

## Ontario Power Generation Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the financial condition and results of operations of Ontario Power Generation Inc. (the "Corporation") should be read in conjunction with the Consolidated Financial Statements and accompanying notes. The results reported herein have been prepared in accordance with accounting principles generally accepted in Canada and are presented in Canadian dollars.

### The Corporation

The Corporation is one of the largest electricity generators in North America with 69 hydroelectric, six fossil-fueled and five nuclear generating stations forming a complementary mix of generating assets. At December 31, 1999, total generating capacity of these stations was approximately 30,900 megawatts (MW), consisting of 7,300 MW of hydroelectric generation capacity, 9,700 MW of fossil-fueled generation capacity and 13,900 MW of nuclear generation capacity, of which 5,100 MW has been laid up.

The Corporation's principal business is the generation and sale of electricity in the Ontario wholesale market, with surplus electricity being sold in the interconnected markets of Quebec, Manitoba and the United States (U.S.) northeast and midwest. In 1999, the Corporation generated approximately 88 per cent of the electricity consumed in Ontario through its own generation and purchases from the interconnected market.

### Incorporation, Commencement of Operations and Acquisition of Business

The Corporation was incorporated on December 1, 1998, pursuant to the *Business Corporations Act* (Ontario). As part of the reorganization of Ontario Hydro and the related restructuring of the electricity industry in Ontario, the Corporation and its subsidiaries purchased and assumed certain assets, liabilities, employees, rights and obligations of the electricity generation business of

Ontario Hydro (the "Acquired Business") on April 1, 1999, and commenced operations on that date.

In consideration of the transfer of assets, liabilities, officers, employees, rights and obligations of the electricity generation business of Ontario Hydro, the Corporation issued to Ontario Electricity Financial Corporation (OEFC) notes payable in the aggregate principal amount of \$8,526 million, including a note in the principal amount of \$5,126 million (the "Equity Note") and assumed a capital lease obligation of Ontario Hydro in the amount of \$30 million on April 1, 1999. The Province has assumed all of the Corporation's obligations under the Equity Note and OEFC has released the Corporation from its obligations thereunder and in connection therewith the Corporation issued to the Province 256,300,000 common shares as fully paid and non-assessable shares. OEFC has agreed that without the consent of the Corporation, it will not sell its \$3,400 million of notes of the Corporation. The Corporation's long term debt on April 1, 1999 was \$3,430 million.

The Corporation has recorded the purchase of the Acquired Business at its fair value as of April 1, 1999, as follows:

<i>(millions of dollars)</i>	FAIR VALUE AS AT APRIL 1, 1999
<b>Assets</b>	
Current assets	1,465
Fixed assets	12,872
Other assets	598
	14,935
<b>Liabilities</b>	
Current liabilities	1,073
Liabilities and capital leases	5,336
	6,409
<b>Net assets acquired</b>	8,526

The purchase price of \$8,526 million was determined based on the present value of estimated future operating results and cash flows of the Acquired Business in a deregulated market. The purchase of the Acquired Business from the related party, OEFC, was recorded at the exchange amount of \$8,526 million in view of the substantive change in ownership interests arising from the transaction. The aggregate value of the net assets acquired was allocated to assets and liabilities based on their estimated fair values.

As part of the restructuring of the Ontario electricity industry, four other successor entities were created in addition to the Corporation. The other successor companies were:

- Ontario Hydro Services Company (“OHSC”), the successor to Ontario Hydro’s transmission, distribution and energy services businesses;
- the Independent Electricity Operator (“IMO”), the independent electricity system coordinator responsible for directing the operation of Ontario’s electricity system;
- the Electrical Safety Authority (“ESA”), which carries out the electrical equipment and electrical wiring installation inspection functions; and
- OEFC, responsible for managing Ontario Hydro’s outstanding debt and other obligations until they are retired.

#### Industry Restructuring

The restructuring of Ontario’s electricity industry is being accomplished in two stages. The first stage, the Transition Period, began on April 1, 1999, with the successor entities to Ontario Hydro commencing operations and will end with the opening of access to the electricity transmission and distribution systems in Ontario. The second stage, Open Access, is scheduled to begin in November 2000. The Ontario electricity industry will

continue to operate during the Transition Period generally as it has in the past from the perspective of the customers. After Open Access, there will be significant changes in the way the industry operates. All consumers will have access to the electricity supplier of their choice. Ontario’s electricity generators will compete with generators and suppliers from both within and outside Ontario to sell electricity in the Ontario wholesale market.

