

Transparency and Accountability Act
2007 ANNUAL PERFORMANCE REPORT



**Newfoundland and Labrador Hydro
Group of Companies**

June 2008

Message from the Board of Directors

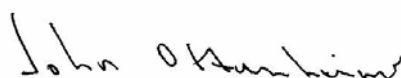
Hon. Roger Fitzgerald, M.H.A.
Speaker of the House of Assembly
East Block
Confederation Building

Dear Mr. Speaker:

In accordance with the *Transparency and Accountability Act*, I am pleased to submit the 2007 Annual Performance Report on behalf of the Board of Directors of the Newfoundland and Labrador Hydro Group of Companies.

The Hydro Corporation Act (2006) mandated Newfoundland and Labrador Hydro to be responsible for activity related to electricity development, operation and marketing, as well as a wide range of activities related to hydrocarbon exploration, development, production, refining, marketing and transportation.

The following report covers the calendar year 2007. The scope of this report covers Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation, Twin Falls Power Corporation, Lower Churchill Development Corporation and Gull Island Power Corporation. As the Board of Directors of Newfoundland and Labrador Hydro, we are accountable for the preparation of this report and are accountable for the actual results.



John Ottenheimer
Chair
Newfoundland and Labrador Hydro

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Overview of the Company

Newfoundland and Labrador Hydro (NLH) is a Crown corporation owned by the Province of Newfoundland and Labrador. NLH is the parent company of Churchill Falls (Labrador) Corporation Limited (CF(L)Co), Lower Churchill Development Corporation, Gull Island Power Company, and Twin Falls Power Corporation. NLH is responsible for achieving outcomes related to the energy sector.

Vision

Newfoundland and Labrador Hydro's vision is to be recognized as an innovative provider of quality energy services.

(Under review in 2008)

Mission

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

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

(Under review in 2008)

Mandate

The Hydro Corporation Act (2006) mandated NLH to be responsible for:

- Developing and purchasing power and energy on an economic and efficient basis.
- Being involved within the province and elsewhere, in all aspects of the development, delivery and use of power and energy produced from a source of any kind (except nuclear).
- Engaging in activities related to the exploration for, development, production, refining, marketing and transportation of, hydrocarbons and products from hydrocarbons.

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

Values

All members of NLH form 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.

Lines of Business

1. Regulated Operations

This division's business is to deliver safe, reliable, least-cost power to industrial, utility and over 35,000 direct customers in rural Newfoundland and Labrador. NLH operates nine hydroelectric generating stations, one oil-fired plant, four gas turbines, four interconnected diesel generating stations and 21 isolated diesel generation and distribution systems. Hydro maintains 54 high-voltage terminal stations, 25 lower voltage interconnected distribution substations, 3,742 km of interconnected high-voltage transmission lines and 3,334 km of distribution lines.

2. Churchill Falls Operations

The Churchill Falls Generating Station is operated by the Churchill Falls (Labrador) Corporation (CF(L)Co). The plant has a rated capacity of 5,428 MW and generates over 30,000 gigawatt-hours (GWh) of energy annually. CF(L)Co operates the town of Churchill Falls, including a school, theatre, library, and recreational facilities. The majority of electricity from the Churchill Falls station is sold to Hydro-Quebec under a long-term contract, though sufficient electricity is retained to supply all current energy requirements on the Labrador Interconnected System.

3. Lower Churchill Project

The Lower Churchill Project includes the development of two hydroelectric sites on the lower Churchill River – Gull Island (2,000 MW) and Muskrat Falls (824 MW). NLH is moving ahead with analysis necessary activities to enable the provincial government to consider a sanction decision.

4. Business Development

In concert with the provincial Energy Plan, NLH is pursuing business opportunities in oil and gas; wind generation; alternative energy sources; and research and development activities.

Number of Employees, Physical Location, and Other Key Statistics

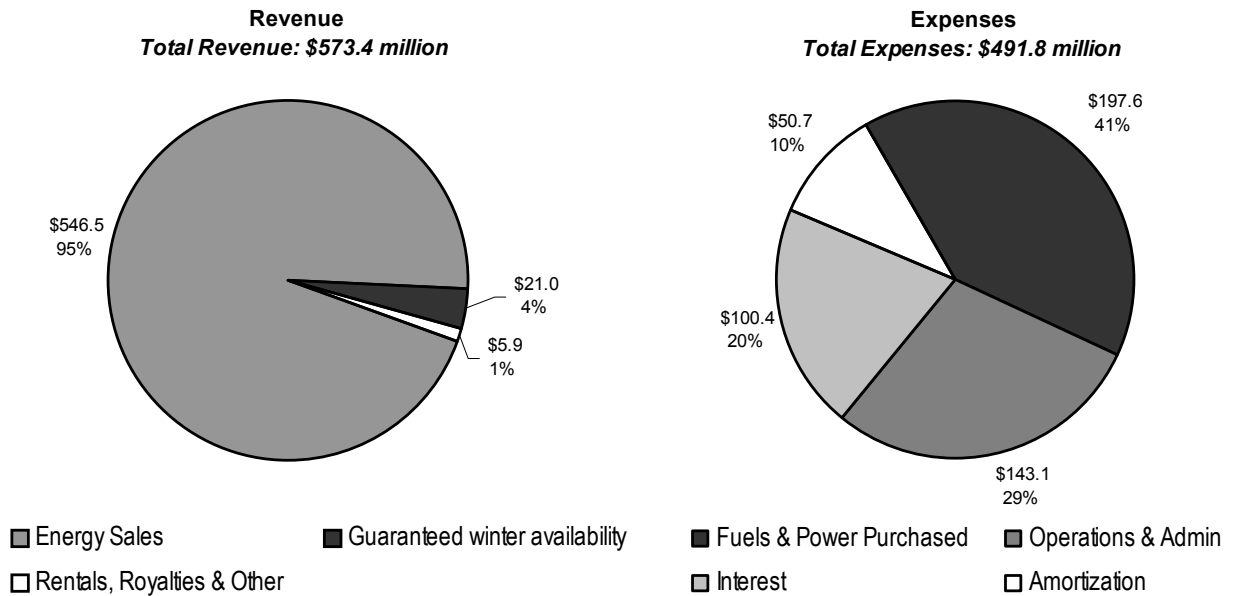
Headquartered in St. John's, NLH is the fourth largest power utility in Canada with 7,288 megawatts (MW) of installed generating capacity, and is the province's main electrical energy provider. NLH supplies over 80 percent of the province's electrical energy, operates the second largest underground hydropower station in the world, and is expanding its operations into oil and gas, wind generation, and research and development. The company has a staffing level of 1173 full time equivalents.

In 2007, Energy Corporation of Newfoundland and Labrador (Energy Corporation) was created by an Act of the provincial legislature. This report reflects the structure in place for 2007; reports for 2008 and onward will reflect the changes in organizational structure as a result of the creation of Energy Corporation.

2007 Consolidated Revenues and Expenses

The following charts summarize the consolidated 2007 revenue and expenses for the NLH group. Full details can be found in NLH's 2007 Business and Financial Report. The report is available on the NLH website www.nlh.nl.ca

2007 NLH Group Consolidated Revenue and Expenses



Shared Commitments

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

Department of Natural Resources

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

Department of Finance

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

Board of Commissioners of Public Utilities

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

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

Outcomes of Objectives

In its 2007 Strategic Plan, NLH highlighted eight strategic issues around which goals and objectives were established. The following details performance in 2007 relative to these goals, objectives, measures and indicators. For each strategic issue, the information provided in the 2007 Strategic Plan is reproduced, followed by an assessment of performance in 2007. Any variances from established targets are identified under the appropriate issues and indicators by use of the phrase "Variance Explanation".

