. In keeping with this separation, Hydro developed its own strategic plan for the 2018-2020 planning period.

Hydro's electricity production assets include nine hydroelectric plants, one oil-fired plant, four gas turbines, and 25 diesel plants. These assets along with a network of transmission and distribution lines bring electricity to communities throughout Newfoundland and Labrador (see Appendix 1).

Hydro also holds a 65.8 per cent interest in Churchill Falls (Labrador) Corporation Limited. The operations of Churchill Falls are managed by Nalcor's Power Supply division and included in the 2018-2020 Nalcor Strategic Plan and 2017 Nalcor Annual Performance Report.

Mandate

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

- Developing and purchasing power and energy on an economic and efficient basis.
- Engaging within the province and elsewhere in the development, generation, production, transmission, distribution, delivery, supply, sale, purchase and use of power from water, steam, gas, coal, oil, wind, hydrogen and other products.

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

Lines of Business

Hydro delivers safe, reliable, and least cost power to utility, industrial, residential and commercial customers in more than 200 communities in the province.

Hydro activities can be grouped as follows:

- Electricity production – Hydro has an installed generating capacity of 1,764 megawatts (MW) which includes the operations of nine hydroelectric generating stations, one oil-fired plant, four gas turbines, and 25 diesel plants, including 20 isolated diesel generating and distribution systems.
- Transmission and distribution – Hydro operates and maintains over 4,400 kilometres of transmission lines and more than 50 high voltage terminal stations which connect to generation and delivery points for Newfoundland Power on the island, industrial customers, and Hydro’s rural distribution systems province-wide. Hydro also operates and maintains approximately 2,700 kilometres of distribution lines throughout the province.
- The Newfoundland and Labrador System Operator (NLSO) acts as the independent operator to manage the provincial electricity system in real-time. It also provides Open Access to the provincial transmission network, which means providing transmission service to users like Hydro and other utilities, in an open, non-discriminatory and non-preferential manner.
- Customer service activities address the electricity requirements of Newfoundland Power, industrial customers and over 38,600 direct residential and commercial customers in rural Newfoundland and Labrador.
- Electricity system planning involves forecasting electricity requirements in the province and advancing options to ensure adequate supply of generation resources and transmission and distribution infrastructure to reliably meet forecasted demand.

Values

Employees of Hydro recognize that electricity is essential to social well-being and economic prosperity in Newfoundland and Labrador. In fulfilling Hydro's mandate, employees are unified by the following core values:

- Safety – relentless commitment to protecting ourselves, our colleagues, and our community.
- Open Communication – fostering an environment where information moves freely in a timely manner.
- Accountability – holding ourselves responsible for our actions and performance.
- 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.

Primary Clients

Hydro sells electricity to three primary customer groups:

- Newfoundland Power - an investor-owned utility which distributes electrical power to 264,000 customers on the island portion of the province, with Hydro supplying over 90 per cent of its energy requirements.
- Industrial customers – regulated sales to North Atlantic Refining Limited, Vale Newfoundland and Labrador, Praxair Canada Inc., Teck Resources Limited, and Corner Brook Pulp and Paper Limited and unregulated sales to the Iron Ore Company of Canada and Wabush Mines in Labrador.
- Over 38,600 residential and commercial customers in rural Newfoundland and Labrador.

Vision

Providing electricity to enable social well-being and economic prosperity for the people of Newfoundland and Labrador.

Number of Employees, Physical Location and Other Key Statistics

Headquartered in St. John's with assets and offices throughout the province, Hydro directly employed 921 people in permanent, term and temporary capacities as of December 31, 2017. The location of these employees reflects Hydro's service area and the location of the company's electricity assets, with 68 per cent located in rural areas. The gender composition of Hydro's employee group is 79 per cent male and 21 per cent female. In 2017 Hydro advanced its commitment to diversity and inclusion and hired ten of 17 apprentices and select technical roles¹ from under-represented groups including women.

Gender	Rural	Urban	Total	Per cent
Female	72	119	191	21%
Male	552	178	730	79%
Total	624	297	921	
Per cent	68%	32%		

Board of Directors

As of December 31, 2017, the Hydro Board of Directors included:

- John Green (Chair)
- Donna Brewer
- Heather Jacobs
- Chris Loomis
- Stan Marshall

2017 Consolidated Revenues and Expenses

In 2017, Hydro had revenues of \$665 million. The majority of Hydro's revenues are from regulated energy sales to utility, rural and industrial customers. Consolidated energy sales also include Hydro's share of Churchill Falls' sales to Hydro Québec². In 2017, Hydro's net income of

¹ Positions include: Electrical Apprentice, Protection and Control Technician, Power System Operator, Millwright Apprentice, and Heavy Duty Repair Mechanic Apprentice.

² Hydro holds a 65.8 percent interest in Churchill Falls (Labrador) Corporation Limited.

\$69 million consisted of \$36 million from Hydro Regulated and \$33 million from Hydro's investment in Churchill Falls. The bulk of this income is reinvested in the electricity system. The following table summarizes the 2017 consolidated revenue and expenses for Hydro:

<i>For the year ended December 31 (millions of dollars)</i>	<i>(\$)</i>	<i>%</i>
Energy sales	636	95.6
Other revenue	29	4.4
Revenue	665	
Fuels	226	32.8
Power purchased	101	14.7
Operating costs	175	25.4
Transmission rental	20	2.9
Depreciation and amortization	96	14.0
Net finance expense	64	9.3
Other expense	6	0.9
Expenses	688	
(Loss) before regulatory adjustments	(23)	
Regulatory adjustments	(92)	
Profit for the year	69	

The 2017 Consolidated Financial Statements for Hydro are appended to this document (see Appendix 2).

2. Highlights and Partnerships

Hydro works with a variety of agencies, departments and commissions to execute its mandate. During 2017, Hydro worked closely with each of these organizations to advance its mandate in the electricity sector in support of the strategic directions of the Provincial Government.

Department of Natural Resources

The Department of Natural Resources works with Hydro in policy-related areas for the electricity sector. In 2017, Hydro supported the work of the Department and Nalcor to identify and evaluate options to mitigate projected customer rate increases, and assess responses to potential new industrial customers. Considerable effort was also directed to establishing the framework required to provide open access to the provincial electricity transmission system, including the establishment of the NLSO to administer open access. As well, Hydro supported the efforts of the Department to progress consideration of renewable generation options for remote communities.

Newfoundland and Labrador Board of Commissioners of Public Utilities

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

During 2017 there was significant regulatory activity related to the completion of the 2013 General Rate Application and the filing of the 2017 General Rate Application. Other regulatory activity included Hydro's 2018 capital budget and a number of supplemental capital project applications as well as significant ongoing reporting.

Department of Finance

The Department of Finance works with Hydro to address requirements related to financial structure, dividend policies as well as providing guarantees for the corporation's debt financing

activities. During 2017 Hydro's debt financing activities, including the Provincial Guarantee, as well as the Province issuing debt specifically on Hydro's behalf and lending those proceeds directly to Hydro, are examples of interactions between the Department and Hydro.

Other Departments/Public Bodies

Hydro also shares commitments with the Department of Municipal Affairs and Environment, Service NL, and the federal Department of Fisheries and Oceans and Environment Canada in relation to the environmental aspects of the corporation's activities. During 2017 for example, Hydro interacted with the Department of Municipal Affairs and Environment on air emissions files, during the construction of the third transmission line from Bay d'Espoir to the western Avalon Peninsula, and during rehabilitation repairs to the Grand Falls Dam. Hydro also engaged the Provincial Archaeology Office when performing distribution line upgrades in southern Labrador. Discussions with the federal Department of Fisheries and Oceans also occurred regarding fish migration on the Exploits River and with a fisheries authorization for one of Hydro's reservoirs.

3. Issues

The strategic issues outlined below will be addressed by Hydro in order to realize its mandate and vision. Consistent with the underlying philosophy of the multi-year performance-based planning required under the provisions of *Transparency and Accountability Act*, these issues are at a governance level and reflect the priorities of the Hydro board and support the Provincial Government's strategic directions for the electricity sector.

Issue 1: Reliable electricity supply

Issue 2: Electricity rates and customer service

Issue 3: Safety

4. Outcomes

Issue 1: Reliable electricity supply

Hydro ensures there is a safe, reliable and least-cost electricity supply available to meet the needs of customers now and in the future. The company's mandate supports fulfillment of the strategic direction of government related to energy security and reliability in Newfoundland and Labrador.

During 2017, Hydro focused on providing a reliable electricity supply by maintaining and renewing assets, preparing for the interconnection between the Island and Nova Scotia via the Maritime link and between Labrador and the Island via the Labrador Island Link, as well as continuing to assess and respond to future growth in customer requirements.

Like most other North American utilities, Hydro is managing a base of aging assets. The majority of Hydro's assets, including the hydroelectric installation at Bay d'Espoir, the Holyrood Thermal Generating Station, the Stephenville Gas Turbine, the Hardwoods Gas Turbine and much of Hydro's transmission and distribution systems, are more than 40 years old. In fact, the hydroelectric generating plant at Bay d'Espoir was in service for 50 years in 2017.

From 2005-2016, Hydro invested over \$1 billion to upgrade or replace its assets. For the 2017-2019 planning period, Hydro's capital expenditures are expected to continue at significant levels to ensure reliability of the electricity system for customers. In 2017, capital expenditures of \$341.3 million included nearly \$213 million related to the construction of a third transmission line from Bay d'Espoir to the western Avalon Peninsula to reliably meet growing demand in this area of the province. In addition, expenditures included sustaining capital focused on addressing the condition of aging assets.

The provincial electricity system will change significantly with the development of the Muskrat

Falls generation project and associated transmission facilities including interconnection to the North American electricity grid through the Maritime link and to Labrador through the Labrador-Island Link. These changes present an opportunity to reliably meet the needs of customers during the planning period and beyond. During 2017, Hydro worked to advance readiness for these changes and completed key commercial deliverables as well as progressing operational studies and requirements for transmission open access.

In addition to meeting current needs, Hydro has a responsibility to assess electricity requirements in the province and identify options to meet future growth in customer requirements. In 2017, Hydro completed updates to the comprehensive risk assessment of options to address Island Interconnected System electricity needs in advance of the completion of the Muskrat Falls project.

In addition to the requirements of the Island electrical system, Hydro continued to assess electricity requirements and options to respond in the Labrador Interconnected System and isolated diesel communities. Hydro also interfaced with potential new industrial and data mining companies seeking possible service in Labrador West, Churchill Falls and Happy Valley-Goose Bay.

Issue 1: Reliable electricity supply	
Goal By December 31, 2019, Hydro will have advanced initiatives to support electricity system reliability.	
Indicators	▪ Developed reliability improvement plans for key generating and transmission assets and supporting infrastructure. ▪ Completed required maintenance work and capital investments to support reliability. ▪ Assessed the adequacy of future electricity supply and identified options to address any issues. ▪ Advanced preparations for interconnection of electricity systems and integration of Muskrat Falls power and assets.
Objective By December 31, 2017, Hydro will have advanced electricity system investments and activities to enhance reliability.	

Issue 1: Reliable electricity supply	
Indicators	2017 Accomplishments
Completed planned capital investments in Hydro assets.	In 2017, Hydro invested \$341.3 million to upgrade or replace electricity generation, transmission and distribution equipment and supporting infrastructure. This expenditure was \$19.3 million below the revised budget of \$360.6 million. This variance was primarily due to deferral of spending for multi-year projects resulting from delays in delivery of materials and inability to complete planned work in 2017 because equipment could not be removed from service without customer outages. Other factors contributing to lower than planned capital expenditures related to the carryover of scope for a number of projects originally planned for completion in 2017 and lower than budgeted expenditures for projects completed in the year. Nearly \$213 million in capital expenditures in 2017 related to the completion of a new transmission line from Bay d’Espoir to Western Avalon. The new line strengthens reliability for customers on the Avalon Peninsula by relieving transmission congestion and providing more capacity to serve the region. It enhances the resiliency of the current transmission network that was started in the 1960s and also reinforces the future interconnection of the island electricity system with Nova Scotia and Labrador.
Completed priority maintenance work required for the winter 2017/ 2018 season.	Hydro completed 96 per cent of the priority maintenance and capital project work required for the 2017/2018 winter season by the target date of December 1, 2017. By year-end 97 per cent of winter readiness activities were complete. All work was not completed due to resourcing and the inability to remove equipment from service without customer outages. All winter readiness work for the Holyrood Thermal Generating Station, within the Bay d'Espoir hydroelectric system, and on the transmission system were completed by the target date, Several items for gas turbines, terminal stations, and capital projects were completed within 2017, but after the target date of December 1, 2017. As well, several capital projects planned for completion by the target date had some work remaining at year-end. However, in all cases where work was not completed, the risks were assessed and determined to be low.

Issue 1: Reliable electricity supply	
Finalized Hydro's 2018 plan for capital investments.	Hydro finalized the 2018 capital budget and submitted it to the PUB on July 27, 2017. On December 22, 2017, Hydro received approval for expenditures of \$170,868,300, with a request for additional information for two projects, Muskrat Falls to Happy Valley Interconnection (\$19,978,500) and Hydraulic Generation Refurbishment and Modernization (\$10,325,400). Hydro submitted additional information for these projects and the Hydraulic Generation Refurbishment and Modernization project was subsequently approved and the interconnection project is under continued review. The 2018 capital plan reflects Hydro's spending priorities including projects related to: replacing and upgrading deteriorating assets; addressing safety, environmental, or other legislative or regulatory requirements; meeting projected load growth and customer requests; and, achieving cost efficiencies.
Complete activities to prepare for interconnection of electricity systems and integration of Muskrat Falls power and assets.	In 2017, Hydro completed planned activities to prepare for interconnection of electricity systems and integration of Muskrat Falls power and assets. This included interconnection and commissioning related activities which enabled the first transfer of power between Nova Scotia and Newfoundland and the energization of Soldier's Pond Terminal Station. Hydro also completed studies on how electricity system performance will change as new assets are integrated, and developed procedures to ensure reliable operation throughout their integration. In addition, Hydro implemented the necessary framework to provide transmission customers with open access to the provincial transmission system, including the establishment of the Newfoundland and Labrador System Operator which will administer open access. Hydro also executed an agreement with Nalcor Energy Marketing for electricity supply from off-island sources over the Maritime Link, and initiated discussions with Hydro Quebec on reliably managing the interchange of electricity between the two provinces.
Analyzed electricity supply requirements in advance of interconnection with the North American grid.	Electricity supply requirements were analyzed in 2017 and reports outlining the findings and recommendations were filed with the PUB in June and November. The November 2017 Near-term Generation Adequacy report concluded that based on asset reliability and in consideration of

Issue 1: Reliable electricity supply	
	its energy in storage, Hydro remains confident in its ability to meet Island Interconnected System customer requirements. This report will be updated and provided to the PUB twice a year.
Monitored electricity supply requirements of any potential new industrial customers, including mining developments in Labrador West, and responded as appropriate.	During 2017, Hydro continued to monitor electricity supply requirements of potential new industrial customers in its service areas on the island and in Labrador. All potential industrial customers follow a process to advance through to interconnection to the provincial electricity system. The process has four distinct phases: preliminary assessment; system impact study; facilities study; and, final implementation. Through this process, Hydro provides information required by the potential customer on the availability of existing capacity to meet the customer's needs, types of upgrades to Hydro's system to supply the customer, and cost estimates and schedules for interconnection. In 2017, Hydro held discussions with mining interests in Labrador west and the island as well as potential data mining companies in several areas of the province.
As required, advanced the assessment of renewable/ alternative power generation options, including wind and small hydro, for communities that rely on diesel for electricity generation.	During 2017, Hydro continued to look for more cost-effective sources of supply for communities that rely on diesel generation. Hydro entered into a new Power Purchase Agreement with St. Mary's River Energy Limited Partnership in 2017. The agreement will allow for the repair and reactivation of the dormant mini-hydroelectric plant in Mary's Harbour, Labrador. The plant will supply renewable power to the communities of Mary's Harbour and Lodge Bay and it is anticipated that it will replace the use of up to 300,000 litres of diesel fuel annually. Hydro also supported the provincial government in exploring alternative sources such as small wind and solar and Hydro met with vendors proposing alternative energy sources for rural areas.

