

# 2002 ANNUAL REPORT



**ONTARIOPOWER**  
GENERATION

## CORPORATE PROFILE

Ontario Power Generation (OPG) is an Ontario-based electricity generator whose principal business is the generation and sale of electricity in Ontario and to interconnected markets. Our focus is on the risk-managed production and sale of reliable electricity from our competitive generation assets. OPG's goal is to be a premier North American energy company, while operating in a safe, open and environmentally-responsible manner.

As of December 31, 2002 OPG's electricity generating portfolio had a total in-service capacity of 22,211 megawatts (MW). This consisted of two operating nuclear stations with a capacity of 5,588 MW (a third nuclear station with a capacity of 2,060 MW was laid up); six fossil-fueled stations with a capacity of 9,700 MW; and 36 hydroelectric stations and 29 EcoLogo<sup>M</sup>-certified green power hydroelectric stations, with a capacity of 6,923 MW. In 2002, OPG generated 115.8 terawatt-hours (TWh) of electricity.

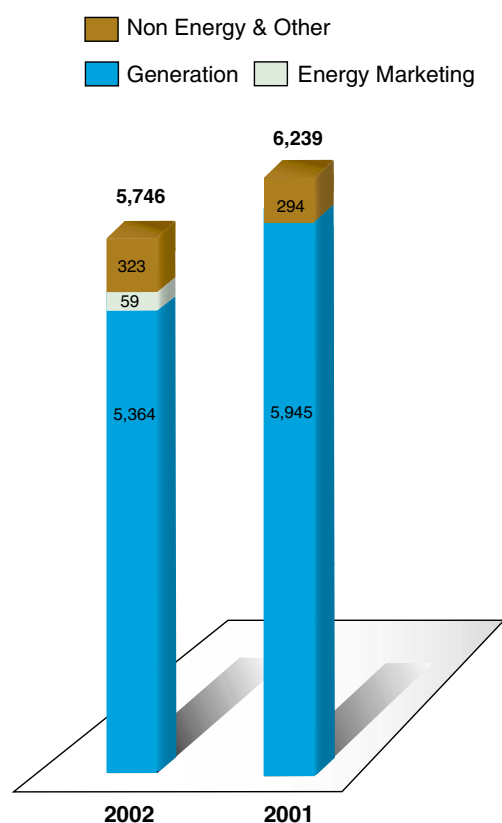
OPG also owns approximately 2.5 MW of wind power, and OPG's share of the Huron Wind joint venture is approximately 4.5 MW of capacity.

Two nuclear stations, formerly operated by OPG, are leased on a long-term basis to Bruce Power L.P.

## FINANCIAL HIGHLIGHTS

| <i>(millions of dollars, unless otherwise noted)</i> | 2002   | 2001   |
|--|--------|--------|
| <b>Revenue</b>                                       |        |        |
| Generation   | 5,364  | 5,945  |
| Energy Marketing                                     | 59     | -      |
| Other  | 323    | 294    |
|  | 5,746  | 6,239  |
| <b>Gross Margin</b>                                  |        |        |
| Generation   | 3,464  | 3,613  |
| Energy Marketing                                     | 59     | -      |
| Other  | 323    | 294    |
|  | 3,846  | 3,907  |
| <b>Net Income</b>                                    | 47     | 152    |
| <b>Earnings per Share (\$)</b>                       | 0.18   | 0.59   |
| <b>Capital Expenditures</b>                          | 869    | 739    |
| <b>As at December 31:</b>                            |        |        |
| Total Assets   | 17,361 | 16,686 |
| Long-Term Debt                                       | 3,352  | 3,015  |
| Shareholder's Equity                                 | 5,383  | 5,470  |
| <b>Operating Highlights</b>                          |        |        |
| <b>Physical Electricity Sales Volume (TWh)</b>       |        |        |
| Generation Segment                                   | 123.1  | 140.2  |
| Energy Marketing Segment                             | 2.2    | -      |
|  | 125.3  | 140.2  |

**TOTAL REVENUES (\$ millions)**



### Electricity Terms

One megawatt (MW) is one million watts. Megawatts are a measure of electricity demand at a point in time.

One kilowatt (kW) is 1,000 watts; one gigawatt (GW) is one billion watts; and one terawatt (TW) is one trillion watts.

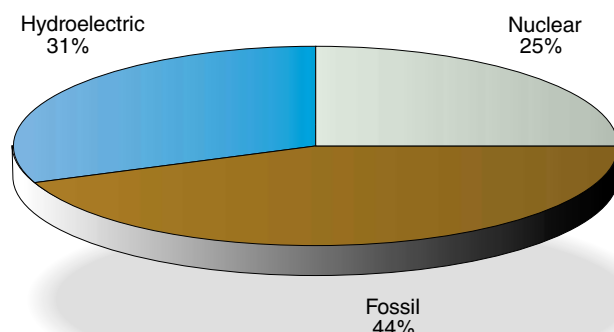
One kilowatt-hour (kWh) is a measure of electricity usage by customers. One kWh is the energy expended by ten 100 watt lights burning for one hour. The average Ontario household uses approximately 1,000 kWh per month.

One megawatt-hour (MWh) is 1,000 kWh; one gigawatt-hour (GWh) is one million kWh; and one terawatt-hour (TWh) is one billion kWh.

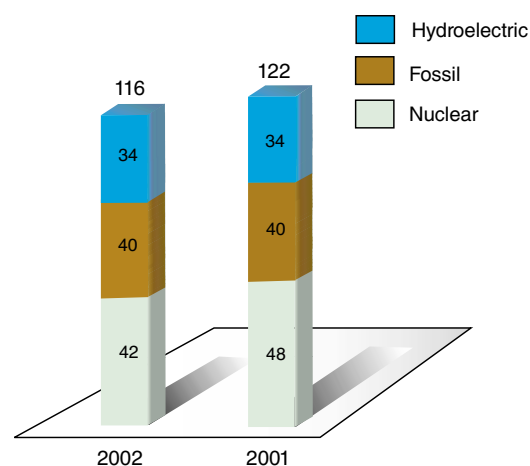
## KEY ACCOMPLISHMENTS

- › Continued to improve nuclear performance, generating an additional 2.8 TWh at our Darlington and Pickering B nuclear stations
- › Successfully contributed to the opening of Ontario's electricity market
- › Sold four Mississagi River hydroelectric stations as part of OPG's requirement to decontrol price-setting generation
- › Divested businesses that can be provided more effectively by other companies, including research and development, information technology and nuclear safety analysis
- › Began operations at Huron Wind, Ontario's first commercial wind farm with a capacity of 9 MW; OPG has a 50 per cent interest in Huron Wind
- › Placed the first of four "Selective Catalytic Reduction" units into operation at our Lambton coal-fired station, helping to reduce OPG's nitrogen oxide emissions

**GENERATING CAPACITY (22,211 MW)**



**ELECTRICITY PRODUCED (TWh)**



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Bill Farlinger, *Chairman*



Ron Osborne, *President and CEO*

## MESSAGE FROM THE CHAIRMAN AND THE PRESIDENT

In a year marked by challenge and change, Ontario Power Generation continued to pursue the strategies that have guided us since we were established in 1999. Key elements of our strategy include: increasing the production efficiency of our electricity generating operations; optimizing our organizational structure; and striving for continuous improvements in business areas such as safety performance, customer focus, environmental and social responsibility, and employee relations.

OPG made a strong contribution to the successful opening of Ontario's competitive electricity market on May 1, 2002. Our people, systems and generating facilities performed well in the new market, providing customers with reliable power under often challenging conditions – including periods of record-setting customer demand.

Earnings for the year were \$47 million or \$0.18 per share, compared with earnings for the year ended December 31, 2001 of \$152 million or \$0.59 per share. Our financial results were negatively affected by transitional price relief for certain industrial customers, corporate restructuring charges, additional costs of the Pickering A return to service project, and a smaller asset base resulting from decontrol transactions with respect to nuclear and hydroelectric generating stations.

### Electricity Industry Developments

Over the past two years, significant changes in the North American electricity sector have occurred. These include: regulatory scrutiny of energy trading and disclosure practices; a weakening U.S. economy; lower average electricity prices due to declining demand and excess capacity in certain regions; and liquidity issues, which have strained balance sheets and resulted in credit rating downgrades.





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**Darlington Nuclear Generating Station:** OPG's largest nuclear station at 3,524 megawatts is located east of Toronto in the Municipality of Clarington. Darlington produced approximately 1.4 terawatt-hours more electricity in 2002 than in 2001 as a result of performance improvements. The additional production is enough to meet Ontario's electricity needs for three days.

These factors have undermined investor confidence and reduced access to capital for merchant generators. Many energy companies have exited from energy trading, postponed or cancelled the building of new generation, and continued to divest assets to shore up liquidity. Because many energy companies cut back on investment, the number of qualified buyers for the generating stations OPG has targeted for decontrol has been limited.

Ontario electricity demand was strong in 2002, especially in the third quarter when high temperatures resulted in three new peak demand records. This put considerable pressure on Ontario's electricity supply, causing prices to rise.

The Ontario government responded in December by passing legislation aimed at lowering electricity bills, which included fixing retail electricity prices at 4.3 cents per kilowatt-hour until at least 2006 for consumers using up to 150,000 kilowatt-hours per year and other consumers designated by regulation. In March 2003, the provincial government announced that it would extend the fixed price to all consumers using up to 250,000 kilowatt-hours annually. Consumers using more than this amount, other than those designated by regulation, will remain in the wholesale and retail markets, helping to maintain a significant competitive market.

### OPG Electricity Generation

The core of OPG's strength is its electricity generation assets. Our nuclear and hydroelectric generating stations, which emit virtually none of the gases contributing to smog, acid rain and climate change, produced more electricity in 2002 than in 2001.

Nuclear production at our Darlington and Pickering B stations rose by 2.8 terawatt-hours. The increase in nuclear production was a direct outcome of our long-term commitment to improving production efficiency. The capability factor of the Darlington station improved from 85.8 per cent in 2001 to 90.3 per cent in 2002; at Pickering B, the capability factor improved from 73.3 per cent to 80.9 per cent.

Hydroelectric production rose by 0.6 terawatt-hours despite the May 2002 sale of four stations on the Mississagi River, totalling 488 megawatts of capacity. Water levels, while lower than their long-term average, were higher in 2002 than in 2001. Over the next five years, investments in our existing hydroelectric stations are expected to add 100 megawatts of renewable and economic hydroelectric capacity.

In November 2002, OPG participated in the development of a nine megawatt wind farm, Huron Wind, with British Energy Investments Inc., whose interest was subsequently acquired by a consortium of the major investors in Bruce Power.

OPG continues to assess the potential implications of public policy statements on the longevity of our coal-fired stations. Meanwhile, the main focus of our investment program for these stations is to improve safety and environmental performance.

OPG is participating in Brighton Beach L.P., a 50/50 partnership between OPG and ATCO Power Canada Ltd. The partnership is building a 580 megawatt combined-cycle, natural gas facility near Windsor. This generating station, whose output will be marketed by a third party, is scheduled to be in service in 2004.

The Pickering A return to service project will also have a positive impact on OPG's electricity supply. During the past year, we identified and addressed many of the problems contributing to the delay in returning Unit 4 to service, the first unit to be returned. We expect that the 515 megawatt Unit 4 will make a significant contribution to meeting Ontario's electricity needs in the summer of 2003.

### Decontrol of Generation

Despite the limited number of available buyers for electricity generation assets, OPG successfully completed a decontrol transaction in May with the sale of the four Mississagi River hydroelectric stations, realizing good value for our shareholder. We were also pleased by the successful transition of the lease for the Bruce nuclear stations – which we had previously decontrolled in May 2001 – to a consortium of Canadian owners in February 2003.

### Restructuring of Non-Core Businesses

This was a year of restructuring as we continued to outsource businesses that can be provided more effectively by other companies, and to reorganize OPG to improve our cost competitiveness and operational flexibility. Our transactions included:

- › the divestiture of our remaining ownership position in Kinectrics, OPG's former research and development arm;
- › the completed transfer of our information technology function to Cap Gemini Canada Inc.; and
- › the outsourcing of our Nuclear Safety Analysis Division.



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**Des Joachims Hydroelectric Generating Station:** Located on the Ottawa River near Deep River, this 429 megawatt station is part of OPG's hydroelectric generation portfolio. These renewable energy facilities represented almost 30 per cent of OPG's electricity production in 2002.

We also have begun the process of divesting our Inspection Services Division. In addition, with the support of our labour unions, we introduced a special employee separation program to bring our employee complement in line with our asset base. During 2002, we achieved significant reductions through voluntary employee departures.

## Safety

Protecting public safety and keeping our employees safe at work are areas where we strive for continuous improvement. Since our creation in 1999, we have made major improvements in employee safety through implementation of comprehensive safety management systems. The all-injury rate (injuries per million hours worked) was reduced by close to 50 per cent between 1999 and 2002; the accident severity rate (days lost due to lost time accidents per million hours worked) has also steadily declined at many of our facilities. Despite these positive trends, the importance of safety was brought home to us, tragically, in two separate accidents in 2002. Two members of the public lost their lives near our Barrett Chute hydroelectric station. An employee also lost his life at our Nanticoke coal-fueled station. The accidents affected us deeply and strengthened our resolve to prevent these types of events from happening in the future.

During 2003, we will continue to focus on improving public safety through the installation of additional physical barriers and warning devices at many of our generating stations, as well as through an increase in our already extensive public education program. We will also intensify our efforts in the area of employee and contractor safety by developing and implementing action plans to address high risks across the company. Our ultimate goal is to be accident-free.

## Customer Energy Products

We are committed to dealing with our customers with openness and integrity. While most of our revenues are derived through sales of electricity on the Ontario spot market, a portion of revenues are fixed through bilateral contracts with commercial and industrial customers. These contracts, along with OPG's portfolio of value-adding products and services, help our customers manage their electricity price risk, and better manage their overall energy needs. Our value-adding offerings include green power; retail consolidated billing; invoice verification services; and Envision™ energy management software, which provides customers with the data they need to improve the efficiency of their operations.

## Environmental and Social Responsibility

Environmental responsibility is an important value for OPG. While our environmental results were mixed in 2002, with improvement necessary in the area of regulatory compliance, we nonetheless had a number of achievements. At our two largest coal-fueled plants, we began to put into operation new equipment that will reduce nitrogen oxide emissions, which contribute to smog. We started up the first of four "selective catalytic reduction" units in December, and continued work on the other three units, the last of which is expected to be operating in late 2003. When all four units are operational, assuming similar production levels as in 2002, they will reduce nitrogen oxide emissions by up to 25 per cent across our fossil fleet.



Other environmental achievements included:

- › planting our one millionth tree in southern Ontario, with a commitment to plant one million more by 2007;
- › playing a major role in the creation of Canada's new Nuclear Waste Management Organization, whose role is to recommend options for the long-term management of used nuclear fuel;
- › supporting scientific research into areas such as air quality, as well as research and development into fuel cells, and technologies for clean coal and mercury emissions reduction; and
- › financing innovative and alternative energy technologies through our venture capital subsidiary, OPG Ventures.



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**Nanticoke Fossil-Fueled Generating Station:** OPG is investing approximately \$250 million in new equipment at the 3,920 megawatt Nanticoke and 1,975 megawatt Lambton generating stations to reduce smog-forming nitrogen oxide emissions. The Nanticoke station is located near Port Dover.

In the communities where we operate, we continued to build strong relationships and to keep residents informed about our operations through communications outreach activities such as newsletters, report cards, presentations to local councils and committees, and open houses. Our Corporate Citizenship Program supported over 600 initiatives in 2002, in the areas of education, environment, and community initiatives. During the year, we were honoured to receive a number of awards recognizing our contributions to station communities.

### Employees

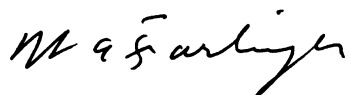
Our commitment to employees is to provide a safe and healthy workplace that fosters respect, engagement, learning and performance. Eighty-nine new partnership initiatives were undertaken with the unions during the year, especially in the areas of increasing profitability and improving quality of work life. We continued to encourage greater productivity through our programs which promote skills broadening and good health, as well as an award-winning disability management program that helps sick or injured employees return safely to work. We thank our employees for their contribution to our 2002 results.

### Board of Directors

We would also like to thank the members of OPG's Board of Directors for their guidance, advice and commitment to the interests of our shareholder and the people of Ontario. Two board members retired in 2002 – Lynton "Red" Wilson and David Kerr. We thank them for their service and wish them success in the future. We would like to welcome a distinguished new member to the Board, L. Jacques Ménard, Chairman of BMO Nesbitt Burns and President of the Bank of Montreal Group of Companies, Quebec.

### Going Forward

Looking to the future, OPG will continue its focus on providing maximum value to our shareholder and to the people of Ontario. Our commitment is to run our businesses safely, efficiently, honestly and openly. We will continue to seek operational excellence through gains in production efficiency, a focus on our core competencies, and a dedication to continuous improvement in key business areas such as safety, environmental protection and relationships with our customers, communities and employees.



Bill Farlinger  
*Chairman*



Ron Osborne  
*President and CEO*

*Toronto, March 31, 2003*



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**Huron Wind:** *OPG is a 50 per cent owner of the nine megawatt Huron Wind, located near Kincardine.*

# ONTARIO POWER GENERATION INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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This discussion and analysis should be read in conjunction with the audited consolidated financial statements and accompanying notes of Ontario Power Generation Inc. ("OPG" or "the Company") as at and for the year ended December 31, 2002. Certain comparative amounts have been reclassified to conform to the 2002 financial statement presentation.

### THE CORPORATION

OPG is an Ontario-based electricity generation company focused on the cost effective, safe and environmentally responsible production, sale and purchase of electricity and energy-related risk management products and services in Ontario and the interconnected markets of Quebec, Manitoba and the northeast and midwest regions of the United States. OPG is governed by the Business Corporations Act (Ontario) and is wholly owned by the Province of Ontario.

As at December 31, 2002, OPG's electricity generating portfolio consisted of three nuclear stations, six fossil-fueled generating stations, 36 hydroelectric generating stations, and a green energy portfolio consisting of 29 hydro and two

wind generating stations. Two of the other nuclear generating stations, formerly operated by OPG, are leased on a long-term basis to Bruce Power L.P. ("Bruce Power"), an entity unrelated to OPG. The Company's Pickering A nuclear generating station, representing 2,060 megawatts ("MW") of capacity, has been laid up since 1997. OPG has commenced the return to service of the first unit of this four unit station.

Total in-service capacity at the end of 2002 was 22,211 MW, comprised of: 5,588 MW of nuclear capacity; 9,700 MW of fossil capacity; and 6,923 MW of hydroelectric capacity (which includes a green energy portfolio of approximately 119 MW). In 2002, OPG generated 115.8 terawatt-hours ("TWh") of electricity.

### HIGHLIGHTS

| <i>(millions of dollars)</i>                      | <b>2002</b>  | 2001  |
|---|--------------|-------|
| Revenues  | <b>5,746</b> | 6,239 |
| Net income  | <b>47</b>    | 152   |
| Cash flow provided by operating activities        | <b>844</b>   | 224   |
| <i>Physical electricity sales volume (TWh)</i>    |              |       |
| Generation segment                                | <b>123.1</b> | 140.2 |
| Energy Marketing segment                          | <b>2.2</b>   | -     |
| Total   | <b>125.3</b> | 140.2 |
| <i>Total energy available (TWh)</i>               |              |       |
| Total production                                  | <b>115.8</b> | 121.6 |
| Purchased power – Generation and Energy Marketing | <b>9.6</b>   | 19.1  |
| Other   | <b>(0.1)</b> | (0.5) |
| Total   | <b>125.3</b> | 140.2 |

Net income for the year ended December 31, 2002 was \$47 million compared with \$152 million for the year ended December 31, 2001. Total revenues in 2002 were \$5,746 million compared to \$6,239 million in 2001. Total volume of electricity sales from the



Generation and Energy Marketing segments for the years ended December 31, 2002 and 2001 were 125.3 TWh and 140.2 TWh, respectively.