During the Transition Period, the average electricity prices charged to customers remain fixed and customers are billed on a bundled basis. The Corporation receives the bundled payments and distributes the funds to the successor entities of Ontario Hydro under the terms of revenue allocation arrangements. The revenue allocation arrangements provide relatively fixed amounts to the other successor businesses. The revenue allocation arrangements were designed so the undistributed balance of funds would provide the Corporation with planned revenue of 4¢/kilowatt-hour (kWh) based on forecast energy demand and customer mix, together with a fixed amount for ancillary services provided during the year. Changes in forecast demand and customer mix will vary the Corporation’s actual revenue per kWh.

In order to ensure an orderly and gradual transition to a competitive electricity industry after Open Access, the Province has adopted a framework for market power mitigation designed to address issues regarding the Corporation’s market position in Ontario. Under this framework, the Corporation must reduce its control over specified sources of electricity generating capacity. The Corporation must relinquish effective control of at least 4,000 MW of fossil-fueled generating capacity within 42 months of Open Access, with the option of substituting up to 1,000 MW of hydroelectric generating capacity for an equal amount of fossil-fueled generating capacity.

#### Financial Highlights

	PRO FORMA YEAR ENDED		
	APRIL 1 TO DECEMBER 31 1999	1999	1998
<i>(millions of dollars except as noted)</i>			
Revenues	4,339	5,796	5,585
Operating income	750	1,011	1,211
Net income	326	446	813
Electricity sales volume (TWh)	102.0	136.9	131.7

Within 10 years of Open Access, the Corporation must reduce its effective control over the generation capacity available to the province to no more than 35 per cent. In addition, under an average annual price cap mechanism that is scheduled to be applicable for the first 48 months after Open Access, the Corporation will have to pay rebates to the IMO on approximately 105 TWh per year of its expected energy sales in Ontario if the average annual spot market price for wholesale electricity exceeds 3.8¢/kWh.

#### Financial Highlights

Since commencing operations on April 1, 1999, the Corporation earned a net income of \$326 million based on revenues of \$4,339 million. Total volume of electricity sales in the Ontario and interconnected markets during the nine months ended December 31, 1999, was 102.0 terawatt-hours (TWh).

On a pro forma basis, which reflects the results of operations as if the purchase of net assets had occurred on January 1, 1999, and January 1, 1998, respectively, the net income for 1999 was \$446 million compared with \$813 million in 1998. Although volumes and revenue increased in 1999 over 1998, net income decreased due to the one-time recognition in 1998 of income from a deferred pension asset and an increase in operation, maintenance and administration ("OM&A") expenses in 1999 related to the nuclear recovery program and other initiatives.

#### Analysis of Operating Results

The following section provides an analysis of the operating results for the Corporation since commencing business on April 1, 1999, and a discussion of operating results for 1999 compared with 1998 on a pro forma basis.

The financial position, results of operations and cash flows presented in the Corporation's Consolidated Financial Statements as at dates and for periods prior to April 1, 1999, represent all assets, liabilities, rights and obligations of Ontario Hydro pertaining to the Acquired Business now conducted by the Corporation. These financial statements have been prepared through specific identification of assets, liabilities (other than debt), revenues and expenses relating to the Acquired Business, and through an allocation of certain common financial statement accounts and items of Ontario Hydro. In particular, a portion of Ontario Hydro's revenues and debt, and a corresponding portion of related interest and other financial expenses, have been allocated to the Acquired Business.

#### Operating Results for Nine Months

Ended December 31, 1999

<i>(millions of dollars)</i>	NINE MONTHS ENDED DECEMBER 31, 1999
<b>Revenues</b>	4,339
<b>Operating expenses</b>	
Operation, maintenance and administration	1,791
Fuel	816
Power purchased	153
Depreciation and amortization	573
Property and capital taxes	256
	<u>3,589</u>
<b>Operating income</b>	750
Interest expense	135
Income taxes	289
<b>Net income</b>	<u>326</u>

#### Revenues

Revenues consist of energy sales in Ontario and interconnected markets and non-energy revenues. Total revenues for the nine-month period ended December 31, 1999, were \$4,339 million.

Ontario energy revenues are earned from the generation and sale of electricity to the wholesale market. Customers in Ontario include 237 municipal electric utilities ("MEUs") that in turn serve more than 3 million customers, 101 large direct industrial customers and OHSC, which serves a further 930,000 customers. Ontario energy revenues amounted to \$4,044 million for the nine-month period based on electricity sales of 97.9 TWh. The Corporation earned 4.05¢/kWh, an increase over the planned revenue of 4¢/kWh for energy delivered to Ontario customers as a result of changes in forecast demand and customer mix.

