

## **STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL INFORMATION**

Ontario Power Generation Inc.'s ("OPG") management is responsible for presentation and preparation of the annual consolidated financial statements and Management's Discussion and Analysis ("MD&A").

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and the requirements of the Ontario Securities Commission ("OSC"), as applicable. The MD&A has been prepared in accordance with the requirements of securities regulators, including National Instrument 51-102 of the Canadian Securities Administrators and its related published requirements.

The consolidated financial statements and information in the MD&A necessarily include amounts based on informed judgments and estimates of the expected effects of current events and transactions with appropriate consideration to materiality. Something is considered material if it is reasonably expected to have a significant impact on the Company's earnings, cash flow, value of an asset or liability, or reputation. In addition, in preparing the financial information we must interpret the requirements described above, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. The MD&A also includes information regarding the impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from our present assessment of this information because future events and circumstances may not occur as expected.

In meeting our responsibility for the reliability of financial information, we maintain and rely on a comprehensive system of internal control and internal audit, including organizational and procedural controls and internal controls over financial reporting. Our system of internal controls includes written communication of our policies and procedures governing corporate conduct and risk management; comprehensive business planning; effective segregation of duties; delegation of authority and personal accountability; careful selection and training of personnel; and sound and conservative accounting policies, which we regularly update. This structure ensures appropriate internal control over transactions, assets and records. We also regularly audit internal controls. These controls and audits are designed to provide us with reasonable assurance that the financial records are reliable for preparing financial statements and other financial information, assets are safeguarded against unauthorized use or disposition, liabilities are recognized, and we are in compliance with all regulatory requirements.

Management, including the President and Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of OPG's disclosure controls and procedures (as defined in Multilateral Instrument 52-109 of the Canadian Securities Administrators) as of December 31, 2006. Management concluded that, as of December 31, 2006, OPG's disclosure controls and procedures were effective to provide reasonable assurance that material information relating to OPG and its consolidated subsidiaries and interests in jointly controlled entities would be made known to them by others within those entities, particularly during the period in which this report was being prepared.

Management has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Accordingly, we, as OPG's Chief Executive Officer and Chief Financial Officer, will certify OPG's annual disclosure documents filed with the OSC, which includes attesting to the design and effectiveness of OPG's disclosure controls and procedures and the design of internal control over financial reporting.

The Board of Directors, based on recommendations from its Audit and Risk Committee, reviews and approves the consolidated financial statements and the MD&A, and oversees management's responsibilities for the presentation and preparation of financial information, maintenance of appropriate internal controls, management and control of major risk areas and assessment of significant and related party transactions.

The consolidated financial statements have been audited by Ernst & Young LLP, independent external auditors appointed by the Board of Directors. The Auditors' Report outlines the auditors' responsibilities and the scope of their examination and their opinion on OPG's consolidated financial statements. The independent external auditors, as confirmed by the Audit and Risk Committee, had direct and full access to the Audit and Risk Committee, with and without the presence of management, to discuss their audit and their findings therefrom, as to the integrity of OPG's financial reporting and the effectiveness of the system of internal controls.

**Jim Hankinson (signed)**  
*President and Chief Executive Officer*

**Donn W. J. Hanbidge (signed)**  
*Chief Financial Officer*

February 14, 2007

## **AUDITORS' REPORT**

### **To the Shareholder of Ontario Power Generation Inc.**

We have audited the consolidated balance sheets of Ontario Power Generation Inc. as at December 31, 2006 and 2005 and the consolidated statements of income, retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of Ontario Power Generation Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Ontario Power Generation Inc. as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**ERNST & YOUNG LLP (signed)**  
**Chartered Accountants**  
Toronto, Canada  
February 14, 2007

## CONSOLIDATED STATEMENTS OF INCOME

### Years Ended December 31

(millions of dollars except where noted)

	2006	2005
<b>Revenue</b> (Note 19)		
Revenue before revenue limit and Market Power Mitigation Agreement rebates	5,725	6,949
Revenue limit rebate (Note 16)	(161)	(739)
Market Power Mitigation Agreement rebate (Note 17)	-	(412)
	<u>5,564</u>	<u>5,798</u>
Fuel expense	1,098	1,297
<b>Gross margin</b>	<u>4,466</u>	<u>4,501</u>
<b>Expenses</b> (Note 19)		
Operations, maintenance and administration	2,777	2,516
Depreciation and amortization (Note 5)	664	753
Accretion on fixed asset removal and nuclear waste management liabilities (Note 9)	499	476
Earnings on nuclear fixed asset removal and nuclear waste management funds (Note 9)	(371)	(381)
Property and capital taxes	106	107
Restructuring	-	10
	<u>3,675</u>	<u>3,481</u>
<b>Income before the following:</b>	791	1,020
Impairment of long-lived assets (Note 5)	22	265
<b>Income before interest, income taxes and extraordinary item</b>	<u>769</u>	<u>755</u>
Net interest expense	193	197
<b>Income before income taxes and extraordinary item</b>	<u>576</u>	<u>558</u>
Income tax expense (Note 10)		
Current	60	80
Future	26	38
	<u>86</u>	<u>118</u>
<b>Income before extraordinary item</b>	490	440
<b>Extraordinary item</b> (Note 10)	-	74
<b>Net income</b>	<u>490</u>	<u>366</u>
<b>Basic and diluted income per common share before extraordinary item</b> (dollars)	1.91	1.72
<b>Basic and diluted income per common share</b> (dollars)	<u>1.91</u>	<u>1.43</u>
<b>Common shares outstanding</b> (millions)	<u>256.3</u>	<u>256.3</u>

See accompanying notes to the consolidated financial statements

## CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

**Years Ended December 31**  
*(millions of dollars)*

	<u>2006</u>	<u>2005</u>
<b>Retained earnings (deficit), beginning of year</b>	<b>261</b>	(105)
Net income	<b>490</b>	366
Dividend <i>(Note 19)</i>	<b>(128)</b>	-
<b>Retained earnings, end of year</b>	<b><u>623</u></b>	<u>261</u>

*See accompanying notes to the consolidated financial statements*

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31

(millions of dollars)

### Operating activities

	2006	2005
Net income	490	366
Adjust for non-cash items:		
Depreciation and amortization (Note 5)	664	753
Accretion on fixed asset removal and nuclear waste management liabilities (Note 9)	499	476
Earnings on nuclear fixed asset removal and nuclear waste management funds (Note 9)	(371)	(381)
Pension cost (Note 11)	218	115
Other post employment benefits and supplementary pension plans (Note 11)	255	181
Future income taxes	26	38
Transition rate option contracts (Note 15)	(12)	(36)
Provision for restructuring	-	10
Mark-to-market adjustment on energy contracts	(29)	23
Provision for used nuclear fuel	33	28
Impairment of long-lived assets (Note 5)	22	265
Excess inventory write-off	-	57
Regulatory assets and liabilities (Note 6)	27	11
Extraordinary item (Note 10)	-	74
Other	(11)	18
	<b>1,811</b>	<b>1,998</b>
Contributions to nuclear fixed asset removal and nuclear waste management funds (Note 9)	(454)	(454)
Expenditures on fixed asset removal and nuclear waste management (Note 9)	(164)	(90)
Reimbursement of expenditures on nuclear fixed asset removal and nuclear waste management (Note 9)	19	23
Contributions to pension fund (Note 11)	(261)	(254)
Expenditures on other post employment benefits and supplementary pension plans (Note 11)	(69)	(65)
Revenue limit rebate (Note 16)	(860)	-
Market Power Mitigation Agreement rebate (Note 17)	-	(851)
Expenditures on restructuring	(8)	(18)
Net changes to other long-term assets and liabilities	(94)	(92)
Changes in non-cash working capital balances (Note 23)	477	1,004
<b>Cash flow provided by operating activities</b>	<b>397</b>	<b>1,201</b>
<b>Investing activities</b>		
Increase in regulatory assets (Note 6)	(13)	(265)
Investment in fixed assets (Notes 5 and 18)	(637)	(494)
Proceeds on sale of other fixed assets	-	3
Net proceeds from purchase of long-term investments	-	(4)
<b>Cash flow used in investing activities</b>	<b>(650)</b>	<b>(760)</b>
<b>Financing activities</b>		
Issuance of long-term debt (Note 8)	270	495
Repayment of long-term debt (Note 8)	(806)	(4)
Dividend paid	(128)	-
Net increase (decrease) in short-term notes (Note 7)	15	(26)
<b>Cash flow (used in) provided by financing activities</b>	<b>(649)</b>	<b>465</b>
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(902)</b>	<b>906</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>908</b>	<b>2</b>
<b>Cash and cash equivalents, end of year</b>	<b>6</b>	<b>908</b>

See accompanying notes to the consolidated financial statements

## CONSOLIDATED BALANCE SHEETS

As at December 31

(millions of dollars)

	2006	2005
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	6	908
Accounts receivable (Notes 4 and 19)	256	538
Future income taxes (Note 10)	-	18
Fuel inventory (Note 18)	669	581
Materials and supplies (Note 18)	112	115
	<b>1,043</b>	2,160
<b>Fixed assets (Notes 5 and 18)</b>		
Property, plant and equipment	17,136	15,172
Less: accumulated depreciation	4,375	3,760
	<b>12,761</b>	11,412
<b>Other long-term assets</b>		
Deferred pension asset (Note 11)	706	663
Nuclear fixed asset removal and nuclear waste management funds (Note 9)	7,594	6,788
Long-term materials and supplies (Note 18)	326	273
Regulatory assets (Note 6)	251	266
Long-term accounts receivable and other assets	69	61
	<b>8,946</b>	8,051
	<b>22,750</b>	21,623

See accompanying notes to the consolidated financial statements

## CONSOLIDATED BALANCE SHEETS

As at December 31

(millions of dollars)

	2006	2005
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued charges (Notes 11, 15, and 19)	989	958
Revenue limit rebate payable (Note 16)	40	739
Short-term notes payable (Note 7)	15	-
Long-term debt due within one year (Note 8)	406	806
Future income taxes (Note 10)	3	-
Deferred revenue due within one year	12	12
Income and capital taxes payable (Note 10)	128	81
	<u>1,593</u>	<u>2,596</u>
<b>Long-term debt (Note 8)</b>	<u>2,953</u>	<u>3,089</u>
<b>Other long-term liabilities</b>		
Fixed asset removal and nuclear waste management (Note 9)	10,520	8,759
Other post employment benefits and supplementary pension plans (Note 11)	1,396	1,212
Long-term accounts payable and accrued charges	150	183
Deferred revenue	132	144
Future income taxes (Note 10)	246	241
Regulatory liabilities (Note 6)	11	12
	<u>12,455</u>	<u>10,551</u>
<b>Shareholder's equity</b>		
Common shares (Note 13)	5,126	5,126
Retained earnings	623	261
	<u>5,749</u>	<u>5,387</u>
	<u>22,750</u>	<u>21,623</u>

Commitments and Contingencies (Notes 2, 5, 7, 8, 9, 10, 12, 14 and 18)

See accompanying notes to the consolidated financial statements

On behalf of the Board of Directors:

**Honourable Jake Epp (signed)**  
Chairman

**M. George Lewis (signed)**  
Director

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005**

### **1. DESCRIPTION OF BUSINESS**

Ontario Power Generation Inc. was incorporated on December 1, 1998 pursuant to *the Business Corporations Act* (Ontario). As part of the reorganization of Ontario Hydro, under the *Electricity Act, 1998* and the related restructuring of the electricity industry in Ontario, Ontario Power Generation Inc. and its subsidiaries (collectively “OPG” or the “Company”) purchased and assumed certain assets, liabilities, employees, rights and obligations of the electricity generation business of Ontario Hydro on April 1, 1999 and commenced operations on that date. Ontario Hydro has continued as Ontario Electricity Financial Corporation (“OEFEC”), responsible for managing and retiring Ontario Hydro’s outstanding debt and other obligations.

### **2. BASIS OF PRESENTATION**

These consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

The consolidated financial statements include the accounts of OPG and its subsidiaries. OPG accounts for its interests in jointly controlled entities using the proportionate consolidation method. All significant intercompany transactions have been eliminated on consolidation.

Certain of the 2005 comparative amounts have been reclassified from financial statements previously presented to conform to the 2006 financial statement presentation.

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

Cash and cash equivalents include cash on deposit and money market securities with a maturity of less than 90 days on the date of purchase. All other money market securities with a maturity on the date of purchase that is greater than 90 days, but less than one year, are recorded as short-term investments. These securities are valued at the lower of cost or market.

Interest earned on cash and cash equivalents and short-term investments of \$21 million (2005 – \$13 million) at an average effective rate of 4.0 per cent (2005 – 2.8 per cent) is offset against interest expense in the consolidated statements of income.

#### **Sales of Accounts Receivable**

Asset securitization involves selling assets such as accounts receivable to independent entities or trusts, which buy the receivables and then issue interests in them to investors. These transactions are accounted for as sales, given that control has been surrendered over these assets in return for net cash consideration. For each transfer, the excess of the carrying value of the receivables transferred over the estimated fair value of the proceeds received is reflected as a loss on the date of the transfer, and is included in net interest expense. The carrying value of the interests transferred is allocated to accounts receivable sold or interests retained according to their relative fair values on the day the transfer is made.

Fair value is determined based on the present value of future cash flows. Cash flows are projected using OPG's best estimates of key assumptions, such as discount rates, weighted average life of accounts receivable and credit loss ratios.

As part of the sales of accounts receivable, certain financial assets are retained and consist of interests in the receivables transferred. Any retained interests held in the receivables are accounted for at cost. The receivables are transferred on a fully serviced basis and do not create a servicing asset or liability.

### **Inventories**

Fuel inventory is valued at weighted average cost.

Materials and supplies are valued at the lower of average cost or net realizable value with the exception of critical replacement parts that are unique to OPG's generating stations. The cost of the critical replacement parts inventory is charged to operations on a straight-line basis over the remaining life of the related facilities and is classified in long-term assets.

### **Fixed Assets and Depreciation**

Property, plant and equipment are recorded at cost. Interest costs incurred during construction are capitalized as part of the cost of the asset based on the interest rate on OPG's long-term debt. Expenditures for replacements of major components are capitalized.

Depreciation rates for the various classes of assets are based on their estimated service lives. Any asset removal costs that have not been specifically provided for in current or previous periods are also charged to depreciation expense. Repairs and maintenance are expensed when incurred.

