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Subject: Upper Churchill Redress Agreement
Date: Friday, December 4, 2009 1:24:22 PM
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Hi Kent/Rob,

We have drafted a position paper related to the payments under the redress agreement. We would like to know if your group sees any issues with this position in relation to the impairment test for LCP. Let us know if you'd like to discuss.

Thanks,

Elizabeth

Upper Churchill redress payments.doc

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Accounting treatment of payments under the Upper Churchill Redress Agreement

Legal Entity Impacted: **Nalcor Energy**
Year End: **December 31, 2010**

Description of Issue	In September 2008, the Province of Newfoundland and Labrador (the Province), Nalcor Energy, and the Innu Nation signed the New Dawn Agreement which provided a framework for the conclusion of negotiations for three agreements related to Innu Nation lands: 1. Land Claim Agreement in Principle (AIP) 2. Upper Churchill Redress Agreement (Upper Churchill Redress) 3. Impacts and Benefits Agreement for the Lower Churchill Project (IBA) The Upper Churchill Redress requires Nalcor Energy to make a payment of $2.0 million annually (increased annually by 2.5%) to the Innu Nation from the effective date (the date of execution) until 2041. After 2041, the Upper Churchill Redress requires Nalcor to pay to the Innu Nation 3% of dividends paid by CF(L)Co. to Nalcor or an affiliate of Nalcor. The issue is how should the payments under the Upper Churchill Redress by accounted for?
Analysis Performed and Alternatives Considered	Professional literature referenced: CICA Handbook Section 1000 – Financial Statement Concepts CICA Handbook Section 3061 – Property, plant and equipment CICA Handbook Section 3855 – Financial Instruments – recognition and measurement <u>Issue 1 – Timing of Recognition</u> There are two commitments made by Nalcor Energy under the Upper Churchill Redress agreement: 1. Payment of $2.0 million from effective date to 2041 2. Payment of 3% of dividends paid by CF(L)Co. to Nalcor Energy or an affiliate after 2041 HB 1000.33 provides defines a liability as having "three essential characteristics: a) they embody a duty or responsibility to others that entails settlement by future transfer or use of assets, provision of services or other yielding of economic benefits, at a specified or determinable date, on occurrence of a specified event, or on demand b) the duty or responsibility obligates the entity leaving it little or no discretion to avoid it c) the transaction or event obligation the entity has already occurred" Criteria a) is clearly met by the payments under the Upper Churchill Redress as they provide a duty that entails settlement by the future transfer of funds to the

Innu Nation on an annual basis.

To determine whether criteria c) is met it is necessary to determine what the obligation event or transaction is. The Upper Churchill Redress is intended to address the affects the Churchill Falls Hydro-electric Development may have had and may continue to have on the Innu Nation rights, title and interests. According to the intention of the agreement it appears that the obligation event is the construction of the Churchill Falls Hydro-electric Development.

The only remaining criteria is b), whether the duty or responsibility obligates the entity leaving little or no discretion to avoid it. For the $2.0 million annual payment, this criteria is clearly met. However, for the payment subsequent to 2041 Nalcor Energy would have some discretion to avoid payment as the payment is linked to dividends paid by CF(L)Co. which is jointly controlled by Nalcor Energy.

In conclusion the payment of $2.0 million annually from the effective date to 2041 must be recognized in the financial statements of Nalcor Energy once the agreement is ratified.

<u>Issue 2 – Measurement of the Liability</u>

HB 3855.55 states that a financial liability should be measured initially at fair value. To determine the fair value the net present value of the cash flows will be calculated. This calculation, using a discount rate equal to WACC of 7.34% gives a fair value of $31.8 million.

For subsequent measurement, HB 3855.70 requires financial liabilities to be classified as held for trading or other liabilities. This liability would be classified as other liabilities and measured using the effective interest method as required by HB 3855.71.

<u>Issue 3 – Capitalization or expense</u>

The final issue is whether the liability should be recorded as an expense in Nalcor Energy or whether it can be capitalized as part of the Lower Churchill Project (LCP).

The policy for determining the cost of construction of the LCP, as discussed in annual position papers analyzing the costs capitalized in LCP, is to capitalize all costs that would have been avoided had construction of the LCP not occurred.

According to this policy, there must be a link between the Upper Churchill Redress payments and the construction of the LCP in order for the payments to be capitalized.

The intent of the New Dawn Agreement was to provide a framework for simultaneously negotiating the Upper Churchill Redress and the IBA as the settlement of issues related to Upper Churchill was a prerequisite imposed by the Innu Nation for negotiating the IBA. This link is further demonstrated by:

1. Section 4 of the New Dawn Agreement which states that a failure to execute any of the agreements in a failure to execute all. This inextricable links the negotiations of the Upper Churchill Redress with the

	negotiations of the IBA. 2. The fact that the Upper Churchill Redress agreement is between the Innu Nation and Nalcor Energy, the agreement in no way releases CF(L)Co. from any potential liability which is a clear indicator that the negotiations are part of the LCP construction process. In conclusion, the payments made under the Upper Churchill Redress agreement should be capitalized under as part of the Lower Churchill Project as the agreement would not have been negotiated if it were not for the construction of the LCP.
Conclusions Reached	1. The net present value of the liability related the annual $2.0 million payment from the effective date to 2041 should be recognized as a liability once the agreement is ratified. 2. The amount should be capitalized as part of construction of the Lower Churchill Project.
Disclosure Requirements	