Issue 1: Safety Leadership

Goal: In 2007 continue to improve NLH's safety performance by increasing the quality and number of reports that identify conditions or behaviours that contribute to disabling and disabling/medical aid incidents

2007 Plan Summary

Measure: Improved safety performance

Indicators:

- Achieved safety lead/lag ratio of 100:1. The safety lead/lag ratio is an indicator of the degree of condition and behaviour reporting (leading measures) relative to the number of safety incidents (lagging indicators). Companies employing best practices in safety performance have high lead/lad ratios.
- Reduced the number of disabling injuries by 50%.
- Reduced the number of medical aid injuries by 25%.

2007 Results

Indicator	Target	2007 Actual	Comments
Safety lead/lag ratio	100:1	280:1	Corporate target achieved. CF(L)Co ratio was 185:1. The balance of the corporation recorded a ratio of 323:1.

Indicator	Target	2007 Actual	Comments
No. disabling injuries	50% reduction	60% reduction	<p>Corporate target achieved.</p> <p>CF(L)Co recorded an 83% reduction versus 2006.</p> <p>The balance of the corporation recorded a reduction of 44% versus 2006.</p> <p>Variance Explanation: There were five disabling injuries in the regulated utility in 2007, three of which were associated with activities in the area of transmission and distribution. During the second half of the year an additional special focus was placed upon preventing unsafe work practices.</p>
No. medical aid injuries	25% reduction	30% reduction	<p>Corporate target achieved.</p> <p>CF(L)Co recorded a 43% reduction versus 2006</p> <p>The balance of the corporation recorded a reduction of 14% versus 2006.</p> <p>Variance Explanation: There were six medical aid injuries in 2007, half of which were due to cuts received while performing work duties. In conjunction with the special focus undertaken in the second half of the year, specific attention was paid to addressing prevention of cuts.</p>

Objective: Further enhance NLH's safety programs in 2007

2007 Plan Summary

Measure: Action on individual components of safety improvement programs

Indicators:

- Implemented a Safe Workplace Observation Program
- Undertook activity related to a new safety accountability framework for all individuals and teams
- Undertook activity related to assessing and changing NLH's safety culture.
- Promoted NLH's new safety rules following review and revision by NLH's Corporate Safety Advisory Committee.

2007 Results and Highlights

Activity and results noted in the following table are common to all divisions of the NLH group of companies, including those in the regulated utility, CF(L)Co and the Energy Corporation.

Indicator	Results & Highlights
Implemented a Safe Workplace Observation Program	<p>Complete. In 2007, NLH fully implemented, reinforced and enhanced its new Safe Workplace Observation Program (SWOP). The program was heavily promoted across the entire organization, and an electronic application was developed to support the reporting, tracking and remediation of conditions and behaviours that can lead to safety incidents. The application became an essential element of SWOP program, and was used throughout the NLH group of companies.</p> <p>In 2007, there was a 163% increase in SWOP reports generated compared to 2006, reflecting the combined impact of full program implementation, reinforcement and enhancement.</p>
Undertook activity related to a new safety accountability framework for all individuals and teams	<p>Complete. In 2007, NLH developed a new safety accountability framework for implementation throughout the NLH group in 2008. The framework helps clarify roles and responsibilities for safety-related issues, and reinforces the role of each individual in contributing to the fundamental goal of making sure each worker throughout the NLH group can return home safely.</p>

Indicator	Results & Highlights
Undertook activity related to assessing and changing NLH's safety culture.	Complete. In 2007, NLH performed extensive work in assessing and establishing a plan to improve its safety culture. Specific activities included conducting a safety culture survey, consultation with Occupational Health and Safety committees, and consultation with NLH's Corporate Safety Advisory Committee. The results of the work will form the basis for future activity to help in the process of transforming the NLH group into one that consistently exhibits safety leadership.
Promoted NLH's new safety rules following review and revision by NLH's Corporate Safety Advisory Committee	Complete. In 2007, NLH completed a review of its general safety rules, and produced a revised, simplified, and improved set. The new set of rules will be introduced in 2008 as the NLH group Safety Credo.

2008 Objectives, Measures and Indicators

Objectives, measures and indicators for 2008 are contained in the 2008-2010 Strategic Plan for the Energy Corporation of Newfoundland and Labrador.

Issue 2: Environmental Leadership

Note that for strategic issue 2, two separate goal/objective pairs were identified in the 2007 Strategic Plan. All other strategic issues have a single goal/objective pair.

Goal and

Objective: In 2007 complete all preparatory steps required to increase contributions from renewable energy resources and energy conservation activities targeted for future years. **NLH Regulated Utility Only**

2007 Plan Summary

Measure: Action on non-thermal generation maximization initiatives. **NLH Regulated Utility Only**

Indicators:

- Completed a study on a hydroelectric efficiency improvement strategy
- Completed a conservation and demand management study
- Commenced construction on the St. Lawrence wind farm
- Executed a power purchase agreement for a second 25 MW wind farm

2007 Results

NLH Regulated Utility Only

Indicator	Results and Highlights
Completed a study on a hydroelectric efficiency improvement strategy	Complete. Study completed and multi-year action plan developed to assist with increasing hydroelectric yield from existing resources.
Completed a conservation and demand management study	Incomplete. Variance Explanation: Conservation and demand management (CDM) potential study undertaken. The study was commenced in 2007, but was not completed until the first quarter of 2008. The delay was due to resource limitations on the part of the consultant engaged to perform the study.
Commenced construction on the St. Lawrence wind farm	On schedule. A groundbreaking ceremony was held on July 26, 2007 marking the commencement of construction on the 27 MW wind farm at St. Lawrence. Construction continued in 2007, with an estimated in-service date of late 2008.

Indicator	Results and Highlights
Executed a power purchase agreement for a second 25 MW wind farm	Complete. In December 2007, a power purchase agreement was signed with SkyPower Corporation for a 27 MW wind farm to be developed in Fermeuse. The Fermeuse wind farm is expected in service in late 2008.

Goal: In 2007 increase the number of Environmental Management System (EMS) targets and objectives accomplished.

2007 Plan Summary

Measure: Annual accomplishment of EMS milestones and targets
Indicators:

- Annual milestone tracking progress. Milestone for each EMS program are established each year to establish key activities and accomplishments required to complete the EMS program expectations. Completion of milestones is a means of tracking progress in completing EMS targets.
- Annual target tracking progress. EMS targets are the primary manner in which the objectives of the EMS programs are met. Just as milestones measure progress towards EMS targets, EMS targets measure progress towards achieving the objectives of the EMS program.

2007 Results

Indicator	Target	2007 Actual	Comments
Annual milestone tracking progress	95%	98%	Corporate target achieved. NLH regulated utility milestone completion level for 2007 was 98%. CF(L)Co milestone completion level was 97%.

Indicator	Target	2007 Actual	Comments
Annual target tracking progress	95%	95%	<p>Corporate target achieved.</p> <p>NLH regulated utility completion level was 95%</p> <p>CF(L)Co completion level was 94%.</p> <p>Variance Explanation: Of the 34 targets established of the year, 32 were accomplished. The incomplete targets were in relation to environmental work on the airport facilities. Targets were missed due to the combined effects of design delays, contractor workload, and the onset of winter.</p>

Objective: Develop EMS tracking system

2007 Plan Summary

Measure: Complete and functioning tracking system

Indicators:

- Developed and implemented progress tracking system

2007 Results and Highlights

Activity and results noted in the following table are common to all divisions of the NLH group of companies, including those in the regulated utility, CF(L)Co and the Energy Corporation.