Fixed assets are depreciated on a straight-line basis except for computers, and transport and work equipment, which are depreciated on a declining balance basis as noted below:

Nuclear generating stations and major components	15 to 49 years <sup>1</sup>
Fossil generating stations and major components	25 to 40 years <sup>2</sup>
Hydroelectric generating stations and major components	25 to 100 years
Administration and service facilities	10 to 50 years
Computers, and transport and work equipment assets – declining balance	9% to 40% per year
Major application software	5 years
Service equipment	5 to 10 years

<sup>1</sup> The end of station life for depreciation purposes for the Darlington, Pickering A, Pickering B, and Bruce B nuclear generating stations ranges between 2012 and 2021. Major components are depreciated over the lesser of the station life and the life of the components. The Bruce A nuclear generating station was fully depreciated in 2003. Bruce Power decided to refurbish the Bruce A generating station contributing to an increase in the asset retirement obligation at December 31, 2006 and an increase in the carrying value of the Bruce A station. The station will now be depreciated over the period to 2030.

<sup>2</sup> Commencing July 1, 2006, the end of station life for depreciation purposes for the coal-fired generating stations was changed to 2012, due to the expected shutdown of these stations by the end of 2012. The Lennox generating station is depreciated to 2016.

### **Impairment of Fixed Assets**

OPG evaluates its property, plant and equipment for impairment whenever conditions indicate that estimated undiscounted future net cash flows may be less than the net carrying amount of assets. In cases where the undiscounted expected future cash flows are less than the carrying amount, an impairment loss is recognized equal to the amount by which the carrying amount exceeds the fair value. Fair value is determined using expected discounted cash flows when quoted market prices are not available.

## **Rate Regulated Accounting**

In December 2004, the *Electricity Restructuring Act, 2004* (Ontario) received royal assent. A regulation made pursuant to that statute provides that OPG receives regulated prices beginning April 1, 2005 for most of its baseload hydroelectric facilities and all of the nuclear facilities that it operates. This includes electricity generated by Sir Adam Beck 1, 2 and Pump generating station, DeCew Falls 1 and 2, and R.H. Saunders hydroelectric facilities, and the Pickering A and B, and Darlington nuclear generating stations. The regulation was amended in February 2007. The amendment clarified certain aspects of the regulation and directed OPG to establish a deferral account related to certain changes in its liability for nuclear used fuel management and its liability for nuclear decommissioning and low and intermediate level waste management.

OPG's regulated prices were established by the Province of Ontario (the "Province") based on a forecast of production volumes and total operating costs, and a return on rate base, which assumed an average five per cent return on equity. Rate base is a regulatory construct that represents the average net level of investment in regulated fixed assets, deferred charges, and an allowance for working capital. The initial prices took effect April 1, 2005, and are expected to remain in effect until at least March 31, 2008, at which time it is anticipated that new regulated prices to be established by the Ontario Energy Board ("OEB") will take effect. If there are changes to the fundamental assumptions on which the initial prices were developed, the Province may amend these initial prices.

The OEB is a self-funding Crown corporation. Its mandate and authority come from the *Ontario Energy Board Act, 1998*, the *Electricity Act, 1998*, and a number of other provincial statutes. The OEB is an independent, quasi-judicial tribunal that reports to the Legislature of the Province through the Minister of Energy. It regulates the Province's natural gas and electricity industries and carries out its regulatory functions through public hearings and other more informal processes such as consultations.

Accounting standards recognize that rate regulation can create economic benefits and obligations, which are reported in the consolidated financial statements as regulatory assets and liabilities. When the regulation provides sufficient assurance that incurred costs will be recovered in the future, then OPG may defer those costs and report them as a regulatory asset. If current recovery is provided for costs expected to be incurred in the future, then OPG reports a regulatory liability. Also, if the regulation provides for lesser or greater than planned revenue to be received or returned by OPG through future regulated prices, then OPG recognizes and reports a regulatory asset or liability, respectively. The measurement of such regulatory assets and liabilities is subject to certain estimates and assumptions, including assumptions made in the interpretation of the regulation. See the Company's revenue recognition policy and Notes 6 and 10 to the consolidated financial statements for additional disclosures required under rate regulated accounting.

## **Long-Term Portfolio Investments**

Long-term portfolio investments, other than investments owned by the Company's wholly owned subsidiary OPG Ventures Inc. ("OPGV"), are stated at amortized cost and include the nuclear fixed asset removal and nuclear waste management funds. Gains and losses on long-term investments are recognized in other income when investments are sold. When a decline in the value of investments occurs, which is considered to be other than temporary, a provision for loss is established.

In accordance with Accounting Guideline 18, Investment Companies ("AcG-18"), investments owned by OPGV are recorded at fair value, and changes to the fair value of the investments are included in revenue in the period in which the change occurs. The fair values of these investments are estimated based on readily available market information or using estimation techniques based on historical performance.

## **Fixed Asset Removal and Nuclear Waste Management Liability**

OPG recognizes asset retirement obligations for fixed asset removal and nuclear waste management, discounted for the time value of money. OPG has estimated both the amount and timing of future cash expenditures based on current plans for fixed asset removal and nuclear waste management. The liabilities are initially recorded at their estimated fair value, which is based on a discounted value of the expected costs to be paid.

On an ongoing basis, the liability is increased by the present value of the variable cost portion of the nuclear waste generated each year, with the corresponding amounts charged to operating expenses. Expenses relating to low and intermediate level waste are charged to depreciation and amortization expense. Expenses relating to the disposal or storage of nuclear used fuel are charged to fuel expense. The liability may also be adjusted due to any changes in the estimated amount or timing of the underlying future cash flows. Upon settlement of the liability, a gain or loss would be recorded.

Accretion arises because liabilities for fixed asset removal and nuclear waste management are reported on a net present value basis. Accretion expense is the increase in the carrying amount of the liabilities due to the passage of time. The resulting expense is included in operating expenses.

The asset retirement cost is capitalized by increasing the carrying value of the related fixed assets. The capitalized cost is depreciated over the remaining useful life of the related fixed assets and is included in depreciation expense.

### **Nuclear Fixed Asset Removal and Nuclear Waste Management Funds**

Pursuant to the Ontario Nuclear Funds Agreement (“ONFA”) between OPG and the Province of Ontario, OPG established a Used Fuel Fund and a Decommissioning Fund (together the “Nuclear Funds”). The Used Fuel Fund is intended to fund expenditures associated with the disposal of highly radioactive used nuclear fuel bundles, while the Decommissioning Fund was established to fund expenditures associated with nuclear fixed asset removal and the disposal of low and intermediate level nuclear waste materials. OPG maintains the Nuclear Funds in third party custodial accounts that are segregated from the rest of OPG’s assets.

The Nuclear Funds are invested in fixed income and equity securities, which OPG records as long-term investments and accounts for at their amortized cost value. Therefore, gains and losses are recognized only upon the sale of an underlying security. As such, there may be unrealized gains and losses associated with the investments in the Nuclear Funds, which OPG has not recognized in its consolidated financial statements. After applying the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3855, Financial Instruments – Recognition and Measurement in 2007, the Nuclear Funds will be measured at fair value with gains and losses recognized in net income. More detail on the impact of the new accounting standards is provided in the Future Accounting Changes section.

### **Revenue Recognition**

All of OPG’s electricity generation is sold into the real-time energy spot market administered by the Independent Electricity System Operator (“IESO”). Prior to April 1, 2005, revenue was recorded as electricity was generated and metered based on the spot market sales price, net of the Market Power Mitigation Agreement rebate and hedging activities. At each balance sheet date, OPG computed the average spot energy price that prevailed since the beginning of the current settlement period and recognized a Market Power Mitigation Agreement rebate if the average price exceeded 3.8¢/kilowatt hour (“kWh”), based on the amount of energy subject to the rebate.

Effective April 1, 2005, the generation from most of OPG’s baseload hydroelectric facilities and all of the nuclear facilities that OPG operates became rate regulated. As a result, energy revenue generated from the nuclear facilities is recognized based on a regulated price of 4.95¢/kWh. The regulated price received by OPG for the first 1,900 megawatt hours (MWh) of production from the regulated hydroelectric facilities in any hour is 3.3¢/kWh. Any production from these regulated hydroelectric facilities above 1,900 MWh in any hour receives the Ontario electricity spot market price.

The production from OPG’s remaining hydroelectric, fossil-fuelled and wind generating stations remains unregulated and continues to be sold at the Ontario electricity spot market price. However, 85 per cent of the generation output from these other generating assets, excluding the Lennox generating station and forward sales as of January 1, 2005, is subject to a revenue limit. The output from a generating unit where there has been a fuel conversion and the incremental output from a generating station where there has been a refurbishment or expansion of these assets are also excluded from the output covered by the revenue limit. In addition, until the Transition – Generation Corporation Designated Rate Options (“TRO”)

expired on April 30, 2006, volumes sold under such options were also excluded from the revenue limit rebate. This revenue limit, which was originally established for a period of 13 months ending April 30, 2006, was subsequently extended for an additional three years. Starting May 1, 2006, the revenue limit decreased to 4.6¢/kWh from the previous limit of 4.7¢/kWh. On May 1, 2007, the revenue limit will return to 4.7¢/kWh and increase to 4.8¢/kWh effective May 1, 2008. In addition, beginning May 1, 2006, volumes sold under a Pilot Auction administered by the Ontario Power Authority ("OPA") are subject to a revenue limit that is 0.5¢/kWh higher than the revenue limit applicable to OPG's other generating assets. Revenues above these two revenue limits are returned to the IESO for the benefit of consumers.

OPG also sells into, and purchases from, interconnected markets of other provinces and the U.S. northeast and midwest. All contracts that are not designated as hedges are recorded in the consolidated balance sheets at market value with gains or losses recorded in the consolidated statements of income. Gains and losses on energy trading contracts (including those to be physically settled) are recorded on a net basis in the consolidated statements of income. Accordingly, power purchases of \$163 million in 2006 and \$228 million in 2005 were netted against revenue.

OPG derives non-energy revenue under the terms of a lease arrangement with Bruce Power L.P. ("Bruce Power") related to the Bruce nuclear generating stations. This includes lease revenues, interest income and revenues for engineering analysis and design, technical and ancillary services. OPG also earns revenue from its joint venture share of the Brighton Beach Power Limited Partnership ("Brighton Beach") related to an energy conversion agreement between Brighton Beach and Coral Energy Canada Inc. ("Coral"). In addition, non-energy revenue includes isotope sales to the medical industry and real estate rentals. Revenues from these activities are recognized as services are provided or as products are delivered.

#### *Accounting for Certain Leases*

OPG accounts for certain lease revenues relating to the regulated business using the cash basis of accounting. Under the cash basis of accounting, OPG recognizes lease income as stipulated in the lease agreement to the extent that the lease payments are expected to be included in future regulated prices charged to customers.

If OPG did not apply the cash basis of accounting for leases and the taxes payable method for the related income tax accounting in 2006, the revenue and the related future income tax expense would have increased by \$21 million (2005 – \$15 million) and \$6 million (2005 – \$5 million) respectively.

As of December 31, 2006, had OPG accounted for the leases related to the regulated business using a straight-line basis and the related income taxes using the liability method, OPG would have reported a deferred lease receivable of \$36 million (2005 – \$15 million) and a related future income tax liability of \$11 million (2005 – \$5 million).

#### **Derivatives**

OPG is exposed to changes in electricity prices associated with a wholesale spot market for electricity in Ontario. To hedge the commodity price risk exposure associated with changes in the wholesale price of electricity, OPG enters into various energy and related sales contracts. These contracts are expected to be effective as hedges of the commodity price exposure on OPG's generation portfolio. Gains or losses on hedging instruments are recognized in income over the term of the contract when the underlying hedged transactions occur. These gains or losses are included in unregulated revenue and are not recorded on the consolidated balance sheets. All contracts not designated as hedges are recorded as assets or liabilities at fair value with changes in fair value recorded in other revenue.

OPG also enters into derivative contracts with major financial institutions to manage the Company's exposure to foreign currency movements. Foreign exchange translation gains and losses on these foreign currency denominated derivative contracts are recognized as an adjustment to the purchase price of the commodity or goods received.

OPG is exposed to changes in market interest rates on debt expected to be issued in the future. OPG uses interest rate derivative contracts to hedge this exposure. Gains and losses on interest rate hedges are recorded as an adjustment to interest expense for the debt being hedged. Gains and losses that do not meet the effectiveness criteria are recorded through net income in the period incurred.

OPG utilizes emission reduction credits ("ERCs") and allowances to manage emissions within the prescribed regulatory limits. ERCs are purchased from trading partners in Canada and the United States. Emission allowances are obtained from the Province and purchased from trading partners in Ontario. The cost of ERCs and allowances are held in inventory and charged to OPG's operations at average cost as part of fuel expense as required. Options to purchase ERCs are accounted for as derivatives and are recorded at estimated market value.

Hedge accounting is applied when the derivative instrument is designated as a hedge and is expected to be effective throughout the life of the hedged item. When such derivative instrument ceases to exist or be effective as a hedge, or when designation of a hedging relationship is terminated, any associated deferred gains or losses are carried forward to be recognized in income in the same period as the corresponding gains or losses associated with the hedged item. When a hedged item ceases to exist, any associated deferred gains or losses are recognized in the current period's consolidated statement of income.

### **Foreign Currency Translation**

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian currency at year-end exchange rates. Any resulting gain or loss is reflected in other revenue.

### **Research and Development**

Research and development costs are charged to operations in the year incurred. Research and development costs incurred to discharge long-term obligations such as the nuclear waste management liabilities, for which specific provisions have already been made, are charged to the related liability.

### **Pension and Other Post Employment Benefits**

OPG's post employment benefit programs include a contributory defined benefit registered pension plan, a defined benefit supplementary pension plan, group life insurance, health care and long-term disability benefits. OPG accrues its obligations under pension and other post employment benefit ("OPEB") plans. The obligations for pension and other post retirement benefit costs are determined using the projected benefit method pro-rated on service. The obligation for long-term disability benefits is determined using the projected benefit method on a terminal basis. The obligations are affected by salary levels, inflation, and cost escalation. Pension and OPEB costs and obligations are determined annually by independent actuaries using management's best estimate assumptions. The discount rates used by OPG in determining projected benefit obligations and the costs for the Company's employee benefit plans are based on representative AA corporate bond yields.

Pension fund assets are valued using market-related values for purposes of determining actuarial gains or losses and the expected return on plan assets. The market-related value recognizes gains and losses on equity assets relative to a six per cent assumed real return over a five-year period.

Pension and OPEB costs include current service costs, interest costs on the obligations, the expected return on pension plan assets, adjustments for plan amendments and adjustments for actuarial gains or losses, which result from changes in assumptions and experience gains and losses. Past service costs arising from pension and OPEB plan amendments are amortized on a straight-line basis over the expected average remaining service life of the employees covered by the plan, since OPG will realize the economic benefit over that period. Due to the long-term nature of post-employment liabilities, the excess of the net cumulative unamortized gain or loss, over 10 per cent of the greater of the benefit obligation and the market-related value of the plan assets, is also amortized over the expected average remaining service life.

When the recognition of the transfer of employees and employee-related benefits gives rise to both a curtailment and a settlement, the curtailment is accounted for prior to the settlement. A curtailment is the loss by employees of the right to earn future benefits under the plan. A settlement is the discharge of a plan's liability.