The objectives and indicators for 2018 are consistent with the direction outlined in the 2017-2019 Strategic Plan.

Issue 1: Reliable electricity supply

Objective

By December 31, 2018, Hydro will have progressed investments and implemented initiatives to enhance electricity system reliability.

Indicators

- Developed annual reliability improvement plans for key generating and transmission assets and completed priority activities.
- Completed required maintenance activities and capital projects to support readiness for the 2018/19 winter season.
- Completed planned 2018 capital investments.
- Completed a study of supply adequacy for the Island Interconnected System (IIS) and developed draft options as required.
- Complete a transmission planning study of western Labrador including a review of alternatives to reliably meet long-term load growth generally associated with mining in the area.
- Completed planned activities related to the inter-provincial flow of electricity and the integration of Muskrat Falls power and assets.

Issue 2: Electricity rates and customer service

As the primary generator of electricity in the province, Hydro has a significant impact on social well-being and economic prosperity in the province. In fulfilling its mandate, Hydro supports the strategic direction of the Provincial Government regarding maximized value and more specifically the focus to minimize the burden on electricity customers in the province. This section of the report outlines Hydro progress related to electricity rates as well as customer service and energy efficiency activities.

Electricity rates are impacted by a number of factors including capital investments in the electricity system, power purchases, fuel costs and the overall cost of operations. Hydro's mandate requires a commitment to the provision of least-cost power to customers in Newfoundland and Labrador. This commitment is reflected in a prudent approach to capital investment that ensures the appropriate balance between cost and reliability. In 2017, Hydro placed increased emphasis on completing the required maintenance of assets while managing operating costs.

A key driver of future electricity rates is the cost of the Muskrat Falls project. During 2017, Hydro supported the work of the Government of Newfoundland and Labrador and Hydro's parent company, Nalcor, to determine potential options to mitigate and manage these cost increases for customers. Hydro is looking for opportunities to manage operating and capital costs as well as the cost of electricity supply. For example, with the availability of transmission prior to the full commissioning of the Muskrat Falls Project, there is an opportunity to reduce thermal generation using less costly off-island electricity purchases in 2018, 2019 and 2020. As part of its 2017 General Rate Application, Hydro proposed that the savings that result from the off-island purchases be collected into a deferral account that would be used to smooth the customer transition to higher rates. This proposal remains under review as part of the General Rate Application before the PUB.

Hydro delivers the majority of the electricity needed by Newfoundland Power to address their customers' needs and also directly serves over 38,600 residential and commercial customers and several large industrial customers. Better understanding the needs and expectations of customers and identifying approaches that sustain or improve customer satisfaction was a focus in 2017. Hydro's commitment to customers also includes education and programs to help customers reduce their electricity use and costs. In 2017, Hydro continued efforts to help electricity residential, commercial and industrial consumers conserve energy.

Issue 2: Electricity rates and customer service	
Goal By December 31, 2019, Hydro will have supported measures to mitigate electricity rate increases and advanced customer service and energy efficiency initiatives.	
Indicators	- Identified and implemented measures to manage operating and capital costs. - Supported assessment and implementation of measures to mitigate the impact of the Muskrat Falls costs on rates. - Evaluated customer satisfaction and developed and implemented initiatives to enhance customer service. - Promoted energy conservation by residential, commercial and industrial customers.
Objective By December 31, 2017, Hydro will have managed costs and implemented initiatives to enhance customer service and energy efficiency	
Indicators	2017 Accomplishments
Prioritized capital investments to ensure appropriate balance between reliability and costs.	Hydro has a Five Year Capital Plan, which details the cost and timing of asset replacements and refurbishments. The plan is a living document and is revised on an ongoing basis as new asset condition information becomes available, as asset management strategies evolve, and demands and priorities change. The 2018 capital plan is based on the five year plan with projects prioritized based on improving customer reliability while minimizing the total amount of capital. All 2018 projects address both the need to sustain the existing asset base and to grow the asset base in response to growing customer demand, while improving reliability and adhering to Hydro's principles of safety and environmental responsibility.

Issue 2: Electricity rates and customer service	
Identified and implemented measures to manage operating costs.	In 2017, Hydro actual operating expenses of \$130.1 million were \$8.5 million lower than budget. This result was primarily due to decreased overall salary related costs, lower professional fees, and a net decrease in intercompany costs. In addition to actively managing position vacancies to achieve higher than budget vacancy savings in 2017, Hydro has identified and is evaluating and implementing other potential savings opportunities starting in 2018. Potential savings opportunities include: continued rollout of automated meter reading technology to reduce meter reading costs; compression of the annual hydraulic plant maintenance schedule to reduce fuel use at Holyrood; and, promoting customer use of Hydro's mobile and web portal platform to improve service and replace mailed communication.
Supported efforts of the Government of Newfoundland and Labrador and Nalcor to assess and implement measures to mitigate the impact of Muskrat Falls costs on rates.	In 2017, a Rate Mitigation Steering Committee chaired by the Department of Natural Resources with representatives from the Department of Finance, Nalcor and Hydro was formed. The Committee coordinates efforts to identify and evaluate options to mitigate the impact of Muskrat Falls costs on rates. In addition to supporting the Rate Mitigation Steering Committee, Hydro is continuing its efforts to manage its operating and capital costs as well as investigating options to reduce the cost of electricity supply through imports.
Implemented customer service initiatives related to residential and commercial customers, Newfoundland Power, and industrial customers.	Hydro implemented planned 2017 customer service initiatives for residential and commercial customers, Newfoundland Power and industrial customers. In 2017, Hydro continued to use the mobile and web portal platform providing customers with access to their electricity accounts and the ability to subscribe to text and email notifications about power outages in their regions. Throughout 2017, Hydro also advised customers of significant equipment outages through public advisories posted on its website and social media outlets. Hydro has enhanced its website with educational content to aid interested customers' understanding of how the overall system works, energy conservation tips, and outage preparation tools. In 2017, Hydro also progressed the implementation of automatic meter reading technology to provide more efficient

Issue 2: Electricity rates and customer service	
	meter reading and continued the move to electronic billing (eBilling). Also in 2017, Hydro completed planning activities related to the 2018 implementation of new billing and customer service software. This software should support efforts to produce a more streamlined, accurate and effective customer experience. In 2017, Hydro also continued to use its Account Management Framework developed in 2015. Through this framework, Hydro engaged industrial customers as well as key commercial accounts on key service and business areas including: commercial arrangements, outage planning and unplanned outage response and follow-up and, future power requirements. Hydro also implemented new software to support industrial billing in 2017. This software improved the accuracy and timeliness of billing for industrial and wholesale customer accounts. In 2017, Hydro continued to engage representatives at different levels of Newfoundland Power on how it can help serve and build a stronger relationship between the two companies to improve the experience of all electricity customers in the province.
Measured commercial customer satisfaction and identified key areas for improvement.	In 2017, Hydro measured commercial customer satisfaction. The purpose of this research is to assess customer satisfaction with Hydro's performance in providing service to commercial customers and to determine any changes in customer satisfaction over time. The vast majority of commercial customers remain satisfied with Hydro with 85 percent either very satisfied (43 per cent provided a rating of 9 or 10) or somewhat satisfied (42 per cent provided a rating of 7 or 8). Compared to 2014, the proportion of customers who are very satisfied increased from 36 to 43 percent. Hydro performed well on key drivers of commercial customer satisfaction. Customers continue to be satisfied with Hydro's service reliability, overall customer service, as well as its speed in restoring power when a problem occurs. Commercial customers did rate the price they paid for electricity lower.

Issue 2: Electricity rates and customer service	
Delivered energy efficiency programs to residential and commercial customers, including those in isolated communities.	In 2017, Hydro continued to deliver energy efficiency programs to residential and commercial customers. These programs included the joint utility program offerings for residential and commercial customers through the takeCHARGE program delivered in partnership with Newfoundland Power as well as Hydro's energy efficiency programs in isolated communities. <i>takeCHARGE program</i> In 2017, the takeCHARGE energy efficiency program continued to see success with rebates to Hydro's residential customers for insulation upgrades, thermostats, heat recovery ventilators, and small technologies and appliances. There were also rebates for energy efficient technologies purchased by Hydro's commercial customers. <i>Isolated Systems Community Energy Efficiency Program</i> In 2017, Hydro also continued delivery of the Isolated Systems Community Energy Efficiency Program. This program promotes energy efficiency to residential and commercial customers in communities served by diesel electricity systems in Labrador and on the island. During 2017, 1,007 residential and business customers benefited from the direct, free installation of energy efficient technologies with a total annual energy savings of 1,141 MWh. Hydro also delivered programs to business customers in the company's interconnected and isolated areas in 2017. These programs provide facility audits and technical support to identify economical energy efficiency opportunities, and provide financial support for capital upgrades. In 2017, 25 commercial facility audits were completed to inform customers of opportunities for energy savings and 10 projects were completed resulting in annual savings of 232 MWh. The Business Efficiency Program also supported 676 MWh of energy savings through mail-in rebates.
Worked with industrial customers through the Industrial Customers Energy Efficiency Program to identify and assess energy efficiency opportunities.	Hydro's Industrial Energy Efficiency Program is a customized program that offers support and financial incentives based on energy savings for the retrofit of industrial process equipment. Participation in the industrial program has been variable given the small number of industrial customers in the province. In 2017, promotion of the program continued under Hydro's

Issue 2: Electricity rates and customer service	
	Account Management Framework. Each of the five industrial customers was directly engaged to assist them with the Program, and for Hydro to better understand each customer's facilities, processes, plans and schedules for potential energy efficiency improvement projects. In 2017, three industrial customers initiated projects, all of the projects centered on lighting retrofits. Hydro anticipates these projects will generate 500 MWh of energy savings annually.

The objectives and indicators for 2018 are consistent with the direction outlined in the 2017-2019 Strategic Plan.

Issue 2: Electricity rates and customer service	
Objective By December 31, 2018, Hydro will have implemented initiatives to manage costs, enhance customer service and energy efficiency.	
Indicators	▪ Completed priority capital investments for 2018 and identified 2019 capital projects. ▪ Identified and implemented measures to manage costs. ▪ Supported Government of Newfoundland and Labrador and Nalcor efforts to evaluate opportunities to mitigate the impact of the Muskrat Falls Project costs on rates. ▪ Measured residential customer satisfaction and developed a customer centric culture plan. ▪ Completed priority customer service activities for Newfoundland Power and key accounts. ▪ Delivered energy conservation programs to residential, commercial and industrial customers. ▪ Complete planned energy efficiency initiatives for Hydro facilities and equipment.

Issue 3: Safety

Achieving excellence in safety is Hydro's number one priority and safety is a shared core value. For Hydro, safety excellence is more than a way of operating - it is an integral part of Hydro's identity and strategy for the planning period and into the future. Hydro's pursuit of safety excellence encompasses the safety of employees, customers and the general public.

In 2017, many areas of Hydro sustained excellent safety performance and the company is continuing to see its safety culture mature with employees identifying and addressing unsafe conditions and behaviours and accepting personal responsibility for their safety and the safety of others.

Achieving and maintaining excellent safety performance in all areas of the company remains an ongoing challenge. To move the company forward on its journey to safety excellence, Hydro completed initiatives involving procedures for performing high-risk work, electrical safety training to maintain employee competence, and employee injury prevention communication. To identify opportunities for improvement, Hydro also completed investigations of safety incidents and analysed performance to identify areas for improving the design and delivery of its safety programs.

On June 19, 2017, during work on the construction of the new transmission line (TL 267) from Bay d'Espoir to the Avalon Peninsula, a serious accident occurred that resulted in two fatalities. The individuals were employed by a contractor company (Forbes Bros. Ltd.) that had been engaged by Hydro. The project was halted for the incident investigation and to provide employee support to both Hydro and Forbes employees to cope with this tragic loss.

Customer safety and public safety around electrical equipment are also key elements of Hydro's safety commitment. During 2017, and for the balance of the planning period, power outage safety and winter preparedness along with safety around hydroelectric dams and other

electrical equipment are key themes for Hydro's customer and public communications.

