



boundlessenergy



Key Accomplishments at a Glance

Safety

- Safety lead/lag ratio target met (ratio of safety observations to incidents).
- Safe Workplace Observation Program (SWOP) reporting increased by 15% with 6,636 safety observations.
- Hydro Work Protection Code updated and 75% of required personnel trained.
- 400 employees attended safety culture workshops.
- Hydro launched new public safety campaign - Back it Up.
- Hydro's Holyrood Plant awarded the Eastern Canada Boilermaker's Award for SWOP.

Environment

- ISO 14001 Environmental Management System certification maintained for Hydro and Churchill Falls.
- Switched to cleaner fuel at Holyrood Generating Station and further reduced some emissions by 30%.
- Island's two wind projects produced 154,377 megawatt hours, generating green energy for over 8,100 homes.
- First wind power and hydrogen produced from the Wind-Hydrogen-Diesel research and development project in Ramea.
- Filed Environmental Impact Statement for lower Churchill Generation and Environmental Assessment for Labrador-Island Transmission Link.
- New takeCHARGE energy efficiency rebate programs launched for Hydro's retail customers.

Business Excellence

- Corporate-wide asset management framework standardized and related organization design completed.
- Acquired interests in two offshore oil developments and became operator of drilling exploration program in western Newfoundland.
- Hydro achieved 91% retail customer service satisfaction rating, up from 89% in 2008.
- Agreement signed to wheel power from the Churchill Falls plant through Québec to the Canada-United States border.
- Water Management application submitted to Public Utilities Board to establish terms of a water management agreement between Nalcor and Churchill Falls Labrador Corporation (CFLCo) in preparation for the Lower Churchill Project.
- Requested Hydro-Québec renegotiate the pricing terms for the remainder of the 1969 Power Contract between CFLCo and Hydro-Québec for upper Churchill power.
- Hydro achieved 98% winter availability for key electricity generating assets.

People

- Employee recognition programs resulted in over 2,000 peer recognitions and nine employees presented with prestigious President's Awards.
- Recruitment and retention strategy completed.
- Employee Wellness Program, Wellness Works, developed and launched.

Community

- Awarded over \$40,000 in scholarships and endowments.
- Supported more than 30 organizations through Employee Matching and Volunteer Contribution Programs.
- Over 500 seniors attended safety workshops with Seniors Resource Centre, sponsored by Hydro.

Key Financial Highlights

Years ended December 31 (<i>millions of dollars</i>)	2009	2008
Revenues	572.6	570.3
Net income	60.0	82.2
Capital assets, net	2,095.5	1,975.5
Long-term debt	1,141.6	1,175.7
Shareholder's equity	1,142.0	934.5
Dividends	-	-
Debt to capital	47%	56%
Return on capital employed	7.7%	8.8%

Vision: Our vision is to build a strong economic future for successive generations of Newfoundlanders and Labradorians.

Values: At Nalcor Energy, our employees share a set of values that shape how we do business every day. Our core values set common direction on how to make decisions with a sense of pride and leadership. We recognize that it is not only what we achieve, but how we achieve it that truly makes us proud of our accomplishments. We believe our core values develop a culture based on high standards and expectations. We feel empowered to challenge the norms and seize new opportunities while working towards our corporate vision.

Nalcor Energy is a proud, diverse energy company, whose people are committed to building a bright future for Newfoundland and Labrador, unified by our core values.

Open Communication - Fostering an environment where information moves freely in a timely manner

Accountability - Holding ourselves responsible for our actions and performance

Safety - Relentless commitment to protecting ourselves, our colleagues and our community

Honesty and Trust - Being sincere in everything we say and do

Teamwork - Sharing our ideas in an open and supportive manner to achieve excellence

Respect and Dignity - Appreciating the individuality of others by our words and actions

Leadership - Empowering individuals to help guide and inspire others

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Message from the Chair



Nalcor Energy is taking its place as an energy leader for the people of this province.

The company continues to pursue energy related business opportunities. From the Lower Churchill Project, to new business developments and partnerships in the oil and gas sector, we have taken the necessary steps to position the company as a significant driver for economic growth in Newfoundland and Labrador.

In 2009, Nalcor Energy's Board of Directors continued its work to build a strong and sustainable company. Throughout the year, the Board continued to review Nalcor's performance, plan for the company's future and provide guidance through the Audit, Corporate Governance and Compensation Committees.

Our 2009 Business and Financial Report highlights our progress and performance on the company's business strategy. Our continued focus on our five corporate goals: safety, environmental performance, operational excellence, our people and the community, is reflected in our achievements. As we move into 2010, our Board of Directors will continue its focus on the long-term strategy and direction for the company.

As Nalcor pursues new opportunities in the energy sector, one of the Board's roles is to establish acceptable levels of risk and to ensure these opportunities are embodied within decisions and corporate policies that flow through the company. Prudent risk management is a key component of Nalcor's business operations and considered an ongoing process where business risks are continually assessed and practices refined.

Nalcor's Board of Directors has made a firm commitment to best governance practices but our commitment goes far beyond simply adhering to these standards. We view best governance practices as those encouraging each director to be well informed and highly engaged inside the company and in the business community at large.

The Board continues to demand transparency, accountability and the highest level of ethical conduct from all operations and activities. In early 2010, the company released its Code of Conduct, which applies to all employees and representatives of the company, including the Board.

I thank the employees of all Nalcor Energy companies for their tremendous dedication and contributions to our strong performance, and my fellow Board members for their efforts over the past year. We have a diverse Board membership of vast business experience and knowledge, who bring both commitment and guidance to our affairs.

I also thank our Shareholder, the Government of Newfoundland and Labrador, and particularly the Department of Natural Resources, for their continued support. Our Shareholder takes a long-term view, and supports our corporate vision and the sustainability and growth of our business. Realizing the full potential of our province's energy resources for Newfoundlanders and Labradorians is an exciting challenge that Nalcor Energy is positioned to achieve.

A handwritten signature in black ink that reads "John Ottenheimer". The signature is written in a cursive, slightly slanted style.

John Ottenheimer

Chair, Board of Directors

Message from the CEO



Despite tough economic times, our province is focused on its immense and diverse energy warehouse. There are successful developments in operation today and promising mega-projects on the horizon.

Nalcor Energy is leading the way forward. Our focus is to harness opportunities in a disciplined manner that is safe, well planned and executed, and provides the maximum benefit for Newfoundland and Labrador.

Our Commitment to Safety

Nalcor has one enduring priority – our relentless commitment to safety. In that spirit, we have implemented many initiatives to achieve sustained best-in-class safety performance.

In 2009, we introduced our Internal Responsibility System (IRS), which was developed in concert with both International Brotherhood of Electrical Workers (IBEW) locals, and builds on our Safety Credo. I commend our labour leaders for their continued vision, focus and alignment on safety. The IRS promotes personal responsibility for safety regardless of where we work in the company, from the front lines to the boardroom. Enhancements were also made to other elements of our safety program including the Work Protection Code, continued safety culture training for employees and improvements to our contractor safety management program.

We are also very proud of a major safety milestone achieved in 2009. Our Holyrood Generating Station reached one million hours without a lost-time injury.

Holyrood was also presented with a safety award at the Boilermaker's Eastern Canada Tripartite Conference for their participation in the Nalcor-wide Safe Workplace Observation Program.

Our safety journey is one of persistence and commitment. In 2009, we met our lead/lag ratio and most areas of the company achieved sustained safety performance with zero incidents. Although we reduced the number of workplace incidents last year, we had targeted a greater improvement. We are striving for sustained safety performance and recognize this takes time, significant effort and a relentless commitment. Our safety programs are in place and our commitment to safety is unwavering.

Operational Excellence

With our asset base, a strategic focus on asset management is a key success factor for Nalcor Energy and its subsidiaries. In 2009, we consolidated our practices into a common asset management framework that will facilitate first-class management of our assets and will be critical in maintaining business continuity and excellence as we pursue new opportunities. We are pressing forward with our focus on asset management excellence, which is a critical component to continue meeting the demands of our customers and stakeholders.

Growth and Sustainability

Nalcor Energy is a diverse and growing company. For decades, our electricity businesses, Hydro and Churchill Falls, have been responsible for the generation and transmission of safe, reliable, electrical power. Now, we are building on the operational excellence and growth potential of our five lines of business to position Nalcor for future energy developments and growth.

Hydro: Hydro's business strategy is to manage its assets to optimize total cost of operation and maintenance while delivering safe, reliable service. The company will continue to make significant investments in concert with its comprehensive, long-term asset management strategy. In 2009, Hydro invested \$54 million in its provincial electricity grid to ensure the continued reliability and safe operation for electricity customers.

Churchill Falls: Operational excellence is the keystone of Churchill Falls, with a focus on safety excellence, reliability and ensuring future generations benefit from this resource through long-term asset management. In 2009, the company completed significant repairs on two generating units. In November 2008, a fire caused extensive damage to two sets of high-voltage cables connecting two generating units. Repairs were completed on schedule in 2009, with one unit repaired and back in service in February, and the second unit back in service in October.

Oil and Gas: In 2009, our Oil and Gas division finalized the purchase of a five per cent working interest in the White Rose Growth Project. This was followed in early 2010 by the completion of the acquisition of a 10 per cent working interest in the Hibernia Southern Extension subsea tie-back project. We also acquired an average 67 per cent interest in three onshore exploration permits on the province's Northern Peninsula, signifying a significant step forward in the development of the province's oil and gas resources.

Lower Churchill Project: The lower portion of the Churchill River represents a tremendous opportunity for the production of over 3,000 megawatts of clean, renewable and affordable energy. In 2010, Nalcor and the Government of Newfoundland and Labrador finalized the agreements contemplated in the Tshash Petapen (New Dawn) Agreement reached in September 2008 with the Innu Nation of Labrador. These agreements include a provincial Innu Rights Agreement, the Upper Churchill Redress Agreement and the Lower Churchill Impacts and Benefits Agreement. The Lower Churchill Project reached other significant milestones in 2009, including the submission of the Environmental Impact Statement for the generation elements of the Project and the environmental registration of the Labrador-Island Transmission Link. Nalcor also submitted a Water Management application to the Public Utilities Board, and prepared for hearings before the Régie de l'énergie relating to issues surrounding our transmission applications through Québec.

Bull Arm Fabrication: In March 2009, Nalcor Energy became the owner and operator of the Bull Arm Fabrication Site. The facility is an important asset for the continued development of our province's fabrication industry. In the near term, we are preparing Bull Arm for the Hebron development, which is anticipated to use the site from 2011 to 2017. We are also focused, for the near future, on developing a long-term site strategy.

Shaping our Future

Nalcor is experiencing the challenge of an aging workforce base while also managing tremendous business growth. To ensure our long-term sustainability and success, employee retention and recruitment has been a key focus for the company. In 2009, Nalcor completed a recruitment and retention strategy to ensure the people and skill sets necessary to meet our corporate goals are in place and ready to grow with the company.

Our accomplishments in 2009 are a direct result of the quality, dedication and the deep commitment of our employees. Our people continue to focus their efforts to achieve the highest standards of performance in each of our business areas to position Nalcor Energy as a leader in the energy sector.

The Evolution of Nalcor Energy

From generating power, to partnerships in our oil and gas developments, and the expansion of our vast hydroelectric potential, our vision is to build a strong economic future for successive generations of Newfoundlanders and Labradorians, and we are taking steps towards this every day.

Working together, our potential for future success is truly boundless.



Ed Martin

President and CEO

Corporate Profile

Nalcor Energy's business includes the development, generation, transmission and sale of electricity; the exploration, development, production and sale of oil and gas; industrial fabrication; and energy marketing.

Focused on sustainable growth, the company is leading the development of the province's energy resources and has a corporate-wide framework which facilitates the prudent management of its assets while continuing an unwavering focus on the safety of its workers and the public.

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



Newfoundland and Labrador Hydro

Hydro's primary business is to generate and deliver electricity in Newfoundland and Labrador to utility, industrial, residential and commercial customers.

Churchill Falls

Nalcor's flagship operation in Churchill Falls is one of the largest underground hydroelectric powerhouses in the world, providing clean, renewable energy to millions of consumers throughout North America. The majority of that energy is sold to Hydro-Québec through a long-term power purchase agreement.

Oil and Gas

Nalcor holds offshore and onshore oil and gas interests in Newfoundland and Labrador. The company is a partner in three offshore developments and is the majority owner and operator of an onshore exploration program on the province's west coast.

Lower Churchill Project

The Lower Churchill Project is the most attractive undeveloped hydroelectric project in North America. The Project's two proposed installations at Gull Island and Muskrat Falls will have a combined capacity of over 3,000 megawatts and can provide 16.7 terawatt hours of electricity per year.

Bull Arm Fabrication

The Bull Arm Fabrication Site is Atlantic Canada's largest industrial fabrication site. This world-class facility spans over 2,560 hectares and has integrated and comprehensive infrastructure to support fabrication and assembly in three key project areas simultaneously.



Hydro

For more than 50 years, Hydro has generated and delivered safe, reliable, cost-effective power to utility and industrial customers, as well as residential customers in rural Newfoundland and Labrador.

A commitment to safety extends across all Nalcor Energy companies. In 2009, this dedication was demonstrated by the employees of Hydro's Holyrood Generating plant. In addition to achieving one million hours without a lost-time injury, the plant was presented with a safety award at the Boilermaker's Eastern Canada Tripartite Conference for participation in the company-wide Safe Workplace Observation Program (SWOP). SWOP began at Hydro in 2007, and has become a corporate-wide safety initiative at Nalcor. Focused on making the workplace safer and preventing major incidents, SWOP encourages reporting and fixing safety-related observations.

Creating a safer workplace for employees underlies Hydro's updated Work Protection Code (WPC), which is structured to meet the Canadian Standards Association's standard of practice. The WPC creates a consistently safe work environment that eliminates or controls hazards and requires all employees to approach potentially hazardous situations in the same way. In 2009, as planned, 75 per cent of required Hydro personnel were trained on the new WPC.

Hydro's commitment to safety extends beyond its employees to the public. For the second consecutive year, Hydro distributed its children's electrical safety book, "Why my Dad's job is so important" to all Grade 1 students across the province. A companion web page and SafetyWise pamphlet were also included this year.



In December 2009, Hydro launched a new public safety campaign called Back it Up. The campaign helps Newfoundland and Labrador residents make safer decisions at work and at home. To support the campaign, Hydro launched a website HydroSafety.ca, which provides tips and videos to help people learn more about being safe in their day-to-day lives. Hydro's commitment to promoting safety to employees, contractors and the public is demonstrated through programs like Back it Up.

A cornerstone of Hydro's business is its commitment to ensure consistent, efficient and effective asset management, from design to retirement. Hydro defines asset management as the comprehensive management of asset requirements, planning, procurement, operations, maintenance, rehabilitation, disposal and replacement to achieve maximum value for stakeholders based on the required standard of service to current and future generations. Hydro will continue to focus on rigorous asset management practices to ensure its infrastructure is in sound working order to meet customers' expectations for safe and reliable service.

The company recognizes that reliable electricity is an essential part of daily life. Significant annual investments are made to the provincial electricity system. In 2009, Hydro invested over \$54 million in capital upgrades focused on continued performance and improved reliability. The expenditure included some important projects in Labrador West, specifically, the preparation for an upgrade to the distribution system to improve reliability and meet growth demands in the area.

The reliability of the province's electrical system is of paramount importance to Hydro. The company must ensure a stable and reliable power supply during periods of peak customer demand, particularly in the winter months. In 2009, Hydro achieved nearly 98 per cent winter availability for its key electricity generating assets.

Hydro is demonstrating its commitment as an environmental leader. In 2009, in an effort to reduce emissions from burning fossil fuels, Hydro increased its renewable generation. Hydro has power purchase agreements for 54 megawatts of clean, renewable wind energy. The integration of wind power in Newfoundland has broadened Hydro's energy mix and allowed the company to continue providing electricity at a reasonable cost. Newfoundland's two wind projects produced enough green energy in 2009 to power over 8,100 homes - that's equivalent to burning 245,000 barrels of oil at the Holyrood thermal plant, and is a reduction of more than 122,000 tonnes of greenhouse gas emissions.

In addition to wind energy, Hydro took other steps in 2009 to improve its environmental performance and reduce emissions. In March, the company switched to a cleaner fuel at the Holyrood plant - from one per cent to 0.7 per cent sulphur fuel. The switch will further reduce the plant's sulphur emissions by 30 per cent.

To complement Hydro's environmental efforts, the company is educating customers about energy conservation. Hydro, with its partner and utility customer, Newfoundland Power, strengthened its takeCHARGE energy efficiency program in 2009. In June, new rebates for programmable thermostats, insulation, ENERGY STAR® windows and efficient commercial lighting were introduced. In 2010, takeCHARGE will increase its outreach activities through partner programs with construction and home building associations, businesses and municipalities.

Over the last five years, Hydro has maintained a consistently high retail customer satisfaction rating, and achieved 91 per cent satisfaction in 2009. The results of the satisfaction surveys are a testament to the top-quality service delivered by Hydro's employees across the province.

Hydro's commitment to its customers extends beyond customer service and into the community. Giving back to communities is a critical piece of Hydro's culture. Through its Community Investment Program, Hydro and its parent company, Nalcor Energy, support, educate and strengthen communities through charitable donations, youth scholarships, and the support of employee volunteerism.

Churchill Falls

Nalcor Energy – Churchill Falls, operates one of the largest underground powerhouses in the world. Eleven turbines harness the power of the massive Churchill River. With a capacity of 5,428 megawatts, this power is used by millions of consumers in North America. In 2009, more than 30 terawatt hours of renewable electricity was produced.

In 2009, Churchill Falls (Labrador) Corporation (CFLCo) requested that Hydro-Québec enter into discussions to amend the pricing terms for the remainder of the 1969 Power Contract. Hydro-Québec did not respond and therefore, in early 2010, CFLCo filed a motion against Hydro-Québec in the Québec Superior Court seeking to change, on a go forward basis, the pricing terms for the remaining term of the Power Contract to establish a fair and equitable return to both parties, under the provisions of the Québec Civil code which require parties to act in good faith in the execution of contracts.

Presently, the purchase price under the Power Contract is one-quarter of one cent per kilowatt hour and the automatic renewal clause fixes the purchase price at one-fifth of one cent for a 25-year period, beginning in 2016. This will mean that until 2041, for the remainder of the contract, power will be sold to Hydro-Québec for less than five per cent of its recent commercial value.

Since 1999, Churchill Falls has annually renewed a Guaranteed Winter Availability Contract (GWAC) with Hydro-Québec to maximize revenue from the Power Contract. This has focused Churchill Falls on delivering 100 per cent availability during the

months of November to March until the end of the Power Contract in 2041.

2009 was a challenging year at Churchill Falls as plant personnel worked to repair extensive fire damage to two sets of cables that occurred in November 2008. The fire occurred in a cable shaft at the Churchill Falls plant and the damaged cables resulted in two of the 11 generating units at the facility being unavailable. The reduction in generating capacity resulted in decreased GWAC revenue for the year. Employees at Churchill Falls dedicated themselves to getting the facility fully operational again and in late February 2009, one set of cables was repaired, which allowed one unit to be returned to service. Repairs to the second set of cables was completed in October 2009, returning the second unit to service. Planning and completing the repairs took a tremendous effort and commitment by employees allowing the plant to return to full commercial operation.

The business strategy for Churchill Falls focuses on operating, maintaining and investing in its assets to maximize long-term value while meeting all contractual obligations. Key factors of this strategy of operational excellence include the pillars of safety leadership, asset management and environmental stewardship.

Nalcor Energy is taking steps to ensure the continued performance of the Churchill Falls facilities through long-term asset management processes and strategic investment. Maintaining assets at the Churchill Falls Generating Station is critical to the company's ability to provide excellent service to customers over a long-term period and support business continuity.

In 2009, Churchill Falls employees reported an increased number of safety observations through the corporate-wide Safe Workplace Observation Program (SWOP) — a total of 2,140. SWOP significantly enhances the company's capability to analyze and correct health and safety issues in the workplace and is critical to preventing major or serious incidents. Employees in Churchill Falls are focused in their determination to create a safe workplace where everyone goes home safely to their families at the end of each work day.



Environmental performance is a commitment at Churchill Falls and ISO 14001 Certified Environmental Management Systems (EMS) govern its environmental activities. In 2009, Churchill Falls successfully completed 95 per cent of its EMS environmental targets and milestones. Throughout the year, the company continued to clean up construction debris on five large sites in the Twin Falls and Churchill Falls areas.

The Churchill River is a shared river system between the Churchill Falls Generating Station and the proposed lower Churchill hydroelectric development. Hydroelectric operators sharing a river system, as will be the case on the Churchill River, are required by the Electrical Power Control Act to enter into water management agreements to coordinate production.

Nalcor Energy applied to the Public Utilities Board (PUB) to establish the terms of an agreement between the two facilities. In March 2010, Nalcor received a successful decision from the PUB on its water management application.

Having such a water management agreement in place ensures production from both facilities is optimized and negative impacts are mitigated through the cooperation of both developments, ensuring the most efficient production, transmission and distribution of power possible.