## **Taxes**

Under the *Electricity Act, 1998*, OPG is responsible for making payments in lieu of corporate income and capital taxes to the OEFC. These payments are calculated in accordance with the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario), and are modified by the *Electricity Act, 1998* and related regulations. This effectively results in OPG paying taxes similar to what would be imposed under the federal and Ontario tax acts.

OPG follows the liability method of accounting for income taxes of its unregulated operations. Under the liability method, future tax assets and liabilities are determined based on differences between the accounting and tax bases of assets and liabilities and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period the change is substantively enacted. Future income tax assets are evaluated and if realization is not considered more likely than not, a valuation allowance is established.

Commencing April 1, 2005, with the introduction of rate regulation, OPG accounts for income taxes relating to the rate regulated segments of its business using the taxes payable method. Under the taxes payable method, OPG does not recognize future income taxes relating to the rate regulated segments of its business to the extent those future income taxes are expected to be recovered in future regulated prices charged to customers.

OPG makes payments in lieu of property tax on its nuclear and fossil-fuelled generating assets to the OEFC, and also pays property taxes to municipalities.

OPG pays charges on gross revenue derived from the annual generation of electricity from its hydroelectric generating assets. The gross revenue charge ("GRC") includes a fixed percentage charge applied to the annual hydroelectric generation derived from stations located on provincial Crown lands, in addition to graduated rate charges applicable to all hydroelectric stations. GRC costs are included in fuel expense.

## **Changes in Accounting Policies and Estimates**

### *Depreciation of Long-Lived Assets*

The accounting estimates related to the depreciation of long-lived assets require significant management judgment to assess the appropriate useful lives of OPG's long-lived assets, including consideration of various technological and other factors.

Effective January 1, 2006, following the completion of a review of the life limiting components of the Pickering B nuclear generating station, OPG revised and extended, for the purpose of calculating depreciation, the estimated remaining service life of the Pickering B nuclear generating station to 2014 from 2009. The extension reduced depreciation expense by \$36 million in 2006.

The Province has accepted the advice of the IESO in their June 2006 report that indicates a need for 2,500 to 3,000 MW of additional capacity to maintain system reliability. Therefore, further delays will be necessary in the Province's plan to replace coal-fired generation by 2009. As a result of these delays, effective July 1, 2006, OPG extended the life for all of the coal-fired generating stations, for purposes of calculating depreciation, to December 31, 2012. The extension reduces depreciation expense by \$64 million in 2006, \$126 million in 2007, and \$46 million in 2008. From 2009 to 2012, the depreciation expense will increase by \$59 million in each year. OPG will reassess the service life of the coal-fired stations upon release of the submitted Integrated Power System Plan, and as subsequently approved by the OEB. Any change to the estimated service life of the coal-fired generating stations, for purposes of calculating depreciation, could have a material impact on OPG's consolidated financial statements.

OPG will continue to review the estimated useful lives of its generating stations including the Darlington and Bruce nuclear generating units. Any changes resulting from the review would be reflected in 2007.

### *Reportable Segments*

As noted in Note 18, effective April 1, 2005, the output from most of OPG's baseload hydroelectric facilities and all of the nuclear facilities that OPG operates became rate regulated. OPG continues to receive the spot market price for the output from its other generating stations, subject to a revenue limit on the majority of this output. With the introduction of rate regulation, OPG revised its reportable business segments to separately reflect the regulated and unregulated aspects of its business. Since the second quarter of 2005, OPG reported its business segments as Regulated – Nuclear, Regulated – Hydroelectric, and Unregulated Generation. Commencing in the first quarter of 2006, OPG separated the Unregulated Generation business segment into two reportable segments, identified as Unregulated – Fossil-Fuelled and Unregulated – Hydroelectric, as a result of changes in the management structure of these segments. Results for the comparative periods have been reclassified to reflect the revised disclosure.

### **Future Accounting Changes**

In 2005, the CICA issued three new accounting standards: Handbook Section 1530, Comprehensive Income; Handbook Section 3855, Financial Instruments – Recognition and Measurement; and Handbook Section 3865, Hedges. These standards apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006.

These standards are effective for OPG beginning in 2007. OPG has completed assessing the impact of these standards on its consolidated financial statements. The impact of implementing these new standards on OPG's consolidated financial statements is summarized below under the heading Impact of Adoption. The following provides further information on each of the three new accounting standards as they relate to OPG.

#### *Comprehensive Income*

As a result of adopting these standards, a new category, accumulated other comprehensive income, will be added to shareholder's equity in the consolidated balance sheets. Major components for this category will include unrealized gains and losses on financial assets classified as available-for-sale, changes in the fair value of the effective portion of cash flow hedging instruments, and unrealized foreign currency translation amounts, net of hedging, arising from self-sustaining foreign operations. These amounts will be recorded in the statement of other comprehensive income until the criteria for recognition in the consolidated statement of income are met.

#### *Financial Instruments – Recognition and Measurement*

Under the new standard, for accounting purposes, financial assets will be classified as one of the following: held-to-maturity, loans and receivables, held-for-trading or available-for-sale, and financial liabilities will be classified as held-for-trading or other than held-for-trading. Financial assets and liabilities held-for-trading will be measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading, will be measured at amortized cost. Available-for-sale instruments will be measured at fair value with unrealized gains and losses recognized in other comprehensive income. The standard also permits designation of any financial instrument as held-for-trading upon initial recognition. All derivatives, including embedded derivatives that must be separately accounted for, generally must be classified as held-for-trading and recorded at fair value in the consolidated balance sheets.

## Hedges

This new standard specifies the criteria under which hedge accounting can be applied and how hedge accounting is to be executed for each of the permitted hedging strategies: fair value hedges, cash flow hedges and hedges of a foreign currency exposure of a net investment in a self-sustaining foreign operation. In a fair value hedging relationship, the carrying value of the hedged item is adjusted by gains or losses attributable to the hedged risk and recognized in net income. This change in fair value of the hedged item, to the extent that the hedging relationship is effective, is offset by changes in the fair value of the derivative. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative will be recognized in other comprehensive income. The ineffective portion will be recognized in net income. The amounts recognized in accumulated other comprehensive income will be reclassified to net income in the periods in which net income is affected by the variability in the cash flows of the hedged item. In hedging a foreign currency exposure of a net investment in a self-sustaining foreign operation, foreign exchange gains and losses on the hedging instruments will be recognized in other comprehensive income.

## Impact of Adoption

Upon adoption of the financial instruments accounting standards, the assets in the Nuclear Funds that have been carried at amortized cost until the end of 2006, will be classified as held-for-trading in 2007 and reported at fair value. The transition adjustment related to the change in accounting for the funds will be recognized in the opening balance of retained earnings as at January 1, 2007. The transition adjustment for embedded derivatives within long-term contracts will also be recognized in the opening balance of retained earnings as at January 1, 2007. Prior to January 1, 2007, OPG valued securities in the Nuclear Funds based on the closing price of the securities. Starting January 1, 2007, OPG will apply bid pricing, however, the change in the pricing methodology is not expected to have a significant impact to the Nuclear Funds balance on the consolidated balance sheets. The fair value of hedging instruments designated as cash flow hedges will be recognized in the opening accumulated other comprehensive income on a net of tax basis. The fair values of these hedges are disclosed in Note 12 to the audited consolidated financial statements.

The transition amounts that will be recorded in the opening retained earnings or in the opening accumulated other comprehensive income balance on January 1, 2007 are as follows:

	At Cost December 31 2006	At Fair Value January 1 2007	Transition Amounts – January 1, 2007	
			Opening Retained Earnings	Opening Accumulated Other Comprehensive Income
<i>(millions of dollars)</i>				
Nuclear funds balance <sup>1</sup>	7,694	9,041	1,347	-
Due to Province	(100)	(928)	(828)	-
	<b>7,594</b>	<b>8,113</b>	<b>519</b>	<b>-</b>
Accounts receivable and other assets	325	372	-	47
Accounts payable and accrued charges	(989)	(1,005)	(6)	(10)
Net future income tax liability	(249)	(265)	-	(16)
Transition adjustments			513	21

<sup>1</sup> OPG applied bid pricing for securities in the Nuclear Funds. As a result, the fair value of the Nuclear Funds above is lower than that reported under Note 9 of the financial statements. The change in pricing methodology does not have any impact to the overall balance on the consolidated balance sheets because the reduction in fair value is offset by the corresponding change in the due to Province balance.

#### 4. SALE OF ACCOUNTS RECEIVABLE

On October 1, 2003, the Company signed an agreement to sell an undivided co-ownership interest in its current and future accounts receivable (the "receivables") to an independent trust. The Company also retains an undivided co-ownership interest in the receivables sold to the trust. Under the agreement, OPG continues to service the receivables. The transfer provides the trust with ownership of a share of the payments generated by the receivables, computed on a monthly basis. The trust's recourse to the Company is generally limited to its income earned on the receivables. In December 2005, the Company extended this agreement to August 2009.

OPG reflected the initial transfer to the trust of the co-ownership interest, and subsequent transfers required by the revolving nature of the securitization, as sales in accordance with CICA Accounting Guideline 12, *Transfer of Receivables*. In accordance with this Guideline, the proceeds of each sale to the trust were deemed to be the cash received from the trust net of the undivided co-ownership interest retained by the Company. For 2006, OPG has recognized pre-tax charges of \$13 million (2005 – \$9 million) on such sales at an average cost of funds of 4.4 per cent (2005 – 3.1 per cent). As at December 31, 2006, OPG had sold receivables of \$300 million from its total portfolio of \$392 million.

The accounts receivable reported and securitized by the Company are as follows:

<i>(millions of dollars)</i>	Principal amount of receivables as at December 31		Average balance of receivables for year ended December 31	
	2006	2005	2006	2005
Total receivables portfolio <sup>1</sup>	392	668	445	559
Receivables sold	300	300	300	300
Receivables retained	92	368	145	259
Average cost of funds			4.4%	3.1%

<sup>1</sup> Amount represents receivables outstanding, including receivables that have been securitized, which the Company continues to service.

An immediate 10 per cent or 20 per cent adverse change in the discount rate would not have a material effect on the current fair value of the retained interest. There were no credit losses for the year ended December 31, 2006 and 2005.

Details of cash flows from securitizations for the years ended December 31, 2006 and 2005 are as follows:

<i>(millions of dollars)</i>	2006	2005
Collections reinvested in revolving sales <sup>1</sup>	3,600	3,600
Cash flows from retained interest	2,020	2,927

<sup>1</sup> Given the revolving nature of the securitization, the cash collections received on the receivables securitized are immediately reinvested in additional receivables resulting in no further cash proceeds to the Company over and above the initial cash amount of \$300 million. The amounts reflect the total of 12 monthly amounts.

## 5. FIXED ASSETS

Depreciation and amortization expense consists of the following:

<i>(millions of dollars)</i>	2006	2005
Depreciation and amortization	659	748
Nuclear waste management costs	5	5
	<b>664</b>	<b>753</b>

Fixed assets consist of the following:

<i>(millions of dollars)</i>	2006	2005
Property, plant and equipment		
Nuclear generating stations	6,275	4,754
Regulated Hydroelectric generating stations	4,384	4,379
Unregulated Hydroelectric generating stations	3,481	3,447
Fossil-Fuelled generating stations	1,465	1,411
Other fixed assets	854	833
Construction in progress	677	348
	<b>17,136</b>	<b>15,172</b>
Less: accumulated depreciation		
Generating stations	4,066	3,497
Other fixed assets	309	263
	<b>4,375</b>	<b>3,760</b>
	<b>12,761</b>	<b>11,412</b>

Interest capitalized to construction in progress at 6.0 per cent during the years ended December 31, 2006 and 2005 was \$21 million and \$27 million, respectively.

### Impairment of Long-Lived Assets

The accounting estimates related to asset impairment require significant management judgment to identify factors such as short and long-term forecasts for future sales prices, the supply of electricity in Ontario, inflation, fuel prices, and station lives. The amount of the future cash flow that OPG will ultimately realize with respect to these assets could differ materially from the carrying values recorded in the consolidated financial statements.

#### *Pickering A Nuclear Generating Station Units 2 and 3*

OPG completed, in the second quarter of 2005, an assessment of the cost, schedule and risks related to the return to service of Units 2 and 3 at the Pickering A nuclear generating station. The assessment considered results from inspection programs with respect to feeder pipe and steam generator degradation mechanisms, and potential degradation of the calandria vault components, all of which could impact the future capability factor, operating costs and the life of the units. Upon consideration of the scope of the refurbishment work, the costs and the risks related to the return to service of these two units, OPG determined that the return to service of these two units was not justified on a commercial basis even though technically feasible. OPG recorded an impairment loss of \$63 million in the second quarter of 2005 related to the carrying amount of these two units including construction in progress. In addition to the impairment loss for these two units, OPG recorded OM&A expenses of \$57 million related to the write-off of inventory identified as excess or unusable, as a result of not returning Units 2 and 3 to service.

OPG expects to recover the amounts recorded in the deferral account established under a regulation pursuant to the *Electricity Restructuring Act, 2004* (Ontario) relating to non-capital costs incurred on or after January 1, 2005 associated with the return to service of Units 2 and 3. The deferred costs relating to Units 2 and 3 are disclosed in Note 6 to the audited consolidated financial statements.

#### *Lennox Generating Station*

As a result of the Government's "Request for Information/Request for Proposal for 2,500 MW of New Clean Generation and Demand Side Management Projects" released in September 2004 and the related contractual arrangements, future wholesale electricity market revenue is expected to be lower than previously anticipated. As a relatively high variable cost generating station, the Lennox generating station will not be able to recover its fixed operating costs and its carrying value from the wholesale electricity market in the future. Given these factors, OPG had initiated discussions with the Province, with the expectation of entering into a contractual arrangement for the recovery of the annual fixed operating costs and the carrying value of the Lennox generating station. In March 2005, OPG was advised by the Province that it would continue to support OPG in negotiating an arrangement that would allow for the recovery of fixed operating costs, but that the Province would not support an arrangement that would allow for the recovery of the carrying value of the Lennox generating station. As a result of this change in circumstance, OPG recorded the impairment loss of \$202 million in the first quarter of 2005.

In March 2006, the OEB issued a decision approving a reliability must-run ("RMR") contract between OPG and the Independent Electricity System Operator ("IESO") for the Lennox generating station, for the period October 1, 2005 to September 30, 2006. Reliability must-run contracts are designed to ensure that generating stations remain available to maintain the reliability of the electricity system. In its decision, the OEB found it appropriate for OPG to recover the fixed and variable operating costs of the Lennox generating station that are not recovered through market revenues. As a result of the decision, OPG recorded \$59 million in revenue in 2006. The RMR contract is a cost-based contract that provides for regular payments, which are subject to adjustments for actual costs. OPG negotiated a similar contract with the IESO for the period October 1, 2006 to September 30, 2007. The contract was approved by the OEB in January 2007.

