
2008 ANNUAL REPORT

ONTARIO POWER GENERATION

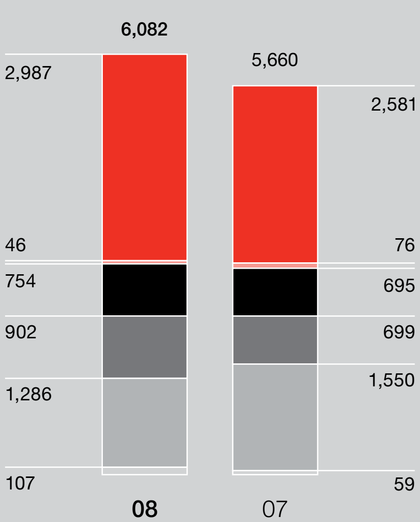
# 2008 Overview

## FINANCIAL HIGHLIGHTS

| **Year Ended December 31** (millions of dollars) | **2008** | 2007 |
|---|---|---|
| **Revenue** | | |
| Revenue before revenue limit rebate | **6,359** | 5,887 |
| Revenue limit rebate | **(277)** | (227) |
| | **6,082** | 5,660 |
| Earnings | | |
| Income before interest and income taxes by segment: | | |
| Regulated – Nuclear Generation | **235** | (58) |
| Regulated – Nuclear Waste Management | **(670)** | (26) |
| Regulated – Hydroelectric | **310** | 249 |
| Unregulated – Hydroelectric | **508** | 329 |
| Unregulated – Fossil-Fuelled | **(25)** | 74 |
| Other | **78** | 52 |
| Income before interest and income taxes | **436** | 620 |
| Net interest expense | **165** | 143 |
| Income tax expense (recovery) | **183** | (51) |
| Net income | **88** | 528 |
| **Electricity production (TWh)** | **107.8** | 105.1 |
| **Cash flow** | | |
| Cash flow provided by operating activities | **870** | 379 |

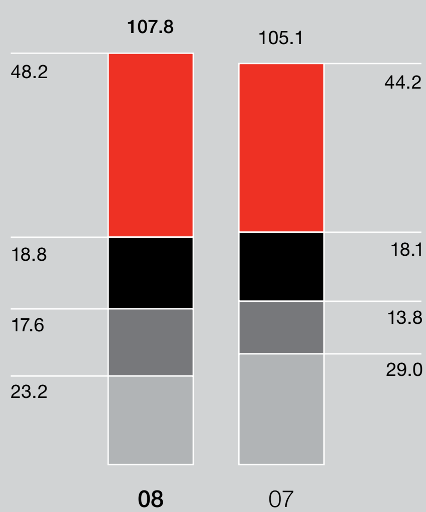
## REVENUE AND OPERATING HIGHLIGHTS

**Revenue, Net of Revenue Limit Rebate by Segment**
(millions of dollars)



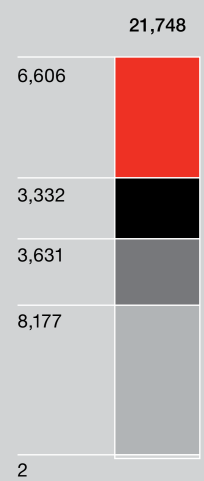

- Regulated – Nuclear Generation
- Regulated – Nuclear Waste Management
- Regulated – Hydroelectric
- Unregulated – Hydroelectric
- Unregulated – Fossil-Fuelled
- Other

**Electricity Generation by Segment**
(TWh)




- Regulated – Nuclear Generation
- Regulated – Hydroelectric
- Unregulated – Hydroelectric
- Unregulated – Fossil-Fuelled

**In-Service Generating Capacity by Segment**
December 31, 2008
(MW)




- Regulated – Nuclear
- Regulated – Hydroelectric
- Unregulated – Hydroelectric
- Unregulated – Fossil-Fuelled
- Other

# Corporate Profile





OPG is an Ontario-based electricity generation company whose principal business is the generation and sale of electricity in Ontario. OPG's focus is on the efficient production and sale of electricity from its generating assets, while operating in a safe, open and environmentally responsible manner. OPG was established under the Business Corporations Act (Ontario) and is wholly owned by the Province of Ontario.

In 2008, OPG had approximately 12,000 regular employees and generated 107.8 terawatt hours (TWh) of electricity.

OPG's electricity generating portfolio as of December 31, 2008, had a total in-service capacity of 21,748 megawatts (MW), which consisted of:

- three nuclear generating stations with a capacity of 6,606 MW
- five fossil-fuelled generating stations with a capacity of 8,177 MW
- 64 hydroelectric generating stations with a capacity of 6,963 MW, and
- two wind power turbines with a capacity of 2 MW.

In addition, OPG and TransCanada Energy Ltd. co-own the Portlands Energy Centre gas-fired generating station. OPG, ATCO Power Canada Ltd. and ATCO Resources Ltd. co-own the Brighton Beach gas-fired generating station. OPG also owns two other nuclear generating stations, which are leased on a long-term basis to Bruce Power L.P. ("Bruce Power").

**Electricity Terms**

One megawatt (MW) is one million watts. Megawatts are a measure of electricity supply capacity 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 demand per hour by customers. One kilowatt hour is the energy expended by fifty 20-watt compact fluorescent 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.

**Contents**

# The Power to Achieve

OPG is selected by the Ontario government to operate two new nuclear units on the Darlington site.

The first phase of the 550 MW gas-fuelled Portlands Energy Centre – a partnership between OPG and TransCanada Energy – is completed on time and on budget, helping to meet Toronto's energy needs.

OPG continues biomass testing at its coal-fuelled plants involving longer test burns of carbon neutral biomass – a potential new energy source for Ontario.

OPG receives the President's Gold Award of Excellence for Employee Safety from the Canadian Electricity Association – for three consecutive years of achieving top quartile safety performance.

OPG's 1,000 hydroelectric employees achieve over three years worked without a lost-time injury.

Over 15,000 people attend the major anniversaries at OPG generating stations: DeCew (110 years); Abitibi (75 years); R.H. Saunders (50 years); and Thunder Bay (45 years).

Darlington and Pickering B nuclear stations receive 5-year operating licence renewals from the Canadian Nuclear Safety Commission (CNSC).

OPG signs milestone equity partnership agreement with the Lac Seul First Nation.

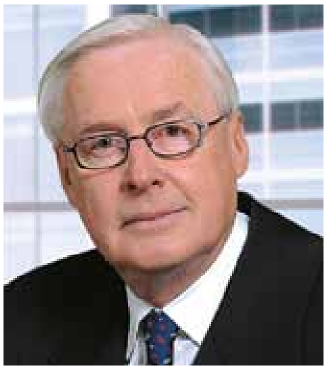
Hydroelectric production is the best since 1979; hydroelectric availability is the best since 1984.

# The Power to Achieve

**The Lac Seul Generating Station in northwestern Ontario is OPG's newest hydroelectric station since 1977.**

Virtually completed in 2008 and declared in service in February 2009, the generating station operates as a partnership between the Lac Seul First Nation and OPG. The facility's Ojibway name is "Obishikokaang Waasiganikewigamig," which means "White Pine Narrows electricity generating building."

# Chairman's Message



**"The Board was very pleased with OPG's performance in 2008, the strong leadership provided by its management, and the role of OPG as a major provider of electricity for Ontario."**

OPG's Board of Directors consists of seasoned business professionals with extensive experience in areas important to OPG's success. These areas include: the management and operation of nuclear stations; management of complex projects; overseeing capital intensive enterprises; expertise in financing and financial services; and the restructuring of large business enterprises.

The Board was very pleased with OPG's performance in 2008, the strong leadership provided by its management, and the role of OPG as a major provider of electricity for Ontario.

Operational performance in 2008 included surpassing a number of milestones for OPG's nuclear and hydroelectric generation; as well as recognition for OPG's safety and environmental performance.

During 2008, the Board was particularly pleased that OPG was selected by its Shareholder, the Ontario government, to operate two new nuclear units at its Darlington site. Nuclear expertise is one of the Board's strengths, and this decision was seen by the Board as an affirmation of OPG's capability as a responsible and effective nuclear operator.

OPG's signing of an equity partnership agreement with the Lac Seul First Nation for a 12.5 MW hydroelectric project in Ear Falls was another major milestone for OPG – and the first of its kind in Ontario. A model for future such agreements, the partnership agreement will help increase Ontario's supply of clean, renewable hydroelectric power.

OPG continued to explore in 2008 the possibility of burning carbon-neutral biomass fuel on units at some of its coal-fired stations. The Board sees biomass fuelled generation as an important complement to OPG's mandate to develop new sources of clean, renewable power, and is proud of the company's efforts in this area.

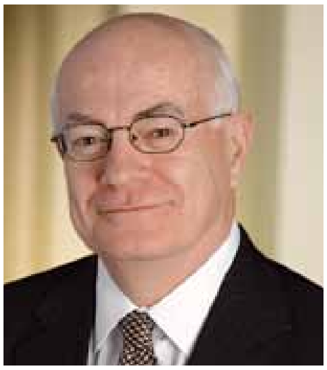
While the current global economic downturn poses challenges for Ontario's economy and for OPG going forward, the Board will ensure that OPG's assets, its investments in electricity infrastructure, and the expertise of its employees will continue to serve Ontario's electricity needs.

On behalf of the Board, I would like to express appreciation to President and CEO Jim Hankinson and his management team for their leadership and significant contribution to OPG's continued strong performance in 2008. Under the CEO's direction, OPG also enhanced its leadership and succession planning capability and developed a new strategic vision to position OPG as a leading, low emitting generator.

Jake Epp

**Jake Epp**
Chairman

# President's Message



**"A deep commitment to performance excellence remains the bedrock of OPG's strategy and success."**

A deep commitment to performance excellence remains the bedrock of OPG's strategy and success. This commitment was reflected in OPG's many safety achievements, its excellent environmental performance and its positive operational results. These results included very strong hydroelectric and nuclear output as well as continued excellent reliability from our fossil-fuelled plants. Output from our existing nuclear fleet was the best in OPG history. Our hydroelectric business had one of its best years, achieving strong results across virtually all major indices – including safety, production, availability and environmental performance. Individual stations and generating units also performed well. The Darlington nuclear station, for example, had another excellent year in terms of safety, generation, unit capability and planned outage completion. In addition, four OPG nuclear units finished the year among the top five performing CANDU reactors in the world.

There were challenges as well. Some stations experienced unexpected extensions to planned outages. And while employee safety performance was strong, there were areas requiring improvement. The number of workplace injuries did not improve compared to 2007 and there were a number of "near miss" incidents that could have resulted in serious employee injury. We put plans in place during 2008 to address both these issues – intensifying our already extensive outage preparation procedures and launching programs to mitigate risks that contribute to injuries, and improve our root cause investigation of near-miss safety incidents.

Our performance focus also includes achieving financial sustainability. In 2008, we moved closer to this goal as a result of the Ontario Energy Board's (OEB) decision to increase regulated prices on electricity produced by our nuclear and regulated hydroelectric stations.

OPG earned just over $1 billion before interest and income taxes in 2008 from its electricity generating segment. This compares to $594 million earned from this segment during 2007. The strong operating performance of our nuclear and hydroelectric stations contributed to our improved results.

In contrast, OPG's 2008 net income fell to $88 million compared to net income of $528 million in 2007. The decline was primarily due to the effects of the global economic downturn, which had a negative effect on the current value of OPG's nuclear decommissioning fund. At the end of 2008, the value of this fund declined to $4.3 billion compared to $5.1 billion at the end of 2007.

OPG continued its strong commitment to develop new supplies of largely low-emission and renewable generation – such as new nuclear, hydroelectric and, potentially, biomass – for Ontario's businesses and residents. Our new supply initiatives not only add to Ontario's electricity supply, they contribute significantly to Ontario's infrastructure development, economic growth and employment.

I was particularly proud of the initiatives launched in 2008 to strengthen our capabilities and outcomes in recruiting, training, leadership and succession planning. These steps will help address our growing need for skilled and talented employees to sustain current operations, manage new projects and enhance our workforce.

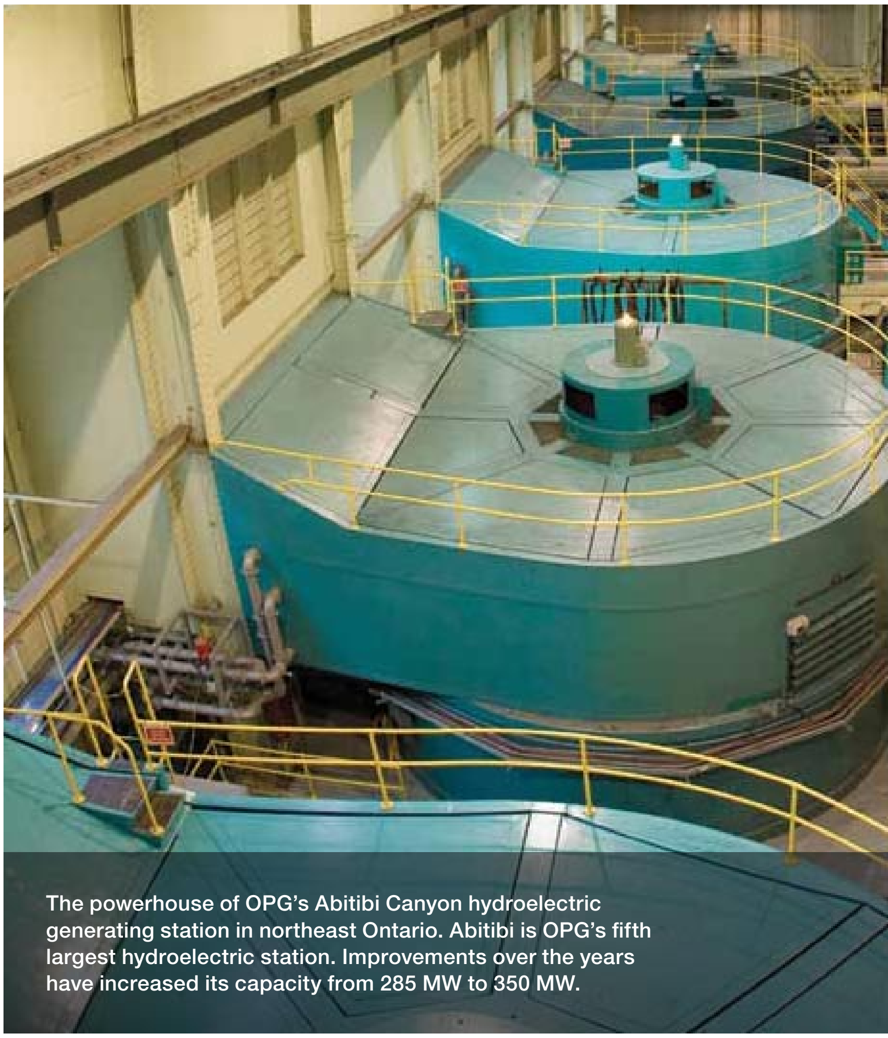
OPG's vision is to be a leading clean energy company, powering Ontario to a more sustainable energy future. In 2008, nearly 80 percent of OPG's generation was from our nuclear and hydroelectric stations. These facilities produce virtually no emissions contributing to smog or climate change. We are working to reduce emissions even more by expanding our hydroelectric capability and exploring the possibility of burning carbon-neutral biomass fuel at our coal-fired stations, which have been directed by the Ontario government to stop burning coal by the end of 2014.

Finally, I want to thank all employees for their efforts in making 2008 another productive year for OPG. Their focus on the safe and reliable operation of our plants, coupled with their strong community commitment, has contributed significantly to our success. I am confident our employees will continue to perform, as they always have, at the highest levels to the benefit of OPG and the people of Ontario.

**Jim Hankinson**
President and CEO

# The Power to Deliver

OPG's generating assets consistently provided safe, reliable power to Ontario's families, communities and businesses.



The powerhouse of OPG's Abitibi Canyon hydroelectric generating station in northeast Ontario. Abitibi is OPG's fifth largest hydroelectric station. Improvements over the years have increased its capacity from 285 MW to 350 MW.

OPG's nuclear, hydroelectric and fossil generating stations delivered solid performance in 2008, producing 107.8 TWh of electricity – representing over 70 percent of the electricity consumed in Ontario. Strong nuclear and hydroelectric output, supported by production from our reliable fossil-fuelled plants, drove performance during the year.

**NUCLEAR:** OPG's nuclear stations are the backbone of Ontario's electricity system, accounting for almost one-third of the energy used in 2008 by the Province. Our nuclear stations had a strong year in 2008, generating more than 48 TWh of electricity that has virtually no emissions that contribute to smog or climate change. Despite some challenging forced outages which impacted output, this was the highest nuclear production level in the company's history from its existing nuclear fleet. Individual nuclear units also delivered strong performance – with five of OPG's 10 operating units achieving unit capability factors of over 90 percent.

In addition, Darlington, Pickering B and the Pickering Nuclear Waste Management Facility had their operating licences renewed by the Canadian Nuclear Safety Commission (CNSC). These licences are for the maximum length of time granted by the CNSC. This is a strong testament to the safe and effective operation of our nuclear stations by OPG's experienced nuclear staff.

OPG's nuclear operations also received positive assessments from the internationally recognized nuclear safety organization, the World Association of Nuclear Operators (WANO). In July, a team from WANO visited Pickering B for more than a week. While noting a need for improvement in some areas, the WANO team commented on the station's progress in safety culture, preventive maintenance and leadership alignment. Later in the year, a second WANO team reviewed the corporate functions that support OPG's nuclear operations. The WANO team identified a number of key strengths, including staffing and hiring, contract management and leadership, and management development. WANO also pointed out opportunities for improvement which OPG will be addressing in 2009.

**HYDROELECTRIC:** OPG's hydroelectric stations play a critical role in providing Ontario with clean and renewable power at an affordable price. In 2008, these stations produced 36.4 TWh of electricity – making it the best year for hydroelectric production since 1979. Hydroelectric availability was also excellent, ending the year in the mid-90 percent range – the best since 1984. OPG's strong hydroelectric performance benefited from higher water flows on most river systems throughout the Province.

OPG employees Mike Morgan (left) and Jamie Smith (right) perform maintenance work during a planned outage on Unit 4 at the Lambton coal-fired generating station. OPG planned and executed 24 major outages in 2008 to ensure its fossil plants are ready to provide electricity during peak demand periods in summer and winter.

In addition, major planned outages took place at key hydroelectric sites – including the Beck complex, Cameron Falls, Otto Holden, Des Joachims, Chats Falls and Chenaux. These outages provided effective maintenance and targeted improvements which contributed to the company's strong hydroelectric performance.

**FOSSIL:** OPG's fossil-fuelled stations provide flexible, reliable generation during periods of high demand when electricity is needed most. Fossil generation in 2008 was just over 23 TWh. This was lower than in previous years, due to a relatively mild summer, some forced outage challenges, and stronger production from OPG's nuclear and hydroelectric stations. Nevertheless, OPG's fossil stations continued to deliver excellent reliability throughout the year. Reliability during the critical summer months was very strong. From June through August, Fossil's Equivalent Forced Outage Rate was under 8 percent – a 30 percent improvement compared to the same period in 2007. This achievement is the result of sound planning, smart investment and quality work by OPG employees.

Going forward, OPG will be operating its coal-fired plants less frequently as a result of the Ontario government's revised carbon dioxide emission requirements. Fossil operations will focus on producing power primarily during the summer and winter peak demand periods. The ability to consistently achieve this performance goal will define Fossil's success in the future.

## Excellence in Reliability

| | |
|---|---|
| **NUCLEAR** Percentage of OPG's 10 operating nuclear units that had unit capability factors above 90 percent | 50% |
| **HYDROELECTRIC** OPG's hydroelectric stations achieve their best availability since 1984 | 94.3% |
| **FOSSIL** OPG's fossil stations continue to maintain their excellent reliability, achieving a forced outage rate for 2008 that is among their best ever | 12.8% |

# The Power to Grow

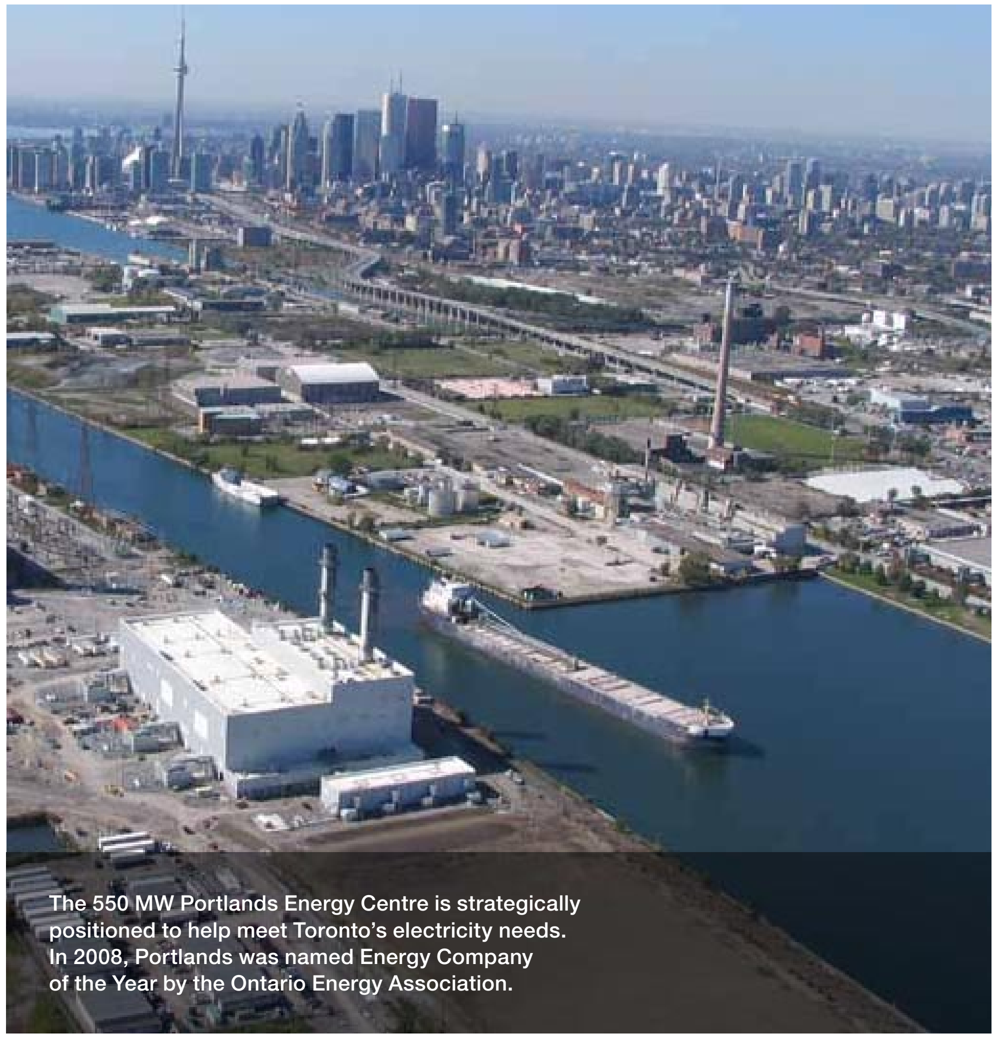
OPG's new generation projects and ongoing asset improvements to its existing generating facilities help ensure Ontario has sufficient power to meet its long-term electricity needs for many decades to come.

The Darlington nuclear site in Durham Region can accommodate up to four additional nuclear reactors representing a total of 4,800 MW virtually free of emissions contributing to smog and climate change.

**NEW NUCLEAR:** Nuclear energy represents the single most important large-scale energy source to meet Ontario's electricity needs in the future. Nuclear generation has the added advantage of being virtually free of emissions that cause air pollution and contribute to global warming. In June 2008, OPG was selected by the Ontario government to be the operator of two new nuclear units at its Darlington site. The decision reflected OPG's strong performance and community support as a nuclear operator. Throughout the year, OPG conducted extensive site evaluation and environmental studies of the Darlington site – as well as comprehensive community consultations – as part of the required Federal approval process. When complete, the new units will provide over 2,000 MW of generating capacity for Ontario's future energy supply. Next steps in the process include completion of an ongoing Environmental Assessment (EA) and licensing processes by OPG and the selection of the appropriate reactor technology by the Ontario Government. The Government has indicated the first reactor is expected to be in service by 2018 and the second by 2019.

**NUCLEAR REFURBISHMENT:** OPG is also assessing the feasibility of refurbishing two of its existing nuclear generating stations – Pickering B (brought into service: 1983-86) and Darlington (brought into service: 1990-93). Together, these stations contribute over 5,500 MW to Ontario's electricity supply. Extending their operating lives represents an important potential supply option for Ontario. After extensive reviews by various federal departments, a key milestone was completed in 2008 with a public hearing on the EA for Pickering B's refurbishment. Following this hearing, the CNSC concluded in early 2009 that Pickering B's refurbishment is not likely to cause significant adverse environmental effects after taking into account mitigation measures. Preliminary work for assessing Darlington's refurbishment also got underway in 2008. Even though Darlington will not need to be refurbished until the middle of the next decade, OPG is starting to plan early to ensure the process goes smoothly.

**HYDROELECTRIC DEVELOPMENT:** OPG has a mandate from the Ontario government to develop and expand the Province's supply of clean, renewable hydroelectric energy. To help meet this goal, OPG has three major hydroelectric projects underway – the Niagara Tunnel; the Upper Mattagami and Hound Chute redevelopment project in northeast Ontario; and the Lac Seul generating station in northwest Ontario. At the end of 2008, excavation of the 10.4 kilometre Niagara Tunnel was about one-third completed – slower than expected progress due to challenging rock conditions inside the Tunnel itself. When completed, the Tunnel will operate for at least 90 years – adding an annual average of 1.6 TWh of energy to the output generated by OPG's Beck hydroelectric complex near Niagara Falls.



The 550 MW Portlands Energy Centre is strategically positioned to help meet Toronto's electricity needs. In 2008, Portlands was named Energy Company of the Year by the Ontario Energy Association.

Meanwhile, in northern Ontario, construction of the Upper Mattagami/Hound Chute redevelopment projects began in the summer. Construction of the 12.5 MW Lac Seul generating station was completed in February 2009 and the station is now producing power for Ontario. OPG also has eight new hydroelectric projects in various stages of planning, representing a potential 600 MW of additional hydropower for Ontario.

**HYDROELECTRIC IMPROVEMENTS:** OPG also added to its hydroelectric supply through proactive maintenance, upgrades and equipment improvements at its existing hydroelectric stations. Runner upgrades completed on units at Chats Falls and Des Joachims resulted in energy improvements representing 13.8 GWh of additional energy – enough to power about 1,400 households for one year.

**FOSSIL:** Working in partnership with TransCanada Energy, OPG completed the first phase of the Portlands Energy Centre in 2008. Portlands provides 550 MW of added capacity to help meet central Toronto's electricity needs. The second, combined cycle phase of the natural gas-generating facility is expected to be completed to meet its scheduled in-service date of June 1, 2009. The timely execution and completion of the first phase of the Portlands Energy Centre earned for it the distinction of being named "Energy Company of the Year" by the Ontario Energy Association.

Going forward, OPG will position itself to respond to future natural gas opportunities under the Ontario Power Authority's Request for Proposals process.

## Enhancing Capacity

| | |
|---|---|
| Number of potential megawatts OPG's hydroelectric development projects will contribute to Ontario's electricity supply | about **600** MW |
| Number of hours OPG employees devoted to the Environmental Assessment process for the Pickering B refurbishment | over **50,000** |
| Amount of energy produced in 2008 by biomass test-burns at OPG's coal-fired generating stations | **7** million kWh |


Young people learn about nature as part of the Pickering nuclear station's "Tuesdays on the Trail" program on the Waterfront Trail in Durham Region. The program is one of more than 1,000 local community initiatives that OPG helped support in 2008.

# The Power of People

Investing in employees and communities helps ensure our long-term success.

**A WORKPLACE TO BE PROUD OF:** OPG is building a workplace that leverages the power of people. The company offers employees broad-based opportunities for interesting and engaging work, professional growth and personal fulfillment. It also means attracting highly qualified people to choose OPG as an employer.