Indicator	Results & Highlights
Developed and implemented progress tracking system	<p>Complete. NLH has been certified under the ISO 14001 Environmental Management System. Through its EMS, NLH seeks to mitigate its impact on the environment. A key element of EMS activity is continual improvement in the manner in which an organization manages its impact on the environment. A means of tracking this improvement is the development of EMS programs and targets for completion within a year.</p> <p>In 2007, NLH developed and implemented a comprehensive tracking and reporting system to help ensure success in executing activities under its EMS program. In 2007, overall NLH achieved 95% completion of its EMS targets, up substantially from 2006.</p>

2008 Objectives, Measures and Indicators

Objectives, measures and indicators for 2008 are contained in the 2008-2010 Strategic Plan for the Energy Corporation of Newfoundland and Labrador.

Issue 3: Finance and Corporate Governance

Goal: In 2007 continue to establish a governance and financial structure that supports NLH's expanded mandate

2007 Plan Summary

Measure: Improved governance and financial structure

Indicators:

- Completed a strategy for financing wind and oil and gas projects, as well as various acquisition opportunities
- Implemented the first phase of a corporate restructuring plan
- Completed a corporate governance review and a baseline for governance performance established

2007 Results

Indicator	Comments
Completed a strategy for financing wind and oil and gas projects, as well as various acquisition opportunities	Complete. Financing plan developed, including a request to the Shareholder for an equity injection of \$215 million that was included in the 2008/09 Provincial Budget.
Implemented the first phase of a corporate restructuring plan	Complete. The first phase of the corporate restructuring plan was completed, including the creation of the Energy Corporation.
Completed a corporate governance review and a baseline for governance performance established	Complete. A review of the Corporation's corporate governance practices that commenced in 2006 was completed, including revised mandates and policies.

Objective: By December 2007 complete key initiatives required to support NLH's expanded mandate

2007 Plan Summary

Measure: Completion of initiatives

Indicators:

- Completed a corporate governance review for NLH
- Developed a comprehensive plan to obtain an investor-owned return on equity

2007 Results and Highlights

Indicator	Results & Highlights
Completed a corporate governance review for NLH (NLH group)	Complete. Revised mandates for the Board and its Committees and related policies.
Developed a comprehensive plan to obtain an investor-owned return on equity (NLH Regulated Utility Only)	Complete. The Corporation has identified its needs with regard to future Return on Equity in the regulated business

2008 Objectives, Measures and Indicators

Objectives, measures and indicators for 2008 are contained in the 2008-2010 Strategic Plan for the Energy Corporation of Newfoundland and Labrador.

Issue 4: Growth

Goal: By 2007 achieve progress in the pursuit of new business opportunities

2007 Plan Summary

Measure: Progress towards assuming equity positions in new business areas

Indicators:

- Sought equity positions in oil and gas developments in concert with Provincial policy

2007 Results

Indicator	Comments
Sought equity positions in oil and gas developments in concert with Provincial policy	Achieved. Pursued offshore oil equity positions per Provincial policy. Equity position in White Rose oil field successfully negotiated in 2007. In addition, a non-binding Memorandum of Understanding was signed with the partners of Hebron to acquire a 4.9% equity interest in the Hebron oil field.

Objective: By December 2007 undertake initial activities required to enter oil and gas and wind development opportunities

2007 Plan Summary

Measure: Completion of preparatory activities for new business areas

Indicators:

- Executed a Power Purchase Agreement for a second 25 MW wind farm
- Completed an organization plan for pursuit of oil and gas and wind developments

2007 Results and Highlights

Indicator	Results & Highlights
Executed a Power Purchase Agreement for a second 25 MW wind farm	Complete. See "2007 Results and Highlights" under Issue 2
Completed an organization plan for pursuit of oil and gas and wind developments	Complete. Organizational plan and structure established and ready for implementation in 2008.

2008 Objectives, Measures and Indicators

Objectives, measures and indicators for 2008 are contained in the 2008-2010 Strategic Plan for the Energy Corporation of Newfoundland and Labrador.

Issue 5: Operational Excellence

Goal: In 2007, improve or maintain corporate reliability indices while achieving capital and operating budget financial targets.

2007 Plan Summary

Measure: Progress towards improving operational excellence

Indicators:

- Improved outage performance indices (winter availability and transmission reliability) – **NLH Regulated Utility Only**. Winter availability is a measure of the reliability of the major facilities on the island interconnected system during the critical winter season. Transmission network reliability is measured through unserved energy, which represents forgone sales as a result of network failures.
- Maintained high customer satisfaction levels – **NLH Regulated Utility Only**
- Guaranteed Winter Availability (GWAC) performance – **CF(L)Co only**. GWAC is calculated under the provision of an agreement between CF(L)Co and Hydro-Quebec. During key winter months, CF(L)Co receives revenue based upon plant availability. The indicator tracks actual availability revenue as a percentage of maximum possible availability revenue.
- Operating cost performance

2007 Results

NLH Regulated Utility Only

Indicator	Metric	Target	2007 Actual	Comments
Improved outage performance indices	Weighted Winter Availability	98%	94.1%	Variance Explanation: Target not achieved due primarily to extended forced outages on units at the Holyrood Generating Station. Investigations have been completed and remedial action plans have been incorporated into the 2008-2010 strategic plan.

Indicator	Metric	Target	2007 Actual	Comments
	Unsupplied Energy	19,000 MW-minutes	20,616 MW-minutes	Variance Explanation: Target not achieved due to problems related to automatic electrical fault detection and isolation, affecting the White Bay and Avalon Peninsula areas. Remedial plan to be part of the 2008 operational plan.
Maintained high customer satisfaction levels	Customer Satisfaction Index	89%	89%	Target achieved
Operating Cost		100% of budget or less	104% of budget	Variance Explanation: Target not achieved due in large part to costs incurred to address problems associated with equipment forced outages and forced maintenance extensions. Remedial action plans have been incorporated into the 2008-2010 strategic plan.

CF(L)Co Only

Indicator	Metric	Target	2007 Actual	Comments
Improved outage performance indices	GWAC	98%	99.7%	Target achieved
Operating Cost		100% of budget or less	98.1%	Target achieved

Objective: Achieve targets for reliability, cost control, and long term asset management in 2007

2007 Plan Summary

Measure: Reliability, cost control target, and long term asset management plan performance

Indicators:

- Capital program delivery performance
- Asset management strategy development – **NLH Regulated Utility Only**

2007 Results and Highlights

Except as noted, activity and results noted in the following table are common to all divisions of the NLH group of companies, including those in the regulated utility, CF(L)Co and the Energy Corporation.

Indicator	Results & Highlights
Capital program delivery performance	<p>Not achieved.</p> <p>Variance Explanation</p> <p>In 2007, the total capital program budget for the regulated utility and for CF(L)Co was \$55.8 million. Actual spending for the year was \$42.9 million, or 77% completion. The target completion level was 95%.</p> <p>The 2007 regulated utility capital program was for \$43.3 million, of which \$35.7 million was delivered (83% completion). Of the remaining \$7.6 million of undelivered capital in 2007, roughly two-thirds was the result of NLH's decisions to defer work into 2008. These decisions were made in light of a variety of factors, including unanticipated market conditions and delays to facilitate customer negotiations. The balance of the unspent capital funds were the results of projects coming in under budget, and projects whose completion date was carried over into 2008.</p> <p>The CF(L)Co capital program was for \$12.5 million, of which \$7.2 million was delivered, or 58% completion. Of the remaining \$5.3 million of undelivered capital in 2007, \$4.3 million was comprised of projects cancelled during the year. The remaining unspent capital was the result of projects coming in under budget, and projects being carried over into 2008.</p>

Indicator	Results & Highlights
<p>Asset management strategy development (NLH Regulated Utility Only)</p>	<p>2007 scheduled activity complete. In 2007, NLH continued its work in the area of asset maintenance and management for the regulated utility. The purpose of the strategy is to identify the short term and long term asset maintenance, replacement, and upgrade requirements necessary to support continued provision of safe, reliable, low cost electricity. The focus of the activity for 2007 was the completion of maintenance strategies for NLH's four gas turbines, as well as 25% of the equipment at the Holyrood Generating Station. The balance of the plant asset maintenance and management strategy will be undertaken in 2008 and beyond.</p> <p>The asset management strategy is a key focus to address reliability and operating cost issues for NLH, and is therefore a key element of the 2008-2010 strategic plan.</p>

2008 Objectives, Measures and Indicators

Objectives, measures and indicators for 2008 are contained in the 2008-2010 Strategic Plan for the Energy Corporation of Newfoundland and Labrador.

