COST OF LONG-TERM DEBT

1.0 PURPOSE
This evidence provides the details of OPG’s existing and planned annual long-term borrowing and associated costs for 2005 - 2009 determined pursuant to the methodology discussed in Ex. C1-T1-S2.

2.0 OVERVIEW

2.1 Existing Long-Term Debt Issues: Year End 2005, 2006 and 2007
OPG’s long-term debt outstanding at December 31, 2007, as reflected in OPG’s audited financial statements, is $3,853M. This balance consisted of corporate debt held by the Ontario Electricity Financing Corporation (“OEFC”) of $3,195M, and project-related debt held by the OEFC related to regulated and unregulated operations of $240M and $230M respectively. The remaining $188M of OPG’s long-term debt obligation outstanding as of December 31, 2007 is non-OEFC project-related financing associated with OPG’s unregulated operations.

A summary of corporate and project-related debt related to OPG’s regulated operations, as reflected in OPG’s audited financial statements, is provided at Ex. C1-T2-S2 Tables 1-3.

The majority of OPG’s corporate debt at December 31, 2007 was issued as part of OPG’s initial capitalization. All OPG debt issues with the OEFC contain the standard covenant conditions that apply to corporate debt issued in the public debt markets. The average remaining term of these long-term debt issues is approximately 4.7 years1.

OEFC debt outstanding at December 31, 2007 consists of both senior and subordinate notes under which the OEFC has different rights. The existence of subordinate debt in OPG’s debt portfolio could make any senior issue offered into the capital market more

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1 The issuance of $400M on December 21, 2007 and refinancing for 10 year terms of issues maturing in 2007 increased the average term of OPG’s debt by 1.2 years from the 3.5 year average remaining term of OPG’s corporate debt portfolio at December 31, 2006.
attractive to investors. Payments on subordinated notes (issues 16, 19, 20, and 21 in Ex. C1-T2-S2 Tables 1 and 2) are made only after full payment is made on senior notes obligations. The maturity of the subordinated notes cannot be accelerated upon the occurrence of an event of default unless the maturity of the senior debt has also been accelerated. At any time OPG may defer the payment of any interest of any subordinated note for not more than the earlier of five years or the maturity of the subordinated note. During any period that the payment of interest is deferred, OPG cannot make any payment of principal or interest in respect of any indebtedness ranking equally with OPG’s other notes.

Existing OEFC debt will be retired or refinanced at maturity, depending on OPG’s liquidity at the time of maturity. OPG does not plan to redeem the debt prior to its maturity since its current agreements with the OEFC contain a standard Canada Call provision which makes it more expensive to redeem the debt compared to the potential benefit of refinancing in a lower interest rate environment.

The maturity dates for $500M of debt issues scheduled to mature in March and September of 2005 (issues 13, 14, 17, and 18) were extended to March and September 2010 respectively pursuant to an agreement between OPG and the OEFC. The interest rate on the notes remained unchanged. The OEFC and OPG also agreed to defer all the interest due and payable on March 22, 2005 in respect of all of these notes, converting OPG’s interest payment obligation into a new loan for $95M (issue number 21). In addition, on April 29, 2005 OPG borrowed $400M under a new credit agreement with the OEFC for notes issued with a seven-year term (issue number 22).

In September 2006, OPG reached an agreement with the OEFC to provide debt financing for the Niagara Tunnel project. OPG may borrow up to $1B over the duration of the project to meet the financial requirements of the project. This agreement enables OPG to issue notes each quarter with a term of up to 10-years to meet OPG’s financing obligations for this project. On October 22, 2006 OPG borrowed $160M pursuant to this agreement.

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2 Government of Canada bond yield of equivalent maturity plus one-quarter of the issue spread.
agreement for notes with a ten-year term (Niagara 1), and in 2007 OPG borrowed a
further $80M on the same basis (Niagara 2 and 3).

OPG refinanced all outstanding debt issues maturing during 2007, with the exception of
one issue (issue 7). For this issue which matured March 22, 2007, OPG did not require
the full $200M. Instead, OPG issued $100M in new debt on June 22, 2007.