Cash flow provided from operating activities in 2002 was \$844 million compared to \$224 million in 2001. The increase in cash flow is mainly due to higher energy prices. Under the market power mitigation agreement, a rebate is paid to the IMO for ultimate distribution to customers. At December 31, 2002, the rebate payable totalled \$572 million, after taking into account an interim payment.

Significant factors impacting earnings in 2002 compared to 2001 included the following:

#### Change in Earnings

|   |       |
|---|-------|
| <i>(millions of dollars – after tax)</i>  |       |
| Net income for the year ended December 31, 2001   | 152   |
| Higher energy prices compared to fixed revenue rate prior to market opening   | 97    |
| Impact of decontrol – decrease in gross margin partially offset by OM&A and other savings                                   | (36)  |
| Other changes in generation segment gross margin due to higher coal costs partially offset by a decrease in power purchases | (12)  |
| Higher activity levels and expenditures related to the return to service of the Pickering A nuclear generating station      | (82)  |
| Loss on Transition Rate Option contracts for industrial customers after market opening                                      | (140) |
| Restructuring charge for costs related to a reduction in workforce  | (101) |
| Gain on sale of Mississagi River stations   | 79    |
| Gain on sale of investments   | 49    |
| Amortization of a decrease in the estimate of long-term nuclear waste management liability                                  | 31    |
| One time impact of the reduction in income tax rates in 2001 and other temporary differences                                | (32)  |
| Other items, net  | 42    |
| Decrease in earnings  | (105) |
| Net income for the year ended December 31, 2002   | 47    |

#### ONTARIO ELECTRICITY MARKET

On May 1, 2002, Ontario opened its wholesale and retail markets to competition. Generators, wholesalers, suppliers and marketers, both from within and outside Ontario compete to sell electricity into, and buy electricity out of, the real-time energy market or spot market administered by the Independent Electricity Market Operator ("IMO").

Following market opening, OPG and other generators in Ontario must offer their entire production into the spot market in order to be dispatched by the IMO. In addition to revenue earned from spot market sales, revenue is earned through offering to supply operating reserve and contracting to supply other ancillary services. Generators and other suppliers also earn revenue through offering financial risk management products and sales of energy-related products and services to meet customers' needs for energy solutions.

The average Ontario market clearing price for the May to June 2002 period was 3.2¢/kilowatt-hour ("kWh") compared with an average fixed rate of 4.0¢/kWh prior to market opening. During the July to September 2002 period, unusually warm weather contributed to significant increases in spot market prices. The average market clearing price during the July to September period was 6.6¢/kWh. For the period from May 1 to December 31, 2002, the average market clearing price was 5.2¢/kWh.

In November 2002, the Government of Ontario introduced Bill 210 *Electricity Pricing, Conservation and Supply Act, 2002*. The Bill became law on December 9, 2002. The new legislation and related regulations include the following key features:

- Effective December 1, 2002 and until April 30, 2006, electricity commodity prices are set at 4.3¢/kWh for low volume consumers (consumers using less than 150,000kWh annually) and other designated consumers including those who have a demand of 50 kW or less.

- › Refunds will be provided to these consumers for the difference between the 4.3¢/kWh and the amount actually paid by these consumers since market opening.
- › The rates for transmission and distribution, and the fees for the operation of the IMO are capped at current levels.
- › IMO market uplift charges to distributors and low volume and designated consumers are capped at 0.62¢/kWh.
- › The Minister of Energy has been given increased powers including the ability to review market rules made by the IMO to ensure that the new rules do not unduly and adversely affect the interests of consumers, with respect to prices or the reliability or quality of electricity service. The Minister has also been given powers to control rates approved by the Ontario Energy Board ("OEB") and to require certain orders to be amended.
- › Tax incentives are provided to promote conservation, use of alternate fuels and support for clean energy production through a variety of mechanisms.

The new legislation and related regulations introduced in November 2002 did not include any changes in the electricity prices or the market rules related to the IMO-administered real-time market or spot market, nor did they address the form of electricity pricing for customers other than low volume and designated customers. The *Electricity Pricing, Conservation and Supply Act, 2002*, as it relates to the low volume and other designated consumers, is not expected to have a material impact on OPG.

On March 21, 2003, the Province announced a business protection plan for large electricity consumers in Ontario. Under this plan, consumers

using up to 250,000 kWh per year will be included in the fixed price rate of 4.3¢/kWh retroactive to May 1, 2002. Except for certain designated customers, all consumers using above 250,000 kWh per year will remain in the competitive wholesale and retail markets and receive rebates under the terms of the existing market power mitigation agreement arrangements for the 12 months ending April 30, 2003. Effective May 1, 2003, rebates to these customers will be fixed at 50 per cent of the amount by which the average spot price in the IMO-administered market exceeds 3.8¢/kWh, with rebates paid on a quarterly basis. OPG will continue to be responsible for a rebate commitment based on the existing market power mitigation agreement arrangement under which the level of payment is impacted by the degree of decontrol implemented by OPG. This business protection plan is not expected to have a material impact on OPG's operating results.

## BUSINESS SEGMENTS

Commencing May 1, 2002, following the opening of the Ontario electricity market to competition, OPG classifies its operations into two business segments: Generation and Energy Marketing. A separate category, Non-Energy and Other, includes revenue and certain costs which are not allocated to the two business segments.

### Generation Segment

With the opening of the Ontario electricity market to competition on May 1, 2002, all of OPG's electricity generation is sold into the real-time energy spot market administered by the IMO. As such, the majority of OPG's revenue is derived from spot market sales for which OPG receives a variable price based on supply and demand dynamics. Revenue is also earned through offering available capacity as operating reserve and through the supply of other ancillary services

including voltage control/reactive support, black start capability and automatic generation control. Prior to market opening, OPG sold electricity at fixed rates directly to wholesale electricity customers in Ontario, including local distribution companies and large industrial customers, and to customers in the interconnected markets of Quebec, Manitoba and the northeast and midwest regions of the United States.

OPG has entered into various energy and related sales contracts with its customers to hedge commodity price exposure to changes in electricity prices associated with an open spot market for electricity in Ontario. Contracts that are designated as hedges of OPG's generation revenues are included in Generation segment activities. Gains or losses on these hedging instruments are recognized over the term of the contract when the underlying hedged transactions occur and are included in Generation segment revenue as realized.

### Energy Marketing Segment

OPG sells electricity into, and purchases electricity from, interconnected markets of neighbouring Canadian provinces and the U.S. northeast and midwest. The Energy Marketing segment also includes trading and the sale of other energy-related products and services to meet customers' needs for energy solutions. All contracts that are not designated as hedges are recorded as assets or liabilities at fair value, with changes in fair value recorded in Energy Marketing revenue as gains or losses.

### Non-Energy and Other

OPG derives non-energy revenue under the terms of a lease arrangement with Bruce Power related to the Bruce nuclear generating stations. This includes lease revenue, interest income and revenue from engineering analysis and design,

technical and ancillary services. Non-energy revenue also includes isotope sales to the medical industry and real estate rentals.

## DISCUSSION OF OPERATING RESULTS

### Generation Segment

| <i>(millions of dollars)</i>               | <b>2002</b>  | 2001  |
|--|--------------|-------|
| Revenue                                    | <b>5,364</b> | 5,945 |
| Fuel                                       | <b>1,610</b> | 1,453 |
| Power purchased                            | <b>290</b>   | 879   |
| Gross margin                               | <b>3,464</b> | 3,613 |
| Operations, maintenance and administration | <b>2,463</b> | 2,475 |
| Depreciation and amortization              | <b>645</b>   | 746   |
| Property and capital taxes                 | <b>101</b>   | 97    |
| Operating income                           | <b>255</b>   | 295   |

### Gross Margin

Gross margin from electricity sales in the Generation segment was \$3,464 million in 2002 compared to \$3,613 million in 2001, a decrease of \$149 million. The most significant factor contributing to the decrease in gross margin was the impact of the decontrol of the Bruce nuclear generating stations. On May 11, 2001, OPG completed the agreement to lease its Bruce nuclear generating stations to Bruce Power. Higher coal costs also contributed to the decrease in gross margin in 2002 compared to last year. The impact of decontrol and higher coal costs were partially offset by higher electricity spot market prices in 2002, a favourable generation mix related to higher production from OPG's nuclear and hydroelectric generating stations in 2002, and a decrease in high cost power purchases and other resources that were required to meet peak demand in 2001. Under the fixed price regime prior to market opening, OPG had an obligation to serve customer demand and was not always able to fully recover these higher costs.

## Revenue

| (millions of dollars)   | 2002  | 2001  |
|---|-------|-------|
| Spot market sales, net of market power mitigation agreement rebate and financial transactions | 3,343 | -     |
| Electricity sales (prior to market opening)   | 1,939 | 5,945 |
| Other   | 82    | -     |
| Total generation revenue  | 5,364 | 5,945 |

Generation revenue was \$5,364 million in 2002 compared to \$5,945 million in 2001, a decrease of \$581 million. The decrease in generating revenue was primarily due to lower volumes resulting from the decontrol of the Bruce nuclear generating stations and the elimination, subsequent to market opening, of OPG's obligation to serve Ontario market demand, partially offset by higher electricity prices.

Spot market prices in Ontario were impacted significantly by much warmer summer temperatures in 2002. There were 517 cooling degree days<sup>1</sup> during 2002 compared to 392 cooling degree days in 2001 and the ten year weather normal average of 259 cooling degree days. While the unusually warm summer weather during 2002 resulted in higher Ontario spot market prices, a significant portion of OPG's energy sales are subject to an average annual revenue cap of 3.8¢/kWh through a market power mitigation agreement rebate mechanism. Since market opening on May 1, 2002, OPG's average spot market sales price, after taking into account the market power mitigation agreement rebate, was 4.4¢/kWh compared to the fixed revenue rate of 4.0¢/kWh prior to market opening.

### Market Power Mitigation Agreement Rebate

In order to address the potential for OPG to exercise market power in Ontario, OPG is required under its generating licence to comply with prescribed market power mitigation measures, including a rebate mechanism. Under the rebate mechanism, for the first four years after market

opening, a significant majority of OPG's expected energy sales in Ontario are subject to an average annual revenue cap of 3.8¢/kWh. OPG is required to pay a rebate to the IMO (for ultimate distribution to certain customers) equal to the excess, if any, of the average hourly spot energy price over 3.8¢/kWh for the amount of energy sales subject to the rebate mechanism. At each balance sheet date, OPG computes the average spot energy price that prevailed since the beginning of the current settlement period and recognizes a liability if the average price exceeds 3.8¢/kWh, based on the amount of energy subject to the rebate mechanism.

Under OPG's generating licence, approved by the Ontario Energy Board, the Company has the ability to reduce the amount of energy subject to the market power mitigation agreement rebate by the transfer of effective control of certain of its generating facilities to other market participants. As OPG transfers effective control of facilities and meets certain milestones, it can apply to the OEB for an order determining that the transactions represent the transfer of effective control and thereby eliminate a portion of the market power mitigation agreement rebate obligation. In order for a transaction to qualify for decontrol, OPG must meet the following three tests:

- › The transaction must transfer control over timing, quantity, and bidding of output into the Ontario market to a third party.
- › There must not be ongoing arrangements which facilitate interdependent behaviour between OPG and the transferee.
- › The transferee may not control more than 25 per cent of Ontario capacity.

In May 2001, OPG leased its Bruce nuclear generating stations to Bruce Power and in May 2002, OPG sold four hydroelectric stations located

<sup>1</sup> Cooling Degree Days represent the aggregate of the excess of average daily temperatures over 18°C, as measured at Pearson International Airport in Toronto.



on the Mississagi River to the Mississagi Power Trust. OPG has filed applications with the OEB seeking a reduction in the amount of energy subject to the rebate mechanism ("Q relief") as a result of the decontrol of the Bruce nuclear generating stations and the sale of the Mississagi River stations. While there is no assurance as to the outcome of the OEB decision, the Company believes that it has met all of the requirements for the transfer of effective control and therefore should receive a reduction in energy sales subject to the market power mitigation agreement rebate. OEB approval of the applications would result in a reduction in volumes subject to the market power mitigation agreement rebate for the twelve-month settlement period ending April 30, 2003 from 101.8 TWh to 81.4 TWh.

Since the average hourly spot price since May 1, 2002 has exceeded the 3.8¢/kWh revenue cap, OPG has recorded a total of \$907 million as a market power mitigation agreement rebate. The rebate is calculated in accordance with the market power mitigation agreement, after taking into account the amount of energy sales subject to the rebate mechanism for only those generating stations that OPG continues to control. The liability with respect to the market power mitigation agreement rebate was reduced to \$572 million at December 31, 2002, after taking into account an interim payment to the IMO of \$335 million in December 2002.

OPG expects to receive a decision from the OEB regarding Q relief during the second quarter of 2003. If OPG's applications are not approved, pre-tax income in the period in which the determination is made would be decreased by the amount of the Q relief, which totalled approximately \$182 million at December 31, 2002. Also, the Company must obtain OEB approval of Q relief before the end of the first settlement period ending April 30, 2003, as a condition of OPG's generating licence, in order to qualify for Q relief during that period.

## Volume

Electricity sales volumes in 2002 were 123.1 TWh, compared to 140.2 TWh for 2001. The decrease in volumes was primarily due to lower sales resulting from the decontrol of generation from the Bruce nuclear generating stations. Upon closing the operating lease agreement with Bruce Power, OPG was obligated to purchase and resell all of Bruce Power's electricity generation up to the date of market opening. Upon market opening, Bruce Power began selling electricity directly into the IMO-administered real-time energy market, thereby lowering OPG's sales revenue and volumes.

## Fuel and Power Purchases

| Total Energy Available for Generation Segment (TWh)      | 2002      | 2001        |
|--|-----------|-------------|
| Production   |           |             |
| Nuclear:<br>Darlington & Pickering<br>Bruce <sup>1</sup> | 41.9<br>- | 39.1<br>8.6 |
| Total Nuclear  | 41.9      | 47.7        |
| Fossil   | 39.6      | 40.2        |
| Hydroelectric  | 34.3      | 33.7        |
| Total Production   | 115.8     | 121.6       |
| Power Purchased  | 7.4       | 19.1        |
| Other <sup>2</sup>                                       | (0.1)     | (0.5)       |
| Total Energy Available                                   | 123.1     | 140.2       |

1 Represents generation from Bruce nuclear generating stations prior to decontrol.

2 Represents deposits and withdrawals of electricity with utilities in neighbouring jurisdictions under energy banking arrangements.

Fuel expense for 2002 was \$1,610 million compared to \$1,453 million in 2001, an increase of \$157 million. The increase was primarily due to higher coal costs, partially offset by the impact of lower production related to the decontrol of the Bruce nuclear generating stations.

Power purchased during 2002 was \$290 million compared to \$879 million in 2001, based on purchases of 7.4 TWh and 19.1 TWh for 2002 and

2001, respectively. The decrease was primarily due to lower purchases of electricity from Bruce Power, and the elimination of OPG's requirement to purchase electricity to meet Ontario market demand after market opening. OPG purchased 6.8 TWh of electricity from Bruce Power during the period from January 1 to April 30, 2002, compared to 15.4 TWh from May 11 to December 31, 2001.

### *Operating Expenses*

Operations, maintenance and administration ("OM&A") expenses were \$2,463 million for 2002 compared to \$2,475 million for 2001, a decrease of \$12 million. The decrease was primarily due to reduced operating expenses from the decontrol of the Bruce nuclear generating stations of \$114 million, lower pension and other post-employment benefits expenses of \$47 million due to the resumption of employee contributions to the pension plan and a reduction in the number of employees collecting long-term disability, a one-time reduction of \$24 million resulting from the Workplace Safety and Insurance Board ("WSIB") assuming the liabilities with respect to OPG's existing and future worker's compensation claims in exchange for a cash payment, and other decreases of \$36 million related primarily to completion of nuclear recovery programs. These decreases were largely offset by increased operating expenses related to the return to service of the Pickering A nuclear generating station of \$136 million, the write-off of obsolete and surplus materials and supplies at nuclear generating stations of \$25 million, and inflation and other increases of \$48 million.

### *Depreciation and Amortization*

Depreciation and amortization expense was \$645 million in 2002 compared to \$746 million in 2001, a decrease of \$101 million. The decrease in 2002 is mainly due to the full year effect of reclassifying depreciation related to the Bruce nuclear generating stations from the Generation segment to Non-Energy and Other commencing in May 2001, and

lower costs resulting from the amortization of a decrease in the estimate of the long-term nuclear waste management liability.

### **Energy Marketing Segment**

Since market opening in May 2002, OPG has transacted with counterparties in Ontario and neighbouring energy markets in predominantly short-term trading activities ranging from one day to one year. These activities relate primarily to physical energy that is purchased and sold at the Ontario border, the sale of financial risk management products and sales of energy-related products and services to meet customers' needs for energy solutions. Prior to market opening, OPG's energy marketing activity was not a reportable business segment. Accordingly, there are no comparative amounts for 2001.

| <i>(millions of dollars)</i>               | <b>2002</b> | <b>2001</b> |
|--|-------------|-------------|
| Revenue, net of power purchases            | <b>59</b>   | -           |
| Operations, maintenance and administration | <b>6</b>    | -           |
| Operating income                           | <b>53</b>   | -           |

Beginning fourth quarter 2002, interconnected purchases and sales (including those to be physically settled) and mark-to-market gains and losses (realized and unrealized) on energy trading contracts, are disclosed on a net basis in the consolidated statements of income. Previously, OPG reported physically settled interconnected transactions on a gross basis in operating revenues, and the associated costs in operating expenses, in accordance with prevailing industry practice. The amounts in the second and third quarter 2002 interim consolidated statements of income have been reclassified to conform to the fourth quarter and 2002 year end presentation. The change from gross to net presentation for energy trading activities reduced OPG's revenues and cost of power

purchases for the year ended December 31, 2002 by \$91 million, with no impact on net income.

### Non-Energy and Other

| <i>(millions of dollars)</i>                 | <b>2002</b>  | <b>2001</b> |
|--|--------------|-------------|
| Revenue                                      | <b>323</b>   | 294         |
| Operations, maintenance and administration   | <b>55</b>    | 84          |
| Depreciation and amortization                | <b>107</b>   | 64          |
| Property and capital taxes                   | <b>14</b>    | 17          |
| Loss on transition rate option contracts     | <b>210</b>   | -           |
| Operating income (loss) before restructuring | <b>(63)</b>  | 129         |
| Restructuring                                | <b>222</b>   | 67          |
| Operating income (loss)                      | <b>(285)</b> | 62          |
| Other income                                 | <b>171</b>   | -           |
| Net interest expense                         | <b>150</b>   | 139         |
| Income (loss) before income taxes            | <b>(264)</b> | (77)        |

### Revenue

Non-energy revenue for 2002 was \$323 million compared to \$294 million for 2001, an increase of \$29 million. The increase in non-energy revenue was primarily due to an increase in lease and ancillary revenue earned under the agreements with Bruce Power, partially offset by reduced revenue as a result of OPG's sale of its interest in Kinectrics Inc.

### Bruce Nuclear Generating Stations

Under the lease agreement with Bruce Power, the Company leased its Bruce A and Bruce B nuclear generating stations until 2018, with options to renew for up to 25 years. As part of the initial payment, OPG received \$370 million in cash proceeds and a \$225 million note receivable. Under the terms of the original operating lease agreement, the receivable of \$225 million was payable to OPG in two installments of \$112.5 million, no later than four and six years from the date the transaction was completed.