Issue 6: Lower Churchill

Goal: In 2007, continue engagement in the seven key areas highlighted for the project

2007 Plan Summary

Measure: Progress in each of the seven key areas

Indicators:

- Engineering
- Financing
- Environment
- Commercial/Market Access
- Aboriginal Impacts and Benefits Agreement
- Project Execution Planning
- Operations

2007 Results

In each area of focus in 2007, the progress per the 2007 Strategic Plan was achieved. The following provides highlights of progress in the areas of focus

Area of Focus	Results
Engineering	In 2007, an extensive engineering program was conducted, which included further field investigation work at both the Gull Island and Muskrat Falls project sites, as well as along the potential transmission routes. The field program consisted of surveying, test pitting, exploratory drilling and seismic investigations as well as sub-sea surveying of the Strait of Belle Isle and Cabot Strait.
Financing	Financing alternatives and strategies were developed and evaluated.

Area of Focus	Results
Environment	<p>The Provincial and Federal Governments have decided the Project will be subject to a joint environmental assessment and to an Independent Review Panel and as a part of the process issued the draft Environmental Impact Statement (EIS) guidelines for public review on December 19, 2007.</p> <p>In 2007, a series of information sessions were held throughout Labrador, allowing community members to speak directly to project members and have their feedback factor into the planning and development of the Project. These sessions assist in ensuring that the potential environmental and social effects of developing the lower Churchill resource are included in the EIS for the Project. These consultations will continue in 2008.</p>
Commercial/Market Access	<p>Once the domestic and industrial needs of the province have been met, potential market opportunities for Lower Churchill power exist in Ontario, Québec, the Maritime Provinces and the Northeastern United States. These market options were further analyzed and a portfolio of market destinations for power is under consideration. Potential routing options being explored include the Maritimes submarine route and transmission through Hydro-Québec's transmission system.</p>
Aboriginal Impacts & Benefits Agreement	<p>Impacts and Benefits Agreement negotiations have commenced, and will continue into 2008.</p>
Project Execution Planning	<p>Project execution planning has commenced and is underway.</p>
Operations	<p>Operations assessment has commenced and will continue to be evaluated in light of project development.</p>

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

2007 Plan Summary

Measure: Completion of preparatory milestones

Indicators:

- Engaged engineering consultants to complete required engineering studies
- Engaged financial advisors
- Progressed discussions to identify viable customer options for lower Churchill power
- Progressed review and evaluation of market access options for lower Churchill power

2007 Results and Highlights

Indicator	Results & Highlights
Engaged engineering consultants to complete required engineering studies	Complete. Consultants were involved in the successful 2007 engineering program.
Engaged financial advisors	Complete.
Progressed discussions to identify viable customer options for lower Churchill power	2007 progress achieved per 2007 Strategic Plan. Significant progress in identifying viable customer options for lower Churchill power.
Progressed review and evaluation of market access options for lower Churchill power	2007 progress achieved per 2007 Strategic Plan. Significant progress in review and evaluation of market access options. To complement initiative currently underway in other jurisdictions, a service request was made to the New Brunswick System Operator in February 2007 regarding possible access via two routes – one a high voltage DC submarine Maritime transmission route via Newfoundland; a second via the Hydro-Québec grid.

2008 Objectives, Measures and Indicators

Objectives, measures and indicators for 2008 are contained in the 2008-2010 Strategic Plan for the Energy Corporation of Newfoundland and Labrador.

Issue 7: People

Goal: In 2007 continue to improve all elements of employee engagement to a level where NLH would qualify for recognition as one of Canada's best employers in reference to an acceptable external benchmark

2007 Plan Summary

Measure: Progress towards ensuring alignment between employee and corporate goals

Indicators:

- Increased Employee Survey participation rate
- Improved Employee Opinion Survey score
- Completion of the Leadership Fundamentals Program by all front-line supervisors and superintendents

2007 Results

Indicator	Target	2007 Actual	Comments
Increased Employee Survey participation rate	70%	81%	Corporate target achieved. Increase from 58% participation rate in prior survey (2005) CF(L)Co participation rate was 78% Participation rate for balance of NLH was 82%

Indicator	Target	2007 Actual	Comments
Improved Employee Opinion Survey score	3.65	3.62	<p>Corporate target marginally missed, however the 2007 result was an improvement over the 2005 score of 3.48.</p> <p>CF(L)Co score was 3.57 Variance Explanation: Despite a 5% improvement in its score over the 2005 survey, CF(L)Co results were below target. The results generally tracked those of NLH as a whole in relation to individual score categories, but overall values were slightly lower. No single category accounted for the failure to meet target. Results from the 2007 survey will be used to assess areas where further improvements can be made.</p> <p>The score for the balance of the NLH was 3.69</p>
Completion of the Leadership Fundamentals Program by all front-line supervisors and superintendents	100%	92%	<p>Corporate target marginally missed.</p> <p>NLH completion rate was 95% Variance Explanation: The remaining 5% was not completed in 2007 due to a number of unforeseen factors, including individuals becoming promoted after the courses had been delivered, vacation and sick leave time during periods when the courses were delivered, and unforeseen maintenance/outage work that diverted front-line staff during periods when the courses were delivered.</p>

Indicator	Target	2007 Actual	Comments
			<p>CF(L)Co completion rate was 80%</p> <p>Variance Explanation: In addition to the causes noted above, program delivery was complicated by the scheduling and logistical issues associated with providing training to individuals who missed the original scheduled training.</p> <p>The balance of the NLH and CF(L)Co program delivery is scheduled to be completed in 2008.</p>

Objective: Undertake activities required to enable closer business-employee alignment by December 2007

2007 Plan Summary

Measure: Completion of feedback and engagement activities

Indicators:

- Undertook an organizational review of NLH's vision and values through an appropriate corporate-wide engagement process
- Developed and implemented a corporate-wide program for recognizing exemplary employee service and contribution to the company
- Ensured appropriate union representation on committees and working groups within NLH

2007 Results and Highlights

Activity and results noted in the following table are common to all divisions of the NLH group of companies, including those in the regulated utility, CF(L)Co and the Energy Corporation.

Indicator	Results & Highlights
Undertook an organizational review of NLH's vision and values through an appropriate corporate-wide engagement process	Complete. In 2007, the NLH group undertook a corporate values review. As a part of the review, a Values Engagement Team (VET) was created, comprised of employees from a wide range of locations with the NLH group. The VET entered into a facilitated process to establish and confirm the core values of the company. As a result of the review, the values of the company were clearly and concisely defined and established.
Developed and implemented a corporate-wide program for recognizing exemplary employee service and contribution to the company	Complete. In 2007, the NLH group completed development of a corporate-wide program for recognizing exemplary employee service and contribution to the company. The program will receive full implementation in 2008.
Ensured appropriate union representation on committees and working groups within NLH	Complete. In 2007, the company continued to focus on ensuring appropriate union representation on committees and working groups. Representation now covers a wide range of areas, from safety-related committees to goal working groups for corporate strategy planning.