In 2007 OPG began to issue debt under two new credit facilities established with the
OEFC. A $500M facility and a $950M facility were established to enable OPG to
refinance its existing debt and finance a deferred payment on OPG’s nuclear liability
obligation associated with the Bruce Lease. At the time these facilities were negotiated,
OPG planned to borrow the full amount of debt allowed under each of these credit facility
arrangements. This refinancing plan is designed to extend the term of OPG’s debt
portfolio and smooth its maturity profile to better match OPG’s cash flows.

2.2 Planned Long-Term Debt Issues: 2008 and 2009

Approximately $1.6B in new borrowing is needed to finance new generation projects
over the 2008 - 2009 period. In addition, OPG will retire approximately $0.75B of debt
maturing between 2008 and 2009 as follows: 2008 - $400M, and 2009 - $350M. OPG’s
updated forecast was based on the assumption that the OEB would approve its
application for an interim rate increase. OPG forecasts that it will refinance $350M of its
$400M of outstanding debt issues maturing in 2008. OPG forecasts that it will repay
$50M maturing in 2008 and all debt maturing in 2009 based on its current business plan.

OPG has made arrangements to refinance its current debt maturing in 2008 and 2009
under a credit facility agreement established with the OEFC. OPG is also developing
plans to issue new incremental corporate debt into the public market and intends to be in
a position to issue corporate debt in 2009, should OPG’s updated long-term borrowing
requirements turn out to be greater than currently forecast.
Borrowings under project-related credit facility agreements between OPG and the OEFC are for the purpose of financing construction requirements of specific projects; however, the OEFC has recourse against the entire company (not just the project) in the event of a default.

3.0 COST OF DEBT

3.1 Ontario Electricity Financing Corporation Debt Issues

The interest rate associated with OEFC debt is fixed at the time the funds are advanced. The rate of interest is determined prior to the date the funds are advanced based on the prevailing benchmark Government of Canada 10-year bond as published by a verifiable market monitoring service (currently Bloomberg) on the day prior to the date funds are advanced, plus a credit margin determined five business days before the date funds are advanced. The credit margin is determined based on a sample of quotes for OPG’s credit margin as provided by a selected group of Canadian banks.

The cost of planned new and refinanced corporate debt and project-related debt for 2008 and 2009 is based on the December 2007 Global Insight forecast of the 10-year Long Canada Bond. The forecast quarterly interest rates are 4.18, 4.26, 4.36 and 4.74 percent in quarters 1 to 4 respectively in 2008 and 4.98, 5.17, 5.25 and 5.28 percent in quarters 1 to 4 respectively in 2009. A credit risk spread for OPG of 130 basis points as discussed in Ex. C1-T1-S2 is added to the Global Insight rates noted above to determine the forecast rate for OPG’s OEFC debt in 2008 and 2009.

OPG does incur costs to set-up each new credit facility with the OEFC (e.g., legal fees), these costs are relatively minor and are reflected in OPG’s forecast OM&A costs for its legal department in the period the credit facility is forecast to be established. OPG may incur expenses to compensate the OEFC in the event of default; however OPG has not planned to incur such expenses in 2008 or 2009.
The cost of OPG’s existing long-term debt financing attributable to specific assets in-service or projects under development associated with OPG’s regulated operations is directly assigned to OPG’s regulated operations, as discussed in Ex. C1-T1-S2. The Niagara Tunnel project is part of OPG’s prescribed assets; therefore the cost of debt issued pursuant to this financing agreement is directly assigned to OPG’s regulated operations. The Niagara Tunnel project is the only existing or planned project specifically assigned to OPG’s regulated operations.

OPG has hedged its interest rate risks for a number of OPG’s existing and planned OEFC debt issues. OPG’s hedging activity and costs are described in section 3.5.

3.2 Existing Long-Term Debt Issues: Year End 2005, 2006 and 2007

2005 and 2006 Summary
The majority of OPG’s corporate debt issues outstanding at December 31, 2007 were issued as part of OPG’s initial capitalization. OPG issued corporate long-term debt during 2005 and 2006 primarily to replace maturing debt. To the extent the amount and type of corporate long-term debt was extended, the interest rate applicable to that debt was also extended. OPG also replaced maturing debt with subordinated debt issues at rates determined to reflect the increased risks associated with these agreements. The interest expense for all other debt is determined using the method discussed in section 3.1 above.