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 on February 14, 2003. Upon closing, the \$225 million note receivable was repaid and lease payments commenced to be paid monthly. In addition, for 2004 through 2008, minimum payments under the lease will, subject to limited exceptions, be \$190 million. The remaining terms of the operating lease agreement remain substantially unchanged.

### Operations, Maintenance and Administration

OM&A expenses were \$55 million for 2002 compared with \$84 million for 2001, a decrease of \$29 million. The decrease in OM&A expenses for the year was primarily due to the expiry of a fuel contract, whereby OPG supplied nuclear fuel to Bruce Power. The contract expired on December 31, 2001.

### Depreciation and Amortization

Depreciation and amortization expense was \$107 million for 2002 compared to \$64 million for 2001, an increase of \$43 million. The increase in 2002 was mainly due to the full year effect of reclassifying depreciation related to the Bruce nuclear generating stations from the Generation Segment to Non-Energy and Other.

### Loss on Transition Rate Options

Under a Government regulation known as Transition – Generation Corporation Designated Rate Options ("TRO"), OPG is required to provide transitional price relief upon market opening to certain power customers based on the consumption and average price paid by each customer during a reference period from July 1, 1999 to June 30, 2000. The maximum anticipated volume subject to the transitional price relief is approximately 5.4 TWh in the first year after market opening, 3.6 TWh in the second year and 1.8 TWh in each of the third and fourth years. The maximum length of the program is four years, with the possibility that it will expire after only two years if certain decontrol targets are met.

A provision of \$210 million on the TRO contracts was recorded in the first quarter of 2002 based on the future loss on these contracts. The provision was determined at that time using management's best estimates of the forward price curve for electricity, wholesale electricity market fees, impact of decontrol on the contracts, interruptions of volume, and the recovery of market power mitigation agreement rebates. These estimates are subject to measurement uncertainty. Since the market opened on May 1, 2002, \$66 million has been charged against the provision and included in generation revenue.

#### *Other Income*

Other income for 2002 of \$171 million includes the gain on sale from decontrol activities and other initiatives.

In May 2002, OPG completed the sale of four hydroelectric generating stations located on the Mississagi River to Mississagi Power Trust. OPG received cash proceeds of \$342 million from the sale and recorded a pretax gain of \$99 million. In addition, OPG recorded gains totalling \$72 million related to the sale of OPG's Nuclear Safety Analysis Division and sales of OPG's investments in New Horizon System Solutions Inc., Kinectrics Inc. and other long-term investments.

#### *Restructuring Costs*

In 2001, OPG approved a restructuring plan designed to improve OPG's future cost competitiveness. Completion of significant decontrol activities and other major initiatives over the next two years call for the restructuring of areas within OPG that support these operations. Restructuring charges are related to an anticipated reduction in the workforce of approximately 2,000 employees over a two to three year period. As at December 31, 2002, OPG has approved severance packages for approximately 1,400 employees. Restructuring charges of \$222 million and \$67 million were recorded in 2002 and 2001 respectively.

#### **Income Tax**

For 2002, the effective income tax rate for 2002 was a recovery of 6.8 per cent compared to an effective income tax rate of 30.3 per cent in 2001. The income tax recovery in 2002 was primarily due to the impact of non-taxable items including the non-taxable portion of the capital gain on the sale of the Mississagi River stations.

#### **LIQUIDITY AND CAPITAL RESOURCES**

Cash flow provided from operating activities in 2002 was \$844 million compared to \$224 million in 2001, an increase of \$620 million. The increase in cash flow was mainly due to higher energy prices which reflected higher summer demand due to warmer than normal temperatures. Under the market power mitigation agreement, a rebate is paid to the IMO for ultimate distribution to customers. As at December 31, 2002, the rebate payable totalled \$572 million after taking into account an interim payment made to the IMO.

With market opening, electricity prices are expected to have seasonal variations related to changes in demand. Prices are expected to be higher in the first and third quarters of a fiscal year as a result of winter heating demands in the first quarter and air conditioning / cooling demands in the third quarter. The market power mitigation agreement rebate and the Company's hedging strategies significantly reduce the impact of the seasonal price fluctuations on the Company's operations.

OPG continues to invest in plant and technologies to improve operating efficiencies, increase generating capacity of its existing plant and maintain and improve service, reliability, safety and environmental performance. Capital expenditures during 2002 were \$869 million compared with \$739 million in 2001. The increase in capital expenditures was primarily due to higher activity related to the return to service of the Pickering A nuclear generating



station and expenditures related to the installation of selective catalytic reduction equipment for the purpose of emissions reductions at OPG's Lambton and Nanticoke fossil generating stations.

OPG's planned capital expenditures for 2003 are approximately \$935 million, of which \$290 million relates to sustaining operations. This amount includes expenditures to support the continued operations of current generating capacity, such as expenditures to meet expected emission reduction regulations, and expenditures to expand generating capacity such as the Pickering A return to service project and the nuclear recovery program. For 2004, OPG's planned capital expenditures are approximately \$870 million, of which \$275 million represents sustaining expenditures.

The nuclear fixed asset removal and nuclear waste management funds increased in 2002 by a total of \$391 million compared to \$427 million in 2001 through contributions and income earned on investments. OPG reduced its contributions in 2002 primarily in order to adjust for over contributions in previous years. The balance in the fund at December 31, 2002 was \$1,599 million compared to \$1,208 million at December 31, 2001. OPG is required to make contributions in 2003 of approximately \$454 million to the nuclear fixed asset removal and nuclear waste management fund under the Ontario Nuclear Funds Agreement.

In March 2002, OPG renewed its revolving short-term committed credit facility. The amount of the credit facility was increased from \$600 million to \$1,000 million. The credit facility has a revolving 364 day term, which can be extended for a two-year term. Notes issued under the Company's Commercial Paper ("CP") program are supported by this credit facility. At December 31, 2002, OPG had \$182 million outstanding under the CP program. The Company plans to access the capital markets with a debt offering during 2003.

In March 2002, the Company reached an agreement with the Ontario Electricity Financial Corporation ("OEFC") to defer payment of the \$200 million principal amount of senior notes maturing in 2002 to December 2004. In connection with this deferral, the coupon rate on \$100 million principal amount of these notes was increased, based on commercial terms, by 0.50 per cent; the interest rate for the remaining \$100 million principal amount of these notes was unchanged.

In February 2003, the Company reached an agreement with the OEFC to defer payment on \$700 million principal amount of senior notes maturing in 2003 and 2004 by extending the maturity dates by two years. The interest rates remain unchanged. As a result of the deferral, \$200 million of long-term debt due within one year was reclassified to long-term at December 31, 2002. The notes deferred and the new maturities are as follows:

| Principal Amount<br>of Senior Notes<br>(millions of dollars) | Maturity Prior<br>to Deferral | New Maturity |
|--|-------------------------------|--------------|
| 200  | 2003                          | 2005         |
| 100  | 2004                          | 2006         |
| 300  | 2004                          | 2006         |
| 100  | 2004                          | 2006         |

British Energy plc. entered into an agreement to dispose of its interest in Bruce Power. The transaction was completed on February 14, 2003. Upon closing, the \$225 million note receivable from Bruce Power was repaid. Proceeds from the note will be applied against OPG's funding requirements with respect to the nuclear fixed asset removal and nuclear waste management liabilities.

In May 2002, Dominion Bond Rating Service lowered OPG's senior unsecured long-term debt rating from A to A (low) and confirmed the Commercial Paper rating of R-1 (low). In December 2002, OPG's senior unsecured long-

term debt rating was confirmed and the trend was revised to negative. The trend on the Commercial paper rating remains stable. In July 2002, Standard and Poor's reaffirmed OPG's long-term debt rating of BBB+, while changing the outlook to negative and lowering the short-term debt rating to A-2 from A-1(low). In November 2002, Standard and Poor's Rating Service placed all rated provincial and municipal government owned electricity companies in Ontario on credit watch with negative implications.

The Company paid dividends to the Province of \$134 million during 2002 compared with \$375 million in 2001. The decrease was due to lower earnings in 2002 compared to 2001, and a one-time special dividend paid in 2001 related to proceeds received from the decontrol of the Bruce nuclear generating stations. Dividends are declared and paid to achieve a 35 per cent pay-out based on net income.

In September 2002, Brighton Beach Power L.P. ("Brighton Beach"), a limited partnership formed by OPG, ATCO Power Canada Ltd., ATCO Resources Ltd. and Brighton Beach Power Ltd., completed a \$403 million private bond and term debt financing for its 580 megawatt power project under construction in Windsor, Ontario. Brighton Beach also signed an energy conversion agreement with Coral Energy Canada Inc. to deliver natural gas to the plant and own, market, and trade all the electricity produced. OPG proportionately consolidates its 50 per cent interest in the Brighton Beach partnership. As at December 31, 2002, \$276 million was outstanding under the financing agreement and accordingly \$138 million is included in OPG's long-term debt. During 2003, OPG expects to provide a capital contribution to the project of approximately \$50 million. Brighton Beach is scheduled to be in-service during the first half of 2004.

### *Benefit Plans*

The Company maintains a contributory defined benefit pension plan. All employees of OPG are eligible to participate in these plans. OPG's policy is to fund amounts as required under the *Pension Benefits Act*. No contributions by the Company to the plans were necessary in 2001 or 2002.

Due to the declines in Canadian and United States equity markets during 2001 and 2002, the value of assets held in the trust to satisfy the future obligations of the pension plan has decreased significantly. In December 2002, OPG filed its actuarial valuation as at April 1, 2002 with the Financial Services Commission of Ontario. The plan, as at the valuation date, had a surplus for funding purposes using market-related values representing approximately one year's current service costs. The Company will commence contributions in 2003. OPG will continue to monitor its funding status and determine, as appropriate, if additional funding is warranted. Based on its most recently completed funding plan, the Company expects to make contributions to its defined benefit pension plans totalling approximately \$160 million during 2003. OPG believes it has adequate access to capital resources through cash flows from operations or through existing lines of credit to support these contributions.

OPG introduced a voluntary severance program in 2001 to reduce its workforce by 2,000 employees. As employees take advantage of the voluntary severance program, larger than average cash requirements relating to severance, termination payments and acceleration of retirement and post-retirement benefit payments are incurred by the Company.

## PICKERING A RETURN TO SERVICE

OPG is continuing to progress with the safety and environmental upgrades and other refurbishment work which is required prior to the return to service of the four units at the Pickering A nuclear generating station. Cumulative expenditures on the return to service initiative through the end of December 2002, which include the cost of common operating systems for all four units, totalled approximately \$1,200 million. Approximately two-thirds of these expenditures have been expensed.

Commissioning of various systems is underway and it is anticipated that full commissioning at various power levels will commence early in the second quarter. The first unit is expected to be in-service by the summer of 2003 and will significantly contribute to meeting Ontario's seasonal demands. The additional cost to complete the first unit is estimated at approximately \$150 million. This includes expenditures related to additional work that has been identified through testing of individual systems and additional time required to finalize the regulatory documentation.

There remain risks that could impact the cost and schedule of the return to service of the first unit. This includes the risk of additional construction and other discovery work that may be identified through the testing and commissioning process, additional challenges that may result from the first-time commissioning of the laid-up units and various regulatory risks related to obtaining required approvals.

OPG has commenced planning for the return to service of the second unit. The cost and schedule to return this unit to service are under review and will be estimated, taking into account OPG's experience associated with returning the first unit to service. OPG expects to complete, by the end of the second quarter of 2003, a detailed assessment of timing and the estimated costs to return the second unit to service.

## CRITICAL ACCOUNTING POLICIES

The critical accounting policies that affect the Company's financial statements and which use judgements and assumptions are listed below. In addition, the likelihood that materially different amounts would be reported under varied conditions and the impact of changes in certain conditions or assumptions is highlighted.

### Recoverability of Fixed Assets

OPG's business is capital intensive and has required, and will continue to require, significant investments in property, plant and equipment. At December 31, 2002, the carrying amount of OPG's property, plant and equipment was \$12,946 million. Recoverability of property, plant and equipment is measured by comparing the carrying amount of an asset to the undiscounted future net cash flows expected to be generated from the asset over its estimated useful life. In cases where the undiscounted expected future cash flows are less than the carrying amounts, a write-down is recognized equal to the difference.

The accounting estimates related to asset impairment require significant management judgement to identify factors such as short and long term forecasts for future sales prices, the supply of electricity in Ontario, the return to service dates of laid-up generating stations, 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 financial statements.

### Nuclear Cost Estimate Changes

The estimate of nuclear fixed asset removal and nuclear waste management costs requires significant assumptions in the calculations since the programs run for several decades. Significant assumptions underlying operational and technical factors are used in the calculation of the accrued liabilities and

are subject to periodic review. Changes to these assumptions, including changes in the timing of programs, technology employed, inflation, and discount rate, could result in significant changes in the value of the accrued liabilities.

Critical assumptions are evaluated and updated annually. Changes in the nuclear liability resulting from changes in assumptions are recorded over the remaining useful life of the nuclear facilities. A 0.25 per cent increase in the discount rate, holding all other assumptions constant, would result in a decrease in the nuclear fixed asset removal and nuclear waste management liability at December 31, 2002 of \$464 million. A 0.25 per cent decrease in the discount rate would result in an increase in the liability of \$509 million.

#### Benefit Plans

Assumptions used in determining projected benefit obligations and the fair values of plan assets for the Company's employee benefit plans are evaluated periodically by management in consultation with an independent actuary. Critical assumptions such as the discount rate used to measure the Company's benefit obligations, the expected long-term rate of return on plan assets and health care cost projections are evaluated and updated annually. A change in these assumptions, holding all other assumptions constant, would have the following impact on expenses for 2002:

#### *Pensions*

| Increase (decrease) in costs for a 0.25% change in the following:<br>(millions of dollars) | Increase | Decrease |
|--|----------|----------|
| Expected long-term rate of return  | (17)     | 17       |
| Discount rate  | (25)     | 27       |
| Inflation  | 38       | (36)     |
| Salary increases   | 6        | (7)      |

#### *Other Post Employment Benefits*

A 1.0 per cent increase or decrease in the health care cost trend rate in 2002 would result in an increase in expense of \$22 million or a decrease in expense of \$13 million, respectively.

A 0.25 per cent increase in the discount rate for other post-employment benefits would result in a decrease in expense in 2002 of \$4 million. A 0.25 per cent decrease in the discount rate would result in an increase in expense of \$4 million.

### RISK MANAGEMENT

OPG's portfolio of generation assets and electricity trading and marketing operations are subject to inherent risks, including financial, operational, regulatory and strategic risks. To manage these risks, OPG has implemented an enterprise-wide risk management framework which includes governance policies, organizational structures, and risk measurement and monitoring processes.

Oversight for risk management at OPG begins with the Board of Directors, who regularly monitor the Company's risk exposures and have approved the overriding governance policies, structures and limits for management of OPG's risks. A Risk Oversight Committee, which consists of senior officers and executives of OPG, has been established by the Chief Executive Officer to approve markets and products, monitor policies and compliance issues, and ensure the continuing effectiveness of overall corporate governance under the direction of the Board of Directors. Coordination of corporate-wide risk management activities occurs through a centralized corporate risk office. A well defined separation and independence exists between the corporate risk office and operational management.



OPG maintains a comprehensive trade capture and risk management system with related processes and controls. OPG's commercial activities are separated into portfolios to capture the risks inherent in each transaction for each portfolio. This process facilitates the effective identification and measurement of risks, and the application of appropriate position and risk limits for performance and risk management purposes. The methodology used to measure these risks includes the use of consistent and recognized risk measures for monitoring trading activities and the generation portfolio.

### Risk Classification

For purposes of tracking and communicating risk information, the Company uses four major risk categories including financial, operational, regulatory and strategic:

- › Financial risks are potential threats to achieving earnings and shareholder value objectives, including market price and volatility, credit, foreign exchange, interest rate, liquidity and other risks.
- › Operational risks are threats related to people, processes and systems that may adversely impact the efficiency and effectiveness of operations. These include generation reliability, fuel supply and availability, security, business process risks, personnel risks and information technology risks.
- › Regulatory risks arise from existing or potential regulations, rules and laws, as well as possible non-compliance with those rules that could adversely impact the Company's competitive position and ability to achieve its business objectives. These include risks related to environmental, health & safety and nuclear regulations, and legal issues.

- › Strategic risks are external forces that could significantly change the fundamentals that drive the Company's overall objectives and strategies. These include changes in the business and political environment, reputation risks, business interruption and succession planning.

### Risk Management Tools

In addition to qualitative indicators provided through risk-based internal audits, reviews and self-assessments, OPG uses quantitative tools and metrics for monitoring and managing risks. OPG continuously assesses the appropriateness and reliability of quantitative tools and metrics in light of the changing risk environment. The following are the most important quantitative tools and metrics that OPG currently uses to measure, manage and report on risk:

- › Value-at-Risk (VaR) analysis is used to measure and manage market risks in OPG's electricity trading portfolio. The value-at-risk approach is used to derive a quantitative measure specifically for market risks under normal market conditions. For a given portfolio, value-at-risk measures the possible future loss (in terms of market value) which, under normal market conditions, will not be exceeded within a defined probability in a certain period.
- › Gross-Profit-at-Risk (GPaR) measures the full financial risk of highly volatile spot electricity prices by accounting for the duration of the contract in the calculation. GPaR is a longer-term measure and assumes that positions are taken through to delivery.
- › Stress tests help to determine the effects of potentially extreme market developments on the market values of electricity trading and marketing positions. Stress testing is used to determine the amount of economic capital OPG needs to allocate to cover market risk exposure under extreme market conditions.

- › Economic capital is a measure of the amount of equity capital needed at any given date to absorb unexpected losses arising from exposures on that date. Currently, OPG calculates economic capital primarily in relation to Energy Markets.

### Commodity Price Risk

Commodity price risk is the risk that changes in the market price of electricity or fossil fuels will adversely impact OPG's earnings and cash flow from operations. OPG faces commodity price risk directly related to both the demand and supply of generation in the open market and transmission constraints. OPG's electricity production and a portion of the Company's fossil fuel requirements are exposed to spot market prices. To manage this risk, the Company maintains a balance between the commodity price risk inherent in its electricity production and plant fuel portfolios.

In addition to fixed price contracts for fossil and nuclear fuels, the Company employs derivative instruments to hedge its commodity price risk. The production from the Company's hydro facilities is also a natural hedge of fuel price risk.

The percentage of OPG's generation and fuel requirements hedged over the next three years is shown below:

|   | 2003 | 2004 | 2005 |
|---|------|------|------|
| Estimated generation output hedged <sup>1</sup> | 80%  | 81%  | 75%  |
| Estimated fuel requirements hedged <sup>2</sup> | 84%  | 85%  | 77%  |

<sup>1</sup> Represents the portion of megawatt-hours of future generation production for which the Company has sales commitments, and volumes related to the market power mitigation rebate and transition rate option contracts.

<sup>2</sup> Represents the portion of estimated future fuel requirements (based on MMBTU equivalents) for which OPG has entered contractual arrangements to manage related procurement price risks.

Open trading positions are subject to measurement against VaR limits, which measure the potential change in the portfolio's market value due to price

volatility over a one-day holding period, with a 95 per cent confidence interval. OPG's approved VaR limit is \$5 million. The VaR limits ranged between \$0.7 million to \$1.9 million during 2002.

### Credit Risk

Credit risk is the financial risk of non-performance by contractual counterparties. Subsequent to market opening, the majority of OPG's revenues are derived from sales through the IMO-administered spot market. OPG also derives revenue from several other sources including the sale of financial risk management products to third parties.

OPG actively manages its credit risk exposures through the enforcement of an established counterparty credit policy. OPG manages counterparty credit risk through dealing with investment grade counterparties, monitoring and limiting its exposure to counterparties with lower credit ratings, active collateral management, and by avoiding excessive concentration to any one counterparty or category of counterparties. Credit exposures include both settlement and market-based components. OPG's credit exposure is concentrated in the physical market with the IMO.