2008 Objectives, Measures and Indicators

Objectives, measures and indicators for 2008 are contained in the 2008-2010 Strategic Plan for the Energy Corporation of Newfoundland and Labrador.

Issue 8: Community

Goal and

Objective: In 2007 be recognized as a valued corporate citizen and an active member of the communities in which NLH operates by improving NLH's perception by the public

2007 Plan Summary

Measure: Improvements in NLH's perception by the public

Indicators:

- Increased performance on NLH's reputation index
- Improved performance on NLH's corporate citizenship index

2007 Results and Highlights

Indicator	Target	2007 Actual	Comments
Increased performance on NLH's reputation index	77	77.2	Target achieved
Improved performance on NLH's corporate citizenship index	78	78.1	Target achieved

- In support of the goal and objective of being a valued corporate citizen, NLH undertook a strategic community investment program focused on issues related to safety and the environment. After developing the strategy and assessing needs in the communities in which NLH operates, a decision was made to establish a relationship the Senior's Resource Centre to assist with delivery of programs that address senior's health and safety.

2008 Objectives, Measures and Indicators

Objectives, measures and indicators for 2008 are contained in the 2008-2010 Strategic Plan for the Energy Corporation of Newfoundland and Labrador.

Opportunities and Challenges

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

Energy Costs

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

Workforce Changes

Attracting and retaining qualified, skilled staff poses a significant challenge. In the regulated utility and in CF(L)Co, retirements continue to draw upon the pool of experienced workers. In growth and development areas of the company, there is intense competition for workers in a variety of fields. Addressing the challenges of the changing workforce and the company's requirements will be a key element in the execution of the 2008-2010 strategic plan.

Long Term Asset Maintenance and Management Plan

A significant portion of NLH's asset base is 30 to 40 years old, and is well into its original designed life expectancy. To continue to provide safe, cost effective, reliable power, a long term asset maintenance and management plan is being developed. This plan will address deteriorating or obsolete assets over the long term, identifying the key investments required to enable NLH to continue to deliver on its mandate. NLH anticipates continued and increasing investment will be required into the future as this plan is executed. The costs, challenges and renewal opportunities that arise as a result of the execution of the long term asset maintenance and management plan will be a key element of the 2008-2010 strategic plan.

Implementation of the Energy Plan

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

Shareholder to make a decision regarding sanction of the Lower Churchill Project.

Financial Statements

Attached are NLH's audited consolidated financial statements. The statements can also be found in NLH's 2007 Business and Financial Plan, available on NLH's website www.nlh.nl.ca.

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007

Independent Auditors' Report

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

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 2007 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, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year, except as disclosed in Note 2.



Chartered Accountants
February 25, 2008

BOARD OF DIRECTORS

DEAN T. MacDONALD⁽¹⁾
Chief Executive Officer
Persona Inc.

EDMUND J. MARTIN
President and Chief Executive Officer
Newfoundland and Labrador Hydro

EDNA TURPIN
Consultant

GERALD J. SHORTALL
Chartered Accountant

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

KEN MARSHALL
President
Rogers Cable - Atlantic Region

CHRIS KIELEY
Deputy Minister
Department of Natural Resources

CATHY BENNETT
Business Person

OFFICERS

DEAN T. MacDONALD⁽¹⁾
Chairman

EDMUND J. MARTIN
President and Chief Executive Officer

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

JAMES R. HAYNES
Vice-President, Regulated Operations

JOHN E. MALLAM
Vice-President, Engineering Services

JIM M. KEATING
Vice-President, Business Development

ANDREW E. MacNEILL
Vice-President, Upper Churchill Operations

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

GILBERT J. BENNETT
Vice-President, Lower Churchill Project

WAYNE D. CHAMBERLAIN
General Counsel and Corporate Secretary

PETER A. HICKMAN
Assistant Corporate Secretary

MARK G.S. BRADBURY
Corporate Treasurer

GLENN H. MITCHELL
Corporate Controller

HEAD AND CORPORATE OFFICE

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

⁽¹⁾ Resigned effective December 18, 2007

NEWFOUNDLAND AND LABRADOR HYDRO

CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)

2007

2006

ASSETS

Current assets

Cash and cash equivalents	7.2	10.0
Short-term investments	11.5	11.7
Accounts receivable	80.6	72.4
Current portion of long-term receivable (Note 5)	0.5	1.1
Current portion of regulatory assets (Note 4)	12.1	45.3
Fuel and supplies	69.7	54.4
Prepaid expenses	1.2	1.5
	<u>182.8</u>	<u>196.4</u>
Property, plant and equipment (Note 3)	1,825.7	1,791.5
Long-term receivables (Note 5)	23.3	19.2
Sinking funds (Notes 8 and 12)	151.8	117.1
Regulatory assets (Note 4)	86.4	102.9
Investments (Note 6)	5.2	5.2
Reserve fund (Note 17)	11.1	-
	<u>2,286.3</u>	<u>2,232.3</u>

LIABILITIES AND SHAREHOLDER'S EQUITY

Current liabilities

Bank indebtedness	9.1	6.5
Accounts payable and accrued liabilities	75.9	49.2
Accrued interest	30.7	30.8
Current portion of long-term debt (Note 8)	209.1	22.5
Current portion of regulatory liabilities (Note 4)	23.5	33.7
Promissory notes (Note 8)	7.0	58.8
	<u>355.3</u>	<u>201.5</u>
Long-term debt (Note 8)	1,187.8	1,394.7
Regulatory liabilities (Note 4)	15.5	16.6
Long-term payable (Note 9)	-	0.3
Employee future benefits (Note 10)	47.4	42.3
	<u>62.9</u>	<u>59.2</u>
Non-controlling interest in Lower Churchill Development Corporation	2.5	2.5
Shareholder's equity (Note 11)		
Share capital	22.5	22.5
Contributed capital	114.0	114.0
Retained earnings	521.8	437.9
Accumulated other comprehensive income (Note 12)	19.5	-
	<u>677.8</u>	<u>574.4</u>
Commitments and contingencies (Note 17)		
	<u>2,286.3</u>	<u>2,232.3</u>

See accompanying notes

On behalf of the Board:



DIRECTOR



DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

<i>Year ended December 31 (millions of dollars)</i>	2007	2006
Revenue		
Energy sales	546.5	522.9
Guaranteed winter availability	21.0	18.9
Rentals and royalties	0.3	0.3
Other	5.6	5.9
	<u>573.4</u>	<u>548.0</u>
Expenses		
Operations and administration	143.1	130.4
Fuels	159.2	154.6
Power purchased	38.4	38.8
Amortization	50.7	48.5
Interest (Note 14)	100.4	105.7
	<u>491.8</u>	<u>478.0</u>
Net income	81.6	70.0
Retained earnings, beginning of year	437.9	370.5
Add: adjustment to opening retained earnings (Note 2)	2.3	-
	<u>521.8</u>	<u>440.5</u>
Dividends	-	2.6
Retained earnings, end of year	<u>521.8</u>	<u>437.9</u>

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

<i>Year ended December 31 (millions of dollars)</i>	2007	2006
Net Income	81.6	70.0
Other Comprehensive income		
Change in fair value of sinking fund investments	0.2	-
Comprehensive income	<u>81.8</u>	<u>70.0</u>

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)

2007

2006

Cash provided by (used in)

Operating activities

Net income	81.6	70.0
Adjusted for items not involving a cash flow		
Amortization	50.7	48.5
Accretion of long-term debt	0.8	1.0
Loss on disposal of property, plant and equipment	1.0	1.6
Foreign exchange gain	(0.3)	-
Other	(0.1)	0.4
	133.7	121.5
Change in non-cash balances (Note 15)	42.1	55.4
	175.8	176.9