To help meet these goals, OPG is building a leadership culture that proactively identifies, encourages and develops future leaders within the company. In 2008, OPG's leadership model was rolled out company-wide. This initiative focuses on developing competencies in leadership selection, succession management, performance planning and development. Robust development programs were aimed at all management levels. The company is also embracing a variety of options to expand its leadership pool, including formal training and education, experienced-based learning and mentoring. We are looking deeper into the organization to identify future leaders earlier and accelerate their development.

During the past year, OPG launched a Leadership Forum for more than 100 senior leaders. Under the auspices of this Forum, two leadership events were held in 2008, enabling OPG to tap into the expertise of its current leadership pool. The result was a number of spin-off initiatives to improve performance and efficiency. These Forums are now a regular feature of OPG's operations, aimed at strengthening leadership and organizational effectiveness.

OPG also focused on increasing the number of new employees – especially in the trades and engineering. In 2008, the company hired approximately 800 new employees – including over 300 engineers and technicians. The company has expanded its recruitment efforts at colleges and universities in Ontario and Eastern Canada. Over 100 job offers were made to new university graduates in 2008 as a result of this expanded campaign. OPG also continued to develop and strengthen partnerships with many educational institutions, trade and industry groups. These efforts are helping to broaden the talent pool available to OPG.

To attract the best employees, OPG is committed to becoming an employer that people want to work for – an employer of choice. In 2008, OPG moved closer to this goal by being named one of Canada's Top 100 Employers for the second year in a row. OPG was also named one of the top employers in the Greater Toronto Area for the third consecutive year.

**PRIDE IN OUR COMMUNITIES:** OPG's investment in people includes investing in the communities where we operate. As an Ontario-based company, OPG is proud of its economic contribution to the Province.

In 2008, OPG invested more than $1.4 billion (excluding fuel purchases) on goods and services in Ontario. Much of this investment was directed toward operations and initiatives at our many generating facilities. These investments helped finance such undertakings as our efforts in nuclear new build, upgrades to our hydroelectric stations and biomass testing at our fossil-fuelled stations.

Lucy He, an intern at OPG's Niagara Plant Group in 2008, is studying Environmental Engineering at Carleton University, Ottawa. In 2008, OPG hired over 425 students in its co-op and summer employment program as part of its strategy to attract talented young people as future employees.

Through its Corporate Citizenship Program, OPG helped support nearly 1,000 small, grass-roots community, environmental and educational non-profit initiatives in its host communities.

OPG and its employees and pensioners also contributed over $2 million to Ontario charities and other worthy causes as part of the company's annual Charity Campaign. Many OPG employees and pensioners regularly volunteer their time and effort in our host communities across Ontario.

In addition to its economic contribution, OPG is committed to being an open, accountable and accessible presence in the communities where it operates.

In 2008, the company held more than a dozen information sessions – and established a special Community Kiosk – to share information and seek input about the nuclear new build EA. OPG plant personnel regularly reported to municipal councils and other local groups on plant operations and initiatives. Senior executives, including the CEO, met with community leaders in Durham Region, Niagara, Timmins, Atikokan and other locations across Ontario. OPG also celebrated four major station anniversaries in 2008 – all open to the public – at R.H. Saunders; Thunder Bay; Abitibi; and DeCew generating stations.

Strong community support was also evident at Pickering B's and Darlington's re-licensing hearings, conducted by the CNSC in 2008. At these hearings, the stations received supportive interventions from elected officials, organizations and individuals in OPG's host communities.

## Employee and Community Focus

| | |
|---|---|
| Number of times in the past three years (2006-2008) that OPG has been recognized as one of Canada's and Toronto's top employers | 5 |
| Number of engineers and technicians hired by OPG in 2008 | over 300 |
| Number of community residents attending OPG station anniversaries in 2008 | over 15,000 |

# The Power of Commitment

OPG is committed to safety and environmental excellence. We will meet these commitments through our continued focus on achieving zero workplace injuries and through our determination to become a leading low emissions generating company.

OPG Fossil participants at OPG's Joint Health and Safety Committee (JHSC) Conference. Demonstrating their commitment to OPG's strong safety culture, more than 200 JHSC members from across OPG and those who support them attended this major safety conference in February 2008.

**SAFETY:** Public and workplace safety is a fundamental OPG value. It is the basis for all the trust and respect we have earned from our stakeholders.

OPG's overall safety performance was strong in 2008. A number of sites reached major safety milestones with no lost time injuries, demonstrating our progress towards reaching the goal of zero workplace injuries. OPG was also honoured with several safety awards – including awards from the Industrial Accident Prevention Association, the Electrical and Utilities Safety Association and the Canadian Electricity Association.

OPG measures its workplace safety performance using two industry-recognized standards – Accident Severity Rate (ASR) and All Injury Rate (AIR). Performance in both categories was strong in 2008.

- OPG's 2008 ASR performance is the best in its history. During the year, OPG achieved an ASR of 1.47 days lost per 200,000 hours worked. This betters the company's strong 2007 ASR performance of 1.56 days lost per 200,000 hours worked.
- OPG's 2008 AIR was 1.15 injuries per 200,000 hours worked. While slightly below the company's 2007 AIR of 1.12 injuries per 200,000 hours worked, this was still the second best AIR in OPG's history.

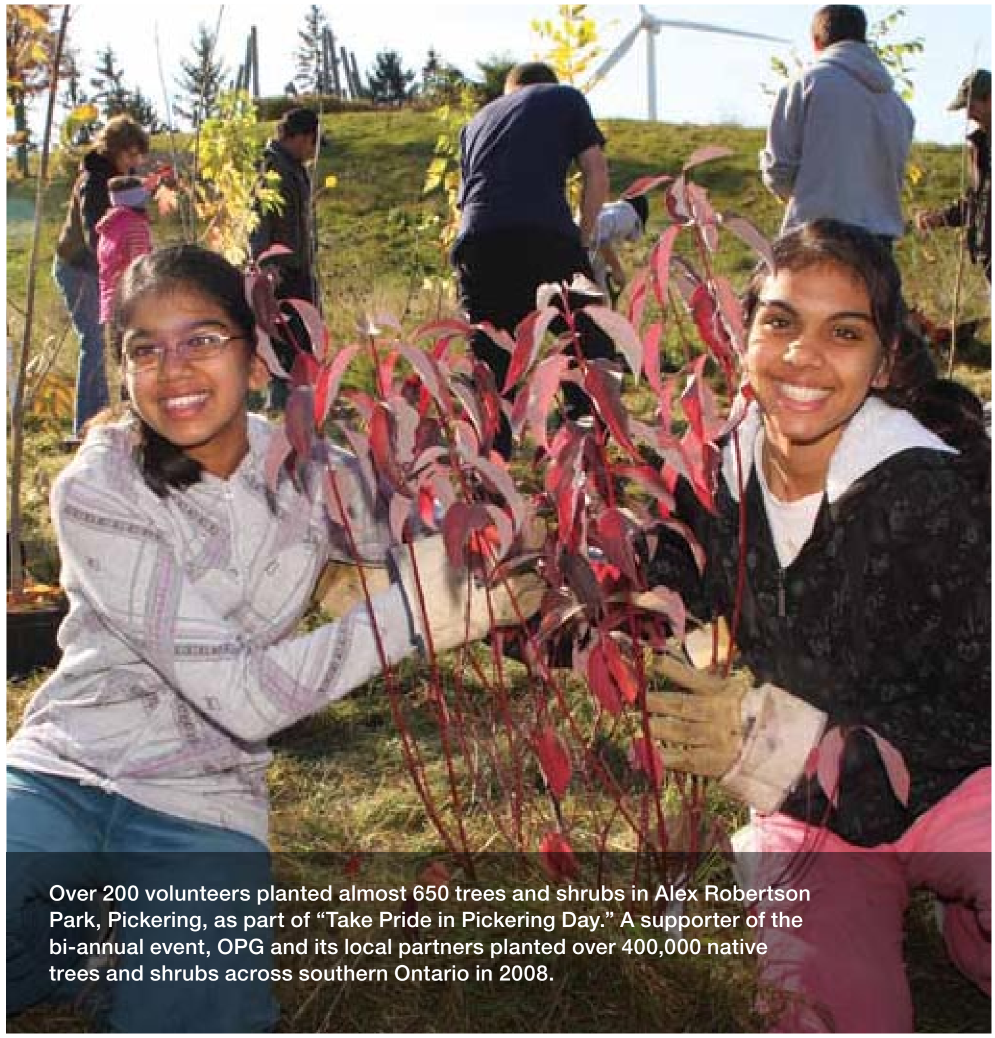
OPG's commitment to continuous improvement in safety was demonstrated in 2008 through programs launched to target the reduction in musculoskeletal disorder injuries and our high risk areas that contribute to "near-miss" incidents, any one of which could have led to serious injuries to one of our employees or contractors.

**ENVIRONMENT:** OPG is committed to becoming a leading low emissions energy company. Environmental performance will define our progress toward this goal.

OPG's environmental performance is assessed annually using a voluntary Environmental Performance Index (EPI). The EPI is based upon weighted scores calculated relative to voluntary performance benchmarks for spills, regulatory compliance, energy efficiency, radiation measures and waste management. An overall score of 100 indicates that, on average, benchmarks were met. Scores greater than 100 indicate performance better than benchmarks, and scores less than 100 indicate performance that did not meet benchmarks. The EPI sets targets for OPG that are more demanding that those set by government regulation and includes targets for several areas not covered by government regulation.

In 2008, OPG's EPI was 117, indicating that OPG's overall environmental performance was better than target in many areas, including spills, regulatory compliance and energy efficiency. Nitrogen oxide emission rates at OPG units equipped with Selective Catalytic Reduction (SCR) technology did not meet targets due to temporary equipment issues and the operation of these units at low loads, which compromised SCR operation. OPG's tritium emissions were worse than target. OPG has actions underway to address this issue and improve its tritium emission performance going forward.

Total emissions from the company's fossil-fuelled plants were significantly lower compared to 2007 levels. This was primarily due to lower demand and higher production from OPG's nuclear and hydroelectric plants. Emissions will be further reduced in 2009 as a result of OPG's plan to focus its fossil production on meeting



Over 200 volunteers planted almost 650 trees and shrubs in Alex Robertson Park, Pickering, as part of "Take Pride in Pickering Day." A supporter of the bi-annual event, OPG and its local partners planted over 400,000 native trees and shrubs across southern Ontario in 2008.

peak demand during the summer and winter months. This is in response to the Ontario government's $CO_2$ reduction initiative, announced in May 2008.

OPG also continued to be honoured for its leadership in biodiversity. The company received the international "Wings Over Wetlands" award from the Wildlife Habitat Council and Ducks Unlimited Inc. for its wetlands stewardship. OPG and its partners were also recognized by the Carolinian Canada Council for its forest restoration efforts. OPG operates one of the largest tree planting programs in the Province.

Longer term, OPG is shaping its generation mix to be one of the most low emitting portfolios in North America. The company's evolving asset mix will include additional nuclear and hydroelectric sources as well as some gas-fired generation. As directed by the Ontario government, OPG will no longer be burning coal at its fossil-fuelled stations after 2014. This will significantly advance OPG's position as a low-emission generator.

OPG is also exploring the feasibility of burning carbon-neutral biomass fuel at some of its coal-fired stations. In 2008, test burns were conducted on units at the Nanticoke, Lambton and Atikokan coal-fired stations. These included tests in which 100 percent biomass fuel was burned – proving that the fuel is technically capable of replacing coal. While these results are promising, more studies are needed to determine whether biomass is a practical commercial option.

## Demonstrating our Values

| | |
|---|---|
| OPG's operations – in the form of salaries, purchases, and payments in lieu of taxes – represent a significant contribution to Ontario's economy and communities | $3.9 billion |
| At the end of 2008, OPG's hydroelectric business unit and its 1,000 employees had worked for a record period without a lost time injury | 3.3 years |
| OPG operates one of the most extensive biodiversity programs in Ontario. Number of trees planted since inception | over 3.2 million |

# Management's Discussion and Analysis

**Management's Discussion and Analysis**








## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") 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, 2008. OPG's consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are presented in Canadian dollars. Certain of the 2007 comparative amounts have been reclassified to conform to 2008 presentation. This MD&A is dated February 12, 2009.

## FORWARD-LOOKING STATEMENTS

The MD&A 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 current or historical is a forward-looking statement. OPG generally uses words such as "anticipate", "believe", "foresee", "forecast", "estimate", "expect", "schedule", "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 does not indicate that a statement is not forward-looking.

All forward-looking statements involve inherent assumptions, risks and uncertainties and, therefore, could be inaccurate to a material degree. In particular, forward-looking statements may contain assumptions such as those relating to OPG's fuel costs and availability, asset performance, nuclear decommissioning and waste management, closure of coal-fired generating stations, refurbishment of existing facilities, development and construction of new facilities, pension and other post employment benefit ("OPEB") obligations, income taxes, spot electricity market prices, the ongoing evolution of the Ontario electricity industry, environmental and other regulatory requirements, health, safety and environmental developments, business continuity events, the weather, the developments with respect to third-party Asset-Backed Commercial Paper, and the impact of decisions by the Ontario Electricity Board. Accordingly, undue reliance should not be placed on any forward-looking statement. The forward-looking statements included in this MD&A are made only as of the date of this MD&A. OPG does not undertake to publicly update these forward-looking statements to reflect new information, future events or otherwise.

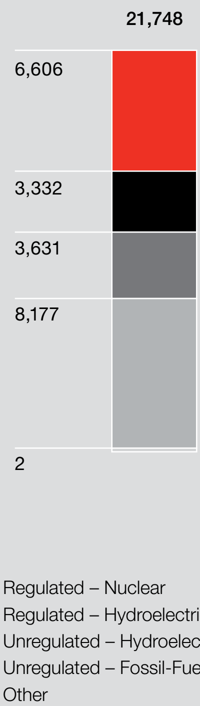
# Management's Discussion and Analysis

## THE COMPANY

OPG is an Ontario-based electricity generation company whose principal business is the generation and sale of electricity in Ontario. OPG's focus is on the efficient production and sale of electricity from its generating assets, while operating in a safe, open and environmentally responsible manner. OPG was established under the *Business Corporations Act* (Ontario) and is wholly owned by the Province of Ontario (the "Province").

At December 31, 2008, OPG's electricity generating portfolio had an in-service capacity of 21,748 megawatts ("MW"). OPG's electricity generating portfolio consists of three nuclear generating stations, five fossil-fuelled generating stations, 64 hydroelectric generating stations, of which four are being redeveloped, and two wind generating stations. In addition, OPG and TransCanada Energy Ltd. co-own the Portlands Energy Centre gas-fired generating station. OPG, ATCO Power Canada Ltd. and ATCO Resources Ltd. co-own the Brighton Beach gas-fired generating station. OPG also owns two other nuclear generating stations, which are leased on a long-term basis to Bruce Power L.P. ("Bruce Power").

**In-Service Generating Capacity by Segment**
December 31, 2008
(MW)




### OPG's Reporting Structure

During the fourth quarter of 2008, OPG revised the composition of its reporting segments to correspond with OPG's strategic business unit structure and changes to internal reporting. OPG's business segments are reported in a manner consistent with the way that management organizes the business for making operating decisions and assessing performance. As part of the revised internal reporting structure and to improve the transparency of the information provided to stakeholders, a new business segment was created and classified under the caption Regulated – Nuclear Waste Management. This new segment includes certain activities associated with the management of used nuclear fuel and low and intermediate level waste, the decommissioning of OPG's nuclear generating stations (including the stations leased to Bruce Power), the management of the nuclear fixed asset removal and nuclear waste management funds (the "Nuclear Funds"), and related activities including the inspection and maintenance of the waste storage facilities. OPG's other business segments include Regulated – Nuclear Generation, Regulated – Hydroelectric, Unregulated – Hydroelectric, and Unregulated – Fossil-Fuelled.

A description of all of OPG's business segments is provided under the heading *Business Segments*. The preceding year figures have been reclassified to conform with this new presentation.

## RATE REGULATION

Since April 1, 2005, OPG has received a regulated price for electricity generated from most of its baseload hydroelectric facilities and all of the nuclear facilities that it operates. This comprises electricity generated from the Sir Adam Beck 1, 2 and Pump generating station, DeCew Falls 1 and 2, and R.H. Saunders hydroelectric facilities, and Pickering A and B and Darlington nuclear facilities. The regulated prices were established pursuant to a regulation issued under the *Electricity Restructuring Act, 2004* (Ontario) for the three-year period that ended on March 31, 2008. The regulated price established for the first 1,900 megawatt hours ("MWh") of production from the regulated hydroelectric facilities in any hour was $33.00/MWh (3.3¢/kWh). For generation above 1,900 MWh, OPG received the spot electricity market price as an incentive mechanism to optimize hydroelectric production. The regulated price established for production from OPG's nuclear facilities was $49.50/MWh (4.95¢/kWh). OPG's production was subject to these regulated prices up to April 1, 2008, and to the hydroelectric incentive mechanism up to December 1, 2008.

The regulation also directed OPG to establish variance and deferral accounts for certain costs incurred and revenues earned or foregone. Variance account balances recorded by OPG captured deviations from the forecast information provided to the Province for the period from April 1, 2005 to April 1, 2008 for the purposes of establishing the above regulated prices. These related to the impact of water conditions on hydroelectric electricity production; revenues for ancillary services from the regulated facilities; transmission outages and transmission restrictions; and non-capital costs related to nuclear capacity refurbishment incurred since April 1, 2005. Deferral account balances recorded by OPG included non-capital costs incurred after January 1, 2005 associated with the planned return to service of all units at the Pickering A nuclear generating station;

the revenue requirement impact of changes in OPG's liabilities for nuclear used fuel management and nuclear decommissioning and low and intermediate level waste management ("Nuclear Liabilities") arising from the 2006 Approved Reference Plan in accordance with the terms of the Ontario Nuclear Funds Agreement ("ONFA"); and non-capital costs related to new nuclear generation development incurred on or after June 13, 2006.

The regulation further prescribed, subject to certain requirements, that the Ontario Energy Board ("OEB") should determine OPG's regulated prices to be effective no earlier than April 1, 2008. In November 2007, OPG filed an application with the OEB for new regulated prices for its regulated facilities effective April 1, 2008.

The OEB's decision on the application was issued on November 3, 2008. This was followed by an OEB order on December 2, 2008 which established the new regulated prices at $36.66/MWh (3.67¢/kWh) and $54.98/MWh (5.50¢/kWh) for OPG's regulated hydroelectric and nuclear facilities, respectively, based on an approved 21-month revenue requirement for the period from April 1, 2008 to December 31, 2009 of approximately $6.0 billion. These prices were approved effective April 1, 2008. The new regulated prices reflect the OEB's decision with respect to the recovery of OPG's variance and deferral account balances recorded prior to April 1, 2008 pursuant to the regulation under the *Electricity Restructuring Act*, 2004 (Ontario). In order to reflect the recovery of these balances, the nuclear regulated price of $54.98/MWh includes a rate rider of $2.00/MWh.

The Independent Electricity System Operator ("IESO") implemented the new prices on December 1, 2008. As the OEB determined that these prices should apply retrospectively to production starting on April 1, 2008, OPG receives additional rate riders of $3.22/MWh for production from its nuclear facilities and $2.18/MWh for its regulated hydroelectric facilities starting on December 1, 2008, as a means of collecting the retrospective revenue.

The OEB also approved a revised incentive mechanism based on market signals to optimize hydroelectric production. This new mechanism became effective on December 1, 2008. Under this mechanism, OPG receives the approved hydroelectric payment amount for the actual average hourly net energy production from the prescribed hydroelectric facilities in that month. In the hours when the net actual energy production in Ontario is greater or less than the average hourly net volume, OPG's revenues are adjusted by the difference between the average hourly net volume in the month and the actual net energy production multiplied by the market price.

The OEB also authorized the continuation of certain existing, and the creation of new variance and deferral accounts effective retrospectively to April 1, 2008. Additional information regarding the OEB decision is provided under the heading *Recent Developments*.

The production from OPG's other generating assets remains unregulated and continues to be sold at the Ontario electricity spot market price. However, 85 percent of the generation output from OPG's other generating assets, excluding the Lennox generating station, stations whose generation output is subject to a Hydroelectric Energy Supply Agreement ("HESA") with the Ontario Power Authority ("OPA") pursuant to a ministerial directive, and forward sales as of January 1, 2005, is subject to a revenue limit. The output from a generating unit where there has been a fuel conversion and the incremental output from a generating station where there has been a refurbishment or expansion of these assets are also excluded from the output covered by the revenue limit.

The revenue limit, which was originally established for a period of 13 months ending April 30, 2006, was subsequently extended for an additional three years. Starting May 1, 2006, the revenue limit decreased to 4.6¢/kWh from the previous limit of 4.7¢/kWh. On May 1, 2007, the revenue limit returned to 4.7¢/kWh and increased to 4.8¢/kWh effective May 1, 2008. In addition, beginning April 1, 2006, volumes sold under a Pilot Auction administered by the OPA are subject to a revenue limit that is 0.5¢/kWh higher than the revenue limit applicable to OPG's other generating assets. Revenues above these limits are returned to the IESO for the benefit of consumers. The term of the revenue limit rebate ends on May 1, 2009.

## HIGHLIGHTS

### Overview of Results

This section provides an overview of OPG's audited consolidated operating results. A detailed discussion of OPG's performance by reportable business segment is included under the heading *Discussion of Operating Results by Business Segment*.

| (millions of dollars) | **2008** | 2007 |
|---|---|---|
| **Revenue** | | |
| Revenue before revenue limit rebate | **6,359** | 5,887 |
| Revenue limit rebate | **(277)** | (227) |
| | **6,082** | 5,660 |
| Fuel expense | **1,191** | 1,270 |
| Gross margin | **4,891** | 4,390 |
| **Expenses** | | |
| Operations, maintenance and administration | **2,967** | 2,974 |
| Depreciation and amortization | **743** | 695 |
| Accretion on fixed asset removal and nuclear waste management liabilities | **581** | 507 |
| Losses (earnings) on nuclear fixed asset removal and nuclear waste management funds | **93** | (481) |
| Other net expenses | **71** | 75 |
| | **4,455** | 3,770 |
| Income before interest and income taxes | **436** | 620 |
| Net interest expense | **165** | 143 |
| Income tax expense (recovery) | **183** | (51) |
| Net income | **88** | 528 |
| **Electricity production (TWh)** | **107.8** | 105.1 |
| **Cash flow** | | |
| Cash flow provided by operating activities | **870** | 379 |

Net income for 2008 was $88 million compared to $528 million for 2007, a decrease of $440 million. Income before income taxes for 2008 was $271 million compared to $477 million for 2007, a decrease of $206 million.

The financial and operating results from OPG's electricity generation business segments improved significantly in 2008 compared to 2007. Income before interest and income taxes from OPG's electricity generation business segments was $1,028 million in 2008 compared to $594 million in 2007. This increase was primarily due to higher electricity prices and electricity production, which resulted in an increase in gross margin in 2008 compared to 2007.

The Regulated Nuclear Waste Management business segment incurred a loss before interest and income taxes of $670 million in 2008 compared to a loss before interest and income taxes of $26 million in 2007. This change was a result of a significant reduction in the earnings from the Nuclear Funds, partly mitigated by the establishment by the OEB of a variance account for differences between actual and forecast revenues and costs related to the nuclear generating stations on lease to Bruce Power ("Bruce variance account") effective April 1, 2008.

The following is a summary of the factors impacting OPG's results for the year ended December 31, 2008 compared to results for 2007, on a before-tax basis:

| (millions of dollars – before tax) | Electricity Generation Segments[1] | Regulated Nuclear Waste Management Segment | Other[2] | Total |
|---|---|---|---|---|
| **Income (loss) before income taxes for the year ended December 31, 2007** | **594** | **(26)** | **(91)** | **477** |
| Changes in gross margin: | | | | |
| Increase in electricity sales price after revenue limit rebate | 307 | – | – | 307 |
| Change in electricity generation by segment: | | | | |
| Regulated – Nuclear Generation | 186 | – | – | 186 |
| Regulated – Hydroelectric | 16 | – | – | 16 |
| Unregulated – Hydroelectric | 157 | – | – | 157 |
| Unregulated – Fossil-Fuelled | (104) | – | – | (104) |
| Increase in fuel price and other fuel-related costs | (92) | – | – | (92) |
| Increase in net trading revenue | – | – | 44 | 44 |
| Other changes in gross margin | 13 | (30) | 4 | (13) |
| | 483 | (30) | 48 | 501 |
| Changes in operations, maintenance and administration expenses ("OM&A"): | | | | |
| Increase in maintenance activities primarily due to higher expenditures at OPG's nuclear generating stations | (94) | – | – | (94) |
| Impact of regulatory accounts and expenditures related to nuclear generation development and capacity refurbishment | (87) | – | – | (87) |
| Decrease in pension and OPEB costs | 74 | – | – | 74 |
| Decrease in expenses related to past grievances by First Nations | 50 | – | – | 50 |
| Other changes in OM&A | 57 | 34 | (27) | 64 |
| | – | 34 | (27) | 7 |
| Increase in accretion on fixed asset removal and nuclear waste management liabilities | – | (74) | – | (74) |
| Decrease in earnings from the Nuclear Funds | – | (907) | – | (907) |
| Increase in regulatory asset related to earnings from the Nuclear Funds associated with stations on lease to Bruce Power | – | 333 | – | 333 |
| (Increase) decrease in depreciation and amortization expense | (58) | – | 10 | (48) |
| Other changes | 6 | – | (1) | 5 |
| **Increase (decrease) in income before other gains and losses, interest and income taxes** | **431** | **(644)** | **30** | **(183)** |
| Changes in other gains and (losses) | 3 | – | (4) | (1) |
| Increase in net interest expense | – | – | (22) | (22) |
| **Income (loss) before income taxes for the year ended December 31, 2008** | **1,028** | **(670)** | **(87)** | **271** |

1 Electricity generation segments include results of the Regulated – Nuclear Generation, Regulated – Hydroelectric, Unregulated – Hydroelectric and Unregulated – Fossil-Fuelled segments.

2 Other includes results of the Other category in OPG's segmented statement of income, inter-segment elimination, and net interest expense.

# Management's Discussion and Analysis

Earnings for 2008 were favourably impacted by an increase in gross margin of $501 million compared to 2007. The increase in gross margin in the electricity generation segments of $483 million was primarily due to higher prices for generation from OPG's regulated facilities following the OEB's decision to increase prices effective December 1, 2008, but applicable retrospectively to April 1, 2008. During the fourth quarter of 2008, OPG recorded $214 million of retrospective revenue for the period from April 1, 2008 to November 30, 2008. Gross margin was also favourably impacted by higher generation from OPG's nuclear and hydroelectric generating stations, partially offset by lower generation from OPG's fossil-fuelled generating stations and higher fuel costs.

Trading revenue also increased in 2008 compared to 2007, primarily due to higher realized earnings and mark-to-market gains from energy trading transactions.

Operations, maintenance and administration ("OM&A") expenses decreased by $7 million in 2008, compared to 2007. The decrease was primarily due to lower pension and OPEB costs, and a reduction in expenses related to the settlement of past grievances with First Nations. These reductions in expenses were largely offset by higher maintenance expenditures primarily at OPG's nuclear generating stations, and the impact of regulatory accounts and expenditures related to nuclear generation development and nuclear capacity refurbishment activities. The change in these regulatory accounts during 2008 was primarily a result of a lower level of costs incurred for new nuclear generation and capacity refurbishment activities than the forecast approved by the OEB in setting the regulated nuclear prices.

Accretion expense increased in 2008 compared to 2007 primarily due to the discontinuance, effective April 1, 2008, of the deferral account associated with the increases in Nuclear Liabilities arising from the 2006 Approved Reference Plan, and the increase in the present value of the liability due to the passage of time. Accretion expense was reduced in 2008 and 2007, through the deferral account, by $19 million and $75 million, respectively.

Losses from the Nuclear Funds, before the mitigating impact of the Bruce variance account established by the OEB, were $426 million compared to earnings of $481 million in 2007, a decrease of $907 million. The decrease in the earnings from the Nuclear Funds was primarily due to lower returns on the Decommissioning Segregated Fund ("Decommissioning Fund") as a result of significant reductions in trading levels of global financial markets, which reduced the current market value of the fund investments. The investments in the Decommissioning Fund include a diversified portfolio of equities and fixed income securities that are invested across many geographic markets. The Nuclear Funds are invested to fund long-term liability requirements, and as such, the portfolio asset mix is structured to achieve the required return over a long-term horizon. While short-term fluctuations in market value will occur, managing the long-term return of the Nuclear Funds remains the primary goal. OPG's earnings on the Used Fuel Segregated Fund ("Used Fuel Fund") are not subject to such capital market volatility since the rate of return on this fund is guaranteed by the Province, for the first 2.23 million used fuel bundles.