Since the Ontario market opened in May 2002, credit exposure to the IMO has fluctuated based on timing and peaked at \$1.2 billion. OPG's management believes that this is an acceptable risk due to the IMO's primary role in the Ontario market. The IMO manages its own credit risk and its ability to pay generators by mandating that all registered IMO spot market participants meet specific IMO standards for creditworthiness and collateralization. OPG also measures its credit concentrations with counterparties in the financial instrument market. OPG management believes these are within acceptable limits and does not anticipate any material effect on its results of operations or cash flows arising from potential defaults.

The following table provides information on credit risk from energy sales and trading activities as at December 31, 2002.

| <i>(millions of dollars)</i> |                                 |                          |   |
|------------------------------|---------------------------------|--------------------------|---|
| Credit Rating <sup>1</sup>   | Potential Exposure <sup>2</sup> | Number of Counterparties | Potential Exposure for 10 Largest Counterparty Exposures <sup>2</sup> |
| AAA to AA                    | 31                              | 10                       | 17  |
| A+ to A-                     | 210                             | 46                       | 128   |
| BBB+ to BBB-                 | 118                             | 72                       | 29  |
| BB+ to BB-                   | 55                              | 30                       | -   |
| B+ to B-                     | 18                              | 10                       | 9   |
| Total                        | 432                             | 168                      | 183   |
| IMO                          | 601                             | 1                        | 601   |
| Total                        | 1,033                           | 169                      | 784   |

1 Credit ratings are based on OPG's own analysis, taking into consideration external rating agency analysis where available, as well as recognizing explicit credit support provided through guarantees and letters of credit or other security.

2 Potential exposure represents OPG's assessment of the maximum exposure of the 10 largest counterparties for OPG as a whole, over the life of each transaction at 95 per cent confidence.

### Liquidity Risk

OPG operates in a capital-intensive business. Significant financial resources are required to return the Pickering A station to service and to fund other improvement projects and potential expenditures necessary to comply with air emission or other regulatory requirements. As well, funds are required for payments under the restructuring initiative, the market power mitigation agreement rebate, contributions under the Ontario Nuclear Funds Agreement, and other obligations including funding of OPG's pension fund commencing in 2003.

OPG has liquidity requirements over the next 18 months which exceed its current banking facilities. In order to meet these liquidity requirements, OPG must successfully access the mid-term note market under its shelf program, as well as defer certain debt maturities and other obligations to the Province. In

February 2003, OPG reached agreement with the Province to defer \$700 million of debt maturities.

OPG's ability to arrange debt financing is dependent on a number of factors including: general economic and capital market conditions; credit availability from banks and other financial institutions; maintenance of acceptable credit ratings; and the status of electricity market restructuring in Ontario.

The Company's liquidity is highly dependent on its debt rating and the mark-to-market value of contracts with counterparties. A change in the rating could result in additional collateral requirements with counterparties, depending on the mark-to-market value of the contracts. In particular, where counterparties are in a positive mark-to-market position and OPG is in a negative position, a downgrade of OPG's long-term debt ratings could trigger increased collateral requirements based on the provisions of the contracts.

OPG believes cash flows from operations, available short-term committed credit facilities and the successful issuance of debt in the capital markets should provide adequate liquidity for OPG's on-going requirements.

### Foreign Exchange and Interest Rate Risk

OPG's foreign exchange risk exposure is attributable primarily to U.S. dollar-denominated transactions such as the purchase of fuel. OPG currently manages its exposure by periodically hedging portions of its anticipated U.S. dollar cash flows according to approved risk management policies.

OPG has interest rate exposure on its short-term borrowings and investment programs. The majority of OPG's debt is fixed on a long-term

basis. Interest rate risk arises with the need to undertake new financing and with the potential addition of variable rate debt. Interest rate risk may be hedged using derivative instruments. The management of these risks is undertaken by selectively hedging in accordance with corporate risk management policies.

### **Generation Risk**

OPG is exposed to the market impacts of uncertain output from its generating units or generation risk. The amount of electricity generated by OPG is affected by such risks as fuel supply, equipment malfunction, maintenance requirements, and regulatory and environmental constraints. To mitigate earnings volatility due to generation risk, OPG enters into multiple short-term and long-term fuel supply agreements and long-term water use agreements, manages fuel supply inventories, and follows industry practices for maintenance and outage scheduling. In addition, OPG ensures regulatory requirements are met, particularly with respect to licensing of its nuclear facilities, and manages environmental constraints utilizing programs such as emission reduction credits.

OPG maintains general public liability, property and business interruption insurance, subject to deductibles. The occurrence of a significant event that is not fully insured or indemnified against, or the failure of a party to meet its indemnification obligations, could materially and adversely affect OPG's consolidated results of operations and financial position.

### **Environmental Risk**

OPG incurs substantial capital and operating costs to comply with environmental laws and its voluntary environmental programs. The regulatory requirements relate to discharges to the environment; the handling, use, storage,

transportation, disposal and clean-up of hazardous materials, including both hazardous and non-hazardous wastes; and the dismantlement, abandonment and restoration of generation facilities at the end of their useful lives.

OPG's Sustainable Energy Development Policy commits OPG to meet all applicable legislative requirements and voluntary environmental commitments, integrate environmental factors into business planning and decision-making, and to apply the precautionary approach principle in assessing risks to human health and the environment. This policy also commits OPG to maintain comprehensive environmental management systems ("EMSs") consistent with the ISO 14001 standard. OPG became one of the first electric utilities in North America to obtain ISO 14001 registration for the EMSs at all its facilities. This registration is obtained and kept current annually by independent audits.

OPG monitors emissions into the air and water and regularly reports the results to various regulators, including the Ministry of the Environment, Environment Canada and the Canadian Nuclear Safety Commission. OPG has implemented internal monitoring, assessment and reporting programs to manage environmental risks such as air and water emissions, discharges, spills, radioactive emissions and radioactive wastes. Further, OPG makes regular reports to the Ministry of the Environment with respect to its contaminated property remediation program.

In addition to the regular reports made to various regulators, the public receives frequent communications from OPG regarding OPG's environmental performance through community-based advisory groups representing communities surrounding OPG's major generating stations, annual environmental performance reports, community newsletters, open houses and the dissemination of information on OPG's Web site.

OPG manages its emissions of sulphur dioxide (SO<sub>2</sub>) and nitrogen oxides (NO<sub>x</sub>). Emissions are reduced through plant improvements and installation of specialized environmental equipment such as scrubbers to reduce SO<sub>2</sub> emissions, low NO<sub>x</sub> burners and selective catalytic reduction equipment to reduce NO<sub>x</sub> emissions, and through the purchase of low sulphur fuel. OPG also utilizes emission reduction credits (ERCs) to manage emission levels of nitric oxide within the prescribed regulatory limits and voluntary caps. ERCs are created when a source reduces emissions below the lower of previous actual emissions or the level required by government regulation.

Canada has ratified the Kyoto Protocol requiring a six per cent reduction in greenhouse gas emissions from 1990 levels by the period 2008 to 2012. Prior to the ratification of the Kyoto Protocol, OPG voluntarily committed to reduce its greenhouse gas emissions, net of emission reduction credits used, to 1990 levels in 2000 and beyond. Negotiations with the federal and provincial governments to define OPG's target under the Kyoto regime will begin in 2003. Currently, there is no assurance that such limits would not impose significant costs on fossil electricity generators such as OPG, although the federal government has promised to cap the cost of CO<sub>2</sub> credits at \$15 per tonne.

### Ownership and Regulation

OPG and the Province have entered into a shareholder's agreement relating to certain aspects of the governance of OPG. The agreement addresses approvals of business transactions, provision of information and dividend policy.

OPG's operations are subject to government regulation that may change. Matters that are subject to regulation include: structure of the electricity market, nuclear operations including regulation pursuant to *Nuclear Safety and Control Act*

(Canada), the *Nuclear Liability Act (Canada)* and the *Emergency Plans Act (Ontario)*, nuclear waste management and decommissioning, water rentals, environmental matters including air emissions, and proxy tax payments. Because legal requirements can be subject to change and are subject to interpretation, OPG is unable to predict the impact of such changes on the Company and its operations.

### OTHER DECONTROL ACTIVITIES

OPG continues to evaluate options for decontrol of stations and is committed to meet its obligations under its generating licence. The process for meeting decontrol of price-setting generation has been impacted by the current market conditions in the energy sector. The amounts that OPG will ultimately realize with respect to these potential transactions could differ materially from the carrying values recorded in the financial statements.

### NORTH AMERICAN ELECTRICITY MARKET

The North American electricity industry has undergone upheaval over the past 18 months. Corporate strategies have been profoundly impacted by: an economic slowdown that has moderated demand; substantial capacity additions that have led to over-supply in many regions; volatile commodity costs; declining electricity prices; regulatory investigations into aggressive energy trading and accounting practices; postponement or even cancellation of deregulation in many regions, the imposition of price caps and significant credit rating agency downgrades due to weakened balance sheets. These events have resulted in deteriorating investor confidence and restricted access to capital markets. Corporate strategies have consequently been modified and now include asset sales, significantly reduced energy trading activity that has negatively impacted market liquidity, and record levels of equity issuance.



## VISION, CORE BUSINESS AND STRATEGY

OPG's vision is to be a premier North American energy company. The Company continues to focus on the risk-managed production and sale of reliable electricity from competitive generation assets. OPG continues to be a low-cost generator offering risk-managed products with a significant regional presence. OPG plans to leverage its strengths and direct its resources to the following strategies:

- › Increase production efficiencies and cost-competitiveness of generating operations;
- › Capitalize on energy marketing and sales opportunities created in the electricity markets;
- › Optimize OPG's organizational structure to ensure operational flexibility; and
- › Undertake sustainable development initiatives aimed at continuous and measurable improvement in environmental performance.

### Key Performance Drivers and Initiatives

#### *Improved Efficiencies and Cost Competitiveness*

OPG's portfolio of generation assets is well balanced and diversified in terms of technology, fuel type, market and dispatch flexibility. Production costs are low relative to other generators in Ontario and the U.S. northeast and midwest, although higher than generators in Manitoba and Quebec. OPG's fundamental strategy in the near term is to increase the productivity, capacity and cost competitiveness of its generating stations.

OPG continues to improve the operating performance of its nuclear generating stations. OPG's goal is to achieve top quartile performance among North American nuclear generators based on a nuclear performance index used by the North American members of the Institute of Nuclear

Power Operators and the World Association of Nuclear Operators. This index is designed to measure the degree by which a nuclear generator is providing safe and reliable nuclear performance.

OPG's fossil plants operate both as base load and peaking stations depending on the particular stations. Plant efficiency, productivity and reduction of airborne emissions are key factors in enhancing competitiveness of these plants. Significant additional improvements to these stations are in progress, such as the installation of selective catalytic reduction equipment on four units, two at Lambton and two at Nanticoke by the end of 2003, at a cost of approximately \$285 million. OPG is also pursuing a broad range of other initiatives, including operational changes, emission reduction credit trading and further developing emission control technologies. The successful implementation of these initiatives is intended to maintain the cost competitiveness of OPG's fossil operations relative to other fossil generators in its regional market area and to ensure continued compliance with environmental performance standards in Ontario.

#### *Pickering A Return to Service*

The return to service of the four laid-up units at the Pickering A nuclear generating station is a key initiative for OPG. The return to service of all four Pickering A units will add 2,060 MW of reliable, low cost electricity and will make a significant contribution towards improving environmental performance within the Ontario electricity market since nuclear stations do not produce emissions resulting in smog, acid rain or global warming.

#### *Energy Marketing and Sales Opportunities*

OPG has developed and enhanced its marketing, sales and trading capabilities, with a focus on three key growth areas of the new marketplace: (i) spot market energy sales and trading; (ii) the sale of financial risk management products; and (iii) sales of energy-related products and services to meet

customer needs for energy solutions. The successful implementation of this strategy is predicated on factors such as sophisticated product structuring and risk management skills to correctly price and manage complex structured products, marketplace recognition and brand equity to facilitate customer acquisition and retention, and the capability to deliver risk management products that meet customer needs.

#### *Focus on Core Business Operations*

OPG is pursuing initiatives to improve the cost competitiveness and operational flexibility of its business and to foster a strong market orientation. In doing so, OPG will be well positioned to adapt to changing conditions in the Ontario market and to pursue new or expanded business opportunities in the interconnected markets. As part of this initiative, in January 2002, OPG announced a restructuring plan that will lead to a company-wide staff reduction of approximately 2,000 employees. OPG's other initiatives to date include: a renewed commitment to workforce skills development and cooperative labour relations which, combined with company-wide incentive programs, have contributed to greater operational flexibility and enhanced productivity.

OPG has also continued the strategic outsourcing of non-core activities and the reorganization of corporate services, internally or with partners. This included the sale of its share of the New Horizon System Solutions information technology services joint venture to Business Transformation Services Inc., a wholly owned subsidiary of Cap Gemini, effective March 2002, and outsourcing certain of its research and development activities with the sale of its interest in Kinectrics Inc. to AEA Technology plc., effective January 2002. In 2002, OPG also finalized the sale of its Nuclear Safety Analysis Division to Nuclear Safety Systems, a subsidiary of NNC Holdings Ltd., an international provider of nuclear safety analysis services. OPG is in the

process of inviting qualified industry experts to propose business opportunities with respect to its Inspection Services Division. The Inspection Services Division provides essential specialized inspection maintenance services both within OPG and to other nuclear generating facilities in Canada.

#### *Sustainable Development Initiatives*

OPG is committed to becoming a sustainable energy company. The Company's goals include meeting all legislative requirements and voluntary environmental commitments with the objective of moving beyond compliance; maintaining environmental management systems consistent with the ISO 14001 environmental management specifications; integrating environmental and social factors into planning, decision-making, and business practices; applying environmental considerations to operating decision making; developing the use of renewable energy and energy efficient technologies; and measuring and communicating our progress towards achieving sustainable development.

#### *Other Initiatives*

OPG is contributing to capacity in Ontario. The successful return to service of Pickering A nuclear generating station will add significant capacity. The Brighton Beach project will add 580 MW of capacity. The plant is scheduled to be in-service in 2004. OPG owns 50 per cent of Huron Wind, the first commercial wind farm in Ontario, located on the shores of Lake Huron near Kincardine. Huron Wind, which consists of five wind turbines that generate a total capacity of nine MW, will market certified green electricity to commercial and industrial customers.

The Ontario Government announced in November 2002 that it would direct OPG to develop the Niagara Tunnel Project, a project designed to more fully utilize water available at the Sir Adam Beck Generating Station at Niagara Falls. Further, the Ministry of Energy is proceeding with an

independent study on the feasibility of moving forward with the Beck 3 generating project in Niagara Falls.

The Government has also directed OPG to accelerate its assessment of the Portlands public-private partnership project, on the site of the Hearn Generating Station in the area of Toronto's downtown waterfront. In December 2002, OPG and TransCanada Energy Limited announced the formation of a 50/50 limited partnership called Portlands Energy Centre L.P. The partnership is reviewing options to assess the feasibility of developing a 550 MW combined cycle natural gas-fueled cogeneration facility to meet the growing energy needs of Toronto's downtown core.

#### QUARTERLY RESULTS OF OPERATIONS

The following tables set out certain unaudited consolidated statements of operations data for each of the eight most recent quarters ended December 31, 2002. The information has been derived from OPG's unaudited consolidated financial statements that, in management's opinion, have been prepared on a basis consistent with the audited consolidated financial statements. These operating results are not necessarily indicative of results for any future period.

| (millions of dollars)                        | 2002 Quarters Ended |         |          |         |            |
|--|---------------------|---------|----------|---------|------------|
|  | March 31            | June 30 | Sept. 30 | Dec. 31 | Total Year |
| Revenues                                     | 1,550               | 1,270   | 1,612    | 1,314   | 5,746      |
| Gross margin                                 | 932                 | 863     | 1,200    | 851     | 3,846      |
| Operating expenses                           | 1,018               | 841     | 798      | 944     | 3,601      |
| Operating income (loss) before restructuring | (86)                | 22      | 402      | (93)    | 245        |
| Net income (loss)                            | (217)               | 63      | 215      | (14)    | 47         |

| (millions of dollars)                 | 2001 Quarters Ended |         |          |         |            |
|---------------------------------------|---------------------|---------|----------|---------|------------|
|                                       | March 31            | June 30 | Sept. 30 | Dec. 31 | Total Year |
| Revenues                              | 1,539               | 1,507   | 1,635    | 1,558   | 6,239      |
| Gross margin                          | 1,069               | 996     | 868      | 974     | 3,907      |
| Operating expenses                    | 844                 | 862     | 807      | 970     | 3,483      |
| Operating income before restructuring | 225                 | 134     | 61       | 4       | 424        |
| Net income (loss)                     | 102                 | 17      | 81       | (48)    | 152        |

#### FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements that reflect OPG's current views regarding certain future events and circumstances. Any statement contained in this document that is not a current or historical fact is a forward-looking statement. OPG generally uses words such as "anticipate", "believe", "foresee", "forecast", "estimate", "expect", "intend", "plan", "project", "seek", "target", "goal", "strategy", "may", "will", "should", "could" and other similar words and expressions to indicate forward-looking statements. The absence of any such word or expression will not, however, mean that a statement is not a forward-looking statement.

All forward-looking statements involve inherent assumptions, risks and uncertainties and, therefore, could be wrong to a material degree. In particular, forward-looking statements contain assumptions such as those relating to: OPG's nuclear recovery plan, fuel costs and availability, nuclear decommissioning and waste management, spot market electricity prices, the ongoing evolution of the Ontario electricity industry, market power mitigation, environmental and other regulatory requirements, and the weather. Accordingly, you should not place undue reliance on any forward-looking statement.

OPG has neither any intention nor any obligation to update or otherwise revise any forward-looking statement, whether as a result of new information, future developments or otherwise. You are invited, however, to review any further documents that OPG files on the public record with the Ontario Securities Commission.

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## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

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The accompanying consolidated financial statements of Ontario Power Generation Inc. ("OPG" or "Company") are the responsibility of management and have been prepared in accordance with Canadian generally accepted accounting principles. Where alternative accounting methods exist, management has selected those it considers most appropriate in the circumstances. The preparation of the consolidated financial statements necessarily involves the use of estimates based on management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The consolidated financial statements have been properly prepared within reasonable limits of materiality.

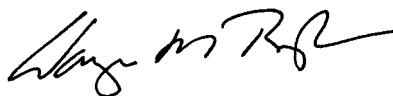
Management maintains a system of internal controls which are designed to provide reasonable assurance that the financial information is relevant, reliable and accurate, and that OPG's assets are safeguarded and transactions are executed in accordance with management's authorization. These systems are monitored and evaluated by management and by an internal audit service and risk management function.

The Audit Committee meets regularly with management, internal audit services and the external auditors to satisfy itself that each group has properly discharged its respective responsibility, and to review the financial statements and independent Auditors' Report, and to discuss significant financial reporting issues and auditing matters before recommending approval of the financial statements by the Board of Directors.

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 auditors had direct and full access to the Audit Committee, with and without the presence of management, to discuss their audit and their findings as to the integrity of OPG's financial reporting and the effectiveness of the system of internal controls.