Oil and Gas

Over the past three years, Nalcor Energy has experienced tremendous growth in its oil and gas business. Today, with working interests in three offshore developments and an onshore operatorship, the company is establishing the role it will play in this sector.

As the petroleum industry in Newfoundland and Labrador continues to flourish and mature, Nalcor itself continued to grow and expand.

In January 2009, Nalcor Energy finalized the purchase of a five per cent working interest in the oil resources contained within the White Rose Growth Project. The project includes the North Amethyst Field, West White Rose and South White Rose Extension.

This was followed in early 2010 by the completion of a 10 per cent working interest acquisition in the Hibernia Southern Extension subsea tie-back project; this includes two new licences, as well as an area of the main field covered by a separate licence. In addition to the Hibernia and White Rose projects, Nalcor is also a co-venturer in the Hebron oil field, holding a 4.9 per cent working interest in the province's fourth offshore oil project.

These oil and gas agreements reflect Nalcor's resolute determination to maximize the benefits that Newfoundland and Labrador receives from the development of its resources. Once in production, these projects will be significant contributors to the company's portfolio and will provide tremendous benefits and opportunities for the people of the province.

Nalcor's near-term strategy for growth in the oil and gas sector is to obtain equity positions in various stages of development. The company also recognizes that another key to advancing the province's oil and gas sector is to encourage additional exploration activity.

In August 2009, Nalcor Energy marked a significant step for the future development of the province's oil and gas resources as the company acquired an average 67 per cent gross working interest in three onshore exploration permits in the Parsons Pond area on the Great Northern Peninsula.

Nalcor Energy's exploration program on Newfoundland's west coast will provide access to new, valuable information about the province's natural resources. The program will provide a unique opportunity to better understand both the onshore and offshore potential in western Newfoundland. Nalcor hopes that improved prospectivity resulting from increased exploration activity in the region will stimulate other interest in the province's oil and gas potential in the west coast basin.

Because the program is exploration-based, there is considerable risk that no commercial quantities of hydrocarbons will be found. Nalcor has determined that the potential commercial success in the Parsons Pond onshore and the opportunity to prove the existence of large fields in the iceberg-free, shallow waters of the near offshore makes the exploration program a worthwhile investment.

Nalcor successfully spudded its first well in Parsons Pond on February 14, 2010. With a rig-sharing arrangement with one of its project partners, Nalcor expects to spud the remaining two wells later in 2010.

Over the past 140 years, there has been significant interest in the oil and gas resources in western Newfoundland. Oil seeps in the Parsons Pond area were first observed in 1812 and the first well was drilled in 1867. Since then, almost 70 wells have been drilled from the Port au Port to the Northern Peninsulas; however, deeper targets have not yet been tested, which is one of the objectives of Nalcor's drilling program. The existing dataset and the information available for the region indicate that the Parsons Pond development will provide a unique opportunity to better understand both the onshore and offshore potential in this region.



Nalcor has a prudent corporate plan for growth, and the company's investments in the oil and gas sector align with its long-term plans to grow a diverse and viable energy business. Nalcor will continue to assess growth opportunities for the province's oil and gas resources with an approach to maximize benefits from these resources to help build a stronger economy in Newfoundland and Labrador.

The company's participation in the three offshore projects will contribute significantly to its production and cash flow objectives. Through investments of this nature and magnitude in the oil and gas industry, Nalcor will see proportionate returns, allowing further expansion and growth of the company.

Lower Churchill Project

The development of the lower Churchill hydroelectric resource is a strategic opportunity for Nalcor Energy. One of the best undeveloped hydroelectric resources in North America, it represents a tremendous prospect for the production of clean, renewable and affordable energy. Combined, the Gull Island and Muskrat Falls installations will have a capacity of over 3,000 megawatts and could displace more than 16 megatonnes of carbon dioxide emissions every year from thermal power generation.

There have been numerous important steps on the road to the development of the Lower Churchill Project, one of which is the initialling of a comprehensive agreement with the Innu Nation of Labrador - Tshash Petapen or New Dawn. The New Dawn includes a provincial Innu Rights Agreement, the Lower Churchill Impacts and Benefits Agreement and the Upper Churchill Redress Agreement and provides the certainty needed to move forward with project planning and further investment.

The submission of the Environmental Impact Statement (EIS) for the generation elements of the development was another milestone for the Project in 2009. In preparation for the submission, Nalcor consulted with communities and groups throughout the province to gather their input into both the process and the ultimate EIS. The EIS is currently being assessed by a joint Federal and Provincial Review Panel, with hearings expected to commence in 2010.

Access to both domestic and export markets is essential to realize the full economic and environmental benefits of the lower Churchill development. Utilizing the power for industrial growth in the province is a key focus, as well two market access alternatives for exporting excess power continue to be advanced: access to the Hydro-Québec transmission system and development of a maritime transmission route.

Nalcor has filed complaints regarding fair and reasonable access to Hydro-Québec's transmission system. These complaints were heard by the Régie de l'énergie, Québec's independent regulator. Further clarity on this routing option is expected when the Régie de l'énergie announces a ruling related to Nalcor's transmission applications later in 2010. Nalcor also made a transmission service application to the New Brunswick System Operator for access to the New Brunswick marketplace.

In early 2009, Nalcor registered the Labrador-Island Transmission Link for environmental assessment. The 1,100 kilometre High-Voltage direct current link would provide clean, reliable and sustainable electricity by displacing fossil fuel generation at Hydro's Holyrood Generating Station. The link would also lay the groundwork for the future interconnection of Newfoundland and Labrador to the North American electricity system via a potential maritime transmission link, and help set the stage for further development and growth in the province's energy sector.

A significant component of the link is determining how to best transport electricity across the Strait of

Belle Isle. Extensive field work was conducted in the Strait in 2009, and engineering analysis focused on two potential methods of crossing: a combination of partial tunnelling and laying cables on the ocean floor, or fully tunnelling under the ocean floor. Adding to existing knowledge, the data gathered will help Nalcor better understand this geographic area to determine the most viable transmission option.

Finally, in preparation for future development activities, Nalcor issued an Expression of Interest in 2009 to six engineering and project management companies to determine their interest in bidding for the Lower Churchill Project's detailed engineering design work. These companies are worldwide specialists in hydroelectric, transmission and civil construction, and Nalcor expects to award the contract in 2010.

The proposed lower Churchill development shares the Churchill River with the Churchill Falls hydroelectric generation plant. The Electrical Power Control Act requires Nalcor to enter into a water management agreement to coordinate production among all facilities on the Churchill River. In late 2009, Nalcor applied to the Public Utilities Board (PUB) to establish the terms of the agreement. The PUB issued a board order in March 2010 establishing a water management agreement. This is an important step forward in the potential development of the Lower Churchill Project.



As part of the assessment for the Labrador-Island Transmission Link, Lower Churchill Project team members took part in offshore seismic, land-based drilling and marine environmental field work to help determine the best route for transmission across the Strait of Belle Isle. One of these was land-based geological investigations on both sides of the Strait. The program consisted of near-shore diamond core-drilling to retrieve core rock samples, and of special water pressure testing to determine the permeability of the rock formations.

Nalcor is committed to developing the untapped hydroelectric potential of the lower Churchill River. The Project is focused on power sales and market access, as well as moving forward with the environmental assessment processes and further engineering.

Bull Arm Fabrication

On March 31, 2009, Nalcor Energy assumed ownership of the Bull Arm Fabrication Site. The Bull Arm site was originally developed in the 1990s to construct the 600,000-tonne Gravity Base Structure (GBS) platform and topside components for the Hibernia Project. Since that time, fabrication and other work associated with Newfoundland and Labrador's offshore oil and gas and mining industry has been completed at the Bull Arm site.

Bull Arm is the largest industrial fabrication site in Atlantic Canada. The site supports fabrication and assembly in three key project areas simultaneously, in three separate theatres: Topsides Fabrication and Assembly; Drydock Fabrication and Construction; and the Deepwater Site.

The Bull Arm facility is an important asset for industrial development in Newfoundland and Labrador and the advancement of the province's fabrication capacity. This site has provided broad benefits to the province through participation in a number of major projects, including the Hibernia, Terra Nova and White Rose projects.



In 2009, the module hall in Bull Arm was used for the systems integration testing for the North Amethyst oil development. All of the components of the subsea structure are put together and tested with Remotely Operated Vehicles before being placed in a large excavated area on the sea floor, known as a glory hole. The module hall is approximately the same size as the offshore glory hole which enabled the North Amethyst project team to assess the full layout of the subsea equipment prior to installation offshore.

In 2009, Bull Arm Fabrication focused on developing a business planning framework for the short, medium and long-term utilization of the site. In addition to creating the planning framework, Nalcor completed a due diligence review of the site, focusing on site safety and maintenance, asset management and environmental remediation. The review ensured the site meets all Nalcor's operational procedures and policies.

In Nalcor's first year of operation, the Bull Arm site was fully utilized. In 2009, North Eastern Constructors Limited utilized the Topsides area for the manifold fabrication and systems integration testing for the North Amethyst offshore oil development, operated by Husky Energy. When complete, North Amethyst will be tied into the existing White Rose oil field.

Also in 2009, Pennecon Energy completed a refurbishment of the GSF Grand Banks, which is owned by a subsidiary of Transocean and currently under a drilling contract with Husky Energy on the White Rose expansion field. This multi-million dollar refit took place on the FPSO Quay and Drydock area of the Bull Arm Fabrication Site, and several of the Topsides buildings were used for equipment overhaul.

Bull Arm is also preparing for the upcoming lease of the site by ExxonMobil Canada Properties. From 2011 to 2017, it is anticipated that the site will be used to construct, integrate and commission the GBS and topsides modules for the Hebron project, the province's fourth offshore oil development. Nalcor is aligning its long-term strategy to ensure a seamless transition to other site operations at the conclusion of the Hebron project construction. The strategy ensures the site is utilized to maximize the benefits

to the province from the number of construction and fabrication projects on the horizon – both locally and around the world.

The company will continue to maintain and operate this facility with a focus on marketing the infrastructure globally, ensuring it is a major player in the growth of the province's industrial sector through projects such as the upcoming Hebron development.

Other Energy Activities

In addition to Nalcor's five lines of business, the company is involved in other energy activities and opportunities, including energy marketing, non-regulated electricity generation, wind energy, and research and development.

Energy Marketing

In 2009, Nalcor Energy established an energy marketing team to sell energy from its existing and future developments and build expertise as a participant in competitive energy markets in Canada and the United States.

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

In March 2009, Nalcor, through its subsidiary, Hydro, signed a Transmission Service Agreement with Hydro-Québec TransÉnergie (HQT) under HQT's Open Access Transmission Tariff. The agreement is for long-term power transmission capacity from Labrador through Québec to the Canada-United States border. Under this arrangement, Nalcor then sells power on the Canadian side of the border to a third-party energy marketer, and directly to Canadian markets.

The marketing of this energy allows the company to build its reputation and experience as a reliable supplier of energy now and into the future. Nalcor will continue to develop its energy marketing capability in 2010.



For the first time in the province's history, Newfoundland and Labrador is wheeling hydroelectric power through neighbouring Québec. In 2009, Nalcor Energy, through Hydro, signed an agreement to wheel power from the Labrador to the Canada-United States border.

Exploits Generation

In December 2008, the provincial government assumed control of the former Abitibi-Consolidated hydro assets on the Exploits River. Nalcor Energy has been licensed to manage and operate the hydroelectric generation facilities on behalf of the province.

Throughout the year, Nalcor worked in full consultation with its Shareholder, the Government of Newfoundland and Labrador, to ensure a safe and smooth transition of the hydroelectric facilities. A key element of the transition was engaging the site and staff in Nalcor's pursuit of safety excellence. Additional areas of focus included determining staffing requirements, ongoing monitoring of the water levels on the Exploits River and developing an asset management plan.

Menihek Generation

Nalcor assumed ownership of the 18.7 MW Menihek Generating Station from the Iron Ore Company of Canada in 2007. The company has entered into a 40-year power purchase agreement with Hydro-Québec to supply electricity from this facility to Hydro-Québec for its customers in the Schefferville region. Under this agreement, Hydro is reimbursed by Hydro-Québec for all operation, maintenance and refurbishment costs for the Labrador assets of the Menihek electrical system. The power generated from the Menihek Generating Station is the only reasonable source of electricity for this isolated area. The continued operation of the plant will supply Hydro-Québec's customers in three northern Québec communities with a safe and reliable source of electricity.

In 2009, Nalcor Energy continued to work with its operating contractor, Kawawachikamach Energy Services Inc. (KESI). Nalcor made significant progress in safety training and compliance and environmental management with KESI.

Wind-Hydrogen-Diesel Energy Project

Significant progress was made on the Wind-Hydrogen-Diesel Energy Project in Ramea this past year. This research and development project will use wind and hydrogen technology to supplement the diesel requirements of this isolated community.

While there are a number of wind-hydrogen projects underway around the world, this energy project is unique because it is one of the first in the world to integrate wind and hydrogen components in a small, diesel-powered community. Through this project, Nalcor Energy seeks to position itself as a world-leader in its ability to provide a sustainable and environmentally-friendly alternative to diesel generation for isolated communities.

By the end of 2009, more than 90 per cent of project construction was completed. In December, first production of hydrogen by the electrolyser, and wind generation from the three new wind turbines, were achieved. Although still in its early stages, the energy project offers an enormous opportunity to increase the renewable generation in isolated diesel systems both in Newfoundland and Labrador, and around the world, as well as reduce Hydro's future use of fossil fuels and its carbon footprint.

Management's Discussion & Analysis





Management's Discussion & Analysis

The following discussion and analysis is the responsibility of management and is as of March 9, 2010. Nalcor Energy maintains appropriate systems of internal control, policies, and procedures that provide management with reasonable assurance that assets are safeguarded and that its financial information is reliable. The Board of Directors carries out its responsibility for review of this disclosure principally through its Audit Committee, comprised exclusively of independent directors. The Audit Committee has reviewed and approved this Management's Discussion and Analysis (MD&A). This MD&A should be read in conjunction with the Consolidated Financial Statements of Nalcor Energy (Nalcor or the Corporation) for the years ended and included in this Business and Financial Report, as well as the notes, for the respective years.

Certain statements in this MD&A are forward-looking statements subject to risks and uncertainties. Statements containing words such as "could", "expect", "may", "anticipate", "believe", "intend",

"estimate", "plan" and similar expressions constitute forward-looking statements. These statements are based on certain factors and assumptions, including: foreign exchange rates, commodity prices, expected growth, results of operations, performance, and business prospects and opportunities. While Nalcor Energy considers these factors and assumptions to be reasonable based on information currently available, they may prove to be incorrect. A number of factors could cause actual results to differ materially from those in the forward-looking statements, including, but not limited to: fluctuations in supply and demand in electricity markets, changes in capital markets, changes in currency and exchange rates or commodity prices, unexpected environmental conditions, fluctuations in future fuel prices, changes in oil reserves and government or regulatory policy changes. Nalcor assumes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or any other reason.



SECTION 1: CORPORATE OVERVIEW AND STRATEGY

Nalcor Energy (Nalcor or the Corporation) is a Crown corporation that was established in 2007. Nalcor Energy's legal structure at December 31, 2009, included three wholly-owned subsidiaries, Newfoundland and Labrador Hydro (Hydro), Nalcor Energy – Oil and Gas Inc. (Oil and Gas) and Nalcor Energy - Bull Arm Fabrication Inc. (Bull Arm Fabrication or Bull Arm). Hydro holds investments in three entities: 65.8% of Churchill Falls (Labrador) Corporation (Churchill Falls); 51% of Lower Churchill Development Corporation (LCDC); and 100% of Gull Island Power Corporation (GIPCo). Churchill Falls holds a 33.3% investment in Twin Falls Power Corporation (Twin Falls).

Nalcor's business includes the development, generation, transmission and sale of electricity; the exploration, development, production and sale of oil and gas; industrial fabrication; and energy marketing. Nalcor Energy has implemented a corporate-wide framework and organizational design which facilitates prudent, safe management and stewardship of its assets.

Nalcor's reporting segments allow senior management to evaluate the operational performance and assess the overall contribution of each segment to Nalcor's long-term objectives. The following summary describes the operations included in each of the Corporation's reportable segments.

Hydro Regulated

Hydro Regulated is the regulated portion of Hydro that generates, transmits and distributes electrical power and energy to customers throughout

Newfoundland and Labrador. Hydro Regulated ensures there is a safe, reliable and cost-effective electricity supply available to meet current demand and future growth. Hydro Regulated's operations consist of sales of electricity to three primary customer groups:

- Newfoundland Power, an investor-owned utility that distributes electrical power to 239,000 customers on the island portion of the Province, with Hydro Regulated supplying 92% of their energy requirements [comprising 80.4% of regulated revenue (2008 – 77.5%)].
- Over 36,000 residential and commercial customers in rural Newfoundland and Labrador [comprising 14.2% of regulated revenue (2008 – 14.4%)].
- Major industrial customers primarily in the pulp and paper, mining and oil refining industries [comprising 4.9% of regulated revenue (2008 – 7.6%)].

Hydro Regulated is regulated by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) and its rates are set through periodic general rate applications using a cost of service (COS) methodology whereby Hydro Regulated is entitled to recover, through customer rates, all reasonable and prudent costs incurred in providing electricity service to its customers including a return on rate base.

In 2009, the Government of Newfoundland and Labrador (Shareholder, Government or Province) issued an Order in Council which provided Hydro Regulated with the ability to earn a return on equity (ROE) equal to that of Newfoundland Power, effective with the next general rate application. Prior to this, Hydro Regulated earned a ROE equal to

Management's Discussion & Analysis

4.47% for the purpose of determining its cost of capital. (This level of return was based on a previous PUB decision which established the ROE at a rate equal to the long-term marginal cost of debt which is the lowest approved ROE target of all utilities in Canada). Hydro Regulated has not yet filed a general rate application to reflect the new ROE; however, it is under consideration.

In 2009, Nalcor contributed \$100.0 million, that it received as an equity contribution from the Shareholder to Hydro Regulated to strengthen its balance sheet. This action, combined with the higher ROE, will provide a strong foundation for future financial performance.

Hydro Regulated's generating assets, with a total capacity of 1,637 megawatts (MW), consist of nine hydroelectric plants (939 MW), one oil-fired plant (490 MW), four gas turbines (150 MW) and 25 diesel plants (58 MW). In addition, Hydro Regulated has entered into a number of power purchase agreements with non-utility generators to supplement its own generation capacity.

Hydro Regulated's business strategy is to manage its assets in a manner that optimizes total cost of operation and maintenance while delivering safe, reliable service.

Churchill Falls

The Churchill Falls Generating Station is one of the largest underground powerhouses in the world with a rated capacity of 5,428 MW. A power contract with Hydro-Québec dated May 12, 1969, provides for the sale of almost 90% of the energy from this facility [approximately 30 terawatt hours (TWh)] until 2041. Churchill Falls sells 300 MW (recall power), the maximum provided for under the

power contract, to Hydro for use in Labrador and for export sales. Churchill Falls also sells 225 MW (approximately 1.8 TWh) to Twin Falls to service the mining industry in Labrador West. In addition, Churchill Falls earns revenues from Hydro-Québec under a Guaranteed Winter Availability Contract (GWAC). The GWAC was signed with Hydro-Québec in 1998 and provides for the sale of up to 682 MW of seasonal availability to Hydro-Québec during the months of November through March until the end of the power contract in 2041.

The strategy for Churchill Falls focuses on safely operating and maintaining its assets to optimize long-term value while meeting all contractual obligations.

Nalcor, through its subsidiary Hydro, holds a 65.8% interest in Churchill Falls, with Hydro-Québec holding the remainder. In 1999, as a result of the Shareholders' Agreement between Hydro, Hydro-Québec and Churchill Falls, Hydro commenced accounting for its investment in Churchill Falls as a joint venture (see Note 2 to the Consolidated Financial Statements) and includes 65.8% of the revenues, expenses, assets and liabilities of Churchill Falls in the consolidated accounts.

Energy Marketing

The revenue and earnings in this segment are derived from electricity sales from the portion of the 300 MW recall power not required to meet demand in Labrador. Since 1998, Hydro has had sales agreements with Hydro-Québec for the recall power from Churchill Falls, with the most recent contract expiring on March 31, 2009.

On March 31, 2009, Nalcor, through its subsidiary, Hydro, signed a Transmission Service Agreement

with Hydro-Québec TransÉnergie (HQT) under HQT's Open Access Transmission Tariff for 265 MW of long-term power transmission capacity from Labrador through Québec to the Canada-United States border. Under this arrangement, Nalcor then sells power on the Canadian side of the border to a third party energy marketer. Nalcor also has arrangements to sell power into New Brunswick.

Oil and Gas

Oil and Gas manages oil and gas interests and is currently a partner in three developments in the Newfoundland and Labrador offshore oil and gas industry – the Hebron oil field, the province's fourth offshore oil project; the White Rose Growth Project, with first production from North Amethyst anticipated in the second quarter of 2010; and the Hibernia Southern Extension offshore project through the acquisition of a 10% working interest completed in February 2010.

In addition, during 2009, Oil and Gas acquired an average 67% working interest in three onshore exploration permits in the Parsons Pond area on the Great Northern Peninsula. Oil and Gas will continue to assess growth opportunities.