OPG’s first project-related financing was issued on October 23, 2006 pursuant to the Niagara Tunnel project agreement (listed as Niagara 1 in Table 2 of Ex. C1-T2-S2). OPG hedged a portion of this debt issue in accordance with the direction approved by OPG’s Risk Oversight Committee described in Ex. C1-T1-S2. The effective interest rate after these interest rate swap transactions is 5.23 percent as discussed in section 3.5 below.

2007 Summary
On March 22, 2007, OPG met its debt retirement obligation by repaying $200M of maturing debt notes (issue 7), temporarily replacing the debt with borrowings under its commercial paper program pending finalization of a new general corporate credit facility with the OEFC. OPG reached an agreement with the OEFC in June, 2007 for a $500M general credit facility covering the period June 1, 2007 to March 31, 2008. The interest rate associated with this credit facility is consistent with the methodology described above.

On June 22, 2007, OPG borrowed $100M in the form 10-year term notes (issue 23) under this facility at a rate of 5.435 percent. The 10-year Government of Canada bond rate was 4.692 percent as published by Bloomberg the day before the debt issue and the applicable OPG spread was 0.7425 percent. OPG did not enter into any interest rate swap transactions associated with this debt given the uncertainty of the timing of the OEFC review/approval of a new credit facility. Absent the availability of this new credit facility, OPG would have continued to borrow on a short-term basis beyond June.

On December 21, 2007, OPG borrowed the remaining $400M available from the $500M general credit facility that is maturing March 31, 2008. The 10-year Government of Canada bond rate was 4.01 percent as published by Bloomberg the day before the debt issue and the applicable OPG spread was 1.30 percent. This debt issue was not hedged.

To ensure adequate financing resources are available beyond the borrowing limit of its short-term bank credit facility, OPG agreed to a $950M refinancing credit agreement with the OEFC to refinance senior notes as they mature over the period September 2007 - September 2009. This facility will allow OPG to fix the term of notes issued for periods up to 10 years. Therefore, as OPG refines its existing debt, it will be able to extend the average term of approximately 4.7 years that is reflected in OPG’s December 31, 2007 corporate current debt portfolio. Refinancing is permitted under the terms of the agreement with the OEFC, subject to a notice period and prepayment of the interest and principal owing to the OEFC using the market rate (including OPG corresponding credit
spread) for the remainder of the original term to calculate the payment. In essence, OPG will make a payment for the difference between the rate on the original debt and the market rate for the remaining term of the original debt, with the market rate applying to the new debt.

OPG fulfilled its $200M debt retirement obligation on September 22, 2007 (issue 8) by issuing $200M ten-year term notes (issue 24) pursuant to its $950M credit facility. An effective interest rate of 5.53 percent is applied to this $200M debt issue. This represents the blend of hedged and unhedged debt costs, and is consistent with the accounting and rate making approach used to determine the effective interest cost as described in section 3.5 below. The effective interest rate is determined in Ex. C1-T2-S2 Table 7.

OPG completed two debt issues pursuant to the Niagara Tunnel project financing agreement in 2007. The interest rates for the two completed debt issues (listed as Niagara 2 and Niagara 3 in Ex. C1-T2-S2 Table 3b) are:

- Niagara 2: $50M on January 22, 2007 at a rate of 4.893 percent reflecting a rate of 4.185 percent and an applicable spread for OPG of 0.7075 percent.
- Niagara 3: $30M on April 23, 2007 at a rate of 4.973 percent reflecting a rate of 4.263 percent and an applicable spread for OPG of 0.71 percent.

OPG did not borrow funds in either Q3 or Q4 of 2007 as a result of delays experienced by OPG’s contractor.

OPG hedged its interest rate exposure with respect to its forecast quarterly borrowing for the Niagara Tunnel project in accordance with the direction approved by OPG’s Risk Oversight Committee described in section 3.5 below. The effective costs of OPG’s Niagara 2 and 3 debt issues is 5.10 and 5.09 percent respectively as determined in Ex. C1-T2-S2 Table 6.