Revenues to interconnected markets totaled \$212 million during the nine months ended December 31, 1999, based on sales of 4.1 TWh. The average sales price during the nine-month period was 5.17¢/kWh.

Non-energy revenues totaled \$83 million. This included

sales of engineering and technical expertise (\$41 million), heavy water and by-product sales such as flyash, cobalt and other nuclear isotopes (\$15 million), and the sale of services to the other successor entities to Ontario Hydro in respect of facility and space management, information technology and other support services (\$27 million).

#### *Operating Expenses*

OM&A expenses consist of labour, materials and administrative support. OM&A expenses were \$1,791 million for the nine months ended December 31, 1999. The expenses included base operating programs for the day-to-day operation of the generating facilities (\$1,056 million), programs to manage outages within nuclear generation (\$92 million) and improvement projects that represent incremental expenditures to repair or improve various operations within the generating stations (\$277 million). Corporate and administrative costs of \$367 million reflected a number of functional programs required for managing the Corporation's operations as well as a variety of business services on behalf of the generating plants that are managed centrally.

Fuel comprises the costs for coal, uranium, oil, water rental payments and a provision for used nuclear fuel disposal based on actual fuel consumed. Total fuel costs, for the nine months ended December 31, 1999, were \$816 million.

Power purchase costs represent electricity purchases from interconnected markets. During the nine months ended December 31, 1999, \$153 million of power was purchased from interconnected utilities. These purchases supported both Ontario sales and those to other interconnected markets.

The depreciation and amortization expense includes depreciation of fixed assets in service based on their estimated service lives, and a charge related to the increase in the accrued costs for low- and intermediate-level waste from waste produced during the period. The depreciation and amortization expense related to these items was \$408 million for the nine months ended December 31, 1999. The depreciation and amortization expense also includes revalorization, a charge that reflects the effect of inflation on cost estimates and the time value of money effect on future obligations when provisions for future fixed asset removal and used nuclear waste disposal costs are updated each year in the balance sheet to reflect the

net present value of the liability. The revalorization charge is offset by a revalorization credit that reflects the growth of segregated funds set aside to discharge these obligations. The revalorization charge is sensitive to movements in both interest and escalation rates. The revalorization charge for the nine months ended December 31, 1999, was \$165 million.

The Corporation is required to make payments in lieu of property and school taxes on its generating assets representing the amount it would be required to pay if the assets were privately owned. These property taxes and the actual capital taxes amounted to \$256 million for the nine months ended December 31, 1999.

#### *Interest Expense*

Interest expense represents interest and other financing costs associated with the Corporation's debt. Interest charged to operations represents the gross interest costs reduced by capitalized interest and interest earned on short-term investments. Interest expense for the nine months ended December 31, 1999, was \$135 million. The interest expense was offset by interest earned of \$10 million and interest capitalized of \$11 million.

#### *Income Taxes*

The Corporation is currently exempt from taxation under the *Income Tax Act* (Canada) and *Corporations Tax Act* (Ontario). However, the Corporation is required to make payments to OEFC in lieu of federal and provincial income taxes. These payments are calculated in accordance with the rules and other related provisions contained in the federal and provincial tax legislation and the regulations made under the *Electricity Act, 1998*. The income tax expense amounted to \$289 million for the nine months ended December 31, 1999.

#### **Pro Forma Operating Results for the Years Ended December 31, 1999 and 1998**

A summary of the pro forma statements of income for the years ended December 31, 1999 and 1998, as disclosed in Note 17 of the Consolidated Financial Statements, is presented below. The historical results prior to April 1, 1999, have been restated to reflect the acquisition-related adjustments including the allocation of the acquisition price to the assets and liabilities of the generation business of Ontario Hydro.

The Corporation believes that the historical results

of operations and financial position as at dates and for the periods prior to April 1, 1999, as reflected in the Consolidated Financial Statements, would have been different if the Corporation had operated as a stand-alone corporation with its own management and capital structure, rather than a business unit of Ontario Hydro. These financial results relate to operations in a different business environment from that which began on April 1, 1999, including a significantly modified regulatory system and a new capital structure.