#### *Thunder Bay and Atikokan Generating Stations*

OPG recognized an impairment loss on the Thunder Bay and Atikokan coal-fired generating stations in 2006 of \$22 million, which represented the carrying amount or net book value of these stations. OPG tested the recoverability of the carrying amounts of the coal-fired stations as a result of changes in circumstance, which included a decrease in forecast Ontario spot market prices and the extension of the lives of the coal-fired stations. The fair value of the coal-fired generating stations, which was determined using a discounted cash flow method, was compared to the carrying value of the generating assets to determine the impairment loss. It was determined that the Thunder Bay and Atikokan coal-fired generating stations would not be able to recover their operating and capital expenditures and carrying amount, over their remaining service lives.

## 6. REGULATORY ASSETS AND LIABILITIES

The regulatory assets and liabilities as at December 31, 2006 and 2005 are as follows:

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Regulatory assets		
Pickering A generating station return to service costs	<b>249</b>	261
Ancillary service revenue variance	-	5
Transmission outages and transmission restrictions variance	<b>2</b>	-
<b>Total regulatory assets</b>	<b>251</b>	266
Regulatory liabilities		
Hydroelectric production variance	<b>4</b>	4
Other	<b>7</b>	8
<b>Total regulatory liabilities</b>	<b>11</b>	12

The changes in the regulatory assets and liabilities for 2006 and 2005 are as follows:

<i>(millions of dollars)</i>	<b>Pickering A Return to Service Costs</b>	<b>Ancillary Service Revenue Variance</b>	<b>Hydro- electric Production Variance</b>	<b>Transmission Outages and Transmission Restrictions Variance</b>	<b>Other</b>
Regulatory assets (liabilities), January 1, 2005	-	-	-	-	-
Increase (decrease) during the year	265	5	(4)	-	(8)
Amortization during the year	(4)	-	-	-	-
Regulatory assets (liabilities), December 31, 2005	261	5	(4)	-	(8)
Increase (decrease) during the year	13	(5)	-	2	1
Amortization during the year	(25)	-	-	-	-
Regulatory assets (liabilities), December 31, 2006	<b>249</b>	-	<b>(4)</b>	<b>2</b>	<b>(7)</b>

### Pickering A Return to Service Costs

Effective January 1, 2005, in accordance with a regulation made under the *Electricity Restructuring Act, 2004* (Ontario), OPG was required to establish a deferral account in connection with non-capital costs incurred on or after January 1, 2005 that are associated with the planned return to service of all units at the Pickering A nuclear generating station. As a result, the change in accounting was prospectively adopted on January 1, 2005. As at December 31, 2006, the deferral account was \$249 million, consisting of non-capital costs of \$232 million relating to Unit 1, \$19 million relating to Units 2 and 3, \$20 million of general return to service costs, interest of \$7 million, and accumulated amortization of \$29 million.

As at December 31, 2005, the deferral account was \$261 million, consisting of non-capital costs of \$228 million relating to Unit 1, \$19 million relating to Units 2 and 3, \$11 million of general return to service costs, interest of \$7 million, and accumulated amortization of \$4 million.

Under the regulation, the OEB is directed to ensure that OPG recovers any balance in the deferral account on a straight-line basis over a period not to exceed 15 years.

Had OPG not charged costs to the deferral account as required by the regulation, OM&A expenses would have been reduced by \$12 million (2005 – would have been increased by \$254 million). Further, the net interest expense would have been \$7 million higher in 2005.

### **Variance Accounts and Other Regulatory Balances**

Effective April 1, 2005, in accordance with a regulation made under the *Electricity Restructuring Act, 2004* (Ontario), OPG was directed to establish variance accounts for capital and non-capital costs incurred and revenues earned or foregone on or after April 1, 2005 due to deviations from the forecast information provided to the Province for the purposes of establishing regulated prices that are associated with differences in hydroelectric electricity production due to differences between forecast and actual water conditions, unforeseen changes to nuclear regulatory requirements or unforeseen technological changes, changes to revenues for ancillary services from the regulated facilities, acts of God (including severe weather events), and transmission outages and transmission restrictions. OPG recorded a reduction in revenue during 2006 of \$5 million, reflecting ancillary services revenue that was favourable compared to the forecast for 2006 provided to the Province for the purposes of establishing regulated prices. OPG recorded revenue during 2006 of \$2 million reflecting lower generation sales caused by transmission outages and transmission restrictions in 2006.

OPG recorded revenue during 2005 of \$5 million, reflecting ancillary services revenue that was unfavourable compared to that forecasted for 2005. OPG recorded a reduction in revenue during 2005 of \$4 million, reflecting water conditions that were favourable compared to those forecasted for 2005.

The OEB is directed by the regulation to ensure recovery of amounts recorded in the variance accounts to the extent that the OEB is satisfied that the revenues recorded in the accounts were earned or foregone, that the costs recorded in the accounts were prudently incurred, and that both revenues and costs are accurately recorded. Any balances approved by the OEB will be amortized over a period not to exceed three years. The amortization will commence when OPG starts to recover the balances through new prices that will be set by the OEB. Any balances in the account disallowed by the OEB will be reflected in results of operations in the period that the OEB decision occurs.

The other regulatory liability includes a portion of non-regulated revenue earned by OPG's regulated assets, which may result in a reduction of future regulated prices to be established by the OEB.

Had OPG not accounted for the variance accounts and other regulatory balances as regulatory assets and liabilities, revenue for 2006 would have been higher by \$2 million (2005 – lower by \$1 million).

### **Liability for Nuclear Used Fuel Management and Liability for Nuclear Decommissioning and Low and Intermediate Level Waste Management**

In February 2007 the Province amended a regulation pursuant to the *Electricity Restructuring Act, 2004* (Ontario) to require OPG to establish a deferral account in connection with certain changes to its liability for nuclear used fuel management and its liability for nuclear decommissioning and low and intermediate level waste management. The deferral account requires OPG to record a regulatory asset or liability representing the revenue requirement impact associated with the changes in these nuclear liabilities arising from an Approved Reference Plan, approved after April 1, 2005, in accordance with the terms of the ONFA. Revenue requirement is a regulatory construct, which represents all costs and a return on rate base at an allowed rate of return that the regulator determines to be appropriate. On December 31, 2006, OPG recorded an increase of \$1,386 million in these nuclear liabilities arising from the 2006 Approved Reference Plan.

Commencing on January 1, 2007 and up to the effective date of the OEB's first order establishing regulated prices, which is expected to be after March 31, 2008, OPG will record a regulatory asset associated with the increase in the nuclear liabilities arising from the 2006 Approved Reference Plan. The OEB is directed by the regulation to ensure that OPG recovers the balance recorded in the deferral account on a straight line basis over a period not to exceed three years, to the extent that the OEB is satisfied that the revenue requirement impacts are accurately recorded.

## 7. SHORT-TERM CREDIT FACILITIES

OPG's \$1 billion revolving committed bank credit facility is divided into two tranches – a \$500 million 364-day term tranche maturing May 22, 2007, and a \$500 million three-year term tranche maturing May 22, 2009. The total credit facility will be used primarily as support for notes issued under OPG's commercial paper program. As of December 31, 2006, there was \$15 million of commercial paper outstanding (2005 – \$ nil). OPG had no other outstanding borrowing under its bank credit facility in 2006 and 2005.

OPG also maintains \$26 million (2005 – \$26 million) in short-term uncommitted overdraft facilities as well as \$240 million (2005 – \$215 million) of short-term uncommitted credit facilities, which support the issuance of Letters of Credit. OPG uses Letters of Credit to support the supplementary pension plans and is required to post Letters of Credit as collateral with Local Distribution Companies ("LDCs") as prescribed by the OEB's Retail Settlement Code. At December 31, 2006, there was a total of \$185 million (2005 – \$157 million) of Letters of Credit issued, which included \$159 million relating to the supplementary pension plans (2005 – \$138 million) and \$16 million (2005 – \$ nil) relating to the construction of the Portlands Energy Centre.

## 8. LONG-TERM DEBT

Long-term debt consists of the following:

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Notes payable to the OEFC	<b>3,165</b>	3,695
Share of non-recourse limited partnership debt	<b>194</b>	200
	<b>3,359</b>	3,895
Less: due within one year		
Notes payable to the OEFC	<b>400</b>	800
Share of limited partnership debt	<b>6</b>	6
	<b>406</b>	806
Long-term debt	<b>2,953</b>	3,089

Holders of the senior debt are entitled to receive, in full, amounts owing in respect of the senior debt before holders of the subordinated debt are entitled to receive any payments. The OEFC currently holds all of OPG's outstanding senior and subordinated notes.

The maturity dates as at December 31, 2006 for notes payable to the OEFC are as follows:

<b>Year of Maturity</b>	<b>Interest Rate (%)</b>	<b>Principal Outstanding (millions of dollars)</b>		<b>Total</b>
		<b>Senior Notes</b>	<b>Subordinated Notes</b>	
2007	5.85	400	-	400
2008	5.90	400	-	400
2009	6.01	350	-	350
2010	6.00	595	375	970
2011	6.65	-	375	375
2012	5.72	400	-	400
2016	4.91	270	-	270
		<b>2,415</b>	<b>750</b>	<b>3,165</b>

In March 2005, the Company reached an agreement with the OEFC to obtain additional financing up to \$600 million until March 31, 2006. In April 2005, \$400 million was drawn under this facility, with a seven-year term.

In September 2005, OPG reached an agreement with the OEFC to provide debt financing for the Niagara Tunnel project. The funding, which is up to \$1 billion over the duration of the project, will be in the form of 10-year notes, which will be issued quarterly to meet the project's obligations. Interest will be fixed for each note issued at the time of advance at a rate equal to the prevailing Benchmark Government of Canada 10-Year Bond, plus a credit spread determined by the OEFC based on a survey of market rates. In October 2006, OPG issued \$160 million against this facility.

In October 2005, OPG reached a similar agreement with the OEFC to provide debt financing for the Thunder Bay Gas Conversion project. Under this credit facility, up to \$95 million was available to OPG and could be drawn as needed over the construction period. In light of the directive to the OPA to determine how best to replace coal-fired generation, the Province determined that it was no longer advisable to continue with the conversion of the Thunder Bay generating station to run on natural gas. On July 12, 2006, OPG received a Shareholder Declaration revoking the October 2005 Shareholder Declaration, effectively cancelling the project.

In December 2006, OPG reached an agreement with the OEFC to provide debt financing for the Lac Seul Hydroelectric Generating Station and the Portlands Energy Centre projects. There will be up to \$50 million available for the Lac Seul project and up to \$400 million available for the Portlands Energy Centre project under each credit facility. The credit facilities will be drawn as needed to fund the respective projects over the construction period. The funding will be in the form of 10-year notes with interest rates fixed for each note issued at the time of advance at a rate equal to the prevailing Benchmark Government of Canada 10-Year Bond, plus a credit spread determined by the OEFC based on a survey of market rates. In December, OPG issued \$20 million and \$90 million against the Lac Seul project credit facility and the Portlands Energy Centre credit facility respectively.

Interest paid in 2006 was \$248 million (2005 – \$235 million), of which \$229 million relates to interest paid on long-term debt (2005 – \$220 million).

## 9. FIXED ASSET REMOVAL AND NUCLEAR WASTE MANAGEMENT

The liabilities for fixed asset removal and nuclear waste management on a present value basis consist of the following:

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Liability for nuclear used fuel management	<b>5,669</b>	4,940
Liability for nuclear decommissioning and low and intermediate level waste management	<b>4,659</b>	3,627
Liability for non-nuclear fixed asset removal	<b>192</b>	192
<b>Fixed asset removal and nuclear waste management liabilities</b>	<b>10,520</b>	8,759

The changes in the fixed asset removal and nuclear waste management liability for the years ended December 31, 2006 and 2005 are as follows:

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Liabilities, beginning of year	<b>8,759</b>	8,339
Increase in liabilities due to accretion	<b>499</b>	476
Increase in liabilities due to nuclear used fuel and nuclear waste management variable expenses	<b>38</b>	34
Liabilities settled by expenditures on waste management	<b>(164)</b>	(90)
Increase in the liability for non-nuclear fixed asset removal	<b>2</b>	-
Increase in the liability for nuclear used fuel management and the liability for nuclear decommissioning and low and intermediate level waste management to reflect the change in cost estimates	<b>1,386</b>	-
<b>Liabilities, end of year</b>	<b>10,520</b>	8,759

OPG's fixed asset removal and nuclear waste management liabilities are comprised of expected costs to be incurred up to and upon termination of operations and the closure of nuclear and fossil-fuelled generating plant facilities. Costs will be incurred for activities such as dismantling, demolition and disposal of facilities and equipment, remediation and restoration of sites and the ongoing and long-term management of nuclear used fuel and low and intermediate level waste material.

The following costs are recognized as a liability:

- The present value of the costs of dismantling the nuclear and fossil-fuelled production facilities at the end of their useful lives;
- The present value of the fixed cost portion of any nuclear waste management programs that are required based on the total volume of waste expected to be generated over the assumed life of the stations;
- The present value of the variable cost portion of any nuclear waste management program to take into account actual waste volumes incurred to date.

The determination of the accrual for fixed asset removal and nuclear waste management costs requires significant assumptions, since these programs run for many years. As at December 31, 2006, OPG updated the estimates for the nuclear used fuel management and nuclear decommissioning and low and intermediate level waste management liabilities. The resulting updated Reference Plan ("2006 Approved Reference Plan") was approved by the Province in accordance with the terms of the ONFA. The increase in cost estimates reflected in the Approved Reference Plan is mainly due to additional used fuel and waste quantities resulting from station life extension, recent experience in decommissioning reactors, and changes in economic indices. The increase is partially offset by the deferral of some station decommissioning dates.

As a result of the approval of the new Reference Plan, OPG will recognize additional expenses including accretion on the fixed asset removal and nuclear waste management liabilities and depreciation of the carrying value of the related fixed assets. The impact of these additional expenses will be reduced by the recognition of a regulatory asset to be recovered through future prices charged to customers, as prescribed by the amended regulation pursuant to the *Electricity Restructuring Act, 2004* (Ontario) discussed in Note 6 to the consolidated financial statements.

Nuclear and fossil-fuelled plant closures are projected to occur over the next six to 33 years. The updated Reference Plan includes cash flow estimates to 2073 for decommissioning nuclear stations and to approximately 2159 for nuclear used fuel management. The undiscounted amount of estimated cash flows associated with the liabilities expected to be incurred up to and upon closure of generating stations is approximately \$24 billion. The discount rate used to calculate the present value of the liabilities was 5.75 per cent for liabilities established prior to December 31, 2006. The upward revision in the amount of

the undiscounted estimated cash flows for OPG's liability for nuclear waste management and decommissioning was discounted at 4.6 per cent. The cost escalation rates ranged from 1.8 per cent to 3.6 per cent. Under the terms of the lease agreement with Bruce Power, OPG continues to be responsible for the nuclear fixed asset removal and nuclear waste management liabilities associated with the Bruce nuclear generating stations.