Issue 3: Safety	
Goal 1 By December 31, 2019, Hydro will have continued progress towards sustained safety excellence.	
Indicators	- Delivered electrical safety training for employees. - Completed safety-related communications activities for employees and the general public.
Objective By December 31, 2017, Hydro will have implemented safety training and communication programs in support of safety excellence.	
Indicators	2017 Accomplishments
Delivered employee safety training including: - Completed planned training for employees working around electrical equipment. - Completed safety training for new employees, employees taking on new roles and refresher training for existing employees including: work protection code, confined space entry, and working at heights.	During 2017, Hydro delivered safety training for employees taking on new roles and refresher training for other employees. This training included technical training (e.g. work protection code refresher training for individuals working around electrical equipment), training required to meet legislative requirements such as confined space entry as well as safety coaching training. <i>Work protection code, confined space entry, and working at heights training</i> During 2017, required training for new Hydro employees, employees taking on new roles and responsibilities and employees needing refresher training was completed. In total, 264 employees completed work protection code training, 42 employees completed confined space entry training, and 97 employees completed working at heights training. <i>High voltage principles and practices training</i> During 2017, 22 Hydro employees completed high voltage switching principles and practices training to re-fresh knowledge related to this high risk work activity in electricity operations. <i>Safety coaching training</i> Safety coaching training helps build the skills required to take action relating to at-risk behaviours by outlining a consistent approach to safety interactions and providing an opportunity to practice the approach. The majority of Hydro employees have completed safety coaching training but the training is

Issue 3: Safety	
	offered periodically to new employees and others who have not completed the training. During 2017, 35 Hydro employees completed the training. <i>Safe workplace observation program (SWOP) and incident investigation training</i> SWOP and incident investigation training is offered annually to new employees and employees taking on new roles. In 2017, this training was completed as planned with 46 Hydro employees participating in SWOP training and 10 completing incident investigation training.
Assessed employee competence in completing high risk work through task observations.	In addition to safety training, Hydro completes task observations. Observations are used to verify and test documented work methods used to complete critical tasks and to assess employee competence in completing high risk line worker tasks such as climbing poles and towers, high angle rescue and working at heights. In 2017, a total of 666 task observations were completed – primarily in the transmission and distribution areas of the corporation.
Completed employee communication activities for the 2017 injury prevention campaign.	During 2017, Hydro continued employee safety communications (as part of Nalcor's employee safety communications campaign – Take a Moment for Safety) and completed all planned activities. To support the organization's top trending injuries, communication efforts focused on key topics throughout the year: vehicle safety; slips, trips and falls; mental health; alcohol and drug program; dropped objects; and, hand related injuries. Internal communication included safety moments, fact sheets, posters, infographics and other education and awareness materials.
Completed customer and public safety communication activities.	In 2017, Hydro completed customer and public safety communication activities related to power line safety, safety around hydroelectric dams and reservoirs, power outage safety, and safety around construction areas. <i>Power line safety</i> The public safety communications and advertising campaign for power line hazards continued to be a focus in 2017. This campaign, which is delivered in partnership with Newfoundland Power, the Newfoundland and Labrador Construction Safety Association, and Workplace NL, promotes

Issue 3: Safety	
	power line safety to the general public as well as targeted audiences such as heavy equipment operators and contractors. The campaign included TV, print, digital and social media and was supplemented with presentations to contractors who operate heavy equipment near power lines. <i>Public safety around hydroelectric facilities</i> Work continued in 2017 to promote public safety around dams, dykes and hydroelectric facilities, including through social media and stakeholder engagements. As well, as part of Hydro's commitment to public safety around dams, public safety advisories regarding changing water levels and controlled spilling were issued throughout the year when required. <i>Power Outage Safety</i> Hydro continued to promote power outage safety during 2017 with particular focus on the winter months when outages are more of an issue. Hydro also developed additional material on the topic – including refreshed infographics and other digital content shared via its Twitter and Facebook channels. <i>Safety Around Construction</i> With significant construction activity on new transmission lines in 2017, there was an effort to educate people about the associated dangers to the public and to Hydro's workers. Communication was issued through social media, radio and other channels regarding the risks of travelling on access roads and rights-of-way where workers and equipment could be present.

The objectives and indicators for 2018 are consistent with the direction outlined in the 2017-2019 Strategic Plan.

Issue 3: Safety
Objective By December 31, 2018, Hydro will have advanced safety training and communication programs to achieve long-term safety excellence.

Indicators	▪ Delivered employee safety training. ▪ Completed employee communication activities for the 2017 injury prevention campaign. ▪ Completed public safety communication activities related to power line safety, safety around electricity facilities, and power outage safety.
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5. Opportunities and Challenges

During the remainder of the planning period, Hydro will build on accomplishments of the past and address future challenges and opportunities. The key challenges and opportunities that will be addressed reflect the next phase of Hydro's strategy execution.

Reliable Electricity Supply

In keeping with its mandate, Hydro ensures there is a reliable electricity supply available to meet current customer needs and future growth. Core to this is maintaining Hydro's systems in reliable operating condition through a combination of planned maintenance, rehabilitation of existing assets, and replacement of assets that have reached the end of their useful lives. In 2018, 2019 and beyond Hydro will sustain its focus on reliable improvement plans and the completion of required maintenance and capital investment. Hydro will also assess the impact of electricity system interconnection and assess the need to future asset investment to meet customer needs.

Readiness for Interconnection/Integration

The development of the Muskrat Falls project transmission facilities will have implications for Newfoundland and Labrador's electricity system including the benefit of increased reliability and strategic export capabilities. It is anticipated that both the Labrador-Island Link and the Maritime Link interconnections will be in operation in 2018. Interconnection with the North American grid and the move away from reliance on Holyrood is the biggest change that Hydro has experienced since the 1960's. Hydro is preparing for this change and is evaluating opportunities and risks associated with interconnection to ensure it continues to provide reliable service to its customers.

Electricity Rates

Nalcor Energy's June 23, 2017 Muskrat Falls project update stated that average island

residential electricity rates are expected to increase to 22.89 cents (¢) (plus HST) per kilowatt hour (kWh) in 2021 as a result of the project. The present average rate for these customers is 11.7 ¢ per kWh (plus HST), a gap of 11.19 ¢ per kWh. Hydro will continue to support efforts of the Department of Natural Resources, the Department of Finance, and Nalcor to mitigate the forecasted increase in electricity rate associated with the Muskrat Falls project. Hydro is also leading rate mitigation activities related to managing its operating and capital costs and using the new transmission lines to secure lower cost supplies of electricity prior to Muskrat Falls electricity becoming available.

Safety

Achieving and maintaining excellent safety performance in all areas of the company is an ongoing challenge. During the planning period, Hydro will continue to implement initiatives to move forward on the journey to sustaining safety excellence.

Appendix 1

Provincial Electricity Generation and Transmission System



Appendix 2

Newfoundland and Labrador Hydro Consolidated Financial Statements

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017

Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of Newfoundland and Labrador Hydro, which comprise the consolidated statement of financial position as at December 31, 2017, and the consolidated statements of profit and comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Newfoundland and Labrador Hydro as at December 31, 2017, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.



Chartered Professional Accountants
March 8, 2018

NEWFOUNDLAND AND LABRADOR HYDRO

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

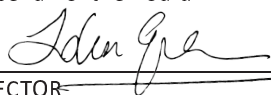
<i>As at December 31 (millions of Canadian dollars)</i>	<i>Notes</i>	2017	2016
ASSETS			
Current assets			
Cash and cash equivalents	5	38	26
Short-term investments		15	-
Trade and other receivables	6	148	119
Inventories	7	106	89
Current portion of sinking funds	11	-	75
Current portion of reserve fund	11	-	5
Prepayments		6	5
Deferred asset	8	31	51
Total current assets		344	370
Non-current assets			
Property, plant and equipment	9	2,554	2,279
Intangible assets	10	7	8
Long-term investments	12	34	34
Investment in joint arrangement		1	1
Other long-term assets	11	190	203
Total assets		3,130	2,895
Regulatory deferrals	13	117	164
Total assets and regulatory deferrals		3,247	3,059
LIABILITIES AND EQUITY			
Current liabilities			
Short-term borrowings	15	369	435
Trade and other payables	14	189	174
Current portion of long-term debt	15	7	143
Current portion of deferred contributions	16	1	1
Derivative liability	24	31	51
Total current liabilities		597	804
Non-current liabilities			
Long-term debt	15	1,482	872
Deferred contributions	16	12	13
Decommissioning liabilities	17	15	16
Employee future benefits	18	109	103
Total liabilities		2,215	1,808
Shareholder's equity			
Share capital	20	23	23
Contributed capital	20	150	148
Reserves		12	26
Retained earnings		768	706
Total equity		953	903
Total liabilities and equity		3,168	2,711
Regulatory deferrals	13	79	348
Total liabilities, equity and regulatory deferrals		3,247	3,059

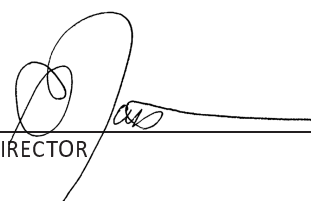
Commitments and contingencies (Note 26)

Subsequent event (Note 30)

See accompanying notes

On behalf of the Board:


DIRECTOR


DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF PROFIT AND COMPREHENSIVE INCOME

<i>For the year ended December 31 (millions of Canadian dollars)</i>	<i>Notes</i>	2017	2016
Energy sales		636	648
Other revenue		29	27
Revenue		665	675
Fuels		226	168
Power purchased		101	99
Operating costs	21	175	173
Transmission rental		20	19
Depreciation and amortization	9,10	96	85
Net finance expense	22	64	70
Other expense	23	6	6
Expenses		688	620
(Loss) profit before regulatory adjustments		(23)	55
Regulatory adjustments	13	(92)	(1)
Profit for the year		69	56
Other comprehensive income			
<i>Total items that may or have been reclassified to profit or loss</i>			
Actuarial (loss) gain on employee future benefits		(3)	3
Net fair value (loss) gain on available-for-sale financial instruments		(3)	14
Reclassification adjustments related to:			
Disposals of available-for-sale financial instruments		(8)	(10)
Other comprehensive (loss) income for the year		(14)	7
Total comprehensive income for the year		55	63

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

<i>(millions of Canadian dollars)</i>	Notes	Share Capital	Contributed Capital	Fair Value Reserve	Employee Benefit Reserve	Retained Earnings	Total
Balance at January 1, 2017		23	148	45	(19)	706	903
Profit for the year		-	-	-	-	69	69
Other comprehensive income							
Net change in fair value of available-for-sale financial instruments	19	-	-	(3)	-	-	(3)
Net change in fair value of financial instruments reclassified to profit or loss	19	-	-	(8)	-	-	(8)
Actuarial loss on employee future benefits	18	-	-	-	(3)	-	(3)
Total comprehensive (loss) income for the year		-	-	(11)	(3)	69	55
Contributed capital	20	-	3	-	-	-	3
Regulatory adjustment	20	-	(1)	-	-	-	(1)
Dividends	20	-	-	-	-	(7)	(7)
Balance at December 31, 2017		23	150	34	(22)	768	953
Balance at January 1, 2016		23	133	41	(22)	663	838
Profit for the year		-	-	-	-	56	56
Other comprehensive income							
Net change in fair value of available-for-sale financial instruments	19	-	-	14	-	-	14
Net change in fair value of financial instruments reclassified to profit or loss	19	-	-	(10)	-	-	(10)
Actuarial gain on employee future benefits	18	-	-	-	3	-	3
Total comprehensive income for the year		-	-	4	3	56	63
Contributed capital	20	-	15	-	-	-	15
Dividends	20	-	-	-	-	(13)	(13)
Balance at December 31, 2016		23	148	45	(19)	706	903

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO

CONSOLIDATED STATEMENT OF CASH FLOWS

<i>For the year ended December 31 (millions of Canadian dollars)</i>	Notes	2017	2016
Operating activities			
Profit for the year		69	56
Adjusted for items not involving a cash flow:			
Depreciation - property, plant and equipment	9	94	83
Amortization - intangible assets	10	2	2
Amortization - sinking fund discount		(11)	(13)
Employee future benefits		4	3
Regulatory adjustments	13	(92)	(2)
Other		6	9
		72	138
Changes in non-cash working capital balances	28	(38)	(9)
Net cash provided from operating activities		34	129
Investing activities			
Additions to property, plant and equipment		(385)	(246)
Additions to intangible assets	10	(1)	(2)
Decrease (increase) in sinking funds	11	88	(8)
Increase in long-term investment	12	-	(34)
Increase in short-term investment		(15)	-
Withdrawal from reserve fund	11	15	16
Proceeds on disposal of property, plant and equipment		10	-
Changes in non-cash working capital balances	28	6	28
Net cash used in investing activities		(282)	(246)
Financing activities			
Issuance of long-term debt	15	612	-
Retirement of long-term debt	15	(150)	(225)
Dividends paid to Nalcor Energy	20	(7)	(13)
(Decrease) increase in short-term borrowings	15	(66)	338
Decrease in other long-term assets		1	1
Other		1	2
Rate stabilization plan refund		(131)	-
Net cash provided from financing activities		260	103
Net increase (decrease) in cash and cash equivalents		12	(14)
Cash and cash equivalents, beginning of year		26	40
Cash and cash equivalents, end of year		38	26
Interest received		24	3
Interest paid		91	86

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro (Hydro or the Company) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the Province). The principal activity of Hydro is the generation, transmission and sale of electricity. Hydro's operations include both regulated and non-regulated activities. Hydro is a 100% owned subsidiary of Nalcor Energy (Nalcor). Hydro's head office is located at 500 Columbus Drive in St. John's, Newfoundland and Labrador A1B 0C9, Canada.

Hydro holds interests in the following entities:

A 65.8% interest in Churchill Falls (Labrador) Corporation Limited (Churchill Falls). Churchill Falls is incorporated under the laws of Canada and owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW).

A 51% interest in Lower Churchill Development Corporation (LCDC), an inactive subsidiary. 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.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Statement of Compliance and Basis of Measurement

These annual audited consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). Hydro has adopted accounting policies which are based on the IFRS applicable as at December 31, 2017, and includes individual IFRS, International Accounting Standards (IAS), and interpretations made by the IFRS Interpretations Committee and the Standing Interpretations Committee.

These annual audited consolidated financial statements have been prepared on a historical cost basis, except for financial instruments at fair value through profit or loss (FVTPL) and available-for-sale (AFS) financial assets which have been measured at fair value. The annual audited consolidated financial statements are presented in Canadian Dollars (CAD) and all values rounded to the nearest million, except when otherwise noted. The annual audited consolidated financial statements were approved by Hydro's Board of Directors (the Board) on March 2, 2018.

2.2 Basis of Consolidation

The annual audited consolidated financial statements include the financial statements of Hydro, its subsidiary company, LCDC, and its share of investments in a joint operation and a joint venture. Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls, and Hydro-Québec entered into a Shareholders' Agreement (the Shareholders' Agreement) which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec on the Board of Directors of Churchill Falls. Although Hydro holds a 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 a joint operation. Accordingly, Hydro has recognized its share of assets, liabilities and profit or loss in relation to its interest in Churchill Falls subsequent to the effective date of the Shareholders' Agreement.

Churchill Falls holds 33.33% of the equity share capital of Twin Falls Power Corporation Limited (Twin Falls). This investment is accounted for using the equity method.

NEWFOUNDLAND AND LABRADOR HYDRO

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2.3 Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents consist of amounts on deposit with a Schedule 1 Canadian Chartered bank, as well as highly liquid investments with maturities of three months or less. Investments with maturities greater than three months and less than twelve months are classified as short-term investments. Cash and cash equivalents are measured at cost, which approximates fair value, while short-term investments are measured at fair value.

2.4 Trade and Other Receivables

Trade and other receivables are classified as loans and receivables and are measured at amortized cost using the effective interest method.

2.5 Inventories

Inventories are carried at the lower of cost and net realizable value. Cost is determined on a weighted average basis and includes expenditures incurred in acquiring the inventories and bringing them to their existing condition and location. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

2.6 Property, Plant and Equipment

Items of property, plant and equipment are recognized using the cost model and thus are recorded at cost less accumulated depreciation and accumulated impairment losses. Cost includes materials, labour, contracted services, professional fees and, for qualifying assets, borrowing costs capitalized in accordance with Hydro's accounting policy outlined in Note 2.8. Costs capitalized with the related asset include all those costs directly attributable to bringing the asset into operation. When significant parts of property, plant and equipment are required to be replaced at intervals, Hydro recognizes such parts as individual assets with specific useful lives and depreciation, respectively. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied. All other repairs and maintenance costs are recognized in profit or loss as incurred. Property, plant and equipment is not revalued for financial reporting purposes. Depreciation of these assets commences when the assets are ready for their intended use.