Financing activities

Decrease in promissory notes	(51.8)	(92.0)
Long-term debt issued	-	225.0
Long-term debt retired	(13.1)	(215.1)
Dividends	-	(2.6)
Foreign exchange loss recovered	0.1	0.7
	(64.8)	(84.0)

Investing activities

Additions to property, plant and equipment	(86.5)	(60.9)
Increase in sinking funds	(19.6)	(18.5)
Decrease (increase) in short-term investments	0.2	(5.6)
Additions to regulatory assets	-	(1.9)
Increase in reserve fund	(11.1)	-
Proceeds on disposal of property, plant and equipment	0.6	0.5
	(116.4)	(86.4)

Net (decrease) increase in cash

Cash position, beginning of year

Cash position, end of year

(5.4)	6.5
3.5	(3.0)
(1.9)	3.5

Cash position is represented by

Cash and cash equivalents	7.2	10.0
Bank indebtedness	(9.1)	(6.5)
	(1.9)	3.5

Supplementary disclosure of cash flow information

Income taxes paid	0.2	0.2
Interest income received	1.2	1.7
Interest paid	105.4	111.3

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Gull Island Pond 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 (Gull Island Project). Lower Churchill Development Corporation (LCDC) is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (Lower Churchill Development). Both GIPCo. and LCDC are inactive.

CF(L)Co. is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (CF(L)Co. Project). Twin Falls Power Corporation (Twin Falls) is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, litigation, environmental and asset retirement obligations, amortization, property, plant, and equipment and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's revenues from electricity sales to most customers within the Province are subject to rate regulation by the PUB. As well, 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%. Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 4.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, GIPCo., (100% owned) and LCDC, (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co.) and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co. be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co., 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 CF(L)Co. subsequent to the effective date of the shareholders' agreement.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Principles of Consolidation (cont'd.)

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

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

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. The short-term investments outstanding at December 31, 2007 bear interest rates of 4.12% to 5.00% (2006 - 4.28% to 4.35%) per annum.

Fuel and Supplies

Fuel and supplies inventories are recorded at average cost.

Property, Plant and Equipment

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

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

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

Hydro, GIPCo. and LCDC

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

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

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

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Estimated service lives of the major assets are as follows:

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

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

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

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

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

CF(L)Co.

CF(L)Co. uses the group amortization method for certain property, plant and equipment other than the generation plant, transmission and terminals and service facilities.

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

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

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

Impairment of Long-Lived Assets

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Revenue Recognition

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

A power contract with Hydro-Québec, dated May 12, 1969 (Power Contract) provides for the sale of substantially all the energy from the CF(L)Co. Project until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The base rate is predetermined in the Contract and decreases from the existing rate of 2.5425 mills per kWh to 2.0 mills per kWh upon renewal in 2016.

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

Also included in revenue are amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2006 - 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 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.
 - (i) Foreign exchange gains and losses are included in income in the current year except for unrealized gains and losses related to First Mortgage Bonds which were recoverable under the Power Contract. The First Mortgage Bonds were paid out during the year. Churchill Falls recovered a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract.

Credit Risk

Hydro is exposed to credit risk associated with trade receivables. Although a significant portion of the total accounts receivable balance are due from one customer, management does not consider Hydro to be exposed to a material credit risk since that customer is another regulated utility.

Employee Future Benefits

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

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

2. NEW ACCOUNTING POLICIES

Effective January 1, 2007, Hydro adopted four new accounting standards issued by The Canadian Institute of Chartered Accountants' (CICA). Section 1530, "Comprehensive Income," introduces a new financial statement which shows the change in net assets of an enterprise attributable to transactions and other events from non-owner sources. Section 3855, "Financial Instruments - Recognition and Measurement," establishes standards for recognizing and measuring financial instruments, namely financial assets, financial liabilities and derivatives. The new standards prescribe how financial instruments are to be recognized on the balance sheet and the measurement of such amount. Depending on financial instruments' classification, changes in subsequent measurements are recognized in net income or Other Comprehensive Income (OCI). Section 3861, "Financial Instruments - disclosure and presentation" establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. Section 3865, "Hedges" specifies when and how hedge accounting may be applied. Hydro did not engage in any hedging relationships during this period.

Under the new standards, all financial instruments are classified into one of the following five categories: held-to-maturity, loans and receivables, available-for-sale, held-for-trading or other liabilities. All financial instruments, including derivatives, are carried at fair value on the consolidated balance sheet except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in OCI until the instrument is derecognized or impaired.

The Company has classified its financial instruments as follows:

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

These new standards have been applied prospectively without restatement of prior period amounts. Hydro recognized an increase to opening retained earnings of \$2.3 million upon adoption of these standards. This adjustment arose from the measurement of outstanding long-term debt at amortized cost, using the effective interest method. As well, Hydro recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of \$19.3 million.

3. PROPERTY, PLANT AND EQUIPMENT

	Property Plant and Equipment in Service	Contributions In aid of Construction	Accumulated Amortization	Construction In Progress	Net Book Value
<i>millions of dollars</i>					
	2007				
Generation Plant					
Hydroelectric	1,363.5	20.5	313.2	114.4	1,144.2
Thermal	244.2	0.8	188.3	0.8	55.9
Diesel	61.3	5.9	29.7	0.1	25.8
Transmission and Distribution	767.2	60.7	229.2	0.8	478.1
Service facilities	22.0	-	11.1	-	10.9
Other	306.0	32.0	167.5	4.3	110.8
	<u>2,764.2</u>	<u>119.9</u>	<u>939.0</u>	<u>120.4</u>	<u>1,825.7</u>

3. PROPERTY, PLANT AND EQUIPMENT (cont'd.)

	Property Plant and Equipment in Service	Contributions In aid of Construction	Accumulated Amortization	Construction In Progress	Net Book Value
<i>millions of dollars</i>					
			2006		
Generation Plant					
Hydroelectric	1,362.0	20.5	300.8	70.4	1,111.1
Thermal	235.7	0.8	184.3	1.0	51.6
Diesel	59.7	6.1	27.9	1.0	26.7
Transmission and Distribution	753.0	60.8	213.9	2.3	480.6
Service facilities	22.0	-	10.8	-	11.2
Other	<u>289.9</u>	<u>29.1</u>	<u>155.5</u>	<u>5.0</u>	<u>110.3</u>
	<u>2,722.3</u>	<u>117.3</u>	<u>893.2</u>	<u>79.7</u>	<u>1,791.5</u>

Included in the above amounts are CF(L)Co. assets in service amounting to \$653.7 million (2006 - \$651.9 million) which are pledged as collateral for long-term debt.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

			Remaining Recovery Settlement Period (years)
<i>millions of dollars</i>	2007	2006	
Regulatory assets			
Long-term receivable	12.1	63.1	0.5
Foreign exchange losses	73.3	75.5	35.0
Deferred regulatory costs	0.4	0.6	2.0
Deferred major extraordinary repairs	12.3	8.7	5.0
Deferred study costs	0.4	0.3	2.0
Total regulatory assets	<u>98.5</u>	<u>148.2</u>	
Less current portion	<u>12.1</u>	<u>45.3</u>	
	<u>86.4</u>	<u>102.9</u>	
Regulatory liabilities			
Rate stabilization plan	38.3	49.6	n/a
Deferred purchased power savings	0.7	0.7	20.0
Total regulatory liabilities	<u>39.0</u>	<u>50.3</u>	
Less current portion	<u>23.5</u>	<u>33.7</u>	
	<u>15.5</u>	<u>16.6</u>	

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

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

Rate Stabilization Plan and Related Long-Term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

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

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2007, \$31.5 million was recognized (2006 - \$3.9 million deferred) in the RSP and \$8.9 million (2006 - \$83.6 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, generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of \$2.2 million annually, is included in interest expense (Note 14).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 14 (2004), the PUB approved the deferral of external costs associated with the general rate application and hearing, to be amortized over a three-year period, which commenced in 2004. Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of \$0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2007, \$0.2 million (2006 - \$0.7 million) of amortization was recognized in operations and administration expenses.