Ronald W. Osborne  
*President and Chief Executive Officer*



Wayne M. Bingham  
*Executive Vice President and Chief Financial Officer*

January 24, 2003 except as to notes 6(b), 13(b) and 23(b)  
which are as at March 25, 2003

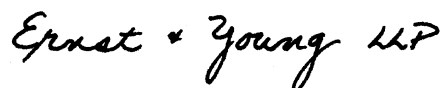


### To the Shareholder of Ontario Power Generation Inc.

We have audited the consolidated balance sheets of Ontario Power Generation Inc. as at December 31, 2002 and 2001 and the consolidated statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of Ontario Power Generation Inc.'s management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Ontario Power Generation Inc. as at December 31, 2002 and 2001 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  
Chartered Accountants  
Toronto, Canada

January 24, 2003 except as to notes 6(b), 13(b) and 23(b)  
which are as at March 25, 2003

## CONSOLIDATED STATEMENTS OF INCOME

| <b>Years Ended December 31</b><br><i>(millions of dollars except where noted)</i> | <b>2002</b>  | <b>2001</b> |
|---|--------------|-------------|
| <b>Revenues</b>   | <b>5,746</b> | 6,239       |
| Fuel  | <b>1,610</b> | 1,453       |
| Power purchased   | <b>290</b>   | 879         |
| <b>Gross Margin</b>   | <b>3,846</b> | 3,907       |
| <b>Operating expenses</b>   |              |             |
| Operations, maintenance and administration  | <b>2,524</b> | 2,559       |
| Depreciation and amortization <i>(note 4)</i>                                     | <b>752</b>   | 810         |
| Property and capital taxes  | <b>115</b>   | 114         |
| Loss on transition rate option contracts <i>(note 15)</i>                         | <b>210</b>   | -           |
|   | <b>3,601</b> | 3,483       |
| <b>Operating income before restructuring</b>                                      | <b>245</b>   | 424         |
| Restructuring <i>(note 14)</i>  | <b>222</b>   | 67          |
| <b>Operating income</b>   | <b>23</b>    | 357         |
| Other income <i>(note 21)</i>   | <b>171</b>   | -           |
| Net interest expense  | <b>150</b>   | 139         |
|   | <b>(21)</b>  | 139         |
| <b>Income before income taxes</b>   | <b>44</b>    | 218         |
| Income taxes (recoveries) <i>(note 10)</i>  |              |             |
| Current   | <b>29</b>    | (65)        |
| Future  | <b>(32)</b>  | 131         |
|   | <b>(3)</b>   | 66          |
| <b>Net income</b>   | <b>47</b>    | 152         |
| <b>Basic and diluted earnings per common share <i>(dollars)</i></b>               | <b>0.18</b>  | 0.59        |
| <b>Common shares outstanding <i>(millions)</i> <i>(note 11)</i></b>               | <b>256.3</b> | 256.3       |

## CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

| <b>Years Ended December 31</b><br><i>(millions of dollars)</i> | <b>2002</b>  | <b>2001</b> |
|--|--------------|-------------|
| <b>Retained earnings, beginning of year</b>                    | <b>344</b>   | 567         |
| Net income   | <b>47</b>    | 152         |
| Dividends  | <b>(134)</b> | (375)       |
| <b>Retained earnings, end of year</b>                          | <b>257</b>   | 344         |

See accompanying notes to the consolidated financial statements

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| Years Ended December 31<br>(millions of dollars)                       | 2002  | 2001  |
|--|-------|-------|
| <b>Operating activities</b>  |       |       |
| Net income   | 47    | 152   |
| Adjust for non-cash items:   |       |       |
| Depreciation and amortization  | 752   | 810   |
| Deferred pension asset   | 16    | 21    |
| Other post employment benefits   | 55    | (13)  |
| Future income taxes (note 10)  | (32)  | 131   |
| Provision for restructuring  | 222   | 67    |
| Transition rate option contracts (note 15)                             | 144   | -     |
| Gain on sale of investments  | (72)  | -     |
| Gain on sale of decontrol fixed assets                                 | (99)  | -     |
| Mark to market on energy contracts (note 9)                            | 2     | -     |
| Earnings on nuclear waste management funds                             | 78    | 57    |
| Other  | 91    | (4)   |
|  | 1,204 | 1,221 |
| Contributions to fixed asset removal and nuclear waste management fund | (391) | (427) |
| Expenditures on nuclear waste management                               | (92)  | (56)  |
| Market power mitigation agreement rebate payment (note 16)             | (335) | -     |
| Expenditures on restructuring (note 14)                                | (134) | -     |
| Net changes to other long-term assets and liabilities                  | 117   | (67)  |
| Changes in non-cash working capital balances (note 22)                 | 475   | (447) |
| <b>Cash flow provided by operating activities</b>                      | 844   | 224   |
| <b>Investing activities</b>  |       |       |
| Proceeds from Bruce decontrol (note 13)                                | -     | 370   |
| Net proceeds from short-term investments                               | 39    | 296   |
| Proceeds on sale of decontrol fixed assets (note 13)                   | 342   | 12    |
| Cash proceeds from sale of investments (note 21)                       | 83    | -     |
| Purchases of fixed assets  | (869) | (739) |
| <b>Cash flow used in investing activities</b>                          | (405) | (61)  |
| <b>Financing activities</b>  |       |       |
| Issuance of long-term debt (note 6)                                    | 138   | -     |
| Repayment of long-term debt  | (1)   | (203) |
| Dividends paid   | (134) | (375) |
| Short-term notes issued  | 446   | -     |
| Short-term notes repaid  | (264) | (150) |
| <b>Cash flow provided by (used in) financing activities</b>            | 185   | (728) |
| <b>Net increase (decrease) in cash and cash equivalents</b>            | 624   | (565) |
| <b>Cash and cash equivalents, beginning of year</b>                    | -     | 565   |
| <b>Cash and cash equivalents, end of year</b>                          | 624   | -     |

See accompanying notes to the consolidated financial statements

## CONSOLIDATED BALANCE SHEETS

| <b>As at December 31</b><br><i>(millions of dollars)</i>                       | <b>2002</b>   | <b>2001</b>   |
|--|---------------|---------------|
| <b>Assets</b>  |               |               |
| <b>Current assets</b>  |               |               |
| Cash and cash equivalents  | 624           | -             |
| Short-term investments   | -             | 39            |
| Accounts receivable  | 736           | 1,010         |
| Note receivable <i>(note 13)</i>   | 225           | -             |
| Income taxes recoverable   | 80            | 77            |
| Fuel inventory   | 514           | 537           |
| Materials and supplies   | 80            | 35            |
|  | <b>2,259</b>  | <b>1,698</b>  |
| <b>Fixed assets <i>(note 4)</i></b>  |               |               |
| Property, plant and equipment  | 15,014        | 14,460        |
| Less: accumulated depreciation   | 2,068         | 1,479         |
|  | <b>12,946</b> | <b>12,981</b> |
| <b>Other long-term assets</b>  |               |               |
| Deferred pension asset <i>(note 8)</i>   | 305           | 330           |
| Nuclear fixed asset removal and nuclear waste management funds <i>(note 7)</i> | 1,599         | 1,208         |
| Long-term note receivable <i>(note 13)</i>                                     | -             | 225           |
| Materials and supplies   | 193           | 179           |
| Long-term accounts receivable and other assets                                 | 59            | 65            |
|  | <b>2,156</b>  | <b>2,007</b>  |
|  | <b>17,361</b> | <b>16,686</b> |

See accompanying notes to the consolidated financial statements

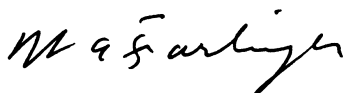
## CONSOLIDATED BALANCE SHEETS

| As at December 31<br><i>(millions of dollars)</i>                 | 2002          | 2001          |
|---|---------------|---------------|
| <b>Liabilities</b>  |               |               |
| <b>Current liabilities</b>  |               |               |
| Accounts payable and accrued charges <i>(notes 14, 15)</i>        | 1,235         | 1,505         |
| Market power mitigation agreement rebate payable <i>(note 16)</i> | 572           | -             |
| Short-term notes payable  | 182           | -             |
| Deferred revenue due within one year                              | 12            | 13            |
| Long-term debt due within one year <i>(note 6)</i>                | 5             | 205           |
|   | <b>2,006</b>  | <b>1,723</b>  |
| <b>Long-term debt <i>(note 6)</i></b>                             | <b>3,352</b>  | <b>3,015</b>  |
| <b>Other long-term liabilities</b>                                |               |               |
| Fixed asset removal and nuclear waste management <i>(note 7)</i>  | 4,915         | 4,724         |
| Other post employment benefits <i>(note 8)</i>                    | 958           | 924           |
| Long-term accounts payable and accrued charges <i>(note 15)</i>   | 321           | 336           |
| Deferred revenue <i>(note 13)</i>                                 | 179           | 215           |
| Future income taxes <i>(note 10)</i>                              | 247           | 279           |
|   | <b>6,620</b>  | <b>6,478</b>  |
| <b>Shareholder's equity</b>                                       |               |               |
| Common shares <i>(note 11)</i>                                    | 5,126         | 5,126         |
| Retained earnings   | 257           | 344           |
|   | <b>5,383</b>  | <b>5,470</b>  |
|   | <b>17,361</b> | <b>16,686</b> |

Commitments and Contingencies *(note 12)*

*See accompanying notes to the consolidated financial statements*

On behalf of the Board of Directors:



William A. Farlinger  
*Chairman*



Ronald W. Osborne  
*President and Chief Executive Officer*



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

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## 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 ("OEFC"), responsible for managing and retiring Ontario Hydro's outstanding debt and other obligations.

## 2. BASIS OF PRESENTATION

The consolidated financial statements of OPG have been 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 Ontario Power Generation Inc. and its subsidiaries. OPG accounts for its interests in jointly controlled entities using the proportionate consolidation method. All significant inter-company transactions have been eliminated on consolidation.

Certain of the 2001 comparative amounts have been reclassified from statements previously presented to conform to the 2002 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 an original term to maturity less than 90 days on the date of purchase. All other money market securities with original terms to maturity on the date of purchase greater than 90 days, but less than one year, are recorded as short-term investments. These securities are valued at lower of cost or market.

Interest earned on cash and cash equivalents and short-term investments is offset against interest expense in the consolidated statements of income.

### Inventories

Fuel inventory is valued at the lower of average cost or net realizable value.

Materials and supplies are valued at the lower of average cost or net realizable value with the exception of critical replacement parts which are unique to nuclear and fossil 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   | 25 and 40 years <sup>1</sup> |
| Fossil generating stations  | 40 to 50 years               |
| Hydroelectric generating stations                                     | 100 years                    |
| Administration and service facilities                                 | 50 years                     |
| Computers and transport and work equipment assets – declining balance | 9 to 40% per year            |
| Major application software  | 7 years                      |

<sup>1</sup> The nuclear stations are depreciated for accounting purposes over 25 years with the exception of Pickering A. The Pickering A station is depreciated over 40 years as a result of the completion, during the 1980s, of the retubing of the Pickering A station.

## Impairment of Fixed Assets

OPG evaluates its property, plant and equipment for impairment whenever conditions indicate that estimated future net cash flows may be less than the net carrying amount of assets. The difference, if any, is recognized as an impairment loss.

## Long-Term Portfolio Investments

Long-term portfolio investments are stated at 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.

## Market Power Mitigation Agreement Rebate

OPG is 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 include a rebate mechanism and the requirement to decontrol generating capacity. Under the rebate mechanism, for the first four years after the electricity market opened to competition on May 1, 2002 ("market opening"), a significant majority of OPG's expected energy sales in Ontario are subject to an average annual revenue cap of 3.8¢/kilowatt-hour ("kWh"). OPG is required to pay a rebate to the Independent Electricity Market Operator ("IMO") equal to the excess, if any, of the average hourly spot

energy price over 3.8¢/kWh for a twelve month settlement period, multiplied by the amount of energy subject to the rebate mechanism. The first settlement period ends April 30, 2003. The quantities of energy subject to the rebate, as well as the hourly weights used to compute the annual average spot price for rebate purposes, have been fixed in advance but may be reduced by the Ontario Energy Board for decontrol transactions completed by OPG. At each balance sheet date, OPG computes the average spot energy price that prevailed since the beginning of the current settlement period and recognizes a liability if the average price exceeds 3.8¢/kWh, based on the amount of energy subject to the rebate.

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

OPG recognizes a liability for fixed asset removal and nuclear waste management, taking into account the time value of money. OPG is able to estimate both the amount and timing of future cash expenditures based on current plans for fixed asset removal and nuclear waste management. On April 1, 1999, when OPG commenced operations, the following costs were recognized as a liability:

- › The present value of the costs of dismantling the nuclear and fossil 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 regardless of volume of waste generated.
- › The present value of the variable cost portion of any nuclear waste management program to take into account actual waste volumes incurred up to April 1, 1999.

The liability for nuclear waste management is increased for 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 of used fuel are charged to fuel expense. Changes in estimates of the liability are amortized over the average remaining service life of the nuclear generating stations.

OPG funds the nuclear fixed asset removal and nuclear waste management liability based on funding requirements prescribed under the Ontario Nuclear Funds Agreement ("ONFA"). This funding is segregated and used only for nuclear fixed asset removal or nuclear waste management.

Revalorization arises because liabilities for fixed asset removal and nuclear waste management are reported on a net present value basis. The revalorization charge is the adjustment that results from restating the liabilities to reflect the effect of inflation on the cost estimates and the time value of money effect on the future liabilities. Revalorization is reported net of the earnings on the nuclear fixed asset removal and nuclear waste management funds and the interest improvement on the receivable from the OEFC. Revalorization is recorded in the consolidated financial statements as part of depreciation and amortization.

## **Revenue Recognition**

Commencing May 1, 2002, with the opening of the Ontario electricity market to competition, all of OPG's electricity generation is sold into the real-time energy spot market administered by the IMO. Revenue is recorded as electricity is generated and metered based on the spot market sales price, net of the market power mitigation agreement rebate and hedging activities. 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 valued at market value. Gains and losses on energy trading contracts (including those to be physically settled) are disclosed on a net basis in the consolidated statements of income. Accordingly, power purchases of \$91 million in 2002 and nil in 2001 were netted against revenue.

Prior to May 1, 2002, revenues were earned primarily through the sale of electricity to wholesale and large industrial customers in Ontario and to interconnected markets. The wholesale electricity prices charged to Ontario customers were billed on a bundled basis including transmission and other related charges. OPG received the bundled payments and distributed funds to the successor entities of Ontario Hydro under the terms of revenue allocation arrangements. The revenue allocation arrangements were designed so the undistributed balance of funds would provide OPG with planned revenue of 4.0¢/kWh based on forecasted energy demand and customer mix, together with a fixed amount for ancillary services.

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. Non-energy revenue also includes isotope sales. Revenues from these activities are recognized as services are provided or products are delivered.

## **Foreign Currency Translation**

Current 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.

## **Derivatives**

OPG is exposed to changes in electricity prices associated with an open 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 generation revenue and are not recorded on the consolidated balance sheet. All contracts not designated as hedges are recorded as assets or liabilities at fair value with changes in fair value recorded in Energy Marketing revenue as gains or losses.

OPG also uses derivative contracts 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.

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.

### **Emission Reduction Credits**

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

### **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 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. Pension fund assets are valued using market-related values for purposes of determining actuarial gains or losses. 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. Pension and OPEB expenses and obligations are determined annually by independent actuaries using management's best estimates.

Pension and OPEB expenses include current service costs, interest costs on the obligations, the expected return on pension plan assets, adjustments for plan amendments and changes in assumptions, that result in actuarial gains or 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. 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.

### **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 regulations made under the *Electricity Act, 1998*. OPG makes payments in lieu of property tax on its nuclear and fossil 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.

## **Business Segments**

Commencing May 1, 2002, upon the opening of the Ontario electricity market to competition, OPG began operating in two reportable business segments: Generation and Energy Marketing. Previously, OPG's energy marketing activity was not a reportable business segment. Accordingly, there are no comparative amounts for 2001. A separate category, Non-Energy and Other, includes revenue and costs which are not allocated to the two business segments.

## **New Accounting Recommendations**

### *Hedging Relationships*

In December 2001, the Accounting Standards Board of the Canadian Institute of Chartered Accountants ("CICA") issued Accounting Guideline 13, "Hedging Relationships". This Guideline, which is required to be adopted for annual periods beginning after July 1, 2003, establishes standards for documenting and assessing the effectiveness of hedging activities. OPG expects to meet the hedging criteria in the new standard, and accordingly, to continue existing accounting for hedging relationships.

### *Impairment of Long-Lived Assets*

The CICA approved a new standard "Impairment of Long-Lived Assets". The new standard provides guidance on the recognition, measurement and disclosure of the impairment of long-lived assets and is effective for years beginning on or after April 1, 2003. Impairments are to be recognized when the carrying amount exceeds the sum of undiscounted cash flows. The impairment recognized is the amount by which the carrying amount exceeds its fair value. Introduction of the new standard is not expected to have a material impact on OPG's consolidated financial position.

### *Asset Retirement Obligations*

The CICA approved a new standard "Asset Retirement Obligations". The new standard provides guidance on the recognition and measurement of liabilities for legal obligations associated with the retirement of property, plant and equipment. The new standard is effective for fiscal years beginning on or after January 1, 2004. OPG is assessing the impact of adopting this standard.

#### 4. FIXED ASSETS

Depreciation and amortization expense consists of the following:

| <i>(millions of dollars)</i>   | 2002 | 2001 |
|--------------------------------|------|------|
| Depreciation and amortization  | 585  | 578  |
| Revalorization                 | 184  | 198  |
| Nuclear waste management costs | (17) | 34   |
|                                | 752  | 810  |

Fixed assets consist of the following:

| <i>(millions of dollars)</i>      | 2002   | 2001   |
|-----------------------------------|--------|--------|
| Property, plant and equipment     |        |        |
| Nuclear generating stations       | 3,447  | 3,313  |
| Fossil generating stations        | 1,791  | 1,671  |
| Hydroelectric generating stations | 7,601  | 7,754  |
| Other fixed assets                | 925    | 770    |
| Construction in progress          | 1,250  | 952    |
|                                   | 15,014 | 14,460 |
| Less: accumulated depreciation    |        |        |
| Generating stations               | 1,726  | 1,227  |
| Other fixed assets                | 342    | 252    |
|                                   | 2,068  | 1,479  |
|                                   | 12,946 | 12,981 |

Interest capitalized at 6 per cent (2001 – 6 per cent) during the year ended December 31, 2002 was \$44 million (2001 - \$29 million).

#### 5. SHORT-TERM CREDIT FACILITIES

OPG maintains a \$1,000 million revolving short-term committed credit facility with certain financial institutions ("Bank Credit Agreement") that makes funds available to OPG for working capital requirements, for general corporate purposes and as a back-stop facility for OPG's Commercial Paper ("CP") program. The facility may be drawn upon in either Canadian or U.S. dollars in various forms including Prime loans, LIBOR loans, Banker's Acceptances and Letters of Credit and has a term of 364 days which may be extended for an additional two year term. This facility is subject to renewal in March 2003. OPG's CP program is supported by the Bank Credit Agreement. Under the CP program, OPG has authority to issue short-term promissory notes up to a maximum outstanding principal amount of \$1,000 million in Canadian currency or the equivalent thereof in U.S. currency. At December 31, 2002, OPG has \$182 million outstanding under the CP program compared to nil outstanding as at December 31, 2001.

OPG also maintains \$175 million of short-term uncommitted credit facilities that make funds available for collateral requirements under the retail electricity market rules, and other commitments in the form of Letters of Credit. Of this amount, \$45 million was used for Letters of Credit posted with local distribution companies in support of OPG's obligations under the retailer consolidated billings of the retail settlement code, and \$97 million was used for Letters of Credit in support of certain other long-term obligations.