Hydro

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

Generation plant	
Hydroelectric	45 to 100 years
Thermal	35 to 65 years
Diesel	25 to 55 years
Transmission	
Lines	30 to 65 years
Terminal stations	40 to 55 years
Distribution system	30 to 55 years
Other assets	5 to 55 years

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

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Terminal station assets are used to step up voltages of electricity and to step down voltages for distribution. Distribution system assets include poles, transformers, insulators, and conductors. Other assets include telecontrol, buildings, vehicles, furniture, tools and equipment.

NEWFOUNDLAND AND LABRADOR HYDRO

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Churchill Falls

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

Hydroelectric generation plant	25 to 100 years
Transmission and terminals	30 to 65 years
Service facilities and other	5 to 45 years

Hydro and Churchill Falls assets' residual values, useful lives and method of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate. The carrying value of property, plant and equipment is reviewed for impairment whenever events indicate that the carrying amounts of those assets may not be recoverable.

2.7 Intangible Assets

Intangible assets that are expected to generate future economic benefit and are measurable, including computer software costs, costs of technical services and studies are capitalized as intangible assets in accordance with IAS 38.

Intangible assets with finite useful lives are carried at cost less accumulated amortization and accumulated impairment losses. The estimated useful life and amortization method are reviewed at the end of each year with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives are carried at cost less accumulated impairment losses.

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

Feasibility studies	5 to 20 years
Computer software	7 to 10 years

2.8 Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

2.9 Impairment of Non-Financial Assets

At the end of each reporting period, Hydro reviews the carrying amounts of its non-financial assets, to determine whether there is any indication that those assets may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any.

Where it is not possible to estimate the recoverable amount of an individual asset, Hydro estimates the recoverable amount of the cash generating unit (CGU) to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual CGUs, or otherwise they are allocated to the smallest group of CGUs for which a reasonable and consistent allocation basis can be identified. The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. Value in use is generally computed by reference to the present value of future cash flows expected to be derived from non-financial assets.

If the recoverable amount of an asset or CGU is estimated to be less than its carrying amount, the carrying amount of the asset or CGU is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

2.10 Investment in Joint Arrangement

A joint arrangement is an arrangement in which two or more parties have joint control. Control exists when Hydro has the power, directly or indirectly, to govern the financial and operating policies of another entity, so as to obtain benefits from its activities. A joint arrangement is either classified as a joint operation or a joint venture based on the rights of the parties involved.

Hydro accounts for its investment in Churchill Falls by recognizing its share of assets, liabilities and profit or loss in relation to its interest in the joint operation.

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 using the equity method. Under the equity method, the interest in the joint venture is carried in the Statement of Financial Position at cost plus post acquisition changes in Churchill Falls' share of net assets of the joint venture. The Statement of Profit and Comprehensive Income reflects the share of the profit or loss of the joint venture.

2.11 Employee Future Benefits

(i) Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. Contributions by Hydro to this plan are recognized as an expense when employees have rendered service entitling them to the contributions. Liabilities associated with this plan are held with the Province.

(ii) Other Benefits

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a retirement allowance upon retirement.

The cost of providing these benefits is determined using the projected unit credit method, with actuarial valuations being completed on an annual basis based on service and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs.

Actuarial gains and losses on Hydro's defined benefit obligation are recognized in reserves in the period in which they occur. Past service costs are recognized in operating costs as incurred. Pursuant to Order No. P.U. 36 (2015), Hydro recognizes the amortization of employee future benefit actuarial gains and losses in profit or loss as a regulatory adjustment.

The retirement benefit obligation recognized in the Statement of Financial Position represents the present value of the defined benefit obligation.

2.12 Provisions

A provision is a liability of uncertain timing or amount. A provision is recognized if Hydro has a present legal obligation or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognized for future operating losses. The provision is measured at the present value of the best estimate of the expenditures expected to be required to settle the obligation using a discount rate that reflects the current market assessments of the time value of money and the risks specific to the obligation. Provisions are re-measured at each Consolidated Statement of Financial Position date using the current discount rate.

2.13 Decommissioning, Restoration and Environmental Liabilities

Legal and constructive obligations associated with the retirement of property, plant and equipment are recorded as liabilities when those obligations are incurred and are measured as the present value of the expected costs to settle the liability, discounted at a rate specific to the liability. The liability is accreted up to the date the liability will be incurred with a corresponding charge to net finance (income) expense. The carrying amount of decommissioning, restoration and environmental liabilities is reviewed annually with changes in the estimates of timing or amount of cash flows added to or deducted from the cost of the related asset or expensed in profit or loss if the liability is short-term in nature.

2.14 Revenue Recognition

Revenue from the sale of energy is recognized when Hydro has transferred the significant risks and rewards of ownership to the buyer, recovery of the consideration is probable and the amount of revenue can be reliably measured. Sales within the Province are primarily at rates approved by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), whereas export sales and sales to certain major industrial customers are either at rates under the terms of the applicable contracts, or at market rates.

Churchill Falls provides energy to two primary customers: Hydro-Québec and Hydro.

A power contract with Hydro-Québec dated May 12, 1969 (the Power Contract) provided for the sale of a significant amount of the energy from Churchill Falls. The Power Contract had a 40-year term that expired August 31, 2016, and was followed by a Renewed Power Contract with Hydro-Québec for an additional 25 years beginning September 1, 2016. The rate during the term of the Renewed Power Contract is 2.0 mills per kWh.

Churchill Falls also recognizes revenue from Hydro-Québec under a Guaranteed Winter Availability Contract (GWAC) through 2041. The GWAC was signed with Hydro-Québec in 1998 and provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Québec during the months of November through March in each year until 2041.

Under the Power Contract and Renewed Power Contract, Churchill Falls has the right to recall 300 MW (Recall Power). All of the Recall Power is sold by Churchill Falls to Hydro. Churchill Falls also sells an additional 225 MW to Hydro.

2.15 Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Lessor accounting

Amounts due from lessees under finance leases are recognized as receivables at the amount of Hydro's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on Hydro's net investment outstanding in respect of the leases.

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized on a straight-line basis over the lease term.

Lessee accounting

Assets held under finance leases are initially recognized as assets of Hydro at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the Consolidated Statement of Financial Position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognized immediately in profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with Hydro's general policy on borrowing costs (Note 2.8). Contingent rental costs are recognized as operating costs in the periods in which they are incurred.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognized as a liability. The aggregate benefit of incentives is recognized as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

2.16 Net Finance (Income) Expense

For all financial instruments measured at amortized cost and interest bearing financial assets classified as AFS, interest income or expense is recorded using the effective interest rate method.

2.17 Foreign Currencies

Transactions in currencies other than Hydro's functional currency (foreign currencies) are recognized using the exchange rate in effect at the date of transaction, approximated by the prior month end close rate. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates of exchange in effect at the period end date. Foreign exchange gains and losses not included in regulatory deferrals are recorded in profit or loss as other (income) expense.

2.18 Income Taxes

Hydro is exempt from paying income taxes under Section 149(1) (d.2) of the Income Tax Act.

2.19 Financial Instruments

Financial assets and financial liabilities are recognized in the Consolidated Statement of Financial Position when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Financial instruments are classified into the following specified categories: financial assets at FVTPL, AFS financial assets, loans and receivables, held-to-maturity investments, financial liabilities at FVTPL, financial instruments used for hedging and other financial liabilities. The classification depends on the nature and purpose of the financial instruments and is determined at the time of initial recognition.

Classification of Financial Instruments

Hydro has classified each of its financial instruments into the following categories: financial assets at FVTPL, loans and receivables, held-to-maturity investments, AFS financial assets, financial instruments used for hedging and other financial liabilities.

<u>Financial Instrument</u>	<u>Category</u>
Cash and cash equivalents	Loans and receivables (L&R)
Short-term investments	AFS financial assets
Trade and other receivables	Loans and receivables
Derivative instruments	At FVTPL and financial instruments used for hedging
Reserve fund	AFS financial assets
Sinking funds – investments in same Hydro issue	Held-to-maturity investments (HTM)
Sinking funds – other investments	AFS financial assets
Long-term receivables	Loans and receivables
Long-term investments	AFS financial assets
Trade and other payables	Other financial liabilities (OFL)
Short-term borrowings	Other financial liabilities
Long-term debt	Other financial liabilities

(i) Effective Interest Method

The effective interest method is a method of calculating the amortized cost of a financial instrument and allocating interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial instrument, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Income or expense is recognized on an effective interest basis for financial instruments other than those financial assets and liabilities classified at FVTPL.

Financial Assets

(ii) Financial Assets at FVTPL

Financial assets are classified as at FVTPL when the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling it in the near term; or
- on initial recognition it is part of a portfolio of identified financial instruments that Hydro manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with Hydro's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on re-measurement recognized in other (income) expense. The net gain or loss incorporates any dividends or interest earned.

(iii) Loans and Receivables

Trade receivables, loans and other receivables with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

(iv) Held-to-Maturity Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity dates that Hydro has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment, with revenue recognized on an effective yield basis.

(v) AFS Financial Assets

AFS financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the previous categories. Gains and losses arising from changes in fair value are recognized in other comprehensive income and accumulated in the fair value reserve with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognized in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the fair value reserve is reclassified to profit or loss.

Financial Liabilities and Equity Instruments

(vi) Classification as Debt or Equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement and the definitions of a financial liability and equity instrument.

(vii) Financial Liabilities at FVTPL

A financial liability may be classified as at FVTPL if the contracted liability contains one or more embedded derivatives, and if the embedded derivative significantly modified the cash flows or if the embedded derivative is not closely related to the host liability. Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising from re-measurement recognized in profit or loss.

(viii) Other Financial Liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

(ix) Derivative Instruments and Financial Instruments Used for Hedging

Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Derivatives are initially measured at fair value at the date the derivative contracts are entered into and are subsequently measured at their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging relationship.

2.20 Derecognition of Financial Instruments

Hydro derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If Hydro neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, its retained interest in the asset and any associated liability for amounts it may have to pay is recognized. If Hydro retains substantially all the risks and rewards of ownership of a transferred financial asset, it continues to recognize the financial asset and also recognizes the collateralized borrowing for the proceeds received. Hydro derecognizes financial liabilities when, and only when, its obligations are discharged, cancelled or they expire.

2.21 Impairment of Financial Assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the asset have been affected.

Evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty;
- default or delinquency in interest or principal payments; or,
- the borrower, more probable than not, entering into bankruptcy or financial re-organization.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include Hydro's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with defaults on receivables.

For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to profit or loss in the period.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

2.22 Government Grants

Government grants are recognized when there is reasonable assurance that Hydro will comply with the associated conditions and that the grants will be received.

Government grants are recognized in profit or loss on a systematic basis over the periods in which Hydro recognizes as expenses the related costs for which the grants are intended to compensate. Specifically, government grants whose primary condition is that Hydro should purchase, construct or otherwise acquire non-current assets are recognized as deferred revenue in the Statement of Financial Position and transferred to profit or loss on a systematic and rational basis over the useful lives of the related assets.

Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to Hydro with no future related costs are recognized in profit or loss in the period in which they become receivable.

2.23 Regulatory Deferrals

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 methodology. Hydro's allowed rate of return based upon Board Order No. P.U. 49 (2016) is 6.6% in 2017 and 6.6% in 2016 +/- 20 basis points. 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 are expected to be recovered or refunded in future rates. In the absence of rate regulation, these amounts would be included in the determination of profit or loss in the year the amounts are incurred. The effects of rate regulation on the annual audited consolidated financial statements are disclosed in Note 13.

3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the annual audited consolidated financial statements in conformity with IFRS requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ materially from these estimates, including changes as a result of future decisions made by the PUB. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period in which the estimate is reviewed if the revision affects only that period or future periods.

3.1 Use of Judgments

(i) Property, Plant and Equipment

Hydro's accounting policy relating to property, plant and equipment is described in Note 2.6. In applying this policy, judgment is used in determining whether certain costs are additions to the carrying amount of the property, plant and equipment as opposed to repairs and maintenance. If an asset has been developed, judgment is required to identify the point at which the asset is capable of being used as intended and to identify the directly attributable borrowing costs to be included in the carrying value of the development asset. Judgment is also used in determining the appropriate componentization structure for Hydro's property, plant and equipment.

(ii) Revenue

Management exercises judgment in estimating the value of electricity consumed by retail customers in the period, but billed subsequent to the end of the reporting period. Specifically, this involves an estimate of consumption for each retail customer, based on the customer's past consumption history.

When recognizing deferrals and related amortization of costs or credits in Hydro Regulated, Management assumes that such costs or credits will be recovered or refunded through customer rates in future years. Recovery of some of these deferrals is subject to a future PUB order. As such, there is a risk that some or all of the regulatory deferrals will not be approved by the PUB which could have a material impact on Hydro Regulated's profit or loss in the year the order is received.

(iii) Determination of CGUs

Hydro's accounting policy relating to impairment of non-financial assets is described in Note 2.9. In applying this policy, Hydro groups assets into the smallest identifiable group for which cash flows are largely independent of the cash flows from other assets or groups of assets. Judgment is used in determining the level at which cash flows are largely independent of other assets or groups of assets.

(iv) Discount Rates

Certain of Hydro's financial liabilities are discounted using discount rates that are subject to Management's judgment.

(v) Consolidation of Joint Arrangements

Management exercises judgment when applying the criteria outlined in IFRS 11 to determine whether joint arrangements constitute joint ventures or joint operations. Management has determined that its interest in Churchill Falls is considered a joint operation and its interest in Twin Falls is considered a joint venture.

3.2 Use of Estimates

(i) Property, Plant and Equipment

Amounts recorded for depreciation are based on the useful lives of Hydro's assets. The useful lives of property, plant and equipment are determined by independent specialists and reviewed annually by Hydro. These useful lives are Management's best estimate of the service lives of these assets. Changes to these lives could materially affect the amount of depreciation recorded.

(ii) Intangible Assets

Amounts recorded for amortization are based on the useful lives of Hydro's assets. These useful lives are Management's best estimate of the service lives of these assets. Changes to these lives would not materially affect the amount of amortization recorded.

(iii) Decommissioning Liabilities

Hydro recognizes a liability for the fair value of the future expenditures required to settle obligations associated with the retirement of property, plant and equipment. Decommissioning liabilities are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of decommissioning liabilities is included in the Consolidated Statement of Profit and Comprehensive Income through net finance (income) expense. Differences between the recorded decommissioning liabilities and the actual decommissioning costs incurred are recorded as a gain or loss in the settlement period.

(iv) Employee Future Benefits

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 benefits is accounted for on an accrual basis, and has been actuarially determined using the projected unit credit method prorated on service, and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs.

(v) Revenue

In the absence of a signed agreement with Hydro-Québec relating to the AEB, Churchill Falls has an agreement with Hydro-Québec to continue to use the 2008 AEB on an interim basis until final judgment is obtained in the Declaratory Judgment case.

3.3 Use of Assumptions

Deferred Assets and Derivative Liabilities

Effective October 1, 2015, Hydro entered into a power purchase agreement (PPA) with Nalcor Energy Marketing Corporation (Nalcor Energy Marketing) which allows for the purchase of available recapture energy from Hydro for resale by Energy Marketing in export markets or through agreements with counterparties. Additionally, the PPA allows for the use of Hydro's transmission service rights by Nalcor Energy Marketing to deliver electricity, through rights which are provided to Hydro pursuant to a Transmission Service Agreement with Hydro-Québec dated April 1, 2009. In September 2016, the terms of the PPA were amended to require a 60 day termination notice by either party. This replaced the previous termination clause of 90 days prior the end of the operating year. Management's assumption is that the term of the PPA at December 31, 2017, will continue for at least the next 12 months.