To enhance comparability between reporting periods, the pro forma statements of income have been prepared for the years ended December 31, 1999, and December 31, 1998. These pro forma statements of income reflect the purchase of the Acquired Business as if the purchase of net assets had occurred on January 1, 1999, and January 1, 1998. The pro forma results are not necessarily indicative of the results that would have occurred had the transactions occurred on the relevant dates because of the significant changes in the regulatory

environment, financing and other factors. As well, the pro forma results may not be fully indicative of the Corporation's future financial performance.

Some of the more significant effects of the purchase that occurred on April 1, 1999, included the following:

- Revenues for electricity sales in Ontario were reduced to reflect the revenue allocation arrangements for the Transition Period.
- The method of accounting for the acquisition of the Acquired Business, which resulted in recording assets and liabilities at fair value, has resulted in a significant change in values of the assets and liabilities.
- There is a large reduction in operating expenses due to lower depreciation and amortization arising from a significantly reduced fixed asset valuation.
- Interest expense is considerably lower due to the significant reduction in debt financing.
- The Corporation will bear an income and capital tax burden that the previous business, operating in a rate-regulated environment, did not incur.

	<b>PRO FORMA (unaudited)</b>	
	1999	1998
<i>(millions of dollars)</i>		
<b>Revenues</b>	5,796	5,585
<b>Operating expenses</b>		
Operation, maintenance and administration	2,365	2,086
Fuel	1,116	1,031
Power purchased	198	175
Depreciation and amortization	765	734
Property and capital taxes	341	348
	4,785	4,374
<b>Operating income</b>	1,011	1,211
Interest expense	180	196
Income from deferred pension asset	—	(487)
Income taxes	385	689
<b>Net income</b>	446	813

### *Net Income*

The pro forma net income for 1999 was \$446 million compared with \$813 million in 1998. The decrease in earnings from 1998 was primarily due to income from a deferred pension asset that was recognized in 1998 as a result of a change in legislation and an increase in OM&A expenses in 1999 related to the nuclear recovery program and other initiatives.

### *Revenues*

Total revenues for 1999 were \$5,796 million compared with \$5,585 million in 1998, an increase of \$211 million. Of the total, Ontario revenues were \$5,446 million (1998: \$5,248 million), interconnected market revenues were \$233 million (1998: \$148 million) and non-energy revenues amounted to \$117 million (1998: \$189 million).

Ontario revenues in 1999 were \$5,446 million compared with \$5,248 million in 1998, an increase of \$198 million. The increase in revenues was due to a higher volume of electricity sales (\$150 million) and a slightly higher average revenue rate related to changes in forecast demand and customer mix in 1999 (\$48 million). Total sales of electricity in Ontario of 132.4 TWh increased by 3.7 TWh over 1998 due primarily to the warmer than normal weather in the summer of 1999, which resulted in a higher electricity demand for air conditioning, and generally a healthier economic climate. The average price was 4.04¢/kWh compared with the planned revenue of 4¢/kWh.

Revenues to interconnected markets were \$233 million in 1999 compared with \$148 million in 1998, an increase of \$85 million. The increase in interconnected revenue was due to higher interconnected sales volumes (\$76 million) and slightly higher prices (\$9 million). The interconnected sales volumes in 1999 were 4.5 TWh, an increase of 1.5 TWh over 1998. The increase in sales volumes was due primarily to warmer than normal weather and supply shortages in these markets. The average sales price in 1999 was 5.18¢/kWh compared with 4.93¢/kWh in 1998.

Non-energy revenues for 1999 were \$117 million compared with \$189 million in 1998, a decrease of \$72 million. The decrease was due primarily to a reduction in external engineering service revenues (\$60 million) since technical expertise was required in-house on a number of improvement initiatives and strategic projects such as the restart of the Pickering A Nuclear Generating Station. In addition, there were significant heavy water

sales in 1998 that were not repeated in 1999 given reduced market conditions (\$22 million).

### *Operating Expenses*

OM&A costs in 1999 were \$2,365 million compared with \$2,086 million in 1998, an increase of \$279 million. The increase was due primarily to higher expenditures related to the nuclear outages and the nuclear recovery program (\$90 million), higher project-related costs (\$145 million) which include the Pickering A restart, an increase in employee costs related to bonus, gainsharing and salary increases (\$100 million), higher operating and maintenance costs related to a 6 per cent increase in generating activity for fossil-fueled operations (\$15 million) and the establishment of a commercial operations function in preparation for Open Access (\$12 million). Offsetting these increases was a reduction in OM&A expenses due to lower legal claims (\$110 million).