Other

This business segment includes the Lower Churchill Project, the most attractive undeveloped hydroelectric project in North America. Its two proposed installations at Gull Island and Muskrat Falls will have a combined capacity of over 3,000 MW and can provide 16.7 TWh of electricity per year.

The Bull Arm Fabrication Site, Atlantic Canada's largest industrial fabrication site, is also included in this segment. This facility spans over 2,560 hectares

and has integrated and comprehensive infrastructure to support fabrication and assembly in three key project areas simultaneously. Also included in this business segment are certain non-regulated activities of Hydro including the operations of the Menihek Generating Station and sale of power to two industrial customers in Labrador, as well as business development and corporate activities.

SECTION 2: PERFORMANCE

Financial Highlights

This section provides an overview of Nalcor Energy's financial performance based on its audited Consolidated Financial Statements.

<i>millions of dollars</i>	2009	2008
Revenue	\$ 572.6	\$ 570.3
Expenses	512.6	488.1
Net income	\$ 60.0	\$ 82.2

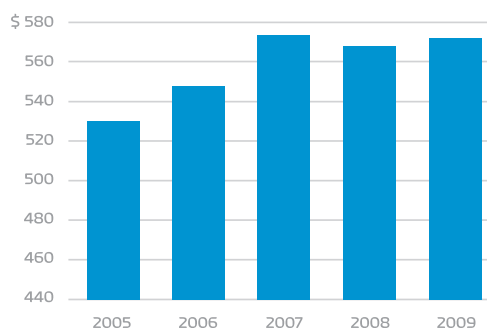
Key Financial Performance Indicators

Return on Equity	5.8%	10.0%
Return on Capital Employed	7.7%	8.8%

Description of Performance Indicators

Return on Equity (ROE) – Net Income/Average Equity
 Return on Capital Employed (ROCE) – Net Income plus Interest/Average Debt plus Equity (adjusted for assets under development)

Five-Year Summary of Revenue
(\$ millions)



Management's Discussion & Analysis

Nalcor Energy - Segment Income Comparison (2009 vs. 2008)
(\$ millions)



Overall net income for 2009 was \$60.0 million, a decrease of \$22.2 million from the \$82.2 million reported for 2008. The primary reasons for the decrease in net income were a decrease in the Energy Marketing segment of \$13.8 million; a reduction in earnings from the Churchill Falls segment of \$9.1 million; an increase in other costs of \$5.9 million and increased oil and gas operating costs of \$2.3 million. These reductions were offset by an increase in earnings from Hydro of \$8.9 million. These items are outlined below and discussed in more detail in the business segment review.

- Revenue was \$572.6 million, an increase of \$2.3 million in 2009 compared to 2008, primarily due to increased lease revenue from the Bull Arm Fabrication Site.
- Interest was \$83.5 million, an increase of \$5.3 million compared to \$78.2 million in 2008. This increase is primarily related to a reduction in the amount of interest capitalized offset by lower debt balances.
- Operations and administration costs were \$171.9 million, an increase of \$23.7 million over 2008, primarily the result of the cost of transmission rental and marketing related costs for Energy Marketing.
- Fuel expense was \$155.2 million compared to \$164.8 million in 2008, a decrease of \$9.6 million, primarily the result of reduced fuel consumption of \$10.8 million due to higher power purchases; diesel and gas turbines savings of \$2.9 million offset by an increase in fuel cost of \$3.4 million as a result of Rate Stabilization Plan (RSP) activity.
- Power purchased costs were \$47.1 million, an increase of \$6.1 million in 2009 over 2008 costs of \$41.0 million, primarily the result of increased wind purchases.
- Amortization was \$54.9 million, an increase of \$1.7 million over 2008, primarily the result of the increasing levels of property, plant and equipment and marginally higher amortization levels each year as a result of using the sinking fund method of amortization for some regulated assets.

Return on equity declined due to the decrease in earnings coupled with increased equity. This resulted from the significant equity contributions from the Province over the past two years augmented by the continued suspension of dividends to the Shareholder, the Province of Newfoundland and Labrador. Return on capital employed (ROCE) declined largely due to the impact of decreased earnings on an average capital employed base that was largely unchanged from the previous year. Oil and Gas investments are still in the development stage and ROCE can be expected to be positively impacted as these developments move into production and generate revenues.

Business Segment Review

In 2009, Nalcor Energy reported its financial results in five business segments: Hydro Regulated, Churchill Falls, Energy Marketing, Oil and Gas and Other. These business segments include the five lines of business of Nalcor Energy and are

differentiated on the basis of regulatory status and management accountability. The 2009 financial results by business segment are shown in the following table:

Segment Earnings		
<i>millions of dollars</i>	2009	2008
Hydro Regulated	\$ 17.9	\$ 9.0
Churchill Falls	11.7	20.8
Energy Marketing	34.0	47.8
Oil and Gas	(2.4)	(0.1)
Other	(1.2)	4.7
Total	\$ 60.0	\$ 82.2

Hydro Regulated

The operations of Hydro Regulated are impacted by many external factors, primarily, the domestic economy, weather patterns and fuel costs. During 2009, there was a contraction in the pulp and paper industry with the closure of the Abitibi Bowater Inc. (Abitibi) Grand Falls mill in February 2009, and reduced operations in the Corner Brook Pulp and Paper mill. This resulted in a reduction in demand for electricity. In addition, the temporary electric boiler heating plant shut down at Canadian Forces Base (CFB) Goose Bay resulted in decreased secondary energy sales.

The demand for electricity is met through a combination of hydroelectric generation, thermal generation and power purchases including wind generation. In addition, Hydro Regulated utilizes an RSP for island customers that provides a mechanism to adjust variations in energy sales, fuel prices and hydraulic production to the levels that were in effect when rates were set in 2007. Resulting variations are deferred into the RSP to be collected from or refunded to some electricity consumers in the annual RSP rate adjustment.



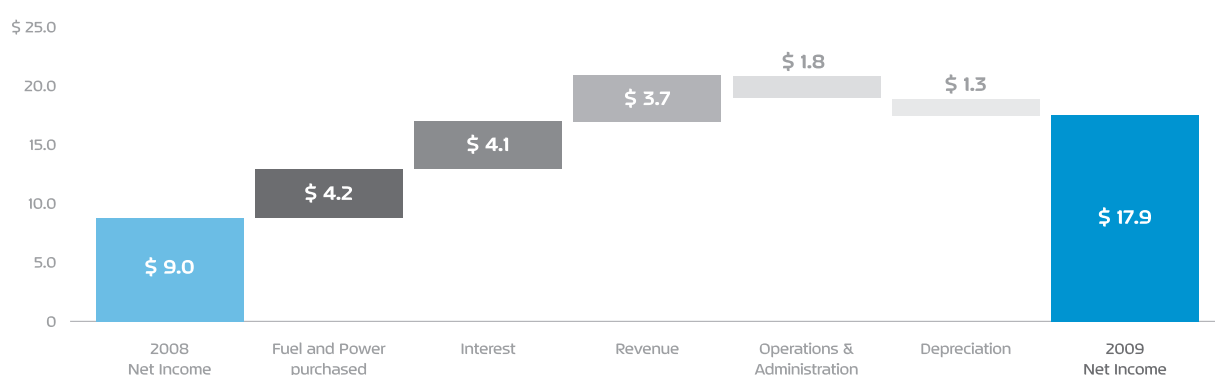
Management's Discussion & Analysis

In 2009, energy production from the island's hydroelectric plants was lower than in 2008; however, there was increased power supplied from wind generation facilities in St. Lawrence and Fermeuse which, when combined with the overall decrease in demand for electricity, resulted in a decrease in higher-cost thermal based production from the Holyrood Generating Station.

The Province continued to waive the payment of the debt guarantee fee (\$11.7 million) in 2009. The guarantee fee is based on 1% of the total debt outstanding (net of sinking funds) guaranteed by the Province, as at the preceding December 31. Net income for 2009 was \$17.9 million, an increase of \$8.9 million over the 2008 net income of \$9.0 million. The factors affecting the 2009 increased earnings are depicted in the following chart:



Hydro Regulated - 2009 vs. 2008 Segment Earnings
(\$ millions)



Revenue: Revenue by major customer category is outlined below:

<i>millions of dollars</i>	2009	2008
Newfoundland Power	\$ 358.7	\$ 342.6
Rural Customers	63.3	63.8
Industrial Customers	21.8	33.7
Other	2.2	2.2
Total revenue	\$ 446.0	\$ 442.3

Revenue from Newfoundland Power increased overall by \$16.1 million due to increased sales and increased RSP recovery. Sales to Newfoundland Power increased by 151.4 gigawatt hours (GWh), mainly as a result of load growth on the Newfoundland Power system resulting in an increase of \$12.7 million in revenue. Revenue from demand and secondary energy sales increased by \$2.2 million. In addition, there was increased recovery of balances in the RSP of \$1.2 million over the 2008 recovery levels.

Sales to industrial customers, including secondary energy sales to CFB Goose Bay, decreased by 374 GWh. This reduction in energy requirements resulted in an \$11.9 million reduction in revenue. On the island, sales to the pulp and paper industrial sector were down significantly with the closure of the Abitibi Grand Falls mill and the reduced production at Corner Brook Pulp and Paper. Sales to the island industrial mining customer were up 3.3 GWh. Secondary energy sales to CFB Goose Bay declined by 41.3 GWh resulting in a decrease in revenue of \$4.4 million.

Electricity rates for rural customers decreased 6.6% effective July 1, 2009, and when combined with higher energy sales resulted in a slight decline in revenue from rural customers of \$0.5 million.

Rate Stabilization Plan: The RSP was established in 1986 to mitigate the impact of volatile fuel prices and quantities on consumers' electricity rates. The difference between the actual cost of fuel consumed to generate electricity and the cost upon which electricity rates are based (cost of service) accumulates in the RSP. Balances in the RSP are recovered in each following year, with the exception of the hydraulic variation, which is recovered or refunded at a rate of 25% annually.

The hydraulic variation has been positive in recent years and results from higher than average water levels for hydroelectric production, reducing the need for thermal generation and related fuel costs. Rates are also adjusted annually based on forecast fuel prices through a rate adjustment or fuel rider. The fuel rider component and RSP adjustment become effective annually on July 1 for residential and commercial customers. New rates for industrial customers, reflecting the fuel rider component and RSP adjustment, would normally become effective on January 1. However, industrial rates which were set by the PUB effective January 1, 2007 have remained in place on an interim basis since that time. This rate freeze results from the uncertainty caused by the decline in industrial load on the island. A public hearing on finalizing industrial rates has been scheduled by the PUB for May 2010.

Fuel: Hydro Regulated utilizes No. 6 fuel at the 490 MW Holyrood Generating Station and diesel fuel at its diesel plants. The following table summarizes fuel consumed at the Holyrood plant and the average price per barrel.

	2009	2008
No. 6 fuel		
Consumption (millions of barrels)	1.5	1.7
Average price (\$ / barrels)	\$ 52.5	\$ 71.6

Management's Discussion & Analysis

Fuel expense includes the cost of No. 6 fuel, diesel fuel, adjustments to the fuel cost from variations from COS that are deferred in the RSP and fuel costs recognized from the amortization of the RSP balance during the year. Fuel costs are summarized below:

<i>millions of dollars</i>	2009	2008
No. 6 fuel / RSP / Other	\$ 142.6	\$ 149.8
Diesel	12.6	15.0
Total fuel expense	\$ 155.2	\$ 164.8

No. 6 fuel/RSP/Other costs declined by \$7.2 million due to a number of factors. No. 6 fuel costs declined by \$10.8 million because production from the Holyrood plant was reduced mainly as a result of higher generation from non-utility generators including wind generation sources. These savings were offset by an RSP adjustment related to prescribed efficiency levels at the Holyrood plant. Holyrood's operating efficiency is set, for RSP purposes, at 630 kilowatt hours (kWh) per barrel and actual performance below this level results in increased expense. When the plant operates at lower output levels than forecast, due to lower thermal generation requirements, fuel efficiency declines as a result. These savings were offset by an increase in fuel expense amortized from the RSP and other costs of \$3.6 million.

Diesel fuel expense decreased by \$2.4 million, primarily due to lower fuel prices (\$2.6 million) offset by an increase in litres used (\$0.2 million). Diesel fuel costs are not included as part of the RSP.

Power Purchased: To supplement Hydro Regulated's electricity generation on the island, Hydro Regulated purchases power under long-term agreements with

non-utility generators (see Note 19(f) to the Consolidated Financial Statements). In Labrador, on the interconnected grid, Hydro Regulated purchases substantially all of its energy requirements from Churchill Falls.

Total purchased power increased from \$41.4 million in 2008 to \$46.8 million in 2009. This increase is due to increased purchases from wind generation of \$10.1 million, which was offset by decreases in purchases from Corner Brook Pulp and Paper of \$2.4 million, secondary energy purchases of \$0.9 million and other sources in the amount of \$1.4 million.

Interest: Hydro Regulated's net interest expense decreased by \$4.1 million from \$87.6 million in 2008 to \$83.5 million in 2009. Lower average debt balances and borrowing costs accounted for the variance.

Operations & Administration: Hydro Regulated's 2009 operating costs comprised 59% (2008 – 66%) of consolidated operating costs and are outlined below:

<i>millions of dollars</i>	2009	2008
Salaries	\$ 60.4	\$ 58.5
Maintenance	22.1	22.3
Other	18.4	18.3
Total	\$ 100.9	\$ 99.1

Total operating costs increased by \$1.8 million over the 2008 level. Salaries increased by \$1.9 million due to normal cost of living adjustment increases



which were offset by additional labour costs capitalized as a result of an increased capital program. Maintenance and other costs remained consistent in 2009 as compared to 2008.

Churchill Falls

In 2009, Churchill Falls segment earnings were \$11.7 million, a decrease of \$9.1 million compared

to 2008. Factors contributing to this decrease are primarily the reduction in energy sales to Hydro-Québec of \$6.9 million; a reduction in preferred dividends of \$1.8 million and a reduction in GWAC revenue of \$1.1 million as a result of a cable fire that occurred in 2008. The factors affecting the 2009 reduced earnings are depicted in the following chart:

Churchill Falls - 2009 vs. 2008 Segment Earnings
(\$ millions)



Management's Discussion & Analysis

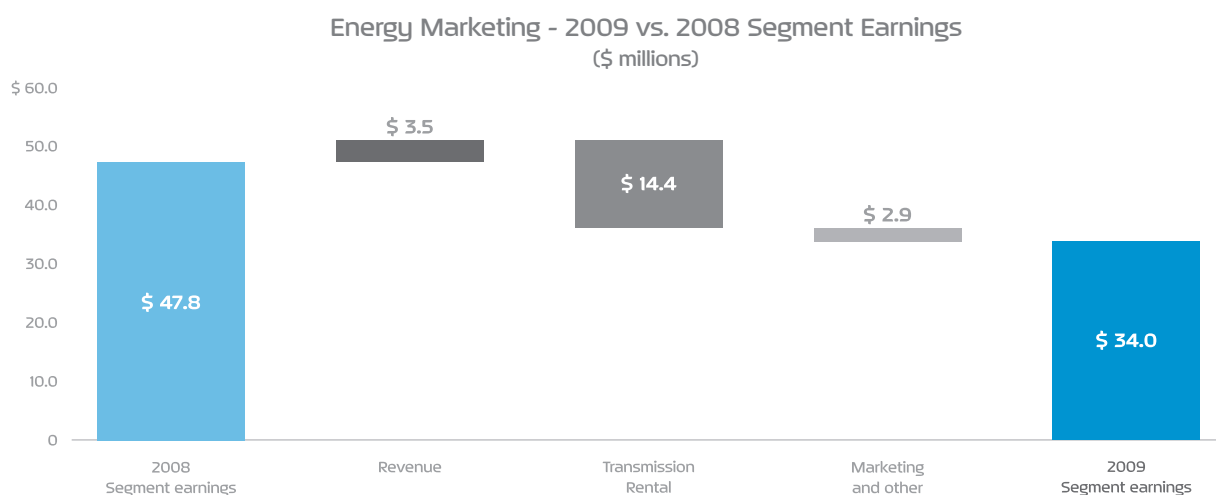
On November 3, 2008, a fire occurred in a cable shaft at the Churchill Falls plant causing extensive damage to two sets of cables, resulting in two of the 11 generating units being unavailable. This resulted in a reduction in generating capacity available and a decrease in the GWAC revenue (see Note 21 to the Consolidated Financial Statements). One set of cables was repaired in late February 2009, allowing one unit to be returned to service. Cable repairs to allow the second unit to return to service were completed in October 2009 with a return to full commercial operation. The estimated costs of the repairs of \$8.0 million are covered by an insurance policy with the exception of a \$2.0 million deductible which was expensed in 2008. The impact of the fire is estimated to be a reduction in GWAC revenue of \$12.7 million and \$11.6 million in 2008 and 2009 respectively and a reduction in energy sales of \$3.2 million and \$3.8 million for 2008 and 2009 respectively.

Energy Marketing

In 2009, revenue was \$55.4 million compared to \$51.3 million in 2008 and segment earnings for energy marketing activities were \$34.0 million, a decrease of \$13.8 million from 2008. The primary



reason for this decrease is the downturn in the electricity markets combined with the change in strategic direction for this segment. Energy markets were depressed in 2009 due to a downturn in the economy, lower energy demand in the Northeast United States industrial markets, and lower natural gas prices, thereby creating downward pressure on electricity pricing. Details of the year-over-year change in Energy Marketing earnings are noted in the following chart:



Prior to 2009, Nalcor, through its subsidiary Hydro, sold power exclusively to Hydro-Québec under a bilateral power sales agreement. This agreement expired on March 31, 2009, allowing Nalcor the opportunity to engage an energy marketer to sell power on its behalf to various markets in Canada and the United States. In addition, Nalcor has retained the ability to enter into bilateral sales agreements. A combination of fixed price contracts and spot and day-ahead sales provides Nalcor with a more diversified sales portfolio. Nalcor also maximizes the value of energy sales by directing sales to markets according to peak seasonal and daily demand. Performance of the energy marketing group is evaluated based on benchmark pricing at an interface in the New York Independent System Operator (NYISO). In 2009, Nalcor's pricing exceeded the NYISO benchmark pricing by approximately 25% on average.

Energy Marketing revenues are denominated primarily in US dollars (USD) and in 2009, Nalcor entered into a series of forward foreign exchange contracts to mitigate the impact of currency fluctuations on earnings. These forward contracts are accounted for as hedges and revenue for 2009 includes \$2.4 million in gains resulting from the qualifying hedges.

Oil and Gas

On January 30, 2009, Oil and Gas completed a \$30.0 million purchase of a 5% working interest in the oil resources contained within the White Rose Growth Project, which includes the North Amethyst Field, West White Rose and South White Rose Extension. The purchase cost is to be paid in two installments. The first installment of \$7.0 million was paid on January 30, 2009; the remaining payment, not to exceed \$23.0 million, will be made upon the determination of the West White Rose Extension Oil Reserves. First production from North Amethyst is planned for 2010. In addition, in February 2010, Oil and Gas signed agreements to purchase a 10% working interest in the Hibernia Southern Extension subsea tie-back project.

Oil and Gas has also engaged in onshore oil exploration through the acquisition of an average 67% working interest in three onshore exploration permits in Parsons Pond on the West Coast of Newfoundland. The working interests were purchased for \$0.6 million. Nalcor is the operator of this project and commenced drilling the first of three wells in February 2010.

In 2009, costs capitalized as petroleum and natural gas properties totaled \$81.7 million (2008 - \$112.1 million) and include, in addition to direct acquisition costs, legal fees, environmental consulting and project management.

Management's Discussion & Analysis

Proved Oil and Gas Reserves

Nalcor engaged independent qualified reserve evaluators to evaluate and prepare reports on Oil and Gas' oil reserves according to the Canadian Oil and Gas Evaluation Handbook reserve definitions and standards.

Proved Reserves as at December 31, 2009:

	Light and Medium Oil	
	Gross (Mbbbl)	Net (Mbbbl)
Developed	-	-
Undeveloped	1,390	1,371
Total	1,390	1,371

Reconciliation of Gross Proved Reserves (before royalty):

	Light and Medium Oil (Mbbbl)
December 31, 2008	-
Extensions	-
Improved Recovery	-
Technical Revisions	-
Discoveries	-
Acquisitions	1,390
Dispositions	-
Economic Factors	-
Production	-
December 31, 2009	1,390

Depletion, Depreciation and Amortization (DD&A)

Under the full cost method of accounting for oil and gas activities, DD&A is calculated on a country-by-country basis. The DD&A rate is calculated by dividing the capital costs subject to DD&A by the proved oil and gas reserves expressed as equivalent barrels (boe). The resultant dollar per boe is assigned to each boe of production to determine the DD&A expense for the period.

During 2009 and 2008, no DD&A expense was recorded as there has been no production of oil and gas to date.

At December 31, 2009, capital costs in respect of unproved properties and major development projects were \$117.0 million compared with \$112.1 million at the end of 2008. These costs are excluded from the DD&A calculation until the unproved properties are evaluated and proved reserves are attributed to the project or the project is deemed to be impaired.