Fair values relating to Hydro's financial instruments and derivatives that have been classified as Level 3 have been determined using inputs for the assets or liabilities that are not readily observable. Certain of these fair values are classified as Level 3 as the transactions do not occur in an active market, or the terms extend beyond the period for which a quoted price is available.

Hydro's PPA with Energy Marketing is accounted for as a derivative instrument, where Hydro determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability, nor based on a valuation technique that uses only data from observable markets. These derivative transactions are initially measured at fair value and the expected difference is deferred. Subsequently, the deferred difference is recognized in other comprehensive income (loss) on an appropriate basis over the life of the related derivative instrument but not later than when the valuation is wholly supported by observable market data or the transaction is completed.

Hydro has elected to defer the difference between the fair value of the power purchase derivative liability upon initial recognition and the transaction price of the power purchase derivative liability and to amortize the deferred asset on a straight-line basis over its effective term (Note 8). These methods, when compared with alternatives, were determined by Management to more accurately reflect the nature and substance of the transactions.

4. FUTURE CHANGES IN ACCOUNTING POLICIES

The following new and revised IFRSs became effective for the accounting period commencing on January 1, 2017 and did not have a material impact on Hydro's annual audited consolidated financial statements.

IAS 7 – Disclosure Initiative became effective for the accounting period commencing January 1, 2017 and did not have a material impact on Hydro's annual audited non-consolidated financial statements.

The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The amendments do not prescribe a specific format to disclose financing activities; however, an entity may fulfil the disclosure objective by providing a reconciliation between the opening and closing balances in the Statement of Financial Position for liabilities arising from financing activities.

The following is a list of standards/interpretations that have been issued and are effective for accounting periods commencing on January 1, 2018 or January 1, 2019, as specified.

- *IFRS 9 - Financial Instruments*¹
- *IFRS 15 - Revenue from Contracts with Customers*¹
- *IFRIC 22 - Foreign Currency Transactions and Advance Consideration*¹
- *IFRS 16 - Leases*²

¹Effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

²Effective for annual periods beginning on or after January 1, 2019, with earlier application permitted.

4.1 IFRS 9 - Financial Instruments

In July 2014, the IASB finalized the reform of financial instruments accounting and issued IFRS 9 (as revised in 2014), which contains the requirements for a) the classification and measurement of financial assets and financial liabilities, b) impairment methodology, and c) general hedge accounting. IFRS 9 (as revised in 2014) will supersede IAS 39 - Financial Instruments: Recognition and Measurement upon its effective date.

Phase 1: Classification and measurement of financial assets and financial liabilities

With respect to classification and measurement, the number of categories of financial assets under IFRS 9 has been reduced; all recognized financial assets that are currently within the scope of IAS 39 will be subsequently measured at either amortized cost or fair value under IFRS 9.

IFRS 9 also contains requirements for the classification and measurement of financial liabilities and derecognition requirements. One major change from IAS 39 relates to the presentation of changes in the fair value of a financial liability designated as at FVTPL attributable to changes in the credit risk of that liability. Under IFRS 9, such changes are presented in other comprehensive income, unless the presentation of the effect of the change in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss.

Phase 2: Impairment of financial assets

The impairment model under IFRS 9 reflects expected credit losses, as opposed to incurred credit losses under IAS 39. Under the impairment approach in IFRS 9, it is no longer necessary for a credit event to have occurred before credit losses are recognized. Instead, an entity always accounts for expected credit losses and changes in those expected credit losses. The amount of expected credit losses should be updated at each reporting date to reflect changes in credit risk since initial recognition.

Phase 3: Hedge accounting

The general hedge accounting requirements of IFRS 9 retain the three types of hedge accounting mechanisms in IAS 39. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is no longer required. Far more disclosure requirements about an entity's risk management activities have been introduced.

Transitional provisions

IFRS 9 (as revised in 2014) is effective for annual periods beginning on or after January 1, 2018 with earlier application permitted. Management has elected to adopt the standard as of the effective date. The classifications of existing financial instruments and related disclosures will change and there may be material adjustments to the amounts reported in Hydro's annual audited Consolidated financial statements.

4.2 IFRS 15 – Revenue from Contracts with Customers

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. It will supersede the following revenue standards and interpretations upon its effective date:

- IAS 18 Revenue;
- IAS 11 Construction Contracts;
- IFRIC 13 Customer Loyalty Programs;
- IFRIC 15 Agreements for the Construction of Real Estate;
- IFRIC 18 Transfers of Assets from Customers; and
- SIC 31 Revenue-Barter Transactions Involving Advertising Services

As suggested by the title of the new revenue standard, IFRS 15 will only cover revenue arising from contracts with customers. Under IFRS 15, a customer of an entity is a party that has contracted with the entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration. Unlike the scope of IAS 18, the recognition and measurement of interest income and dividend income from debt and equity investments are no longer within the scope of IFRS 15. Instead, they are within the scope of IAS 39.

As mentioned above, the new standard has a single model to deal with revenue from contracts with customers. Its core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Specifically, the standard introduces a five-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Extensive disclosures are also required by the new standard.

IFRS 15, together with clarifications thereto issued in April 2016, is effective for reporting periods beginning on or after January 1, 2018 with earlier application permitted. Management has elected to adopt the standard as of the effective date. The related disclosures will change, and although Management does not expect an impact on profit or loss, there will be material adjustments in the presentation of note disclosures reported in Hydro's annual audited Consolidated financial statements.

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4.3 IFRIC 22 Foreign Currency Transactions and Advance Consideration

IFRIC 22 addresses how to determine the 'date of transaction' for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income, when consideration for that item has been paid or received in advance in a foreign currency which resulted in the recognition of a non-monetary asset or non-monetary liability (for example, a non-refundable deposit or deferred revenue).

The Interpretation is effective for annual periods beginning on or after January 1, 2018 with earlier application permitted. Entities can apply the Interpretation either retrospectively or prospectively. Specific transition provisions apply to prospective application. Management does not anticipate that the application of these amendments to IFRIC 22 will have a material impact on Hydro's annual audited consolidated financial statements.

4.4 IFRS 16 - Leases

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It will supersede the following lease standard and interpretations upon its effective date:

- IAS 17 Leases;
- IFRIC 4 Determining Whether an Arrangement contains a Lease;
- SIC-15 Operating Leases – Incentives; and
- SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

IFRS 16 applies a control model to the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer.

The standard introduces significant changes to lessee accounting: it removes the distinction between operating and finance leases under IAS 17 and requires a lessee to recognize a right-of-use asset and a lease liability at lease commencement for all leases, except for short-term leases and leases of low value assets.

In contrast to lessee accounting, the IFRS 16 lessor accounting requirements remain largely unchanged from IAS 17, which continue to require a lessor to classify a lease as either an operating lease or a finance lease.

IFRS 16 is effective for reporting periods beginning on or after January 1, 2019 with early application permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16. A lessee can apply IFRS 16 either by a full retrospective approach or a modified retrospective approach. If the latter approach is selected, an entity is not required to restate the comparative information and the cumulative effect of initially applying IFRS 16 must be presented as an adjustment to opening retained earnings. Management anticipates that the application of IFRS 16 in the future may have a material impact on the amounts reported and disclosures made in Hydro's annual audited non-consolidated financial statements. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until Management performs a detailed review.

5. CASH AND CASH EQUIVALENTS

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Cash	38	13
Cash equivalents	-	13
	38	26

The effective interest rate on cash equivalents at December 31, 2016 was 0.97%.

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6. TRADE AND OTHER RECEIVABLES

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Trade receivables	118	96
Due from related parties	13	15
Other receivables	34	24
Allowance for doubtful accounts	(17)	(16)
	148	119
<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
0-60 days	134	115
60+ days	14	4
	148	119
<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Allowance for doubtful accounts, beginning of year	(16)	(12)
Amounts provided for during the year	(1)	(4)
Allowance for doubtful accounts, end of year	(17)	(16)

7. INVENTORIES

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
No. 6 fuel	48	35
Material and other	47	43
Diesel fuel	4	4
Other fuel	4	4
Construction aggregates	3	3
	106	89

The cost of inventories recognized as an expense during the year is \$234.1 million (2016 - \$173.9 million) and is included in operating costs and fuels.

8. DEFERRED ASSET

The deferred asset related to Hydro's PPA with Nalcor Energy Marketing is amortized into income on a straight-line basis over the assumed 12 month term of the contract, which commenced on January 1, 2017. The components of change are as follows:

<i>As at (millions of Canadian dollars)</i>	2017	2016
Deferred asset, beginning of year	51	61
Additions	31	51
Amortization	(51)	(61)
Deferred asset, end of year	31	51

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9. PROPERTY, PLANT AND EQUIPMENT

<i>(millions of Canadian dollars)</i>	Generation Plant	Transmission and Distribution	Other	Construction in Progress	Total
Cost					
Balance at January 1, 2016	1,701	765	222	59	2,747
Additions	-	-	-	261	261
Disposals	(6)	(3)	(4)	-	(13)
Transfers	94	97	25	(216)	-
Other adjustments	(1)	-	-	-	(1)
Decommissioning liabilities and revisions	(14)	1	-	-	(13)
Balance at December 31, 2016	1,774	860	243	104	2,981
Additions	-	1	-	388	389
Disposals	(3)	(4)	(4)	-	(11)
Transfers	68	334	22	(424)	-
Other adjustments	-	-	(1)	(13)	(14)
Decommissioning liabilities and revisions	(1)	-	-	-	(1)
Balance at December 31, 2017	1,838	1,191	260	55	3,344
Depreciation					
Balance at January 1, 2016	413	138	73	-	624
Depreciation	47	23	13	-	83
Disposals	(2)	(1)	(2)	-	(5)
Balance at December 31, 2016	458	160	84	-	702
Depreciation	53	27	14	-	94
Disposals	(2)	(1)	(3)	-	(6)
Balance at December 31, 2017	509	186	95	-	790
Carrying value					
Balance at January 1, 2016	1,288	627	149	59	2,123
Balance at December 31, 2016	1,316	700	159	104	2,279
Balance at December 31, 2017	1,329	1,005	165	55	2,554

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10. INTANGIBLE ASSETS

<i>(millions of Canadian dollars)</i>	Computer Software	Feasibility Studies	Assets Under Development	Total
Cost				
Balance at January 1, 2016	10	2	-	12
Additions	-	-	2	2
Balance at December 31, 2016	10	2	2	14
Additions	-	-	1	1
Transfers	1	-	(1)	-
Balance at December 31, 2017	11	2	2	15
Amortization				
Balance at January 1, 2016	3	1	-	4
Amortization	2	-	-	2
Balance at December 31, 2016	5	1	-	6
Amortization	2	-	-	2
Balance at December 31, 2017	7	1	-	8
Carrying value				
Balance at January 1, 2016	7	1	-	8
Balance at December 31, 2016	5	1	2	8
Balance at December 31, 2017	4	1	2	7

11. OTHER LONG-TERM ASSETS

<i>(millions of Canadian dollars)</i>	2017	2016
Long-term receivables (a)	-	1
Reserve fund (b)	-	15
Sinking funds (c)	190	267
Other long-term assets	190	283
Less: current portion of reserve fund	-	(5)
Less: current portion of sinking funds	-	(75)
	190	203

- (a) The balance of \$0.3 million (2016 - \$0.5 million) includes the non-current portion of receivables associated with customer payment plans and the long-term portion of employee purchase programs.
- (b) In 2007, Churchill Falls commenced the creation of a \$75.0 million segregated reserve fund pursuant to the terms of the Shareholders' Agreement to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested \$17.0 million in each of 2007, 2008 and 2009 and \$8.0 million in each of 2010, 2011 and 2012. In December 2017, \$22.5 million (2016 - \$23.4 million) was withdrawn to fund a portion of capital expenditures. Hydro has recorded its 65.8% proportionate share of the amount withdrawn \$14.8 million (2016 - \$15.4 million). As per the terms of the Shareholders' Agreement, these funds will be replaced over a five year period beginning in 2018.

This fund must remain in place until the end of the Shareholders' Agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holdings consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 and 2 Canadian Chartered Banks.

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Hydro's proportionate share of the reserve fund consists of the following:

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Reserve fund, beginning of year	15	31
Principal withdrawals	(15)	(15)
Earnings withdrawn	-	(1)
Reserve fund, end of year	-	15
Less: current portion	-	(5)
	-	10

Hydro's proportionate share of reserve fund contributions due for the next five years are as follows:

<i>(millions of Canadian dollars)</i>	2018	2019	2020	2021	2022
Reserve fund contributions	12	12	12	6	6

- (c) As at December 31, 2017, sinking funds include \$190.2 million (2016 - \$267.0 million) related to repayment of Hydro's long-term debt. Sinking fund investments consist of bonds, debentures, short-term borrowings and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2022 to 2033.

Hydro debentures, which are intended to be held to maturity, are deducted from debt while all other sinking fund investments are shown separately on the Consolidated Statement of Financial Position as assets. Annual contributions to the various sinking funds are in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 2.57% to 6.82% (2016 – 0.97% to 9.12%).

The sinking funds consist of the following:

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Sinking funds, beginning of year	267	243
Contributions	7	8
Disposals and maturities	(95)	-
Earnings	22	12
Mark-to-market adjustment	(11)	4
Sinking funds, end of year	190	267
Less: current portion	-	(75)
	190	192

Sinking fund installments due over the next five years are as follows:

<i>(millions of Canadian dollars)</i>	2018	2019	2020	2021	2022
Sinking fund installments	7	7	7	7	7

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12. LONG-TERM INVESTMENTS

<i>As at December 31 (millions of Canadian dollars)</i>	Year of Maturity	2017	2016
\$28.0 million Long-Term Redeemable Guaranteed Investment Certificate (GIC), with interest paid at 1.40%	2019	18	18
\$23.6 million Long-Term Redeemable GIC, with interest paid at 1.46%	2019	16	16
		34	34

Hydro recorded its 65.8% proportionate share of the \$51.6 million GIC purchased by Churchill Falls in 2016 for a total of \$34.0 million.