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

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of \$500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program will be recognized as a regulatory asset which will be amortized over the subsequent five-year period. In 2006, Hydro incurred \$2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007, Hydro incurred \$2.0 million in expenses to repair a turbine at Holyrood Thermal Generating Station. These costs have been deferred as a major extraordinary repair. Subject to PUB approval, these costs will be amortized over a five-year period commencing in 2008. In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube and turbine repairs in the year in which they were incurred. In 2007, \$2.1 million (2006 - \$1.1 million) of amortization was recognized in operating costs.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred. In 2007, \$0.2 million (2006 - \$0.2 million) was deferred in relation to these studies and \$0.1 million (2006 - nil) of amortization was recognized in operating costs.

Deferred Purchased Power Savings

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

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. Since Hydro's AFUDC (7.6%) is lower than its cost of debt (8.0%), the amount capitalized is lower and interest expense is higher by \$0.3 million (2006 - \$0.3 million) than that which would be permitted in the absence of rate regulation (Note 14).

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

During 2005, 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 \$170-180 million lower than it would otherwise be, and annual amortization expense is \$10-11 million lower, primarily due to the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets. An update to this study is planned for 2008.

5. LONG-TERM RECEIVABLES

Included in long-term receivables are two refundable deposits associated with an application for transmission service into Québec, bearing interest at prime until April, 2007 and at one year Guaranteed Income Certificate (GIC) rates thereafter.

6. INVESTMENTS

<i>millions of dollars</i>	2007	2006
Lower Churchill Option	<u>5.2</u>	<u>5.2</u>

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

If LCDC is chosen as the ownership and financing vehicle for further development of the Lower Churchill Project, GIPCo.'s assets and the hydroelectric development rights to the Lower Churchill River, (Water Rights), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (Option Agreement). The purchase price in respect of GIPCo.'s assets will be a maximum of \$100.0 million less \$5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo.'s assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of \$94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is \$10,000. The Option Agreement expires November 24, 2008.

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

7. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co.'s assets and liabilities at December 31, 2007, and its proportionate interest in CF(L)Co.'s operations for the year ended December 31, 2007.

<i>millions of dollars</i>	2007	2006
Current assets	39.5	44.0
Long-term assets	328.9	325.1
Current liabilities	12.5	24.8
Long-term liabilities	36.6	37.4
Revenues	70.6	70.6
Expenses	<u>51.0</u>	<u>48.7</u>
Net income	19.6	21.9
Cash provided by (used in)		
Operating activities	40.4	33.6
Financing activities	(19.7)	(19.8)
Investing activities	(16.3)	(10.1)

8. LONG-TERM DEBT

	Hydro	CF(L)Co.	Total	Hydro	CF(L)Co.	Total
<i>millions of dollars</i>	2007			2006		
Summary of long-term debt						
Long-term debt	1,359.4	37.5	1,396.9	1,365.6	51.6	1,417.2
Less current portion	<u>208.3</u>	<u>0.8</u>	<u>209.1</u>	<u>8.3</u>	<u>14.2</u>	<u>22.5</u>
	<u>1,151.1</u>	<u>36.7</u>	<u>1,187.8</u>	<u>1,357.3</u>	<u>37.4</u>	<u>1,394.7</u>

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

<i>millions of dollars</i>	2008	2009	2010	2011	2012
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayments	<u>200.9</u>	<u>0.9</u>	<u>35.9</u>	<u>-</u>	<u>-</u>
	<u>209.1</u>	<u>9.1</u>	<u>44.1</u>	<u>8.2</u>	<u>8.2</u>

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity	2007	2006
<i>millions of dollars</i>					
AA	5.50	1998	2008	199.9	199.6
V	10.50	1989	2014	124.4	124.7 (a)
X	10.25	1992	2017	149.0	149.4 (a)
Y	8.40	1996	2026	292.7	294.5 (a)
AB	6.65	2001	2031	307.1	306.6 (a)
AD	5.70	2003	2033	123.5	123.6 (a)
AE	4.30	2006	2016	<u>223.3</u>	<u>223.2</u>
Total debentures				1,419.9	1,421.6
Less sinking fund investments in own debentures				<u>60.8</u>	<u>56.5</u>
				1,359.1	1,365.1
Other				<u>0.3</u>	<u>0.5</u>
				1,359.4	1,365.6
Less current portion				<u>208.3</u>	<u>8.3</u>
				<u>1,151.1</u>	<u>1,357.3</u>

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

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2006 - 4.50% to 9.86%).

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

Hydro uses promissory notes to fulfill its short-term funding requirements. At year-end the promissory notes outstanding were at an interest rates ranging from 4.30 to 4.45% (2006 - 4.25% - 4.55%).

Hydro maintains a \$50 million Canadian or US equivalent unsecured operating credit facility with its banker. Advances may take the form of a prime rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the prime rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the prime rate.

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

CF(L)Co.

<i>millions of dollars</i>	2007	2006
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (2006 - U.S. \$10.6)	-	12.4
7.875% Series B due December 15, 2007	-	1.1
General Mortgage Bonds		
7.500% due December 15, 2010	<u>37.5</u>	<u>38.1</u>
	37.5	51.6
Less current portion	<u>0.8</u>	<u>14.2</u>
	<u>36.7</u>	<u>37.4</u>

The First Mortgage Bonds, Series A and B, were repayable in fixed semi-annual and in contingent annual sinking fund instalments. There were contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments which commenced in June 1980. Each payment will be an amount equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date with a final principal payment of \$35.9 million due in 2010. These bonds were subordinate to the First Mortgage Bonds (Note 19).

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

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

9. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec, arising from the difference between energy deliveries and the Annual Energy Base (AEB) pursuant to the Power Contract, bears an interest at 7.0% per annum and is repayable over a four-year period which commenced in September 2004. The current portion of \$0.4 million (2006 - \$0.4 million) is included in accounts payable and accrued liabilities.

10. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employers' contributions of \$4.6 million (2006 - \$4.2 million) are expensed as incurred.

10. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2007, cash payments to beneficiaries for its unfunded other employee future benefits was \$2.3 million (2006 - \$2.4 million). The most recent actuarial valuation was performed as at December 31, 2007.

<i>millions of dollars</i>	2007	2006
Accrued benefit obligation		
Balance at beginning of year	67.8	49.0
Current service cost	2.3	2.0
Interest cost	3.6	3.0
Actuarial (gain) loss	(2.8)	16.2
Benefits paid	(2.3)	(2.4)
Balance at end of year	<u>68.6</u>	<u>67.8</u>
Plan deficit at end of year	68.6	67.8
Unamortized actuarial loss	(20.9)	(25.2)
Unamortized past-service cost	(0.3)	(0.3)
Accrued benefit liability at end of year	<u>47.4</u>	<u>42.3</u>
<i>millions of dollars</i>	2007	2006
Components of benefit cost		
Current service cost	2.3	2.0
Interest cost	3.6	3.0
Actuarial (gain) loss	(2.8)	16.2
	3.1	21.2
Adjustments		
Difference between actual actuarial loss and amount recognized	4.3	(15.0)
Benefit expense	<u>7.4</u>	<u>6.2</u>

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

	2007	2006
Discount rate	5.5%	5.3%
Rate of compensation increase	3.5%	3.5%

Assumed health care trend rates:

	2007	2006
Initial healthcare expense trend rate	8.0%	12.0%
Cost trend decline to	5.0%	5.0%
Year that rate reaches the rate it is assumed to remain at	2011	2010