The significant assumptions underlying operational and technical factors used in the calculation of the accrued liabilities are subject to periodic review. Changes to these assumptions, including changes to assumptions on the timing of the programs, financial indicators or the technology employed may result in significant changes to the value of the accrued liabilities. With programs of this duration and the evolving technology to handle the nuclear waste, there is a significant degree of uncertainty surrounding the measurement accuracy of the costs for these programs, which may increase or decrease over time.

### **Liability for Nuclear Used Fuel Management Costs**

The liability for nuclear used fuel management represents the cost of managing the highly radioactive used nuclear fuel bundles. The current assumptions that have been used to establish the accrued used fuel costs include long-term management of the spent fuel bundles through deep geological disposal; an in-service date of 2035 for used nuclear fuel disposal facilities; and an average transportation distance of 1,000 kilometres between nuclear generating facilities and the disposal facilities. Alternatives to deep geological disposal have been studied by Canadian nuclear utilities via the Nuclear Waste Management Organization as part of the options study required by the federal *Nuclear Fuel Waste Act* (Canada) ("NFWA"). The options study was submitted to the federal government in November 2005. The federal government will decide which management alternative should be followed. The pending decision could have a significant impact on OPG's estimate of the liability.

### *Liability for Nuclear Decommissioning and Low and Intermediate Level Waste Management Costs*

The liability for nuclear decommissioning and low and intermediate level waste management represents the estimated costs of decommissioning nuclear generating stations after the end of their service lives, as well as the cost of managing low and intermediate level radioactive wastes generated by the nuclear stations. The significant assumptions used in estimating future nuclear fixed asset removal costs include decommissioning of nuclear generating stations on a deferred dismantlement basis where the reactors will remain in a safe storage state for a 30-year period prior to a 10-year dismantlement period.

The life cycle costs of low and intermediate level waste management include the costs of processing and storage of such radioactive wastes during and following the operation of the nuclear stations, as well as the costs of ultimate long-term disposal of these wastes. The current assumptions used to establish the accrued low and intermediate level waste management costs include a disposal facility for low and intermediate level waste with an in-service date of 2017. The option has been approved by the Municipality of Kincardine and the Environmental Assessment ("EA") process is now underway.

### *Liability for Non-Nuclear Fixed Asset Removal Costs*

The liability for non-nuclear fixed asset removal is based on third-party cost estimates after an in-depth review of active plant sites and an assessment of required clean-up and restoration activities. This liability represents the estimated costs of decommissioning fossil-fuelled generating stations at the end of their service lives. The estimated retirement date of these stations is between 2012 and 2039.

In addition to the \$103 million liability for active sites, OPG also has an asset retirement obligation liability of \$89 million for decommissioning and restoration costs associated with plant sites that have been divested or are no longer in use.

OPG has no legal obligation associated with the decommissioning of its hydroelectric generating facilities. Also, the costs cannot be reasonably estimated because of the long service life of these assets. With either maintenance efforts or rebuilding, the water control structures are assumed to be used for the foreseeable future. Accordingly, OPG has not recognized a liability for the decommissioning of its hydroelectric generating facilities.

### **Ontario Nuclear Funds Agreement**

OPG sets aside funds to be used specifically for discharging its nuclear fixed asset removal and nuclear waste management liabilities. In July 2003, OPG and the Province completed arrangements, pursuant to the ONFA. To comply with the ONFA, OPG established the Nuclear Funds. OPG jointly oversees the investment management of the Nuclear Funds with the Province. The assets of the Nuclear Funds are maintained in third party custodian accounts that are segregated from the rest of OPG's assets.

The Decommissioning Fund will be used to fund the future costs of nuclear fixed asset removal and long-term low and intermediate level nuclear waste management and a portion of used fuel storage costs after station life. The initial funding of the Decommissioning Fund was intended to be sufficient to fully discharge the 1999 estimate of the liability. OPG bears the risk and liability for cost estimate increases and fund earnings in the Decommissioning Fund.

The Used Fuel Fund will be used to fund future costs of long-term nuclear used fuel waste management. OPG is responsible for the risk and liability for cost increases for used fuel waste management, subject to graduated liability thresholds specified in the ONFA, which limit OPG's total financial exposure at approximately \$6.0 billion, a present value amount at April 1, 1999 (approximately \$9.1 billion in 2006 dollars) based on used fuel bundle projections of 2.23 million bundles consistent with the station lives included within the initial financial reference plan. The graduated liability thresholds do not apply to additional used fuel bundles as projected in the 2006 Approved ONFA Reference Plan. OPG makes quarterly payments to the Used Fuel Fund over the life of its nuclear generating stations, as specified in the ONFA. Required funding for 2006 under the ONFA was \$454 million, including a contribution to The Ontario NFWA Trust (the "Trust") of \$50 million.

The NFWA was proclaimed into force in November 2002. In accordance with the NFWA, the Nuclear Waste Management Organization was formed to prepare and review alternatives, and to provide recommendations to the federal government for long-term management of nuclear fuel waste by November 2005. The federal government will select the option for dealing with the long-term management of nuclear fuel waste based on submitted plans. As required under the NFWA, OPG made an initial deposit of \$500 million into the Trust in November 2002. The NFWA also requires OPG to make annual contributions of \$100 million to the Trust, to be deposited into the Trust no later than the November anniversary of the NFWA. To comply with this requirement, OPG contributed \$150 million to the Trust in 2005 (\$50 million of the funding was part of OPG's funding requirement for 2006), and \$50 million in 2006 to complete the 2006 funding requirement. Under the NFWA, OPG must continue to deposit \$100 million annually into the Trust until the federal government has approved a long-term plan. Future contributions to the Trust beyond 2006 will be dependent on the direction chosen by the federal government based on the recommendations submitted in November 2005. Given that the Trust forms part of the Used Fuel Fund, contributions to the Trust, as required by the NFWA, are applied towards the ONFA payment obligations.

As required by the *Nuclear Safety and Control Act* (Canada), and under the terms of the ONFA, the Province issued a guarantee to the Canadian Nuclear Safety Commission ("CNSC"), on behalf of OPG, for up to \$1,510 million. This is a guarantee that there will be sufficient funds available to discharge the current nuclear decommissioning and waste management liabilities. The provincial guarantee will supplement the Used Fuel Fund and the Decommissioning Fund until they have accumulated sufficient funds to cover the accumulated liabilities for nuclear decommissioning and waste management. The guarantee, taken together with the Used Fuel Fund and Decommissioning Fund, was in satisfaction of OPG's nuclear licensing requirements with the CNSC. OPG pays the Province an annual guarantee fee of 0.5 per cent of the amount guaranteed by the Province. OPG paid the annual guarantee fee for 2006 of \$8 million in 2006 (2005 – \$8 million).

Under the ONFA, the Province guarantees OPG's annual return in the Used Fuel Fund at 3.25 per cent plus the change in the Ontario Consumer Price Index ("committed return"), but only for the Used Fuel Fund relating to the liability associated with the first 2.23 million used fuel bundles. The difference between the committed return on the Used Fuel Fund and the actual market return, based on the fair value of fund assets, which includes realized and unrealized returns, is due to or due from the Province. Since OPG accounts, up to December 31, 2006, for the investments in the segregated funds on an amortized cost basis, the amount due to or due from the Province recorded in the consolidated financial statements is the difference between the committed return and the actual return based on realized returns only. At December 31, 2006, the Used Fuel Fund accounts included an amount due to the Province of \$100 million (2005 – \$4 million). If the investments in the Used Fuel Fund were accounted for at fair market value in the consolidated financial statements, at December 31, 2006, there would be an amount due to the Province of \$641 million (2005 – \$306 million).

Under the ONFA, the Decommissioning Fund had a long-term target rate of return of 5.75 per cent per annum. Under the 2006 Approved Reference Plan, the rate was revised to 5.15 per cent. The target rate of return is subject to future changes in the ONFA Reference Plan. If the rate of return deviates from 5.15 per cent, or if the estimate of the liabilities changes under the current approved ONFA Reference Plan, the Decommissioning Fund may become over or underfunded. Under the ONFA, if there is a surplus in the Decommissioning Fund such that the liabilities, as defined by the Current Approved ONFA Reference Plan, are at least 120 per cent funded, OPG may direct up to 50 per cent of the surplus over 120 per cent as a contribution to the Used Fuel Fund, and the OEFC is entitled to a distribution of an equal amount. In addition, upon termination of the ONFA, the Province has a right to any excess funds, which is the extent to which the fair market value of the Decommissioning Fund exceeds the estimated completion costs approved under the Current Approved ONFA Reference Plan. As at December 31, 2006, the Decommissioning Fund became underfunded on an amortized cost basis as a result of the approval of the 2006 Approved ONFA Reference Plan. Accordingly, no excess adjustment was reported in the Decommissioning Fund as at December 31, 2006. At December 31, 2005, the Decommissioning Fund exceeded the estimated completion cost under the previous ONFA Reference Plan approved in 1999 on an amortized cost basis. OPG reported an excess of \$7 million due to the Province on an amortized cost basis in 2005. If the investments in the Decommissioning Fund were accounted for at fair market value in the consolidated financial statements at December 31, 2006, and the Decommissioning Fund was terminated under the ONFA, there would be an amount due to the Province of \$294 million (2005 – \$484 million).

The nuclear fixed asset removal and nuclear waste management funds as at December 31, 2006 and 2005, consist of the following:

<i>(millions of dollars)</i>	<b>Amortized Cost Basis</b>		<b>Fair Value</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Decommissioning Fund	<b>4,356</b>	4,106	<b>5,169</b>	4,583
Due to Province – Decommissioning Fund	-	(7)	<b>(294)</b>	(484)
	<b>4,356</b>	4,099	<b>4,875</b>	4,099
Used Fuel Fund <sup>1</sup>	<b>3,338</b>	2,693	<b>3,879</b>	2,995
Due to Province – Used Fuel Fund	<b>(100)</b>	(4)	<b>(641)</b>	(306)
	<b>3,238</b>	2,689	<b>3,238</b>	2,689
	<b>7,594</b>	6,788	<b>8,113</b>	6,788

<sup>1</sup> The Ontario NFWA Trust represents \$1,102 million as at December 31, 2006 (December 31, 2005 – \$1,003 million) of the Used Fuel Fund on an amortized cost basis.

The amortized cost and fair value of the securities invested in the segregated funds, which include the Used Fuel Fund and Decommissioning Fund, as at December 31, 2006 and 2005 are as follows:

<i>(millions of dollars)</i>	<b>Amortized Cost Basis</b>		<b>Fair Value</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Cash and cash equivalents and short-term investments	<b>556</b>	516	<b>553</b>	515
Marketable equity securities	<b>4,250</b>	3,772	<b>5,608</b>	4,547
Bonds and debentures	<b>2,306</b>	1,757	<b>2,305</b>	1,762
Receivable from the OEFC	<b>588</b>	759	<b>588</b>	759
Administrative expense payable	<b>(6)</b>	(5)	<b>(6)</b>	(5)
	<b>7,694</b>	6,799	<b>9,048</b>	7,578
Due to Province – Decommissioning Fund	-	(7)	<b>(294)</b>	(484)
Due to Province – Used Fuel Fund	<b>(100)</b>	(4)	<b>(641)</b>	(306)
<b>Total</b>	<b>7,594</b>	6,788	<b>8,113</b>	6,788

The bonds and debentures held in the Used Fuel Fund and the Decommissioning Fund as at December 31, 2006 and 2005 mature according to the following schedule:

<i>(millions of dollars)</i>	<b>Fair Value</b>	
	<b>2006</b>	<b>2005</b>
Less than 1 year	-	-
1 - 5 years	<b>1,167</b>	769
5 - 10 years	<b>467</b>	485
More than 10 years	<b>671</b>	508
<b>Total maturities of debt securities</b>	<b>2,305</b>	1,762
<b>Average yield</b>	<b>4.5%</b>	4.3%

The receivable of \$588 million (2005 – \$759 million) from the OEFC does not have a specified maturity date. The effective rate of interest on the OEFC receivable was 3.9 per cent in 2006 (2005 – 5.8 per cent).

The change in the Nuclear Funds for the years ended December 31, 2006 and 2005 are as follows:

<i>(millions of dollars)</i>	<b>Amortized Cost Basis</b>		<b>Fair Value</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Decommissioning Fund, beginning of year	<b>4,099</b>	3,858	<b>4,099</b>	3,882
Increase in fund due to return on investments	<b>256</b>	255	<b>592</b>	459
Decrease in fund due to reimbursement of expenditures	<b>(6)</b>	(7)	<b>(6)</b>	(7)
Decrease (increase) in Due to Province	<b>7</b>	(7)	<b>190</b>	(235)
<b>Decommissioning Fund, end of year</b>	<b>4,356</b>	4,099	<b>4,875</b>	4,099
Used Fuel Fund, beginning of year	<b>2,689</b>	2,118	<b>2,689</b>	2,118
Increase in fund due to contributions made	<b>454</b>	454	<b>454</b>	454
Increase in fund due to return on investments	<b>204</b>	133	<b>443</b>	283
Decrease in fund due to reimbursement of expenditures	<b>(13)</b>	(16)	<b>(13)</b>	(16)
(Increase) decrease in Due to Province	<b>(96)</b>	-	<b>(335)</b>	(150)
<b>Used Fuel Fund, end of year</b>	<b>3,238</b>	2,689	<b>3,238</b>	2,689

#### **10. INCOME TAXES**

Commencing April 1, 2005, OPG accounts for income taxes related to the rate regulated segments of its business using the taxes payable method. Under the taxes payable method, OPG does not recognize future income taxes related to the rate regulated segments of its business to the extent that the future income taxes are expected to be recovered in future regulated prices charged to customers. As part of the transition, on April 1, 2005, OPG reversed the net future income tax asset balance of \$74 million relating to the rate regulated segments of its business, and recognized the amount as an extraordinary loss in determining net income. The extraordinary item reduced basic and diluted earnings per share for the year ended December 31, 2005 by \$0.29 per share.

A reconciliation between the statutory and the effective rate of income taxes is as follows:

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Income before income taxes	<b>576</b>	558
Combined Canadian federal and provincial statutory income tax rates, including surtax	<b>36.1%</b>	36.1%
Statutory income tax rates applied to accounting income	<b>208</b>	202
Increase (decrease) in income taxes resulting from:		
Large corporations tax in excess of surtax	-	28
Lower future tax rate on temporary differences	<b>(4)</b>	(12)
Non-taxable income items	<b>(5)</b>	7
Unrecorded future income tax related to regulated operations	<b>(89)</b>	(157)
Change in income tax positions	<b>10</b>	50
Other changes in future tax rate	<b>(34)</b>	-
	<b>(122)</b>	(84)
Income tax expense	<b>86</b>	118
Effective rate of income taxes	<b>14.9%</b>	21.1%

The Company has revised its future income tax assets and liabilities to reflect the lower federal income tax rates recently enacted.