13. REGULATORY DEFERRALS

<i>As at December 31 (millions of Canadian dollars)</i>		January 1 2017	Reclass & Disposition	Regulatory Activity	December 31 2017	Remaining Recovery Settlement Period (years)
Regulatory asset deferrals						
2014 cost deferral	(a)	39	(38)	(1)	-	n/a
2015 cost deferral	(b)	25	(28)	3	-	n/a
2016 cost deferral	(c)	32	(36)	4	-	n/a
Deferred energy conservation costs	(e)	8	-	1	9	n/a
Deferred foreign exchange on fuel	(f)	-	-	(1)	(1)	n/a
Deferred lease costs	(g)	5	-	(1)	4	3.4
Energy supply deferral	(j)	-	31	21	52	n/a
Foreign exchange losses	(k)	54	-	(2)	52	24.0
Phase Two hearing costs	(q)	1	-	-	1	n/a
Other	(d,m)	-	-	-	-	n/a
		164	(71)	24	117	
Regulatory liability deferrals						
Insurance amortization and proceeds	(n)	(4)	-	1	(3)	n/a
Labrador refund	(o)	-	(1)	-	(1)	2.0
Rate stabilization plan (RSP)	(r)	(344)	203	66	(75)	n/a
Other	(h)	-	-	-	-	n/a
		(348)	202	67	(79)	

NEWFOUNDLAND AND LABRADOR HYDRO
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13.1 Regulatory Adjustments Recorded in the Consolidated Statement of Profit and Comprehensive Income

<i>For the year ended December 31 (millions of Canadian dollars)</i>		2017	2016
RSP amortization		(53)	(40)
RSP fuel deferral		(19)	42
RSP interest		9	25
Rural rate adjustment		(3)	(8)
Total RSP activity	(r)	(66)	19
2014 cost deferral	(a)	1	8
2015 cost deferral	(b)	(3)	2
2016 cost deferral	(c)	(4)	(32)
Amortization of deferred foreign exchange losses	(k)	2	2
Deferred energy conservation	(e)	(1)	(1)
Deferred foreign exchange on fuel	(f)	1	1
Deferred lease costs	(g)	1	1
Energy supply deferral	(j)	(21)	-
Fuel supply deferral	(l)	-	1
Insurance amortization and proceeds	(n)	(1)	(1)
Non-Customer contributions in aid of construction	(p)	(1)	-
Phase Two hearing costs	(q)	-	(1)
Other	(d,h,i,m,o)	-	-
		(92)	(1)

The following section describes Hydro's regulatory assets and liabilities which will be, or are expected to be, reflected in customer rates in future periods and have been established through the rate setting process. In the absence of rate regulation, these amounts would be reflected in operating results in the year and profit or loss for 2017 would have decreased by \$91.9 million (2016 – a decrease of \$0.8 million).

13.(a) 2014 Cost Deferral

In Board Order No. P.U. 22 (2017), the Board approved \$37.7 million of the \$38.7 million 2014 cost deferral, resulting in a loss in 2017 of \$1.0 million (2016 - \$8.0 million loss), and the disposition of the deferral balance from the RSP.

13.(b) 2015 Cost Deferral

In Board Order No. P.U. 22 (2017), the Board approved \$27.7 million of the 2015 cost deferral, resulting in a gain in 2017 of \$3.2 million (2016 - \$1.6 million loss), and the disposition of the deferral balance from the RSP.

13.(c) 2016 Cost Deferral

The 2016 cost deferral of \$32.4 million consisted of energy supply costs of \$31.0 million and other costs of \$1.4 million. As a result of Board Order No. P.U. 22 (2017), \$31.0 million was re-classified to the energy supply deferral. The Board also approved other 2016 costs of \$5.0 million, which resulted in an increase in profit or loss of \$3.6 million in 2017, and the disposition of the deferral balance from the RSP.

13.(d) Asset Disposal

As per Board Order No. P.U. 49 (2016), the PUB ordered that Hydro recognize a regulatory asset of \$0.4 million related to the Sunnyside transformer that was disposed of in 2014. Hydro is required to recover the deferred asset in rate base and amortize the asset for 22.4 years commencing in 2015. Hydro is required to exclude the new Sunnyside transformer from rate base until the Sunnyside Transformer Original Asset Deferral has been fully amortized.

13.(e) Deferred Energy Conservation

In 2017, Hydro deferred \$1.5 million (2016 - \$1.1 million) in the Energy Conservation Costs regulatory asset associated with an electrical conservation program for residential, industrial, and commercial sectors. In addition, as per Board Order No. P.U. 22 (2017), Hydro recovered \$0.5 million (2016 – \$nil) of the balance through a rate rider.

13.(f) Deferred Foreign Exchange on Fuel

Hydro purchases a significant amount of fuel for Holyrood Thermal Generating Station (HTGS) in USD. The RSP allows Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2017, Hydro recognized in regulatory assets, foreign exchange gains on fuel purchases of \$0.4 million (2016 - \$0.9 million gain).

13.(g) Deferred Lease Costs

In 2017, pursuant to Board Order No. P.U. 38 (2013), Board Order No. P.U. 17 (2016) and Board Order No. P.U. 23 (2016), Hydro deferred lease costs of \$nil (2016 - \$1.6 million) for diesel units and other necessary infrastructure to ensure black start capability at the HTGS. In Board Order No. P.U. 17 (2016), Board Order No. P.U. 23 (2016) and Board Order No. P.U. 49 (2016) the Board approved the amortization of diesel units at HTGS over a period of five years. In 2017, Hydro recorded amortization of \$1.3 million (2016 - \$2.2 million) of the deferred lease costs.

13.(h) Deferred Purchased Power Savings

In 1997, the PUB ordered Hydro to defer \$1.1 million related to reduced purchased power rates resulting from the interconnection of communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system and amortize the balance over a 30 year period. The remaining unamortized savings in the amount of \$0.4 million (2016 - \$0.4 million) are deferred as a regulatory liability.

13.(i) Employee Future Benefits Actuarial Loss

Pursuant to Board Order No. P.U. 36 (2015), Hydro has recognized the amortization of employee future benefit actuarial gains and losses in net income. During 2017, Hydro recorded \$0.1 million (2016 - \$0.2 million) employee future benefits losses as a regulatory adjustment. In the absence of rate regulation, IFRS would require Hydro to include employee future benefits actuarial gains and losses in other comprehensive income. As a result, during 2017 Hydro also recorded a decrease of \$0.1 million (2016 - \$0.2 million) to other comprehensive income to recognize the amount that was reclassified to profit or loss.

13.(j) Energy Supply Deferrals

Pursuant to Board Order No. P.U. 22 (2017), the Board approved the deferral of Energy Supply deferrals which includes the Energy Supply, Holyrood Conversion and Isolated Systems Supply deferral. The recovery of the deferral is subject to future Board order. In 2017, \$31.0 million relating to energy supply deferred for the periods 2015-2016 was re-classified from the 2016 Cost deferral to the Energy Supply deferral. The net increase to profit or loss in 2017 was \$21.3 million.

13.(k) Foreign Exchange Losses

In 2002, the PUB ordered Hydro to defer realized foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt and amortize the balance over a 40 year period. Accordingly, these costs were recognized as a regulatory asset. During 2017, the amortization of \$2.2 million (2016 - \$2.2 million) reduced regulatory assets.

13.(l) Fuel Supply Deferral

Pursuant to Board Order No. P.U. 56 (2014), Hydro received approval in 2014 to defer \$9.6 million as a regulatory asset in additional capacity related supply costs incurred during the three months ended March 31, 2014. As per Board Order No. P.U. 13 (2016) and Board Order No. P.U. 49 (2016), Hydro recorded a reduction of \$1.5 million in 2016 based upon the results of a Prudence Review. In 2016, as per Board Order No. P.U. 49 (2016), the remaining balance of \$8.1 million was re-classified to the 2014 Cost Deferral.

13.(m) Hearing Costs

As per Board Order No. P.U. 49 (2016), the Board approved \$0.8 million in hearing costs to be deferred and amortized over a three year period commencing 2015. In 2017, Hydro recorded amortization of \$0.3 million (2016 - \$0.5 million).

13.(n) Insurance Amortization and Proceeds

Pursuant to Board Order No. P.U. 13 (2012), Hydro records net insurance proceeds against the capital costs and amortizes the balance over the life of the asset. Under IFRS, Hydro is required to recognize the insurance proceeds and corresponding amortization in regulatory liabilities. During 2017, Hydro recorded a decrease to regulatory liabilities resulting from amortization of \$0.5 million (2016 - \$0.6 million) related to the assets.

13.(o) Labrador Refund

Pursuant to Board Order No. P.U. 22 (2017), during 2017 Hydro refunded Labrador Industrial Transmission customers' excess revenues relating to the period of 2014 to 2017. The PUB also ordered that Hydro apply a rate reduction for a 30-month period to address excess revenues relating to Hydro's rural customers on the Labrador Interconnected System. In July 2017, Hydro began the amortization of excess revenues which resulted in a decrease to profit of \$0.5 million (2016 – \$nil).

13.(p) Non-Customer Contributions in Aid of Construction

Pursuant to Board Order No. P.U. 1 (2017), Hydro recognized amortization of deferred contributions in aid of construction (CIAC) from entities which are not customers in profit or loss. During 2017, Hydro recorded \$1.1 million (2016 - \$0.1 million) non-customer CIAC amortization as a regulatory adjustment. In the absence of rate regulation, IFRS requires non-customer CIACs to be recorded as contributed capital with no corresponding amortization. As a result, during 2017 Hydro also recorded an increase of \$1.1 million (2016 - \$0.1 million) to contributed capital to recognize the amount that was reclassified to profit or loss.

13.(q) Phase Two Hearing Costs

Pursuant to Board Order No. P.U. 13 (2016), Hydro received approval to defer consulting fees, salary transfers and overtime relating to Phase Two of the investigation into the reliability and adequacy of power on the Island Interconnected system after the interconnection with the Muskrat Falls generating station. As a result, Hydro recorded a regulatory asset of \$0.3 million (2016 - \$0.9 million).

13.(r) RSP

In 1986, the PUB ordered Hydro to implement the RSP which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, hydrology and load and associated interest. Additionally, the RSP also includes costs associated with the island interconnected and isolated systems. Adjustments required in utility rates to cover the amortization of the balance are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year. On June 30, 2017, the PUB approved rates for Hydro's Island Interconnected and Rural customers in Board Order No. P.U. 25 (2017).

During 2017, Hydro recorded a net decrease in regulatory liabilities of \$269.4 million (2016 - increase of \$19.0 million) resulting in an RSP ending balance for 2017 of \$74.2 million (2016 - \$343.6 million). The decrease in the RSP balance is primarily caused by the RSP surplus payout, the disposition of the 2014-2016 Cost Deferrals and GRA related payments, and the normal operation of the RSP. As per Board Order P.U. 36 (2016), the RSP was reduced by \$130.8 million relating to the refund of the utility surplus balance. The reduction was comprised of \$128.8 million refund to customers and \$2.0 million in administrative costs. The remaining portion of the utility surplus balance is \$12.6 million (2016 - \$143.4 million). As per Board Order No. P.U. 22 (2017) and Board Order No. P.U. 24 (2017), the Board approved a \$72.4 million recovery of the 2014-2016 Cost Deferrals and other GRA related payments through the RSP. The normal operation of the RSP resulted in an increase to net income of \$66.2 million (2016 – decrease of \$19.0 million).

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14. TRADE AND OTHER PAYABLES

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Trade payables	131	113
Accrued interest payable	24	27
Payables due to related parties	8	13
Other payables	26	21
	189	174

As at December 31, 2017 trade and other payables included balances of \$18.6 million (2016 - \$8.4 million) denominated in USD.

15. DEBT

15.1 Short-term Borrowings

On July 27, 2017 Hydro converted its \$50.0 million demand operating facility, to a \$200.0 million CAD or USD equivalent committed revolving term credit facility, with a maturity date of July 27, 2019. As at December 31, 2017 there were no amounts drawn on the facility (2016 - \$nil). Borrowings in CAD may take the form of Prime Rate Advances, Bankers' Acceptances (BAs), and letters of credit, with interest calculated at the Prime Rate or prevailing Government BA fee. Borrowings in USD may take the form of Base Rate Advances, London Interbank Offer Rate (LIBOR) Advances and letters of credit. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate.

On September 29, 2017 Hydro renewed an intercompany loan with Nalcor in the amount of \$225.0 million to Hydro. This loan will mature on March 30, 2018 and has an interest rate of 1.845%.

In addition, Hydro utilized its government guaranteed promissory note program to fulfil its short-term funding requirements. As at December 31, 2017, there were \$144.0 million in promissory notes outstanding with a maturity date of January 3, 2018 bearing an interest rate of 1.13% (2016 - \$210.0 million bearing an interest rate of 0.63%). Upon maturity, a promissory note was reissued in the amount of \$155.0 million with a maturity date of January 16, 2018 bearing an interest rate of 1.17%.

<i>As at (millions of Canadian dollars)</i>	2017	2016
Promissory notes - borrowed from Nalcor	225	225
Promissory notes - borrowed from external markets	144	210
	369	435

Churchill Falls maintains a \$10.0 million CAD or USD equivalent unsecured demand operating credit facility with its primary banker. There were no amounts drawn on this facility as at December 31, 2017 (2016 - \$nil), however \$1.0 million of the borrowing limit has been used to issue irrevocable letters of credit (2016 - \$1.0 million). Borrowings in CAD may take the form of Prime Rate Advances, BAs, or letters of credit, with interest calculated at the Prime Rate or prevailing Government BA fee. Borrowings in USD may take the form of Base Rate Advances. The facility also provides coverage for overdrafts on Churchill Falls bank accounts, with interest calculated at the Prime Rate. Churchill Falls has issued three irrevocable letters of credit, totalling \$2.0 million, to ensure satisfactory management of its waste management and compliance with a certificate of approval for the transportation of special hazardous wastes granted by the Department of Environment and Conservation.

NEWFOUNDLAND AND LABRADOR HYDRO
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15.2 Long-term Debt

The following table represents the value of long-term debt measured at amortized cost:

<i>As at December 31 (millions of Canadian dollars)</i>	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2017	2016
Hydro						
X*	150	10.25	1992	2017	-	150
Y*	300	8.40	1996	2026	295	295
AB*	300	6.65	2001	2031	305	306
AD*	125	5.70	2003	2033	124	124
AF	500	3.60	2014/2017	2045	480	197
1A	300	3.70	2017	2048	330	-
Total	1,675				1,534	1,072
Less: Sinking fund investments in own debentures					45	57
					1,489	1,015
Less: maturities of debentures due within one year					-	150
Less: sinking fund payments due within one year					7	7
Less: maturities of sinking funds in own debentures					-	(14)
Total					1,482	872

*Sinking funds have been established for these issues.

**Hydro's V Series debentures had a balance of \$0.2 million outstanding as at December 31, 2017.

Hydro's promissory notes and debentures are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province, with exception of Series 1A and promissory notes borrowed from Nalcor. The Province charges Hydro a guarantee fee of 25 basis points annually on the total debt (net of sinking funds) with a remaining term to maturity of less than or equal to 10 years and 50 basis points annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years for debt outstanding as of December 31, 2010. For debt issued subsequent to December 31, 2010, the guarantee rate is 25 basis points annually on the total debt (net of sinking funds) with an original term to maturity of less than or equal to 10 years and 50 basis points annually on total debt (net of sinking funds) with an original term to maturity greater than 10 years. The guarantee fee charged by the Province for the year ended December 31, 2017 was \$4.1 million (2016 - \$4.5 million).

On January 20, 2017, Hydro issued new long-term debt through the reopening and sale of \$300.0 million of Series AF debentures to its underwriting syndicate. The debentures mature on December 1, 2045 with a coupon rate of 3.60% paid semi-annually.