The losses from the Nuclear Funds were partially mitigated by the establishment of the Bruce variance account, effective April 1, 2008, since a portion of the losses from the Nuclear Funds related to the nuclear generating stations on lease to Bruce Power. OPG recorded a regulatory asset of $333 million in this variance account that reduced the reported losses from the Nuclear Funds.

Depreciation and amortization expense was $743 million in 2008 compared to $695 million in 2007. The increase in depreciation and amortization expense was primarily due to the discontinuance on April 1, 2008 of the deferral of depreciation expense associated with the increase in the Nuclear Liabilities arising from the 2006 Approved Reference Plan. Depreciation and amortization expense was reduced in 2008 and 2007, through the deferral account, by $13 million and $54 million, respectively.

Net interest expense for the year ended December 31, 2008 was $165 million compared to $143 million for 2007, an increase of $22 million. The increase was primarily due to the impact of a higher average debt balance and a lower amount of interest deferred associated with regulatory balances, partially offset by higher interest capitalization for capital projects.

For the year ended December 31, 2008, income tax expense was $183 million compared to a tax recovery of $51 million for 2007. The increase in income tax expense in 2008 compared to 2007 was partly due to an increase in earnings before the impact of the losses on the Nuclear Funds. Also, in 2007, income tax expense was reduced as a result of additional contributions made to the Nuclear Funds. The increase in tax expense in 2008 was partly offset by a reduction in income tax liabilities as a result of the resolution of tax uncertainties related to the audit of OPG's 1999 taxation year.

## Average Sales Prices

The weighted average Ontario spot electricity market price and OPG's average sales prices by reportable electricity generation business segment, net of the revenue limit rebate for the years ended December 31, 2008 and 2007, were as follows:

| (¢/kWh) | 2008 | 2007 |
|---|---|---|
| Weighted average hourly Ontario spot electricity market price | **5.2** | 5.1 |
| Regulated – Nuclear Generation | **5.3** | 4.9 |
| Regulated – Hydroelectric | **3.9** | 3.5 |
| Unregulated – Hydroelectric | **4.8** | 4.7 |
| Unregulated – Fossil-Fuelled | **5.0** | 4.8 |
| OPG's average sales price | **4.9** | 4.6 |

The weighted average hourly Ontario spot electricity market price was 5.2¢/kWh for 2008 compared to 5.1¢/kWh in 2007. The increase was primarily due to higher coal and natural gas prices, partially offset by an increase in hydroelectric and nuclear production.

The increase in OPG's average sales price for the Regulated – Nuclear Generation and Regulated – Hydroelectric segments for 2008 compared to 2007 primarily reflected the impact of the increase in the regulated prices resulting from the OEB's decision in 2008, applicable to production from OPG's regulated facilities, effective on April 1, 2008. The increase in OPG's average sales price from the Unregulated – Hydroelectric and Unregulated – Fossil-Fuelled segments in 2008 compared to 2007 reflected the impact of higher Ontario spot market prices and a higher revenue limit in 2008.

As a result of regulated prices and the revenue limit rebate, OPG's average sales price during 2008 and 2007 was lower than the weighted average hourly Ontario spot electricity market price.

## Electricity Generation

OPG's electricity generation for the years ended December 31, 2008 and 2007, was as follows:

| (TWh) | **2008** | 2007 |
|---|---|---|
| Regulated – Nuclear Generation | **48.2** | 44.2 |
| Regulated – Hydroelectric | **18.8** | 18.1 |
| Unregulated – Hydroelectric | **17.6** | 13.8 |
| Unregulated – Fossil-Fuelled | **23.2** | 29.0 |
| Total electricity generation | **107.8** | 105.1 |

Total electricity generated during 2008 was 107.8 TWh compared to 105.1 TWh during 2007. The increase of 2.7 TWh was primarily due to higher generation from OPG's nuclear and unregulated hydroelectric generating stations, partially offset by lower generation from the fossil-fuelled generating stations.

The increase in generation from the nuclear generating stations during 2008 compared to 2007 was primarily due to a reduction in outage days at the Pickering A and Darlington nuclear generating stations.

The increase in generation from the regulated and unregulated hydroelectric generating stations in 2008 compared to 2007 was primarily due to higher river flows across the province as a result of significant snowfall and rain, along with high availability of the hydroelectric generating stations.

Electricity generation from the fossil-fuelled generating stations was lower during 2008 compared to 2007 primarily due to higher generation from the nuclear and hydroelectric generating stations, and lower market demand.

OPG's operating results are impacted by changes in demand resulting from variations in seasonal weather conditions. The following table provides a comparison of Heating and Cooling Degree Days for the years ended December 31:

| | **2008** | 2007 |
|---|---|---|
| Heating Degree Days[1] | | |
| Total for year | **3,807** | 3,684 |
| Ten-year average | **3,662** | 3,601 |
| Cooling Degree Days[2] | | |
| Total for year | **279** | 454 |
| Ten-year average | **384** | 394 |

1 Heating Degree Days are recorded on days with an average temperature below 18°C, and represent the aggregate of the differences between the average temperature and 18°C for each day during the period, as measured at Pearson International Airport in Toronto, Ontario.

2 Cooling Degree Days are recorded on days with an average temperature above 18°C, and represent the aggregate of the differences between the average temperature and 18°C for each day during the period, as measured at Pearson International Airport in Toronto, Ontario.

Heating Degree Days in 2008 increased compared to 2007 as a result of colder than average temperatures during the fourth quarter of 2008 compared to the same quarter in 2007. Cooling Degree Days decreased in 2008 as a result of cooler temperatures during the second and third quarters of 2008 compared to the same periods in 2007.

The Ontario primary electricity demand was 148.7 TWh and 152.2 TWh for the years ended December 31, 2008 and 2007, respectively.

## Cash Flow from Operations

Cash flow provided by operating activities for 2008 was $870 million compared to $379 million for 2007. The increase in cash flow was primarily due to higher cash receipts from generation revenue and a decrease in contributions to the Nuclear Funds in 2008 compared to 2007. In 2007, there was a one-time contribution of $334 million to the Used Fuel Fund as required by the ONFA. The increase in cash flow from operating activities was partially offset by higher revenue limit rebate payments.

## Recent Developments

### OEB's Decision on Payment Amounts for Prescribed Facilities

The OEB's decision on OPG's application for new payment amounts for its regulated hydroelectric and nuclear facilities was issued in November 2008. The OEB established prices of $36.66/MWh and $54.98/MWh for production from OPG's regulated hydroelectric and nuclear facilities, respectively, effective April 1, 2008 using a forecast cost of service methodology. This methodology establishes regulated payment amounts based on a revenue requirement taking into account a forecast of production volumes and total operating costs, and a return on rate base. Rate base is a regulatory construct that represents the average net level of investment in regulated fixed assets and an allowance for working capital.

To ensure that OPG collected the new prices effective April 1, 2008, the OEB approved additional rate riders of $2.18/MWh and $3.22/MWh for the production from OPG's hydroelectric and nuclear facilities, respectively. These riders allow OPG to recover the retrospective amounts for production during the period from April 1, 2008 to November 30, 2008 over the 13-month period from December 1, 2008 to December 31, 2009.

In its decision on OPG's application, the OEB determined that the appropriate rate of return on equity for OPG's regulated facilities for the purposes of determining the new regulated prices, is 8.65 percent. This rate is higher than the five percent rate of return on equity, which was the basis for the initial regulated prices established by the Province for the period up to April 1, 2008. The OEB determined that the appropriate deemed capital structure, for the purposes of determining the new regulated prices, is 47 percent equity and 53 percent debt. The OEB also approved OPG's application for an adjustment formula for the return on equity for years after 2009 that would result in a 75 basis point change in the rate of return on equity for every 100 basis point change in the 30-year Long Canada Bond forecast. The OEB determined the new payment amounts based on an approved revenue requirement of $6.0 billion as compared to the $6.2 billion submitted in OPG's application.

In accordance with the regulation, the OEB required OPG to continue to include the difference between OPG's revenues and costs associated with its ownership of the two nuclear stations on lease to Bruce Power in the determination of the regulated prices for production from prescribed nuclear facilities. The respective revenues reduce regulated prices and the respective costs are recovered through the regulated prices.

As part of the decision, the OEB approved OPG's application for the disposition of regulatory balances recorded as at December 31, 2007, without significant adjustments. This resulted in an inclusion of a rate rider of $2.00/MWh in the nuclear regulated price of $54.98/MWh. Any shortfall or over-recovery of the regulatory balances will be collected from, or refunded to ratepayers following OPG's next application to the OEB. OPG will also apply for the disposition of regulatory asset and liability balances recorded since January 1, 2008 in its next application to the OEB.

In determining the recovery of OPG's regulatory balances, the OEB decreased the recovery period for the Pickering A return to service deferral account balance from a proposed period of 15 years to a period of 45 months ending December 31, 2011. The OEB also confirmed that the appropriate period of recovery for the nuclear deferral and variance accounts shall be the 33-month period ending December 31, 2010, and the recovery period for hydroelectric accounts shall be the 21-month period ending December 31, 2009. The higher revenue resulting from the recovery of the deferral and variance accounts is offset by additional amortization expense retrospective to April 1, 2008. OPG recorded amortization expense of $75 million in the fourth quarter of 2008, retrospective to April 1, 2008, as a result of the OEB's decision.

Retrospective to April 1, 2008, the OEB also authorized the continuation of the variance accounts related to the impact of water conditions on hydroelectric electricity production as well as revenues for ancillary services from the regulated facilities. It also established variance accounts for nuclear fuel costs, new nuclear generation development and capacity refurbishment costs, revenues and costs associated with the stations on lease to Bruce Power, income and other taxes, and interim period revenue recovery. These variance accounts capture the differences between actual costs and revenues, and the corresponding forecast amounts approved by the OEB in the setting of the regulated prices.

**Investments in Asset-Backed Commercial Paper**

In August 2007, the Asset-Backed Commercial Paper ("ABCP") market experienced a liquidity event when paper sponsored by third-party non-bank conduits could not be refinanced as it matured. At that time, OPG's total ABCP investment was $103 million. Of that amount, $45 million was restructured, with OPG receiving payment of approximately 98.7 percent of the face value of the notes in December 2007, which resulted in a loss of $1 million. Of the remaining $58 million, OPG recorded an impairment loss of $9 million as at December 31, 2007. An additional $14 million impairment loss was recorded during 2008, including $5 million in the fourth quarter. The impairment loss was recorded in other gains and losses. As at December 31, 2008, the carrying value of OPG's investments in ABCP was $35 million. OPG's remaining holdings of third-party ABCP are recorded as long-term investments.

On January 21, 2009, the Pan-Canadian Investors Committee for third-party ABCP announced that the restructuring plan (the "Plan") affecting $32 billion of third-party ABCP had been fully implemented. Pursuant to the terms of the Plan, OPG's short-term commercial paper has been exchanged for longer term notes equal to approximately $58 million. OPG received five classes of notes, which are supported by margin funding facilities from third-party asset providers, Canadian banks, and governments. OPG also received a partial payment of the accrued interest, totaling $1.9 million, for its short-term commercial paper held over the past 17 months.

The restructured notes are expected to have a maturity of eight to nine years. The exact maturity will be impacted by the release of collateral as underlying swap trades mature. The stated maturity of the notes is 2056. OPG continues to monitor the development of a secondary market to assess the fair value of its remaining holdings.

OPG has sufficient credit facilities to satisfy its financial obligations as they come due and does not expect any material adverse impact on its operations as a result of this current third-party ABCP liquidity issue.

### Contingent Support for Lambton and Nanticoke Generating Stations

In May 2008, the Province announced new annual limits on carbon dioxide ("$CO_2$") emissions from OPG's coal-fired generating stations to ensure that such emissions are reduced by two-thirds of the 2003 levels by 2011. In accordance with a May 15, 2008 Shareholder Declaration and a May 16, 2008 Shareholder Resolution, OPG is required to stage the reduction measures to meet, on a forecast basis, the interim $CO_2$ emission targets of 19.6 million tonnes in 2009 and 15.6 million tonnes in 2010.

The Shareholder Resolution stated that the Province will ensure that an appropriate cost recovery mechanism is established to enable OPG to recover the costs of its coal-fired generating stations following the implementation of the $CO_2$ reductions. OPG has reached an agreement with the Ontario Electricity Financial Corporation ("OEFC") for contingent support for ongoing costs and the recovery of net book value of the Nanticoke and Lambton generating stations during the period from 2009 to 2014.

### Lennox Generating Station

The Lennox generating station operated under a reliability must run ("RMR") contract approved by the OEB for the period beginning on October 1, 2007 to September 30, 2008. The IESO has concluded that all four units at the Lennox generating station continue to be required for the purpose of reliability, and recommended that all four units be covered by an RMR contract for the period from October 1, 2008 to September 30, 2009. An RMR contract with the IESO for the period from October 1, 2008 to September 30, 2009, was approved by the OEB in December 2008.

## VISION, CORE BUSINESS AND STRATEGY

OPG's mandate is to cost-effectively produce electricity from its diversified generating assets, while operating in a safe, open, and environmentally responsible manner. OPG's goal is to be a leader in clean energy generation and to have a major role in leading Ontario's transition to a more sustainable energy future. OPG is focused on three corporate strategies: performance excellence; generation development; and developing and acquiring talent.

### Performance Excellence

Performance excellence is essential to OPG. Every business segment and corporate function exhibits our commitment to generation, safety, the environment, and fiscal performance. It is through our focus on performance excellence that OPG is able to efficiently and reliably provide electricity to the province and deliver value to its shareholder.

### Nuclear Generating Assets

Performance excellence of OPG's nuclear generating assets is defined as safe, efficient and cost-effective operation, with prudent investments to improve reliability. Programs and initiatives have been implemented that will continue to: improve safety performance; increase equipment reliability to reduce generation interruptions; plan and execute outages more efficiently to realize optimal generation potential; mitigate technological risks through essential and effective inspection and testing programs; and address workforce planning issues. These initiatives, combined with ongoing cost control efforts, are expected to result in lower production unit energy costs.

Nuclear inspection and testing programs are largely driven by maintenance governance requirements designed to ensure that equipment is fit for service and performs as expected. This enables OPG to satisfy regulatory requirements that the stations are safe to operate, and that nuclear safety is not compromised.

OPG's maintenance strategy is evolving from programs designed to improve equipment condition into initiatives to increase the reliability of generation and the predictability of performance. The view of maintenance of components and equipment has shifted to become a comprehensive life cycle maintenance of systems. OPG plans to perform major scheduled maintenance over the next three years, including vacuum building outages at both the Darlington and Pickering stations in addition to ongoing maintenance work, including steam generator maintenance, and servicing of pumps, valves and other equipment and components.

Reducing maintenance backlogs to improve equipment reliability is another major aspect of achieving performance excellence. Corrective maintenance backlogs were successfully reduced to industry levels in 2007 and are being sustained. Additionally, by year end 2008, all sites achieved significant reductions in elective maintenance backlogs compared to 2007, with Darlington achieving industry standard levels.

OPG is focused on reducing the number and duration of planned outages to increase generation time. The planned outage schedule at the Darlington station has moved from a two-year cycle to a three-year cycle. The Pickering stations remain on a two-year planned outage schedule. The reduction in outage duration targeted at the nuclear stations reflects ongoing and new programs aimed at improving the planning, execution, monitoring and reporting of outage work. Darlington has demonstrated excellent outage performance. As of the end of 2008, the last three outages at Darlington came in on or ahead of schedule.

OPG continues to implement its hiring and training programs to improve employee performance and promote leadership development, while addressing demographic development issues.

### Pickering A Units 2 and 3 Safe Storage Project

The Pickering A safe storage project includes isolating Units 2 and 3 from the rest of the generating station, redesigning the control room for the remaining two operating units, and de-watering and de-fuelling the units. De-fuelling of the units was completed in October 2008.

In the third quarter of 2007, the Canadian Nuclear Safety Commission ("CNSC") concluded that an Environmental Assessment ("EA") was necessary for certain aspects of the safe storage project. EA approval was received from the CNSC in December 2008 allowing the Unit 2 de-watering to proceed. The bulk de-watering of both the moderator and heat transport systems of Unit 2 is complete with vacuum drying to begin shortly. The project remains on schedule for completion in the fall of 2010 with a projected completion cost of $349 million.

### Hydroelectric Generating Assets

Performance excellence at OPG's hydroelectric generating assets is defined as improving production in a cost-effective and efficient manner. Programs and initiatives are underway to replace aging equipment such as turbines, generators and transformers. OPG plans to increase the capacity of existing stations by 87 MW over the next five years by replacing existing turbine runners with more efficient equipment. The replacement of control equipment will also improve efficiency and accommodate market dispatch requirements. Aging civil structures will be repaired, rehabilitated or replaced.

The hydroelectric generating assets achieved an availability of 94.3 percent in 2008, which is the best performance in 24 years. OPG plans to maintain high reliability levels as measured by availability factors in excess of 90 percent and an equivalent forced outage rate of less than 1.6 percent. The hydroelectric generating assets produced 36.4 TWh in 2008, the second highest production on record for the existing fleet.

In June and July of 2008, Sandy Falls generating station and Lower Sturgeon generating station were removed from service, as part of the Upper Mattagami Redevelopment Project. The new upgraded stations are planned to return to service at the end of 2010 with significantly increased capacities.

The hydroelectric business segment is strengthening its relationships with First Nations and local communities. In 2008, a number of ceremonies recognizing the settlement of past grievances were held with First Nations.

OPG is meeting the demographic challenges faced by its hydroelectric business unit by training staff to perform new roles and by hiring new staff, including graduate trainees. OPG mentors these new employees in safe work practices and technical skills to ensure continuing performance improvements.

### Fossil-Fuelled Generating Assets

Performance excellence at OPG's fossil-fuelled generating assets is defined as maintaining the productive capability of its coal-fired generating facilities for as long as they are required, while continuing to operate in compliance with all applicable environmental laws and emission regulations. OPG's fossil-fuelled generating assets will operate in a reliable, cost-effective, safe, and environmentally responsible manner. In particular, fossil units will be maintained to ensure their availability for summer and winter peak production periods.

During 2008, the overall reliability of OPG's fossil-fuelled generating assets, as measured by equivalent forced outage rates, was comparable to the favourable levels of 2007. This level of reliability is expected to be maintained on a fleet basis over the next few years. Greater emphasis will be placed on equipment maintenance and inspection to ensure that fossil units are available when needed, especially during peak periods.

OPG's unregulated fossil-fuelled business segment has more than 1,500 employees. During the past three years, approximately 30 percent of employees have been replaced in order to manage the effects of an aging workforce. The majority of the new hires were external recruits. OPG provides in-house technical training to assist staff with their new roles, and to adopt safe work practices.

### Safety

OPG's safety culture is rooted in the belief that zero injuries can be a reality. OPG is committed to achieving performance excellence in employee, contractor and public safety through continuous improvement in its safety management systems and risk control programs and a corporate commitment to achieving the goal of zero injuries in the workplace. Continuous oversight and reporting provides management with information on the effectiveness of safety management initiatives, compliance with legal and corporate requirements, and safety performance trends. Oversight activities include internal and external safety management system audits, work protection code audits, and specific operational safety risk reviews. OPG also has a rigorous incident management system, which requires that all incidents including near misses be reported and investigated, as appropriate, and that corrective action plans are developed to prevent reoccurrences.

OPG measures its safety performance primarily through two performance indicators – Accident Severity Rate ("ASR") and All Injury Rate ("AIR"). The ASR is a measure of the number of days lost due to injuries. OPG's 2008 ASR performance of 1.47 days lost per 200,000 hours was an improvement over the 2007 ASR of 1.56, and is the best performance that the Company has achieved since its inception in 1999. The AIR provides a measure of the frequency of injuries resulting in lost time or requiring medical treatment. In 2008, OPG experienced 1.15 injuries per 200,000 hours worked compared to 1.12 in 2007. OPG strives for continuous improvement through visible leadership and commitment to safety, a strong safety culture where employees take personal responsibility for safety, and maintaining effective safety management systems. To improve OPG's AIR going forward and to strive for zero injuries, OPG is committed to reducing the number of workplace injuries through targeted risk reduction programs. Given that musculoskeletal disorders ("MSD") comprise 40 percent of injuries, OPG has launched comprehensive MSD reduction programs which include initiatives to educate employees on MSD risk factors and develop strategies to reduce these risks through changes in work methods and in the design of equipment.

In 2008, safety performance was marked by the achievement of a number of significant safety milestones. Of particular note was the hydroelectric business segment which achieved three years without a lost time accident. In addition, in 2008, OPG was recognized with two prestigious safety awards, receiving the President's Gold Award from the Canadian Electricity Association for consistent top quartile safety performance for the last three years, and a Gold Award from the Electrical and Utilities Safety Association for maintenance of a strong safety management system over the last three years.

## Environmental Performance

OPG's Environmental Policy states that "OPG will strive to continually improve its environmental performance." This policy further commits OPG to meet all legal requirements and voluntary commitments, with the objective of exceeding those standards where appropriate and feasible. Other goals include integrating environmental factors into business planning and decision-making, and maintaining environmental management systems.

To achieve the goal of continuous improvement in environmental performance, each year OPG sets key performance targets, which are managed through the ISO 14001 (2004) Environmental Management System ("EMS"). These efforts are reinforced by an annual incentive plan that links management's compensation to meeting or surpassing internally established environmental targets. Targets are established for a wide spectrum of environmental indicators, including spills; air emissions inclusive of Nitrogen Oxides ("$NO_x$"), Sulphur Dioxide ("$SO_2$"), tritium, and dioxins/furans emissions; regulatory infractions; energy efficiency improvements; and biomass usage.

OPG manages air emissions of $NO_x$ and $SO_2$ through the installation of specialized equipment such as scrubbers, low $NO_x$ burners, and selective catalytic reduction equipment. OPG also purchases low sulphur fuel and utilizes a regulatory approved emissions trading program to manage emission levels within regulatory limits.

OPG monitors emissions into the air and water and regularly reports the results to regulators that include the Ministry of the Environment, Environment Canada and the CNSC. The public also receives ongoing communications regarding OPG's environmental performance. OPG has developed and implemented internal monitoring, assessment, and reporting programs to manage environmental risks such as air and water emissions, discharges, spills, the treatment of radioactive emissions, and radioactive wastes. OPG also continues to address historical land contamination through its voluntary land assessment and remediation program.

OPG's environmental performance for 2008 met, or was better than target, regarding all spills (Categories A, B and C), infractions, energy efficiency, biomass usage, and dioxins/furans emissions. OPG also maintained its ISO 14001 certification for its corporate level EMS and all of its generating stations. OPG met its external regulatory target for tritium emissions but did not meet the stringent internal target for tritium emissions set by the Company. Certain units at the Lambton and Nanticoke generating stations are equipped with Selective Catalytic Reduction ("SCR") technology for $NO_x$ removal. These units met their external regulatory emission limits, however internal emission targets set by the Company for $NO_x$ removal were not met due to equipment issues and the operation of these units at low loads, which compromised the SCR operation. Acid gas ($SO_2$ and $NO_x$) emissions were 104.8 gigagrams ("Gg") in 2008 compared to 139.9 Gg in 2007. The decrease in acid gas emissions was primarily a result of decreased generation from the fossil facilities.

In April 2007, the Federal Government announced its "Turning the Corner" plan for reducing both greenhouse gas ("GHG") emissions and air pollutants from 2006 levels. Under the Federal proposal, OPG would be required to reduce its intensity levels of GHG emissions from its corporate fleet from 2006 levels by 18 percent in 2010, with an eventual reduction of 26 percent by 2015. The Federal Government confirmed these GHG targets in March 2008. The Federal Government also confirmed that the GHG intensity for the electricity sector would be calculated at the corporate level, rather than at the station or fleet levels. The Federal Government had planned to release the draft GHG regulations as well as a regulatory framework for air pollutants in December 2008; however, these documents have not been released to date. In addition, the Government of Canada has recently expressed an interest in entering into discussions with the new administration in the United States about a North American Cap and Trade regime. In support of this, Environment Canada has created a new Associate Deputy Minister position, which is expected to lead future discussions with the United States. The Cap and Trade regime is expected to require hard caps on industry, which would not include "intensity" based targets envisioned in Canada's "Turning the Corner" plan.

In May 2008, the Province announced new annual limits on $CO_2$ emissions from OPG's coal-fired generating stations to ensure that such emissions are reduced by two-thirds of the 2003 levels by 2011. A draft regulation under the *Environmental Protection Act* requires a reduction in $CO_2$ emissions to an annual limit of 11.5 million tonnes beginning on January 1, 2011, one third of the 34.5 million tonnes of $CO_2$ emissions produced in 2003. In accordance with the May 15, 2008 Shareholder Declaration and the May 16, 2008 Shareholder Resolution, OPG is required to develop a strategy to meet, on a forecast basis, the interim $CO_2$ emission targets of 19.6 million tonnes in 2009 and 15.6 million tonnes in 2010. OPG submitted a strategy to meet, on a forecast basis, the 2009 $CO_2$ emission target to the Minister of Energy and Infrastructure on November 28, 2008, and within one year thereafter, is required to submit a strategy for 2010. These strategies may result in a reduction to OPG's revenues. The Shareholder Resolution stated that the Province will ensure that an appropriate cost recovery mechanism is established to enable OPG to recover the costs of its coal-fired generating stations following the implementation of the $CO_2$ reductions. An agreement with the OEFC for contingent support for the appropriate cost recovery was discussed under the heading *Recent Developments*.

In July 2008, the Province of Ontario joined the Western Climate Initiative ("WCI"). WCI is an intergovernmental organization, which was created to identify, evaluate and implement collective and cooperative ways to reduce GHGs in the region, focusing on a market-based cap-and-trade system. It is expected that a cap and trade system impacting OPG facilities emitting 25,000 megagrams ("Mg") and higher will be operating in 2012. The financial impact on OPG of the Province's involvement in WCI is uncertain at this time. Reporting requirements for the WCI will begin in 2010 with results submitted in 2011. Based on the draft reporting requirements, OPG will be required to report emissions on a facility basis where emissions are 10,000 Mg and higher. In addition, for facilities with emissions at 25,000 Mg and higher, reporting and verification will be required.

To achieve further improvements in OPG's GHG emissions, OPG launched its Greenhouse Gas Management Plan in 2007. The plan focuses on: improving the energy efficiency of OPG's facilities, the use of biofuels as a partial replacement for coal, researching the impact of climate change on OPG's operations, expanding the tree planting effort through OPG's extensive biodiversity program, and an education program for employees.

### Financial Sustainability

OPG's financial priority, operating as a commercial enterprise, is to achieve a sustainable level of financial performance. Inherent in this priority are the objectives of: earning an appropriate return on OPG's regulated assets; receiving market prices for production from unregulated assets; identifying and exploring efficiency improvement opportunities; and ensuring that sufficient funds are available to achieve OPG's strategic objectives of performance excellence and generation development. OPG has employed a number of strategies to achieve a level of sustainable financial performance.

OPG's mandate, as agreed with its shareholder, states that: as an Ontario Business Corporations Act corporation with a commercial mandate, OPG will operate on a financially sustainable basis and maintain the value of its assets for its shareholder, the Province.

OPG receives regulated prices for electricity produced from its nuclear generating stations and most of its baseload hydroelectric generating stations. These prices were set by the Province for the period April 1, 2005 to March 31, 2008. The Province also determined that the OEB would become responsible for setting regulated prices for OPG's regulated production after March 31, 2008. OPG filed an application with the OEB in November 2007 for new payment amounts for its regulated facilities effective April 1, 2008. The OEB issued its decision and final payment amounts order in the fourth quarter of 2008. A portion of OPG's revenues is subject to a revenue limit pertaining to the majority of the output from its other generating assets. This limit was established in April 2005, and ends on May 1, 2009.

To the extent that additional funds, beyond those generated from operations, are required, OPG seeks agreement with its shareholder on options to ensure that adequate financing resources are available to fund ongoing operational requirements and new generation development. OPG will continue to seek opportunities to diversify its sources of funding and increase its access to cost-effective capital. By ensuring access to cost-effective funding and maintaining its investment grade credit ratings, OPG will ensure its status as a long-term, commercially viable investment.