In the third quarter of 2006, OPG received a preliminary communication from the Provincial Tax Auditors ("Tax Auditors") with respect to their initial findings from their audit of OPG's 1999 taxation year. Many of the issues raised through the audit are unique to OPG and relate either to start-up matters and positions taken on April 1, 1999 upon commencement of operations, or matters that were not adequately addressed through the *Electricity Act, 1998*. OPG has estimated that the proposed adjustments could result in additional taxes payable for the 1999 taxation year in excess of \$200 million. Although OPG has subsequently resolved some of these issues, there is uncertainty as to how the remaining issues will be resolved.

OPG expects to receive a reassessment for its 1999 taxation year. The Company would defend its position through the tax appeals process. The potential increase in taxes payable related to these issues for 1999 and subsequent taxation years could be material. Because OPG uses the taxes payable method to account for income taxes in the regulated business segments and the liability method for the unregulated business segments, the impact of any potential adjustments on future income tax expense could vary significantly, depending on the resolution of these issues.

OPG has previously recorded income tax charges related to certain income tax positions that the Company has taken in prior years that may be disallowed. Given the uncertainty as to how these income tax matters will be resolved, OPG has not adjusted its income tax liabilities. Should the ultimate outcome materially differ from OPG's recorded income tax liabilities, the Company's effective tax rate and its earnings could be affected positively or negatively in the period in which the matters are resolved.

Significant components of the provision for income tax expense are presented in the table below:

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Current income tax expense	<b>60</b>	80
Future income tax expense (benefits):		
Change in temporary differences	-	(51)
Non-capital loss carry-forward	<b>52</b>	88
Other	<b>(26)</b>	1
	<b>26</b>	38
Income tax expense	<b>86</b>	118

The income tax effects of temporary differences that give rise to future income tax assets and liabilities are presented in the table below:

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Future income tax assets:		
Fixed asset removal and nuclear waste management liabilities	<b>29</b>	27
Other liabilities and assets	<b>107</b>	107
Non-capital loss carry-forward	<b>28</b>	98
Future recoverable Ontario minimum tax	<b>64</b>	37
	<b>228</b>	269
Future income tax liabilities:		
Fixed assets	<b>332</b>	351
Other liabilities and assets	<b>145</b>	141
	<b>477</b>	492
Net future income tax liabilities	<b>249</b>	223
Represented by:		
Current portion liability (asset)	<b>3</b>	(18)
Long-term portion	<b>246</b>	241
	<b>249</b>	223

The following table summarizes the difference in the balance sheet amounts under the taxes payable method used by the Company to account for income taxes compared to what would have been reported had OPG applied the liability method for the regulated business as at December 31, 2006 and 2005:

<i>(millions of dollars)</i>	<b>2006</b>		<b>2005</b>	
	<b>As Stated</b>	<b>Liability Method <sup>1</sup></b>	<b>As Stated</b>	<b>Liability Method <sup>1</sup></b>
Future income tax (liabilities) assets – current	<b>(3)</b>	<b>(4)</b>	18	38
Long-term future income tax liabilities	<b>(246)</b>	<b>(417)</b>	(241)	(344)

<sup>1</sup> As discussed in note 3, OPG accounts for certain lease revenues relating to the regulated business using the cash basis of accounting. The related future income tax impact disclosed in note 3 is excluded from the above.

The following table summarizes the difference in the income statement amounts under the method used by the Company to account for income taxes compared to what would have been reported had OPG applied the liability method for the regulated business for the years ended December 31, 2006 and 2005:

<i>(millions of dollars)</i>	2006		2005	
	As Stated	Liability Method <sup>1</sup>	As Stated	Liability Method <sup>1</sup>
Extraordinary item	-	-	74	-
Future income tax expense	26	115	38	195

<sup>1</sup> As discussed in note 3, OPG accounts for certain lease revenues relating to the regulated business using the cash basis of accounting. The related future income tax impact disclosed in note 3 is excluded from the above.

As at December 31, 2006, OPG had available approximately \$308 million (2005 – \$236 million) of non-capital loss carry-forwards for Ontario income tax purposes. The non-capital loss carry-forward for the purpose of calculating Ontario income taxes is related to the following taxation years:

<i>(millions of dollars)</i>	Ontario Loss-Carry Forward	Expiry Date <sup>1</sup>
2004	236	2014
2006	72	2026

<sup>1</sup> The Province of Ontario recently introduced legislation in anticipation of the Ontario Corporate tax harmonization whereby these losses would be replaced by a special tax credit which would expire in 2011.

The amount of cash income taxes paid during 2006 was \$24 million (2005 – \$20 million).

## 11. BENEFIT PLANS

The post employment benefit programs include pension, group life insurance, health care and long-term disability benefits. The registered pension plan is a contributory defined benefit plan covering most employees and retirees. Pension fund assets include equity securities and corporate and government debt securities, real estate and other investments which are managed by professional investment managers. The fund does not invest in equity or debt securities issued by OPG. The supplementary pension plans are defined benefit plans covering certain employees and retirees.

Pension and OPEB obligations are impacted by factors including interest rates, adjustments arising from plan amendments, changes in assumptions and experience gains or losses. The pension and OPEB obligations, and the pension fund assets, are measured at December 31, 2006.

	Registered and Supplementary Pension Plans		Other Post Employment Benefits	
	2006	2005	2006	2005
<i>Weighted Average Assumptions – Benefit Obligation at Year End</i>				
Rate used to discount future benefits	5.25%	5.00%	5.22%	4.97%
Salary schedule escalation rate	3.00%	3.00%	-	-
Rate of cost of living increase to pensions	2.00%	2.00%	-	-
Initial health care trend rate	-	-	7.34%	7.76%
Ultimate health care trend rate	-	-	4.68%	4.68%
Year ultimate rate reached	-	-	2014	2014
Rate of increase in disability benefits	-	-	2.00%	2.00%

	Registered and Supplementary Pension Plans		Other Post Employment Benefits	
	2006	2005	2006	2005
<i>Weighted Average Assumptions – Cost for the Year</i>				
Expected return on plan assets net of expenses	<b>7.00%</b>	7.00%	-	-
Rate used to discount future benefits	<b>5.00%</b>	6.00%	<b>4.97%</b>	5.88%
Salary schedule escalation rate	<b>3.00%</b>	3.25%	-	-
Rate of cost of living increase to pensions	<b>2.00%</b>	2.25%	-	-
Initial health care trend rate	-	-	<b>7.76%</b>	7.03%
Ultimate health care trend rate	-	-	<b>4.68%</b>	4.46%
Year ultimate rate reached	-	-	<b>2014</b>	2014
Rate of increase in disability benefits	-	-	<b>2.00%</b>	2.25%
Average remaining service life for employees (years)	<b>11</b>	11	<b>11</b>	11

	Registered Pension Plan		Supplementary Pension Plans		Other Post Employment Benefits	
	2006	2005	2006	2005	2006	2005
<i>(millions of dollars)</i>						
<i>Changes in Plan Assets</i>						
Fair value of plan assets at beginning of year	<b>7,921</b>	7,056	-	-	-	-
Contributions by employer	<b>261</b>	254	<b>7</b>	7	<b>62</b>	58
Contributions by employees	<b>61</b>	56	-	-	-	-
Actual return on plan assets net of expenses	<b>945</b>	858	-	-	-	-
Settlements	-	(2)	-	-	-	-
Benefit payments	<b>(359)</b>	(301)	<b>(7)</b>	(7)	<b>(62)</b>	(58)
Fair value of plan assets at end of year	<b>8,829</b>	7,921	-	-	-	-
<i>Changes in Projected Benefit Obligation</i>						
Projected benefit obligation at beginning of year	<b>9,095</b>	7,663	<b>144</b>	144	<b>2,065</b>	1,499
Employer current service costs	<b>212</b>	163	<b>6</b>	7	<b>71</b>	47
Contributions by employees	<b>61</b>	56	-	-	-	-
Interest on projected benefit obligation	<b>459</b>	461	<b>7</b>	9	<b>104</b>	88
Past service costs	-	-	-	-	<b>13</b>	1
Settlement gain	-	(2)	-	-	-	-
Benefit payments	<b>(359)</b>	(301)	<b>(7)</b>	(7)	<b>(62)</b>	(58)
Net actuarial loss (gain)	<b>(155)</b>	1,055	<b>2</b>	(9)	<b>(124)</b>	488
Projected benefit obligation at end of year	<b>9,313</b>	9,095	<b>152</b>	144	<b>2,067</b>	2,065
Funded Status – Deficit at end of year	<b>(484)</b>	(1,174)	<b>(152)</b>	(144)	<b>(2,067)</b>	(2,065)

The assets of the OPG pension fund are allocated among three principal investment categories. Furthermore, equity investments are diversified across Canadian, U.S. and non-North American stocks. The fund also has a small real estate portfolio that is less than one per cent of plan assets.

	2006	2005
Registered pension plan fund asset investment categories		
Equities	67%	64%
Fixed income	30%	33%
Cash and short-term	3%	3%
<b>Total</b>	<b>100%</b>	<b>100%</b>

Based on the most recently filed actuarial valuation, as at January 1, 2005, there was an unfunded liability on a going-concern basis of \$465 million and a deficiency on a wind-up basis of \$1,979 million. The deficit disclosed in the next filed funding valuation, which must have an effective date no later than January 1, 2008, could be significantly different.

The supplementary plans are not funded, but are secured by Letters of Credit totalling \$159 million (2005 – \$138 million).

	Registered Pension Plan		Supplementary Pension Plans		Other Post Employment Benefits	
	2006	2005	2006	2005	2006	2005
<i>(millions of dollars)</i>						
<i>Reconciliation of Funded Status to Accrued Benefit Asset (Liability)</i>						
Funded status – deficit at end of year	(484)	(1,174)	(152)	(144)	(2,067)	(2,065)
Unamortized net actuarial loss	1,108	1,737	20	18	699	885
Unamortized past service costs	82	100	3	4	25	16
Accrued benefit asset (liability) at end of year	706	663	(129)	(122)	(1,343)	(1,164)
Short-term portion	-	-	(6)	(7)	(70)	(67)
Long-term portion	706	663	(123)	(115)	(1,273)	(1,097)

	Registered Pension Plan		Supplementary Pension Plans		Other Post Employment Benefits	
	2006	2005	2006	2005	2006	2005
<i>(millions of dollars)</i>						
<i>Components of Cost Recognized</i>						
Current service costs	212	163	6	7	71	47
Interest on projected benefit obligation	459	461	7	9	104	88
Expected return on plan assets net of expenses	(551)	(527)	-	-	-	-
Amortization of past service costs	18	18	1	1	4	3
Amortization of net actuarial loss	80	-	-	1	62	25
<b>Cost recognized</b>	<b>218</b>	<b>115</b>	<b>14</b>	<b>18</b>	<b>241</b>	<b>163</b>

	Registered Pension Plan		Supplementary Pension Plans		Other Post Employment Benefits	
<i>(millions of dollars)</i>	2006	2005	2006	2005	2006	2005
<i>Components of Cost Incurred and Recognized</i>						
Current service costs	212	163	6	7	71	47
Interest on projected benefit obligation	459	461	7	9	104	88
Actual return on plan assets net of expenses	(945)	(858)	-	-	-	-
Past service costs	-	-	-	-	13	1
Net actuarial loss (gain)	(155)	1,055	2	(9)	(124)	488
Cost incurred in year	(429)	821	15	7	64	624
Differences between costs incurred and recognized in respect of:						
Actual return on plan assets net of expenses	394	331	-	-	-	-
Past service costs	18	18	1	1	(9)	2
Net actuarial (gain) loss	235	(1,055)	(2)	10	186	(463)
Cost recognized	218	115	14	18	241	163

A one per cent increase or decrease in the health care trend rate would result in an increase in the service and interest components of the 2006 OPEB cost recognized of \$34 million (2005 – \$26 million) or a decrease in the service and interest components of the 2006 OPEB cost recognized of \$26 million (2005 – \$20 million), respectively. A one per cent increase or decrease in the health care trend rate would result in an increase in the projected OPEB obligation at December 31, 2006 of \$342 million (2005 – \$343 million) or a decrease in the projected OPEB obligation at December 31, 2006 of \$265 million (2005 – \$266 million).

## 12. FINANCIAL INSTRUMENTS

Contracts for all trading transactions are carried on the consolidated balance sheet as assets or liabilities at fair value, with changes in fair value recorded in trading revenue as gains or losses.

Fair values of derivative instruments have been estimated by reference to quoted market prices for actual or similar instruments where available. Where quoted market prices are not available, OPG considers various factors to estimate forward prices, including market prices and price volatility in neighbouring electricity markets, market prices for fuel, and other factors.

Forward pricing information is inherently uncertain so that fair values of the derivative instruments may not accurately represent the cost to enter into these positions. To address the impact of some of this uncertainty on trading positions, OPG established liquidity reserves against the mark-to-market gains or losses of these positions. During 2006, the liquidity reserve increased trading revenue by \$1 million (2005 – \$4 million).

### Derivative Instruments Used for Hedging Purposes

The following table provides the estimated fair value of derivative instruments designated as hedges. The majority of OPG's derivative instruments are treated as hedges, with gains or losses recognized upon settlement when the underlying transactions occur. OPG holds financial commodity derivatives primarily to hedge the commodity price exposure associated with changes in the price of electricity.

<i>(millions of dollars except where noted)</i>	<b>Notional Quantity</b>	<b>Terms 2006</b>	<b>Fair Value</b>	<b>Notional Quantity</b>	<b>Terms 2005</b>	<b>Fair Value</b>
Gain (loss)						
Electricity derivative instruments	<b>4.3 TWh</b>	<b>1-4 yrs</b>	<b>51</b>	4.1 TWh	1-2 yrs	(125)
Foreign exchange derivative instruments	<b>U.S. \$2</b>	<b>Jan/07</b>	-	U.S. \$15	Jan/06	-
Floating to fixed interest rate hedges	<b>45</b>	<b>1-12 yrs</b>	<b>(3)</b>	47	1-13 yrs	(3)
Forward start interest rate hedges	<b>622</b>	<b>1-14 yrs</b>	<b>(9)</b>	400	1-15 yrs	(7)

Foreign exchange derivative instruments are used to hedge the exposure to anticipated U.S. dollar denominated purchases. The weighted average fixed exchange rate for contracts outstanding at December 31, 2006 was U.S. \$0.87 (2005 – U.S. \$0.87) for every Canadian dollar.

One of the Company's joint ventures is exposed to changes in interest rates. The joint venture entered into an interest rate swap to manage the risk arising from fluctuations in interest rates by swapping the short-term floating interest rate with a fixed rate of 5.33 per cent. OPG's proportionate interest in the swap is 50 per cent and is accounted for as a hedge.