On July 14, 2017 Hydro's \$150.0 million long-term debt, Series X, matured. Sinking fund disposals during the year in the amount of \$95.1 million were used to offset the Series X maturity.

On December 20, 2017, Hydro issued new long-term debt, Series 1A, with face value of \$300.0 million. The Province of Newfoundland and Labrador issued debt specifically on Hydro's behalf and lent the proceeds to Hydro. The debt matures on October 17, 2048 with a coupon rate of 3.70% paid semi-annually.

On January 3, 2018, Hydro reissued a promissory note in the amount of \$155.0 million with a maturity date of January 16, 2018 bearing an interest rate of 1.17%.

NEWFOUNDLAND AND LABRADOR HYDRO
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16. DEFERRED CONTRIBUTIONS

Hydro has received contributions in aid of construction of property, plant and equipment. These contributions are deferred and amortized to other revenue over the life of the related property, plant and equipment asset.

<i>As at (millions of Canadian dollars)</i>	2017	2016
Deferred contributions, beginning of year	14	13
Additions	1	2
Amortization	(2)	(1)
Deferred contributions, end of year	13	14
Less: current portion	(1)	(1)
	12	13

17. DECOMMISSIONING LIABILITIES

Hydro has recognized liabilities associated with the retirement of portions of the HTGS and the disposal of Polychlorinated Biphenyls (PCB).

The reconciliation of the beginning and ending carrying amounts of decommissioning liabilities for December 31, 2017 and December 31, 2016 are as follows:

<i>As at (millions of Canadian dollars)</i>	2017	2016
Decommissioning liabilities, beginning of year	16	29
Liabilities settled	-	(1)
Accretion	-	1
Revisions	(1)	(13)
Decommissioning liabilities, end of year	15	16

The total estimated undiscounted cash flows required to settle the HTGS obligations as at December 31, 2017 are \$15.2 million (2016 - \$15.2 million). In 2016, the HTGS decommissioning obligation decreased primarily due to an updated assumption that Holyrood will be used as an industrial site for the foreseeable future because of the operation of assets such as the Holyrood CT and the black start diesels. Payments to settle the liability are expected to occur between 2020 and 2023. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at Hydro's credit adjusted risk free rate of 2.6% (2016 - 2.5%). Hydro has recorded \$13.5 million (2016 - \$13.4 million) related to HTGS obligations.

The total estimated undiscounted cash flows required to settle the PCB obligations as at December 31, 2017 are \$1.8 million (2016 - \$2.7 million). Payments to settle the liability are expected to occur between 2018 and 2025. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at Hydro's and Churchill Falls' credit adjusted risk free rates of 2.8% to 3.2%, respectively, (2016 - 2.9% to 3.7%). Hydro has recorded \$1.5 million (2016 - \$2.4 million) related to PCB obligations.

A significant number of Hydro's assets include generation plants, transmission assets and distribution systems. These assets can continue to run indefinitely with ongoing maintenance activities. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and, consequently, a reasonable estimate of the fair value of any related decommissioning liability cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is required to remove, a decommissioning liability for those assets will be recognized at that time.

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18. EMPLOYEE FUTURE BENEFITS

18.1 Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions for the year ended December 31, 2017 of \$9.8 million (2016 - \$9.0 million) are expensed as incurred.

18.2 Other Benefits

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a retirement allowance upon retirement. In 2017, cash payments to beneficiaries for its unfunded other employee future benefits were \$4.1 million (2016 - \$3.0 million). An actuarial valuation was performed as at December 31, 2017.

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Accrued benefit obligation, beginning of year	103	103
Current service cost	4	4
Interest cost	4	4
Benefits paid	(4)	(3)
Actuarial loss (gain)	3	(3)
Transfers and other	(1)	(2)
Accrued benefit obligation, end of year	109	103

When an employee transfers to a related party, the associated accrued benefit obligation is allocated to each respective party based on years of service.

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Component of benefit cost		
Current service cost	4	4
Interest cost	4	4
Total benefit expense for the year	8	8

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

	2017	2016
Discount rate - benefit cost	3.90%	4.10%
Discount rate - accrued benefit obligation	3.55%	3.90%
Rate of compensation increase	3.50%	3.50%

Assumed healthcare trend rates:

	2017	2016
Initial health care expense trend rate	6.00%	5.85%
Cost trend decline to	4.50%	4.50%
Year that rate reaches the rate it is assumed to remain at	2027	2025

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

<i>Increase (millions of Canadian dollars)</i>	2017	2016
Current service and interest cost	2	2
Accrued benefit obligation	18	17
<i>Decrease (millions of Canadian dollars)</i>	2017	2016
Current service and interest cost	(1)	(1)
Accrued benefit obligation	(14)	(13)

NEWFOUNDLAND AND LABRADOR HYDRO
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19. ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of, and changes in, accumulated other comprehensive income are as follows:

Items that may or have been reclassified to profit or loss:

<i>(millions of Canadian dollars)</i>	2017	2016
Available-for-sale financial instruments		
Balance at January 1	45	41
Net fair value (loss) gain during the year	(3)	14
Amounts reclassified to profit or loss	(8)	(10)
Balance at December 31	34	45

<i>(millions of Canadian dollars)</i>	2017	2016
Employee future benefits		
Balance at January 1	(19)	(22)
Net actuarial (losses) gains on defined benefit plans	(3)	3
Balance at December 31	(22)	(19)

20. SHAREHOLDER'S EQUITY

20.1 Share Capital

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Common shares of par value of \$1 each		
Authorized - 25,000,000		
Issued, paid and outstanding - 22,503,942	23	23

20.2 Contributed Capital

<i>As at December 31 (millions of Canadian dollars)</i>	2017	2016
Contributed capital, beginning of year	148	133
Additions	3	15
Amortization	(1)	-
Contributed capital, end of year	150	148

During 2017, the Churchill Falls (Labrador) Corporation Trust (the Trust) contributed capital in the amount of \$0.2 million (2016 - \$0.3 million). In addition, Lower Churchill Management Corporation (LCMC) contributed \$2.7 million (2016 - \$14.9 million) in additions to property, plant and equipment. Pursuant to Board Order No. P.U. 1 (2017), Hydro recognized \$1.1 million (2016 - \$0.1 million) in amortization as a regulatory adjustment.

20.3 Dividends

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Declared during the year		
Final dividend for prior year: \$0.02 per share (2016 - \$0.05)	1	1
Interim dividend for current year: \$0.28 per share (2016 - \$0.52)	6	12
	7	13

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21. OPERATING COSTS

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Salaries and benefits	108	105
Maintenance and materials	34	32
Professional services	8	9
Rental and royalty	4	5
Travel and transportation	6	5
Equipment rental	2	4
Other operating costs	13	13
	175	173

22. NET FINANCE EXPENSE

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Finance income		
Interest on sinking fund	12	14
Interest on reserve fund	-	1
Other interest income	2	1
	14	16
Finance expense		
Long-term debt	78	82
Debt guarantee fee	4	5
Accretion	1	1
Other	6	2
	89	90
Interest capitalized during construction	(11)	(4)
	78	86
Net finance expense	64	70

23. OTHER EXPENSE

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Loss on disposal of property, plant and equipment	8	7
Net change in PPA fair value (a)	-	-
Foreign exchange gain	(1)	-
Other	(1)	(1)
Other expense	6	6

(a) Net change in PPA fair value

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
PPA gains		
Settlement of realized profit	(42)	(38)
Mark-to-market of derivative	(9)	(23)
	(51)	(61)
PPA losses		
Amortization of deferral	51	61
	51	61
Net change in PPA fair value	-	-

NEWFOUNDLAND AND LABRADOR HYDRO
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24. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

24.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2017 and December 31, 2016 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions.

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

Establishing Fair Value

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

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. For assets and liabilities that are recognized at fair value on a recurring basis, Hydro determines whether transfers have occurred between levels in the hierarchy by reassessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. There were no transfers between Level 1, 2 and 3 fair value measurement for the years ended December 31, 2017 and December 31, 2016.

	Level	Category	Carrying Value December 31, 2017	Fair Value December 31, 2017	Carrying Value December 31, 2016	Fair Value December 31, 2016
<i>As at (millions of Canadian dollars)</i>						
Financial assets						
Sinking funds - investments in Hydro debt issue	2	HTM	45	56	57	71
Sinking funds - other investments	2	AFS	190	190	267	267
Reserve fund	2	AFS	-	-	15	15
Long-term receivables	2	L&R	-	-	1	1
Financial liabilities						
Derivative liabilities	3	FVTPL	31	31	51	51
Long-term debt (including amount due within one year before sinking funds)	2	OFL	1,534	1,848	1,072	1,334

The fair value of cash and cash equivalents, trade and other receivables, short-term borrowings and trade and other payables, approximates their carrying values due to their short-term maturity. The fair value of long-term investments approximates its carrying value due to the underlying nature of the investment.

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The fair values of Level 2 financial instruments are determined using quoted prices in active markets, which in some cases are adjusted for factors specific to the asset or liability. Level 2 derivative instruments are valued based on observable commodity future curves, broker quotes or other publicly available data. Level 2 fair values of other risk management assets and liabilities and long-term debt are determined using observable inputs other than unadjusted quoted prices, such as interest rate yield curves and currency rates.

Level 3 financial instruments include the derivative liability relating to the PPA with Nalcor Energy Marketing and represents the future value provided to Nalcor Energy Marketing through the contract.

The following table summarizes quantitative information about the valuation techniques and unobservable inputs used in the fair value measurement of Level 3 financial instruments as at December 31, 2017:

<i>(millions of Canadian dollars)</i>	Carrying Value	Valuation Techniques	Significant Unobservable Input(s)	Range
Derivative liability (PPA)	31	Modelled pricing	Volumes (MWh)	14-34% of available generation

The derivative liability arising under the PPA is designated as a Level 3 instrument as certain forward market prices and related volumes are not readily determinable to estimate a portion of the fair value of the derivative liability. Hence, fair value measurement of this instrument is based upon a combination of internal and external pricing and volume estimates. As at December 31, 2017, the effect of using reasonable alternative assumptions for volume inputs to valuation techniques may have resulted in a -\$2.2 million to a +\$3.9 million change in the carrying value of the power purchase derivative liability.

24.2 Risk Management

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

Credit Risk

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

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

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

	Issuer Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value of Portfolio (%)
	2017		2016	
Provincial Governments	AA- to AAA	-	AA- to AAA	0.41%
Provincial Governments	A- to A+	46.25%	A- to A+	43.86%
Provincially owned utilities	A- to A+	53.75%	A- to A+	48.88%
Schedule 1 Canadian banks	A- to A+	-	A- to A+	6.85%
		100.00%		100.00%

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

	Issuer Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value of Portfolio (%)
	2017		2016	
Provincial Governments	AA- to AAA	-	AA- to AAA	7.32%
Provincial Governments	A- to A+	-	A- to A+	30.63%
Schedule 1 Canadian banks	AA- to AAA	-	AA- to AAA	9.07%
Schedule 1 or 2 Canadian banks	A- to A+	-	A- to A+	52.98%
		-		100.00%

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

Hydro's exposure to credit risk on its energy sales and associated accounts receivable is determined by the credit quality of its customers. Hydro's three largest customers account for 81.9% (2016 - 82.7%) of total energy sales and 55.8% (2016 - 62.6%) of accounts receivable. Energy sales for the three largest customers include \$409.6 million (2016 - \$419.3 million) for regulated Hydro, as well as \$39.9 million (2016 - \$39.8 million) for Non-Regulated Hydro. Churchill Falls' exposure to credit risk on energy sales is limited, as Churchill Falls' main customer, Hydro-Québec is an investment grade utility.

Liquidity Risk

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

Short-term liquidity is mainly provided through cash and cash equivalents on hand, funds from operations, and a \$300.0 million (2016 - \$300.0 million) promissory note program. In addition, Hydro maintains a \$200.0 million (2016 - \$50.0 million) unsecured demand operating facility with its primary banker in order to meet any requirements beyond those forecasted for a given period. Churchill Falls also maintains a \$23.0 million (2016 - \$22.0 million) minimum cash balance, business interruption insurance, as well as a \$10.0 million (2016 - \$10.0 million) unsecured credit facility with its banker.

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Long-term liquidity risk for Hydro is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2026 to 2048. Sinking funds have been established for these issues, with the exception of the issues maturing in 2045 and 2048.

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

The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2017:

<i>(millions of Canadian dollars)</i>	<1 Year	1-3 Years	3-5 years	> 5 Years	Total
Trade and other payables	189	-	-	-	189
Short-term borrowings	369	-	-	-	369
Derivative liability	31	-	-	-	31
Long-term debt including sinking funds	7	13	13	1,492	1,525
Interest	81	163	163	1,026	1,433
	677	176	176	2,518	3,547

Market Risk

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

Interest Rates

Changes in prevailing interest rates will impact the fair value of financial assets and liabilities classified as held for trading or available-for-sale, which includes Hydro's cash and cash equivalents, short-term investments and sinking funds. Expected future cash flows associated with those financial instruments can also be impacted. The impact of a 0.5% change in interest rates on net income and other comprehensive income associated with cash and cash equivalents and short-term debt was negligible throughout 2017 due to the short time period to maturity. There was no impact on profit and other comprehensive income associated with long-term debt as all of Hydro's long-term debt has fixed interest rates.

The table below shows the impact of a 0.5% change in interest rates on other comprehensive income associated with the sinking funds and reserve fund as at December 31, 2017:

	Impact of Change in Rates on Other Comprehensive (Loss) Income	
	0.5% Decrease	0.5% Increase
<i>(millions of Canadian dollars)</i>		
Interest on sinking fund	9.5	(9.0)

Foreign Currency and Commodity Exposure

Hydro's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS, and these risks are mitigated through operation of the RSP.

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The components of the change impacting the carrying value of the derivative asset and derivative liability for the year ended December 31, 2017 are as follows:

<i>(millions of Canadian dollars)</i>	Level II	Level III	Total
Balance at January 1, 2017	-	(51)	(51)
Purchases	-	(31)	(31)
Changes in profit or loss			
Mark-to-market	-	9	9
Settlements	-	42	42
Total	-	51	51
Balance at December 31, 2017	-	(31)	(31)
 Balance, January 1, 2016	 2	 (61)	 (59)
Purchases	-	(51)	(51)
Changes in profit or loss			
Mark-to-market	-	23	23
Settlements	(2)	38	36
Total	(2)	61	59
Balance at December 31, 2016	-	(51)	(51)

25. RELATED PARTY TRANSACTIONS

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

Related Party	Relationship
Nalcor	100% shareholder of Hydro
Churchill Falls	Joint arrangement of Hydro
The Province	100% shareholder of Nalcor
Twin Falls	Joint venture of Churchill Falls
Energy Marketing	Wholly-owned subsidiary of Nalcor
Hydro Québec	34.2% shareholder of Churchill Falls
Labrador-Island Link Operating Corporation (LIL Opco)	Wholly-owned subsidiary of Nalcor
Lower Churchill Management Corporation	Wholly-owned subsidiary of Nalcor
Nalcor Energy – Bull Arm Fabrication Inc.	Wholly-owned subsidiary of Nalcor
Nalcor Energy – Oil and Gas Inc.	Wholly-owned subsidiary of Nalcor
PUB	Agency of the Province
The Trust	Created by the Province with Churchill Falls as the beneficiary

Routine operating transactions with related parties are settled at prevailing market prices under normal trade terms. Outstanding balances due to or from related parties are non-interest bearing with no set terms of repayment, unless otherwise stated.