## Generation Development

With the aging of OPG's generating fleet, it is essential that focus be placed on generation development. OPG endeavours to pursue capacity expansion or life extension opportunities where possible. Increasing the production potential of existing infrastructure reduces the environmental impact of meeting Ontario's electricity demands. Pursuing opportunities to leverage existing sites and assets will enable OPG to realize the additional benefits from these assets. OPG's major projects include nuclear plant refurbishment, new nuclear generation, new hydroelectric generation and plant upgrades, capitalization on emerging biomass opportunities, and expansion into gas-fired generation for contingent electricity production.

### Pickering Refurbishment Project

Work is proceeding on the feasibility study to refurbish the Pickering B nuclear generating station. This includes an assessment of the station's condition, an EA, and an Integrated Safety Review ("ISR"), which is designed to ensure safe and secure operations of the station for the proposed future period.

OPG submitted a draft Environmental Impact Statement ("EIS") report to the CNSC in December 2007. The CNSC staff accepted the EA Study Report in June 2008 and held open houses on their draft EA Screening Report, which was issued in July 2008. The CNSC finalized their Screening Report in October 2008. The CNSC held a one-day public hearing to consider the results of the EA Screening Report on December 10, 2008. On January 26, 2009, the CNSC concluded that, taking into account the identified mitigation measures, the refurbishment and continued operation of the Pickering B nuclear station is not likely to cause significant adverse environmental effects.

OPG has submitted all required Safety Factor Reports to the CNSC. The CNSC continues to review these reports and OPG is providing additional information as required. OPG is preparing the final ISR for submission in late 2009.

### Darlington Refurbishment Project

Planning work for the assessment of the feasibility of refurbishing the Darlington nuclear generating station began in early 2008. The preliminary scope and a reference schedule have been developed for planning purposes. Planning for the plant condition assessment commenced in the second quarter of 2008 and will continue throughout 2009. In addition, a number of technical studies are underway to evaluate the condition of critical plant components in order to finalize the project's scope. In late 2008, OPG commenced the ISR process. The ISR Basis Document, which identifies the ISR scope and methodology, was submitted to the CNSC in November 2008. The ISR is expected to be completed for submission to the CNSC by late 2011.

### New Nuclear Generating Units

OPG initiated a federal approvals process by filing an Application for a Site Preparation Licence with the CNSC for new nuclear generating units at the Darlington nuclear generating site. In January 2008, the CNSC recommended to the Federal Minister of Environment that the project be referred to a review panel, which is the highest level of review under current legislation. In March 2008, the recommendation was accepted and the project EA was referred to a review panel. Work continues on the EIS, which is planned for completion in 2009. The Canadian Environmental Assessment Agency ("CEAA") and the CNSC, on September 5, 2008, issued draft EIS guidelines and a Joint Review Panel Terms of Reference for a 90-day public comment period. The review period was completed and the documents are pending finalization by the CEAA and the CNSC.

In March 2008, the Minister of Energy announced a two-phase competitive Request For Proposal ("RFP") process to select a nuclear reactor vendor for two units of baseload generation to provide 2,000 to 3,500 MW of generating capacity to the Ontario electricity grid. The target in-service date, as stated by Infrastructure Ontario, is mid-2018 for the first unit, and mid-2019 for the second unit. A commercial team, directed by Infrastructure Ontario, and supported by OPG, Bruce Power, and the Ministries of Energy and Infrastructure and Finance, is managing the procurement process to select a nuclear reactor vendor. It is expected that the preferred vendor will be announced in the late spring of 2009.

Phase one of the RFP process was aimed at assessing the ability of the invited vendors to support a successful construction licence application in compliance with Canadian regulatory requirements and to successfully deliver the overall project, as well as to ascertain their financial strength and legal position. Phase one was completed in June 2008 with Areva NP, Atomic Energy of Canada Limited, and Westinghouse Electric Company advancing to phase two.

Phase two of the competitive RFP process was launched in June 2008 to select a nuclear reactor vendor. The competitive process is to select a vendor to design, develop, construct, and provide licensing and commissioning support, and fuel supply, of a stand-alone two-unit nuclear power plant at the Darlington site. Respondents will be evaluated in three key areas: lifetime cost of power, ability to meet Ontario's timetable to bring new supply on line in 2018, and the level of investment in Ontario.

### Niagara Tunnel

As of December 31, 2008, the tunnel boring machine had advanced 3,306 metres. The progress of the tunnel boring machine continues to be slower than what was expected under the original contractor schedule, primarily due to excess overbreak of the Queenston shale in the tunnel crown. To minimize further excavation in the Queenston shale, a change in the vertical alignment of the tunnel has been initiated.

A dispute review hearing process was initiated earlier in 2008 to assess, among other things, whether the actual subsurface conditions encountered are materially different from those that were anticipated as part of the design-build contract. The Dispute Review Board issued its non-binding recommendations in late August 2008. OPG and the contractor are using the Dispute Review Board recommendations as a basis for negotiating revisions to the design-build contract. These revisions are expected to have a significant impact on the project completion schedule and the cost estimate. The negotiations are underway and are targeted for completion in the first quarter of 2009. Uncertainties will continue with respect to cost and schedule.

The capital project expenditures for the year ended December 31, 2008 were $132 million and life-to-date capital expenditures were $435 million. The project is debt financed through the OEFC.

### Lac Seul

The Lac Seul hydroelectric generating station is expected to be declared in-service in February 2009. The station has a capacity of 12.5 MW. The project was originally expected to be in-service by the end of the third quarter of 2007. However, it was delayed as a result of various contractor difficulties. A settlement in principle has been negotiated to compensate the contractor for recovery of certain additional costs.

At December 31, 2008, life-to-date expenditures were $54 million. The final project cost is expected to be $55 million. The project is debt financed through the OEFC.

OPG has entered into a partnership agreement with the Lac Seul First Nations ("LSFN"). The partnership is a first for OPG and the LSFN, who will own 25 percent of the new facility.

### Upper Mattagami and Hound Chute

In December 2007, OPG's Board of Directors approved the replacement of four existing hydroelectric generating stations. Three of the generating stations are on the Upper Mattagami River (Wawaitin, Sandy Falls and Lower Sturgeon) and the fourth (Hound Chute) is located on the Montreal River. The project includes the demolition and decommissioning of the four existing powerhouses that are at the end of their useful lives. Upon completion of the project, the total installed capacity of the four stations will increase from 23 MW to 44 MW, and the annual energy will increase from 134 gigawatt hours ("GWh") to 223 GWh.

Design and construction activities are in progress at all four sites. The Sandy Falls and Lower Sturgeon generating stations have been demolished to make way for construction of the new stations. The shutdown of these stations reduced the unregulated hydroelectric capacity by 9 MW.

Life-to-date expenditures as of December 31, 2008 were $62 million. Total project costs are expected to be $300 million. A significant proportion of this capital cost relates to a design-build contract to construct the facilities.

### Lower Mattagami

OPG is proceeding with a development plan to increase the generating capacity of four hydroelectric generating stations on the Lower Mattagami River from 483 MW to 933 MW, an increase of 450 MW. In September 2008, the Minister of the Environment for Canada approved the decision that a comprehensive study is the most appropriate type of EA. Fisheries and Oceans Canada is leading the comprehensive study and will submit its report to the Minister of the Environment and to the CEAA in 2009.

OPG is also engaged with First Nations stakeholders to address past grievances and to establish a new commercial relationship.

### Hydroelectric Projects Directive
In December 2007, the Minister of Energy issued a directive to the OPA to negotiate a HESA for the Lac Seul, Upper Mattagami, Hound Chute, Healey Falls and Lower Mattagami projects. The Lac Seul, Upper Mattagami and Hound Chute agreements have been executed. The HESA for the Healey Falls project is being finalized. The negotiations for the HESA for Lower Mattagami began in the fourth quarter of 2008.

### Biomass Generation Opportunities
The potential to convert some of the existing coal-fired units to biomass fuelling is continuing to be assessed. Biomass is considered to be carbon neutral. This fuelling option can provide the ability to use existing assets beyond the 2014 coal plant closure date. Studies are currently underway to assess biomass availability, costs and end-to-end requirements for the safe handling, storage and combustion of biomass.

### Portlands Energy Centre
OPG entered into a partnership with TransCanada Energy Ltd., through the Portlands Energy Centre L.P. ("PEC"), to pursue the development of a 550 MW gas-fired, combined cycle generating station on the site of the former R.L. Hearn generating station, near downtown Toronto. OPG has a 50 percent ownership interest in the joint venture. In May 2008, the construction for the simple cycle mode of operations for the PEC was completed. The station was available to operate in a simple cycle mode as needed during the summer of 2008.

In September 2008, the simple cycle mode of operations for the PEC ended and the plant was returned to the custody of the contractor for completion of the combined cycle plant. Final system commissioning and preparation for the guarantee performance testing and the demonstration runs was conducted during the last two months of 2008. The PEC is expected to be in-service in a combined cycle mode in the first quarter of 2009, earlier than its contractual in-service date of June 1, 2009.

OPG's share of capital expenditures for the year ended December 31, 2008 was $87 million, and life-to-date expenditures were $360 million. Total project costs continue to be within the $730 million approved budget, excluding capitalized interest. A significant proportion of the capital cost relates to an engineer-procure-construct contract to construct the facility. OPG's share of the project is debt financed through the OEFC.

### Southwest Greater Toronto Area Generation
In January 2009, the OPA announced the four companies that have successfully qualified to submit proposals to construct a natural gas generating station in the Southwest Greater Toronto Area ("GTA"). The partnership of TransCanada Energy and OPG, working under the name of the Portlands Energy Centre, is one of the successful qualifiers.

The OPA is expected to issue their RFPs during the first quarter. At that time, more will be known about the specific project requirements. OPG will work with TransCanada to complete the required EA, develop the project, engage suppliers and contractors, and submit a competitive bid later in the year. The OPA is likely to require an in-service date of 2013.

### Lakeview Site
In 2008, OPG completed the decommissioning and demolition of the Lakeview coal-fired generating station, having closed the station in 2005 after more than 40 years of service. OPG explored the potential development of a gas-fuelled electricity generating station at the site. However, in July 2008, the Ontario government announced that the Lakeview site will not be used for a new gas-fired generating station.

## Developing and Acquiring Talent
Essential to workforce management at any organization is good planning. OPG's ability to sustain on-going operations and the successful delivery of the portfolio of planned projects is dependent on developing and maintaining a talented and engaged workforce, and a strong leadership capability. OPG's resource strategy is to develop and acquire necessary talent focused on developing excellent leadership and the necessary resources to meet the demand that will be generated by retirements and the forecast skilled labour shortages.

### Skilled Workforce
As of December 31, 2008, OPG had approximately 12,000 regular employees. OPG's employees have considerable technical experience in operating and maintaining the Company's generating stations. Due to an aging workforce, OPG's challenge is to attract and retain a skilled workforce to replace retiring employees. Approximately 37 percent of OPG's workforce was over the age of 50 at December 31, 2008. OPG has a comprehensive resource and succession planning program to address demographic issues and issues associated with closure of the coal-fired generating stations. OPG is well positioned in the competitive market place to attract new employees.

The Company's collective agreement with the Power Workers' Union runs through March 31, 2009 and the labour agreement with The Society of Energy Professionals runs through December 31, 2010. As of December 31, 2008, the Company had approximately 90 percent of its regular labour force represented by collective bargaining agreements.

## CAPABILITY TO DELIVER RESULTS

## Generating Assets
OPG continues to implement specific initiatives to improve the reliability and predictability of each nuclear generating station. These initiatives are designed to address the specific technology requirements, operational experience, and mitigate risks. The Darlington nuclear generating station has transitioned to a three-year outage cycle to take advantage of the physical condition of the plant, the availability of backup systems, and the ability to refuel during operations. The Pickering A and B nuclear generating stations will continue to focus on implementing targeted improvements in reliability.

OPG has increased the productive capacity of its hydroelectric stations, extended their service lives and invested significant capital to replace aging equipment, upgrade runners, increase station automation, and enhance maintenance practices. Programs are in place to further improve the efficiency and availability of existing hydroelectric stations.

OPG will continue to maintain the reliability and productive capacity of its coal-fired generating stations until their scheduled closure dates.

In addition to the discussion in this section, OPG's capability to deliver results is affected by factors discussed in the *Risk Management* section.

### ONTARIO ELECTRICITY MARKET TRENDS

In its 18-Month Outlook published in December 2008, the IESO indicated that Ontario's installed electricity generating capacity was 33,045 MW, an increase of 1,377 MW from the previously reported capacity in September 2008 of 31,668 MW. The capacity increase includes an addition of 1,153 MW from Greenfield Energy Centre, 99 MW from the Melancthon II Wind Project, 101 MW from Kruger Energy's Port Alma Wind Power Project, and 24 MW from the Umbata Falls Hydroelectric Project. OPG's in-service electricity generating capacity as at December 31, 2008 was 21,748 MW or 66 percent of Ontario's capacity. The IESO reported that the outlook for the reliability of Ontario's electricity system remains positive over the next 18 months. Nearly 4,000 MW of new and refurbished supply is scheduled to come into service, including approximately 2,600 MW of gas-fired generation, 750 MW of refurbished nuclear generation, 100 MW of hydroelectric generation, 60 MW of generation from by-product fuels, and about 400 MW of wind capacity. Ontario's import capability is planned to increase with the first stage of the new interconnection between Ontario and Quebec that is scheduled to be completed by the middle of 2009. The Outlook incorporates the implementation of emission reductions for coal-powered generation in Ontario which commence in 2009.

The IESO expects energy demand in 2009 to decrease by 1.3 percent to 147.5 TWh, with a further 2.6 percent decrease in 2010 to 143.6 TWh. The decrease in demand is primarily attributable to lower industrial demand and the growing impact of conservation initiatives. The expected peak electricity demand in the summer of 2009, under normal weather conditions, is forecast by the IESO to be 24,972 MW.

Both the spot electricity market price and fuel prices can have a significant impact on OPG's revenue and gross margin. Uranium market prices have increased significantly over the past several years and peaked in May 2007. The impact on revenue and margin due to volatility in uranium market prices has been partially mitigated by deliveries under existing lower priced long-term supply agreements, and the consumption of existing lower-cost inventory.

Fuel costs for nuclear operations are expected to be significantly higher in the future. After peaking in June 2008 at $12.68/mmBtu, natural gas prices at Henry Hub declined to an average of $5.84/mmBtu in December. Despite a late-year price decline, average natural gas prices for 2008 finished 27 percent higher than the 2007 annual average. Average 2008 eastern bituminous coal prices, despite their recent softening, still averaged over 125 percent above average 2007 prices while western sub-bituminous coal prices in 2008 averaged 35 percent higher than the 2007 average. The continued depreciation of the Canadian dollar relative to the U.S. dollar could offset a significant portion of the decline in OPG's U.S. dollar denominated fuel costs.

### BUSINESS SEGMENTS

Prior to the fourth quarter of 2008, OPG had four reportable business segments. The business segments were Regulated – Nuclear Generation, Regulated – Hydroelectric, Unregulated – Hydroelectric, and Unregulated – Fossil-Fuelled.

Commencing in the fourth quarter of 2008, OPG separated the Regulated – Nuclear segment into two reportable segments identified as Regulated – Nuclear Generation segment and Regulated – Nuclear Waste Management segment. The revised segment reporting is consistent with the manner in which performance is evaluated by management given the magnitude of significant growth in nuclear decommissioning and waste management activities, assets and liabilities. The revised segments also enable OPG to provide greater transparency with respect to its nuclear generation and nuclear waste management and decommissioning activities. Results for the comparative periods have been reclassified to reflect the revised disclosure.

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 the spot market for electricity in Ontario. Contracts that are designated as hedges of OPG's generation revenues are included in the Unregulated – Hydroelectric and Unregulated – Fossil-Fuelled generation segments. Gains or losses from these hedging transactions are recognized in revenue over the terms of the contract when the underlying transaction occurs.

#### Regulated – Nuclear Generation Segment

OPG's Regulated – Nuclear Generation business segment operates in Ontario, generating and selling electricity from the nuclear generating stations that it owns and operates. The business segment includes electricity generated by the Pickering A and B, and Darlington nuclear generating stations. This business segment also includes revenue under the terms of a lease arrangement with Bruce Power related to the Bruce nuclear generating stations. This arrangement includes lease revenue and revenue from engineering analysis and design, technical and other services. Revenue is also earned from isotope sales and ancillary services. Ancillary revenues are earned through voltage control and reactive support.

# Management's Discussion and Analysis

### Regulated – Nuclear Waste Management Segment

OPG's Regulated – Nuclear Waste Management segment engages in the management of used nuclear fuel and low and intermediate level waste, the decommissioning of OPG's nuclear generating stations (including the stations on lease to Bruce Power), the management of the Nuclear Funds, and related activities including the inspection and maintenance of the waste storage facilities. Accordingly, accretion expense on the Nuclear Liabilities and earnings (losses) from the Nuclear Funds are reported under this segment.

As the nuclear generating stations operate over time, OPG incurs variable costs related to nuclear used fuel and low and intermediate level waste generated. These costs increase the Nuclear Liabilities through the generation of additional used nuclear fuel bundles and other waste. These variable costs are charged to current operations in the Regulated – Nuclear Generation segment in order to appropriately reflect the cost of producing energy and the earning of revenues under the lease arrangement with Bruce Power that are recorded in this segment. Since variable costs increase the Nuclear Liabilities in the Regulated – Nuclear Waste Management segment, OPG records an inter-segment charge between the Regulated – Nuclear Generation and the Regulated – Nuclear Waste Management segments. The impact of the inter-segment charge between these segments is eliminated on OPG's consolidated statements of income and balance sheets.

The Regulated – Nuclear Waste Management segment is considered regulated because the costs associated with the Nuclear Liabilities are included in the calculation of prices for production from OPG's regulated nuclear facilities by the OEB.

### Regulated – Hydroelectric Segment

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

### Unregulated – Hydroelectric Segment

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

### Unregulated – Fossil-Fuelled Segment

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

### Other

The Other category includes revenue that OPG earns from its 50 percent joint venture share of the Brighton Beach Power Limited Partnership ("Brighton Beach") related to an energy conversion agreement between Brighton Beach and Coral Energy Canada Inc. The revenue and expenses related to OPG's trading and other non-hedging activities are also included in the Other category. As part of these activities, OPG transacts with counterparties in Ontario and neighbouring energy markets in predominantly short-term trading activities of typically one year or less in duration. These activities relate primarily to physical energy that is purchased and sold at the Ontario border, sales of financial risk management products and sales of energy-related products. All contracts that are not designated as hedges are recorded as assets or liabilities at fair value, with changes in fair value recorded in other revenue as gains or losses. In addition, the Other category includes revenue from real estate rentals, and will include OPG's share of the results of the PEC gas-fired generating station, which is co-owned with TransCanada Energy Ltd.

## KEY GENERATION AND FINANCIAL PERFORMANCE INDICATORS

Key performance indicators that directly pertain to OPG's mandate and corporate strategies are measures of production efficiency, cost-effectiveness, and environmental performance. OPG evaluates the performance of its generating stations using a number of key performance indicators, which vary depending on the generating technology. These indicators are defined in this section and are discussed in the *Discussion of Operating Results by Business Segment* section.

### Nuclear Unit Capability Factor

OPG's nuclear stations operate as baseload facilities as they have low marginal costs and are not designed for fluctuating production levels to meet peaking demand. The nuclear unit capability factor is a key measure of nuclear station performance. It is the amount of energy that the unit(s) generated over a period of time, adjusted for externally imposed constraints such as transmission or demand limitations, as a percentage of the amount of energy that would have been produced over the same period had the unit(s) produced maximum generation. Capability factors are primarily affected by planned and unplanned outages. Capability factors by industry definition exclude grid-related unavailability and high lakewater temperature losses.

## Fossil-Fuelled and Hydroelectric Equivalent Forced Outage Rate (“EFOR”)

OPG’s fossil-fuelled stations provide a flexible source of energy and operate as baseload, intermediate and peaking facilities, depending on the characteristics of the particular stations. OPG’s hydroelectric stations operate primarily as baseload facilities and provide a reliable and low-cost source of renewable energy. A key measure of the reliability of the fossil-fuelled and hydroelectric generating stations is the proportion of time they are available to produce electricity when required. EFOR is an index of the reliability of the generating unit measured by the ratio of time a generating unit is forced out of service, including any forced deratings, compared to the amount of time the generating unit was available to operate.

## Hydroelectric Availability

Hydroelectric availability is a measure of the reliability of a hydroelectric generating unit represented by the percentage of time the generating unit is capable of providing service, whether or not it is actually in-service, compared to the total time for a respective period.

## Nuclear Production Unit Energy Cost (“PUEC”)

Nuclear PUEC is used to measure the cost-effectiveness of the operations-related costs of production of OPG’s nuclear generating assets. Nuclear PUEC is defined as nuclear fuel, OM&A expenses including allocated corporate costs, and variable costs related to used fuel disposal and storage and the disposal of low and intermediate level radioactive waste materials, divided by nuclear electricity generation.

## Hydroelectric OM&A Expense per MWh

Hydroelectric OM&A expense per MWh is used to measure the cost-effectiveness of the hydroelectric generating stations. It is defined as total hydroelectric OM&A expenses, including allocated corporate costs, divided by hydroelectric electricity generation.

## Fossil-Fuelled OM&A Expense per MW

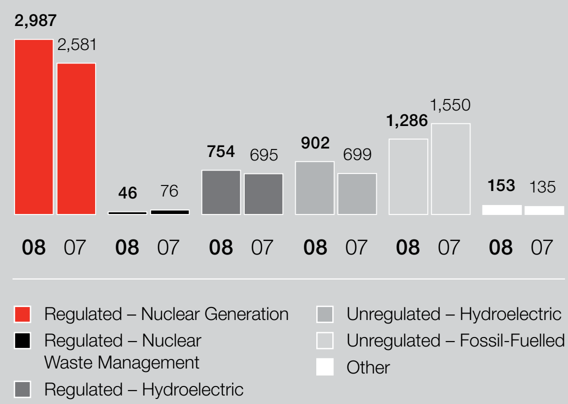
Since fossil-fuelled generating stations are primarily employed during periods of intermediate and peak demand, the cost effectiveness of these stations is measured by their annualized OM&A expenses for the period, including allocated corporate costs, divided by total station nameplate capacity.

## Other Key Indicators

In addition to performance and cost-effectiveness indicators, OPG has identified certain environmental indicators. These indicators are discussed under the heading *Risk Management*.

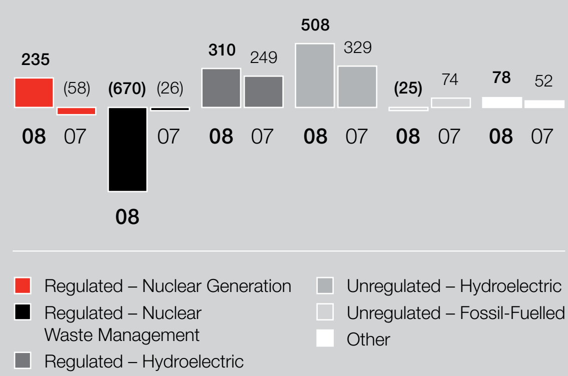
### Revenue, Net of Revenue Limit Rebate by Segment

Years Ended December 31 (millions of dollars)



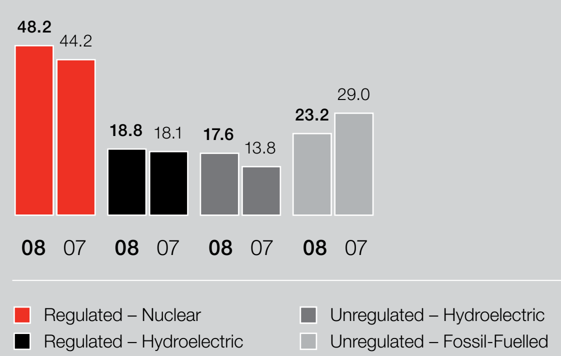

### Income (Loss) Before Interest and Income Taxes by Segment

Years Ended December 31 (millions of dollars)




### Electricity Generation by Segment

Years Ended December 31 (TWh)



## DISCUSSION OF OPERATING RESULTS BY BUSINESS SEGMENT

This section summarizes OPG's key results by segment for the years ended December 31, 2008 and 2007. The following table provides a summary of revenue, earnings and key generation and financial performance indicators by business segment:

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| **Revenue, net of revenue limit rebate** | | |
| Regulated – Nuclear Generation | **2,987** | 2,581 |
| Regulated – Nuclear Waste Management | **46** | 76 |
| Regulated – Hydroelectric | **754** | 695 |
| Unregulated – Hydroelectric | **902** | 699 |
| Unregulated – Fossil-Fuelled | **1,286** | 1,550 |
| Other | **153** | 135 |
| Elimination | **(46)** | (76) |
| | **6,082** | 5,660 |
| **Income (loss) before interest and income taxes** | | |
| Regulated – Nuclear Generation | **235** | (58) |
| Regulated – Nuclear Waste Management | **(670)** | (26) |
| Regulated – Hydroelectric | **310** | 249 |
| Unregulated – Hydroelectric | **508** | 329 |
| Unregulated – Fossil-Fuelled | **(25)** | 74 |
| Other | **78** | 52 |
| | **436** | 620 |
| **Electricity generation (TWh)** | | |
| Regulated – Nuclear Generation | **48.2** | 44.2 |
| Regulated – Hydroelectric | **18.8** | 18.1 |
| Unregulated – Hydroelectric | **17.6** | 13.8 |
| Unregulated – Fossil-Fuelled | **23.2** | 29.0 |
| Total electricity generation | **107.8** | 105.1 |
| **Nuclear unit capability factor (percent)** | | |
| Darlington | **94.5** | 89.5 |
| Pickering A | **71.8** | 41.3 |
| Pickering B | **71.4** | 75.0 |
| **Equivalent forced outage rate (percent)** | | |
| Regulated – Hydroelectric | **1.5** | 1.8 |
| Unregulated – Hydroelectric | **0.9** | 1.5 |
| Unregulated – Fossil-Fuelled | **12.8** | 11.5 |
| **Availability (percent)** | | |
| Regulated – Hydroelectric | **93.8** | 94.1 |
| Unregulated – Hydroelectric | **94.6** | 93.9 |
| **Nuclear PUEC ($/MWh)** | **44.31** | 47.18 |
| **Regulated – Hydroelectric OM&A expense per MWh ($/MWh)** | **6.01** | 5.30 |
| **Unregulated – Hydroelectric OM&A expense per MWh ($/MWh)** | **10.97** | 13.33 |
| **Unregulated – Fossil-Fuelled OM&A expense per MW ($000/MW)** | **65.20** | 66.80 |

### Regulated – Nuclear Generation Segment

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Regulated generation sales | **2,570** | 2,179 |
| Variance accounts | **22** | – |
| Other | **395** | 402 |
| Total revenue | **2,987** | 2,581 |
| Fuel expense | **167** | 133 |
| Gross margin | **2,820** | 2,448 |
| Operations, maintenance and administration | **2,098** | 2,053 |
| Depreciation and amortization | **462** | 426 |
| Property and capital taxes | **25** | 31 |
| Income (loss) before other gains and losses, interest and income taxes | **235** | (62) |
| Other (gains) and losses | **–** | (4) |
| Income (loss) before interest and income taxes | **235** | (58) |

### Revenue
Regulated – Nuclear Generation revenue was $2,987 million for the year ended December 31, 2008 compared to $2,581 million in 2007. The increase in revenue of $406 million was primarily due to higher generation of 4.0 TWh, and the increase in the regulated price approved by the OEB during the fourth quarter of 2008, for production retrospective to April 1, 2008.

### Electricity Prices
Electricity generation from stations in the Regulated – Nuclear Generation segment received a fixed price of 4.95¢/kWh throughout 2007 and during the first quarter of 2008. The OEB's payment amounts order issued in December 2008 established a new regulated price of 5.50¢/kWh, which includes a deferral and variance account recovery rider of 0.20¢/kWh, applied retrospectively to production from April 1, 2008 onward. OPG recorded the retrospective revenue of $170 million for the period April 1 to November 30 in the fourth quarter of 2008 based on the difference between the revenue earned at this new rate and the amounts received at the previous rate. The retrospective revenue is collected through rate riders applied to production over the period from December 1, 2008 to December 31, 2009.