OPG entered into a number of forward start interest rate swap agreements to hedge against the effect of future interest rate movement based on the anticipated future borrowing requirement for the Niagara Tunnel and the Portlands Energy Centre projects. These transactions are accounted for as hedges.

### Derivative Instruments Not Used for Hedging Purposes

The carrying amount (fair value) of derivative instruments not designated for hedging purposes is as follows:

<i>(millions of dollars except where noted)</i>	<b>Notional Quantity 2006</b>	<b>Fair Value</b>	<b>Notional Quantity 2005</b>	<b>Fair Value</b>
Foreign exchange derivative	-	-	U.S. \$3	-
Commodity derivative instruments				
Assets	<b>3.9 TWh</b>	<b>25</b>	3.3 TWh	13
Liabilities	<b>2.6 TWh</b>	<b>(25)</b>	1.1 TWh	(37)
Liquidity reserve		-		(24)
		<b>(2)</b>		(3)
<b>Total</b>		<b>(2)</b>		<b>(27)</b>

Foreign exchange derivative instruments that were not designated as hedges had a weighted average exchange rate of U.S. \$0.85 as at December 31, 2005.

## Fair Value of Other Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued charges, Market Power Mitigation Agreement rebate payable, and short-term notes payable approximate their fair values due to the immediate or short-term maturity of these financial instruments. Fair values for other financial instruments have been estimated by reference to quoted market prices for actual or similar instruments where available.

The carrying values and fair values of these other financial instruments are as follows:

<i>(millions of dollars)</i>	<b>Carrying Value 2006</b>	<b>Fair Value</b>	<b>Carrying Value 2005</b>	<b>Fair Value</b>
Financial Assets				
Nuclear fixed asset removal and nuclear waste management funds	<b>7,594</b>	<b>8,113</b>	6,788	6,788
Long-term accounts receivable and other assets	<b>69</b>	<b>69</b>	61	61
Financial Liabilities				
Long-term debt due within one year	<b>406</b>	<b>409</b>	806	814
Long-term debt	<b>2,953</b>	<b>3,082</b>	3,089	3,267
Long-term accounts payable and accrued charges	<b>150</b>	<b>150</b>	183	183

## Credit Risk

Credit risk is the financial risk of non-performance by contractual counterparties. Credit risk excludes any operational risk resulting from a third party failing to deliver a product or service as expected. The majority of OPG revenues are derived from sales through the IESO administered spot market. However, OPG also derives revenue from several other sources including the sale of energy products and financial risk management products to third parties.

Credit exposure to the IESO fluctuates based on spot prices and the volume of rate regulated and unregulated generation, and is reduced each month upon settlement of the accounts. Credit exposure to the IESO peaked at \$1,029 million during the year ended December 31, 2006 and at \$1,146 million during the year ended December 31, 2005.

## 13. COMMON SHARES

As at December 31, 2006 and 2005, OPG had 256,300,010 common shares issued and outstanding at a stated value of \$5,126 million. OPG is authorized to issue an unlimited number of common shares without nominal or par value.

## 14. COMMITMENTS AND CONTINGENCIES

### Litigation

Various legal proceedings are pending against OPG or its subsidiaries covering a wide range of matters that arise in the ordinary course of its business activities.

In July 2004, OPG and two individual OPG employees were each charged with criminal negligence causing death and criminal negligence causing bodily harm in relation to a 2002 drowning accident at Barrett Chute. Further to a recent summary application by all three, OPG was acquitted of all charges on November 14, 2006. On December 18, 2006, the two employees were acquitted of all the remaining charges. The appeal period expired on January 18, 2007. Since no appeal was filed, the acquittals of OPG and its employees are considered final.

Certain First Nations have commenced actions for interference with reserve and traditional land rights. The claims by some of these First Nations total approximately \$50 million and claims by others are for unspecified amounts.

On August 9, 2006, a Notice of Action and Statement of Claim in the amount of \$500 million (the "Claim") was served on OPG and Bruce Power L.P. by British Energy Limited and British Energy International Holdings Limited ("British Energy"), claiming that OPG is liable to them for breach of contract and negligence. OPG leased the Bruce nuclear generating stations to Bruce Power L.P. in 2001. British Energy was an investor in Bruce Power L.P. In 2003, British Energy sold its interest in Bruce Power L.P. to a group of investors (the "Purchasers"). The Purchasers are claiming that British Energy is liable to them with respect to this purchase transaction. Their claim is currently the subject of an arbitration proceeding (the "Arbitration"). British Energy is therefore suing OPG in order to preserve any similar claim it may have against OPG pursuant to the 2001 lease transaction. British Energy has indicated that it does not require OPG to actively defend the Claim at this point in time as British Energy is defending the Arbitration commenced by the Purchasers. The Arbitration may narrow or eliminate the claims or damages British Energy has, so as to narrow or eliminate the need to continue the Claim against OPG. British Energy has reserved the right to require OPG to defend the Claim prior to the conclusion of the Arbitration should British Energy at some point believe there is some advantage of doing so.

Each of these matters is subject to various uncertainties. Some of these matters may be resolved unfavourably with respect to OPG and could have a significant effect on OPG's financial position. Management has provided for contingencies that are determined to be likely and are reasonably measurable.

### **Environmental**

OPG was required to assume certain environmental obligations from Ontario Hydro. A provision of \$76 million was established as at April 1, 1999 for such obligations. During the year ended December 31, 2006, expenditures of \$4 million (2005 – \$4 million) were recorded against the provision. As at December 31, 2006, the remaining provision was \$52 million (December 31, 2005 – \$56 million).

Current operations are subject to regulation with respect to air, soil and water quality and other environmental matters by federal, provincial and local authorities. The cost of obligations associated with current operations is provided for on an ongoing basis. Management believes it has made adequate provision in its consolidated financial statements to meet OPG's current environmental obligations.

### **Guarantees**

As part of normal business, OPG and certain of its subsidiaries and joint ventures enter into various agreements providing financial or performance assurance to third parties on behalf of certain subsidiaries. Such agreements include guarantees, standby Letters of Credit and surety bonds.

## Contractual and Commercial Commitments

The Company's contractual obligations and other significant commercial commitments as at December 31, 2006 are as follows:

<i>(millions of dollars)</i>	2007	2008	2009	2010	2011	Thereafter	Total
Contractual obligations:							
Fuel supply agreements	670	514	202	153	167	351	2,057
Contributions under the ONFA <sup>1</sup>	454	679	350	350	350	1,053	3,236
Long-term debt repayment	400	400	350	970	375	670	3,165
Interest on long-term debt	181	158	135	103	55	80	712
Unconditional purchase obligations	25	20	17	15	12	194	283
Long-term accounts payable	28	9	-	-	-	-	37
Operating lease obligations	10	9	11	10	10	123	173
Operating licence	16	17	17	17	18	-	85
Pension contributions <sup>2</sup>	268	-	-	-	-	-	268
Other	144	30	26	28	24	26	278
Significant commercial commitments:							
Niagara Tunnel	167	178	132	2	-	-	479
Lac Seul	24	-	-	-	-	-	24
Portlands Energy Centre	155	63	22	2	1	24	267
<b>Total</b>	<b>2,542</b>	<b>2,077</b>	<b>1,262</b>	<b>1,650</b>	<b>1,012</b>	<b>2,521</b>	<b>11,064</b>

<sup>1</sup> Contributions under ONFA are subject to adjustment due to the 2006 approved Reference Plan.

<sup>2</sup> The pension contributions include additional funding requirements towards the deficit and ongoing funding requirements in accordance with the actuarial valuation as at January 1, 2005, as well as a voluntary contribution of approximately \$20 million. The contributions are affected by various factors including market performance, changes in actuarial assumptions, plan experience, and the timing of funding valuations. Funding requirements after 2007 are excluded due to significant variability in the assumptions required to project the timing of future cash flows.

The Niagara Tunnel project will increase the amount of water flowing to existing turbines at OPG's Sir Adam Beck generating stations in Niagara, allowing the stations to utilize available water more effectively. On-site assembly of the tunnel boring machine was completed in September 2006 and boring of the tunnel commenced during the month. The intake configuration required the replacement of the existing accelerating wall and the installation of a cellular cofferdam, which were completed in 2006. Capital project expenditures for the year ended December 31, 2006 were \$161 million and life-to-date capital expenditures were approximately \$244 million. The project is debt financed through the Ontario Electricity Financial Corporation ("OEFEC").

OPG is constructing a new 12.5 MW hydroelectric generating station on the English River. The new Lac Seul generating station will utilize a majority of the spill currently passing the existing Ear Falls generating station, thus increasing the overall efficiency, capacity and energy generated from this location. A design-build contract was awarded and construction started during the first quarter of 2006. In 2006, the water conveyance tunnel, the tailrace channel excavation, and the intake cofferdam were completed. The powerhouse civil foundation and envelope was completed in January 2007. Major sub-assemblies have been delivered to the site and pre-installation work has started. Capital project expenditures for the year ended December 31, 2006 were approximately \$24 million and life-to-date capital expenditures were approximately \$27 million. OPG has negotiated the project's debt financing with the OEFEC.

OPG entered into a partnership with TransCanada Energy Ltd. ("TransCanada"), called Portlands Energy Centre L.P. ("PEC"), to pursue the development of a 550 MW gas-fired, combined cycle station on the site of the former R.L. Hearn generating station, near downtown Toronto. During the first quarter of 2006, the Province directed the OPA to negotiate an agreement with PEC for the purchase of electricity. PEC signed a 20-year Accelerated Clean Energy Supply ("ACES") contract with the OPA during the third quarter of 2006. PEC entered into a design-build contract for the construction of the facility, and

construction started in 2006. A significant proportion of the capital cost relates to this contract. OPG's share of capital project expenditures for the year ended December 31, 2006 as approximately \$97 million. OPG has negotiated financing for its share of the project with the OEFC.

#### *Other Commitments*

In addition to the above commitments, the Company has the following commitments:

The Company maintains labour agreements with the Power Workers' Union and The Society of Energy Professionals; the agreements are effective until March 31, 2009 and December 31, 2010, respectively. As of December 31, 2006, OPG had approximately 11,500 regular employees and approximately 90 per cent of its regular labour force is covered by the collective bargaining agreements.

Contractual and commercial commitments above exclude certain purchase orders as they represent purchase authorizations rather than legally binding contracts and are subject to change without significant penalties.

#### **Proxy Property Taxes**

In November 2005, OPG received a letter from the Ministry of Finance indicating its intent to recommend to the Minister of Finance that an Ontario regulation covering proxy property taxes be updated retroactive to April 1, 1999 to reflect reassessments and appeal settlements of certain OPG properties since that date. OPG continues to discuss resolution to this issue with the Ministry of Finance as updates to the regulation may not occur for several years. OPG has not recorded any amounts relating to this anticipated regulation change.

#### **15. TRANSITION RATE OPTION CONTRACTS**

Under a regulation known as Transition – Generation Corporation Designated Rate Options (“TRO”), OPG was required to provide transitional price relief since market opening to certain power customers for up to four years based on the consumption and average price paid by each customer during a reference period of July 1, 1999 to June 30, 2000. The TRO was treated as a hedge of generation revenue. The maximum anticipated volume subject to the transitional price relief was approximately 5.4 TWh in the first year after market opening and 3.6 TWh in the second year. The maximum anticipated volume in each of the third and fourth years is 1.8 TWh. The maximum length of the program was four years, which expired April 30, 2006.

The change in the TRO contracts provision for the years ended December 31, 2006 and 2005 is as follows:

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Provision, beginning of year	<b>12</b>	48
Decrease of provision during the year	<b>(12)</b>	(36)
Provision, end of year	-	12

#### **16. REVENUE LIMIT REBATE**

Eighty-five per cent of the generation output from OPG's unregulated generation assets, excluding the Lennox generating station and forward sales as of January 1, 2005, is subject to a revenue limit. The output from a generating unit where there has been a fuel conversion and the incremental output from a generating station where there has been a refurbishment or expansion of these assets is also excluded

from the output covered by the revenue limit. In addition, until the TRO contracts expired on April 30, 2006, volumes sold under such options were also excluded from the revenue limit rebate.

The revenue limit, which was originally established for a period of 13 months ending April 30, 2006, was subsequently extended for an additional three years. Starting May 1, 2006, the revenue limit decreased to 4.6¢/kWh from the previous limit of 4.7¢/kWh. On May 1, 2007, the revenue limit will return to 4.7¢/kWh and increase to 4.8¢/kWh effective May 1, 2008. In addition, beginning May 1, 2006, volumes sold under a Pilot Auction administered by the Ontario Power Authority (“OPA”) are subject to a revenue limit that is 0.5¢/kWh higher than the revenue limit applicable to OPG’s other generating assets. Revenues above these two revenue limits are returned to the IESO for the benefit of consumers.

The changes in the revenue limit rebate liability for the years ended December 31, 2006 and 2005 are as follows:

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Liability, beginning of the year	<b>739</b>	-
Increase to provision during the year	<b>161</b>	739
Payments made during the year	<b>(860)</b>	-
Liability, end of year	<b>40</b>	739

#### **17. MARKET POWER MITIGATION AGREEMENT REBATE**

Until April 1, 2005, OPG was required under its generating licence to comply with prescribed market power mitigation measures to address the potential for OPG to exercise market power in Ontario. The market power mitigation measures included both a rebate mechanism and the requirement to decontrol generating capacity. Under the rebate mechanism, a majority of OPG’s expected energy sales in Ontario were subject to an average annual revenue cap of 3.8¢/kWh. During the term of the Market Power Mitigation Agreement, OPG was required to pay a rebate to the Independent Electricity System Operator equal to the excess, if any, of the average hourly spot energy price over 3.8¢/kWh for a 12-month settlement period, multiplied by the amount of energy subject to the rebate mechanism. The Market Power Mitigation Agreement was replaced effective April 1, 2005 by regulated prices for the output from most of OPG’s baseload hydroelectric facilities and all of the nuclear facilities operated by OPG, and a revenue limit that applies to OPG’s unregulated generation assets.

In accordance with the Market Power Mitigation Agreement, the rebate was calculated after taking into account the amount of energy sales subject to the rebate mechanism for only those generating stations that OPG continues to control. Since the average hourly spot price during the three months ended March 31, 2005, when the rebate mechanism ended, exceeded the 3.8¢/kWh revenue cap, OPG provided \$412 million in 2005 as a Market Power Mitigation Agreement rebate.

The change in the Market Power Mitigation Agreement rebate liability for the year ended December 31, 2005 is as follows:

<i>(millions of dollars)</i>	<b>2005</b>
Liability, beginning of year	439
Increase to provision during the year	412
Payments	(851)
Liability, end of year	-

## 18. BUSINESS SEGMENTS

With the introduction of rate regulation effective April 1, 2005, OPG revised its reportable business segments to separately reflect the regulated and unregulated aspects of its business. In the first quarter of 2006, OPG separated the Unregulated Generation business segment into two reportable segments identified as Unregulated – Fossil-Fuelled and Unregulated – Hydroelectric, as a result of changes in the management structure of these segments. Results for the comparative periods have been reclassified to reflect the revised disclosure.