- (a) On September 29, 2017 Hydro renewed an intercompany loan with Nalcor in the amount of \$225.0 million to Hydro. This loan will mature on March 30, 2018 and has an interest rate of 1.845%.
- (b) For the year ended December 31, 2017, Lower Churchill Management Corporation contributed \$2.7 million (December 31, 2016 - \$14.9 million) in additions to property, plant and equipment.
- (c) Hydro is required to incur the costs of operations, hearings and application costs of the PUB, including costs of any experts and consultants engaged by the PUB. During 2017, Hydro incurred \$1.8 million (2016 - \$1.3 million) in costs related to the PUB and has included \$3.0 million (2016 - \$2.1 million) in trade and other payables.

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- (d) As at December 31, 2017, Hydro has a payable to related parties of \$8.1 million (2016 - \$12.7 million) and a receivable from related parties for \$13.4 million (2016 - \$15.0 million). This payable/receivable consists of various intercompany operating costs and power purchases.
- (e) The debt guarantee fee for 2017 was \$4.1 million (2016 - \$4.5 million). It was paid to the Province on March 27, 2017.
- (f) For the year ended December 31, 2017, Hydro recovered \$2.2 million (2016 - \$3.2 million) of operating costs from related parties representing the provision of administrative services.
- (g) For the year ended December 31, 2017, Hydro incurred costs of \$3.9 million (2016 - \$3.7 million) in operating costs from related parties representing the provision for administrative services.
- (h) For the year ended December 31, 2017, Hydro has purchased \$26.3 million (2016 - \$25.2 million) of power generated from assets related to Exploits Generation, which are owned by the Province. In addition, Hydro operates these assets on behalf of Nalcor and recovered costs in the amount of \$21.9 million (2016 - \$29.1 million).
- (i) For the year ended December 31, 2017, Hydro has incurred intercompany labour expense of \$1.5 million (2016 - \$2.1 million) and recovered intercompany labour expense of \$1.4 million (2016 - \$2.1 million).
- (j) Hydro received \$0.8 million (2016 - \$0.9 million) from Nalcor associated with the Upper Churchill Redress Agreement to be used to reduce the electricity accounts of each residential Innu customer in Innu Communities or to Mushuau Innu First Nation.
- (k) Hydro recorded \$nil (2016 - \$0.2 million) as a rate subsidy for rural isolated customers from the Province and \$1.8 million (2016 - \$1.8 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan. As at December 31, 2017, there is a balance of \$0.6 million (2016 - \$1.3 million) outstanding in trade and other receivables.
- (l) Hydro received \$0.5 million (2016 - \$1.3 million) from other lines of business as a contribution in aid of construction for Information Systems assets.
- (m) During 2017, Churchill Falls generated revenue from Hydro-Québec of \$94.6 million (2016 - \$102.4 million) and Hydro has recognized its share of \$62.2 million (2016 - \$67.4 million).
- (n) Under the terms of the Lease and amendments thereto, Churchill Falls is required to pay the Province an annual rental of 8% of the consolidated net profits before income taxes and an annual royalty of \$0.50 per horsepower year generated, as defined in the Lease. At December 31, 2017, \$6.4 million (2016 - \$7.5 million) was payable to the Province. Hydro has recognized its share of \$4.2 million (2016 - \$4.9 million).
- (o) In February 3, 2010, the Province established the Trust with Churchill Falls as the beneficiary. The purpose of the Trust is to fund the external costs and expenses incurred in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. To date, \$5.6 million (2016 - \$5.3 million) has been received and \$nil (2016 - \$13.0 thousand) has been accrued as receivable from the Trust. Hydro has recognized its share of \$3.7 million (2016 - \$3.5 million) as received and \$nil (2016 - \$8.6 thousand) accrued as receivable from the Trust.
- (p) As at December 31, 2017, Churchill Falls capacity penalty payable was \$0.4 million (2016 - \$0.4 million), of which Hydro has recorded its share of \$0.3 million (2016 - \$0.3 million). The capacity penalty relates to the supply of power to Hydro-Québec. Churchill Falls did not incur a capacity penalty in 2017 (2016 - \$nil).

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- (q) On December 20, 2017, Hydro issued new long-term debt, Series 1A, with face value of \$300.0 million. The Province of Newfoundland and Labrador issued debt specifically on Hydro's behalf and lent the proceeds to Hydro.

25.1 Key Management Personnel Compensation

Compensation for key management personnel, which Hydro defines as its executives who have the primary authority and responsibility for planning, directing and controlling the activities of the entity, includes compensation for senior executives. Salaries and employee benefits include base salaries, performance contract payments, vehicle allowances and contributions to employee benefit plans. Post-employment benefits include contributions to the Province's Public Service Pension Plan in the amount of \$0.2 million (2016 - \$0.1 million).

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2017	2016
Salaries and employee benefits	2	1

26. COMMITMENTS AND CONTINGENCIES

- (a) Hydro has received claims instituted by various companies and individuals with respect to power delivery claims and other miscellaneous matters. Although the outcome of such matters cannot be predicted with certainty, Management believes that Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, is not expected to materially affect its financial position.
- (b) Outstanding commitments for capital projects total approximately \$54.4 million as at December 31, 2017 (2016 - \$153.1 million).
- (c) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	Effective Date	Term
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
Wind	300 kW	2010	Continual
Hydroelectric	175 kW	2017	15 years

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

<i>(millions of Canadian dollars)</i>	2018	2019	2020	2021	2022
Power purchases	30.7	31.9	32.5	32.6	32.7

- (d) Through a power purchase agreement signed October 1, 2015, with Energy Marketing, Hydro maintains the transmission services contract it entered into with Hydro Québec TransÉnergie which concludes in 2024.

The transmission rental payments for the next five years are estimated to be as follows:

2018	\$21.0 million
2019	\$21.3 million
2020	\$21.5 million
2021	\$21.7 million
2022	\$21.9 million

- (e) In August 2016, Churchill Falls received judgment from the Québec Court of Appeal upholding the 2014 Québec Superior Court ruling on the motion filed by Churchill Falls to address the inequities of the pricing terms of the 1969 Power Contract between Churchill Falls and Hydro-Québec. The Court ruled against Churchill Falls and the ruling requires Churchill Falls to pay court costs of \$1.4 million to Hydro-Québec. In April 2017, Churchill Falls was granted leave to appeal the case to the Supreme Court of Canada, the case was presented in December 2017 and a final ruling is anticipated some time in 2018.
- (f) In August 2016, Churchill Falls received judgment from the Québec Superior Court regarding a Motion for Declaratory Judgment filed by Hydro-Québec relating to the interpretation of the 1969 Power Contract between Churchill Falls and Hydro-Québec and the associated Renewal Contract. The Court ruled in favour of Hydro-Québec and the ruling requires Churchill Falls to pay court costs of approximately \$0.4 million to Hydro-Québec. Churchill Falls has filed a Notice of Appeal with the Québec Court of Appeal. The date of the appeal hearing has not yet been set but it is anticipated that it will be scheduled for some time in 2018.
- (g) In 2013, Hydro entered into a Power Purchase Agreement with Muskrat Falls for the purchase of energy and capacity from the Muskrat Falls Plant. The supply period under the agreement is 50 years and commences at the date of commissioning of the Muskrat Falls Plant. Estimated payments for the next five years have not yet been determined.
- (h) In 2013, Hydro entered into the Transmission Funding Agreement (TFA) with LIL Opco, in which Hydro has committed to make payments which will be sufficient for LIL Opco to recover all costs associated with rent payments under the LIL Lease and payments to cover operating and maintenance costs incurred by LIL Opco. Hydro will be required to begin mandatory payments associated with the TFA upon commissioning of the Lower Churchill Project assets. The term of the TFA is anticipated to continue until the service life of the LIL assets has expired.
- (i) In 2014, Hydro entered into three Capacity Assistance Agreements, one with Vale Newfoundland & Labrador Limited (Vale) and two with Corner Brook Pulp and Paper Limited (CBPP) for the purchase of relief power during the winter period. In 2016, Hydro also entered into two new Capacity Assistance Agreements, one with Praxair and a second agreement with Vale for the purchase of relief power. The agreements with Vale and Praxair have a supply period defined as December 1 to March 31 for each contract year, concluding March 2018. In November 2017, Hydro entered into a revised agreement with CBPP that expires the earlier of April 30, 2022 or the commissioning of the Muskrat Falls plant. Payment for services will be dependent on the successful provision of capacity assistance for the winter period by Vale, CBPP and Praxair.

27. CAPITAL MANAGEMENT

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

The capital managed by Hydro is comprised of debt (long-term debentures, short-term borrowings, bank credit facilities and bank indebtedness) and equity (share capital, shareholder contributions, reserves and retained earnings).

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A summary of the capital structure is outlined below:

<i>(millions of Canadian dollars)</i>	2017		2016	
Debt				
Sinking funds	(190)		(267)	
Short-term borrowings	369		435	
Current portion of long-term debt	7		143	
Long-term debt	1,482		872	
	1,668	63.6%	1,183	56.7%
Equity				
Share capital	23		23	
Contributed capital	150		148	
Reserves	12		26	
Retained earnings	768		706	
	953	36.4%	903	43.3%
Total Debt and Equity	2,621	100.0%	2,086	100.0%

27.1 Hydro

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

For the regulated portion of Hydro's operations, Management targets a capital structure comprised of 75% debt and 25% equity, a ratio which Management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, shareholder contributions and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of the PUB. Hydro's committed operating facility has a covenant restricting the issuance of debt such that consolidated debt to total capitalization ratio cannot exceed 85%. As at December 31, 2017, Hydro was in compliance with this covenant.

Legislation stipulates that the total of the Government guaranteed short-term loans issued by Hydro and outstanding at any time shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at \$300.0 million and \$144.0 million is outstanding as at December 31, 2017 (2016 - \$210.0 million). Issuance of short-term borrowings and long-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both short-term and long-term debt to \$2.1 billion at any point in time.

Historically, Hydro addressed longer-term capital funding requirements by issuing government guaranteed long-term debt in the domestic capital markets. However, in December 2017, Hydro changed its process to one whereby the Province issues debt specifically on Hydro's behalf and lends the proceeds to Hydro. The Province authorized funding up to \$700.0 million, which includes \$225.0 million to repay an outstanding promissory note to the Province through Nalcor, due March 31, 2018. As at December 31, 2017, \$300.0 of the \$700.0 million authorized had been issued.

27.2 Churchill Falls

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

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

Churchill Falls has issued three irrevocable letters of credit totaling \$2.0 million (2016 - \$2.0 million), \$1.0 million of which does not impact the borrowing limit of the operating credit facility (2016 - \$1.0 million). The letters of credit ensure satisfactory management of its waste management system and compliance with a certificate of approval for the transportation of special and hazardous wastes, granted by the Provincial Department of Environment and Conservation.

28. SUPPLEMENTARY CASH FLOW INFORMATION

<i>For the period ended December 31 (millions of Canadian dollars)</i>	2017	2016
Trade and other receivables	(29)	(11)
Inventories	(17)	(11)
Prepayments	(1)	1
Trade and other payables	15	40
Changes in non-cash working capital balances	(32)	19
Related to:		
Operating activities	(38)	(9)
Investing activities	6	28
	(32)	19

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29. SEGMENT INFORMATION

Hydro operates in four business segments. The operating structure as at December 31, 2017 reflects organizational changes that resulted in revised operating segments effective January 1, 2017. The designation of segments is based on a combination of regulatory status and management accountability. Previously reported segmented information has been presented to conform with the current operating structure.

Hydro Regulated activities encompass sales of electricity to customers within the Province that are regulated by the PUB. Hydro Non-Regulated activities include the sale of recapture energy, purchased from Churchill Falls, to mining operations in Labrador West as well as costs of Hydro that are excluded from the determination of customer rates. Churchill Falls operates a hydroelectric generating facility which sells electricity to Hydro-Québec and Hydro. Energy Marketing includes the sale of electricity and transmission to Nalcor Energy Marketing.

	Hydro Regulated	Churchill Falls	Energy Marketing	Non-Regulated Activities	Inter- Segment	Total
<i>(millions of Canadian dollars)</i>						
For the year ended December 31, 2017						
Energy sales	506	91	3	40	(4)	636
Other revenue	5	1	20	-	3	29
Revenue	511	92	23	40	(1)	665
Fuels	226	-	-	-	-	226
Power purchased	62	-	3	39	(3)	101
Operating costs	130	44	-	1	-	175
Transmission rental	-	-	20	-	-	20
Depreciation and amortization	78	18	-	-	-	96
Net finance expense (income)	65	(1)	-	-	-	64
Other expense	6	-	-	-	-	6
Expenses	567	61	23	40	(3)	688
Preferred dividends	-	(2)	-	-	2	-
(Loss) profit before regulatory adjustments	(56)	33	-	-	-	(23)
Regulatory adjustments	(92)	-	-	-	-	(92)
Profit for the year	36	33	-	-	-	69
Capital expenditures*	344	46	-	-	(1)	389
Total assets	2,605	592	32	18	-	3,247

*Capital expenditures include non-cash additions of \$2.7 million contributed by Lower Churchill Management Corporation.

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	Hydro Regulated	Churchill Falls	Energy Non-Regulated Marketing Activities	Inter- Segment	Total	
<i>(millions of Canadian dollars)</i>						
For the year ended December 31, 2016						
Energy sales	511	96	4	40	(3)	648
Other revenue	4	1	19	-	3	27
Revenue	515	97	23	40	-	675
Fuels	168	-	-	-	-	168
Power purchased	60	-	4	39	(4)	99
Operating costs	124	44	-	5	-	173
Transmission rental	-	-	19	-	-	19
Depreciation and amortization	68	17	-	-	-	85
Net finance expense (income)	71	(1)	-	-	-	70
Other expense	6	-	-	-	-	6
Expenses	497	60	23	44	(4)	620
Preferred dividends	-	(4)	-	-	4	-
Profit (loss) before regulatory adjustments	18	41	-	(4)	-	55
Regulatory adjustments	(1)	-	-	-	-	(1)
Profit (loss) for the year	19	41	-	(4)	-	56
Capital expenditures*	219	41	-	1	-	261
Total assets	2,442	560	57	-	-	3,059

*Capital expenditures include non-cash additions of \$14.9 million contributed by Lower Churchill Management Corporation.

30. SUBSEQUENT EVENT

On March 8, 2018, the Province of Newfoundland and Labrador issued long-term debt with a face value of \$300.0 million, specifically on Hydro's behalf. The debt matures on October 17, 2048 with a coupon rate of 3.70% paid semi-annually. Hydro expects to use a portion of the proceeds to repay the \$225.0 million intercompany loan with Nalcor.