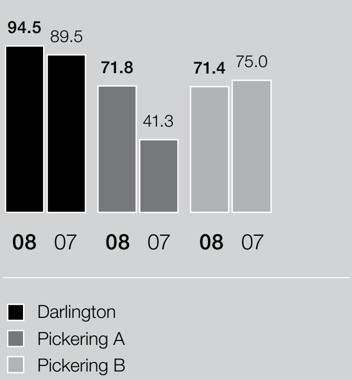
The average price received for generation from OPG's nuclear stations during 2008 was 5.33¢/kWh, reflecting the regulated price of 4.95¢/kWh for the period from January 1, 2008 to March 31, 2008 and the new regulated price of 5.50¢/kWh for the nine months ended December 31, 2008.

### Volume
Electricity generation from OPG's nuclear stations was 48.2 TWh for the year ended December 31, 2008 compared to 44.2 TWh in 2007. The increase of 4.0 TWh was due to a reduction in outage days at the Pickering A and Darlington nuclear generating stations, partly offset by an increase in outage days at the Pickering B nuclear generating station.

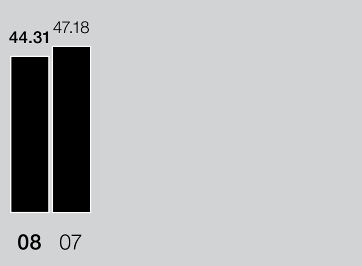
In 2007, generation at the Pickering A station was impacted by the shutdown of Units 1 and 4 from early June through September to perform modifications on a backup electrical system. Generation at the Pickering A station during 2007 was also impacted by an extension to a planned outage during the first quarter of 2007 for significant additional repair work required as a result of a component failure during inspection.

Nuclear generation for 2008 was unfavourably impacted by a higher number of outage days at the Pickering B station primarily due to the extended shutdown of Unit 7 during April to November to replace a calandria and pressure tube. In 2007, generation from the Pickering B station was impacted by an unplanned outage caused by an inadvertent release of resin by a third-party contractor from the water treatment plant into the station's demineralized water system, and the requirement for maintenance related to the recovery of resin.

**Nuclear Unit Capability Factor**
Years Ended December 31 (%)




**Nuclear PUEC**
Years Ended December 31 ($/MWh)



The Darlington nuclear generating station's unit capability factor for 2008 was 94.5 percent compared to 89.5 percent for the same period in 2007. The higher capability factor contributed to the increase in generation in 2008 compared to 2007. The high capability factors reflect the continuing high performance of the generating station.

The unit capability factor for the Pickering A nuclear generating station for 2008 was 71.8 percent compared to 41.3 percent for the same period in 2007. In 2007, the Pickering A units were shutdown to perform modifications on the backup electrical systems.

The unit capability factor for the Pickering B nuclear generating station was 71.4 percent in 2008 compared to 75.0 percent for the same period in 2007. The lower capability factor in 2008 reflects an increase in the outage days at the Pickering B nuclear generating station due to the shutdown of Unit 7 during the period from April to November of 2008. In 2007, the unit capability factor was impacted by the higher unplanned outage days related to the release of resin into the demineralized water system during the first quarter of 2007.

### Fuel Expense

Fuel expense for the year ended December 31, 2008 was $167 million compared to $133 million during 2007. The increase in fuel expense in 2008 compared to 2007 was primarily due to an increase in uranium prices and a higher generation volume.

### Operations, Maintenance and Administration

OM&A expenses for the year ended December 31, 2008 were $2,098 million compared to $2,053 million during 2007. The increase in OM&A expenses during 2008 compared to 2007 was primarily due to higher costs for maintenance activities, and an increase in costs related to regulated liabilities and other charges required by the OEB. This increase in OM&A expenses in 2008 compared to 2007 was partially offset by lower outage expenditures at the Pickering A nuclear generating station and a reduction in pension and OPEB costs.

The OM&A expenses in 2008 included $36 million recorded as a regulatory liability for new nuclear generation development activities and potential capacity refurbishment at the Pickering B and Darlington nuclear stations. This regulatory liability was a result of a lower level of costs incurred for new nuclear generation and capacity refurbishment activities for the period from April 1, 2008 to December 31, 2008 than the corresponding forecast approved by the OEB in setting the new nuclear payment amounts. The OM&A expenses in 2008 also included a write-off of a $16 million regulatory asset relating to capacity refurbishment costs incurred prior to April 1, 2008, in accordance with the OEB's decision. The OM&A expenses related to new nuclear generation development activities and potential capacity refurbishment, inclusive of the impact of the variance accounts and the regulatory asset write-off, were $95 million in 2008.

Nuclear PUEC for the year ended December 31, 2008 was $44.31/MWh compared to $47.18/MWh during the same period in 2007. The decrease was primarily due to higher generation.

### Depreciation and Amortization

Depreciation and amortization expense for the year ended December 31, 2008 was $462 million compared to $426 million in 2007. The increase in depreciation and amortization expense was primarily due to the discontinuance on April 1, 2008 of additions to the deferral account associated with the increase in the Nuclear Liabilities arising from the 2006 Approved Reference Plan in accordance with the ONFA. The discontinuance of the account, which was effective for the period January 1, 2007 to March 31, 2008 as per the regulation pursuant to the *Electricity Restructuring Act*, *2004* (Ontario), resulted in an increase to depreciation expense of $41 million in 2008 compared to 2007. OPG also recorded higher amortization of regulatory balances in 2008 primarily as a result of recovery of these balances through new regulated prices. Amortization expense increased to $105 million in 2008 from $96 million in 2007. The impact of these increases was partly offset by a reduction in depreciation expense resulting from the extension of service lives, for accounting purposes, of the Darlington, Bruce A and Bruce B nuclear generation stations effective January 1, 2008.

## Regulated – Nuclear Waste Management Segment

| (millions of dollars) | **2008** | 2007 |
|---|---|---|
| Revenue | **46** | 76 |
| Operations, maintenance and administration | **50** | 84 |
| Accretion on fixed asset removal and nuclear waste management liabilities | **573** | 499 |
| Loss (earnings) on nuclear fixed asset removal and nuclear waste management funds | **93** | (481) |
| Loss before interest and income taxes | **(670)** | (26) |

### Revenue

Regulated – Nuclear Waste Management revenue was $46 million for the year ended December 31, 2008 compared to $76 million in 2007. The decrease in revenue was due to a lower inter-segment charge between the Regulated – Nuclear Generation and the Regulated – Nuclear Waste Management segments for variable costs that are charged to current operations in the Regulated – Nuclear Generation segment.

### Operations, Maintenance and Administration

OM&A expenses for the year ended December 31, 2008 were $50 million compared to $84 million in 2007. The decrease was a result of a reduction in services provided to an external party.

### Accretion

Accretion expenses for the year ended December 31, 2008 were $573 million compared to $499 million for the same period in 2007. The increase in accretion expense during 2008 compared to the same period in 2007 was primarily due to the discontinuance on April 1, 2008 of additions to the deferral account associated with the increase in the Nuclear Liabilities arising from the 2006 Approved Reference Plan. Accretion expense also increased due to the higher balance of Nuclear Liabilities primarily as a result of the increase in the present value of the liabilities due to the passage of time.

### (Losses) Earnings on the Nuclear Fixed Asset Removal and Nuclear Waste Management Funds

Losses from the Nuclear Funds for the year ended December 31, 2008 were $93 million compared to earnings of $481 million in 2007. In 2008, before the mitigating impact of the Bruce variance account, the Nuclear Funds incurred losses of $426 million. The decrease in earnings from the Nuclear Funds of $907 million before the impact of the regulatory asset in 2008 compared to 2007 was primarily due to lower returns on the Decommissioning Fund as a result of significant reductions in the trading levels of global financial markets, which reduced the current market value of the fund investments. In addition, during 2007, the earnings on the Nuclear Funds were favourably impacted due to a $46 million reimbursement for expenditures related to the safe storage of Units 2 and 3 at the Pickering A nuclear generating station.

OPG's earnings from the Used Fuel Fund are not subject to the volatility of the capital markets, since the Province guarantees the rate of return on the Used Fuel Fund for the first 2.23 million used fuel bundles at 3.25 percent per annum plus the change in the Ontario Consumer Price Index. As of December 31, 2008, there were approximately 1.8 million used fuel bundles. The current projection indicates that the 2.23 million used fuel bundle threshold will be reached in 2012 – 2013.

A portion of the Nuclear Funds relates to OPG's obligations with respect to decommissioning the nuclear stations on lease to Bruce Power, as well as managing nuclear used fuel and waste produced by these stations. As a result of the OEB's decision, OPG established the Bruce variance account for the differences between actual and forecast revenues and costs associated with the Bruce nuclear generating stations. The forecast of earnings associated with the Bruce generating stations included in the approved nuclear payment amounts was significantly higher than the actual earnings. As a result, in the fourth quarter, OPG recorded a regulatory asset of $333 million for the period April 1, 2008 to December 31, 2008, in this variance account that reduced the reported losses on the Nuclear Funds. OPG intends to apply for the disposition of the balance in the Bruce variance account in its next application to the OEB.

## Regulated – Hydroelectric Segment

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Regulated generation sales[1] | **733** | 635 |
| Variance accounts | **(32)** | 15 |
| Other | **53** | 45 |
| Revenue | **754** | 695 |
| Fuel expense | **254** | 244 |
| Gross margin | **500** | 451 |
| Operations, maintenance and administration | **108** | 123 |
| Depreciation and amortization | **70** | 68 |
| Property and capital taxes | **12** | 11 |
| Income before interest and income taxes | **310** | 249 |

1 Regulated generation sales included revenue of $189 million and $158 million that OPG received at the Ontario electricity spot market price for generation over 1,900 MWh in any hour during the 11 months ended November 30, 2008 and the year ended December 31 2007, respectively. OPG also earned additional revenue of $3 million during December 2008 based on a revised regulated hydroelectric incentive mechanism, as described under the heading, *Rate Regulation*.

### Revenue

Regulated – Hydroelectric revenue was $754 million for the year ended December 31, 2008 compared to $695 million in 2007. The increase in revenue was primarily due to the increase in the regulated price approved by the OEB during the fourth quarter of 2008, for production retrospective to April 1, 2008.

### Electricity Prices

Electricity generation up to 1,900 MWh in any hour from stations in the Regulated – Hydroelectric segment received a fixed price of 3.3¢/kWh throughout 2007 and during the first quarter of 2008, and the spot electricity market price for generation above this level.

As determined by the OEB, for the eight months ended November 30, 2008, electricity generation up to 1,900 MWh in any hour received a new regulated price of 3.67¢/kWh and the spot electricity market price for generation above this level. During December 2008, electricity generation received a fixed price of 3.67¢/kWh subject to a revised incentive mechanism, as described under the heading, *Rate Regulation*. OPG recorded retrospective revenue of $44 million for the period April 1 to November 30 in the fourth quarter of 2008 based on the difference between the revenue earned at the new regulated rate and the amounts received at the previous rate. The revision to the incentive mechanism became effective on December 1, 2008.

# Management's Discussion and Analysis

### Volume

Electricity generation volume for the years ended December 31, 2008 and 2007 was 18.8 TWh and 18.1 TWh, respectively. The increase in volume was primarily due to unusually high water flows in 2008.

For the 11 months ended November 30, 2008, volume related to production levels above 1,900 MWh in any hour was 3.5 TWh. For the year ended December 31, 2007, 3.3 TWh related to production above 1,900 MWh in any hour.

For the years ended December 31, 2008 and 2007, the EFOR for the Regulated – Hydroelectric stations was 1.5 percent and 1.8 percent, respectively. The decrease in EFOR was due to improved equipment performance in 2008.

The availability for the Regulated – Hydroelectric stations was 93.8 percent in 2008 compared to 94.1 percent in 2007. The decrease in availability was primarily due to an increase in planned maintenance. The regulated hydroelectric stations continued to have strong performance in 2008.

### Fuel Expense

OPG pays charges to the Province and the OEFC 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.

Fuel expense was $254 million for the year ended December 31, 2008 compared to $244 million in 2007. The increase in fuel expense reflected the impact of higher generation.

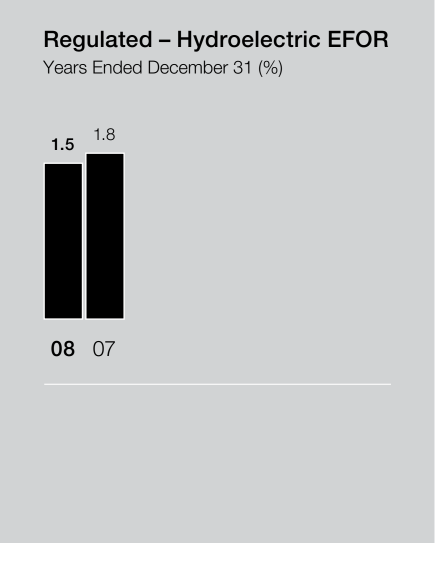
### Variance Accounts

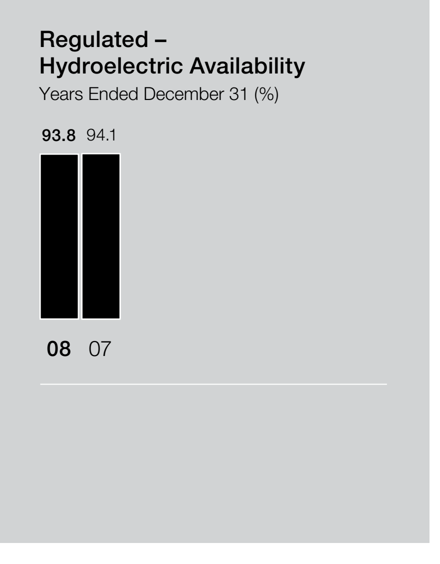
During 2008, OPG recorded a decrease in revenue of $32 million due to regulatory variance accounts that reflect the impact of differences between forecast and actual hydroelectric production and ancillary service revenue. During 2007, OPG recorded an increase to revenue of $15 million due to a regulatory asset in these variance accounts. For the period up to March 31, 2008, OPG computed the differences relative to the forecast provided to the Province for the purposes of setting the previous regulated price of 3.3¢/kWh. For the nine-month period starting April 1, 2008, OPG computed the differences relative to the forecast approved by the OEB in setting the new regulated hydroelectric prices, as the OEB authorized the continuation of these accounts effective April 1, 2008. The OEB's decision on OPG's new prices also eliminated OPG's regulatory liability of $13 million associated with the segregated mode of operations and water transaction net revenues for the period from April 1, 2005 to March 31, 2008. OPG reversed this liability to income in the fourth quarter of 2008.

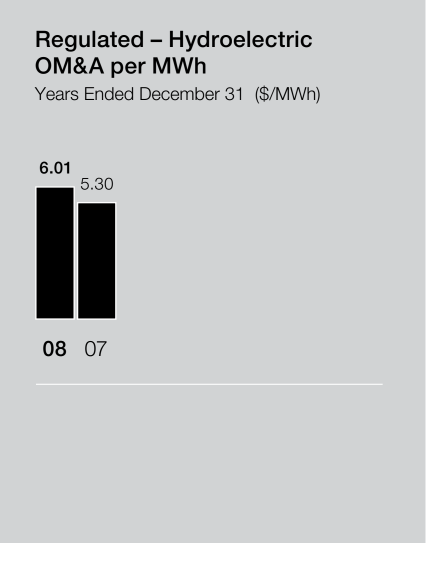
### Operations, Maintenance and Administration

OM&A expenses for the year ended December 31, 2008 were $108 million compared to $123 million in 2007. The lower OM&A expenses for the year were primarily due to a reduction in expenses related to the settlement of past grievances with First Nations.

OM&A expense per MWh for the regulated hydroelectric stations was $6.01/MWh during the 12 months ended December 31, 2008 compared to $5.30/MWh in the same period in 2007. OM&A expense per MWh excludes expenses related to past grievances by First Nations. The increase in OM&A expense per MWh in 2008 compared to 2007 was primarily due to increased repairs and maintenance costs, partially offset by higher generation.



## Unregulated – Hydroelectric Segment

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Spot market sales, net of hedging instruments | **921** | 725 |
| Revenue limit rebate | **(72)** | (64) |
| Other | **53** | 38 |
| Revenue, net of revenue limit rebate | **902** | 699 |
| Fuel expense | **111** | 81 |
| Gross margin | **791** | 618 |
| Operations, maintenance and administration | **198** | 207 |
| Depreciation and amortization | **76** | 68 |
| Property and capital taxes | **9** | 10 |
| Income before other gains and losses, interest and income taxes | **508** | 333 |
| Other losses | **–** | 4 |
| Income before interest and income taxes | **508** | 329 |

### Revenue
Unregulated – Hydroelectric revenue was $902 million for the year ended December 31, 2008 compared to $699 million in 2007. The increase in revenue of $203 million during the year ended December 31, 2008 compared to 2007 was primarily due to higher generation volume of 3.8 TWh.

### Electricity Prices
After taking into account the revenue limit rebate, OPG's average sales price for its unregulated hydroelectric generation for the years ended December 31, 2008 and 2007 was 4.8¢/kWh and 4.7¢/kWh, respectively.

### Volume
For the years ended December 31, 2008 and 2007, electricity generation volume was 17.6 TWh and 13.8 TWh, respectively. The increase in volume during 2008 compared to 2007 was primarily due to higher water flows in the Northwestern, Northeastern, and Eastern part of the Province.

The EFOR for the Unregulated – Hydroelectric generating stations was 0.9 percent during the year ended December 31, 2008 compared to 1.5 percent in 2007. The decrease in EFOR was due to improved equipment performance.

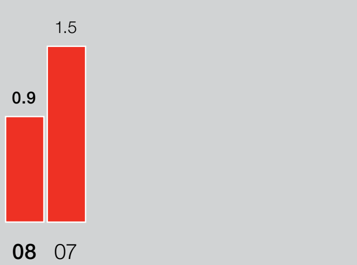
The availability for the Unregulated – Hydroelectric stations was 94.6 percent for the year ended December 31, 2008 compared to 93.9 percent in 2007. The increase in availability and decrease in EFOR reflected the continuing strong performance of the Unregulated – Hydroelectric stations.

### Fuel Expense
Fuel expense was $111 million for the year ended December 31, 2008 compared to $81 million in 2007. The increase in fuel expense was primarily due to the impact of higher generation, which is subject to the highest GRC rates.

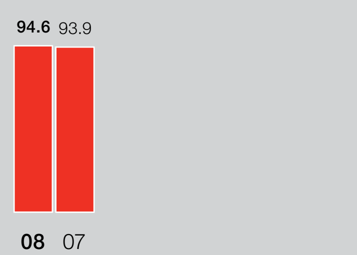
### Operations, Maintenance and Administration
During 2008, OM&A expenses were $198 million compared to $207 million for 2007. The decrease in OM&A expenses was primarily due to a reduction in expenses related to the settlement of past grievances with First Nations.

OM&A expense per MWh for the unregulated hydroelectric stations for the years ended December 31, 2008 and 2007 was $10.97/MWh and $13.33/MWh, respectively. The lower OM&A expense per MWh was primarily due to higher generation. OM&A expense per MWh excludes expense related to past grievances by First Nations.

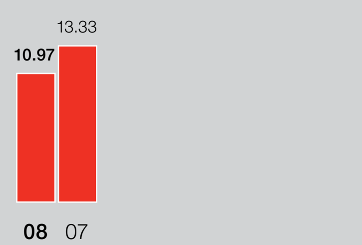
**Unregulated – Hydroelectric EFOR**
Years Ended December 31 (%)




**Unregulated – Hydroelectric Availability**
Years Ended December 31 (%)




**Unregulated – Hydroelectric OM&A per MWh**
Years Ended December 31 ($/MWh)



### Unregulated – Fossil-Fuelled Segment

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Spot market sales, net of hedging instruments | **1,366** | 1,590 |
| Revenue limit rebate | **(205)** | (163) |
| Other | **125** | 123 |
| Revenue, net of revenue limit rebate | **1,286** | 1,550 |
| Fuel expense | **659** | 812 |
| Gross margin | **627** | 738 |
| Operations, maintenance and administration | **552** | 573 |
| Depreciation and amortization | **94** | 82 |
| Accretion on fixed asset removal liabilities | **8** | 8 |
| Property and capital taxes | **21** | 21 |
| Income (loss) before other gains and losses, interest and income taxes | **(48)** | 54 |
| Other (gains) and losses | **(23)** | (20) |
| (Loss) income before interest and income taxes | **(25)** | 74 |

#### Revenue

Unregulated – Fossil-Fuelled revenue was $1,286 million for the year ended December 31, 2008 compared to $1,550 million in 2007, a decrease of $264 million. The decrease in revenue during the year ended December 31, 2008 compared to 2007 was due to significantly lower electricity generation, partly offset by higher electricity prices.

#### Electricity Prices

OPG's average sales price net of the revenue limit rebate for its unregulated fossil-fuelled generation was 5.0¢/kWh for the year ended December 31, 2008 compared to 4.8¢/kWh for the year ended December 31, 2007.

#### Volume

Electricity generation volume for the year ended December 31, 2008 was 23.2 TWh compared to 29.0 TWh during 2007. The decrease in generation in 2008 compared to 2007 was primarily due to higher generation from OPG's hydroelectric and nuclear generating stations and lower market demand, which resulted in lower generation being required from OPG's fossil-fuelled generating stations.

The EFOR for the Unregulated – Fossil-Fuelled stations during the year ended December 31, 2008 was 12.8 percent compared to 11.5 percent in 2007. The increase in EFOR during 2008 compared to 2007 was primarily due to forced and extended outages at the Lambton and Atikokan generating stations.

#### Fuel Expense

During the year ended December 31, 2008, fuel expense was $659 million compared to $812 million in 2007. The decrease of $153 million in 2008 compared to 2007 was primarily due to lower electricity generation, partly offset by higher commodity and rail transportation costs.

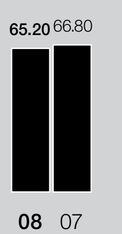
#### Operations, Maintenance and Administration

OM&A expenses for the year ended December 31, 2008 were $552 million compared to $573 million during the year ended December 31, 2007. The decrease in OM&A expense in 2008 compared to the same period last year was primarily due to the completion during 2007 of non-recurring project work, and the impact of lower generation during 2008.

Annualized OM&A expense per MW ($/MW) for the unregulated fossil-fuelled stations was $65,200/MW for the year ended December 31, 2008 compared to $66,800/MW in 2007. The decrease in OM&A expense per MW during 2008 compared to 2007 was primarily due to lower OM&A expenses.

**Unregulated – Fossil-Fuelled EFOR**
Years Ended December 31 (%)


**Unregulated – Fossil-Fuelled OM&A per MW**
Years Ended December 31 ($000/MW)



### Other Gains and Losses

In 2007, OPG recorded a recovery of $20 million to reflect a change in the estimated costs required to complete decommissioning of the Lakeview generating station. The demolition of the Lakeview generating station was substantially completed during 2007.

Other gains and losses of $23 million in 2008 primarily consist of a $21 million recovery recognized in 2008 to reflect a change in estimated costs to decommission the other fossil-fuelled generating stations, including the expected costs associated with environmental and site remediation work.

## Other

| (millions of dollars) | **2008** | 2007 |
|---|---|---|
| Revenue | **153** | 135 |
| Operations, maintenance and administration | **7** | 10 |
| Depreciation and amortization | **41** | 51 |
| Property and capital taxes | **13** | 12 |
| Income before other gains and losses, interest and income taxes | **92** | 62 |
| Other losses | **14** | 10 |
| Income before interest and income taxes | **78** | 52 |

Other revenue was $153 million for the period ending December 31, 2008 compared to $135 million in 2007. The increase in other revenue during the year was primarily due to higher realized earnings and mark-to-market gains from energy trading transactions.

OM&A expenses of the generation business segments include an inter-segment service fee for the use of certain property, plant and equipment held within the Other category. The total service fee is recorded as a reduction to the Other category's OM&A expenses. For the year ended December 31, 2008, the service fee was $29 million for Regulated – Nuclear Generation, $3 million for Regulated – Hydroelectric, $4 million for Unregulated – Hydroelectric and $9 million for Unregulated – Fossil-Fuelled, with a corresponding reduction in OM&A expenses of $45 million for the Other category. For the year ended December 31, 2007, the service fee was $33 million for Regulated – Nuclear Generation, $2 million for Regulated – Hydroelectric, $4 million for Unregulated – Hydroelectric, $11 million for Unregulated – Fossil-Fuelled, with a corresponding reduction in OM&A expenses of $50 million for the Other category.

Interconnected purchases and sales, including those to be physically settled, and unrealized mark-to-market gains and losses on energy trading contracts are disclosed on a net basis in the consolidated statements of income. If disclosed on a gross basis, revenue and power purchases for the year ended December 31, 2008 would have increased by $177 million (December 31, 2007 – $120 million).

The changes in the fair value of derivative instruments not qualifying for hedge accounting are recorded in Other revenue, and the fair value of derivative instruments are carried on the consolidated balance sheets as assets or liabilities at fair value. The carrying amounts and notional quantities of the derivative instruments are disclosed in Note 13 in the audited annual consolidated financial statements as at and for the year ended December 31, 2008.

## Net Interest Expense

Net interest expense for 2008 was $165 million compared to $143 million for 2007, an increase of $22 million. The increase was primarily due to the impact of higher average debt balances in 2008 and a lower amount of interest deferred associated with regulatory balances, partially offset by higher interest capitalization for capital projects.

## Income Taxes

OPG follows the liability method of tax accounting for its unregulated operations. Under the liability method, future tax assets and liabilities are determined based on differences between the accounting and tax bases of assets and liabilities and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Following the introduction of rate regulation on April 1, 2005, OPG has accounted for income taxes relating to the rate regulated segments of its business using the taxes payable method. Under the taxes payable method, OPG does not recognize future income taxes relating to the rate regulated segments of its business to the extent those future income taxes are expected to be recovered or refunded through future regulated prices charged to customers. As a result, OPG did not record future tax expenses of $22 million and $127 million for the rate regulated segments during the years ended December 31, 2008 and 2007, respectively, which would have been recorded had OPG accounted for income taxes for the regulated segments using the liability method.

Income tax expense for the year ended December 31, 2008 was $183 million, compared to a net income tax recovery of $51 million for the year ended December 31, 2007. The increase in income tax expense in 2008 was partly due to higher earnings before the impact of the losses on the Nuclear Funds. Earnings on the Nuclear Funds are not taxable, and losses are not deductible, when incurred. The earnings are recognized for tax purposes when OPG receives reimbursements from the Nuclear Funds. Contributions to the Nuclear Funds are deductible for tax purposes. Future income taxes related to the Nuclear Funds are not recorded to the extent that the future income taxes are expected to be recovered through future regulated prices charged to customers. Income tax expense in 2008 included $95 million recorded as part of the Bruce variance account established by the OEB.

The increase in income tax expense in 2008 was partially offset by a reduction in the income tax liabilities as a result of the resolution of tax uncertainties related to the audit of OPG's 1999 taxation year by the Provincial Tax Auditors. During 2008, all outstanding tax matters related to the 1999 tax audit were resolved and as a result, OPG reduced its income tax liability by $106 million.

In 2007, income tax expense was reduced as a result of an additional contribution of $334 million made to the Nuclear Funds. In addition, income tax expense for 2007 was favourably impacted by a reduction in Federal future tax rates that were substantively enacted in that year.

The audit of OPG's taxation years subsequent to 1999 is expected to commence in 2009. Should the outcome of the audit for subsequent years differ from OPG's recorded income tax liabilities, the Company's effective tax rate and its net income could be materially affected either negatively or positively in the period in which the matters are resolved.

The OEB's decision in 2008 on OPG's new payment amounts established a taxation variance account retrospective to April 1, 2008. The scope of the account with respect to income tax includes variances in the income tax expense for the regulated business caused by changes in tax rates or rules under the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario), as modified by the *Electricity Act*, *1998*, as well as variances caused by reassessments due to the audit of taxation years subsequent to 1999. OPG did not record any such variances in the account during the year ended December 31, 2008.