Fuel costs during 1999 were \$1,116 million compared with \$1,031 million in 1998, an increase of \$85 million. The increase in costs was due to higher power generation in nuclear (1.5 TWh), fossil-fueled (1.9 TWh) and hydroelectric (1.7 TWh) facilities.

Power purchase costs represent electricity purchases from interconnected markets. Purchased power costs in 1999 were \$198 million compared with \$175 million in 1998, an increase of \$23 million. The volume of power purchases was relatively constant for the two years. Escalating prices (\$17 million) were the primary cause of the increase in 1999.

Depreciation and amortization charged to operations in 1999 was \$765 million compared with \$734 million in 1998, an increase of \$31 million. The increase was due to a higher fixed asset base in 1999 resulting from asset additions. The revalorization charge was relatively constant at \$223 million in 1999 compared with \$222 million in 1998.

Property and capital taxes in 1999 remained relatively unchanged at \$341 million compared with \$348 million in 1998.

### *Interest Expense*

Interest expense in 1999 was \$180 million compared with \$196 million in 1998, a decrease of \$16 million. Higher investment income on short term investments accounted for most of the decrease in interest expense.

### *Income from Deferred Pension Asset*

The income from deferred pension asset for the year

ended December 31, 1998, was based on an actuarial determination of Ontario Hydro's deferred pension asset. As a result of changes in legislation that allowed the Corporation to recognize the surplus in the pension fund, the deferred pension asset was adjusted with a corresponding credit to operations. The total amount that was recognized in the operating statement for Ontario Hydro for the year ended December 31, 1998, was \$887 million. The amount of \$487 million represents the proportion applicable to the Acquired Business based on the actual number of employees and retirees out of the total number of employees and retirees of Ontario Hydro.

#### *Income Taxes*

Income tax expense was \$385 million in 1999 compared with \$689 million in 1998. The decrease in the income tax expense in 1999 was due primarily to lower pre-tax earnings in 1999, in part related to the deferred pension asset income effect.

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

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

The Corporation's nuclear facilities commenced production in the early 1970s. In the initial years, Ontario Hydro made no provisions in its accounts to reflect the estimated future costs of its nuclear waste management and asset removal costs. Commencing in 1982, Ontario Hydro began collecting provisions through its rates in amounts that, together with interest accumulated on provision balances, were calculated to cover all such future liabilities. The funds collected from customers with respect to these provisions totaled \$2,344 million as at December 31, 1998. These funds were not placed in a segregated fund, but were used for general corporate purposes and therefore reduced Ontario Hydro's borrowing requirements.

Effective April 1, 1999, as a result of the purchase, the Corporation recognized a liability equal to the total present value of the costs of dismantling the nuclear and fossil-fueled production facilities at the end of their useful lives, the fixed-cost portion of any nuclear waste management programs and the variable-cost portion of any nuclear waste management program to account for

actual waste volumes incurred up to April 1, 1999. At December 31, 1999, the liability for nuclear waste management and asset removal was \$6,715 million (nuclear \$6,591 million; non-nuclear \$124 million).

On April 1, 1999, the Province agreed that the Province or its agent would fund certain nuclear waste management and asset removal liabilities that were incurred prior to April 1, 1999. The particulars of which liabilities are to be funded are currently under discussion with the Province. The balance of the provincial contribution of \$2,480 million represents the Province's liability of \$2,378 million as at April 1, 1999, as well as interest in the amount of \$102 million accrued during the nine months ended December 31, 1999, based on a rate of 5.75%. The interest rate is still under negotiation with the Province and is subject to change. The impact of the finalization of the interest rate for 1999 is not expected to result in a material difference to the liability balance.

#### **Segregated Funds**

The Corporation is contributing to segregated funds to provide for or discharge the remaining unfunded nuclear liabilities. It is the Corporation's intent that these funds be held outside of the Corporation and be used solely for nuclear waste remediation and nuclear fixed asset removal. Until such time as the legal nature of the segregated funds can be established, the Corporation has set these funds aside internally and is managing their investment and growth distinct from its other cash holdings. These funds amount to \$367 million at December 31, 1999.

#### **Nuclear Risk Sharing**

The Corporation and senior staff at the Ontario Ministry of Finance have reached an understanding on key principles for the development of a nuclear risk-sharing agreement. In order to implement these principles, it will be necessary to successfully negotiate a definitive agreement and obtain the necessary authorizations from the Province, including any necessary Orders in Council. The Province or its agent would provide a risk-sharing cap on certain nuclear waste management costs in the event that the estimated present value of these costs were to exceed certain thresholds. Execution of this agreement would effectively limit the Corporation's exposure to significant increases in the estimated present value costs of nuclear waste management.