Other

Lower Churchill Project: The Lower Churchill Project (Project or LCP) is comprised of two developments on the Churchill River, Gull Island (2,250 MW) and Muskrat Falls (824 MW). The LCP is currently undertaking environmental assessments, preliminary field work, market assessment, exploring transmission routes and economic analysis to support approval of the development scenario and concept selection (i.e., Decision Gate Two). The increase in assets for 2009 of \$34.4 million reflects the continued pre-sanction investment in the Lower Churchill Project to move towards Decision Gate Two. The effort to assess feasibility of the development is continuing and has involved further study on the Project's technical and environmental elements, its configuration and market access options.

Significant engineering and environmental activities took place during 2009 in support of the Strait of Belle Isle crossing, transmission routing on the island portion of the province and continued support to the submission of the Environmental Impact Statement of the generation project in Labrador, which is currently being assessed by a joint Federal and

Provincial Review Panel, with Panel hearings expected to commence in 2010.

A significant milestone was reached in late 2008 in negotiations with the Innu Nation of Labrador with the establishment of the New Dawn Agreement. In February 2010, representatives of Innu Nation, Mushuau Innu First Nation, Sheshatshiu Innu First Nation, Nalcor Energy and the Government of Newfoundland and Labrador initialed the final agreements which includes the bilateral Land Claims Agreement-in-Principle, the Lower Churchill Innu Impacts and Benefits Agreement and the Churchill Falls Hydroelectric Development Redress Agreement. This agreement is subject to ratification by the Innu Nation but provides further certainty needed to move forward with LCP planning and further investment.

Also moving the Project forward is continued assessment of markets. Potential market access includes a potential subsea route into the Maritime Provinces and through Hydro-Québec's transmission systems.

During 2009, efforts to secure transmission service for LCP continued. Transmission service applications were made in 2006 and 2007 to HQT and the New Brunswick System Operator (NBSO), under their respective transmission open access rules. LCP's requests have been proceeding in accordance with these prescribed procedures. Studies were undertaken by both HQT and NBSO. In the case of HQT, however, Nalcor disagreed with certain assumptions used and interpretations of the rules applied in the study. These disagreements led to the filing of complaints with the Régie de l'énergie (Régie), the regulatory agency with jurisdiction

over transmission and distribution of electricity in Québec. A complaints hearing was held by the Régie from January 19 to February 12, 2010 and the decision is pending.

The NBSO completed studies on deliveries to the NBSO system from two transmission paths, a maritime subsea High Voltage direct current line and the HQT grid into New Brunswick. Additional requests were made that will require more study in 2010. LCP will also continue its work with other transmission providers and developers in the Northeast region to assess transmission access options.

In June 2007, the Province passed an amendment to the Electrical Power Control Act, 1994. The amendment requires hydroelectric operators sharing a river system to enter into water management agreements to coordinate production. If the operators cannot negotiate an agreement, an operator may apply to the PUB to have the terms of an agreement established. A tentative agreement reached between Management of Nalcor and Churchill Falls was not approved by the Churchill Falls Board of Directors. As a result, on November 10, 2009, Nalcor applied to the PUB to establish the terms of the agreement. On March 9, 2010, the PUB issued a board order establishing a water management agreement. The agreement permits the two power producers, Nalcor and Churchill Falls, to use available storage, primarily in the Churchill Falls reservoir, and their respective generating facilities to optimize the production of power while maintaining the contractual obligations of Churchill Falls to its customers.

Management's Discussion & Analysis

Bull Arm Fabrication: Bull Arm is a valuable asset in the development of the oil and gas industry in Newfoundland and Labrador and the advancement of the province's fabrication capacity. The Bull Arm site was originally developed in the 1990s to construct the 600,000-tonne Gravity Base Structure platform and topside components for the Hibernia Project. Since that time, fabrication and other work associated with Newfoundland and Labrador's offshore oil and gas and mining industries has been completed at this site. In August 2008, the Government announced the transfer of the Bull Arm Site Corporation to Nalcor Energy, and the transfer was completed on March 31, 2009. During 2009, earnings from the activities at the Bull Arm site were \$3.1 million (2008 - nil).

Menihek Operations: In 2007, Hydro assumed ownership of the Menihek Generating Station from the Iron Ore Company of Canada and entered into a 40-year power purchase agreement to supply electricity from this facility to Hydro-Québec for its customers in the Schefferville region. Revenue was \$1.3 million for 2008 and 2009 and with certain cost recoveries from Hydro-Québec, resulted in net income of \$1.5 million (2008 - \$1.1 million).

Electricity Sales to Mining Industry: Sales to the iron ore industry in Labrador are from two sources. The first is through Churchill Falls' joint venture, Twin Falls, and the second is through direct sales by Hydro sourced from recall power. These direct sales in 2009 were \$4.6 million compared to \$5.6 million in 2008. The decrease is the result of a slow down in the mining industry in Labrador resulting from reduced global demand. Net earnings were \$1.9 million in 2009 and \$2.7 million in 2008.

Business Development: Business development includes activities related to Labrador wind, research and development and other business opportunities. During 2009, the business development group continued activity associated with the Wind-Hydrogen-Diesel Project in Ramea. This research and development project will use wind and hydrogen technology to supplement the diesel requirements of this isolated community and has the potential to eventually replace diesel with zero-emission power. Commissioning of the project originally scheduled for 2009 was delayed and is now expected in 2010. The project aims to develop a wind-hydrogen-diesel energy solution designed for small-scale energy production in isolated locations. Nalcor's collaborating and project partners for the Ramea project are the Government of Newfoundland and Labrador; CANMET Energy Technology Centre at NRCan; Faculty of Engineering and Applied Science, Memorial University of Newfoundland; and the University of New Brunswick Sustainable Power Research Group. In 2009, none of these activities were in a commercial stage and as a result did not produce any revenues. Costs expensed and capitalized in 2009 were \$1.9 million (2008 - \$0.9 million) and \$2.8 million (2008 - \$3.3 million), respectively.

Other: Investments in LCDC and GIPCo are included in this category. Both companies are inactive and had minimal transactions in 2008 and 2009.

Corporate Costs: Costs associated with the operation of Nalcor Energy, the parent company, are recorded in this category. In 2009, operating and other costs of \$7.1 million increased \$2.6 million over 2008 costs of \$4.5 million. The primary reasons for this increase is additional consulting costs related

to business development activities, additional personnel primarily as a result of reorganization of staff within Nalcor and its subsidiary companies and normal cost of living salary increases.

On December 16, 2008, the Province licensed Nalcor Energy to manage and operate the former Abitibi-Consolidated hydro assets on behalf of the Province. Nalcor is operating the Star Lake, Grand Falls and Bishop's Falls facilities on a cost recovery basis. The power purchase agreements that previously applied to these facilities have been cancelled through Legislation

2010 FINANCIAL OUTLOOK

Outlook

Nalcor Energy's consolidated financial position is expected to improve in 2010. Improvements are anticipated in earnings to interest coverage through improved earnings and a slight decrease in gross interest. Reduced debt in the capital structure and a reduced debt load generally have facilitated declining interest costs in recent years.

Hydro Regulated's net income in 2010 is expected to decline from 2009 levels. Hydro is anticipating paying a common dividend during 2010 to restore its regulated debt to capital ratio to the targeted level of 75% as at the end of 2009.

Earnings from the Energy Marketing business segment are expected to increase in 2010 due to anticipated improvements in energy markets.

Churchill Falls' net income is expected to improve due largely to increased revenues from power sales and revenues under the GWAC. Churchill Falls expects to fund the full repayment of the Bank of Nova Scotia Credit Agreement loan from available funds and as a result, anticipates being debt free at the end of 2010.

On February 23, 2010, Churchill Falls filed a motion against Hydro-Québec in the Québec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The outcome of this motion is not determinable at this time.



Management's Discussion & Analysis

Oil and Gas is expected to realize revenues from its first oil producing well during 2010 and is expected to post positive net income during that year. Funding of Oil and Gas' operations will be through equity contributions from the parent company, Nalcor Energy, and cash flow from operations.

With respect to the Lower Churchill Project, progress is anticipated during 2010 in the determination of a viable transmission route to access export electricity markets. Progress and clarity is also anticipated in key areas such as environmental assessment and market opportunities.

Bull Arm Fabrication had over \$2.0 million in working capital at the end of 2009. This position is expected to remain relatively unchanged at the end of 2010. Reductions in government grants, coupled with reduced lease revenues, are expected to lead to a return to 2008 earnings levels.

Price Hedging

Nalcor Energy has hedged a substantial portion of its market price exposure for 2010 as it pertains to electricity exports by hedging approximately 75% of the exposure to foreign exchange and approximately 70% of the exposure to changes in market prices through forward currency and swap contracts, respectively.

With respect to oil sales, a risk management plan, including the possible use of hedges, will be implemented concurrent with first oil from the White Rose Growth Project.

FINANCIAL CONDITION REVIEW

Assets

Total assets were \$2,630.7 million at December 31, 2009, an increase of \$155.7 million or 5.9% over December 31, 2008. There were a number of contributing factors to the increase in assets. Nalcor Energy invested \$81.7 million related to the acquisition and development of oil and gas properties (2008 - \$112.1 million). In addition, the corporation invested \$96.4 million in property, plant and equipment (2008 - \$93.4 million). The following table shows capital expenditures by segment:

<i>millions of dollars</i>	2009	2008
Oil and Gas	\$ 82.6	\$ 112.4
Hydro Regulated	54.1	45.6
Churchill Falls	3.7	4.3
Other	37.7	43.2
	\$ 178.1	\$ 205.5

Additions to property, plant and equipment were, in part, offset by amortization of \$54.9 million (2008 - \$53.2 million). Short-term investments increased by \$24.6 million, sinking fund investments by \$22.0 million and the third payment to the Reserve Fund of \$11.1 million (Nalcor's share of the \$17.0 million contribution by Churchill Falls) was made in 2009. These increases were offset by a decrease in regulatory assets, primarily the amortization of regulated charges of \$5.5 million (2008 - \$18.9 million) and a reduction in cash and cash equivalents of \$35.8 million.

Liabilities

Total liabilities decreased by \$51.8 million from \$1,540.5 million at December 31, 2008, to \$1,488.7 million at December 31, 2009. The decrease in liabilities was primarily due to the reduction in promissory notes in the amount of \$163.0 million offset by an increase in regulatory liabilities of \$68.8 million and increased accrued liabilities primarily related to oil and gas expenditures in the amount of \$13.2 million and \$11.0 million related to the Lower Churchill Project.

Equity

Total Shareholder's equity increased by \$207.5 million from \$934.5 million to \$1,142.0 million in 2009. Retained earnings increased due to net earnings for 2009 of \$60.0 million. The remaining increase in equity is due to an injection of contributed capital by the Shareholder of \$142.0 million and an increase in accumulated other comprehensive income of \$5.5 million resulting from unrealized gains on financial instruments.

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

Cash flows relating to operating, investing and financing activities are summarized in the following table:

<i>millions of dollars</i>	2009	2008
[Cash provided by (used in)]		
Operating activities	\$ 212.5	\$ 177.2
Financing activities	(15.9)	127.1
Investing activities	(232.4)	(252.9)
Net (decrease) increase in cash	\$ (35.8)	\$ 51.4

Liquidity requirements are met through a variety of sources, including funds from operations, short-term borrowings, issuance of long-term debt and contributed capital. Nalcor Energy's primary uses of funds during 2009 were operating expenses, capital spending, including expenditures for the Lower Churchill Project and oil and gas properties, and interest and principal payments on its debt. Cash from operating activities of \$212.5 million was higher than the previous year and included net earnings and other non-cash items as well as changes in working capital. Investing activities included \$96.4 million in property, plant and equipment; \$81.7 million related to oil and gas investments; sinking fund and reserve fund investments of \$33.0 million and short-term investments of \$24.6 million. Cash used in financing activities in the amount of \$15.9 million was primarily due to a \$163.0 million reduction in short-term borrowings offset by an equity injection of \$142.0 million of contributed capital.

Nalcor Energy and its subsidiaries use a combination of funds from operations, short-term and long-term debt, and equity instruments to finance operations. Nalcor Energy maintains an unsecured revolving short-term credit facility with a limit of \$150.0 million, with covenants that require Nalcor Energy to maintain a non-consolidated Debt to Capitalization Ratio not greater than 70:30 and a non-consolidated Debt Service Coverage Ratio of greater than 1.5 to 1. With the exception of a \$1.5 million letter of credit outstanding, the facility was unencumbered as at the end of 2009.

Management's Discussion & Analysis

Nalcor Energy's subsidiary, Hydro, maintains a short-term promissory note program for funding its daily requirements. This program has an authorized limit of \$300.0 million and is guaranteed by the Government of Newfoundland and Labrador. The current credit rating of R1 (low) assigned to this program by Dominion Bond Rating Service (DBRS), combined with the Government guarantee, allows Hydro to access short-term funds in the Canadian Money Market at attractive rates. At December 31, 2009, there were no short-term notes outstanding. Unsecured bank credit facilities are also in place in the amount of \$50.0 million and with the exception of letters of credit outstanding of \$7.5 million, this bank credit facility was unencumbered as at the end of 2009. In February 2010, Hydro issued 22 letters of credit reducing the availability of the credit facility by an additional \$11.5 million.

Capital markets are the principal source of longer-term funding for Hydro. Hydro's debenture issues are currently assigned an "A" credit rating by DBRS, and are also fully guaranteed by the Government. Hydro's total borrowings outstanding, net of sinking funds and exclusive of borrowings pertaining to Churchill Falls, are limited by legislation to \$1,612.0 million. As of December 31, 2009, \$970.2 million was outstanding.

The operations of Churchill Falls are financed by cash from operations. During 2009, Churchill Falls used cash balances to repay \$1.1 million of long-term debt held in the 4.4% fixed rate credit facility and to make the scheduled \$17.0 million contribution to the capital reserve fund as required under the 1999 Shareholders' Agreement between Hydro and Hydro-Québec. It is management's expectation that cash flow from operations during 2010 will be

sufficient to retire the \$44.5 million balance outstanding at December 31, 2009. Unsecured bank credit facilities are also in place in the amount of \$10.0 million and with the exception of a letter of credit outstanding of \$1.0 million, this bank credit facility was unencumbered as at the end of 2009.

The operating and capital requirements of Oil and Gas are financed by funds from operations and injections of equity capital from Nalcor Energy. Oil and Gas currently does not issue any short-term or long-term debt in its own name, and as a result has a capital structure as at December 31, 2009 that is 100% equity financed (2008 - 100%). During 2009, there were no revenues from the sale of crude oil, and investments in oil and gas assets of \$81.7 million were funded through injections of equity capital from Nalcor. Revenue from the sale of crude oil is anticipated during 2010, at which time production from its investment in the White Rose Growth Project is expected to come on line. Until such time as Oil and Gas has an earnings and credit profile sufficient to support entry into either the money markets or the capital markets, any borrowings required to supplement earnings from operations will occur at the parent company level. At such time Management will review the funding strategy.

Bull Arm Fabrication's short-term liquidity requirements are met by a combination of cash and cash equivalents on hand and funds from operations. Long-term liquidity needs are minimized through the provision of annual operating grants from the Province.



Access to Working Capital

Overall economic conditions in 2010 are expected to favorably impact funds from operations of Nalcor Energy and its subsidiaries, as well as have a positive impact on the availability of short-term capital at competitive rates. Nalcor anticipates continued access to short-term capital. Funds from operations are expected to be consistent with prior years, and the availability of short-term funding under Nalcor's \$150.0 million credit facility is considered sufficient to meet both anticipated and unanticipated working capital needs. Covenants under the credit facility are intact and draw downs to date have been without incident. Borrowing costs under the credit facility are based on Bankers' Acceptance (BA) rates plus a stamping fee of 35 basis points.

Hydro's short-term debt is rated as R1 (low) by DBRS and A-1 mid by Standard and Poors. Both are investment grade credit ratings that facilitate Hydro's access to short-term capital markets. Hydro

sells a large portion of its power to Newfoundland Power, which is a regulated distribution utility in the Province and whose First Mortgage Bonds are rated by DBRS as an "A" credit. Hydro continues to obtain short-term funding through its promissory note program. The notes issued under this program are guaranteed by the Shareholder. Market receptivity for Hydro's short-term paper was strong during 2009, with a total of \$421.0 million in promissory notes issued during the year.

Churchill Falls' revenue stream is fixed at pricing under a long-term power contract with Hydro-Québec. Churchill Falls' cash requirements are funded by cash from operations with periodic working capital needs met through ready access to cash and high quality short-term investments. At year end, Churchill Falls had access to nearly \$30.0 million in cash and highly liquid short-term investments. It also had access to a reserve fund totaling \$53.0 million for use in meeting unanticipated capital expenditures.

Management's Discussion & Analysis

To date, working capital requirements of Oil and Gas have been met through contributions of equity capital from Nalcor Energy. During 2010, this funding source will be augmented by funds from oil and gas operations. These funds from operations will be exposed to fluctuations in both the market price of crude oil and the USD/CAD exchange rate. This exposure will be managed in accordance with Nalcor's corporate Financial Risk Management Policy.

CAPITAL STRUCTURE

Nalcor Energy's debt and equity and related ratios are shown in the following table:

<i>millions of dollars</i>	2009	2008
Short-term debt	\$ -	\$ 163.0
Current portion long-term debt	37.5	9.1
Long-term debt (net of sinking funds)	962.0	1,011.8
Total debt	\$ 999.5	\$ 1,183.9
Shareholder's equity	\$ 1,142.0	\$ 934.5
Total debt to capital ⁽¹⁾	47%	56%
Fixed rate debt as a percentage of total indebtedness ⁽²⁾	100%	86%
EBIT to interest coverage ⁽³⁾	1.8	1.8

⁽¹⁾ *Debt to Capital - Total debt (promissory notes, long-term debt including current portion less sinking funds), divided by debt plus Shareholder's equity.*

⁽²⁾ *Long-term debt divided by total debt.*

⁽³⁾ *EBIT divided by gross interest. Earnings before interest and taxes and includes interest income but is net of the guarantee fee. Gross interest is interest expense before interest income, guarantee fee, capitalized interest, accretion and foreign exchange provision.*

Nalcor Energy manages its capital to ensure the financial viability of its various lines of business and to sustain its growth objectives. It uses the key measures of debt to capital and earnings before interest and taxes (EBIT) to interest coverage to monitor its capital structure. In 2009, the corporation realized a significant improvement in the debt to capital ratio as a direct result of contributed capital received from the Shareholder in the amount of \$142.0 million. This equity funding, combined with a policy to reinvest all earnings, resulted in a significant reduction in leverage in Nalcor Energy's capital structure. A similar improvement in EBIT to interest coverage was not achieved due largely to reduced earnings offset to a degree by a decrease in gross interest. The reduction in gross interest during 2009 was largely due to a reduction in the average debt balances outstanding, coupled with lower short-term interest rates. The reduction in earnings is seen as temporary and is expected to lead to a future improvement in the EBIT to interest coverage.

The proportion of fixed rate debt as a percentage of total indebtedness increased from 86% at the end of 2008 to 100% at the end of 2009. The increased fixed rate percentage compared to 2008 was due to the application of contributed equity funding to outstanding short-term debt. This was augmented by positive cash flows resulting from reduced fuel purchases caused by favorable pricing, hydrology and reduced consumption due to decreased industrial load.

OBLIGATIONS AND COMMITMENTS

Obligations and commitments for the five-year period of 2010 to 2014 are as follows:

<i>millions of dollars</i>	2010	2011	2012	2013	2014
Debt repayments ⁽¹⁾	\$ 29.3	\$ -	\$ -	\$ -	\$ 125.0
Sinking fund installments	8.2	8.2	8.2	8.2	8.2
Reserve fund payments ⁽²⁾	5.3	5.3	5.3	-	-
Power purchase agreements ⁽³⁾	27.0	27.6	28.5	29.5	30.2
Transmission capacity ⁽⁴⁾	19.2	19.2	19.2	19.2	4.8
Total	\$ 89.0	\$ 60.3	\$ 61.2	\$ 56.9	\$ 168.2

⁽¹⁾ Includes repayment of long-term debt

⁽²⁾ In accordance with the Shareholders' Agreement, Churchill Falls is required to establish a \$75.0 million Reserve Fund for major repairs, which commenced with an initial payment in January 2007. The amount represents Nalcor's 65.8% share of the payments.

⁽³⁾ Hydro has entered into a number of power purchase agreements with remaining terms ranging from 15 to 26 years.

⁽⁴⁾ Hydro has the right to renew its transmission service contract at the end of the contract term.

RELATED PARTY TRANSACTIONS

Hydro purchases recall power from Churchill Falls and in 2009 purchases were \$5.9 million (2008 - \$6.0 million). Additionally, in the normal course of operations, Nalcor Energy and Hydro provide certain engineering, technical, management and administrative services to Churchill Falls. Fees paid by Churchill Falls to Nalcor Energy and Hydro for these services amounted to \$2.3 million in 2009 (2008 - \$2.2 million).