3.3 Planned Corporate Long-Term Debt Issues: 2008 and 2009
OPG’s planned debt issues are listed in Ex. C1-T2-S2 Table 4 (2008), and Table 5 (2009). In 2008, OPG will retire one $200M debt issue on March 22 (issue 9), replacing it with a $200M issue of 10-year term debt also on March 22 (issue 26). OPG will retire a second $200M debt issue on September 22 (issue 10), replacing it with a $150M issue of 10-year term debt forecast to also be issued on September 22 (issue 27), and $50M funded from operations based on the current business plan. The $350M in replacement debt issues will be financed under the $950M refinancing agreement with the OEFC. OPG has hedged $100M associated with each of these forecast debt issues. The effective interest rates after these interest rate swap transactions are 5.53 percent for issue 26 and 5.71 percent for issue 27 as determined in Ex. C1-T2-S2 Table 4b.

OPG forecasts that it will repay the $175M debt issue maturing on March 22, 2009 (issue 11) and a second $175M debt issue maturing on September 22, 2009 (issue 12) from operations based on its current business plan. However, both of these debt issues (issues 11 and 12) could be refinanced under the $950M refinancing agreement with the OEFC if sufficient cash flow is not available.

3.4 Planned Project-Related Long-Term Debt Issues: 2008 and 2009

Other than the Niagara Tunnel project, OPG does not plan to undertake projects involving project-related financing for the prescribed assets during the test period. Any cost associated with nuclear refurbishments are reflected in OM&A expense during the test-period, and no specific borrowing requirement has been identified at this time.

Quarterly borrowing associated with financing progress payments to OPG’s contractor for the Niagara Tunnel project are forecast to resume in Q1 2008 and continue through 2009. OPG plans to borrow $210M under its Niagara Tunnel project related debt facility during 2008. OPG forecasts borrowing $40M in January 2008 and the remaining $170M in three instalments, $50M drawn in April, $50M draw in July and $70M drawn in October (listed as Niagara 4 - Niagara 7 in Ex. C1-T2-S2 Table 4 (2008) and Table 5 (2009). OPG has hedged all four of its forecast debt issues during 2008. The effective cost of these issues is determined in Ex. C1-T2-S2 Table 4b.
In 2009, OPG forecasts borrowing $350M under its Niagara Tunnel project-related debt facility, comprised of $80M in January, $90M in April, $80M in July and $100M in October (listed as Niagara 8 - Niagara 11 in Ex. C1-T2-S2 Table 5). OPG has hedged all four of its forecast debt issues during 2009. The effective cost of these issues is determined in Ex. C1-T2-S2 Table 5b.

3.5 Hedging Costs

OPG’s risk management initiative is described in section 3.3 of Ex. C1-T1-S2. The impact of hedging activities on OPG’s effective debt cost is described below. As only a portion of the forecast face value of the debt is hedged in any period, the interest rate cost for each specific debt issue reflects a weighted average of the hedge amount and the unhedged amount.

In 2005 and 2006, OPG entered into transactions to hedge a portion of its interest rate exposure on the project-related financing associated with the Niagara Tunnel project. Forward interest rate swaps were used to minimize volatility and to mitigate the risk of an increase in the interest rate since the planned draw dates are in the future, and correspond to the projected cash flow schedule for the project, net of any contingencies. The interest rate swap requires OPG to sell the “floating” OEFC debt rate determined at the date funds are advanced and receive the “fixed” interest rate established in the interest rate swap agreement. Since the maximum term of the debt notes from the OEFC is 10-years, each of OPG’s debt notes and hedges will have a 10-year term.