### Waste Management Organization

As a future risk mitigation measure, the Corporation has held discussions with both the Province and the federal government regarding the establishment of a Waste Management Organization (“WMO”) to manage all future operating expenditures for the life cycle management of nuclear waste. The WMO would have participation from nuclear waste producers across Canada and operate separately from the Corporation. The WMO would receive operating capital in part from the segregated funds set aside by the Corporation. Operation of the WMO outside of the Corporation would have the benefits of centralization of technical and management skills, would aid in the development of Canada-wide solutions to nuclear waste issues and would be in line with corporate structures adopted across the world for management of radioactive wastes.

### Nuclear Recovery Program

A comprehensive nuclear recovery plan was developed in the fall of 1997 by Ontario Hydro. The nuclear recovery plan is designed to improve the operating performance of the nuclear generating stations. Planned expenditures are approximately \$1,700 million on the nuclear recovery plan over the period from 1997 to 2004. Spending on the nuclear recovery program was \$308 million during the 1999 year and \$238 million in 1998. The planned expenditures on these projects are projected to total \$334 million in 2000. The projects within the nuclear recovery program include standardizing operations and implementing initiatives to improve accountability, management and operational control systems, maintenance and inspection programs, regulatory compliance, performance standards and employee training.

Under the nuclear recovery plan, the Pickering A Nuclear Generating Station was placed in short term lay-up on December 31, 1997, and the Bruce A Nuclear Generating Station was placed in longer-term lay-up on March 31, 1998. This allowed the Corporation to focus its initial recovery efforts on the remaining 12 nuclear generating units of Darlington, Pickering B and Bruce B.

With the staffing, planning and execution of the recovery program well under way, attention is now focused on returning Pickering A to service. The current plans call for the return to service of the four Pickering A units at approximately six-month intervals commencing in the fourth quarter of 2001. The Corporation has been

advised by the staff of the Atomic Energy Control Board (“AECB”) that an environmental assessment is required before the AECB will allow a restart at Pickering A. The Corporation anticipates the review procedure to be completed in October 2000.

### Liquidity and Capital Resources

The Corporation’s primary sources of liquidity are funds generated from operations and a short term credit facility with certain Canadian chartered banks. Sufficient cash was generated from operations in 1999 to finance working capital requirements and investment in fixed assets. In the future, the Corporation expects to seek external sources of capital such as debt capital market borrowings to obtain funds required to carry out its capital program and refinance its existing debt.

The Corporation has arranged a credit facility for \$600 million with certain Canadian chartered banks (“Bank Credit Agreement”) to fund working capital requirements and for general corporate purposes. This facility may be drawn upon in either Canadian or U.S. dollars at varying rates based on certain benchmark rates, including a prime rate, a bankers’ acceptance rate and a LIBOR rate. This facility became effective on September 1, 1999. Prior to September 1, 1999, the Corporation had negotiated a temporary credit agreement with the OEFC whereby it could borrow from OEFC on substantially the same financial terms and conditions as those in the Bank Credit Agreement.

The Corporation’s debt of \$3,430 million, issued as part of the April 1, 1999, transaction, consists of \$2,650 million of senior notes due in the years 2001 to 2009, \$750 million of subordinated notes due in the years 2010 and 2011 and a \$30 million capital lease obligation. Certain covenants applicable to public debt issued by the Corporation in the future will automatically become applicable to the notes.

Cash provided from operations during the nine months ended December 31, 1999, amounted to \$549 million. This cash, together with the opening cash position of \$146 million at April 1, 1999, financed investments in fixed assets of \$450 million and dividend payments of \$35 million.

The Corporation invests in fixed assets to improve operating efficiencies, increase generating capacity and maintain service, reliability, safety and environmental

performance. The investment in fixed assets of \$450 million for the nine months ended December 31, 1999, compared with \$38 million in the first quarter of 1999 and \$486 million during the year ended December 31, 1998.

The Corporation's planned capital expenditures for 2000 are \$650 million. This amount includes sustaining capital expenditures to support the continued operations of current generating capacity and capital expenditures to expand generating capacity. Sustaining capital for nuclear operations represents approximately two-thirds of the expected capital spending in 2000. Capital expenditures designed to increase generating capacity include amounts to prepare for the restart of Pickering A station.