### Regulated – Nuclear Segment

OPG's Regulated – Nuclear business segment operates in Ontario, generating and selling electricity from the nuclear generating stations that OPG owns and operates. The business segment includes electricity generated by the Pickering A and B, and Darlington nuclear generating stations.

OPG's Regulated – Nuclear business segment includes revenue under the terms of a lease arrangement with Bruce Power related to the Bruce nuclear generating stations. The arrangement includes lease revenue, interest income and revenue from engineering analysis and design, technical and other services. The Regulated – Nuclear business segment also includes revenue earned from isotope sales and ancillary services. Ancillary revenues are earned through voltage control/reactive support. These earnings are included in the Regulated – Nuclear business segment since they were included in determining the regulated price for production from the nuclear facilities operated by OPG.

#### *Bruce Nuclear Generating Stations*

In May 2001, the Company leased its Bruce A and Bruce B nuclear generating stations to Bruce Power until 2018, with options to renew for up to 25 years.

Under the terms of the lease, OPG agreed to transfer certain fuel and material inventory to Bruce Power, in addition to certain fixed assets. Pension assets and liabilities related to the approximately 3,000 employees were transferred to Bruce Power. Bruce Power assumed the liability for other post employment benefits for these employees. OPG makes payments to Bruce Power in respect of other post employment benefits of approximately \$2.3 million per month over a 72-month period, ending in 2008.

As part of the closing, OPG recorded deferred revenue to reflect the initial payments of \$595 million less net assets transferred to Bruce Power under the lease agreement. The deferred revenue is being amortized over the initial lease term of approximately 18 years and is recorded as revenue.

In December 2002, British Energy plc. entered into an agreement to dispose of its entire 82.4 per cent interest in Bruce Power. The transaction was completed in February 2003 and a consortium of Canadian companies assumed the lease of the Bruce A and Bruce B nuclear generating stations that was formerly held by British Energy plc. The Bruce facilities will continue to be operated by Bruce Power. Upon closing of the transaction, the \$225 million note receivable was paid to OPG, and lease payments commenced to be paid monthly. Proceeds from the note are to be applied by March 2008 against OPG's funding requirements with respect to the nuclear fixed asset removal and nuclear waste management liabilities.

As part of the agreement reached in October 2005 between the Province and Bruce Power, OPG received a Shareholder Declaration from the Province instructing OPG's Board of Directors to accept certain amendments to the lease agreement. These amendments included a change to the provisions regarding the transfer of Bruce Power's interest in the site and included a reduction of the annual lease payment for three of the four refurbished Bruce A units to \$5.5 million per unit (in 2002 dollars, escalated at CPI), that will affect the three Bruce A units to be refurbished, once the planned future refurbishments are completed. These changes to the lease agreement will affect OPG when Units 1 and 2 of the Bruce A nuclear generating station are returned to service, and when Unit 3 is refurbished at the end of its current operational life. Other changes to the existing arrangements were made to address Cameco Corporation's decision not to participate in the refurbishment of the Bruce A nuclear generating station.

For 2004 through 2008, minimum payments under the lease are \$190 million annually, subject to limited exceptions. The lease revenue of \$251 million (2005 – \$244 million) was recorded in revenue. The remaining terms of the operating lease agreement will remain substantially unchanged until the planned future refurbishments are completed.

The net book value of fixed assets on lease to Bruce Power at December 31, 2006 was \$1,273 million (2005 – \$492 million). The net book value at December 31, 2006 includes the impact of the increase in the nuclear fixed asset removal and nuclear waste management liabilities relating to the Bruce units as a result of the new Reference Plan described in Note 9.

### **Regulated – Hydroelectric Segment**

OPG's Regulated – Hydroelectric business segment operates in Ontario, generating and selling electricity from most of OPG's baseload hydroelectric generating stations. The business segment is comprised of electricity generated by the Sir Adam Beck 1, 2 and Pump generating station, DeCew Falls 1 and 2, and the R.H. Saunders hydroelectric facilities. The Regulated – Hydroelectric business segment also includes ancillary revenues related to these stations earned through offering available generating capacity as operating reserve and through the supply of other ancillary services including voltage control/reactive support, certified black start facilities and automatic generation control.

### **Unregulated – Hydroelectric Segment**

The Unregulated – Hydroelectric business segment operates in Ontario, generating and selling electricity from its hydroelectric generating stations that are not subject to rate regulation. The Unregulated – Hydroelectric business segment also includes ancillary revenues earned through offering available generating capacity as operating reserve, and through the supply of other ancillary services including voltage control/reactive support, certified black start facilities and automatic generation control, and revenues from other services.

### **Unregulated – Fossil-Fuelled Segment**

The Unregulated – Fossil-Fuelled business segment operates in Ontario, generating and selling electricity from its fossil-fuelled generating stations, which are not subject to rate regulation. The Unregulated – Fossil-Fuelled business segment also includes ancillary revenues earned through offering available generating capacity as operating reserve, and through the supply of other ancillary services including voltage control/reactive support, automatic generation control, and revenues from other services.

### **Other**

OPG earns revenue from its joint venture share of the Brighton Beach related to an energy conversion agreement between Brighton Beach and Coral. In addition, the Other category includes revenue from real estate rentals.

The revenue and expenses related to OPG's trading and other non-hedging activities are also included in the Other category. As part of these activities, OPG transacts with counterparties in Ontario and neighbouring energy markets in predominantly short-term trading activities of typically one year or less in duration. These activities relate primarily to physical energy that is purchased and sold at the Ontario border, sales of financial risk management products and sales of energy-related products. All contracts that are not designated as hedges are recorded as assets or liabilities at fair value, with changes in fair value recorded in other revenue as gains or losses.

Operations, maintenance and administration ("OM&A") expenses of the generation business segments include an intersegment service fee for the use of certain property, plant and equipment of the Other category. The total service fee is recorded as a reduction to the Other category's OM&A expenses. For the year ended December 31, 2006, the service fee was \$25 million for Regulated – Nuclear, \$2 million for Regulated – Hydroelectric, \$3 million for Unregulated – Hydroelectric and \$9 million for Unregulated – Fossil-Fuelled, with a corresponding reduction in OM&A expenses of \$39 million for the Other category. Results of the comparative periods have been reclassified to reflect the service fee.

<b>Segment Income (Loss) for the Year Ended December 31, 2006</b> <i>(millions of dollars)</i>	<b>Regulated</b>		<b>Unregulated</b>			<b>Total</b>
	<b>Nuclear</b>	<b>Hydro-electric</b>	<b>Hydro-electric</b>	<b>Fossil-Fuelled</b>	<b>Other</b>	
Revenue before revenue limit rebate	2,665	685	780	1,430	165	5,725
Revenue limit rebate	-	-	(44)	(117)	-	(161)
	2,665	685	736	1,313	165	5,564
Fuel expense	122	245	88	643	-	1,098
Gross margin	2,543	440	648	670	165	4,466
Operations, maintenance and administration	1,967	92	189	524	5	2,777
Depreciation and amortization	343	66	69	133	53	664
Accretion on fixed asset removal and nuclear waste management liabilities	490	-	-	9	-	499
Earnings on nuclear fixed asset removal and nuclear waste management funds	(371)	-	-	-	-	(371)
Property and capital taxes	44	18	15	19	10	106
Income (loss) before impairment of long-lived assets	70	264	375	(15)	97	791
Impairment of long-lived assets	-	-	-	22	-	22
Income (loss) before interest, income taxes and extraordinary item	70	264	375	(37)	97	769

<b>Segment (Loss) Income for the Year Ended December 31, 2005</b> <i>(millions of dollars)</i>	<b>Regulated</b>		<b>Unregulated</b>			<b>Total</b>
	<b>Nuclear</b>	<b>Hydro-electric</b>	<b>Hydro-electric</b>	<b>Fossil-Fuelled</b>	<b>Other</b>	
Revenue before revenue limit and Market Power Mitigation Agreement rebates	2,607	857	1,000	2,399	86	6,949
Revenue limit rebate	-	-	(210)	(529)	-	(739)
Market Power Mitigation Agreement rebate	(160)	(65)	(58)	(129)	-	(412)
	2,447	792	732	1,741	86	5,798
Fuel expense	115	254	82	846	-	1,297
Gross margin	2,332	538	650	895	86	4,501
Operations, maintenance and administration	1,804	78	148	455	31	2,516
Depreciation and amortization	359	67	64	203	60	753
Accretion on fixed asset removal and nuclear waste management liabilities	467	-	-	9	-	476
Earnings on nuclear fixed asset removal and nuclear waste management funds	(381)	-	-	-	-	(381)
Property and capital taxes	30	18	15	39	5	107
Restructuring	-	-	-	4	6	10
Income (loss) before impairment of long-lived assets	53	375	423	185	(16)	1,020
Impairment of long-lived assets	63	-	-	202	-	265
(Loss) income before interest, income taxes and extraordinary item	(10)	375	423	(17)	(16)	755

<i>(millions of dollars)</i>	Regulated Nuclear	Hydro- electric	Unregulated Hydro- electric	Fossil- Fuelled	Other	Total
<b>Selected Balance Sheet Information</b>						
As at December 31, 2006						
Segment fixed assets in service, net	4,213	3,907	3,012	408	544	12,084
Segment construction work in progress	165	252	78	49	133	677
Segment property, plant and equipment, net	4,378	4,159	3,090	457	677	12,761
Segment materials and supplies inventory, net:						
Short term	63	1	-	48	-	112
Long term	320	-	3	3	-	326
Segment fuel inventory	183	-	-	486	-	669
As at December 31, 2005						
Segment fixed assets in service, net	3,016	3,963	3,031	484	570	11,064
Segment construction work in progress	140	91	45	47	25	348
Segment property, plant and equipment, net	3,156	4,054	3,076	531	595	11,412
Segment materials and supplies inventory, net:						
Short term	72	-	-	43	-	115
Long term	268	-	4	1	-	273
Segment fuel inventory	158	-	-	423	-	581
<b>Selected Cash Flow Information</b>						
Year ended December 31, 2006	173	171	81	71	141	637
Investment in fixed assets						
Year ended December 31, 2005	273	101	44	46	30	494
Investment in fixed assets						

## 19. RELATED PARTY TRANSACTIONS

Given that the Province owns all of the shares of OPG, related parties include the Province, the other successor entities of Ontario Hydro, including Hydro One Inc. ("Hydro One"), the IESO, and the OEFC. OPG also enters into related party transactions with its joint ventures. The transactions between OPG and related parties are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

These transactions are summarized below:

<i>(millions of dollars)</i>	Revenue 2006	Expenses	Revenue 2005	Expenses
Hydro One				
Electricity sales	34	-	40	-
Services	-	13	-	12
Settlement Transactions	-	-	-	27
Province of Ontario				
GRC water rentals and land tax	-	132	-	132
Guarantee fee	-	8	-	8
Used Fuel Fund rate of return guarantee	-	96	-	-
Decommissioning Fund excess funding	-	(7)	-	7
OEFC				
GRC and proxy property tax	-	205	-	207
Interest income on receivable	-	(29)	-	(75)
Interest expense on long-term notes	-	203	-	211
Capital tax	-	51	-	51
Income taxes	-	86	-	192
Indemnity fees	-	2	-	5
IESO				
Electricity sales	5,029	146	6,517	329
Market Power Mitigation Agreement rebate	-	-	(412)	-
Revenue limit rebate	(161)	-	(739)	-
Ancillary services	132	-	68	-
Other	1	1	-	-
	<b>5,035</b>	<b>907</b>	<b>5,474</b>	<b>1,106</b>

During 2006, OPG's Board of Directors approved the payment of a dividend to its shareholder, the Province. The declared dividend of \$128 million represents 35 per cent of OPG's 2005 net income and was paid in November 2006.

At December 31, 2006, accounts receivable included \$8 million (2005 – \$14 million) due from Hydro One and \$71 million (2005 – \$324 million) due from the IESO. Accounts payable and accrued charges at December 31, 2006 included \$2 million (2005 – \$2 million) due to Hydro One.

## 20. JOINT VENTURES

Significant joint ventures include Brighton Beach and PEC, which are 50 per cent owned by OPG (2005 – 50 per cent).

The following condensed information from the consolidated statements of operations, cash flows and balance sheets detail the Company's share of its investment in joint ventures and partnerships that has been proportionately consolidated:

<i>(millions of dollars)</i>	2006	2005
<b>Proportionate joint venture operations</b>		
Operating revenue	39	46
Operating expenses	(19)	(36)
Net income	20	10
<b>Proportionate joint venture cash flows</b>		
Operating activities	17	21
Investing activities	(109)	(2)
Financing activities	(6)	(4)
Share of increase in cash	(98)	15
<b>Proportionate joint venture balance sheets</b>		
Current assets	25	26
Long-term assets	379	279
Current liabilities	(25)	(11)
Long-term liabilities	(191)	(199)
Share of net assets	188	95

## 21. INVESTMENT COMPANY

The Company applied AcG-18 for all investments owned by OPGV. OPGV is a wholly owned subsidiary of the Company and its results are consolidated into the Company's financial statements. Since OPGV is the only enterprise in the group that satisfies the criteria set out in AcG-18, all other investments made by OPG and its subsidiaries, partnerships or joint ventures continue to be carried at amortized cost. The carrying amount of OPGV's investments was \$32 million (2005 – \$29 million) and the amount was included as long-term accounts receivable and other assets on the consolidated balance sheets.

As a result of the application of this policy, the Company's net income and other assets for 2006 increased by \$2 million (2005 – decreased by \$11 million). The net realized gains and losses for OPGV was \$1 million (2005 – \$ nil).

The gross unrealized gains and losses on the investment held by OPGV as at December 31, 2006 were \$5 million and \$14 million respectively. The gross unrealized gains and losses on the investment held by OPGV as at December 31, 2005 were \$2 million and \$13 million respectively.

## 22. RESEARCH AND DEVELOPMENT

For the year ended December 31, 2006, \$16 million (2005 – \$19 million) of research and development expenses were charged to operations.

**23. CHANGES IN NON-CASH WORKING CAPITAL BALANCES**

<i>(millions of dollars)</i>	<b>2006</b>	<b>2005</b>
Accounts receivable	<b>303</b>	(191)
Fuel inventory	<b>(88)</b>	(12)
Materials and supplies	-	(23)
Market Power Mitigation Agreement rebate payable	-	412
Revenue limit rebate payable	<b>161</b>	739
Accounts payable and accrued charges	<b>54</b>	10
Income and capital taxes payable	<b>47</b>	69
	<b>477</b>	1,004