Nalcor and its subsidiaries have a net payable to the Province of \$9.5 million (2008 - \$4.3 million). This payable consists of various transactions including rentals, royalties, power purchases, cost recoveries and amounts related to the acquisition of Bull Arm Fabrication. Hydro also received \$0.4 million as a rate subsidy for rural isolated customers in 2008 and

2009 and \$1.6 million (2008 - \$1.5 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated customers under the Government's Northern Strategic Plan. An operating grant of \$2.0 million (2008 - \$0.5 million) was received from the Province for the Bull Arm Fabrication facility. Oil and Gas also received \$1.0 million from the Province related to the Petroleum Exploration and Enhancement Program.

Management's Discussion & Analysis

SECTION 3: RISK MANAGEMENT PROCESS

Nalcor's Leadership Team, comprising direct reports to the President and Chief Executive Officer, provides senior management oversight of risk in the Corporation. Nalcor focuses on an execution of risk management and mitigation strategies at the business unit level that utilizes a common risk framework and toolset. The Corporate Treasurer and Chief Risk Officer are responsible for the ongoing monitoring and review of the risk profile and practices and also chairs an Enterprise Risk Management committee that assists in this activity. This committee consists of membership across the various lines of business. In addition, a risk representative, who is responsible for ensuring that risk management policy and related mitigation strategies are carried out, has been appointed in each line of business.

Risks are identified at the business unit level and rated according to severity and likelihood of occurrence. Mitigation strategies are devised for highly rated risks and these strategies form an integral part of the related business plan. Mitigation strategies include initiatives such as insurance contracts, hedging transactions, asset management and capital improvements.

Risk management is viewed not only as a means by which risks are identified and mitigated as appropriate, but also as a means by which business opportunities can be identified and assessed. While recognizing that some acceptance of risk is a necessary part of doing business, Nalcor endeavors to accept only those risks that help ensure competitive advantage and that are within its capability to withstand. The Board of Directors is

regularly updated on higher profile risks and their status. Nalcor is continuing to develop its risk management capability and has engaged consultants to assist in this effort.

Nalcor Energy has identified four major categories of risk: strategic, operational, financial and compliance related risks.

STRATEGIC RISK

Strategic risks have components that are outside the control of Nalcor, such as changes to governance structure, market upheaval, stakeholder influence and regulatory directives. The Leadership Team has identified key strategic risks within each line of business and accepted those that might provide competitive advantage. Others have been analyzed in the context of Nalcor's ability to withstand the attendant risk and mitigation strategies have been formulated for risks carrying a higher rating. Strategic opportunities and mitigation strategies identified as a result of this process are integrated with the corporate planning process.

OPERATIONAL RISK

Risks are identified and assessed based on the probability and severity of a potential occurrence. Events that could have a significant impact on corporate strategic goals are identified and mitigation procedures are effected to provide reasonable assurance that such events will not prevent achievement of corporate goals and objectives. Through continual updating of risk management practices, Nalcor Energy ensures the protection of all physical and financial assets.

This category of risk includes: major damage to critical assets; interruption of electrical service; and liability to third parties arising from property damage or loss, bodily injury or loss of life. To eliminate or lessen the impact of this risk, Nalcor Energy has developed regular maintenance, inspection and insurance programs and initiated redundancy of critical assets.

The corporate insurance program, covering all assets and specified liabilities, is reviewed and updated annually. The review focuses on exposures to loss, insurable values, coverage limits, deductibles, self-insured retentions and loss analysis. Statistics and information compiled during the annual review are utilized to develop renewal strategies resulting in the acquisition of comprehensive coverage at competitive cost.

Each operational area and facility within Nalcor Energy has developed comprehensive response plans to provide guidance and contingency processes in the event of emergency. The plans are based on consideration of adverse events that each area or facility might be subject to in the course of their operations such as fire, explosion, equipment failure and natural events such as floods and ice storms. Nalcor Energy has also established emergency response plans at the corporate level, which provides for executive level and functional support from service areas. In addition to contingency planning for response at the time of occurrence and in the immediate post-emergency time frame, longer-term planning for business continuity related issues is also an on-going priority.

Nalcor Energy has initiated a review of its asset management practices to ensure it manages its

assets effectively and consistently to maximize equipment availability and minimize cost. The review is designed to ensure a consistent framework and process across the Corporation.

Safety

The pursuit of safety excellence is a critical focus at Nalcor Energy and all its lines of business. Safety is reinforced throughout the organization and is evident in the delivery of Safety Culture Change Workshops to employees; the development of a set of core values; a new Safety Credo; and formal documentation of an Internal Responsibility System for safety. Key safety processes are continuously reviewed and updated including: Work Protection Code, work method development, contractor safety management, safety performance communication and personal hazard assessment.

Information Technology

Information technology affects all aspects of Nalcor Energy's operations. Major risk exposures in this environment are: the loss of processing capability due to hardware or software failure, the loss of communication capabilities across the wide-area network and the threat of virus attacks on Nalcor's computer system.

In the event of a major hardware failure, Nalcor has retained a service provider to help restore critical business systems. The service provider supplies a back-up site along with all the necessary hardware and communication links. Nalcor Energy maintains a Disaster Recovery Plan that details actual recovery procedures and processes and is updated and tested on a periodic basis. The Energy Management System that controls Hydro's generation and transmission activities has a backup Energy Control Centre in a separate facility.

Management's Discussion & Analysis

The threat of computer virus attacks on Nalcor Energy's computer system is mitigated through the use of firewalls, anti-virus tools and detection/intrusion prevention appliances. Internet access is tightly controlled and managed by a web-filtering device that reduces the risk of picking up malicious

Targets for improvements in environmental performance for these lines of business are established and monitored as part of the corporate goals and objectives. Nalcor Energy mitigates environmental risk through adherence to the various principles of the EMS, which include periodic internal



code from questionable sites. Nalcor has also initiated increased security measures to align with Shareholder directives to all Crown agencies.

Environmental

The number and diversity of environmental risks facing Nalcor requires a structured and consistent management approach. Nalcor Energy applies the ISO 14001 Environmental Management System (EMS) standard developed by the International Organization for Standardization to its Hydro and Churchill Falls subsidiaries to drive continual improvement in mitigating environmental risks, while fulfilling its mandate to provide customers with safe, reliable and least-cost power.

environmental compliance audits, surveillance audits by an outside contractor and recertification as ISO 14001 compliant.

Regulatory

Rates that Regulated Hydro charges for the provision of electrical service are established by the PUB. The ability to recover the actual costs of providing service depends on achieving forecasts established in the rate setting process. During 2009, the Shareholder issued an Order in Council which provided Hydro with the ability to earn a rate of return equal to that of Newfoundland Power. Rates have not yet been set to achieve this level of earnings.

Growth Activities

As Nalcor Energy considers future growth activities in the energy sector, it will be subject to a number of risks. As investment opportunities are evaluated, strategies will be devised to mitigate identified risks. With respect to its oil and gas investments, a variety of risks exist that Nalcor has considered during its due diligence process and mitigated where deemed appropriate. These risks include reserve levels, capital costs, oil prices, availability of financing and project development schedules. The impact of global and regional economies, availability of labour, cost inflation, foreign exchange rates, commodity prices, regulatory implications, availability of competitively priced financing and strategic compatibility are considered for all investments being evaluated by Nalcor.

Internal Audit

The internal audit function assists Nalcor Energy in achieving its objectives by providing a systematic evaluation of the effectiveness of risk management, cost control and governance processes. Opportunities for improving management control may also be identified during the audits.

FINANCIAL RISK

Nalcor Energy operates in an environment with various forms of financial risk, including credit, liquidity and market risk. In compliance with Board-approved policy, Nalcor utilizes a combination of derivative financial instruments and portfolio management to manage these risks.

Credit Risk

Nalcor Energy is exposed to credit risk in the event of non-performance by counterparties to its financial instruments. Procedures and practices designed to

manage the credit risks associated with the various business activities throughout Nalcor are contained in the Corporate Financial Risk Management Policy and generally include assessment and monitoring of counterparty creditworthiness, setting of credit limits and various forms of credit assurance. The majority of receivables are from regulated utilities and retail consumers, which minimizes credit risk.

Nalcor manages its cash investment credit risk exposure by restricting its investments to high-quality securities. Investments held within the portfolios of Churchill Falls do not exceed 10% with any one institution with the exception of the Government of Canada. Derivative transactions are executed with only highly-rated banking institutions. Credit risk related to the sale of recall power is managed through contractual arrangements with creditworthy counterparties, supported by credit enhancements as appropriate.

Liquidity Risk

Nalcor Energy is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Short-term liquidity is provided by cash and cash equivalents, funds from operations and maintenance of borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within its operations. Cash flows are monitored continuously. Long-term liquidity is provided through the issuance of debentures in the capital markets and injections of equity capital in support of large project investments. The funding obligations associated with the longer-term debentures are managed through a balanced approach to debt maturity and a program of sinking fund investment. Debt maturities are managed to avoid overly demanding funding requirements in any given year.

Management's Discussion & Analysis

Market Risk

Interest Rates

Nalcor Energy has a \$150.0 million unsecured revolving-term credit facility, convertible into non-revolving debt. Hydro's short-term funding is managed under a provincially-guaranteed promissory note program having a \$300.0 million limit and a \$50.0 million unsecured credit facility with its banker. Churchill Falls maintains a short-term investment portfolio that serves its working capital needs. An unsecured credit facility of \$10.0 million is available but has rarely been utilized. Credit capacity is made available to Oil and Gas through Nalcor Energy and as such, is not directly exposed to fluctuations in interest rates.

Nalcor Energy annually establishes clear guidelines for exposure to short-term interest rates and management is regularly apprised of Nalcor's positioning. These exposure limits are reset annually based on ongoing benchmarking against key indices, coupled with the performance of sensitivity analysis against established risk tolerance levels for each subsidiary. In this manner, Nalcor attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates. As Nalcor Energy continues to increase its energy investments, it will review and revise interest rate risk policy as necessary.

Foreign Exchange and Commodity Prices

Nalcor Energy's primary exposure to both foreign exchange and commodity price risk arises from: Hydro's purchases of No. 6 fuel for consumption at its Holyrood Generating Station, the sale of recall power at USD market rates and commencing in 2010, sales by Oil and Gas of crude oil produced from its oil and gas investments. Management of foreign

exchange risk and commodity price risk is governed by the Financial Risk Management Policy approved by the Board of Directors.

Hydro's exposure on the purchase of No. 6 fuel is mitigated through the operation of the RSP. Variances in actual fuel prices and quantities, as compared to that approved in Hydro's most recent COS used to set rates, are captured in the RSP and are either charged or refunded to customers through rate adjustments. Hydro employs the periodic use of forward currency contracts as a means by which future exposure to exchange rate fluctuations on any given day can be avoided. As at December 31, 2009, there were no forward contracts outstanding in connection with No. 6 fuel purchases.

In April 2009, Hydro entered into a contract to sell recall power based on market prices denominated primarily in USD. Foreign exchange and commodity price exposures on sales of recall power are managed through a combination of portfolio management and derivative hedging instruments, including forward exchange contracts and commodity price swaps. During 2009, Hydro executed USD/CAD currency trades on a total notional value of USD \$87.8 million covering the 24-month period from April 2009 to March 2011. As at December 31, 2009, the total notional value of currency trades outstanding was USD \$59.1 million (2008 – nil), representing approximately 75% of anticipated USD cash flows from the sale of recall power for the period January 2010 to March 2011. Depressed pricing in the futures markets at the time of entering into the sales contract made it impractical to hedge commodity prices at that time. Hence, as at December 31, 2009, there were no commodity price swaps outstanding. A partial

recovery in the futures markets early in 2010, coupled with more favourable contract pricing has prompted the implementation of commodity hedge positions in 2010.

Exposure to both foreign exchange and commodity price risk will arise in Oil and Gas from the sale of its share of crude oil generated from projects in which it has an ownership interest. These sales will be denominated in USD. There were no sales during 2009; however, sales are forecast for 2010. Nalcor's hedge strategy in relation to these sales will be heavily dependant upon the production profile.

Commodity price and foreign exchange risk, as it pertains to both energy sales and oil and gas investments, are managed in a manner that considers Nalcor Energy's earnings quality and planned objectives. As added foreign exchange and commodity price exposures emerge, they will continue to be managed in accordance with the Corporate Financial Risk Management Policy.

COMPLIANCE RISK

As a Crown-owned entity with regulated operations, Nalcor Energy is exposed to varying aspects of compliance risk across each of its lines of business. Each line of business is required to assess their risk of non-compliance and to consider mitigation strategies where appropriate. These include compliance with provincial legislation, regulatory directives, environmental standards and a wide variety of contractual arrangements affecting both revenues and expenditures. Specifically, Nalcor has identified various focus areas including compliance with the Shareholder mandate as outlined in the 2007 Energy Plan, legislative

compliance with the Energy Corporation Act, compliance with the corporate governance framework that guides strategic planning and decision making, compliance with International Financial Reporting Standards (IFRS) that are due to come into effect January 1, 2011, and compliance with covenants contained in various credit facilities and debenture issues.

Hydro's compliance risks include legislative compliance with the Hydro Corporation Act, 2007, environmental compliance with emissions standards applicable to thermal generation and marine terminal operations and compliance with regulatory directives of the PUB on such matters as electricity rates, rate stabilization, cost of capital, return on equity, capital planning and capital structure.

Churchill Falls' primary areas of compliance risk include compliance with the Churchill Falls (Labrador) Corporation Limited (Lease) Act, 1961, the 1969 Power Contract with Hydro-Québec and the 1999 Shareholders' Agreement, as well as compliance with water management obligations.

Oil and Gas' compliance risks include compliance with regulatory directives of the Canada-Newfoundland and Labrador Offshore Petroleum Board and contractual obligations associated with acquisition of working interests in various oil and gas projects.

Until the Lower Churchill Project is sanctioned, its primary compliance risks are in the areas of environmental approvals, market access requests, projects control, and governance and compliance with aboriginal agreements.

Management's Discussion & Analysis

In all these risk areas, Nalcor has identified, rated and mitigated each risk as appropriate and ensured their consideration as part of the corporate business planning process.

SECTION 4: CRITICAL ACCOUNTING ESTIMATES

Nalcor Energy's discussion and analysis of its financial condition and results of operations are based on its audited Consolidated Financial Statements, which have been prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP).

Significant accounting policies are contained in Note 2 to the audited Consolidated Financial Statements. Some of these policies involve critical accounting estimates requiring particularly subjective or complex judgments about matters that are inherently uncertain which could result in materially different amounts under different conditions or using different assumptions. Management has discussed the development, selection, and application of its key accounting policies and the critical accounting estimates and assumptions they involve, with the Audit Committee of the Board of Directors, and it has reviewed the disclosures described in this section.

The following section discusses the critical accounting estimates and assumptions that management has made and how they affect the amounts reported in the audited Consolidated Financial Statements. Nalcor Energy considers these estimates to be an important part of understanding the financial statements.

Employee Future Benefits

Nalcor Energy provides pensions and other retirement benefits for employees. Nalcor Energy believes the accounting estimates related to its employee benefit plan costs are critical accounting estimates because the estimates are based on the use of various key assumptions and differences in actual results or changes in assumptions could materially affect Nalcor Energy's Consolidated Financial Statements.

Due to the long-term nature of these plans, the calculation of expenses and obligations depends on various assumptions such as: discount rates, health care cost trend rates, projected salary increases, retirement age, mortality and termination rates. These assumptions are determined by management and are reviewed by Nalcor Energy's actuaries.

The discount rate reflects the weighted average interest rate at which the other post-retirement liabilities could be effectively settled using high-quality bonds at the measurement date. Based on employee demographics and expected future benefit and medical claims, payments are measured and discounted to determine the present value of the expected future cash flows. The cash flows are discounted using yields on high-quality AA-rated non-callable bonds with cash flows of similar timing. Other assumptions are based on actual experience and best estimates.

Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation in future periods. These differences relate primarily to actual actuarial gains/losses incurred on the benefit obligation

versus those expected, as recognized in the Consolidated Financial Statements. For further details on the annual expense and obligation, see Note 11 to the Consolidated Financial Statements.

Asset Retirement Obligations

Nalcor Energy recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. Determining asset retirement obligations requires estimates in relation to the expected life of the asset and the costs of demolition, dismantlement, restoration and remedial work that would be required.

Impairment of Property, Plant and Equipment

Nalcor Energy reviews the carrying value of its development projects at the end of each accounting period. Nalcor Energy reviews the carrying value of its other property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. When applicable, an impairment loss would be recognized equal to the amount by which the carrying amount exceeds the fair value. Various assumptions and accounting estimates are required to determine whether an impairment loss should be recognized and if so, the value of such loss. This includes factors such as short-term and long-term forecasts of the future market price of electricity and fuel, the demand and supply of electricity and fuel, the in-service dates of new generating stations, inflation, capital expenditures and station lives. The amount of future net cash flow that Nalcor Energy expects to receive from its property, plant and equipment could differ materially from the net book values recorded in its Consolidated Financial Statements.

Full Cost Accounting for Petroleum and Natural Gas Properties

Nalcor Energy reviews the carrying value of its development projects at the end of each accounting period. The carrying value of petroleum and natural gas properties, as well as the corresponding DD&A expense, is based on estimates of costs to develop proved undeveloped reserves, proved oil and gas reserves and future net cash flows from proved reserves.

Regulation

Generally, the accounting policies applicable to Hydro are subject to examination and approval by the PUB. These accounting policies may differ from those used by entities not subject to rate regulation. The timing of the recognition of certain assets, liabilities, revenues and expenses may differ from that otherwise expected using Canadian GAAP for entities not subject to rate regulation. Regulatory assets and regulatory liabilities arise as a result of the rate-setting process and have been recorded based on previous, existing or expected future regulatory orders. Certain estimates are necessary until these amounts are finalized pursuant to regulatory decisions or other regulatory proceedings. The final amounts approved by the PUB for deferral as regulatory assets and regulatory liabilities and the approved recovery or settlement periods may differ from those originally expected. Any resulting adjustments to original estimates are reported in earnings in the period in which they become known. As at December 31, 2009, Hydro had \$74.1 million in current and long-term regulatory assets (2008 – \$79.6 million) and \$122.6 million in current and long-term regulatory liabilities (2008 – \$53.8 million). The nature of the Corporation's regulatory assets and liabilities is described in Note 6 to the Consolidated Financial Statements.

Management's Discussion & Analysis

Useful Life of Capital Assets

Property, plant and equipment are amortized over their estimated service lives. Estimated service lives are determined based on the anticipated physical life of the asset, technological obsolescence, and past experience, and are reviewed regularly to ensure that they continue to be appropriate.

Amortization is an estimate based primarily on the anticipated useful life of assets that reflects current facts and historical information. Nalcor Energy's consolidated property, plant and equipment represents approximately 72% of total consolidated assets as at December 31, 2009 (2008 – 75%). Amortization expense associated with property, plant and equipment was \$54.9 million during 2009 (2008 – \$53.2 million). Due to the size of Nalcor's property, plant and equipment, changes in amortization rates can have a significant impact on amortization expense.

During 2005, pursuant to Order No. P.U. 7 (2002 – 2003), Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management estimated that accumulated amortization is approximately \$170.0 – \$180.0 million lower than it would otherwise be, and annual amortization expense is \$10.0 – \$11.0 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets. A more recent study indicated that the amounts could be significantly higher. An update to this study is to be completed in 2010.

Capitalized Overhead

As approved by the PUB, Hydro capitalizes overhead costs that are not directly attributable to specific capital assets but which relate to the overall capital program. This capital overhead is allocated to property, plant and equipment and amortized over their estimated service lives. In 2009, \$2.5 million (2008 – \$3.0 million) was allocated. Any change in the methodology of calculating and allocating general overhead costs to property, plant and equipment could have a significant impact on the amount recorded as operating expenses and property, plant and equipment assets.

SECTION 5: ACCOUNTING CHANGES

New Accounting Policies

Effective January 1, 2009, Nalcor adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA):

Goodwill and Intangible Assets: Section 3064, Goodwill and Intangible Assets establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and provides more comprehensive guidance particularly with respect to internally developed intangible assets. This new standard did not have any impact on Nalcor's financial results or disclosures.

Financial Instruments: EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities issued by the Emerging Issues Committee requires that an entity's own credit risk (for financial liabilities) and the credit risk of the counterparty (for financial assets) should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not



have a material impact on Nalcor's Consolidated Financial Statements.

Nalcor also adopted the changes made by the CICA to Section 3862, Financial Instruments – Disclosures whereby an entity shall classify and disclose fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have 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).

Management's Discussion & Analysis

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. The required disclosures are included in Note 15 of the Consolidated Financial Statements.

Future Accounting Changes

The CICA has issued a number of new accounting standards, which are applicable for the 2010 or subsequent fiscal years. The following provides more information on the new accounting standards:

Business Combinations, Consolidated Financial Statements and Non-controlling Interests: In January 2009, the CICA issued the following new Handbook sections: Section 1582, Business Combinations, Section 1601, Consolidated Financial Statements and Section 1602, Non-controlling Interests which replace Section 1581, Business Combinations and Section 1600, Consolidated Financial Statements. These new Sections will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. Early adoption is permitted to the extent the three new Sections are adopted simultaneously. Together, the new Sections establish standards for the accounting for a business combination, the preparation of consolidated financial statements and the accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. Nalcor does not expect that the adoption of these new Sections will have a material impact on its Consolidated Financial Statements.