## **Risk Management**

### **Overview**

The Corporation's risk management activities involve identifying, assessing and controlling the risk of loss. The Board of Directors approves all risk management policies prior to implementation. The Corporation annually undertakes an assessment of its risk exposures in order to characterize such exposures and the effects of risk management activities, including avoidance, reduction, transfer and substitution. Executive management and the Board of Directors review the Corporation's residual exposure to ensure it is consistent with overall strategy and corporate risk tolerance levels.

### **Industry Restructuring**

Elements of the restructuring of Ontario's electricity industry are still in a state of transition. The Province is developing regulations and the IMO is developing Market Rules that will govern the competitive wholesale and retail electricity markets. In addition, the Minister of Energy, Science and Technology, the Minister of Finance and the Ontario Energy Board ("OEB") are continuing to assess and develop policy positions on various matters that could significantly affect the Corporation, including transmission tariff design, the competition transition charge, new inter-tie capacity and congestion pricing structures.

### **Nuclear Recovery Program**

An important element underlying the Corporation's commercial and financial success over the next five years is improved nuclear performance. The Corporation's expectation of improving financial performance is

dependent on increasing production of low-cost nuclear energy to compete in Ontario and the interconnected markets. This includes the return to service of the Pickering A Nuclear Generating Station. The successful implementation of the nuclear recovery program will depend on many factors, including the discovery of any unanticipated deficiencies or greater than anticipated deterioration to its nuclear generating assets, material changes to the current regulatory structure governing nuclear generation, the ability to hire and retain qualified personnel, the ability to increase productivity and the ability to implement management and operational changes.

The nuclear recovery program includes a rigorous framework for managing risks associated with nuclear operations and processes. This framework addresses the major risk areas, related exposures and impacts, and mitigation strategies in the nuclear business.

### **Environmental Compliance**

The Corporation is committed to meeting all applicable environmental legislative requirements and voluntary environmental commitments. The Corporation's environmental policy involves pollution prevention, continuous environmental improvement, reduction of resource use and efficiency improvements. The Corporation routinely undertakes environmental compliance audits.

The Corporation has set and achieved an international standard for environmental management systems. All of the Corporation's nuclear and fossil-fueled stations and its major hydroelectric station groups have been ISO 14001 registered. Registration means that the stations have put in place a comprehensive program to ensure that they are operated in an environmentally responsible way and that environmental performance is continually improved. Regulatory requirements and terms and conditions issued through environmental legislation, regulations, orders, certificates of approval and permits are managed through the Corporation's environmental management systems.

### **Financial Market Risks**

The Corporation's exposure to interest rates is limited by the fixed rates on its long-term debt. Interest rate risk will arise with the need to undertake new financing and with the addition of any variable rate debt. The management of these risks will be undertaken by selectively hedging in accordance with corporate risk management policies.

To the extent practical and economical, the interest rates for future financing requirements may be hedged using derivative instruments. The Corporation's foreign exchange risk exposure is attributable primarily to U.S. dollar denominated transactions such as the purchase of fossil fuel and the purchase and sale of electricity in the U.S. The Corporation manages this exposure by periodically hedging its U.S. dollar cash flows according to approved risk management policies. The Corporation manages counterparty credit risk by monitoring and limiting its exposure to counterparties with lower credit ratings, by evaluating its counterparty credit exposure on an integrated basis and by performing periodic reviews of the credit worthiness of all counterparties, including obtaining credit security for all transactions beyond approved limits.

#### **Year 2000 Readiness**

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The Corporation completed a significant program that upgraded or replaced affected systems on which it and its customers depend, prior to the year 2000. With the change in date, there have been no system failures affecting the Corporation's ability to conduct normal business operations and financial reporting. In addition, there have been no such system failures with the passing of the February 29, 2000, date. Although the changes in dates have occurred, it is not possible to conclude that all aspects of the Year 2000 Issue that may affect the Corporation, including those related to customers, suppliers or other third parties, have been fully resolved.

#### **Market Outlook**

The Corporation's vision is to be a premier North American energy company, building on its strengths in low-cost generation and wholesale energy sales. The Corporation's initial focus will be primarily in Ontario's electricity marketplace, supplying electricity to wholesale and other large customers. Over time, the Corporation plans to selectively expand into regional markets, particularly in the U.S. northeast and midwest,

and will consider other growth opportunities.