## 6. LONG-TERM DEBT

### (a) Debt Outstanding

Long-term debt consists of the following:

| <i>(millions of dollars)</i>      | <b>2002</b>  | 2001  |
|-----------------------------------|--------------|-------|
| Notes payable to the OEFC         | <b>3,200</b> | 3,200 |
| Capital lease obligations         | <b>19</b>    | 20    |
| Share of limited partnership debt | <b>138</b>   | -     |
|                                   | <b>3,357</b> | 3,220 |
| Less: payable within one year     |              |       |
| Senior notes payable to the OEFC  | -            | 200   |
| Capital lease obligations         | <b>5</b>     | 5     |
|                                   | <b>5</b>     | 205   |
| Long-term debt                    | <b>3,352</b> | 3,015 |

Details of OPG's long-term notes outstanding to the OEFC as at December 31, 2002 are as follows:

| Year of Maturity  | Interest Rate (%) | Principal Outstanding (\$ Canadian) |                    |       |
|-------------------|-------------------|-------------------------------------|--------------------|-------|
|                   |                   | Senior Notes                        | Subordinated Notes | Total |
| 2003 <sup>1</sup> | 5.49              | 200                                 | -                  | 200   |
| 2004 <sup>1</sup> | 5.44              | 100                                 | -                  | 100   |
| 2004 <sup>1</sup> | 5.62              | 300                                 | -                  | 300   |
| 2004 <sup>1</sup> | 5.94              | 100                                 | -                  | 100   |
| 2005              | 5.71              | 300                                 | -                  | 300   |
| 2006              | 5.78              | 300                                 | -                  | 300   |
| 2007              | 5.85              | 400                                 | -                  | 400   |
| 2008              | 5.90              | 400                                 | -                  | 400   |
| 2009              | 6.01              | 350                                 | -                  | 350   |
| 2010              | 6.60              | -                                   | 375                | 375   |
| 2011              | 6.65              | -                                   | 375                | 375   |
|                   |                   | 2,450                               | 750                | 3,200 |

1 OPG reached an agreement with the OEFC in February 2003 to defer payment on \$700 million principal amount of senior notes as outlined in note 6(b).

In March 2002, the Company reached an agreement with the OEFC to defer the payment of the \$200 million principal amount of senior notes maturing in 2002 to December 2004. In connection with this deferral, the coupon rate on \$100 million principal amount of these notes was increased, based on commercial terms, by 0.50 per cent; the interest rate for the remaining \$100 million principal amount of these notes was unchanged.

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.

In September 2002, Brighton Beach Power L.P. ("Brighton Beach"), a limited partnership formed by OPG, ATCO Power Canada Ltd., ATCO Resources Ltd. and Brighton Beach Power Ltd., completed a \$403 million private bond and term debt financing for its 580 megawatt power project under construction in Windsor, Ontario. Brighton Beach also signed an energy conversion agreement with Coral Energy Canada Inc. to deliver natural gas to the plant and own, market and trade all the electricity produced. OPG proportionately consolidates its 50 per cent interest in the Brighton Beach partnership. As at December 31, 2002, \$276 million was outstanding under the loan and accordingly \$138 million is reported by OPG.

Interest paid during the year ended December 31, 2002 was \$204 million (2001 - \$202 million), of which \$198 million relates to interest paid on long-term debt (2001 - \$199 million).

## (b) Financing Agreement

In February 2003, the Company reached an agreement with the OEFC to defer payment on \$700 million principal amount of senior notes. The interest rates remain unchanged. As a result of the deferral, \$200 million of long-term debt due within one year was reclassified to long-term at December 31, 2002. The notes deferred and the new maturities are as follows:

| Principal Amount of Senior Notes<br>(millions of dollars) | Maturity Prior to<br>Deferral | New Maturity |
|---|-------------------------------|--------------|
| 200   | 2003                          | 2005         |
| 100   | 2004                          | 2006         |
| 300   | 2004                          | 2006         |
| 100   | 2004                          | 2006         |

## 7. FIXED ASSET REMOVAL AND NUCLEAR WASTE MANAGEMENT

OPG's nuclear generating stations produce nuclear waste in the form of radioactive nuclear fuel bundles as well as low and intermediate level radioactive waste. At the end of the operating life, each of the nuclear generating stations needs to be safely decommissioned, which includes a storage period followed by dismantling. OPG is also required to decommission its non-nuclear facilities.

The net liability for fixed asset removal and nuclear waste management on a present value basis consists of the following:

| (millions of dollars)                            | 2002  | 2001  |
|--|-------|-------|
| Liability for nuclear waste management           | 5,020 | 4,814 |
| Liability for nuclear fixed asset removal        | 2,702 | 2,556 |
|  | 7,722 | 7,370 |
| Liability for non-nuclear fixed asset removal    | 131   | 127   |
|  | 7,853 | 7,497 |
| Less: Receivable from the OEFC                   | 2,938 | 2,773 |
| Fixed asset removal and nuclear waste management | 4,915 | 4,724 |

The change in the fixed asset removal and nuclear waste management liability is as follows:

| (millions of dollars)                        | 2002  | 2001  |
|--|-------|-------|
| Liability, beginning of year                 | 4,724 | 4,482 |
| Increase in the liability due to revaluation | 262   | 254   |
| Provision                                    | 37    | 44    |
| Waste management expenditures                | (92)  | (56)  |
| Amortization of net cost estimate changes    | (16)  | -     |
| Liability, end of year                       | 4,915 | 4,724 |

The accrual of fixed asset removal and nuclear waste management costs requires significant assumptions in their calculations, since these programs run for several decades. Current plans include cash flow estimates to 2057 for decommissioning nuclear stations and to approximately 2100 for used fuel management. The discount rate used to calculate the present value of the liabilities at December 31, 2002 was 5.75 per cent (2001 - 5.75 per cent) and the cost escalation rates ranged from 1 per cent to 4 per cent (2001 - 2 per cent to 3 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.

Significant assumptions underlying operational and technical factors are used in the calculation of the accrued liabilities and are subject to periodic review. Changes to these assumptions, including changes to assumptions on the timing of the programs or the technology employed, could 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 degree of risk surrounding the measurement of the costs for these programs, which may increase or decrease over time.

#### **Liability for Nuclear Waste Management Costs**

The liability for nuclear waste management costs represents the cost of managing the highly radioactive used nuclear fuel bundles as well as the cost of managing other low and intermediate level radioactive wastes generated by the nuclear stations. 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 kilometers between nuclear generating facilities and the disposal facilities. Alternatives to deep geological disposal are being studied by Canadian nuclear utilities as part of the options study required by the federal *Nuclear Fuel Waste Act*. The options study is to be completed by 2005, with a federal government decision expected no earlier than 2006.

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: an in-service date of 2015 for disposal facilities for low level waste; co-locating short-lived intermediate level waste with low level waste starting in 2015; and co-locating long lived intermediate level waste with used fuel starting in 2035.

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

Accrued nuclear fixed asset removal costs represent the estimated costs of decommissioning nuclear generating stations after the end of their service lives. 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 shut down for a 30 year period prior to a 10 year dismantlement period. Low and intermediate level waste arising during decommissioning will be disposed of at the facilities developed for disposal of operational low and intermediate level waste.



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

Accrued non-nuclear fixed asset removal costs are primarily the costs of decommissioning fossil generating stations and the heavy water production facility at the end of their service lives. The estimated retirement date of these stations is between 2005 to 2025.

OPG does not provide for the removal costs associated with its hydroelectric generating facilities as 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.

### **Ontario Nuclear Funds Agreement**

In March 2002, the Ontario Nuclear Funds Agreement ("ONFA") was finalized with the Province of Ontario (the "Province"). Under ONFA, OPG will establish two custodial funds, a Used Fuel Fund and a Decommissioning Fund, that will be held by an independent custodian. The Agreement will become effective when external investment managers are appointed and the two custodial funds are established, which is expected during 2003.

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 ONFA, which limit OPG's total financial exposure at approximately \$6.0 billion, a present value amount at January 1, 1999 (approximately \$7.5 billion in 2002 dollars). OPG will continue to make annual payments over the life of its nuclear generating stations, as specified in ONFA. The Province guarantees the fund a return of 3.25 per cent over Ontario Consumer Price Index ("CPI"). If the earnings on assets in the Used Fuel Fund exceed Ontario CPI plus 3.25 per cent, the Province is entitled to the excess.

The Decommissioning Fund will be used to fund the future cost of nuclear fixed asset removal and long-term low and intermediate level waste management and a portion of used fuel storage costs after station life. The initial funding, including the commitment from the OEFC, is intended to be sufficient to fully discharge the 1999 estimate of the liability. OPG may direct up to 50 per cent of fund surpluses to the Used Fuel Fund. The OEFC is entitled to the remaining 50 per cent of fund surpluses. While OPG does not expect to be required to make additional contributions, it bears the risk and liability for cost estimate increases and fund earnings.

On April 1, 1999, the Province agreed that the Province or its agent, now designated as the OEFC, would fund certain fixed asset removal and nuclear waste management liabilities that were incurred prior to April 1, 1999. The balance of \$2,938 million as at December 31, 2002 represents the OEFC's liability of \$2,773 million as at January 1, 2002, as well as interest in the amount of \$165 million accrued during 2002 based on the estimated Annual Ontario CPI plus 3.25 per cent.

Since April 1, 1999, OPG has contributed \$1,599 million, including income earned of \$174 million, to its existing nuclear fixed asset removal and nuclear waste management segregated funds. The Decommissioning Fund will be partially funded through the commitment from the OEFC, with the balance funded through OPG's existing segregated funds. The remaining balance in OPG's segregated funds will be applied to the

Used Fuel Fund. OPG will make future annual contributions to the Used Fuel Fund of approximately \$454 million to 2008, and a reduced amount over the remaining life of the nuclear generating stations.

As required by the *Nuclear Safety and Control Act (Canada)*, and under the terms of ONFA, the Province will provide to the Canadian Nuclear Safety Commission ("CNSC") a guarantee that there will be funds available to discharge the nuclear decommissioning and waste liabilities. The provincial guarantee will supplement the Used Fuel Fund and the Decommissioning Fund until they have accumulated sufficient funds to cover the accumulated liability for nuclear waste management and decommissioning. Legal agreements detailing the provision of required CNSC financial guarantees are under development with the CNSC and the Province.

The *Nuclear Fuel Waste Act (Canada)* ("NFWA") was proclaimed into force in November 2002. In accordance with NFWA, the Nuclear Waste Management Organization was formed during 2002 to prepare and review alternatives, and provide recommendations for long-term management of nuclear fuel waste. This submission is to occur within three years of NFWA coming into force. The Federal Government will determine the strategy for dealing with the long-term management of nuclear fuel waste based on submitted plans. OPG made an initial deposit of \$500 million into a trust fund in November 2002 as required under NFWA and will deposit an additional \$100 million annually for the next three years until the Federal Government has approved a long-term plan. The initial deposit was funded by a transfer from OPG's nuclear fixed asset removal and nuclear waste management fund. The trust is consolidated by OPG and forms part of the Used Fuel Fund.

The fixed asset removal and nuclear waste management funds consist of the following:

| <i>(millions of dollars)</i>                                   | <b>2002</b>  | 2001  |
|--|--------------|-------|
| Nuclear fixed asset removal and nuclear waste management funds | <b>1,098</b> | 1,208 |
| Nuclear used fuel trust fund                                   | <b>501</b>   | -     |
|  | <b>1,599</b> | 1,208 |

Interest earned of \$78 million during 2002 (2001 - \$57 million) is included in the segregated funds and is recorded as a component of revalorization, which is included in depreciation and amortization expense.

### **Cost Estimate Changes Made in 2002**

OPG reviewed the significant assumptions that underlie the calculation of the accrued liabilities for fixed asset removal and nuclear waste management liabilities. As a result of this review, a number of assumptions were revised to reflect changes in the timing of certain programs and in the evolving technology used to handle the nuclear waste. These changes included a delay in the in-service date for used nuclear fuel disposal facilities from 2025 to 2035, the recognition of certain costs associated with dry storage of used nuclear fuel during station operating life, and recognition of additional costs related to nuclear waste management programs. In aggregate, these cost estimate changes would result in a net reduction to the nuclear waste management and decommissioning liability of \$215 million. In accordance with Canadian generally accepted accounting principles, the change in liability is being amortized over the average remaining service

life of the nuclear generating stations. As a result of this change, \$16 million was recorded as a decrease to the liability and a reduction to expenses for the year ended December 31, 2002.

## 8. BENEFIT PLANS

The post employment benefit programs include pension, group life insurance, health care and long-term disability benefits. Pension and OPEB obligations are impacted by factors including interest rates, adjustments arising from plan amendments, changes in assumptions and experience gains or losses.

### Pension Plan

The pension plan is a contributory, defined benefit plan covering all regular employees and retirees. OPG's pension plan was established effective December 31, 1999. In 2001, the transfer of the pension plan assets that were previously held by the OEFC was approved by the Financial Services Commission of Ontario under the Pension Benefits Act (Ontario). In June 2001, the pension plan assets were transferred to OPG's pension plan.

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.

Information about OPG's pension plan is as follows:

|  | 2002  | 2001  |
|--|-------|-------|
| <b>Pension Plan Assumptions</b>                      |       |       |
| Expected return on plan assets                       | 7.25% | 7.75% |
| Rate used to discount future pension benefits        | 6.75% | 6.75% |
| Salary schedule escalation rate                      | 3.00% | 3.25% |
| Rate of cost of living increase to pensions          | 2.00% | 2.50% |
| Average remaining service life for employees (years) | 11    | 11    |

| <i>(millions of dollars)</i>                            | 2002  | 2001    |
|---|-------|---------|
| <b>Change in Pension Plan Assets</b>                    |       |         |
| Fair value of plan assets at beginning of year          | 6,342 | 7,642   |
| Contributions by employees                              | 78    | 20      |
| Actual return on plan assets                            | (243) | (11)    |
| Settlements   | (142) | (1,080) |
| Benefit payments  | (294) | (219)   |
| Administrative expense                                  | (14)  | (10)    |
| Fair value of plan assets at end of year                | 5,727 | 6,342   |
| <b>Change in Projected Pension Benefit Obligation</b>   |       |         |
| Projected benefit obligation at beginning of year       | 5,995 | 6,216   |
| Current service costs                                   | 185   | 192     |
| Past service costs                                      | -     | 87      |
| Interest on projected benefit obligation                | 381   | 393     |
| Curtailment (gain) loss                                 | (28)  | 80      |
| Settlement gain   | (124) | (896)   |
| Benefit payments  | (294) | (219)   |
| Net actuarial (gain) loss                               | (150) | 142     |
| Projected benefit obligation at end of year             | 5,965 | 5,995   |
| <b>Pension Plan (Deficit) Surplus</b>                   | (238) | 347     |
| <b>Reconciliation of Pension Plan (Deficit) Surplus</b> |       |         |
| Pension plan (deficit) surplus                          | (238) | 347     |
| Unamortized net actuarial loss (gain)                   | 388   | (199)   |
| Unamortized past service costs                          | 155   | 182     |
| Deferred pension asset                                  | 305   | 330     |
| <b>Components of Pension Expense</b>                    |       |         |
| Current service costs                                   | 107   | 172     |
| Interest on projected benefit obligation                | 381   | 393     |
| Expected return on plan assets                          | (471) | (523)   |
| Curtailment loss  | 10    | 25      |
| Settlement loss   | 5     | 8       |
| Amortization of past service costs                      | 18    | 19      |
| Amortization of net actuarial gain                      | (34)  | (27)    |
| Pension expense   | 16    | 67      |

Using a going-concern funding basis, with assets at market value, OPG estimates that there was a pension fund deficit of \$1.6 billion at December 31, 2002.

## Other Post Employment Benefits

The long-term annual increase in the per capita cost of the major benefits ranges between 2.0 per cent and 4.5 per cent (2001 - between 2.5 per cent and 4.5 per cent), depending on the nature of the benefit. The discount rate used in determining the actuarial present value of the OPEB obligation ranges between 6.00 per cent and 6.75 per cent at December 31, 2002 (2001 - between 6.25 per cent and 6.75 per cent).

Information about OPG's OPEB is as follows:

| <i>(millions of dollars)</i>                   | <b>2002</b>  | 2001  |
|--|--------------|-------|
| <b>Change in Projected OPEB Obligation</b>     |              |       |
| Projected OPEB obligation at beginning of year | <b>1,247</b> | 1,207 |
| Current service costs                          | <b>45</b>    | 51    |
| Interest on projected benefit obligation       | <b>76</b>    | 82    |
| Benefit payments                               | <b>(52)</b>  | (56)  |
| Curtailment loss (gain)                        | <b>2</b>     | (1)   |
| Settlement gain                                | <b>(134)</b> | (138) |
| Net actuarial loss                             | <b>7</b>     | 91    |
| Past service costs                             | <b>-</b>     | 11    |
| Special termination benefits                   | <b>13</b>    | -     |
| Projected OPEB obligation at end of year       | <b>1,204</b> | 1,247 |
| <b>Reconciliation of OPEB Obligation</b>       |              |       |
| Accrued OPEB obligation at end of year         |              |       |
| Long-term obligation                           | <b>958</b>   | 924   |
| Short-term obligation                          | <b>54</b>    | 126   |
| Unamortized net actuarial loss                 | <b>161</b>   | 160   |
| Unamortized past service costs                 | <b>31</b>    | 37    |
| Projected OPEB obligation at end of year       | <b>1,204</b> | 1,247 |
| <b>Components of OPEB Expense</b>              |              |       |
| Current service costs                          | <b>45</b>    | 51    |
| Interest on projected benefit obligation       | <b>76</b>    | 82    |
| Curtailment loss                               | <b>4</b>     | 6     |
| Settlement gain                                | <b>(66)</b>  | -     |
| Amortization of net actuarial loss             | <b>4</b>     | 1     |
| Amortization of past service costs             | <b>4</b>     | 5     |
| Special termination benefits                   | <b>13</b>    | -     |
| OPEB expense                                   | <b>80</b>    | 145   |

## 9. FAIR VALUE OF FINANCIAL INSTRUMENTS, CREDIT RISK, AND RISK MANAGEMENT INSTRUMENTS

### Fair Value of Derivative Instruments

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.

Since November 2002, trading activities and liquidity in the Ontario electricity market have been limited as companies are generally entering only into short-term contracts. Forward pricing information for contracts trading beyond March 2003 may not accurately represent the cost to enter into these contracts. For Ontario based contracts that are not treated as hedges, OPG established liquidity reserves against the fair market value of the assets and liabilities equal to the gain or loss on these contracts. The charge to establish these reserves reduced Energy Marketing revenue by approximately \$7 million. Contracts outside of Ontario continue to be carried on the balance sheet as assets or liabilities at fair value with changes in fair value recorded in Energy Marketing revenue as gains or losses.

### *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 over the term of the contract when the underlying transactions occur. The Company uses financial commodity derivatives primarily to hedge the commodity price exposure associated with changes in the price of electricity.

| (millions of dollars)                         | 2002              |           |            | 2001              |         |            |
|---|-------------------|-----------|------------|-------------------|---------|------------|
|   | Notional quantity | Terms     | Fair Value | Notional quantity | Terms   | Fair Value |
| gain/(loss)                                   |                   |           |            |                   |         |            |
| Electricity derivative instruments            | 37.9 TWh          | 1-4 yrs   | (144)      | 14 TWh            | 1-5 yrs | -          |
| Foreign exchange derivative instruments       | \$179 US          | Apr/03    | 4          | \$147 US          | Mar/02  | 3          |
| Option to purchase emission reduction credits | 6,000,000 tonnes  | 2003-2004 | 1          | -                 | -       | -          |

Foreign exchange derivative instruments are used to hedge exposure to anticipated U.S. dollar denominated purchases. The weighted average fixed exchange rate for the outstanding contracts at December 31, 2002 was U.S. \$0.64 for every Canadian dollar.