International Financial Reporting Standards: On February 13, 2008, the Accounting Standards Board confirmed that publicly-accountable enterprises will be required to adopt IFRS for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Accordingly, beginning in 2011, Nalcor will present its financial statements in accordance with IFRS with IFRS-compliant comparative information for the previous fiscal year. It is likely that Nalcor will make changes to its accounting policies that may have a significant impact on Nalcor Energy's Consolidated Financial Statements and the notes thereto.

Nalcor commenced its IFRS conversion project in 2008 and established a formal project governance structure which includes a steering committee consisting of senior levels of management from various disciplines as appropriate. Regular reporting is provided to the leadership team and the Audit Committee of the Board of Directors. In addition to dedicated internal resources, Nalcor has also engaged an external advisor to assist in the IFRS conversion project.

The conversion project consists of three phases – scoping, solution development and implementation. During 2008, Nalcor completed the scoping phase which involved a high level review of the major differences between current Canadian GAAP and IFRS to identify those differences which have the highest potential impact.

The solution development phase undertaken during 2009 involved a more thorough review of the accounting differences and issues identified during the scoping phase, including an analysis of options and alternatives. It was determined that the

differences which have the highest potential to impact Nalcor are regulatory assets and liabilities, and property, plant and equipment, particularly for Hydro and Churchill Falls. The effects of rate regulation are more fully disclosed in Note 6 to Nalcor Energy's Consolidated Financial Statements. Hydro currently uses certain accounting policies specific to rate-regulated activities under GAAP which permit recognition of regulatory assets and liabilities in its financial statements. The concept of rate-regulated accounting does not exist under current IFRS. The impact of these differences on Nalcor's future financial position and results of operations is not reasonably estimable or determinable at this time, primarily due to the continuing uncertainty over the treatment of regulated assets and liabilities under IFRS. In July 2009, the International Accounting Standards Board (IASB) published an exposure draft regarding accounting for rate-regulated activities which would establish how assets and liabilities arising from rate-regulation should be recognized and measured. This standard was originally planned to be issued mid-2010, but is now is expected to be issued during the fourth quarter of 2011. Other areas of potential impact are impairment of assets, provisions, contingent assets and contingent liabilities, employee benefits, as well as initial adoption of IFRS under the provisions of IFRS 1, First-time Adoption of IFRS.

During 2010, Nalcor Energy will commence the implementation phase, which will involve finalizing and implementing system and process changes, preparing comparative financial information, finalizing and obtaining Audit Committee approval

of IFRS compliant financial statements as well as providing further training and communication to affected stakeholders. During the fourth quarter of 2009, Hydro made a presentation to the PUB regarding the status of its IFRS project and provided an overview of the differences between Hydro's current regulatory accounting practices and IFRS. Hydro will continue to provide regular updates to the PUB.

Nalcor Energy will continue to review all proposed and continuing projects of the IASB, closely monitor any International Financial Reporting Interpretations Committee initiatives with potential to impact financial reporting and will participate in related initiatives as appropriate.

Consolidated Financial Statements





Management Report

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

The Consolidated Financial Statements have been prepared by Management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on Management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to March 9, 2010. Financial information presented elsewhere in the Business and Financial Report is consistent with that in the Consolidated Financial Statements.

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

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

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



Ed Martin

President and Chief Executive Officer



Derrick Sturge

Vice President, Finance and Chief Financial Officer

Auditors' Report

To the Lieutenant-Governor in Council

Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of Nalcor Energy (the Company) as at December 31, 2009, and the consolidated statements of income and retained earnings and comprehensive income and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Energy Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Deloitte & Touche LLP

Chartered Accountants

St. John's, NL

Canada

March 9, 2010

Consolidated Balance Sheet

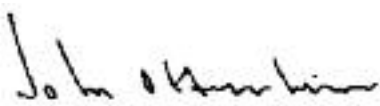
<i>As at December 31 (millions of dollars)</i>	2009	2008
		(Note 1)
ASSETS		
Current assets		
Cash and cash equivalents	14.0	49.8
Short-term investments	49.2	24.6
Accounts receivable	88.9	77.2
Current portion of regulatory assets (Note 6)	4.8	5.0
Fuel and supplies	59.5	52.7
Prepaid expenses	3.3	1.6
	219.7	210.9
Property, plant and equipment (Note 4)	1,901.7	1,863.4
Petroleum and natural gas properties (Note 5)	193.8	112.1
Regulatory assets (Note 6)	69.3	74.6
Other long-term assets (Note 7)	246.2	214.0
	2,630.7	2,475.0
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	124.4	85.1
Current portion of long-term debt (Note 9)	37.5	9.1
Current portion of regulatory liabilities (Note 6)	89.8	22.3
Deferred credits	3.1	0.5
Promissory notes	-	163.0
	254.8	280.0
Long-term debt (Notes 9 and 15)	1,141.6	1,175.7
Regulatory liabilities (Note 6)	32.8	31.5
Other long-term liabilities (Note 10)	5.1	1.7
Employee future benefits (Note 11)	54.4	51.6
	1,488.7	1,540.5
SHAREHOLDER'S EQUITY		
Share capital (Note 12)	122.5	122.5
Contributed capital (Note 12)	333.5	191.5
	456.0	314.0
Accumulated other comprehensive income (Notes 14 and 15)	22.0	16.5
Retained earnings	664.0	604.0
	686.0	620.5
	1,142.0	934.5
	2,630.7	2,475.0

Commitments and contingencies (Note 19)

Subsequent events (Note 24)

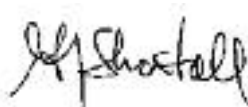
See accompanying notes

On Behalf of the Board



John Ottenheimer

Director



Gerald Shortall

Director

Consolidated Statement of Income and Retained Earnings

<i>Year ended December 31 (millions of dollars)</i>	2009	2008 (Note 1)
Revenue		
Energy sales (Notes 2 and 21)	561.6	563.3
Other	11.0	7.0
	572.6	570.3
Expenses		
Operations and administration	171.9	148.2
Fuels	155.2	164.8
Interest (Note 16)	83.5	78.2
Amortization	54.9	53.2
Power purchased	47.1	41.0
Write-down of investment	-	2.7
	512.6	488.1
Net income	60.0	82.2
Retained earnings, beginning of year	604.0	521.8
Retained earnings, end of year	664.0	604.0

See accompanying notes

Consolidated Statement of Comprehensive Income

<i>Year ended December 31 (millions of dollars)</i>	2009	2008 (Note 1)
Net income	60.0	82.2
Other comprehensive income		
Change in fair value of sinking fund and reserve fund investments (Note 14)	(0.7)	(3.0)
Unrealized gain on derivatives designated as cash flow hedges (Note 14)	6.2	-
Comprehensive income	65.5	79.2

See accompanying notes

Consolidated Statement of Cash Flows

<i>Year ended December 31 (millions of dollars)</i>	2009	2008 (Note 1)
Cash provided by (used in)		
Operating activities		
Net income	60.0	82.2
Adjustments for items not involving cash		
Amortization	54.9	53.2
Accretion of long-term debt	0.4	0.5
Loss on disposal of property, plant and equipment	1.8	2.5
Unrealized gain on derivative instruments	(0.8)	-
Write-down of investments	-	2.7
	116.3	141.1
Changes in non-cash operating working capital balances (Note 17)	96.2	36.1
	212.5	177.2
Financing activities		
(Decrease) increase in promissory notes	(163.0)	156.0
Repayment of long-term debt	(0.9)	(207.5)
Contributed capital	142.0	77.5
Issue of common shares	-	100.0
Increase in deferred credits	2.6	0.5
Increase in other liabilities	3.4	0.6
	(15.9)	127.1
Investing activities		
Additions to property, plant and equipment	(96.4)	(93.4)
Additions to oil and gas properties	(81.7)	(112.1)
Increase in other long-term assets	(31.1)	(35.0)
Increase in short-term investments	(24.6)	(13.1)
Proceeds on disposal of property, plant and equipment	1.4	0.7
	(232.4)	(252.9)
Net (decrease) increase in cash	(35.8)	51.4
Cash position, beginning of year	49.8	(1.6)
Cash position, end of year	14.0	49.8
Cash position is represented by		
Bank indebtedness	(3.0)	(5.1)
Cash equivalents	17.0	54.9
	14.0	49.8
Supplementary disclosure of cash flow information		
Income taxes paid	0.2	0.2
Interest income received	0.8	0.9
Interest paid	92.8	101.6

See accompanying notes

Notes to Consolidated Financial Statements

1. DESCRIPTION OF BUSINESS

Nalcor Energy (Nalcor) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and its business includes the development, generation and sale of electricity, oil and gas, wind energy, industrial fabrication and energy marketing.

Nalcor holds interests in the following subsidiaries and jointly controlled companies:

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

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

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

Nalcor Energy - Oil and Gas Inc. (Oil and Gas) is incorporated under the Corporations Act of Newfoundland and Labrador. Oil and Gas has a broad mandate to engage in upstream and downstream sectors of the oil and gas industry including exploration, development, production, transportation and processing.

Nalcor Energy - Bull Arm Fabrication Inc. (Bull Arm Fabrication) is incorporated under the Corporations Act of Newfoundland and Labrador. Bull Arm Fabrication is Atlantic Canada's largest industrial fabrication site and has a fully integrated infrastructure to support large-scale fabrication and assembly. Its facilities include onshore fabrication halls and shops, a dry-dock, and a deepwater site. The Province transferred its shares in Bull Arm Fabrication to Nalcor effective March 31, 2009. The transfer has been accounted for using the continuity of interests method which resulted in a restatement of 2008 comparative figures to include Bull Arm Fabrication's financial position, results of operations and cash flows as if Bull Arm Fabrication had been combined since its inception.

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

Nalcor and its subsidiaries and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

Notes to Consolidated Financial Statements

2. SIGNIFICANT ACCOUNTING POLICIES

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

Principles of Consolidation

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

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

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

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

Substantially all of Oil and Gas' activities are conducted jointly with others and accordingly these statements reflect only Nalcor's proportionate interest in such activities.

Use of Estimates

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

Rates and Regulations

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4% (2008 - 7.4%). Hydro applies various accounting policies that differ

from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 6.

Cash and Cash Equivalents and Short-term Investments

Cash and cash equivalents and short-term investments consist primarily of Canadian Treasury Bills and Bankers' Acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than 12 months are classified as short-term investments. The short-term investments bear interest rates of 0.26% to 0.65% (2008 – 1.58% to 3.60%) per annum. Cash and cash equivalents and short-term investments are measured at fair value.

Fuel and Supplies

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

Property, Plant and Equipment

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

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

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

Nalcor, Oil and Gas and Bull Arm Fabrication

Amortization is calculated on a straight-line basis over service lives ranging from five to 27 years.

Hydro

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

Notes to Consolidated Financial Statements

Estimated service lives of the major assets are as follows:

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

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

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

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

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

Churchill Falls

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

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

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

Petroleum and Natural Gas Properties

Nalcor employs the full cost method of accounting for oil and gas interests whereby all costs related to the acquisition, exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical costs, carrying charges of non-producing properties, drilling of productive and non-productive wells, the cost of petroleum and natural gas production equipment and administrative costs directly related to exploration and development activities.

Under the full cost method, capitalized costs, together with estimated future capital costs associated with proved reserves, are depleted and depreciated using the unit-of-production method based on estimated gross proved reserves at future prices and costs as determined by independent reservoir engineers.

Costs of acquiring and evaluating unproved properties and certain costs associated with major development projects are not subject to depletion until proved reserves are attributable to the property, production commences or impairment occurs. The carrying value of petroleum and natural gas properties is assessed annually or as circumstances dictate.

Impairment losses are recognized when the carrying value exceeds the sum of:

- the undiscounted future net cash flows from production of proved reserves based on forecast prices and costs;
- the costs of unproved properties, less impairment; and
- the costs of major development projects, less impairment.

The amount of impairment loss is the amount by which the carrying value exceeds the sum of:

- the fair value of proved and probable reserves; and
- the cost, less impairment, of unproved properties and major development projects.

Capitalized Interest

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

Asset Retirement Obligations

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

Impairment of Long-lived Assets

Nalcor reviews the carrying value of its oil and gas properties and development projects at the end of each accounting period. Nalcor reviews the carrying value of its other property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Revenue Recognition

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

Notes to Consolidated Financial Statements

A power contract with Hydro-Québec (Power Contract), dated May 12, 1969, provides for the sale of substantially all the energy from Churchill Falls until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The rate is predetermined in the Power Contract and decreases from the existing rate of 2.5426 mills per kilowatt hour (kWh) to 2.0 mills per kWh upon renewal in 2016.

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

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, are tracked over a four-year period and then either recovered from or refunded to Hydro-Québec over the subsequent four-year period, unless the balance is less than \$1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2008 - 7%).

Foreign Currency Translation

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

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

Employee Future Benefits

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

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

Financial Instruments and Hedging Activities

Financial Instruments

Financial assets and financial liabilities are recognized on the balance sheet when Nalcor becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Nalcor has classified each of its financial instruments into the following categories:

financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

Nalcor has classified its financial instruments as follows:

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

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

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities

Derivative instruments are utilized by Nalcor to manage market risk. Nalcor’s policy is not to utilize derivative instruments for speculative purposes. Nalcor may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Nalcor formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

Nalcor has designated forward foreign exchange contracts as cash flow hedges (Notes 7 (d) and 15). In a cash flow hedge relationship, the portion of gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income.

Nalcor had no fair value hedges in place at December 31, 2009 or 2008.

Notes to Consolidated Financial Statements

3. CHANGES IN ACCOUNTING POLICIES

New Accounting Policies

Effective January 1, 2009, Nalcor adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA):

Goodwill and Intangible Assets

Section 3064, Goodwill and Intangible Assets establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and provides more comprehensive guidance particularly with respect to internally developed intangible assets. This new standard did not have any impact on Nalcor's financial results or disclosures.

Financial Instruments

EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities issued by the Emerging Issues Committee. This abstract requires that an entity's own credit risk (for financial liabilities) and the credit risk of the counterparty (for financial assets) should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not have a material impact on Nalcor's Consolidated Financial Statements.

Nalcor also adopted the changes made by CICA to Section 3862, Financial instruments – Disclosures whereby an entity shall classify and disclose fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels:

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. The required disclosures are included in Note 15.

Future Accounting Changes

Business Combinations, Consolidated Financial Statements and Non-controlling Interests

In January 2009, the CICA issued the following new Handbook sections: Section 1582, Business Combinations, Section 1601, Consolidated Financial Statements and Section 1602, Non-controlling Interests which replace Section 1581, Business Combinations and Section 1600, Consolidated Financial Statements. These new Sections will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. Early adoption is permitted to the extent the three new Sections are adopted simultaneously. Together, the new Sections establish standards for the accounting for a business combination, the preparation of consolidated financial statements and the accounting for a non-controlling interest in a subsidiary in consolidated financial

statements subsequent to a business combination. Nalcor does not expect that the adoption of these new Sections will have a material impact on its Consolidated Financial Statements.

International Financial Reporting Standards (IFRS)

In October 2009, the Accounting Standards Board (AcSB) issued a third and final Omnibus Exposure Draft confirming that publically accountable enterprises in Canada will be required to apply IFRS in full and without modification, for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Accordingly, starting in 2011, Nalcor will present its financial statements in accordance with IFRS, and will be required to present restated comparative information for its year-ended December 31, 2010 balances, and will also restate its opening balance sheet as at January 1, 2010.

Nalcor is continuing to assess the financial reporting impacts of the adoption of IFRS, however, the impact of these differences on Nalcor's future financial position and results of operations are not reasonably estimable or determinable at this time. Nalcor does anticipate a significant increase in disclosure resulting from the adoption of IFRS and is continuing to assess the level of disclosure required as well as any system changes that may be necessary to compile and process the information.

The International Accounting Standards Board (IASB) project schedule had indicated that a final standard on rate-regulated activities would be released in the second quarter of 2010. Commentary received on the Exposure Draft, and the resulting activities now planned by the IASB, creates uncertainty as to if and when a final standard will be released. If a final standard is released, it may not be until late 2011. Accordingly, Nalcor is unable to conclude on the impact, if any, of differences that will apply to accounting for rate-regulated activities under IFRS versus Canadian GAAP.

4. PROPERTY, PLANT AND EQUIPMENT

	Cost	Contributions in aid of Construction	Accumulated Amortization	Net Book Value
<i>(millions of dollars)</i>		2009		
Electric – generation	1,722.1	29.6	581.7	1,110.8
Electric – transmission and distribution	822.9	67.7	263.3	491.9
Development projects	194.2	-	-	194.2
Other	295.5	23.5	167.2	104.8
	3,034.7	120.8	1,012.2	1,901.7
<i>(millions of dollars)</i>		2008		
Electric – generation	1,721.1	27.3	573.9	1,119.9
Electric – transmission and distribution	798.7	60.2	248.2	490.3
Development projects	157.0	-	-	157.0
Other	291.6	32.4	163.0	96.2
	2,968.4	119.9	985.1	1,863.4

As at December 31, 2009, the cost of assets under construction and therefore excluded from costs subject to amortization was \$200.9 million (2008 - \$169.5 million).

Notes to Consolidated Financial Statements

5. PETROLEUM AND NATURAL GAS PROPERTIES

<i>(millions of dollars)</i>	2009	2008
Petroleum and natural gas properties	193.8	112.1
Accumulated depletion	-	-
	193.8	112.1

Internal costs directly related to acquisition, exploration and development activities capitalized in 2009 were \$0.2 million (2008 - \$0.2 million).

As at December 31, 2009 and December 31, 2008 all costs of petroleum and natural gas properties were not subject to depletion and depreciation.

Petroleum and natural gas properties include Nalcor's acquisition costs and proportionate share of exploration and development costs. Nalcor has a 4.9% working interest in the Hebron oil field, a 5.0% working interest in the White Rose Growth Project and an average working interest of 67% in three onshore exploration permits. On February 16, 2010, Nalcor acquired a 10% working interest in the Hibernia Southern Extension.

Acquisitions

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

On August 7, 2009, Oil and Gas announced its operatorship in three exploration permits in Western Newfoundland acquiring an average of 67% gross working interest in the three permits. Oil and Gas acquired the permits from Leprechaun Resources for a purchase price of \$0.6 million. Oil and Gas has also assumed its proportionate share of Leprechaun Resources' work commitments valued at \$0.6 million, which is refundable upon completion of the drilling program.

6. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

<i>(millions of dollars)</i>	2009	2008	Remaining Recovery Settlement Period (years)
Regulatory assets			
Foreign exchange losses	68.9	71.1	32.0
Deferred regulatory costs	-	0.2	-
Deferred major extraordinary repairs	4.9	7.6	2.8
Deferred study costs	0.1	0.2	2.0
Deferred wind power costs	-	0.5	-
Deferred energy conservation costs	0.2	-	n/a
Total regulatory assets	74.1	79.6	
Less current portion	4.8	5.0	
	69.3	74.6	
Regulatory liabilities			
Rate stabilization plan	122.0	53.2	n/a
Deferred purchased power savings	0.6	0.6	17.5
Total regulatory liabilities	122.6	53.8	
Less current portion	89.8	22.3	
	32.8	31.5	

Nalcor's subsidiary, Hydro, has operations that are regulated by the PUB.

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

Rate Stabilization Plan and Related Long-term Receivable

On January 1, 1986, Hydro, having received the approval of the PUB, implemented a Rate Stabilization Plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

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

Notes to Consolidated Financial Statements

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian generally accepted accounting principles require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2009, \$42.3 million was recognized (2008 - \$9.1 million) in the RSP and \$18.3 million (2008 - \$14.9 million) was recovered through rates and included in energy sales, with a corresponding cost amortized in fuel expenses.

Foreign Exchange Losses

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

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a 40-year period. This amortization, of \$2.2 million annually, is included in interest expense (Note 16).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of \$0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include these costs in operating costs in the year incurred. In 2009, \$0.2 million (2008 - \$0.2 million) of amortization was recognized in operations and administration expense.

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of \$0.5 million, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five-year period. In 2006, Hydro incurred \$2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007, \$2.0 million of expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, was expensed in 2008. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2009, \$2.7 million (2008 - \$2.7 million) of amortization was recognized in operations and administration expense.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004), the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three-year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year incurred. In 2009, there were no additions (2008 - nil) and \$0.1 million (2008 - \$0.2 million) of amortization was recognized in operations and administration expense.

Deferred Wind Power Costs

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

Deferred Energy Conservation Costs

Pursuant to Order No. P.U. 8 (2007), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors and, accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include this program as operating costs in the year incurred. In 2009, \$0.2 million (2008 - nil) was deferred.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec electricity system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of \$0.6 million (2008 - \$0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2009, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.2% and the amount capitalized is higher and interest expense is lower by \$0.1 million than that which would be permitted in the absence of rate regulation. In 2008, Hydro's AFUDC of 7.6% was higher than its cost of debt of 7.3%, the amount capitalized was lower and interest expense was higher by \$0.4 million than that which would have been permitted in the absence of rate regulation (Note 16).