## LIQUIDITY AND CAPITAL RESOURCES

OPG's primary sources of liquidity and capital are funds generated from operations, bank financing and credit facilities provided by the OEFC. These sources are utilized for multiple purposes including: investments in plants and technologies; funding obligations such as contributions to the Pension Fund and the Used Fuel and Decommissioning Funds; to service and repay long-term debt; and to meet revenue limit rebate obligations.

| | Years Ended December 31 | |
|---|---|---|
| (millions of dollars) | **2008** | 2007 |
| Cash and cash equivalents, beginning of year | **110** | 6 |
| Cash flow provided by operating activities | **870** | 379 |
| Cash flow (used in) investing activities | **(652)** | (754) |
| Cash flow (used in) provided by financing activities | **(13)** | 479 |
| Net increase | **205** | 104 |
| Cash and cash equivalents, end of year | **315** | 110 |

### Operating Activities

Cash flow provided by operating activities for the year ended December 31, 2008 was $870 million compared to cash flow provided by operating activities of $379 million in 2007. The increase in cash flow was primarily due to higher cash receipts from generation revenue and a decrease in contributions to the Nuclear Funds in 2008 compared to 2007. In 2007, OPG made a one-time contribution of $334 million to the Used Fuel Fund as required by the ONFA. The increase in cash flow from operating activities was partially offset by higher revenue limit rebate payments and an increase in fuel payments.

### Investing Activities

Electricity generation is a capital-intensive business that requires continued investment in plant and technologies to improve operating performance, increase generating capacity of existing stations, invest in new generating stations and to maintain and improve service, reliability, safety and environmental performance.

Investment in fixed assets during the year ended December 31, 2008 was $661 million compared with $666 million for the year ended December 31, 2007. The impact of a decrease in capital expenditures for the PEC during 2008, was largely offset by higher spending on the Niagara Tunnel project and other hydroelectric initiatives.

OPG's forecast capital expenditures for 2009 are approximately $1.1 billion, which includes amounts for nuclear and hydroelectric development projects.

Cash flow used in investing activities for the year ended December 31, 2008 included an increase in net regulatory assets of $6 million compared to an increase of $30 million in 2007. The change is due primarily to a decrease in the amount of interest recorded in the deferral account related to the Pickering A return to service.

### Financing Activities

OPG maintains a $1 billion revolving committed bank credit facility which is divided into two tranches – a $500 million 364-day term tranche and a $500 million five-year term tranche. OPG has renewed and extended the maturity date of the 364-day term tranche to May 20, 2009, and the five-year term tranche to May 20, 2013. The total credit facility will continue to be used primarily as credit support for notes issued under OPG's commercial paper program. As at December 31, 2008, no commercial paper was outstanding (December 31, 2007 – nil), and OPG had no other outstanding borrowings under the bank credit facility.

In the second quarter of 2008, OPG entered into a $100 million five-year revolving committed bank credit facility in support of the Upper Mattagami and Hound Chute project. As at December 31, 2008, there was no borrowing under this credit facility. OPG is also pursuing external project financing of up to $200 million for this project.

OPG also maintains $25 million (December 31, 2007 – $25 million) in short-term uncommitted overdraft facilities and $276 million (December 31, 2007 – $238 million) of short-term uncommitted credit facilities, which support the issuance of Letters of Credit. OPG uses Letters of Credit to support its supplementary pension plans and for other purposes. At December 31, 2008, there was a total of $243 million of Letters of Credit issued (December 31, 2007 – $205 million), which included $212 million for the supplementary pension plans (December 31, 2007 – $175 million), and $16 million related to the construction and operation of the PEC (December 31, 2007 – $16 million).

OPG has an agreement with the OEFC to finance the Niagara Tunnel project for up to $1 billion over the duration of the project. The funding is advanced in the form of 10-year notes, on commercial terms and conditions. Advances under this facility commenced in October 2006, and amounted to $340 million as at December 31, 2008. Similarly, debt financing has been negotiated with the OEFC for OPG's interest in the PEC and the Lac Seul project for up to $400 million and $50 million, respectively. Advances under these facilities commenced in December 2006, and totalled $305 million for the PEC and $20 million for the Lac Seul project as at December 31, 2008. This included $20 million of new borrowing under the PEC facility in the fourth quarter of 2008.

As at December 31, 2008, OPG's long-term debt outstanding with the OEFC was $3.7 billion. Although the new borrowings added in 2008 have extended the maturity profile, approximately $2.1 billion of long-term debt must be repaid or refinanced within the next five years. To ensure that adequate financing resources are available beyond its $1 billion commercial paper program backed by the bank credit facility, OPG reached an agreement with the OEFC in 2007 for a $950 million credit agreement to refinance senior notes as they mature over the period from September 2007 to September 2009.

### Contractual and Commercial Commitments

OPG's contractual obligations and other significant commercial commitments as at December 31, 2008, are as follows:

| (millions of dollars) | 2009 | 2010 | 2011 | 2012 | 2013 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Contractual obligations: | | | | | | | |
| Fuel supply agreements | 743 | 626 | 265 | 217 | 157 | 309 | **2,317** |
| Contributions under the ONFA | 339 | 264 | 250 | 240 | 157 | 852 | **2,102** |
| Long-term debt repayment | 350 | 970 | 375 | 400 | – | 1,565 | **3,660** |
| Interest on long-term debt | 204 | 172 | 124 | 96 | 82 | 323 | **1,001** |
| Unconditional purchase obligations | 17 | 16 | 12 | 13 | 12 | 156 | **226** |
| Operating lease obligations | 23 | 25 | 25 | 26 | 27 | 1 | **127** |
| Operating licence | 30 | 30 | 33 | 36 | 39 | – | **168** |
| Pension contributions[1] | 260 | 270 | – | – | – | – | **530** |
| Other | 47 | 35 | 30 | 22 | 15 | 84 | **233** |
| Significant commercial commitments: | 2,013 | 2,408 | 1,114 | 1,050 | 489 | 3,290 | **10,364** |
| Niagara Tunnel | 113 | 260 | – | – | – | – | **373** |
| Other hydroelectric projects | 140 | 58 | – | – | – | – | **198** |
| Total | 2,266 | 2,726 | 1,114 | 1,050 | 489 | 3,290 | **10,935** |

1 The pension contributions include additional funding requirements towards the deficit and ongoing funding requirements in accordance with the actuarial valuation as at January 1, 2008. The contributions are affected by various factors including market performance, changes in actuarial assumptions, plan experience, and the timing of funding valuations. Funding requirements after 2010 are excluded due to significant variability in the assumptions required to project the timing of future cash flows.

## CREDIT RATING

Maintaining an investment grade credit rating is essential for corporate liquidity and future capital market access. The cost and availability of financing is influenced by credit ratings, which are an indicator of the creditworthiness of a particular company, security or obligation. Lower ratings generally result in higher borrowing costs as well as reduced access to capital markets.

In August 2008, Standard & Poor's (S&P) raised OPG's long-term credit rating to "A-" with a stable outlook, from "BBB+" with a positive outlook. At the same time, S&P affirmed OPG's "A-2" global scale and "A-1(Low)" Canada scale Commercial Paper rating. S&P stated that the upgrade in the long-term rating reflects a closer relationship between the Company and its higher-rated owner, the Province (AA/Stable/A-1+), and a slightly stronger stand-alone credit profile, given the regulatory support and an expected improvement in cash flow metrics. S&P added that regulatory oversight of the Company's baseload nuclear and hydroelectric assets, a diverse generation portfolio, and a cost-competitive position, support OPG's strong business risk profile.

OPG has a long-term credit rating of A(low) and a Commercial Paper rating of R1(low), both with stable trends from Dominion Bond Rating Service.

## BALANCE SHEET HIGHLIGHTS

The following section provides highlights of OPG's audited consolidated financial position using selected balance sheet data as at December 31:

| Selected balance sheet data (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Assets | | |
| Accounts receivable | **525** | 315 |
| Property, plant and equipment – net | **12,787** | 12,777 |
| Nuclear fixed asset removal and nuclear waste management funds | **9,209** | 9,263 |
| Regulatory assets | **522** | 356 |
| Future income taxes | **68** | 12 |
| Liabilities | | |
| Accounts payable and accrued charges | **1,015** | 953 |
| Long-term debt (including debt due within one year) | **3,840** | 3,853 |
| Fixed asset removal and nuclear waste management | **11,384** | 10,957 |
| Long-term accounts payable and accrued charges | **445** | 184 |
| Future income taxes | **–** | 217 |
| Regulatory liabilities | **54** | 14 |

# Management's Discussion and Analysis

## Accounts Receivable

As at December 31, 2008, accounts receivable were $525 million compared to $315 million as at December 31, 2007. The increase of $210 million was primarily due to the accrual for the retrospective increase in regulated prices for electricity generation from the regulated facilities resulting from the OEB's decision effective April 1, 2008.

## Property, Plant and Equipment – Net

Net property, plant and equipment as at December 31, 2008 was $12,787 million compared to $12,777 million as at December 31, 2007. The increase was primarily due to fixed asset additions, largely offset by depreciation for the year.

## Nuclear Fixed Asset Removal and Nuclear Waste Management Funds

### Decommissioning Fund

The Decommissioning Fund was established to fund the future costs of nuclear fixed asset removal and long-term low and intermediate level nuclear waste management and a portion of used fuel storage costs after station life. Upon termination of the ONFA, the Province has a right to any excess funding in the Decommissioning Fund, which is the excess of the fair market value of the Decommissioning Fund assets over the estimated completion costs as per the most recently approved ONFA Reference Plan. When the Decommissioning Fund is overfunded, OPG limits the earnings it recognizes in its consolidated financial statements, through a charge to the Decommissioning Fund with a corresponding payable to the Province, such that the balance of the Decommissioning Fund would equal the cost estimate of the liability based on the most recently approved ONFA Reference Plan. The payable to the Province could be reduced in subsequent periods in the event that the Decommissioning Fund earns less than its target rate of return or in the event that a new ONFA Reference Plan is approved with a higher estimated decommissioning liability. When the Decommissioning Fund is underfunded, the earnings on the Decommissioning Fund reflect actual fund returns based on the market value of the assets.

The Decommissioning Fund's asset value on a fair value basis was $4,325 million at December 31, 2008 compared to $5,072 million as at December 31, 2007. The decrease in asset value in the Decommissioning Fund of $747 million was primarily due to unfavourable returns in the capital markets during the year ended December 31, 2008.

### Used Fuel Fund

Under the ONFA, the Province guarantees OPG's annual return in the Used Fuel Fund at 3.25 percent plus the change in the Ontario Consumer Price Index ("committed return") for funding related to the first 2.23 million used fuel bundles. OPG recognizes the committed return on the Used Fuel Fund and includes it in the earnings on the nuclear fixed asset removal and nuclear waste management funds. The difference between the committed return on the Used Fuel Fund and the actual market return, based on the fair value of the Used Fuel Fund's assets, which includes realized and unrealized returns, is recorded as due to or due from the Province. The asset value as at December 31, 2008 included a receivable from the Province of $460 million. The asset value as at December 31, 2007 was reduced by a payable to the Province of $511 million. The receivable and payable relate to the committed return adjustment. At December 31, 2008, the Used Fuel Fund asset value on a fair value basis was $4,884 million compared to $4,191 million as at December 31, 2007. The increase in the value of the Used Fuel Fund assets was due to the committed return and new contributions to the fund.

The market volatility during 2008 did not have an impact on the Used Fuel Fund balance as a result of the Province's rate of return guarantee.

## Regulatory Assets

As at December 31, 2008, regulatory assets were $522 million compared to $356 million as at December 31, 2007. The increase in regulatory assets was primarily due to the recording of the Bruce revenues and costs variance account of $260 million, in accordance with the OEB decision. The variance account is a regulatory asset and included losses from the Nuclear Funds related to the Bruce generating stations. During the first quarter of 2008, OPG also recorded $33 million in the nuclear liabilities deferral account related to the increase in the Nuclear Liabilities recorded on December 31, 2006. The increase in regulatory assets was partially offset by amortization expense of $102 million, primarily resulting from the recovery of approved regulatory asset balances through new regulated prices.

## Accounts Payable and Accrued Charges

Accounts payable and accrued charges as at December 31, 2008 were $1,015 million compared to $953 million as at December 31, 2007. The increase of $62 million was primarily due to an increase in accruals for the GRC as a result of higher hydroelectric generation, and an increase in amounts payable related to projects. The increase was partially offset by lower general trade payables.

## Long-Term Debt (including debt due within one year)

Long-term debt as at December 31, 2008 was $3,840 million compared to $3,853 million as at December 31, 2007. The decrease was due to the repayment of long-term debt of $408 million during 2008. This decrease was largely offset by the issuance of long-term debt of $200 million under the $950 million credit agreement to refinance maturing notes, $100 million under the Niagara Tunnel facility, and $95 million under the PEC facility.

## Fixed Asset Removal and Nuclear Waste Management

The liability for fixed asset removal for nuclear and fossil-fuelled generating stations and nuclear waste management as at December 31, 2008 was $11,384 million compared to $10,957 million as at December 31, 2007. The increase was primarily due to accretion of $608 million due to the passage of time, partially offset by expenditures on nuclear waste management activities.

## Long-Term Accounts Payable and Accrued Charges and Future Income Tax Asset and Liability

As at December 31, 2008, long-term accounts payable and accrued charges included various contingent liabilities and unrealized mark-to-market losses. The resolution of tax uncertainties related to the 1999 taxation year also impacted the future income tax liability as at December 31, 2008.

## Regulatory Liabilities

As at December 31, 2008, regulatory liabilities were $54 million compared to $14 million as at December 31, 2007. The increase was primarily due to the recording of liabilities in the variance accounts related to the impact of water conditions on hydroelectric electricity production, new nuclear development and capacity refurbishment, which were authorized by the OEB in its decision on OPG's regulated prices. The regulatory liabilities as at December 31, 2007 were largely reversed in 2008 pursuant to the OEB's decision to eliminate OPG's liability associated with the segregated mode of operations, and water transactions net revenue related to the period preceding April 1, 2008.

## Accumulated Other Comprehensive (Loss) Income

Accumulated other comprehensive loss as at December 31, 2008 was $49 million and accumulated other comprehensive income as at December 31, 2007 was $17 million. Accumulated other comprehensive (loss) income reflects the balances related to derivative instruments and amounts that are designated for hedging purposes net of income taxes.

## Off-Balance Sheet Arrangements

In the normal course of operations, OPG engages in a variety of transactions that, under Canadian GAAP, are either not recorded in the Company's consolidated financial statements or are recorded in the Company's consolidated financial statements using amounts that differ from the full contract amounts. Principal off-balance sheet activities that OPG undertakes include securitization of certain accounts receivable agreements, guarantees, which provide financial or performance assurance to third parties on behalf of certain subsidiaries, and long-term fixed price contracts.

### Securitization

In October 2003, OPG completed a revolving securitization agreement with an independent trust. The independent trust is not controlled by OPG, nor is OPG the primary beneficiary. As such, the results of the trust are not consolidated. The securitization provides OPG with an opportunity to obtain an alternative source of cost-effective funding. For the year ended December 31, 2008 and 2007, the average all-in cost of funds was 3.9 percent and 5.1 percent, respectively, and the pre-tax charges on sales to the trust were $12 million and $15 million, respectively. The current securitization agreement extends to August 2009. Refer to Note 5 of OPG's 2008 annual audited consolidated financial statements for additional information.

### Guarantees

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

# CRITICAL ACCOUNTING POLICIES AND ESTIMATES

OPG's significant accounting policies, including the impact of future accounting pronouncements, are outlined in Note 3 to the audited annual consolidated financial statements as at and for the year ended December 31, 2008. Certain of these policies are recognized as critical accounting policies by virtue of the subjective and complex judgments and estimates required around matters that are inherently uncertain and could result in materially different amounts being reported under different conditions or assumptions. The critical accounting policies and estimates that affect OPG's consolidated financial statements, the likelihood that materially different amounts would be reported under varied conditions and estimates and the impact of changes in certain conditions or assumptions, are highlighted below.

## Rate Regulated Accounting

A regulation made pursuant to the *Electricity Restructuring Act, 2004* (Ontario) prescribes that most of OPG's baseload hydroelectric facilities and all of the nuclear facilities that OPG operates receive regulated prices for their output effective April 1, 2005. The regulation established regulated prices up to April 1, 2008. The regulation and related amendments required OPG to establish several variance and deferral accounts for the period up to April 1, 2008. In its decision issued in the fourth quarter of 2008, the OEB provided for the disposition of these account balances as at December 31, 2007 via recovery from ratepayers through the new regulated prices. The OEB also authorized the continuation and establishment of certain existing and new variance and deferral accounts effective April 1, 2008.

OPG has been recording amounts in the variance and deferral accounts established by the regulation prior to April 1, 2008, as well as accounts authorized by the OEB subsequent to that date. The balances in these accounts are reported as regulatory assets and liabilities on OPG's consolidated balance sheets, as Canadian accounting standards recognize that rate regulation can create economic benefits and obligations that are required by the regulator to be obtained from, or settled with the ratepayers. Approved regulatory assets and liabilities are amortized as the amounts are recovered from, or repaid to ratepayers. Amortization of regulatory balances is recorded to depreciation and amortization expense. OPG began amortizing the balances approved by the OEB retrospectively to April 1, 2008 in the fourth quarter of 2008. OPG recorded total amortization of $111 million related to regulatory balances in 2008 (2007 – $96 million).

Disallowed balances, including associated interest, are charged to operations in the time period that the decision regarding the disallowance is issued. The OEB's decision in 2008 disallowed $16 million in costs deferred for nuclear capacity refurbishment prior to April 1, 2008, and eliminated a liability of $13 million associated with the segregated mode of operations and water transactions net revenues for the period from April 1, 2005 to March 31, 2008.

OPG applies interest to its regulatory balances as prescribed by the regulation or the OEB, in order to recognize the cost of financing amounts that are to be recovered from, or to be repaid to ratepayers. Prior to April 1, 2008, the regulation required OPG to apply an annual interest rate of six percent to most of its deferral and variance accounts. Subsequent to April 1, 2008, OPG applies the rate determined by the OEB from time to time for variance and deferral accounts of the entities it regulates. The rate has fluctuated in the range of three percent to four percent during the nine months ended December 31, 2008. OPG deferred net interest expense of $13 million in 2008 (2007 – $33 million).

OPG's most significant regulatory balance as at December 31, 2008 was a regulatory asset that relates to the Bruce revenues and costs variance account. The account captures differences between the forecast revenues and costs associated with the Bruce generating stations that are included in the calculation of the approved nuclear regulated prices and actual amounts. As at December 31, 2008, the variance account balance was $260 million, including interest of $1 million. The account was not in effect in 2007. Amortization of the balance is expected to begin following OPG's next application. The regulatory asset includes a $333 million variance from forecast as a result of losses from the Nuclear Funds related to the Bruce generating stations since April 1, 2008, partially offset by a related variance in income tax expense of $95 million. The account also includes variances for lease revenues, and accretion expense related to Nuclear Liabilities associated with the Bruce generating stations.

OPG's regulatory balances as at December 31, 2008 also include a regulatory asset for the Pickering A return to service deferral account that captures non-capital costs incurred on or after January 1, 2005 that were associated with the planned return to service of all units at the Pickering A nuclear generating station. As at December 31, 2008, the deferral account balance was $123 million, including interest of $43 million and net of accumulated amortization of $191 million. As at December 31, 2007, the deferral account balance was $183 million, including interest of $37 million and net of accumulated amortization of $125 million. OPG commenced amortization of the deferral account in accordance with the terms of the regulation when Unit 1 of the Pickering A nuclear generating station was returned to service in November 2005. Amortization of $66 million was recorded in 2008 (2007 – $96 million). In its decision, the OEB authorized the recovery of the unamortized balance in the account as at December 31, 2007 over a 45-month period ending December 31, 2011.

In addition, under the regulation pursuant to the *Electricity Restructuring Act*, *2004* (Ontario), OPG established a deferral account in connection with the increase of $1,386 million in its Nuclear Liabilities as at December 31, 2006 arising from the 2006 Approved Reference Plan in accordance with the terms of the ONFA. The account has a balance of $132 million as at December 31, 2008 (December 31, 2007 – $131 million). Commencing in the first quarter of 2007 and up to April 1, 2008, OPG recorded a regulatory asset of $164 million, including $6 million of interest, in this deferral account. The amount in the account represents the revenue requirement impact associated with the increase in the Nuclear Liabilities. The OEB authorized the recovery of the balance in this account as at December 31, 2007 over a 33-month period ending December 31, 2010. OPG recorded amortization of $36 million related to this deferral account in the fourth quarter of 2008 retrospective to April 1, 2008 pursuant to the OEB decision. No amortization was recorded during 2007.

OPG's other regulatory asset and liability balances represent a net liability balance of $47 million as at December 31, 2008 (a net asset balance of $28 million as at December 31, 2007). In 2008, this balance primarily included regulatory liabilities recorded for variance accounts related to the impact of water conditions on regulated hydroelectric electricity production, ancillary services revenue from regulated facilities, non-capital new nuclear development costs, and costs incurred for potential capacity refurbishment at Pickering B and Darlington nuclear generating stations. In 2007, the balance consisted primarily of regulatory assets related to costs for new nuclear development and nuclear capacity refurbishment, net of a regulatory liability associated with segregated mode of operations and water transactions net revenue.

Prior to April 1, 2008, OPG accounted for lease revenue from Bruce Power using the cash basis of accounting. Under the cash basis of accounting, OPG recognized lease income as stipulated in the lease agreement to the extent that the lease payments were expected to be included in future regulated prices charged to customers. Pursuant to the OEB's decision, certain lease payments from Bruce Power were included in the determination of regulated prices effective April 1, 2008 on a straight-line basis over the term of the lease agreement. Accordingly, OPG recognized these lease payments on a straight-line basis over the term of the lease effective April 1, 2008.

In late 2008, OPG re-evaluated the Bruce lease for accounting purposes due to a modification to the lease. As a result of the re-evaluation, the timing in which certain of the lease revenues are recognized for accounting purposes has been revised. The revision will result in reductions to the lease revenue for accounting purposes during the initial years of the remaining lease term, and increases in lease revenue for accounting purposes during the later years of the remaining lease term. The impact of these changes on revenue in 2008 was offset by the impact of the Bruce revenues and costs variance account.

## Income Taxes

OPG is exempt from tax under the *Income Tax Act* (Canada). However, under the *Electricity Act*, *1998*, OPG is required to make 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's operations are complex and the computation of the provision for income taxes involves interpretation of the various tax statutes and regulations. The *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario) have a large body of technical interpretations and case law to help determine the Company's filing position. However, the *Electricity Act*, *1998* and tax related regulations are relatively new and it has therefore been necessary for OPG, since its inception, to take certain filing positions in calculating the amount of its income tax provision. These filing positions may be challenged on audit and some of them possibly disallowed, resulting in a potential significant change in OPG's tax provision upon reassessment.

OPG uses the liability method of accounting for income taxes for the unregulated segment of the business and provides future income taxes for temporary differences. The process involves an estimate of OPG's actual current tax liability and an assessment of the Company's future income taxes as a result of temporary differences arising from the difference between the tax basis of an asset or liability and its carrying value on the consolidated balance sheets. In addition, OPG has to assess whether the future tax assets can be realized and to the extent that recovery is not considered likely, a valuation allowance must be established.

Commencing April 1, 2005, OPG accounts for income taxes related to the rate regulated segments of its business in accordance with paragraphs 102 to 104, inclusive, of the Canadian Institute of Chartered Accountants ("CICA") Handbook, Section 3465 – *Income Taxes*. Accordingly, OPG does not recognize future income taxes related to the rate regulated segments of its business to the extent that these income taxes are expected to be recovered or refunded through future regulated prices charged to customers.

Future tax assets of $195 million (2007 – $234 million) have been recorded on the consolidated balance sheet at December 31, 2008. The Company believes there will be sufficient future taxable income and capital gains that will permit the use of these deductions and carry-forwards. Because of the adoption of rate regulated accounting, OPG did not record future tax assets of $3,480 million (2007 – $3,313 million), which it would have recorded under the liability method, resulting primarily from temporary differences related to the nuclear fixed asset removal and nuclear waste management provisions.

Future tax liabilities of $125 million (2007 – $439 million) have been recorded on the consolidated balance sheet at December 31, 2008. Because of the adoption of rate regulated accounting, OPG did not record future tax liabilities of $3,820 million (2007 – $3,749 million), which it would have recorded under the liability method, resulting primarily from temporary differences related to the nuclear fixed asset removal and nuclear waste management funds.

## Fixed Assets

OPG's business is capital intensive and requires significant investment in property, plant and equipment. At December 31, 2008, the net book value of OPG's fixed assets was $12,787 million (2007 – $12,777 million).

Property, plant and equipment are tested for recoverability whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. Recoverability of property, plant and equipment is determined 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, an impairment loss is recognized equal to the amount by which the carrying amount exceeds the fair value, or discounted cash flows.

Various assumptions and accounting estimates are required to determine whether an impairment loss should be recognized and, if so, the value of such loss. This includes factors such as short-term and long-term forecasts of the future market price of electricity, the demand for and supply of electricity, the in-service dates of new and laid-up generating stations, inflation, fuel prices, capital expenditures and station lives. The amount of the future net cash flow that OPG expects to receive from its fixed assets could differ materially from the net book values recorded in OPG's consolidated financial statements.

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

Effective January 1, 2008, the service life of the Darlington nuclear generating station, for the purposes of calculating depreciation, was extended by two years to 2019 after a review of the technical analysis for life limiting components. The life extension reduced depreciation expense by $18 million annually.

Effective January 1, 2009, the service life of fossil-fuelled stations, for the purpose of calculating depreciation, was extended by two years to 2014 based on the Province of Ontario's announcement to phase out coal generation by 2014. The life extension reduced depreciation expense by $31 million annually.

The Company has extended the service life of the Bruce B nuclear generating station to 2014 for depreciation purposes effective January 1, 2008 after reviewing future capacity plans in the OPA's IPSP, and historical information regarding the service lives of major life limiting components of the station. As a result of the extension, depreciation expense decreased by $7 million annually. In addition, effective January 1, 2008, OPG extended the service life of Bruce A nuclear generating station to 2035 for depreciation purposes after the review of future capacity plans filed with the OPA and other publicly available information. The extension of the service life of the Bruce A nuclear generating station for depreciation purposes decreased depreciation expense by $8 million annually.

### Pension and Other Post Employment Benefits

OPG's accounting for pension and OPEB is dependent on management's accounting policies and assumptions used in calculating such amounts.

#### Accounting Policy

In accordance with Canadian GAAP, actual results that differ from the assumptions used, as well as adjustments resulting from changes in assumptions, are accumulated and amortized over future periods and therefore generally affect the recognized expense and the recorded obligation in future periods.

Under OPG's policy on accounting for pension and OPEB, certain actuarial gains and losses have not been charged to expense and are therefore not reflected in OPG's pension and OPEB obligations as a result of the following:

- Pension fund assets are valued using market-related values for purposes of determining actuarial gains or losses and the expected return on plan assets. The market-related value recognizes gains and losses on equity assets relative to a six percent assumed real return over a five-year period.
- For pension and OPEB, the excess of the net cumulative unamortized gain or loss, over 10 percent of the greater of the benefit obligation and the market-related value of the plan assets (the "corridor"), is amortized over the expected average remaining service life.

In addition, past service costs arising from any pension and OPEB amendments are amortized over future periods and therefore affect recognized expense and the recorded obligation in future periods.

At December 31, 2008, the unamortized net actuarial loss and unamortized past service costs for the pension plans and OPEB amounted to $928 million (2007 – $1,993 million). Details of the unamortized net actuarial loss and total unamortized past service costs at December 31, 2008 and 2007, are as follows:

| | Registered Pension Plan | | Supplementary Pension Plans | | Other Post Employment Benefits | |
|---|---|---|---|---|---|---|
| (millions of dollars) | **2008** | 2007 | **2008** | 2007 | **2008** | 2007 |
| Net actuarial loss not yet subject to amortization due to use of market-related values | **1,700** | 2 | **–** | – | **–** | – |
| Net actuarial (gain) loss not subject to amortization due to use of corridor | **(763)** | 960 | **(3)** | 16 | **(70)** | 206 |
| Net actuarial loss subject to amortization | **–** | 384 | **–** | 6 | **–** | 332 |
| Unamortized net actuarial loss (gain) | **937** | 1,346 | **(3)** | 22 | **(70)** | 538 |
| Unamortized past service costs | **46** | 64 | **2** | 3 | **16** | 20 |

#### Accounting Assumptions

Assumptions are significant inputs to actuarial models that measure pension and OPEB obligations and related effects on operations. Two critical assumptions, discount rate and inflation, are important elements of benefit costs and obligations. In addition, the expected return on assets is a critical assumption in the determination of pension costs. These assumptions, as well as other assumptions involving demographic factors such as retirement age, mortality and employee turnover, are all evaluated periodically by management in consultation with an independent actuary. During the evaluation process, the assumptions are updated to reflect actual experience and expectations for the future. Actual results in any given year will often differ from actuarial assumptions because of economic and other factors, and in accordance with Canadian GAAP, the impact of these differences are accumulated and amortized over future periods.