For the Niagara Tunnel project, the total amount of all hedges maturing each quarter did not exceed 75 percent of the total planned cash expenditures for the project. The percentage of each corporate debt issue hedged was exactly 50 percent of the maturing amount. The hedges entered into were consistent with the recommendations approved by the Risk Oversight Committee.
OPG entered into six interest rate hedges amounting to $140M in total for the Niagara Tunnel project debt issued in 2006. OPG issued debt with the OEFC of $160M at a rate of 4.986 percent reflecting a bank of Canada rate of 4.254 percent and a corporate spread for OPG of 0.7325 percent. The financial impact of the six matured hedges resulted in an effective rate of 5.23 percent on the Niagara 1 debt issue, and is summarized in Table 6 of Ex. C1-T2-S2. The settlement on the hedges resulted in a payment of $3.8M by OPG. For accounting purposes, the difference between the interest rate swaps (4.975 percent) as illustrated in Ex. C1-T2-S2 Table 6 and the settlement of the hedges ($3.8M) on the date OPG received the debt from the OEFC is recognized over the 10-year duration of the agreement. OPG proposes to follow its accounting treatment and amortize this payment for the purposes of establishing payment amounts; therefore it has reflected the financial impact of the hedge transaction in its effective interest rate. The amortized $3.8M converted into basis points based on the amount of debt from the OEFC ($160M) results in an incremental cost of 0.24 percent above the OEFC debt rate of 4.986 percent.

OPG has hedged a portion of the interest rate exposure on the 2007 Niagara Tunnel project debt and hedged a portion of the interest rate exposure on its forecast corporate debt refinancing of new issues during 2007.

The two debt issues related to the Niagara Tunnel project reached maturity before December 31, 2007; therefore the financial impact of these transactions is provided in Ex. C1-T2-S2 Table 6. The interest rate difference is realized over the duration of the interest rate swap agreement for accounting and ratemaking purposes. The financial impact of these matured hedges results in an effective rate of 5.10 percent and 5.09 percent for the Niagara 2 and Niagara 3 debt issues respectively.

OPG anticipated higher financial requirements associated with the Niagara Tunnel project during Q3 and Q4 of 2007. As a result of lower than forecast borrowings, OPG had hedges of $30M and $35M relating to the undrawn debt in the third and fourth quarters of 2007 maturing on July 22, 2007 and October 22, 2007 resulting in payments
to OPG of $0.9M (as described in Table 6). The accounting rules require OPG to recognize this income in the period since no debt was drawn relating to the hedge.

On September 22, 2007 OPG issued $200M in debt (issue 24). As it is corporate debt, OPG hedged the maximum 50 percent ($100M) as discussed in Ex. C1-T1-S2 Section 3.3. The interest rate difference is realized over the duration of the interest rate swap agreement for accounting and ratemaking purposes. The financial impact of the matured hedges results in an effective rate of 5.53 percent as described in Ex. C1-T2-S2 Table 7.

Details of hedge transactions that have not matured are provided in Ex. C1-T2-S2 Table 8 for the Niagara Tunnel project and Table 9 for corporate debt. The financial impact of these hedge transactions cannot be determined until the issue reaches maturity. For illustrative purposes the market value (market-to-market) of each of the hedges as at December 31, 2007 has been shown in the tables. A negative market value corresponds to a payment owing by OPG if the hedge had to be settled as at December 31, 2007, similarly a positive market value corresponds to a payment owing to OPG. The consolidated market value of all hedges that had not matured as at December 31, 2007 and that are forecast to mature prior to the end of the test period amounts to a negative $4.5M.

3.6 Other Long-Term Debt Costs

As discussed in Ex. C1-T1-S2 OPG determines a provision for long-term debt to reconcile the debt component of OPG’s regulated capital structure with the proposed rate base that financing supports. OPG’s other long-term debt provision is determined based on:

- The difference between the debt resulting from the application of OPG’s proposed capital structure to its proposed regulated rate base.
- The project-related and corporate long-term debt assigned or allocated to OPG’s regulated operations as discussed above.
- The portion of short-term debt allocated to regulated operations. This calculation is described in Ex. C1-T1-S3.
The average amount of new and refinanced debt issued each year for both corporate and project-related borrowing purposes is applied to the unhedged interest rate to determine the interest rate attributable to the other long-term debt provision necessary to reconcile the debt component of OPG’s regulated capital structure with the proposed rate base that financing supports. OPG has provided a calculation identifying all debt issued in the year, the unhedged interest rate and the resulting average interest rate applicable to its other long-term debt provision in the footnotes of Ex. C1-T2-S2 Table 1 (2005), Table 2 (2006), Table 3 (2007), Table 4 (2008), and Table 5 (2009).