### *Derivative instruments not used for hedging purposes*

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

| (millions of dollars)            | 2002              |            | 2001       |
|----------------------------------|-------------------|------------|------------|
|                                  | Notional quantity | Fair Value | Fair Value |
| Commodity derivative instruments |                   |            |            |
| Assets                           | 15.8 TWh          | 10         | -          |
| Liabilities                      | .5 TWh            | (14)       | -          |
|                                  |                   | (4)        | -          |
| Ontario market liquidity reserve |                   | (7)        | -          |
| Total                            |                   | (11)       | -          |

At December 31, 2002, the fair value of commodity derivative instruments not used for hedging purposes includes a \$9 million liability primarily related to legacy contracts from the previous market structure. The income statement impact of these transactions was reduced by the reversal, upon market opening, of a contract loss provision recorded as at December 31, 2001.

### **Fair Value of Other Financial Instruments**

The carrying value of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued charges, short-term notes payable, and long-term debt due within one year approximates their fair value 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:

| (millions of dollars)                                  | 2002           |            | 2001           |            |
|--|----------------|------------|----------------|------------|
|  | Carrying Value | Fair Value | Carrying Value | Fair Value |
| <b>Financial Assets</b>                                |                |            |                |            |
| Fixed asset removal and nuclear waste management fund  | 1,599          | 1,622      | 1,208          | 1,263      |
| Long-term note receivable                              | -              | -          | 225            | 268        |
| Long-term accounts receivable and other assets         | 59             | 59         | 65             | 65         |
| <b>Financial Liabilities</b>                           |                |            |                |            |
| Long-term debt and long-term portion of capital leases | 3,352          | 3,381      | 3,015          | 2,982      |
| Long-term accounts payable and accrued charges         | 321            | 326        | 336            | 346        |

## Credit Risk

The majority of OPG's revenues are derived from electricity sales through the IMO administered spot market. OPG also derives revenue from several other sources including the sale of financial risk management products to third parties. OPG manages counterparty credit risk by monitoring and limiting its exposure to counter parties with lower credit ratings, evaluating its counterparty credit exposure on an integrated basis, and by performing periodic reviews of the creditworthiness of all counterparties, including obtaining credit security for all transactions beyond approved limits.

## 10. INCOME TAXES

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

| <i>(millions of dollars)</i>  | <b>2002</b>   | 2001  |
|---|---------------|-------|
| Income before income taxes  | <b>44</b>     | 218   |
| Combined Canadian federal and provincial statutory income tax rates, including surtax | <b>38.6%</b>  | 41.3% |
| Statutory income tax rates applied to accounting income                               | <b>17</b>     | 90    |
| Increase (decrease) in income taxes resulting from:                                   |               |       |
| Large corporations tax in excess of surtax  | <b>29</b>     | 33    |
| Lower future tax rate on temporary differences  | <b>4</b>      | (23)  |
| Non-taxable income items  | <b>(27)</b>   | (12)  |
| Adjustment to prior year's future income tax  | <b>(18)</b>   | (23)  |
| Other   | <b>(8)</b>    | 1     |
|   | <b>(20)</b>   | (24)  |
| Provision for (recovery of) income taxes  | <b>(3)</b>    | 66    |
| Effective rate of income taxes  | <b>(6.8%)</b> | 30.3% |

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

| <i>(millions of dollars)</i>                      | <b>2002</b> | 2001 |
|---|-------------|------|
| Current income tax expense (recovery)             | <b>29</b>   | (65) |
| Future income tax expense (benefits):             |             |      |
| Change in temporary differences                   | <b>(32)</b> | 177  |
| Substantively enacted changes in income tax rates | <b>-</b>    | (46) |
| Provision for (recovery of) income taxes          | <b>(3)</b>  | 66   |

The amount of income taxes paid in the year ended December 31, 2002 was \$56 million (2001 - \$207 million).

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

| <i>(millions of dollars)</i>                                 | <b>2002</b>  | 2001  |
|--|--------------|-------|
| Future income tax assets:                                    |              |       |
| Fixed asset removal and nuclear waste management liabilities | <b>1,446</b> | 1,388 |
| Other liabilities  | <b>381</b>   | 297   |
|  | <b>1,827</b> | 1,685 |
| Future income tax liabilities:                               |              |       |
| Fixed assets   | <b>1,389</b> | 1,393 |
| Fixed asset removal and nuclear waste management fund        | <b>481</b>   | 364   |
| Other assets   | <b>204</b>   | 207   |
|  | <b>2,074</b> | 1,964 |
| Net future income tax liabilities                            | <b>247</b>   | 279   |

## **11. COMMON SHARES**

As at December 31, 2002 and 2001, 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.

## **12. COMMITMENTS AND CONTINGENCIES**

### **Litigation**

Various claims, lawsuits and administrative proceedings are pending or threatened against the Company or its subsidiaries, covering a wide range of matters that arise in the ordinary course of its business activities with respect to commercial and environmental matters. Each of these matters is subject to various uncertainties, and some of these matters may be resolved unfavourably with respect to the Company. These contingencies are provided for when they are likely to occur and are reasonably estimable. Management believes that the ultimate resolution of these matters will not have a material effect on the Company's financial position.

#### *Canadian Agra Corporation Claim*

The Canadian Agra Group has commenced an action based on alleged misrepresentations and breach of contract relating to the operation and development of the Bruce Energy Centre by Ontario Hydro and OPG. The Province is also a co-defendant. The claim is for \$146.5 million plus damages for loss of profits. OPG has submitted a demand for particulars and the parties have agreed to attend a mediation after full particulars of the claim and alleged damages have been provided. A preliminary assessment indicates that it is unlikely that OPG would be found liable by a court if this matter proceeded to trial.

### *Integrated Energy Development Corporation Claim*

The Integrated Energy Development Corporation claim is for \$60 million and raises some similar allegations to the Canadian Agra claim, however, the Province has not been made a defendant. A mediation occurred in November, 2002 but the parties were unable to settle the claim. Examinations for discovery started in December 2002. A preliminary assessment indicates that it is unlikely that OPG would be found liable by a court if this matter proceeded to trial.

### *Slate Falls First Nation Claim*

The Slate Falls First Nation claim is for \$40 million. The First Nation has commenced an action in the Ontario Court for declaratory relief and unspecified damages for interference with reserve and traditional land rights from flooding and other acts of trespass. The Government of Canada is also a defendant to this claim. The First Nation is composed of former members of a number of different bands including Osnaburgh. Ontario Hydro had previously entered into a settlement agreement with the Mishkeegogamang First Nation, which was previously known as the Osnaburgh First Nation. Both the Government of Canada and OPG are considering the potential overlap of beneficiaries between the present litigation and the prior settlement. The parties are in the preliminary stage of gathering documentary evidence to assist in the assessment of liability and potential damages, and therefore are unable to evaluate the claim at this time.

## **Environmental**

OPG inherited legacy 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, 2002, expenditures of \$2 million (2001 - \$3 million) were recorded against the provision.

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 financial statements to meet OPG's current environmental obligations.

OPG has undertaken an initiative to install selective catalytic reduction ("SCR") technology on two units at each of the Nanticoke and Lambton fossil generating stations, at an estimated cost of \$285 million. The SCRs are scheduled to be in service by the end of 2003 and will reduce 80 per cent of all nitrogen oxide emissions from these four units.

## **Guarantees**

As part of normal business, OPG and certain subsidiaries enter into various agreements providing financial or performance assurance to third parties on behalf of certain subsidiaries. Such agreements include guarantees, stand-by letters of credit and surety bonds. These agreements are entered into primarily to support or enhance the creditworthiness otherwise attributed to a subsidiary on a stand-alone basis, thereby facilitating the extension of sufficient credit to accomplish the subsidiaries' intended commercial purposes.

OPG has provided limited guarantees in connection with the Brighton Beach financing. If the partnership fails to complete the project or meet certain performance tests by September 30, 2006, OPG may be required to repurchase its proportionate share of the outstanding debt, up to a total of \$202 million. OPG is also responsible for contributing its share of equity up to \$47 million and up to \$13 million of cost overruns as necessary. OPG has also provided guarantees relating to gas transport and other energy-based charges if the commercial operations date is delayed in certain circumstances; and debt service if the energy conversion agreement is terminated, from the date of such termination to the earlier of the entry into a replacement agreement and September 30, 2006.

### Contractual Commitments

The Company's contractual obligations and other commercial commitments as at December 31, 2002 are as follows:

| <i>(millions of dollars)</i>       | <b>2003</b>  | <b>2004</b>  | <b>2005</b>  | <b>2006</b>  | <b>2007</b>  | <b>Thereafter</b> | <b>Total</b>  |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|-------------------|---------------|
| Fuel supply agreements             | 850          | 488          | 243          | 209          | 147          | 201               | 2,138         |
| Contributions under ONFA           | 679          | 454          | 454          | 454          | 454          | 2,557             | 5,052         |
| Long-term debt                     | -            | -            | 500          | 800          | 400          | 1,500             | 3,200         |
| Unconditional purchase obligations | 171          | 168          | 144          | 134          | 133          | 393               | 1,143         |
| Long-term accounts payable         | 22           | 28           | 28           | 28           | 25           | -                 | 131           |
| Operating lease obligations        | 21           | 19           | 18           | 10           | 10           | 67                | 145           |
| Capital lease obligations          | 5            | 7            | 7            | -            | -            | -                 | 19            |
| <b>Total</b>                       | <b>1,748</b> | <b>1,164</b> | <b>1,394</b> | <b>1,635</b> | <b>1,169</b> | <b>4,718</b>      | <b>11,828</b> |

## 13. DECONTROL INITIATIVES

### (a) 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 an option to renew for up to 25 years. As part of the initial payment, OPG received \$370 million in cash proceeds and a \$225 million note receivable. Under the terms of the original operating lease agreement, the receivable of \$225 million was payable to OPG in two installments of \$112.5 million no later than four and six years from the date the transaction was completed. Proceeds from the note will be applied against OPG's funding requirements with respect to the nuclear fixed asset removal and nuclear waste management liabilities.

Under the terms of the lease, OPG agreed to transfer certain fuel and material inventory to Bruce Power, in addition to certain fixed assets. OPG also agreed to transfer pension assets and liabilities related to the approximately 3,000 employees who transferred from OPG 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 \$230 million of deferred revenue to reflect the initial payment less net assets transferred to Bruce Power under the lease agreement. In 2002, deferred revenue was reduced by \$29 million to reflect the settlement of certain remaining outstanding matters and post-closing adjustments. The deferred revenue is being amortized over the initial lease term of approximately 18 years and is recorded as non-energy revenue.

Under the lease agreement, OPG receives annual lease payments from Bruce Power. The lease payments consist of base rent payments set out in a specified schedule and supplemental rent of \$25.5 million per operating unit. The supplemental lease payment structure has been modified, with effect from May 2001, to replace the original net revenue-sharing arrangement. The lease revenue of \$178 million (2001 – \$77 million) was recorded in non-energy revenue.

The net book value of fixed assets on lease to Bruce Power was \$780 million and \$884 million at December 31, 2002 and 2001, respectively.

#### **(b) Bruce Power – Change in Ownership**

In December 2002, British Energy plc. entered into an agreement to dispose of its entire 82.4 per cent interest in Bruce Power. On February 14, 2003 the transaction was completed and a consortium of Canadian companies assumed the lease of the Bruce A and Bruce B nuclear generating stations that were formerly held by British Energy. The Bruce facilities will continue to be operated by Bruce Power. Upon closing, the \$225 million note receivable was repaid, and lease payments commenced to be paid monthly. In addition, for 2004 through 2008, minimum payments under the lease are, subject to limited exceptions, \$190 million. The remaining terms of the operating lease agreement remain substantially unchanged.

#### **(c) Other Decontrol Activities**

In May 2002, OPG sold four hydroelectric generating stations located on the Mississagi River, to Mississagi Power Trust. OPG received cash proceeds of \$342 million from the sale and recorded a pretax gain of \$99 million.

OPG continues to evaluate options for decontrol of stations and is committed to meet its obligations under the market power mitigation agreement. The process for meeting decontrol of price-setting generation has been impacted by current market conditions in the North American energy sector. The amounts that OPG will ultimately realize with respect to these potential transactions could differ materially from the carrying values recorded in the consolidated financial statements.

### **14. RESTRUCTURING**

In 2001, OPG approved a restructuring plan designed to improve OPG's future competitiveness. The restructuring program relates to an anticipated reduction in the workforce of approximately 2,000 employees over a two to three year period. Restructuring charges included severance costs of \$254 million and related pension and other post employment benefit expenses of \$35 million. Pension and other post employment benefit expenses, recorded as part of restructuring, are included in the deferred pension asset



and other post employment benefits on the balance sheet. The total cost of the restructuring plan is expected to be approximately \$400 million.

The change in the restructuring liability for the years ended December 31, 2002 and 2001 is as follows:

| <i>(millions of dollars)</i> | <b>2002</b>  | 2001 |
|------------------------------|--------------|------|
| Liability, beginning of year | <b>67</b>    | -    |
| Restructuring charges        | <b>222</b>   | 67   |
| Payments                     | <b>(134)</b> | -    |
| Liability, end of year       | <b>155</b>   | 67   |

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

Under a regulation known as Transition – Generation Corporation Designated Rate Options ("TRO"), OPG is required to provide transitional price relief upon market opening to certain power customers based on the consumption and average price paid by each customer during a reference period from July 1, 1999 to June 30, 2000. The TRO is treated as a hedge of generation revenue. The maximum anticipated volume subject to the transitional price relief is approximately 5.4 TWh in the first year after market opening, 3.6 TWh in the second year and 1.8 TWh in each of the third and fourth years. The maximum length of the program is four years, with the possibility that it will expire after only two years if certain decontrol targets are met.

A provision of \$210 million for the TRO contracts was recorded in the first quarter of 2002 related to the anticipated future losses on these contracts. The provision was determined during the first quarter of 2002 using management's best estimates of the forward price curve for electricity, wholesale electricity market fees, impact of decontrol on the contracts, interruptions of volume, and the recovery of market power mitigation agreement rebates. It is reasonably possible that actual results experienced may differ materially from the estimated amounts. The provision will be reduced over the term of the contracts based on volume and will be recorded in revenue.

Since market opening on May 1, 2002, the provision has been reduced by \$66 million. At December 31, 2002, the current portion of the provision for loss on these contracts was \$82 million and was included in accounts payable and accrued charges. The long-term portion of the provision, which was included in long-term accounts payable and accrued charges, was \$62 million.

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

Under OPG's generating licence, subject to regulatory approval, the Company has the ability to reduce the amount of energy subject to the market power mitigation agreement rebate by the transfer of effective control of certain of its generating facilities to other market participants. As OPG transfers effective control

of facilities and meets certain milestones, it can apply to the Ontario Energy Board for an order determining that the transactions represent the transfer of effective control and thereby eliminate a portion of the market power mitigation agreement rebate obligation.

In May 2001, OPG completed the agreement to lease its Bruce nuclear generating stations to Bruce Power and in May 2002, completed the sale of four of its hydroelectric generating stations located on the Mississagi River to Mississagi Power Trust. OPG has filed applications with the OEB seeking reductions in the amount of energy sales subject to the rebate mechanism ("Q relief") as a result of the decontrol of the Bruce nuclear generating stations and the Mississagi River stations. While there is no assurance as to the outcome of the OEB decision, the Company believes that it has met all of the requirements for the transfer of effective control and therefore will receive a reduction in energy sales subject to the market power mitigation agreement rebate. OEB approval of the applications would result in a reduction in volumes subject to the market power mitigation agreement rebate for the twelve month settlement period ending April 30, 2003 from 101.8 TWh to 81.4 TWh.

Since the average hourly spot price since May 1, 2002 has exceeded the 3.8¢/kWh revenue cap, OPG provided a market power mitigation agreement rebate liability for the period through December 31, 2002 of \$907 million. The liability is calculated as the excess of the average hourly spot energy price over 3.8¢/kWh, multiplied by the amount of energy subject to the rebate mechanism. OPG made a rebate payment of \$335 million in December 2002 which reduced the balance of the rebate payable at December 31, 2002 to \$572 million. The rebate liability is calculated in accordance with the market power mitigation agreement, after taking into account the amount of energy sales subject to the rebate mechanism for only those generating stations that OPG continues to control.

OPG expects to receive a decision from the OEB regarding the Q relief during the second quarter of 2003. If OPG's applications are not approved, pre-tax income in the period in which the determination is made would be decreased by the amount of the Q relief, which totalled \$182 million at December 31, 2002. Also, the Company must obtain OEB approval of Q relief before the end of the first settlement period ending April 30, 2003, as a condition of OPG's generation licence, in order to qualify for Q relief during that period.

## **17. RESEARCH AND DEVELOPMENT**

For the year ended December 31, 2002, \$39 million (2001 - \$39 million) of research and development expenses were charged to operations. No development costs were capitalized in 2002 (2001 - \$3 million).

## **18. BUSINESS SEGMENTS**

### **Description of Reportable Segments**

With the opening of Ontario's electricity market to competition on May 1, 2002, OPG began operating two reportable business segments: Generation and Energy Marketing. A separate category, Non-Energy and Other, includes revenue and certain costs which are not allocated to the business segments.

## Generation Segment

OPG's principal business segment operates in Ontario, generating and selling electricity. Commencing May 1, 2002, all of OPG's electricity generation is sold into the IMO-administered real-time energy spot market. As such, the majority of OPG's revenue is derived from spot market sales. In addition to revenue earned from spot market sales, revenue is also earned through offering available capacity as operating reserve and through the supply of other ancillary services including voltage control/reactive support, black start capability and automatic generation control. Prior to market opening, OPG sold electricity directly to wholesale electricity customers in Ontario and to interconnected markets in Quebec, Manitoba and the U.S. northeast and midwest.

## Energy Marketing Segment

The Energy Marketing segment derives revenues from various financial and physical energy market transactions with large volume end-use customers and intermediaries such as utilities, brokers, aggregators, traders and other power marketers and retailers. Energy marketing in deregulated markets includes trading, the sale of financial risk management products and sales of energy-related products and services to meet customers' needs for energy solutions. The results of transactions in derivatives not designated as hedges of energy prices are included in the Energy Marketing segment. OPG also markets and sells electricity purchased from the IMO into the interconnected markets of other provinces and the U.S. northeast and midwest. Prior to market opening on May 1, 2002, OPG's energy marketing activity was not a reportable business segment. Accordingly, there are no comparative values for 2001.