In the short term, the Corporation will concentrate on increasing productive capacity and improving the competitiveness of its generation assets, in particular through its nuclear recovery program. As well, the Corporation will focus on identifying and developing the market capabilities necessary to maximize customer relationships and enhance the products and services it provides, as well as expanding the markets for its energy and related products and services. Over the medium to longer term, the Corporation will explore opportunities to purchase generation assets or output or enter into other business ventures in the regional market or elsewhere. The Corporation will also explore regional marketing alliances, convergence opportunities and public-private partnerships.

The Corporation's ability to compete in the U.S. interconnected markets will depend upon numerous factors, including the pace of regulatory restructuring, the level of access to these markets (e.g., Federal Energy Regulatory Commission licences), limitations imposed by interconnection transmission capacity, the applicability of environmental and other regulations, electricity transmission costs and the price of electricity in these markets.

#### **Open Access and the Wholesale Market**

Open Access, scheduled for November 2000, will result in significant changes in the way the industry operates that will have major impacts on the Corporation. All Ontario electricity consumers will have access to the electricity supplier of their choice. Ontario's electricity generators will compete with generators and suppliers from both within and outside Ontario to sell electricity in the Ontario wholesale market. Wholesale market participants will buy and sell electricity either through the IMO-administered spot market or through bilateral contracts, which represent agreements between two market participants to buy and sell electricity. The IMO will dispatch generators based on their bids for each hour and the amount of demand in the market. The selling price of electricity for a time period will be determined by the last bid accepted by the IMO to satisfy demand in that time period.

The Corporation is subject to an average annual price cap mechanism on approximately 105 TWh per year of its expected energy sales in Ontario for the first 48 months after Open Access. OPG will be required to pay rebates to the IMO, for rebate to its customers, if the

average annual spot market price for wholesale electricity exceeds 3.8¢/kWh. Hence, the Corporation will focus on competitively supplying electricity to wholesale and other large customers in Ontario and selectively expanding its activities in the U.S. and other interconnected markets.

The Corporation expects competitive pressures in the Ontario market to come from generation by independent power producers in Ontario, self-generation by wholesale customers, imports of electricity from the interconnected markets and aggregators, brokers and marketers that offer new products and services. An important aspect of the marketplace is the extent to which new generation is built in Ontario. At expected price levels and existing technological capabilities, it is unlikely that significant additional generating capacity will be constructed before 2002. The extent to which generating capacity is constructed thereafter will depend on a number of factors, including actual and anticipated price levels for electricity and natural gas, the ability of parties to structure economic transactions, technological advances and regulatory developments.

#### **Market Power Mitigation**

The Corporation expects to meet its decontrol commitments through asset sales, asset or energy swaps or other arrangements. While the market power mitigation framework effectively will reduce the company's share of generating capacity available to the Ontario market, it does allow for the Corporation to grow its business through export sales and energy trading arrangements.

The Corporation commenced its decontrol process in September 1999 by starting a process to seek private investors for its nuclear facilities, focusing specifically on the 6,200 MW Bruce Nuclear Power Development site in southwestern Ontario. In response to a request from the Province to accelerate the schedule for decontrol, the Corporation has announced it is developing plans for accelerated decontrol of a total of approximately 4,000 MW of predominantly fossil-fueled generating capacity, including its fossil-fueled 2,140 MW Lennox Generating Station and 1,140 MW Lakeview Generating Station. The Corporation's goal is to meet the objective of decontrolling 4,000 MW as close as possible to the market's scheduled opening in November 2000.

#### **Information Technology Initiative**

The Corporation is forming new partnerships in key

business areas with the support of its unions. In the information technology area, the Corporation is currently in discussions with major information technology companies to transfer employees, data centres and equipment to a third party company that will provide information technology services to the Corporation and to other energy companies.

#### **Ontario Power Technologies**

In the area of research and development, Ontario Power Technologies, the technical innovation and development division of the Corporation, is forming a joint venture with AEA Technology of the United Kingdom, Sciencetech of the U.S., and CANATOM NPM Inc. in Canada. Upon closing the transaction, the three new partners will have a 10 per cent cumulative stake in Ontario Power Technologies and options on a further 40 per cent. The partners bring considerable marketing and technology development capabilities to the venture.

#### **Labour Relations**

The Corporation strives to create and maintain strong relationships with its two large labour unions, and to that effect, the Corporation has struck a partnership agreement with both groups to foster a collaborative relationship. This partnership approach will be important to the decontrol process as the Corporation seeks to ensure it maximizes value to the shareholder and protects the interests of employees.