The discount rates used by OPG in determining projected benefit obligations and the costs for the Company's employee benefit plans are based on representative AA corporate bond yields. The respective discount rates enable OPG to calculate the present value of the expected future cash flows on the measurement date. A lower discount rate increases the present value of benefit obligations and increases benefit plan costs. The expected rate of return on plan assets is based on current and expected asset allocation, as well as the long-term historical risks and returns associated with each asset class within the plan portfolio. A lower expected rate of return on plan assets increases pension cost.

The discount rate used to determine the projected pension benefit obligation at December 31, 2008 of 7.5 percent represents a significant increase compared to the 5.6 percent discount rate that was used to determine the obligation at December 31, 2007. The deficit for the registered pension plan decreased from

$679 million at December 31, 2007 to $186 million at December 31, 2008 primarily as a result of the significant increase in the discount rate. The impact of the loss of $1,566 million on the pension fund assets during 2008 was more than offset by the impact of the higher discount rate.

The discount rate used to determine the OPEB obligation at December 31, 2008 of 7.46 percent increased significantly compared to the 5.59 percent discount rate that was used to determine the obligation at December 31, 2007. The projected benefit obligation decreased from $2,064 million at December 31, 2007 to $1,591 million at December 31, 2008 primarily as a result of the significant increase in the discount rate.

A change in assumptions, holding all other assumptions constant, would increase (decrease) 2008 costs, excluding amortization components, as follows:

| (millions of dollars) | Registered Pension Plan | Supplementary Pension Plans | Other Post Employment Benefits |
|---|---|---|---|
| Expected long-term rate of return | | | |
| 0.25% increase | (22) | na | na |
| 0.25% decrease | 22 | na | na |
| Discount rate | | | |
| 0.25% increase | (15) | – | (3) |
| 0.25% decrease | 13 | – | 3 |
| Inflation | | | |
| 0.25% increase | 37 | 1 | – |
| 0.25% decrease | (38) | (1) | – |
| Salary increases | | | |
| 0.25% increase | 10 | 1 | – |
| 0.25% decrease | (10) | (1) | – |
| Health care cost trend rate | | | |
| 1% increase | na | na | 33 |
| 1% decrease | na | na | (24) |

na – change in assumption not applicable

## Asset Retirement Obligations

At December 31, 2008, OPG's asset retirement obligation was $11,384 million ($10,957 as at December 31, 2007), comprised of liabilities for nuclear fixed asset removal and nuclear waste management costs and non-nuclear fixed asset removal costs related to the decommissioning of fossil-fuelled generating stations. The liabilities associated with decommissioning the nuclear generating stations and long-term used nuclear fuel management comprise the most significant amounts of the total obligation. The estimates of the nuclear liabilities are reviewed on an annual basis as part of the ongoing, overall nuclear waste management program. Changes in the nuclear liabilities resulting from changes in assumptions or estimates that impact the amount of the originally estimated undiscounted cash flows are recorded as an adjustment to the liabilities, with a corresponding change in the related asset retirement cost capitalized as part of the carrying amount of fixed assets.

The estimates of nuclear fixed asset removal and nuclear waste management costs require significant assumptions in the calculations since the programs run for many years. 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 rate, and discount rate, could result in significant changes in the value of the accrued liabilities.

## Financial Instruments Measured at Fair Value

Financial assets and liabilities, including exchange traded derivatives, and other financial instruments measured at fair value and for which quoted prices in an active market are available, are determined directly from those quoted market prices.

For financial instruments which do not have quoted market prices directly available, fair values are estimated using forward price curves developed from observable market prices or rates which may include the use of valuation techniques or models, based wherever possible on assumptions supported by observable market prices or rates prevailing at the balance sheet date. This is the case for over-the-counter derivatives, which includes energy commodity derivatives, foreign exchange derivatives, and interest rate swap derivatives. Valuation models use general assumptions and market data and therefore do not reflect the specific risks and other factors that would affect a particular instrument's fair value. The methodologies used for calculating the fair value adjustments are reviewed on an ongoing basis to ensure that they remain appropriate.

OPG's use of financial instruments expose the Company to various risks, including credit risk, commodity price risk, and foreign currency and interest rate risk. A discussion of how OPG manages these and other risks are in the *Risk Management* section.

## Changes in Accounting Policies

### Capital Disclosures and Financial Instruments

In December 2006, the CICA issued three new accounting standards: Handbook Section 1535, *Capital Disclosures* ("Section 1535"), Handbook Section 3862, *Financial Instruments – Disclosures* ("Section 3862"), and Handbook Section 3863, *Financial Instruments – Presentation* ("Section 3863"). These new standards were effective for the Company beginning January 1, 2008.

Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing the disclosure requirements, and carrying forward unchanged the presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

### Inventories

The CICA issued a new accounting standard, Section 3031, *Inventories*, in March 2007, which is based on International Accounting Standard ("IAS") 2. The new section replaced the existing Section 3030, *Inventories*. Under the new section, inventories are required to be measured at the "lower of cost and net realizable value", which is different from the existing guidance of "lower of cost and market". The new section also allows the reversal of any write-downs previously recognized. Further, due to the changes in the section and the consequential amendments, some of OPG's critical spare parts, which were previously reported as materials and supplies on OPG's consolidated balance sheets are now accounted for as property, plant and equipment. The new accounting standard and the consequential amendments were effective for OPG beginning January 1, 2008. OPG reclassified significant critical spare parts of $19 million, net of accumulated depreciation, to property, plant and equipment in 2008.

### Accounting for Regulated Operations

In December 2007, the CICA revised its guidance on accounting for rate-regulated operations. The revision resulted in amendments to Handbook Sections 1100, *Generally Accepted Accounting Principles*, and 3465, *Income Taxes*, and Accounting Guideline 19 ("AcG-19"), *Disclosures by Entities Subject to Rate Regulation*, as follows:

- to remove the temporary exemption pertaining to the application of Section 1100 to rate-regulated operations, including the elimination of the opportunity to use industry practice as an acceptable basis for recognition and measurement of assets and liabilities arising from rate regulation;
- to amend Section 3465 to require the recognition of future income tax liabilities and assets as well as a separate regulatory asset or liability for the amount of future income taxes expected to be included in future rates and recovered from or paid to customers; and
- to amend AcG-19, as necessary, as a result of amendments to Sections 1100 and 3465.

As a result of the changes to Section 3465, OPG will be required to recognize future income taxes associated with its rate-regulated operations. OPG will apply the changes prospectively to interim and annual financial consolidated statements beginning January 1, 2009. Accordingly, on January 1, 2009, OPG will record a future income tax liability of $466 million and a corresponding regulatory asset. The future income tax liability of $466 million includes future income taxes resulting from regulatory assets and liabilities of $126 million that are required to be recorded due to amendments to Section 3465.

### Intangible Assets

In February 2008, the CICA adopted Handbook Section 3064, *Goodwill and Intangible Assets*, which replaces CICA Handbook Section 3062, *Goodwill and other Intangible Assets*, and establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. This section applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008, with early adoption encouraged. The adoption of this standard is not expected to have a significant impact on the Company's financial position or results of operation.

### Reportable Segments

Commencing in the fourth quarter of 2008, OPG separated the Regulated – Nuclear segment into two reportable segments identified as Regulated – Nuclear Generation segment and Regulated – Nuclear Waste Management segment. The revised segment reporting is consistent with the manner in which performance is evaluated by management given the magnitude and significant growth in nuclear decommissioning and waste management activities, assets and liabilities. The revised segments also enable OPG to provide greater transparency with respect to OPG's generation and nuclear waste management and decommissioning activities. Results for the comparative periods have been reclassified to reflect the revised disclosure.

### Conversion to International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that Publicly Accountable Enterprises will be required to transition from Canadian GAAP to International Financial Reporting Standards ("IFRS") for interim and annual financial reporting purposes for fiscal years beginning on or after January 1, 2011. OPG is required to present its first set of published IFRS statements in the first quarter of 2011, with comparative information. In May 2008, the Canadian Securities Administrators issued Staff Notice 52-320, which provides guidance on the disclosure of changes in expected accounting policies related to the change over to IFRS. In accordance with the notice, OPG is required to provide an update of the Company's IFRS conversion plan in each financial reporting period prior to conversion on January 1, 2011.

OPG commenced its IFRS conversion project in 2007 and has established a formal project governance structure. This structure includes a steering committee consisting of senior levels of management from finance, representatives from all business units, and information technology. There is regular reporting to executive management and to the Audit/Risk Committee of the Board of Directors. OPG has also engaged an external expert advisor.

OPG's conversion project consists of three phases: diagnostic, development, and implementation. During the fourth quarter of 2007, OPG completed the diagnostic phase which involved a high level review of the major differences between current Canadian GAAP and IFRS. Currently, OPG has determined that the differences with the highest potential to impact OPG's accounting include rate regulated accounting, accounting for fixed assets, asset retirement obligation accounting, as well as the initial adoption of IFRS under the provision of IFRS 1, First-time Adoption of IFRS. OPG continues to monitor developments at the International Accounting Standards Board and International Financial Reporting Interpretations Committee.

During 2008, OPG has completed a number of milestones as part of the development stage of its IFRS conversion project, which requires a more detailed consideration of those issues identified by the diagnostic exercise as well as a more thorough review of all of the accounting differences, and related system and process impacts. These milestones include training for all components and the completion of all of OPG's component evaluations, identification of the relevant elections available to OPG under IFRS 1, and the determination of and execution against a communication plan for the broader dissemination of IFRS matters to those impacted. OPG has begun the process of determining the systems, process and internal control impacts of the IFRS conversion.

As part of assessing the impact of the IFRS changeover on its financial reporting, OPG is currently working on identifying areas of its financial statements where disclosure gaps exist between current Canadian GAAP and IFRS requirements.

During 2009, OPG will determine the projected impacts of adopting IFRS on its financial statements after consideration of the options available under IFRS 1, develop its significant accounting policies under IFRS, and finalize the determination of the systems, process and internal control impacts of converting to IFRS. Communication of the project will continue through 2009 and OPG will execute against its training plan for the broader organization to ensure that OPG is well positioned to embed IFRS requirements within its underlying systems, processes and internal controls.

## RISK MANAGEMENT

### Overview

The global economic downturn and uncertainties in the economy are expected to increase risks faced by OPG. Potential increased risks include lower revenues as a result of a forecast decrease in electricity market prices, and higher credit exposures as many of OPG's counterparties' creditworthiness may deteriorate in the near term. Generation development initiatives, including the design and development of new nuclear and hydroelectric stations, and a new operating strategy for coal-fired generation, are underway. Specific remediation activities designed to provide early identification of emerging risks and mitigating actions have been initiated to comprehensively address OPG's risks.

### Risk Governance Structure

OPG's Board of Directors has approved, and management has implemented, a risk management governance structure designed to effectively identify, measure, monitor and report on key risk management activities across the Company. These activities are coordinated by a centralized risk management group led by the Chief Risk Officer. An illustration of OPG's governance structure that supports its risk management function is provided on the following page.

In 2008, OPG implemented a revised risk management approach designed to enable the Company to identify and prioritize significant risks, and to assess the impact on specific business plan objectives. In addition, an Executive Risk Committee ("ERC") has been established, which is comprised of the business unit leaders, chaired by the Chief Financial Officer.

OPG has a comprehensive and fully-integrated risk management evaluation process that is able to continually evaluate the effectiveness of risk mitigation activities against significant risks faced by the Company. The findings from this evaluation process are reported quarterly to the Audit/Risk Committee by the Chief Risk Officer.

## Risk Management Activities

OPG faces a wide array of risks as a result of its business operations. For the purposes of disclosure, these risks have been organized into the following five risk categories: (i) Operational; (ii) Financial; (iii) Regulatory; (iv) Enterprise-wide; and (v) Environmental. A brief overview of the significant risks that comprise each of these five categories is presented below.

## Operational Risks

Operational risks are those risks normally inherent in the operation of electricity generating facilities. These risks can lead to interruptions in the operations of generating stations or uncertainty in future production. Risks to OPG's diverse fleet of nuclear, hydroelectric and fossil-fuelled generating stations are a function of the age of the stations, and the technology.

OPG is also exposed to operational risks relating to a portfolio of major generation development projects that are currently underway or are planned.

### Nuclear Generating Stations

The uncertainty associated with production at OPG's nuclear stations is primarily caused by the condition of the plant components and systems, which are all subject to the effects of aging. To respond to this challenge, OPG has implemented extensive inspection and maintenance programs to monitor performance and identify corrective actions required to operate reliably, and within design parameters.

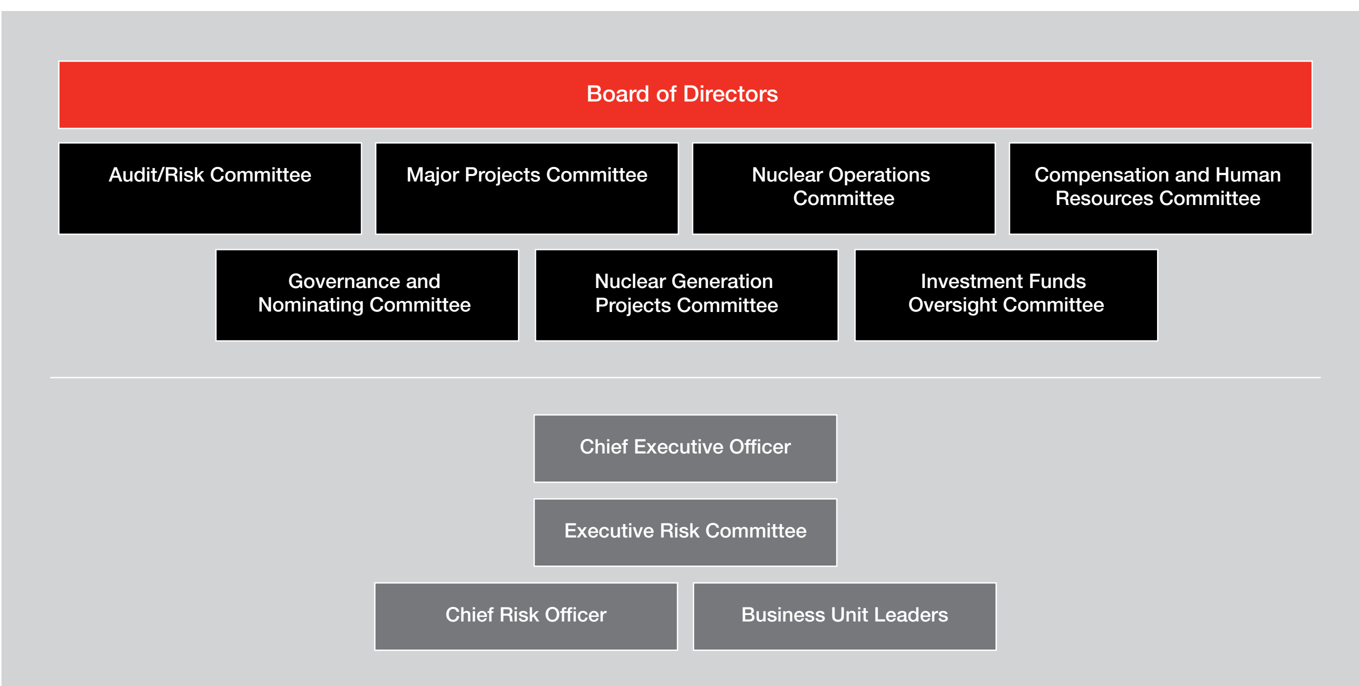
In certain cases, deterioration of plant components progresses in an unexpected manner, resulting in the need to increase monitoring, conduct extensive repairs, or undertake additional remedial measures. To maintain a safe operating margin, a nuclear unit could be derated. When an unexpected risk first appears, a specific monitoring program is established. The primary impact of these discovered risks on OPG is an increase in the long-term cost of operations. The associated mitigation may create additional outage work, thus increasing the number of outages or extending planned outages.

### Hydroelectric Generating Stations

Forecasting water levels for hydroelectric generation is inherently uncertain as water levels vary from year to year due in large part to the weather. The inherent uncertainty in forecasting water levels introduces a significant degree of uncertainty in forecasting hydroelectric generation. OPG manages this hydrology risk by using production forecasting models that incorporate unit efficiency characteristics, water flow conditions and outage plans. Inputs to the models are assessed, monitored and adjusted on an ongoing basis.

The risk associated with the uncertainty in water levels is partly mitigated by the hydroelectric production variance account that was established for OPG's regulated hydroelectric facilities.

**OPG's Risk Governance Structure**



OPG's hydroelectric generating stations vary in age. Over 75 percent of the hydroelectric generating capacity is over 50 years old. Due to the variability and age of the equipment and civil components, there is a risk that some facilities may require significant investment in the near future to sustain their reliability. OPG manages these reliability risks by performing maintenance of critical components, and conducting detailed engineering reviews, plant condition assessments and inspections in order to identify future work necessary to sustain and, if necessary, upgrade a plant.

The hydroelectric business segment operates 239 dams across the Province. Dam operations are subject to provincial dam safety regulations established by the Ministry of Natural Resources ("MNR"). Changes in these regulations by the MNR may result in costly structural enhancements for several of OPG's hydroelectric facilities.

### Fossil-Fuelled Generating Stations

In May 2008, the Province announced new annual limits on $CO_2$ emissions from OPG's coal-fired generating stations to reduce emissions by two-thirds of the 2003 levels by 2011. In accordance with the May 15, 2008 Shareholder Declaration and the May 16, 2008 Shareholder Resolution, OPG is required to develop a strategy to stage the reduction measures in 2009 and 2010 on a forecast basis. OPG must maintain operational readiness of these stations to meet peak demands, and hence the new operating strategy will have a negative impact on revenue and the costs to operate coal-fired units. The Province has agreed to ensure that OPG recovers its net book value and ongoing costs for Lambton and Nanticoke during the period 2009 to 2014.

### Major Development Projects

OPG is undertaking numerous projects designed to enhance and expand its electricity generating portfolio. The risks associated with these projects could adversely impact the Company's financial performance. Major projects include new nuclear units at OPG's Darlington site, potential refurbishment of existing nuclear generating stations, the Niagara Tunnel project, and other hydroelectric and fossil-fuelled projects.

*New Nuclear Units*

OPG is participating in the Ontario government's procurement process to select a nuclear reactor vendor for the Province of Ontario. Once a vendor is selected, OPG will manage this complex, multi-year project. Based on the experience of other new nuclear projects underway in other parts of the world, the risks presented by this project are regarded as significant. The identification and management of the risks are being considered as part of the process to select a nuclear reactor vendor.

*Niagara Tunnel Project*

As at December 31, 2008, the tunnel boring machine has progressed much slower than expected under the original contractor schedule, primarily due to excess overbreak of the Queenston shale in the tunnel crown. OPG and the contractor are using recommendations from the Dispute Review Board as a basis for negotiating revisions to the design-build contract. The revisions are expected to have a significant impact on the project cost estimate and completion schedule. Uncertainties will continue with respect to cost and schedule.

*Other Development Projects*

OPG is engaged in a number of other hydroelectric development projects and is investigating the potential for refurbishment of existing nuclear generating stations. These projects are exposed to a number of risks, including material and equipment cost escalation and delays in permits and approvals.

### Escalation of Material and Equipment Costs

Cost and availability of raw materials and equipment are significant factors for electricity generation projects. Recent economic conditions have precipitated declines in the prices of many commodities. However, costs of major equipment needed for civil construction projects may eventually be higher than forecast due in part to the scarcity of skilled labour and the decline in credit capital. OPG will continuously monitor such input costs and trends in order to keep abreast of emerging issues.

### Delays in Permits and Approvals

Numerous permits and approvals are required in a generation development project. Unforeseen delays in receiving permits or approvals, which may involve various external stakeholders, could result in schedule delays or ultimately, cancellation of a project. OPG attempts to mitigate risks associated with delays in receiving permits and approvals through early involvement and constant communication with applicable government agencies, close consultation with external stakeholders, and ongoing monitoring of contractor performance relative to permits.

## Financial Risks

OPG is exposed to a number of capital market-related risks that could adversely impact its financial and operating performance. Many of these risks arise due to OPG's exposure to volatility in commodity, equity, pension and OPEB costs, foreign exchange, and interest rate markets. OPG manages this complex array of risks to reduce the uncertainty or mitigate the potential unfavourable impact on the Company's financial results. Despite OPG's risk management measures, residual risk to financial results continues due to volatility in the markets.

### Commodity markets

Unpredictable increases in the price of fuels used to produce electricity can adversely impact OPG's earnings. To manage this risk, the Company has a fuel hedging program, which includes using fixed price and indexed contracts, as well as approved derivative products.

OPG's risk associated with changes in fuel costs for nuclear operations is partly mitigated by the nuclear fuel variance account established by the OEB in its recent decision on OPG's regulated payment amounts.

OPG's revenue is also affected by changes in the market or spot price of electricity. The Company takes steps, such as executing forward sales at fixed prices, to mitigate the impact that extreme variations in the spot price could have on the gross margin. In 2009, a difference of $1/MWh in the spot price of electricity compared to the annual average price forecast internally by OPG will impact OPG's gross margin by approximately $20 million. The impact of this difference is both linear and symmetric which reflects the relatively low probability of unexpected financial performance that may result from significantly higher or lower spot prices for electricity.

The percentages of OPG's expected generation, emission requirements and fuel requirements hedged are shown below:

| | 2009 | 2010 | 2011 |
|---|---|---|---|
| Estimated generation output hedged[1] | 89% | 83% | 83% |
| Estimated fuel requirements hedged[2] | 99% | 87% | 77% |
| Estimated nitric oxide ("NO") emission requirement hedged[3] | 100% | 100% | 100% |
| Estimated $SO_2$ emission requirement hedged[3] | 100% | 100% | 100% |

1 Represents the portion of megawatt hours of expected future generation production, including power purchases, for which the Company has sales commitments and contracts including the obligations under regulated pricing commitments, agreements with the IESO, the OPA auction sales and the revenue limit on OPG's unregulated assets (which ends on April 30, 2009).

2 Represents the approximate portion of megawatt hours of expected production (and fossil year-end inventory target) from all types of facilities (fossil, nuclear and hydroelectric) for which OPG has entered into some form of contractual arrangements or obligations in order to secure either the expected availability and/or price of fuel and/or fuel related services. Excess fuel inventory in a given year is attributed to the next year for the purpose of measuring hedge ratios. Since production from hydroelectric facilities is primarily influenced by expected weather and weather patterns, fuel hedge ratios for hydroelectric facilities are assumed to be 100 percent.

3 Represents the approximate portion of megawatt hours of expected fossil production for which OPG has purchased, been allocated or granted emission allowances and Emission Reduction Credits to meet its obligations under Ontario Environmental Regulation 397/01.

**Equity markets**

Unexpected volatility or loss due to the decline in the market value of individual equities and/or equity indices negatively impacts the value of OPG's Nuclear Funds and pension plan assets.

*Nuclear Funds Market Risk*

The weak performance of the global financial markets has negatively affected the market value of the investments held in the Decommissioning Fund. Although the Decommissioning Fund was underfunded at the end of 2008, under the terms of the ONFA between OPG and the Province, OPG is not required to increase the contributions to the Decommissioning Fund prior to the approval of a new ONFA Reference Plan, which is expected in 2011.

The impact on OPG caused by the decrease in value of the Decommissioning Fund has been partially offset by the creation of the Bruce revenues and costs variance account, which captures losses from the Nuclear Funds related to the Bruce generating stations.

For the Used Fuel Fund, the Province guarantees the annual rate of return at 3.25 percent plus the change in the Ontario Consumer Price Index for the first 2.23 million fuel bundles. By providing this rate of return guarantee for the Used Fuel Fund, the Province assumes the risk of the rate of return and therefore, the market volatility does not impact OPG's earnings from this fund.

*Pension and Other Post Employment Benefit Costs*

OPG's post employment benefit programs include pension, group life insurance, health care and long-term disability benefits. The Company's registered pension plan is a contributory defined benefit plan that is indexed to inflation and covers most employees and retirees.

Attractive long-run return characteristics of the equity market have made large equity allocations a common feature of defined-benefit pension plans. Due to the recent volatility in the global markets, a significant risk exists in meeting asset-return targets.

Contributions to OPG's pension plan are determined by actuarial valuations, which are filed with the appropriate regulatory authorities at least every three years. The most recently filed valuation was prepared as at January 1, 2008. As a result of the valuation, OPG will make annual pension contributions in 2009 and 2010 of approximately $260 million and $270 million, respectively. The next valuation will be prepared with an effective date no later than January 1, 2011. The required level of contributions for 2011 and the following two years will be dependent on a number of factors including future investment returns and changes in actuarial assumptions.

The costs of, and obligations for, pension and OPEB are calculated based on assumptions including the long-term rate of return on pension assets, discount rates for pension and OPEB obligations, expected service period of employees, wage or salary increases, inflation and health care cost trend rates. These assumptions are subject to significant changes as they require judgment and involve inherent uncertainties. The most significant assumptions used to calculate the net periodic cost of pension and OPEB are the discount rates for pension and OPEB, the expected return on pension fund assets, and the expected inflation rate for pension benefits.

The Company's future plan assets, accrued benefit obligations, pension and OPEB expenses, and pension contributions could be materially affected by: significant changes in assumptions driven by changes in financial markets; experience gains and losses; changes in the pension plan or regulatory environment; divestitures; and the measurement uncertainty incorporated into the actuarial valuation process.

### Foreign exchange and interest rate markets

OPG's financial results are exposed to volatility in Canadian/U.S. foreign exchange rate as fuels purchased for fossil and nuclear generation stations are paid in U.S. dollars. The magnitude of the impact of this volatility is largely a function of the quantity of the fuels purchased. In addition to this exposure, the market price of electricity in Ontario is influenced by the exchange rate because of the interaction between the Ontario and neighbouring U.S. interconnected electricity markets. In order to manage this risk, OPG employs various financial instruments such as forwards and other derivative contracts in accordance with approved risk management policies.

OPG has interest rate exposure on its short-term borrowings and investment programs. The majority of OPG's existing debt is at fixed interest rates. Interest rate risk arises with the need to undertake new financing and with the potential addition of variable rate debt. The management of these risks is undertaken by using derivatives to hedge the exposure in accordance with corporate risk management policies. OPG periodically uses interest rate swap agreements to mitigate elements of interest rate risk exposure associated with anticipated new financing. As of December 31, 2008, OPG had total interest rate swap contracts outstanding with a notional principal of $272 million.

### Trading

OPG's trading operations are closely monitored and total exposures are measured and reported to senior management on a daily basis. The metric used to measure the risk of this trading activity is known as "value at risk" or "VaR", which is defined as the potential future loss expressed in monetary terms for a portfolio based on normal market conditions for a set period of time. For 2008, the utilization of VaR fluctuated between $0.9 million to $4.2 million versus $0.5 million and $2.0 million for the previous year.

### Credit

The Company's credit exposure is a function of electricity sales and trading as well as commercial transactions with various suppliers of goods and services. OPG's credit exposure relating to electricity sales is considered low as the majority of sales are through the IESO-administered spot market. The IESO oversees the credit worthiness of all market participants.

OPG manages its exposure to various suppliers or "counterparties" by evaluating the financial condition of all counterparties and ensuring that appropriate collateral or other forms of security are held by OPG.