## Non-Energy and Other

OPG derives non-energy revenue under the terms of a lease arrangement with Bruce Power related to the Bruce nuclear generating stations. This includes lease revenue, interest income and revenue from engineering analysis and design, technical and ancillary services. Non-energy revenue also includes isotope sales to the medical industry and real estate rentals.

| <b>Segment Income for year ended December 31, 2002</b><br><i>(millions of dollars)</i> | <b>Generation</b> | <b>Energy Marketing</b> | <b>Non-Energy<br/>and Other</b> | <b>Total</b> |
|--|-------------------|-------------------------|---------------------------------|--------------|
| Revenues   | 5,364             | 59                      | 323                             | 5,746        |
| Fuel   | 1,610             | -                       | -                               | 1,610        |
| Power purchased  | 290               | -                       | -                               | 290          |
| Gross margin   | 3,464             | 59                      | 323                             | 3,846        |
| Operations, maintenance and administration   | 2,463             | 6                       | 55                              | 2,524        |
| Depreciation and amortization  | 645               | -                       | 107                             | 752          |
| Property and capital taxes   | 101               | -                       | 14                              | 115          |
| Loss on transition rate option contracts   | -                 | -                       | 210                             | 210          |
| Operating income (loss) before restructuring   | 255               | 53                      | (63)                            | 245          |
| Restructuring  | -                 | -                       | 222                             | 222          |
| Operating income (loss)  | 255               | 53                      | (285)                           | 23           |
| Other income   | -                 | -                       | 171                             | 171          |
| Net interest expense   | -                 | -                       | 150                             | 150          |
| Income (loss) before income taxes  | 255               | 53                      | (264)                           | 44           |

| <b>Segment Income for year ended December 31, 2001</b><br><i>(millions of dollars)</i> | <b>Generation</b> | <b>Energy Marketing</b> | <b>Non-Energy<br/>and Other</b> | <b>Total</b> |
|--|-------------------|-------------------------|---------------------------------|--------------|
| Revenues   | 5,945             | -                       | 294                             | 6,239        |
| Fuel   | 1,453             | -                       | -                               | 1,453        |
| Power purchased  | 879               | -                       | -                               | 879          |
| Gross margin   | 3,613             | -                       | 294                             | 3,907        |
| Operations, maintenance and administration   | 2,475             | -                       | 84                              | 2,559        |
| Depreciation and amortization  | 746               | -                       | 64                              | 810          |
| Property and capital taxes   | 97                | -                       | 17                              | 114          |
| Operating income before restructuring  | 295               | -                       | 129                             | 424          |
| Restructuring  | -                 | -                       | 67                              | 67           |
| Operating income   | 295               | -                       | 62                              | 357          |
| Other income   | -                 | -                       | -                               | -            |
| Net interest expense   | -                 | -                       | 139                             | 139          |
| Income (loss) before income taxes  | 295               | -                       | (77)                            | 218          |

| <b>Selected Balance Sheet Information</b><br><i>(millions of dollars)</i> | <b>Generation</b> | <b>Energy<br/>Marketing</b> | <b>Non-Energy<br/>and Other</b> | <b>Total</b> |
|---|-------------------|-----------------------------|---------------------------------|--------------|
| <b>December 31, 2002</b>  |                   |                             |                                 |              |
| Segment property, plant and equipment, net                                | 12,003            | -                           | 943                             | 12,946       |
| <b>December 31, 2001</b>  |                   |                             |                                 |              |
| Segment property, plant and equipment, net                                | 12,026            | -                           | 955                             | 12,981       |

| <b>Selected Cash Flow Information</b><br><i>(millions of dollars)</i> |     |   |   |     |
|---|-----|---|---|-----|
| <b>Year ended December 31, 2002</b>                                   |     |   |   |     |
| Capital expenditures  | 869 | - | - | 869 |
| <b>Year ended December 31, 2001</b>                                   |     |   |   |     |
| Capital expenditures  | 739 | - | - | 739 |

Substantially all sales were in Canada. Since the market opened in May 2002, all of OPG's electricity generation was sold into the real-time energy spot market administered by the IMO. As such, the majority of OPG's revenue was derived from spot market sales. Sales to the IMO represented 70 per cent of total revenues for the year ended December 31, 2002 (2001 - nil) and 75 per cent of accounts receivable as at December 31, 2002 (2001 - nil).

## 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 IMO, the OEFC, and the Ontario Electricity Pension Services Corporation ("OEPSC"), which previously managed the pension fund on behalf of OPG. OPG also enters into related party transactions with its joint ventures and equity-owned investments that are subject to significant influence. The transactions between OPG and related parties are in the normal course of business under normal trade terms. These transactions are summarized below:

| (millions of dollars)              | 2002     |          | 2001     |          |
|------------------------------------|----------|----------|----------|----------|
|                                    | Revenues | Expenses | Revenues | Expenses |
| Hydro One                          |          |          |          |          |
| Electricity sales                  | 742      | -        | 1,146    | -        |
| Services                           | 3        | 13       | 8        | 36       |
| Province of Ontario                |          |          |          |          |
| Gross revenue charge/water rentals | -        | 116      | -        | 109      |
| OEFC                               |          |          |          |          |
| Gross revenue charge/property tax  | -        | 237      | -        | 194      |
| Interest on long-term notes        | -        | 192      | -        | 196      |
| Capital tax                        | -        | 48       | -        | 48       |
| Income taxes                       | -        | (3)      | -        | 66       |
| IMO                                |          |          |          |          |
| Electricity sales                  | 3,371    | -        | -        | -        |
| Ancillary services                 | 82       | 67       | 102      | 2        |
| Joint venture companies            |          |          |          |          |
| Services                           | 8        | 1        | 9        | 42       |
| Systems                            | -        | -        | -        | 12       |
| OEPSC-services                     | 1        | 2        | 6        | -        |
|                                    | 4,207    | 673      | 1,271    | 705      |

At December 31, 2002, accounts receivable included \$4 million (2001 - \$131 million) due from Hydro One, \$551 million (2001 - \$9 million) due from the IMO, nil (2001 - \$2 million) due from joint venture companies and nil (2001 - \$1 million) due from OEPSC. Accounts payable and accrued charges at December 31, 2002

included nil (2001 - \$3 million) due to Hydro One, nil (2001 - \$2 million) due to the IMO, nil (2001 - \$1 million) due to joint venture companies and nil (2001 - \$1 million) due to OEPSC.

## 20. OTHER ITEMS

### WSIB Settlement

For purposes of the Workplace Safety and Insurance Board of Ontario ("WSIB"), OPG was reclassified from a schedule 2 self-insured employer to a schedule 1 premium-paying employer. During 2002, the WSIB assumed the liability with respect to OPG's existing and future workers' compensation claims in exchange for a cash payment of \$54.5 million. Accordingly, a settlement of the entire obligation occurred and the Company recorded a one-time reduction in operations, maintenance and administration expenses of \$24 million.

## 21. OTHER INCOME

Other income is comprised of the gain on sales from decontrol activities and other initiatives as follows:

| <i>(millions of dollars)</i>                          | <b>2002</b> | 2001 |
|---|-------------|------|
| Mississagi River generating stations <i>(note 13)</i> | <b>99</b>   | -    |
| Gain on sale of long-term investments                 | <b>54</b>   | -    |
| Nuclear Safety Analysis Division                      | <b>11</b>   | -    |
| Investment in New Horizon System Solutions Inc.       | <b>4</b>    | -    |
| Investment in Kinectrics Inc.                         | <b>3</b>    | -    |
|   | <b>171</b>  | -    |

### Sale of Nuclear Safety Analysis Division

In September 2002, the Company completed the sale of its Nuclear Safety Analysis Division to Nuclear Safety Solutions Limited, a wholly-owned Canadian subsidiary of NNC Holdings Limited. Total proceeds from the sale were approximately \$20 million consisting of cash proceeds of approximately \$15 million and assumption of other liabilities of approximately \$5 million. The Company recorded a gain of approximately \$11 million.

### Sale of Investment in New Horizon System Solutions Inc.

In March 2002, OPG divested its 49 per cent joint venture interest in New Horizon System Solutions Inc. ("New Horizon") to Business Transformation Services Inc., a wholly owned subsidiary of Cap Gemini. OPG is continuing with its 10-year information technology outsourcing agreement with New Horizon that commenced in February 2001. The Company recorded a gain on sale of \$4 million.



### Sale of Investment in Kinectrics Inc.

In January 2002, OPG sold its remaining ownership interest in Kinectrics Inc. to 3982912 Canada Inc., a subsidiary of AEA Technology plc., for approximately \$12 million in cash proceeds. The Company recorded a gain on sale of \$3 million.

## 22. CHANGES IN NON-CASH WORKING CAPITAL BALANCES

| (millions of dollars)                            | 2002  | 2001  |
|--|-------|-------|
| Accounts receivable                              | 274   | (50)  |
| Note receivable                                  | (225) | -     |
| Income taxes recoverable                         | (3)   | (77)  |
| Fuel inventory                                   | 23    | (293) |
| Materials and supplies                           | (45)  | (60)  |
| Market power mitigation agreement rebate payable | 572   | -     |
| Accounts payable and accrued charges             | (121) | 33    |
|  | 475   | (447) |

## 23. REGULATION AND STATUS OF DEREGULATION IN ONTARIO

### (a) Bill 210 "Electricity Pricing, Conservation and Supply Act, 2002"

On May 1, 2002, Ontario opened its wholesale and retail electricity markets to competition. Subsequent to market opening, in November 2002, the Government of Ontario introduced Bill 210, "Electricity Pricing, Conservation and Supply Act, 2002". The Bill became law on December 9, 2002. The new legislation and related regulations include the following key features:

- › Effective December 1, 2002 and until April 30, 2006, electricity commodity prices are set at 4.3¢/kWh for low volume consumers (consumers using less than 150,000 kWh annually) and other designated consumers including those who have a demand of 50 kW or less.
- › Refunds will be provided to these consumers for the difference between the 4.3¢/kWh and the amount actually paid by these customers since market opening.
- › The rates for transmission and distribution, and the fees for the operation of the IMO are capped at current levels.
- › IMO market uplift charges to distributors and low volume and designated consumers are capped at 0.62¢/kWh.

- › The Minister of Energy has been given increased powers including the ability to review market rules made by the IMO to ensure that the new rules do not unduly and adversely affect the interests of consumers with respect to prices or the reliability or quality of electricity service. The Minister has also been given powers to control rates approved by the OEB and to require certain orders to be amended.
- › Tax incentives are provided to promote conservation, use of alternate fuels and support for clean energy production through a variety of mechanisms.

The new legislation and related regulations introduced in November 2002 did not include any changes in the electricity prices or the market rules related to the IMO-administered real-time market or spot market, nor did they address the form of electricity pricing for customers other than low volume and designated customers. *The Electricity Pricing, Conservation and Supply Act, 2002*, as it relates to the low volume and other designated consumers, is not expected to have a significant impact on OPG.

#### **(b) Business Protection Plan for Large Electricity Consumers in Ontario**

On March 21, 2003, the Province announced a business protection plan for large electricity consumers in Ontario. Under this plan, consumers using up to 250,000 kWh per year will be included in the fixed price rate of 4.3¢/kWh retroactive to May 1, 2002. Except for certain designated customers, all consumers using above 250,000 kWh per year will remain in the competitive wholesale and retail markets and receive rebates under the terms of the existing market power mitigation agreement arrangements for the 12 months ending April 30, 2003. Effective May 1, 2003, rebates to these customers will be fixed at 50 per cent of the amount by which the average spot price in the IMO-administered market exceeds 3.8¢/kWh, with rebates paid on a quarterly basis. OPG will continue to be responsible for a rebate commitment based on the existing market power mitigation agreement arrangement under which the level of payment is impacted by the degree of decontrol implemented by OPG. This business protection plan is not expected to have a material impact on OPG's operating results.

## BOARD OF DIRECTORS



JALYNN BENNETT  
*President,  
Jalynn H. Bennett  
& Associates Ltd.*



GRAHAM BROWN  
*Chief Operating Officer,  
Ontario Power Generation*



MARK DEMICHELE  
*Chairman & CEO,  
Urban Realty Partners  
L.L.C.*



BILL FARLINGER  
*Chairman,  
Ontario Power Generation*



PAUL GODFREY  
*President & CEO,  
Toronto Blue Jays  
Baseball Club*



L. JACQUES MÉNARD  
*Chairman, BMO Nesbitt Burns  
President, Bank of Montreal  
Group of Companies*



RON OSBORNE  
*President & CEO,  
Ontario Power Generation*



BRIAN ROBBINS  
*President & CEO,  
EXCO Technologies Ltd.*



ARTHUR SAWCHUK  
*Chairman,  
Manulife Financial  
Corporation*



RICHARD MURRAY  
THOMSON  
*Retired Chairman & CEO,  
The Toronto-Dominion  
Bank*

## ONTARIO POWER GENERATION GOVERNANCE

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The Board of Ontario Power Generation consists of 12 directors. Seven directors are non-related. The Chairman, Bill Farlinger, is elected by the shareholder. Ron Osborne, President and CEO, and Graham Brown, Chief Operating Officer, are members of the Board of Directors. There are two vacancies as of March 31, 2003.

The Board of Directors is responsible for providing the strategic direction and leadership for the company and has established four permanent committees of the Board. The Board meets approximately six times a year. Additional meetings may be held if necessary.

### Audit Committee

The Audit Committee is responsible for advising the Board and making recommendations regarding publicly reported financial information; the appropriateness of accounting policies and practices in accordance with Canadian Generally Accepted Accounting Principles; the adequacy of the processes for identifying and managing risks; the integrity of internal controls; policies and practices relating to business ethics; the appointment, terms of engagement and fees of the external auditor; and the mandate and program of the internal auditor. In addition, the Audit Committee may exercise, on behalf of the Board, powers delegated to it with respect to financing matters. The Committee meets four times a year. Additional meetings may be held if necessary. Members: Richard Thomson (Chair), Jalynn Bennett, Brian Robbins, and Bill Farlinger.

### Human Resources and Corporate Governance Committee

The Human Resources and Corporate Governance Committee is responsible for advising the Board and making recommendations regarding the appointment, annual review and remuneration of the President and Chief Executive Officer; succession planning; annual assessment of company performance and incentive payments under the Corporate Annual Incentive Plan; pension plan governance, including plan amendments, benefits and fund oversight; and the annual review and remuneration, conducted by the President and Chief

Executive Officer, of senior executives. The Committee is also responsible for the Board's governance of the company, including recommending individuals for appointment to the Board of Directors, the terms of reference and membership for Board committees, and other initiatives as required to ensure the Board delivers exemplary corporate governance. The Committee meets four times a year. Additional meetings may be held if necessary. Members: Arthur Sawchuk (Chair), Paul Godfrey, Jalynn Bennett, and Bill Farlinger.

### Environment, Health and Safety Committee

The Environment, Health and Safety Committee is responsible for advising the Board and making recommendations regarding the company's policies in the areas of the environment and health and safety; the adequacy of progress in achieving compliance; the adequacy of processes for identifying and managing environmental, health and safety risks and opportunities for continual improvement; activities, trends and developments pertaining to environmental, health, and safety matters that have a significant impact on OPG's operations, assets and reputation; and the adequacy of processes to ensure that the radiological risk to workers, the public and the environment is acceptably low. The Committee meets four times a year. Additional meetings may be held if necessary. Members: Jalynn Bennett (Chair), Jacques Ménard, Brian Robbins, and Bill Farlinger.

### Nuclear Review Committee

The Nuclear Review Committee is responsible for oversight of the company's nuclear performance, particularly with respect to nuclear risks, safety and operations. Specifically, the Committee advises the Board of Directors with respect to the oversight of safe and efficient operations; continuous improvement over the medium and long term; regulatory compliance by OPG's nuclear facilities; and receiving and reviewing reports on OPG nuclear facilities from independent advisers or assessors. The Committee meets four times a year. Additional meetings may be held if necessary. Members: Mark DeMichele (Chair), Jacques Ménard, Paul Godfrey, Brian Robbins, and Bill Farlinger.

## OFFICERS AND SENIOR MANAGEMENT



BILL FARLINGER\*†  
*Chairman*



RON OSBORNE\*†  
*President  
& Chief Executive Officer*



GRAHAM BROWN\*†  
*Chief Operating  
Officer*



BRUCE BOLAND  
*Senior Vice President,  
Customer Solutions*



GISELLE BRANGET†  
*Vice President,  
Treasurer*



PIERRE CHARLEBOIS\*  
*Chief Nuclear Operating Officer  
& Chief Nuclear Engineer*



RICHARD DICERNI\*†  
*Executive Vice President  
& Corporate Secretary*



DAVID DRINKWATER\*Δ†  
*Executive Vice President  
& Chief Financial Officer*



GARY GRANT  
*Senior Vice President,  
Pickering B Nuclear  
Generating Station*



ADÈLE MALO  
*Vice President,  
Law & General Counsel*



PAT MCNEIL  
*Senior Vice President,  
Nuclear Strategy  
& Support*



SNICK MEYERS  
*Senior Vice President,  
Trading & Portfolio  
Management*



JOHN MURPHY\*†  
*Executive Vice President,  
Human Resources  
& Chief Ethics Officer*



BILL ROBINSON  
*Senior Vice President,  
Pickering A Nuclear  
Generating Station*



GREGORY SMITH  
*Senior Vice President,  
Darlington Nuclear  
Generating Station*



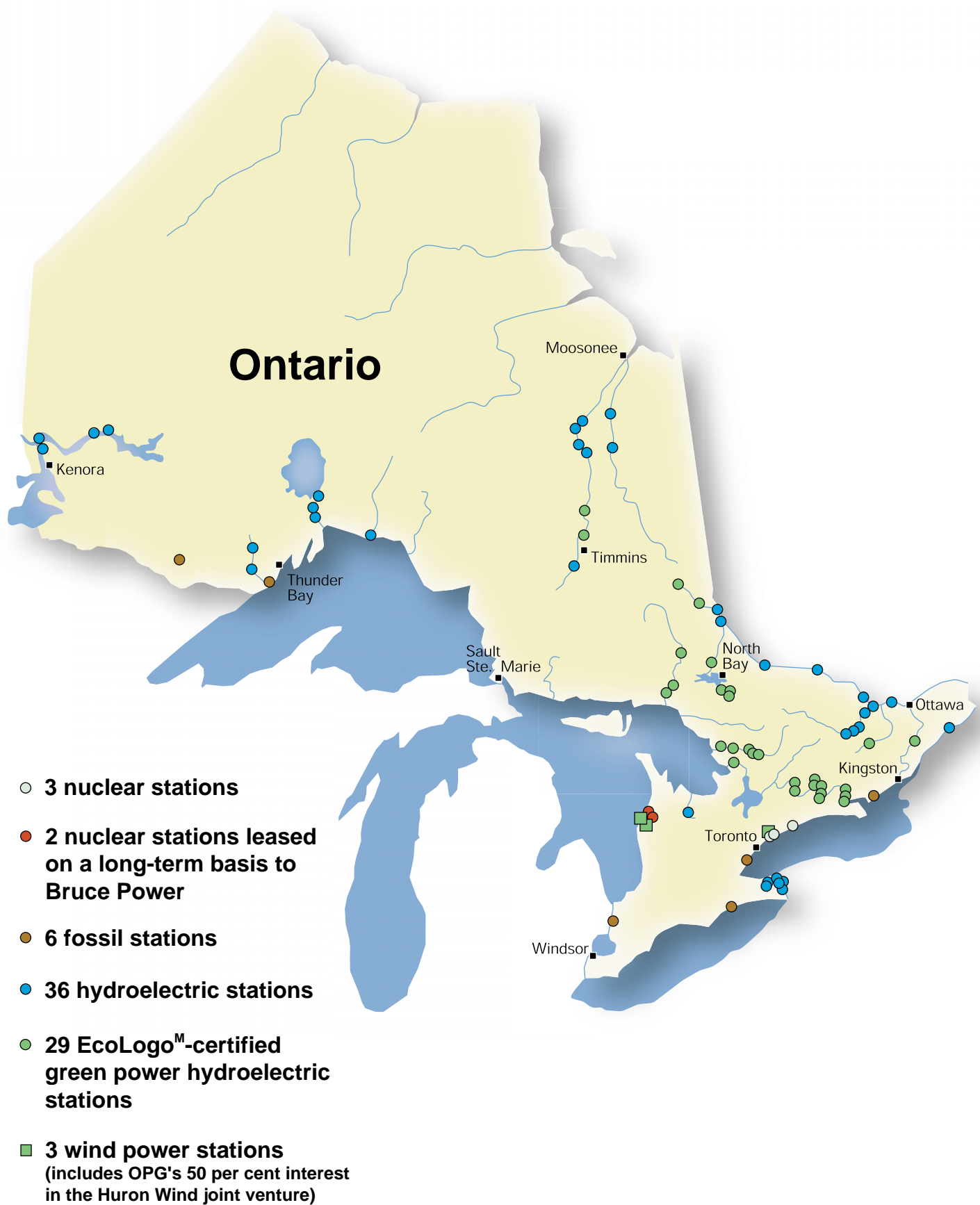
JIM TWOMEY  
*Senior Vice President,  
Electricity Production*

\* Executive Committee

† Officers

Δ Became Chief  
Financial Officer in  
April 2003

## ONTARIO POWER GENERATION FACILITIES





This annual report is also available in French on our Web site - ce rapport est également publié en français - at [www.opg.com](http://www.opg.com).

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