A 1% change in assumed healthcare trend rates would have had the following effects for 2007:

<i>millions of dollars</i>	Increase	Decrease
Current service cost	0.5	(0.4)
Interest cost	0.7	(0.4)
Accrued benefit obligation	11.9	(9.2)

11. SHAREHOLDERS' EQUITY

Share Capital

<i>millions of dollars</i>	2007	2006
Common shares of par value \$1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	<u>22.5</u>	<u>22.5</u>

Contributed Capital

<i>millions of dollars</i>	2007	2006
Lower Churchill Development Corporation	15.4	15.4
Muskrat Falls Project	2.2	2.2
Gull Island Project	<u>96.4</u>	<u>96.4</u>
	<u>114.0</u>	<u>114.0</u>

12. ACCUMULATED OTHER COMPREHENSIVE INCOME

<i>millions of dollars</i>	2007	2006
Adjusted opening balance arising from adoption of new accounting policies regarding financial instruments	19.3	-
Changes in fair value of sinking funds	<u>0.2</u>	<u>-</u>
Balance, end of year	<u>19.5</u>	<u>-</u>

There were no material changes in the fair market value of the reserve fund investments.

13. FINANCIAL INSTRUMENTS

Fair Value

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

	Carrying Value	Fair Value	Carrying Value	Fair Value
<i>millions of dollars</i>	2007		2006	
Long-term debt including current portion	1,396.9	1,731.2	1,417.2	1,781.9

14. INTEREST EXPENSE

<i>millions of dollars</i>	2007	2006
Gross interest		
Long-term debt	105.0	106.6
Promissory notes	<u>0.9</u>	<u>5.1</u>
	105.9	111.7
Accretion of long-term debt	0.8	1.1
Provision for foreign exchange losses	<u>2.2</u>	<u>2.1</u>
	108.9	114.9
Less		
Recovered from Hydro-Québec	1.0	1.1
Interest capitalized during construction	6.3	4.9
Interest earned	<u>14.3</u>	<u>17.2</u>
Net interest expense	87.3	91.7
Debt guarantee fee	<u>13.1</u>	<u>14.0</u>
Net interest and guarantee fee	<u>100.4</u>	<u>105.7</u>

(a) Under the terms of the Power Contract, CF(L)Co. recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co. 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 request fails to attract sufficient advances, CF(L)Co. 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.

15. CHANGE IN NON-CASH BALANCES

<i>millions of dollars</i>	2007	2006
Accounts receivable	(8.2)	(4.5)
Fuel and supplies	(15.3)	5.3
Prepaid expenses	0.3	0.8
Accounts payable and accrued liabilities	26.7	(9.8)
Regulated assets	49.7	39.1
Regulated liabilities	(11.3)	37.6
Accrued interest	(0.1)	1.3
Employee future benefits	5.1	3.8
Long-term receivable	(4.5)	(17.8)
Long-term payable	<u>(0.3)</u>	<u>(0.4)</u>
	<u>42.1</u>	<u>55.4</u>

16. SEGMENT INFORMATION

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

16. SEGMENT INFORMATION (cont'd.)

	Regulated Operations	Other Energy Activities	Churchill Falls	Inter Segment Eliminations	Total
<i>millions of dollars</i>			2007		
Revenue - External customers	440.7	58.5	70.7		573.4
- Inter segment		10.4	3.9	(10.8)	
Amortization	38.4	-	12.3		50.7
Interest	103.2	(5.0)	2.1	0.1	100.4
Net income (loss)	2.9	53.6	25.1		81.6
Assets	1,733.4	148.4	404.5		2,286.3
Capital expenditures	36.0	45.7	4.8		86.5
<i>millions of dollars</i>			2006		
Revenue - External customers	416.5	57.4	70.6		548.0
- Inter segment		10.1	3.9	(10.5)	
Amortization	36.6	-	11.9		48.5
Interest	102.4	(1.3)	4.5	0.1	105.7
Net income (loss)	(6.9)	50.5	26.4		70.0
Assets	1,732.8	97.5	402.0		2,232.3
Capital expenditures	41.6	14.7	4.6		60.9

At December 31, 2007, sales to Hydro's two largest customers amounted to 60% and 10% of total energy sales revenue (2006 - 61% and 14%). At December 31, 2007 approximately 59.7% (2006 - 56.6%) of the total accounts receivable balance outstanding is due from one customer.

Geographic Information

Revenues by geographic area:

<i>millions of dollars</i>	2007	2006
Newfoundland and Labrador	445.1	426.8
Québec	128.3	121.2
	<u>573.4</u>	<u>548.0</u>

Substantially all of Hydro's assets are located in the Province.

17. COMMITMENTS AND CONTINGENCIES

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

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

17. COMMITMENTS AND CONTINGENCIES (cont'd.)

- (b) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a \$75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls completed the first of six consecutive tranches on January 7, 2007. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2008	\$17.0	million
January 1, 2009	\$17.0	million
January 1, 2010	\$8.0	million
January 1, 2011	\$8.0	million
January 1, 2012	\$8.0	million

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Hydro's share of this commitment is 65.8%.

- (c) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be \$1.2 million (2006 - \$1.4 million).

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

- (d) Outstanding commitments for capital projects total approximately \$16.8 million at December 31, 2007 (2006 - \$5.1 million).
- (e) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-Service Date	Term
Hydroelectric	175 kW	1988	15 years
Hydroelectric	3 MW	1995	25 years
Hydroelectric	15 MW	1998	25 years
Hydroelectric	4 MW	1998	25 years
Hydroelectric	32 MW	2003	30 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2008	20 years

Estimated payments due in each of the next 5 years are as follows:

<i>millions of dollars</i>	2008	2009	2010	2011	2012
Power purchases	37.3	56.0	59.0	65.8	66.5

- (f) Hydro has issued two irrevocable letters of credit, one in the amount of \$7.2 million to New Brunswick System Operator as credit support related to 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 \$1.0 million to ensure compliance with a certificate of approval for the transportation of special/hazardous wastes, granted by the Department of Environment and Conservation.

18. RELATED PARTY TRANSACTIONS

The Province, CF(L)Co, LCDC and GIPCo are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

- (a) Hydro has entered into a long-term power contract with CF(L)Co. for the purchase of \$6.1 million (2006 - \$6.1 million) of the power produced by CF(L)Co.
- (b) Under an agreement between Hydro and CF(L)Co., Hydro provides certain engineering, technical, management and administrative services to CF(L)Co. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. For the year ended December 31, 2007 the fees paid to Hydro for these services amounted to approximately \$2.2 million (2006 - \$1.9 million).
- (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 2007, Hydro paid \$1.2 million to the PUB (2006 - \$0.8 million, of which \$0.1 million was included in accrued liabilities reflected at December 31, 2006).
- (d) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co. must pay rentals and royalties to the Province annually.

19. SUBSEQUENT EVENTS

- (a) Effective January 1, 2008, the Province created a new crown corporation to hold its investments in the energy sector. Hydro is in the process of transferring its non-regulated assets and personnel including its investments in CF(L)Co GIPCo and LCDC to the new parent company. The segment information related to regulated operations in Note 16 is indicative of the operations that will remain in Hydro.
- (b) On February 25, 2008 CF(L)Co. completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds, bearing an interest rate of 7.50% (6.00% net of subsidies) were retired and replaced with a 4.40% 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.

20. COMPARATIVE FIGURES

Certain of the 2006 comparative figures have been reclassified to conform with the 2007 financial statement presentation. Specifically, deferred charges in the amount of \$3.4 million have been reclassified to debt as a result of the adoption of CICA Section 3855. In addition, a reclassification of investments of \$19.8 million is reported with the sinking funds as opposed to an offset against debt.