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

Notes to Consolidated Financial Statements

During 2005, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately \$170.0-\$180.0 million lower than it would otherwise be and annual amortization expense is \$10.0-\$11.0 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets. A more recent study indicated that the amounts could be significantly higher. An update to this study is to be completed in 2010.

7. OTHER LONG-TERM ASSETS

<i>(millions of dollars)</i>		2009	2008
Long-term receivable	(a)	24.8	26.7
Sinking funds	(b)	179.6	163.9
Reserve fund	(c)	34.8	23.4
Derivative instruments	(d)	7.0	-
Lower Churchill Development Corporation Limited	(e)	-	-
		246.2	214.0

(a) Included in long-term receivables are two refundable deposits in the amount of \$23.9 million (2008 - \$25.4 million) associated with an application for transmission service into Québec, bearing interest at one-year Guaranteed Income Certificate (GIC) rates and a \$0.1 million deposit associated with an application for transmission service in New Brunswick. The remaining portion of \$0.8 million (2008 - \$1.3 million) is a long-term receivable from Hydro-Québec bearing interest at 7.0%.

(b) Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures, which management intends to hold to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2008 - 4.50% to 9.86%).

(c) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a \$75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested \$17.0 million in each of 2007, 2008 and 2009. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

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

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

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

<i>(millions of dollars)</i>	2009	2008
Opening balance	23.4	11.2
Contribution	11.2	11.2
Total contribution to reserve fund	34.6	22.4
Net interest	(0.2)	0.4
Mark-to-market adjustment	0.4	0.6
Fair value of reserve fund	34.8	23.4

(d) During 2009, Nalcor entered into a series of 24 foreign exchange forward contracts to manage exchange rate risk on US dollar (USD) electricity sales. The nominal contract values range from \$2.4 million to \$6.0 million with an average exchange rate of \$1.17 Canadian to USD. During the year, eight of these contracts were settled with the effective portion of the gain, in the amount of \$2.4 million, reported as energy sales and the ineffective portion as other income. The \$7.0 million represents the fair value of the remaining 16 contracts outstanding as at December 31, 2009. These contracts have been designated as part of a hedging relationship (Note 15).

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

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

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

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

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of \$0.01 million each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

Notes to Consolidated Financial Statements

8. JOINT VENTURE

The following amounts included in the Consolidated Financial Statements represent Nalcor's proportionate share of Churchill Falls' assets and liabilities at December 31, 2009, and its proportionate interest in Churchill Falls' operations for the year then ended.

<i>(millions of dollars)</i>	2009	2008
Current assets	45.7	35.1
Long-term assets	374.5	372.8
Current liabilities	38.8	10.2
Long-term liabilities	12.7	38.0
Revenues	57.4	65.4
Expenses	50.9	51.6
Net income	6.5	13.8
Cash provided by (used in)		
Operating activities	15.3	31.4
Financing activities	0.9	(15.7)
Investing activities	(17.4)	(18.7)

Income tax expense in the amount of \$0.2 million (2008 - \$0.2 million) related to a jointly controlled subsidiary, Twin Falls, has been included in expenses.

9. LONG-TERM DEBT

	Hydro	Churchill Falls	Total	Hydro	Churchill Falls	Total
<i>(millions of dollars)</i>	2009			2008		
Long-term debt	1,149.8	29.3	1,179.1	1,154.7	30.1	1,184.8
Less current portion	8.2	29.3	37.5	8.3	0.8	9.1
	1,141.6	-	1,141.6	1,146.4	29.3	1,175.7

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

<i>(millions of dollars)</i>	2010	2011	2012	2013	2014
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayment	29.3	-	-	-	125.0
	37.5	8.2	8.2	8.2	133.2

Nalcor

Nalcor maintains an unsecured revolving term credit facility with its banker in the amount of \$150.0 million Canadian or US equivalent. Borrowings in Canadian dollars may take the form of Prime Rate advances, Bankers' Acceptances (BAs), and Letters of Credit. Borrowings in USD may take the form of Base Rate advances, LIBOR Advances and Letters of Credit. The facility also provides coverage for overdrafts on Nalcor's bank accounts, with interest calculated at the Prime Rate. The terms of the credit facility provide for the expansion of the facility up to \$300.0 million Canadian or US equivalent as a non-revolving term credit facility, secured by the guarantee of

the Province. At year-end, the only drawing on the facility was one irrevocable letter of credit issued on behalf of Nalcor's subsidiary, Oil and Gas. This letter of credit, in the amount of \$1.5 million, was issued to the Canada-Newfoundland and Labrador Offshore Petroleum Board (C-NLOPB) to satisfy certain financial responsibility requirements specified in the Accords Acts with respect to the issuance of authorizations for petroleum-related work or activities within the Newfoundland and Labrador offshore area.

Hydro

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2009	2008
<i>(millions of dollars)</i>						
V *	125.0	10.50	1989	2014	124.5	124.5
X *	150.0	10.25	1992	2017	149.2	149.1
Y *	300.0	8.40	1996	2026	293.1	292.9
AB *	300.0	6.65	2001	2031	306.8	306.9
AD *	125.0	5.70	2003	2033	123.6	123.5
AE	225.0	4.30	2006	2016	223.7	223.5
Total debentures	1,225.0				1,220.9	1,220.4
Less sinking fund investments in own debentures					71.1	65.9
					1,149.8	1,154.5
Other					-	0.2
					1,149.8	1,154.7
Less payments due within one year					8.2	8.3
					1,141.6	1,146.4

* Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest, and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1.0% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. During 2008 and 2009 the Province waived the payment of this fee.

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2009, no promissory notes were outstanding (2008 - \$163.0 million).

Hydro maintains a \$50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end, there were no amounts drawn on the facility (2008 - nil). Advances may take the form of a Prime Rate advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year-end, Hydro had two letters of credit outstanding (Note 19(g)) reducing the availability of the credit facility by \$7.5 million. In February 2010 Hydro issued 22 additional letters of credit, see Note 24.

Churchill Falls

<i>(millions of dollars)</i>	2009	2008
Bank of Nova Scotia Credit Agreement		
4.4% due December 15, 2010		
Outstanding	29.3	30.1
Due within one year	29.3	0.8
Total long-term debt	-	29.3

Notes to Consolidated Financial Statements

Refinancing

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

Dividend Restriction

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

Operating Credit Facility

Churchill Falls maintains a \$10.0 million Canadian unsecured operating credit facility with its banker and at year-end, there were no amounts drawn on the facility (2008 - nil). Advances may take the form of a Prime Rate advance or the issuance of BAs with interest calculated at the Prime Rate or prevailing Government BA fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate. At year-end, Churchill Falls has one letter of credit outstanding (Note 19(g)) reducing the availability of the credit facility by \$0.7 million.

10. OTHER LONG-TERM LIABILITIES

<i>(millions of dollars)</i>		2009	2008
Long-term payable	(a)	4.3	0.7
Distribution payable to Province	(b)	0.8	1.0
		5.1	1.7

(a) The long-term payable to Hydro-Québec as at December 31, 2009, represents the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, the full amount of \$4.3 million (2008 - \$0.7 million) is long-term bearing interest of 7.0%. The final amount will be determined on August 31, 2012, and will be paid/collected monthly beginning September 2012 and ending August 2016.

(b) Prior to January 1, 2009, the Provincial Minister of Finance was authorized to invest any surplus from Bull Arm Fabrication's operations. Each year, the surplus or deficit from operations was credited or charged to the Distribution payable to the Province, however, there are no set terms of payment. This balance contains the accumulated results of operations of Bull Arm Fabrication since inception up to January 1, 2009, less any distributions paid to the Province. Effective January 1, 2009, rental revenues are to be retained and are reflected in retained earnings.

11. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$5.3 million (2008 - \$4.9 million) are expensed as incurred.

Other Benefits

Additionally, Nalcor provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2009, cash payments to beneficiaries for its unfunded other employee future benefits was \$2.7 million (2008 - \$3.0 million). An actuarial valuation was performed on December 31, 2009.

<i>(millions of dollars)</i>	2009	2008
Accrued benefit obligation		
Balance at beginning of year	52.3	68.6
Current service cost	1.6	2.2
Interest cost	3.9	3.8
Actuarial loss (gain)	17.6	(19.3)
Benefits paid	(2.7)	(3.0)
Balance at end of year	72.7	52.3
Plan deficit	72.7	52.3
Unamortized actuarial loss	(18.1)	(0.4)
Unamortized past-service cost	(0.2)	(0.3)
Accrued benefit liability at end of year	54.4	51.6

<i>(millions of dollars)</i>	2009	2008
Components of benefit cost		
Current service cost	1.6	2.2
Interest cost	3.9	3.8
Actuarial loss (gain)	17.6	(19.3)
	23.1	(13.3)
Difference between actual actuarial (gain) loss and amount recognized	(17.6)	20.4
Benefit expense	5.5	7.1

Notes to Consolidated Financial Statements

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

	2009	2008
Discount rate – benefit cost	7.5%	5.5%
Discount rate – accrued benefit obligation	6.5%	7.5%
Rate of compensation increase	3.5%	3.5%

Assumed health care trend rates:

	2009	2008
Initial health care expense trend rate	7.5%	7.0%
Cost trend decline to	5.0%	5.0%
Year that rate reaches the rate it is assumed to remain at	2014	2011

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

<i>(millions of dollars)</i>	2009	2008
Current service and interest cost	0.8	1.2
Accrued benefit obligation	11.1	7.2

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

<i>(millions of dollars)</i>	2009	2008
Current service and interest cost	(0.6)	(0.8)
Accrued benefit obligation	(8.7)	(5.5)

12. SHAREHOLDER'S EQUITY

Share Capital

<i>(millions of dollars)</i>	2009	2008
Common shares		
Authorized: unlimited;		
Issued and outstanding 122,500,000 (2008 – 122,500,000)	122.5	122.5

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

Contributed Capital

<i>(millions of dollars)</i>	2009	2008
Total contributed capital	333.5	191.5

During 2009, the Province contributed capital in the amount of \$142.0 million (2008 - \$77.5 million).

13. CAPITAL MANAGEMENT

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

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

A summary of the capital structure is outlined below:

<i>(millions of dollars)</i>	2009		2008	
Debt				
Long-term debt	1,141.6		1,175.7	
Current portion of long-term debt	37.5		9.1	
Promissory notes	-		163.0	
Sinking funds	(179.6)		(163.9)	
	999.5	46.7%	1,183.9	55.9%
Equity				
Share capital	122.5		122.5	
Contributed capital	333.5		191.5	
Accumulated other comprehensive income	22.0		16.5	
Retained earnings	664.0		604.0	
	1,142.0	53.3%	934.5	44.1%
Total debt and equity	2,141.5	100.0%	2,118.4	100.0%

Hydro

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

Churchill Falls

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

Notes to Consolidated Financial Statements

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

Oil and Gas

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

14. ACCUMULATED OTHER COMPREHENSIVE INCOME

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

<i>(millions of dollars)</i>	2009	2008
Balance, beginning of year	16.5	19.5
Change in fair value of sinking fund investments	(1.1)	(3.6)
Change in fair value of reserve fund investments	0.4	0.6
Unrealized gains on derivatives designated as cash flow hedges	6.2	-
Balance, end of year	22.0	16.5

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

The estimated fair values of financial instruments as at December 31, 2009 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Nalcor might receive or incur in actual market transactions. As a significant number of Nalcor's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments. The fair value estimates below do not reflect the fair value of Nalcor as a whole.

	Carrying Value	Fair Value	Carrying Value	Fair Value
<i>(millions of dollars)</i>	2009		2008	
Long-term debt including amount due within one year	1,179.1	1,471.0	1,184.8	1,484.8

Establishing Fair Value

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

The fair value of long-term debt is determined using the present value of future cash flows under current financing agreements, based on the Nalcor's current estimated borrowing rate for loans with similar terms and conditions.

Fair Value Hierarchy

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the significance 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.

Financial instruments included in Level 1 are cash and cash equivalents and short-term investments. Financial instruments included in Level 2 are the derivative instruments, the reserve fund and sinking funds - other investments. There are no financial instruments in Level 3.

Risk Management

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

Credit Risk

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

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

Notes to Consolidated Financial Statements

Liquidity Risk

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

Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. During 2009, the Board of Directors of Nalcor approved a formal financial risk management policy that outlined the risks associated with the operations of Nalcor and its subsidiaries and approaches and guidelines to be followed in the management of those risks. This policy will be reviewed by the Board annually, or more frequently if there is a material change to Nalcor's financial risks, and outlines a formal approval process for various hedging instruments used. The Audit Committee will provide oversight on behalf of the Board with the exception of any items that specifically require Board approval.

Interest Rates

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

Within Hydro, exposure to changes in interest rates on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios, creates risk. Hydro estimates that a change of 100 basis points from the actual average yield on the short-term debt portfolio in 2009 would have resulted in a change in interest expense of \$0.5 million (2008 - \$1.3 million). Similarly, a change of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2009 would have resulted in a change in interest income of \$2.3 million (2008 - \$2.0 million) and a change in other comprehensive income of \$16.6 million (2008 - \$16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

Within Churchill Falls, interest rate risk is mitigated on the company's long-term debt by virtue of a fixed interest rate to maturity. Exposure to changes in interest rates exists on investment income related to the short-term and reserve fund investment portfolios. Churchill Falls estimates that a change of 100 basis points from the actual average yield earned on the short-term investment portfolio in 2009 would have resulted in a change in interest income of \$0.1 million (2008 - \$0.2 million). Similarly, a change of 100 basis points from the actual average yield earned on the reserve fund investment portfolio in 2009 would have resulted in a change in interest income of \$0.3 million (2008 - \$0.2 million) and a change in other comprehensive income of \$0.8 million (2008 - \$0.5

million). Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated.

Foreign Currency and Commodity Exposure

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

During 2009, Hydro had total purchases of No. 6 fuel of \$87.5 million (2008 - \$103.9 million), denominated in USD. Nalcor's exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates, as compared to that approved in Hydro's most recent cost of service study used to set rates, are captured in the RSP and are either refunded to or collected from customers through automatic rate adjustments. Nalcor also employs the periodic use of forward currency contracts to avoid exposure to exchange rates on a particular day.

During 2009, total electricity sales denominated in USD were \$42.5 million. Nalcor mitigates this risk through the use of forward contracts. During 2009, Nalcor entered into a series of 24 monthly foreign currency forward contracts, in the amount of \$87.8 million USD at an average exchange rate of 1.17 to hedge 75% of Nalcor's forecasted USD sales, the last of which expires in April 2011. These contracts have been designated as part of a hedging relationship.

Effect of Hedge Accounting on Financial Statements

<i>(millions of dollars)</i>	Net Gains Included in Net Income	Unrealized Gains Included in OCI
Ineffective portion	0.5	-
Effective portion	2.4	6.2

16. INTEREST EXPENSE

<i>(millions of dollars)</i>	2009	2008
Gross Interest		
Long-term debt	92.0	96.0
Promissory notes	0.6	4.2
	92.6	100.2
Accretion of long-term debt	0.4	0.5
Amortization of foreign exchange losses	2.2	2.2
Other	7.2	2.8
	102.4	105.7
Less		
Recovered from Hydro-Québec	-	0.1
Interest capitalized during construction	0.8	9.6
Interest earned	18.1	17.8
Net interest expense	83.5	78.2

Notes to Consolidated Financial Statements

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

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

17. CHANGES IN NON-CASH OPERATING WORKING CAPITAL BALANCES

<i>(millions of dollars)</i>	2009	2008
Accounts receivable	(11.7)	3.1
Fuel and supplies	(6.8)	17.0
Prepaid expenses	(1.7)	(0.4)
Regulatory assets	5.5	18.9
Regulatory liabilities	68.8	14.8
Accounts payable and accrued liabilities	39.3	(21.5)
Employee future benefits	2.8	4.2
	96.2	36.1

18. SEGMENT INFORMATION

Nalcor operates in five business segments. Hydro Regulated encompasses sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. Energy Marketing activities include the sale of electricity to markets outside the Province. Oil and Gas activities include exploration, development, production, transportation and processing sectors of the oil and gas industry. Other encompasses industrial fabrication, some non-regulated electricity sales, development activities including the Lower Churchill Project and corporate activities. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 2.

	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Other	Inter- Segment	Total
<i>(millions of dollars)</i>							
2009							
Revenue							
Energy sales	443.8	61.0	-	54.7	6.0	(3.9)	561.6
Other	2.2	0.3	0.4	0.7	6.1	(1.3)	11.0
	446.0	61.3	0.4	55.4	12.1	(2.6)	572.6
Expenses							
Operations and administration	100.9	37.7	2.7	17.2	13.4	-	171.9
Fuels	155.2	-	-	-	-	-	155.2
Interest	83.5	0.4	-	-	(0.4)	-	83.5
Amortization	41.7	12.8	0.1	-	0.3	-	54.9
Power purchased	46.8	-	-	4.2	-	(3.9)	47.1
	428.1	50.9	2.8	21.4	13.3	(3.9)	512.6
Net income (loss) from operations	17.9	10.4	(2.4)	34.0	(1.2)	1.3	60.0
Preferred dividends	-	1.3	-	-	-	(1.3)	-
Net income (loss)	17.9	11.7	(2.4)	34.0	(1.2)	-	60.0
Capital expenditures	54.1	3.7	82.6	-	37.7	-	178.1
Total assets	1,766.0	420.5	198.3	10.2	286.2	(50.5)	2,630.7
2008							
Revenue							
Energy sales	440.1	68.9	-	51.3	6.9	(3.9)	563.3
Other	2.2	0.3	0.3	-	1.1	3.1	7.0
	442.3	69.2	0.3	51.3	8.0	(0.8)	570.3
Expenses							
Operations and administration	99.1	38.8	0.4	-	9.9	-	148.2
Fuels	164.8	-	-	-	-	-	164.8
Interest	87.6	0.1	-	-	(9.5)	-	78.2
Amortization	40.4	12.6	-	-	0.2	-	53.2
Power purchased	41.4	-	-	3.5	-	(3.9)	41.0
Write-down of investment	-	-	-	-	2.7	-	2.7
	433.3	51.5	0.4	3.5	3.3	(3.9)	488.1
Net income (loss) from operations	9.0	17.7	(0.1)	47.8	4.7	3.1	82.2
Preferred dividends	-	3.1	-	-	-	(3.1)	-
Net income (loss)	9.0	20.8	(0.1)	47.8	4.7	-	82.2
Capital expenditures	45.6	4.3	112.4	-	43.2	-	205.5
Total assets	1,711.4	414.4	112.7	3.7	250.4	(27.6)	2,475.0

Notes to Consolidated Financial Statements

Revenues by geographic area:

<i>(millions of dollars)</i>	2009	2008
Newfoundland and Labrador	459.6	448.7
Québec	69.8	121.6
Nova Scotia	39.7	-
New Brunswick	3.5	-
	572.6	570.3

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

19. COMMITMENTS AND CONTINGENCIES

- (a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, Churchill Falls is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of Twin Falls will revert to Churchill Falls, and Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.
- (b) The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out. Further monitoring is recommended for 2010 and every five years thereafter.
- (c) Effective March 31, 2009, Hydro's five-year power sales agreement to sell energy to Hydro-Québec expired. Effective April 1, 2009, Hydro entered into a power sales agreement with a third party with respect to the energy previously sold to Hydro-Québec. To facilitate market access, Hydro has entered into a five-year transmission service agreement with Hydro-Québec TransÉnergie to acquire access to 265 MW of transmission capacity from Labrador through Québec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing service request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that of the competing request.

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

2010	\$19.2 million
2011	\$19.2 million
2012	\$19.2 million
2013	\$19.2 million
2014	\$4.8 million

- (d) Nalcor and its subsidiaries have received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Nalcor's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be \$0.1 million (2008 - \$0.2 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately \$21.9 million (2008 - \$22.2 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate effect of such an action cannot be ascertained at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(e) Outstanding commitments for capital projects total approximately \$22.4 million (2008 - \$13.6 million). In addition, Oil and Gas has committed to funding its share of all exploration and development projects.

(f) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

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

(millions of dollars)	2010	2011	2012	2013	2014
Power purchases	27.0	27.6	28.5	29.5	30.2

On December 16, 2008, the Province licensed Nalcor Energy to manage and operate hydro facilities on behalf of the Province. Nalcor is operating the Star Lake, Grand Falls and Bishop's Falls facilities on a cost recovery basis. The power purchase agreements that previously applied to these facilities have been cancelled through Legislation.

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

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

Churchill Falls has issued an irrevocable letter of credit, in the amount of \$0.7 million, for waste management and compliance with a Certificate of Approval for the transportation of special hazardous wastes, granted by the Department of Environment and Conservation.

(h) Hydro has received funding in the amount of \$2.5 million from the Atlantic Canada Opportunities Agency in relation to a Wind-Hydrogen-Diesel research and development project; this funding is repayable by annual installments of \$25,000 per commercial implementation of the resulting product. As at December 31, 2009, there have been no commercial implementations.

20. RELATED PARTY TRANSACTIONS

The Province, Hydro, Churchill Falls, Bull Arm Fabrication, LCDC, GIPCo and Oil and Gas are related parties of Nalcor. In addition, the PUB is related to Nalcor by virtue of its status as an agency of the Province. Related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Notes to Consolidated Financial Statements

- (a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of \$5.9 million (2008 - \$6.0 million) of the power produced by Churchill Falls and Nalcor's 65.8% share is eliminated upon consolidation.
- (b) For the year ended December 31, 2009, approximately \$2.3 million (2008 - \$2.2 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. Nalcor's 65.8% share is eliminated upon consolidation.
- (c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2009, Hydro incurred \$0.6 million in costs related to the PUB (2008 - \$0.6 million) of which \$0.1 million (2008 - \$0.1 million) was included in accrued liabilities.
- (d) Nalcor, and its subsidiaries, have a net payable to the Province of \$9.5 million (2008 - \$4.3 million). This payable consists of various transactions including rentals and royalties, power purchases, cost recoveries and amounts related to the acquisition of Bull Arm Fabrication. Of the \$9.5 million, \$8.7 million is included in Accounts payable and accrued liabilities (2008 - \$3.3 million).
- (e) During 2009, Hydro received \$0.4 million (2008 - \$0.4 million) as a rate subsidy for rural isolated customers from the Province and \$1.6 million (2008 - \$1.5 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with \$0.1 million (2008 - \$0.1 million) recorded as accounts receivable at year-end.
- (f) During 2009, Bull Arm Fabrication received \$2.0 million (2008 - \$0.5 million) in funding from the Province. As at December 31, 2009, \$0.5 million is included in deferred credits.
- (g) Oil and Gas administers the Petroleum Exploration Enhancement Program (PEEP), established as part of the Newfoundland and Labrador Energy Plan, on behalf of the Province. PEEP is designed to boost new petroleum exploration in western Newfoundland through the acquisition and assessment of seismic data. Total funding available under PEEP is \$5.0 million over five years. During 2009, \$1.0 million (2008 - nil) in funding was received of which \$0.4 million is included in deferred credits at December 31, 2009 (2008 - \$0.3 million included in receivables).

21. SIGNIFICANT OCCURRENCE

On November 3, 2008, a fire occurred in a cable shaft at Churchill Falls causing extensive damage to two sets of high voltage cables in two units of the cable shaft. This resulted in Nalcor's 65.8% share of lost GWAC revenue and power sales of approximately \$7.7 million and \$2.5 million in 2009 and \$8.4 million and \$2.1 million in 2008.

Nalcor's share of total repair costs of \$5.3 million as of December 31, 2009 was covered by insurance with the exception of a \$1.3 million deductible. Repair work was completed on the first unit in February 2009 and the second unit in October 2009.

22. ACQUISITION

On March 31, 2009, Nalcor acquired 100% of the shares of Bull Arm Fabrication from the Province for cash consideration of one dollar. At the time of acquisition, Nalcor and Bull Arm Fabrication were subject to common control. As a result, the acquisition was accounted for using the continuity of interests method and the assets and liabilities acquired were recorded at their carrying values. Accordingly, these financial statements have been prepared to reflect the financial position and results of operations and cash flows as if Nalcor and Bull Arm Fabrication had been combined since inception.

23. WATER MANAGEMENT AGREEMENT

In June 2007, the Province passed an amendment to the Electrical Power Control Act, 1994 (EPCA). The amendment requires parties, that utilize a common water resource in the province for power production, enter into a water management agreement. If the parties cannot reach an agreement, the PUB has the authority to impose an agreement on the parties. Nalcor's proposed hydroelectric development shares the Churchill River with Churchill Falls' hydroelectric generation plant. The amendment provides that any resulting water management agreement will not adversely affect existing power contracts.

A tentative agreement reached between management of Nalcor and Churchill Falls was not approved by the Churchill Falls Board of Directors. As a result, on November 10, 2009, Nalcor applied to the PUB to establish the terms of the agreement. In March 2010, the PUB established an agreement, see Note 24.

24. SUBSEQUENT EVENTS

- (a) In January 2010, Hydro entered into 28 swap contracts to hedge the commodity price risk on electricity sales in the amount of \$24.7 million.
- (b) On February 16, 2010, Oil and Gas signed formal agreements to purchase a 10% working interest in the Hibernia Southern Extension for \$30.0 million.
- (c) On February 23, 2010, Churchill Falls filed a motion against Hydro-Québec in the Québec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The outcome of this motion is not determinable at this time.

On February 3, 2010, the Province established a trust with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses incurred in relation to this matter.
- (d) In February 2010, Hydro issued 22 letters of credit, for transmission bookings, reducing the availability of its credit facility by \$11.5 million.
- (e) On March 2, 2010, Nalcor received notification that a \$40.0 million equity contribution from the Province was approved.
- (f) On March 9, 2010, the PUB issued a board order establishing the water management agreement proposed by Nalcor in November 2009.

Corporate Information





Financial Statistics

<i>Year ended December 31 (millions of dollars)</i>	2009	2008	2007	2006	2005
OPERATING RESULTS					
Revenue					
Energy sales	561.6	563.3	567.5	541.8	526.8
Other	11.0	7.0	5.9	6.2	5.7
	572.6	570.3	573.4	548.0	532.5
Expenses					
Operations and administration	171.9	148.2	143.1	130.4	130.8
Fuels and power purchased	202.3	205.8	197.6	193.4	176.9
Amortization	54.9	53.2	50.7	48.5	47.0
Interest	83.5	78.2	100.4	105.7	105.9
Write down of assets	-	2.7	-	-	-
	512.6	488.1	491.8	478.0	460.6
Net Income	60.0	82.2	81.6	70.0	71.9
Contributions to net income					
Regulated Electricity	17.9	9.0	2.9	(6.7)	3.3
Energy Marketing	34.0	47.8	49.9	48.6	45.6
Churchill Falls	11.7	20.8	25.1	26.4	21.4
Oil and Gas	(2.4)	(0.1)	-	-	-
Other	(1.2)	4.7	3.7	1.7	1.6
FINANCIAL POSITION					
Total current assets	219.7	210.9	187.5	196.4	181.9
Total current liabilities	254.8	280.0	355.3	201.5	469.2
Net working capital	(35.1)	(69.1)	(167.8)	(5.1)	(287.3)
Property, plant and equipment	2,913.9	2,848.5	2,764.7	2,684.7	2,632.6
Accumulated depreciation	1,012.2	985.1	939.0	893.2	851.0
Property, plant and equipment, net	1,901.7	1,863.4	1,825.7	1,791.5	1,781.6
Petroleum and natural gas properties	193.8	112.1	-	-	-
Sinking funds	179.6	163.9	151.8	117.1	85.8
Other assets	135.9	124.7	121.3	127.3	154.8
Long-term debt	1,141.6	1,175.7	1,187.8	1,394.7	1,174.8
Other liabilities	92.3	84.8	65.4	61.7	53.1
Shareholder's equity	1,142.0	934.5	677.8	574.4	507.0
STAFFING LEVELS					
Full-time equivalents	1,241	1,185	1,173	1,147	1,144

Operating Statistics

<i>Year ended December 31</i>	2009	2008	2007	2006	2005
INSTALLED GENERATING CAPACITY (rated MW)					
Churchill Falls	5,428	5,428	5,428	5,428	5,428
Twin Falls	225	225	225	225	225
Hydro - Hydraulic					
Hydraulic	939	939	939	939	939
Thermal	640	640	640	640	640
Diesel	58	56	56	56	56
Menihék*	19	19	19	-	-
Total	7,309	7,307	7,307	7,288	7,288
ELECTRIC ENERGY GENERATED, NET (GWh)					
Churchill Falls	30,361	34,847	33,254	34,663	33,563
Hydro					
Hydraulic	4,200	4,772	4,689	4,802	4,770
Thermal	930	1,071	1,243	730	1,321
Diesel	46	47	43	42	43
Menihék*	40	41	13	-	-
Total	35,577	40,778	39,242	40,237	39,697
ELECTRIC ENERGY SALES (GWh)					
Churchill Falls Export	25,870	30,007	28,566	29,835	28,748
Hydro					
Utility	5,111	4,960	4,991	4,617	4,664
Rural	925	909	888	834	859
Industrial	575	1,124	1,136	1,145	1,685
Export	1,520	1,393	1,489	1,483	1,422
Menihék* Export	40	41	13	-	-
Twin Falls Industrial	1,591	1,801	1,678	1,801	1,804
Total	35,632	40,235	38,761	39,714	39,182
AVERAGE RATE (cents per kWh)					
Churchill Falls Export	0.25	0.25	0.25	0.25	0.25
Hydro					
Utility	6.59	6.48	6.50	5.24	5.25
Rural	6.84	7.02	6.98	6.13	6.13
Industrial	5.26	4.04	4.21	3.71	3.43
Export	3.44	3.68	3.61	3.55	3.48
Menihék* Export	3.27	3.19	2.91	-	-
TRANSMISSION LINES (km)					
Churchill Falls					
735 kV	608	608	608	608	608
230 kV	431	431	431	431	431
Hydro					
230 kV	1,608	1,608	1,608	1,608	1,608
138 kV	1,500	1,500	1,500	1,500	1,500
69 kV	634	634	634	634	634
Menihék*					
69 kV	39	39	39	-	-
Total	4,820	4,820	4,820	4,781	4,781
PEAK DEMAND (MW)					
Churchill Falls	5,515	4,501	5,575	5,587	5,608
Hydro System	1,390	1,323	1,323	1,310	1,361

* Operations commenced October 1, 2007.

Nalcor Energy Executive Leadership Team

Ed Martin

President & CEO

Jim Keating

Vice President
Oil and Gas

John Mallam

Vice President Engineering Services
Newfoundland and Labrador Hydro

Gilbert Bennett

Vice President
Lower Churchill Project

Chris Kieley

Vice President Strategic Planning &
Business Development

Gerard McDonald

Vice President Human Resources &
Organizational Effectiveness

Jim Haynes

Vice President Regulated Operations
Newfoundland and Labrador Hydro

Andy MacNeill

Vice President & General Manager
Churchill Falls

Derrick Sturge

Vice President Finance & CFO

Nalcor Energy Board of Directors



Tom Clift^{1,3}

Associate Dean, Academic Programs
Memorial University - Faculty of Business

Cathy Bennett³

Owner/Operator
Bennett Restaurants Ltd.

John Ottenheimer Q.C. (Chair)²

Corporate Director

Ken Marshall^{1,2}

President
Rogers Cable - Atlantic Region

Gerald Shortall^{2,3}

Chartered Accountant
Corporate Director

Ed Martin

President & CEO
Nalcor Energy

¹Compensation Committee ²Audit Committee ³Corporate Governance Committee

Nalcor Energy Officers

John Ottenheimer Q.C. (Chair)

Corporate Director

Gilbert Bennett

Vice President
Lower Churchill Project

Chris Kieley

Vice President Strategic Planning
& Business Development

Ed Martin

President & CEO

Wayne Chamberlain

General Counsel & Corporate Secretary

Gerard McDonald

Vice President Human Resources &
Organizational Effectiveness

Derrick Sturge

Vice President Finance & CFO

Peter Hickman

Assistant Corporate Secretary

Glenn Mitchell

Corporate Controller

Mark Bradbury

Corporate Treasurer &
Chief Risk Officer

Jim Keating

Vice President
Oil and Gas

Corporate Governance

Board of Directors

Nalcor Energy's Board of Directors is comprised of six members, including the Chair of the Board and the President and CEO of Nalcor Energy. The Board, chaired by John Ottenheimer, has three active committees: Audit, Corporate Governance and Compensation.

The principal functions of the Board include:

- (a) developing Nalcor's approach to corporate governance;
- (b) reviewing and approving the business, financial, strategic and other plans to enable Nalcor to execute its strategy;
- (c) adopting processes for monitoring the company's progress toward its strategic and operational goals;
- (d) approving the audited financial statements and Management's Discussion and Analysis;
- (e) ensuring that Management has a process for identifying the principal business risks;
- (f) overseeing the integrity of the internal control systems;
- (g) ensuring that Nalcor has processes for operating within applicable laws and regulations;
- (h) ensuring the company has a compensation philosophy and framework;
- (i) ensuring a process is in place to measure the performance of senior executives of Nalcor;
- (j) ensuring Management creates a culture of integrity throughout the organization; and
- (k) ensuring that succession plans are in place for senior Management, including the President and CEO.

The Board met 10 times in 2009, in addition to Committee meetings. Director attendance at Board and Committee meetings in 2009:

Directors	Board of Directors	Audit	Corporate Governance	Compensation
<i>Number of Meetings Held</i>	10	3	2	3
John Ottenheimer*	10	1		
Ed Martin	10			
Cathy Bennett**	10			
Tom Clift	10		2	3
Ken Marshall	10	3		3
Gerald Shortall	10	3	2	

* Appointed to the Audit Committee after two of three 2009 meetings were held.

** Appointed to Corporate Governance after all 2009 meetings were held.

Nalcor has the following subsidiary companies, each with their own independent Board of Directors. In each case there is at least one independent member of the Nalcor Board on the subsidiary Boards.

- Newfoundland and Labrador Hydro
- Churchill Falls (Labrador) Corporation
- Nalcor Energy – Oil & Gas Inc.
- Nalcor Energy – Bull Arm Fabrication Inc.

The Board's independent directors regularly meet as part of scheduled meetings at which non-independent directors including members of Management are not present.

Corporate Governance

Audit Committee

The Audit Committee is comprised of three independent directors. All members of the Committee are required to have a basic understanding of finance and accounting and be able to read and understand financial statements, and at least one member of the Committee shall have accounting or related financial management expertise at a level of sophistication similar to that of Nalcor. The Committee is comprised of Gerald Shortall (Chair), Ken Marshall and John Ottenheimer.

The Audit Committee's primary duties and responsibilities are to:

- (a) monitor the integrity of Nalcor's financial statements, financial reporting process and systems of internal controls;
- (b) identify and monitor the management of the principal risks that could impact the financial reporting of the company;
- (c) appoint, approve compensation, and monitor the independence and performance of the external auditors;
- (d) provide oversight over the internal audit function;
- (e) monitor the compliance with legal and regulatory requirements; and
- (f) facilitate communication among the external auditors, Nalcor's Internal Audit Department, Management and the Board.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the independent auditors. Subject to Board approval, the Audit Committee may retain, at Nalcor's expense, special legal, accounting, or other consultants or experts it deems necessary in the performance of its duties.

The Committee regularly meets separately with the external auditor and Nalcor's Internal Audit Department and Management. The Committee also regularly meets in-camera with only the Committee members present.

Corporate Governance Committee

The Corporate Governance Committee consists of three directors as determined by the Board, all of whom shall be independent. The Committee is comprised of: Tom Clift (Chair), Cathy Bennett and Gerald Shortall. The Corporate Governance Committee is responsible for the following:

- (a) developing governance principles for Nalcor and its subsidiaries that are consistent with high standards of corporate governance;
- (b) identifying and recommending candidates for appointment to the Board for approval by the Shareholder; and
- (c) reviewing and recommending a process for director orientation and assessment.

Compensation Committee

The Compensation Committee is comprised of two members, who are independent directors. The Committee provides oversight of all compensation and human resources issues for Nalcor and its subsidiaries. The Committee is comprised of: Ken Marshall (Chair) and Tom Clift. The primary responsibilities of the Committee include:

- (a) undertake an annual performance review of the President and CEO;
- (b) review and assess Nalcor's succession planning policies and practices;
- (c) establish and maintain a compensation philosophy and framework;
- (d) review and assess compensation and benefit policies and programs and pension plans;
- (e) review collective bargaining mandates and any proposed tentative settlement; and
- (f) review performance management practices and procedures.

Subject to the approval of the Board of Directors, the Committee may engage outside legal and technical specialist to assist the Committee in the discharge of their duties and responsibilities.

Independence

Nalcor Energy has a Director Independence Policy consisting of:

- (a) a majority of the Board of Directors, including the Board chair shall be independent;
- (b) all the members of the Board's Committees shall be independent;
- (c) directors are required to provide a formal declaration indicating that they satisfy the Independence criteria;
- (d) directors have a responsibility to discuss any potential conflicts that might impact their independence with the Board chair or the chair of the Corporate Governance Committee;
- (e) if directors do not satisfy the Independence criteria, they should not participate in any discussion or voting relating to matters that contribute to the independence issue.

Policy on Independence of External Auditors

Nalcor Energy has an Auditor Independence policy that governs all aspects of Nalcor's relationship with the external auditor, including:

- (a) establishing a process for determining whether various audit and other services provided by the external auditor affects their independence;
- (b) identifying the services that the external auditor may and may not provide to Nalcor;
- (c) pre-approving all services to be provided by the external auditor to the company;
- (d) establishing a process for hiring current or former personnel of the external auditor in a financial oversight role to ensure auditor independence is maintained.

External Auditor's Fees

The external auditor of Nalcor and its subsidiaries is Deloitte & Touche LLP. Deloitte has been the external auditor since 2003. Professional fees incurred in 2009 in connection with audit and audit-related service were \$295,000 (2008 - \$167,000) and fees related to non-audit services were \$179,000 (2008 - \$64,000).

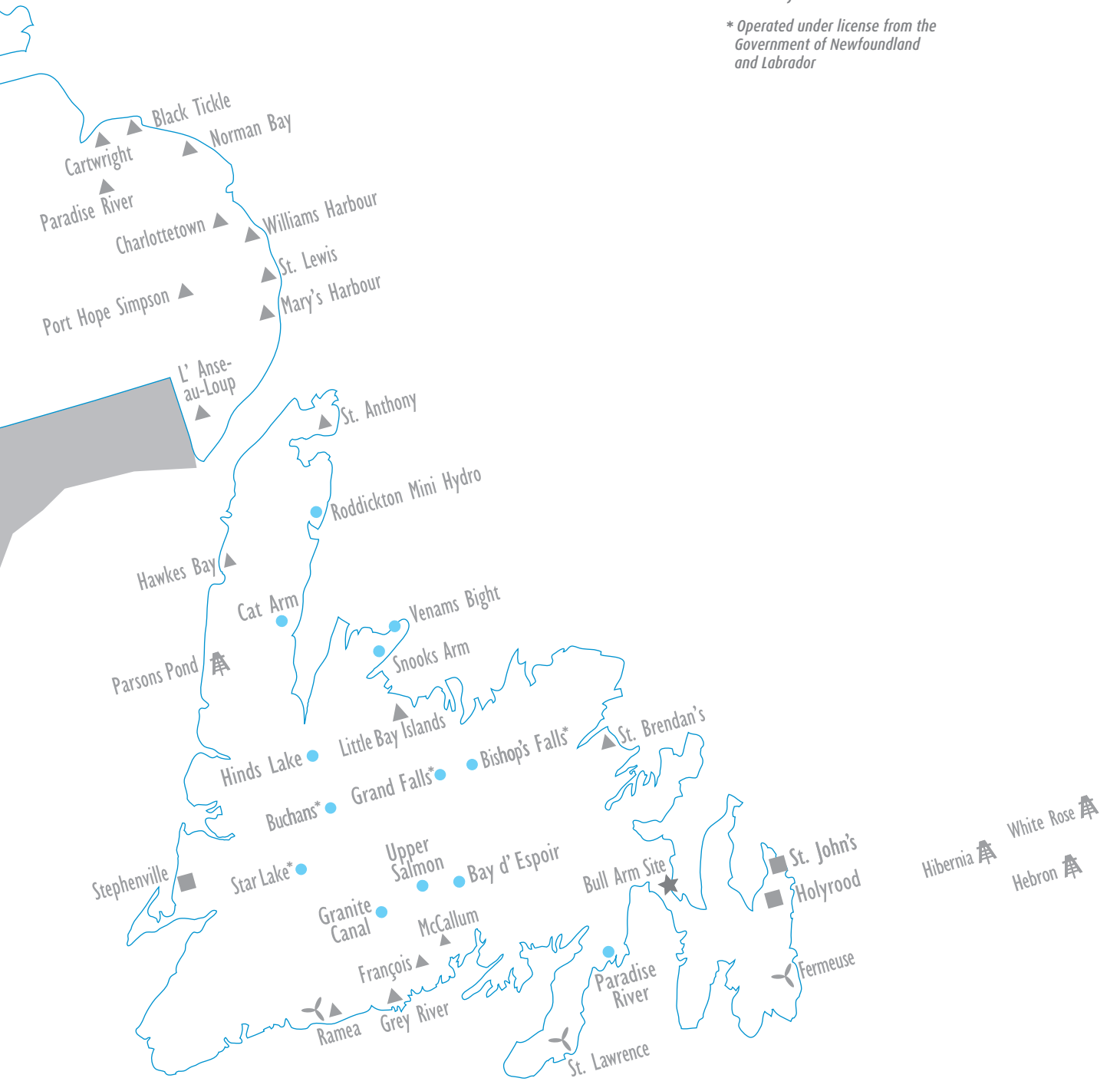
Energy Portfolio



Legend

- Hydroelectric Generation Station
- Thermal Plant
- ▲ Diesel Plant
- ✪ Wind Generation
- ⚓ Offshore and Onshore Oil Projects

** Operated under license from the Government of Newfoundland and Labrador*





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