The following chart summarizes OPG's credit exposure to all counterparties as at December 31, 2008:

| | | | Potential Exposure for Largest Counterparties | |
|---|---|---|---|---|
| Credit Rating [1] | Number of Counterparties[2] | Potential Exposure[3] | Number of Counterparties | Counterparty Exposure |
| | | (millions of dollars) | | (millions of dollars) |
| Investment grade | 162 | 117 | 4 | 84 |
| Below investment grade | 53 | 111 | 6 | 93 |
| IESO[4] | 1 | 471 | 1 | 471 |
| Total | 216 | 699 | 11 | 648 |

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 parental guarantees, Letters of Credit or other forms of security.

2 OPG's counterparties are defined on the basis of individual master agreements.

3 Potential exposure is OPG's statistical assessment of maximum exposure over the life of each transaction at a 95 percent confidence interval.

4 Credit exposure to the IESO peaked at $897 million during the year ended December 31, 2008 and at $883 million during the year ended December 31, 2007.

### Liquidity

OPG operates in a capital intensive business. Significant financial resources are required to fund capital improvement projects and related maintenance programs at generating stations. In addition, the Company has other significant disbursement requirements including investment in new generating capacity, annual funding obligations under the ONFA, pension funding and continuing debt maturities with the OEFC. OPG must ensure it has the financial capacity and sufficient access to cost-effective financing sources to fund its capital requirements. A discussion of corporate liquidity is included in the *Liquidity and Capital Resources* section.

## Regulatory Risks

OPG is subject to regulation by entities including the OEB and the CNSC. The risks that arise from being a regulated entity include the inability to recover costs, reductions in revenue, increases in the cost of operations, and unexpected outages. These unfavourable impacts are mitigated by maintaining close contact with regulators and issuers of standards and codes to ensure early identification and discussion of issues.

#### Rate Regulation
The prices for electricity generated from most of OPG's baseload hydroelectric facilities and all of the nuclear facilities that it operates are determined by the OEB based on a forecast cost of service methodology and will remain in effect until the effective date of the OEB's next order. As with any regulated price established using a forecast cost of service methodology, there is an inherent risk that the prices established by the regulator may not provide for recovery of all actual costs incurred by regulated operations or may result in the regulated operations not earning its allowed rate of return.

#### Nuclear Regulatory Requirements
The uncertainty associated with nuclear regulatory requirements is primarily driven by plant aging, technology risks and changes to technical codes. Proactively addressing these requirements adds to the cost of operations and in some instances, may result in a reduction in the productive capacity of a plant, or in the earlier than planned replacement of a plant component.

OPG manages uncertainty associated with nuclear regulatory requirements by maintaining close contact with the regulator and issuers of standards and codes for the early identification and discussions of issues.

### Enterprise-Wide Risks

#### Human Resources
The risk associated with the availability of skilled and experienced resources continues to exist for OPG. The urgency of this risk will continue to remain high as a growing percentage of staff become eligible to retire. In order to mitigate the impact of this risk, OPG implemented a "Resourcing Strategy Initiative" in 2008, which includes aggressive recruitment strategies, workforce planning and ongoing analysis of potential shortfalls.

OPG's continued commitment to building and strengthening internal capabilities is evidenced by further development of an integrated leadership competency model, focused succession planning efforts, and enhanced supervisory training.

#### Health and Safety
A robust safety culture, evidenced by continuous improvement in safety management and risk controls program, exists at OPG. The importance of safety is continually reinforced in OPG's Corporate Safety Rules, which emphasize higher standards for accountability and training in high risk areas.

The Company's commitment to health and safety is also evident in OPG's Emergency Management program. This program is designed to respond to incidents or developments that could threaten the safety of various stakeholders as well as the continuity of OPG's business operations. The program complies with provincial and federal regulations as they relate to emergency prevention, preparedness, and response and recovery requirements.

#### Corporate Reputation
As a provider of a large portion of the Province's electricity requirements, maintaining a positive corporate reputation is critical for OPG. OPG focuses on building and maintaining its reputation through many practices, including corporate citizenship initiatives across the Province, appropriate and transparent governance practices, and effective communication with stakeholders. In addition, OPG undertakes continuous improvement initiatives in various assurance and risk management activities.

### Environmental Risks
Changes to environmental laws or delays in implementing the current timetable of the Province's coal plant closure policy could create compliance risks that may be addressed by the installation of additional equipment or control technologies, the purchase of additional emission reduction credits, or by constraining production from the fossil-fuelled fleet. In addition, a failure to comply with applicable environmental laws may result in enforcement actions, including the potential for orders or charges. Further, some of OPG's activities have the potential to cause contamination to land or water that may require remediation. The potential liability associated with any of these events could have a material adverse effect on the business.

In order to meet the federal and provincial GHG emission targets previously identified under the heading, *Environmental Stewardship*, there is a risk that OPG will be required to either reduce GHG emissions or purchase offsets, which could have a material adverse impact to OPG.

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

These transactions are summarized below:

| (millions of dollars) | Revenue 2008 | Expenses 2008 | Revenue 2007 | Expenses 2007 |
|---|---|---|---|---|
| Hydro One | | | | |
| Electricity sales | **35** | **–** | 28 | – |
| Services | **–** | **7** | – | 12 |
| Province of Ontario | | | | |
| GRC water rentals and land tax | **–** | **151** | – | 129 |
| Guarantee fee | **–** | **4** | – | 8 |
| Used Fuel Fund rate of return guarantee | **–** | **(971)** | – | (130) |
| Decommissioning Fund excess funding | **–** | **(3)** | – | (291) |
| OEFC | | | | |
| GRC and proxy property tax | **–** | **215** | – | 199 |
| Interest income on receivable | **–** | **–** | – | (6) |
| Interest expense on long-term notes | **–** | **215** | – | 187 |
| Capital tax | **–** | **36** | – | 35 |
| Income taxes | **–** | **88** | – | (51) |
| Indemnity fees | **–** | **–** | – | – |
| IESO | | | | |
| Electricity sales | **5,330** | **127** | 5,094 | 104 |
| Revenue limit rebate | **(277)** | **–** | (227) | – |
| Ancillary services | **155** | **–** | 145 | – |
| Other | **–** | **–** | – | 1 |
| | **5,243** | **(131)** | 5,040 | 197 |

At December 31, 2008, accounts receivable included nil (2007 – $2 million) due from Hydro One and $207 million (2007 – $179 million) due from the IESO. Accounts payable and accrued charges at December 31, 2008 included $1 million (2007 – $2 million) due to Hydro One.

## CORPORATE GOVERNANCE

### Corporate Governance

National Instrument 58-101, *Disclosure of Corporate Governance Practices*, has been implemented by Canadian securities regulatory authorities to provide greater transparency for the marketplace regarding issuers' corporate governance practices. Information with respect to OPG's Board of Directors is as follows:

### Board of Directors and Directorships

OPG's Board of Directors is made up of 12 individuals with substantial capability in managing and restructuring large businesses, managing and operating nuclear stations, managing capital intensive companies, finance and capital markets, and overseeing regulatory, government and public relations. The Board exercises its independent supervision over management as follows: the majority of members of the Board of Directors are independent of the Company; meetings of the Board of Directors are held at least six times a year; a formal Charter for the Board of Directors, and for each Board Committee, has been adopted; each Board Committee is chaired by an independent director; and a portion of each Board and Committee meeting is reserved for directors to meet without management present. The Board delineates the respective role and responsiblities of the Board from that of the President and Chief Executive Officer ("CEO") through the By-laws, Board Charter, Board policies and the CEO's annual goals and objectives.

All directors listed are independent within the meaning of Section 1.4 of National Instrument 52-110 of the Canadian Securities Administrators ("NI 52-110") except for Jim Hankinson who is the CEO of OPG and Gary Kugler who is the Chairman of the Nuclear Waste Management Organization ("NWMO").

At the request of the Board of Directors, Dr. Kugler serves as a Director and Chairman of the NWMO, an organization which is in effect controlled by OPG by virtue of OPG's proportionately larger financial responsibility for nuclear fuel. The Board of Directors believes that Dr. Kugler's service as Director and Chairman is in the best interests of OPG, the NWMO, and OPG's stakeholders, in view of his experience and extensive knowledge of the Canadian nuclear industry, and does not affect his ability to exercise impartial judgment and fulfill his committee responsibilities. As a result, OPG's Board of Directors has determined that it is appropriate for Dr. Kugler to serve as a non-independent member on his current OPG Committees, in accordance with NI 52-110.

The following are the directors of OPG as at February 13, 2009.

**Jake Epp**
Age: 69
Calgary, Alberta, Canada

Jake Epp was appointed as Chairman of the Board of Ontario Power Generation Inc. in April 2004. He held the position of interim Chairman from December 2003 until his current appointment. Jake Epp was a member of the provincial government's review committee that was created in December 2003 and headed by John Manley, to look at OPG's future role in the province's electricity market; examine its corporate and management structure; and decide whether OPG should go ahead with refurbishing three more nuclear reactors at the Pickering A nuclear power plant. The committee's report was presented to the government in March 2004. In May 2003, he was appointed by the Ontario government to lead a panel to review the delays and cost overruns at the Pickering A nuclear generating station. The findings of the report were released in December 2003. He is also certified by the Institute of Corporate Directors.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since December 2003) | 7 of 7 | 100% |
| Compensation and Human Resources Committee (since November 2004) | 7 of 7 | 100% |
| Governance and Nominating Committee (since August 2005) | 3 of 3 | 100% |
| Nuclear Generation Projects Committee (since November 2006) | 6 of 6 | 100% |
| The Board Chair attends all other committee meetings | 17 of 17 | 100% |

**Principal Occupation**
Chairman, Ontario Power Generation Inc. Board of Directors

**Board Memberships for other Reporting Issuers**
None

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers**
None

**James F. Hankinson**
Age: 65
Toronto, Ontario, Canada

James Hankinson was appointed as President and Chief Executive Officer of Ontario Power Generation Inc. in May 2005. He has broad management experience in energy, transportation, resource and manufacturing-based businesses. He served as President and Chief Executive Officer of New Brunswick Power Corporation from 1996 to 2002, and during that time, had a significant impact on improving the operational and financial position of the company. In 1973, he joined Canadian Pacific Limited, and served as Chief Operating Officer from 1990 to 1995. A chartered accountant, Mr. Hankinson has a Master of Business Administration from McMaster University, and a Honorary Doctor of Laws degree from Mount Allison University. He also sits on the Boards of CAE Inc. and Maple Leaf Foods Inc.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since December 2003) | 7 of 7 | 100% |
| The President and CEO attends all committee meetings | 32 of 33 | 97% |

**Principal Occupation**
President and Chief Executive Officer, Ontario Power Generation Inc.

**Board Memberships for other Reporting Issuers**
CAE Inc.
Maple Leaf Foods Inc.

**Independence from OPG**
Not Independent (Member of Management)

**Interlocking Directorships on Boards of other Reporting Issuers:**
None

## Donald Hintz

Age: 66
Punta Gorda, Florida, U.S.A.

Donald Hintz is the retired President of Entergy Corporation, where he was responsible for Entergy's 30,000 megawatts of generating assets, including 10 nuclear plants. Prior to his appointment as President, he spent seven years as President and CEO of Entergy Operations Inc. Here he oversaw the improvement of Entergy's nuclear operations to top quartile performance. Mr. Hintz currently serves on the Board of Entergy Corporation and through May 2008 was the President of the American Nuclear Society, an international organization of more than 10,500 nuclear scientists and engineers. He has a Bachelor of Science in Chemical Engineering from the University of Wisconsin, and has completed the Utility Executive Program and the Advanced Management Program at the University of Michigan and the Harvard Business School, respectively.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since October 2004) | 7 of 7 | 100% |
| Compensation and Human Resources Committee (since November 2004) | 7 of 7 | 100% |
| Nuclear Operations Committee* (since November 2004) | 5 of 5 | 100% |
| Nuclear Generation Projects Committee (since November 2006) | 6 of 6 | 100% |

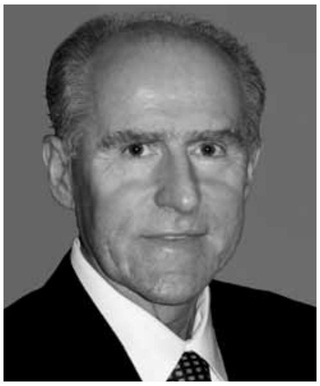
* Chair of Committee

**Principal Occupation**
Retired President of Entergy Corporation

**Board Memberships for other Reporting Issuers**
Entergy Corporation

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers**
None



## Gary Kugler

Age: 68
Burlington, Ontario, Canada

Dr. Gary Kugler currently serves as Chairman of the Board of the Nuclear Waste Management Organization. He is the retired Senior Vice President, Nuclear Products and Services of Atomic Energy of Canada, Limited (AECL), where he was responsible for all of AECL's commercial operations, including nuclear power plant sales and services world-wide. During his 34 years with AECL, he also held various technical, project management, and business development positions. Prior to joining AECL, he served as a pilot in the Canadian air force. He holds a Bachelor of Science degree in honours physics and a Ph.D. in nuclear physics from McMaster University.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since September 2004) | 7 of 7 | 100% |
| Audit/Risk Committee (November 2004 – December 2008) | 4 of 4 | 100% |
| Compensation and Human Resources Committee (since December 2008) | – | – |
| Governance and Nominating Committee (since August 2005) | 3 of 3 | 100% |
| Nuclear Operations Committee (since November 2004) | 5 of 5 | 100% |
| Nuclear Generation Projects Committee (since November 2006) | 6 of 6 | 100% |

**Principal Occupation**
Chairman, Nuclear Waste Management Organization

**Board Memberships for other Reporting Issuers**
None

**Independence from OPG**
Not Independent (Chairman of Nuclear Waste Management Organization)

**Interlocking Directorships on Boards of other Reporting Issuers**
None

**M. George Lewis**
Age: 48
Toronto, Ontario, Canada

George Lewis is Group Head, Wealth Management, RBC Financial Group. Mr. Lewis is also Chairman of RBC Asset Management Inc. Prior to his current appointment, Mr. Lewis was Head of Wealth Management for the Canadian Personal and Business segment of RBC FG, Canada's largest bank, as well as serving as Head of all Products for that segment. Formerly he was Managing Director, Head of Institutional Equity Sales, Trading and Research with RBC Capital Markets and was Canada's top-rated analyst for three consecutive years. He has extensive experience in the investment industry and has a Master of Business Administration degree with distinction from Harvard University, a Bachelor of Commerce degree with high distinction from Trinity College at the University of Toronto and is a chartered financial analyst and chartered accountant, as well as being certified by the Institute of Corporate Directors. Mr. Lewis serves on the Board of Directors of the Bloorview Kids Foundation, the Anglican Diocese of Toronto Foundation, and the Toronto Symphony Orchestra. He is Chair of the Bishop's Company of the Anglican Diocese of Toronto, as well as a member of the Cabinet and Patron of the United Way of Greater Toronto and Patron of Operation Springboard.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since February 2005) | 6 of 7 | 86% |
| Audit/Risk Committee* (since February 2005) | 4 of 4 | 100% |
| Investment Funds Oversight Committee (since March 2005) | 3 of 3 | 100% |

* Chair of Committee

**Principal Occupation**
Group Head, Wealth Management, RBC Financial Group

**Board Memberships for other Reporting Issuers**
None

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers:**
None

**David J. MacMillan**
Age: 55
Barnes, London, United Kingdom

David MacMillan is a Managing Director of Good Energies, a European-based multi-billion dollar private equity fund that invests in renewable energy technology companies and renewable energy companies and projects worldwide. Until early 2008, he was a Non-Executive Director of InterGen N.V., an international owner and operator of utility scale power generation plants. He has extensive international experience in the power generation sector with a focus on investment strategy and financing. Mr. MacMillan was also a former Director of Killingholme Power Limited. Mr. MacMillan holds a B.A. and a M.A. of Economics from McGill University.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since September 2004) | 7 of 7 | 100% |
| Major Projects Committee* (since November 2004) | 6 of 6 | 100% |
| Nuclear Operations Committee (since November 2004) | 5 of 5 | 100% |

* Chair of Committee

**Principal Occupation**
Partner – Good Energies

**Board Memberships for other Reporting Issuers**
None

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers**
None

## Corbin A. McNeill Jr.

Age: 69
Jackson, Wyoming, U.S.A

Corbin McNeill is the retired Chairman and Co-Chief Executive Officer of Exelon Corporation, which was formed by the merger of PECO Energy and Unicom Corp. At PECO, he had been Chairman, President and CEO, having joined PECO in 1988 as Executive Vice President, Nuclear. Prior to PECO, he oversaw nuclear operations at the Public Service Electric and Gas Company and the New York Power Authority. Mr. McNeill currently serves as a Director of Owens-Illinois Inc. and Portland General Electric. Mr. McNeill has a Bachelor of Science degree from the U.S. Naval Academy and has completed the Executive Management Program at Stanford University.

| Board/Committee Membership: | 2008 Attendance: | |
|---|---|---|
| Board (since October 2004) | 7 of 7 | 100% |
| Audit/Risk Committee (since December 2008) | – | – |
| Governance and Nominating Committee* (since August 2005) | 3 of 3 | 100% |
| Investment Funds Oversight Committee (May 2005 – May 2008) | 0 of 1 | 0% |
| Nuclear Operations Committee (since November 2004) | 5 of 5 | 100% |
| Nuclear Generation Projects Committee* (since November 2006) | 6 of 6 | 100% |

* Chair of Committee

**Principal Occupation**
Retired Chairman and Co-Chief Executive Officer of Exelon Corporation

**Board Memberships for other Reporting Issuers**
Owens-Illinois Inc.
Portland General Electric Company

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers:**
None

## Peggy Mulligan

Age: 50
Mississauga, Ontario, Canada

Peggy Mulligan is the Chief Financial Officer, Biovail Corporation. Mrs. Mulligan was most recently a Principal at Priiva Consulting. Prior to that she served as Executive Vice President and Chief Financial Officer of Linamar Corporation. Prior to Linamar, Mrs. Mulligan was with the Bank of Nova Scotia for 11 years as Executive Vice President, Systems and Operations and Senior Vice President, Audit and Chief Inspector. Before joining Scotiabank, she was an Audit Partner with PricewaterhouseCoopers in Toronto. Peggy Mulligan currently serves on the Board of Resolve Business Outsourcing Income Fund. She holds a B. Math (Honours) from the University of Waterloo and was named a Fellow Chartered Accountant (FCA) by the Institute of Chartered Accountants of Ontario in 2003.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since December 2005) | 6 of 7 | 86% |
| Audit/Risk Committee (since February 2006) | 4 of 4 | 100% |
| Investment Funds Oversight Committee* (since February 2007) | 3 of 3 | 100% |
| Nuclear Generation Projects Committee (since May 2008) | 2 of 4 | 50% |

* Chair of Committee

**Principal Occupation**
Chief Financial Officer, Biovail Corporation

**Board Memberships for other Reporting Issuers**
Resolve Business Outsourcing Income Fund

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers**
None

**C. Ian Ross**
Age: 66
Collingwood, Ontario, Canada

Ian Ross served at the Richard Ivey School of Business at the University of Western Ontario from 1997 to September 2003. Most recently he held the position of Senior Director, Administration in the Dean's Office, and was also Executive in Residence for the School's Institute for Entrepreneurship, Innovation and Growth. He has served as Governor and President and CEO of Ortech Corporation; Chairman, President and CEO of Provincial Papers Inc.; and President and CEO of Paperboard Industries Corp. Mr. Ross currently serves as a Director for a number of corporations including Menu Foods Income Trust, GrowthWorks Canadian Fund Ltd., PetValu Canada Inc., RuggedCom Ltd., eJust Systems (formerly Praeda Managements Systems) and the Nuclear Waste Management Organization (NWMO). He is also a member of the Law Society of Upper Canada.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since December 2003) | 7 of 7 | 100% |
| Audit/Risk Committee (since November 2004) | 4 of 4 | 100% |
| Governance and Nominating Committee (since August 2005) | 3 of 3 | 100% |
| Major Projects Committee (since November 2004) | 6 of 6 | 100% |
| Nuclear Generation Projects Committee (since November 2006) | 6 of 6 | 100% |

**Principal Occupation**
Chairman, GrowthWorks Canadian Fund Ltd.

**Board Memberships for other Reporting Issuers**
Clearford Industries Inc.
GrowthWorks Canadian Fund Ltd.
Menu Foods Income Trust
PetValu Canada Inc.
RuggedCom Ltd.

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers**
None

**Marie C. Rounding**
Age: 61
Toronto, Ontario, Canada

Marie Rounding is Counsel at Gowling Lafleur Henderson LLP where she is a member of the National Energy and Infrastructure Industry Group. On November 1, 2007, she was appointed by Prime Minister Stephen Harper to the Advisory Council on National Security. Ms. Rounding served as Chair of the Ontario Energy Board from 1992 to 1998 and as President and Chief Executive Officer of the Canadian Gas Association from 1998 to 2003. Prior to those appointments she was Director of the Crown Law Office, Civil Law at the Ontario Ministry of the Attorney General. She has extensive background in regulatory and administrative law, and as a leading regulator was involved in the deregulation of the natural gas markets and the early restructuring of the electricity sector in Ontario. Ms. Rounding currently serves as a Director for Nova Scotia Power Inc. and as a member of the Independent Review Committee for Sentry Select Capital Corp. and several related entities. She is a graduate of the University of Western Ontario and Osgoode Hall Law School and is certified by the Institute of Corporate Directors.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since September 2004) | 7 of 7 | 100% |
| Investment Funds Oversight Committee (since May 2005) | 3 of 3 | 100% |
| Major Projects Committee (since November 2004) | 5 of 6 | 83% |
| Nuclear Operations Committee (since February 2007) | 5 of 5 | 100% |

**Principal Occupation**
Counsel, Gowling Lafleur Henderson LLP

**Board Memberships for other Reporting Issuers**
Nova Scotia Power Inc.

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers**
None

## William Sheffield
Age: 60
Toronto, Ontario, Canada

William Sheffield is the former Chief Executive Officer of Sappi Fine Paper plc., and a former Executive Vice President of International Operations and Corporate Development at Abitibi Consolidated. He has experience in operating large international industries. He also spent 17 years with Stelco. Mr. Sheffield currently serves on the Boards of Velan Inc., Canada Post, Houston Wire & Cable Company and Corby Distilleries. Mr. Sheffield has a B.Sc. in Chemistry from Carleton University, an M.B.A. from McMaster University and completed the Advanced Management Program at INSEAD School of Business, France, and is certified by the Institute of Corporate Directors.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since September 2004) | 7 of 7 | 100% |
| Compensation and Human Resources Committee* (since November 2004) | 7 of 7 | 100% |
| Investment Funds Oversight Committee (since February 2005) | 3 of 3 | 100% |
| Major Projects Committee (since November 2004) | 6 of 6 | 100% |

* Chair of Committee

**Principal Occupation**
Corporate Director

**Board Memberships for other Reporting Issuers**
Corby Distilleries Ltd.
Houston Wire & Cable Company
Velan Inc.

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers**
None

## David G. Unruh
Age: 64
Vancouver, British Columbia, Canada

David Unruh is a retired lawyer and general counsel currently serving as a Director of Union Gas Limited, Pacific Northern Gas Ltd., Corriente Resources Inc., The Wawanesa Mutual Insurance Company, TransLink (South Coast British Columbia Transportation Authority), Canada Line Rapid Transit Inc., and Globe Foundation of Canada. Prior to this, Mr. Unruh served as Vice Chairman of Westcoast Energy Inc. and Union Gas Limited, before that as Senior Vice President and General Counsel for Houston-based Duke Energy Gas Transmission and, before that as Senior Vice President, Law and Corporate Secretary of Westcoast Energy Inc. Mr. Unruh practiced corporate and commercial law in Winnipeg, Manitoba, before joining Westcoast Energy Inc. in Vancouver, British Columbia, in 1993.

| Board/Committee Membership | 2008 Attendance | |
|---|---|---|
| Board (since September 2004) | 7 of 7 | 100% |
| Audit/Risk Committee (since November 2004) | 4 of 4 | 100% |
| Compensation and Human Resources Committee (since November 2004) | 7 of 7 | 100% |
| Governance and Nominating Committee (since December 2008) | – | – |
| Major Projects Committee (since December 2004) | 6 of 6 | 100% |

**Principal Occupation**
Corporate Director

**Board Memberships for other Reporting Issuers**
Corriente Resources Inc.
Pacific Northern Gas Ltd.
Union Gas Limited

**Independence from OPG**
Independent

**Interlocking Directorships on Boards of other Reporting Issuers**
None

### Orientation and Continuing Education

The Governance and Nominating Committee is responsible for reviewing and recommending appropriate orientation and education programs to the Board. New directors are provided relevant documentation relating to OPG's governance practices, policies and to its business. Directors attend comprehensive introductory briefing sessions from senior executives on OPG's operations and business and plant tours are provided to OPG generating facilities.

The Board supports the continuing education of directors, in both the business of OPG and their duties as directors. Annual plant tours of major facilities and, based on requests from directors, special presentations by internal and external experts are made to the Board or a Committee on topical business-related issues or on specific aspects of OPG's operations. OPG also sponsors the professional certification of its directors.

### Ethical Business Conduct

OPG has a policy for ethical business behaviour and a Code of Business Conduct, which is approved by the Board. The Audit/Risk Committee Charter expressly includes regular reporting by Management on the Code of Business Conduct, including reports on substantiated cases of fraud and the disposition of such cases including disciplinary action. The Audit/Risk Committee also receives an annual report on the Code of Business Conduct in order to satisfy itself that appropriate codes of conduct and compliance programs are in place and are being enforced and remedial action is being taken. A copy of OPG's Code of Business Conduct has been filed on SEDAR (www.sedar.com). The Audit/Risk Committee has also established procedures for the receipt, retention and treatment of complaints received pertaining to internal accounting controls or auditing matters and the confidential anonymous submission by employees concerning such matters.

The Board has a Board of Directors Conflict of Interest Policy to deal with real or potential conflicts of interest and has adopted an annual process of written disclosure of information by directors in order to: (i) identify potential conflicts of interest for the purposes of complying with the Board of Directors Conflict of Interest Policy and with the Ontario Business Corporations Act, (ii) validate their independence and financial literacy for the purposes of complying with securities regulations related to Boards and Audit Committees, and (iii) satisfy other disclosures and filings.

### Nomination of Directors

The Governance and Nominating Committee's responsibilities are to: (i) develop and maintain a list of optimum skills which the Board should collectively possess, (ii) recommend a process to identify director candidates, (iii) recommend selection criteria, (iv) identify director candidates to the Board and (v) recommend to the Board the candidates to stand for election. The Board submits recommended candidates to the shareholder. Nominations of directors by the shareholder are also reviewed by the Governance and Nominating Committee.

The Governance and Nominating Committee consists of five members, four of which are independent of OPG within the meaning of NI 52-110.

### Compensation

#### Director Compensation

The Governance and Nominating Committee is responsible for annually monitoring and reviewing the level and nature of compensation of directors. In 2008, the Governance and Nominating Committee reviewed OPG's Director Compensation against comparable public and private companies and recommended that no change be made to the compensation of directors.

Each director who is not an employee of OPG receives an annual retainer of $25,000. Directors also receive a $3,000 annual retainer to chair committees and for each committee that they are a member of. In recognition of the increased duties and responsibilities placed upon the chair of the Audit/Risk Committee as a result of recent regulatory initiatives in North America, the annual retainer for the Audit/Risk Committee chair is $8,000.

Directors are compensated for each meeting that they attend and receive a fee of $1,500 or $750, as determined by the Board or Committee chair.

In order to retain national and international expertise, non-resident directors are compensated in U.S. dollars exchanged at par and directors who travel long distances receive a travel fee to cover travel time related to Board and Committee meetings they attend.

Directors are also reimbursed for travel and other expenses they incur to attend meetings or to perform other duties in their role as a director.

The Chair of the Board in his role as non-executive Chair receives an all-inclusive annual fee of $150,000 and is reimbursed for out-of-pocket expenses including travel and other expenses.

#### CEO Compensation

The Compensation and Human Resources Committee of the Board consists of five members, four of whom are independent of OPG within the meaning of NI 52-110. The Committee oversees, on behalf of the Board, the setting of the CEO's annual goals and objectives and the annual review of CEO performance, and makes recommendations to the Board with respect to CEO compensation. The Compensation and Human Resources Committee seeks input from an independent advisor with regard to monitoring and benchmarking compensation developments.

During 2008, the Compensation and Human Resources Committee of the Board retained an independent advisor from Mercer Human Resource Consulting, to review the compensation package for the President and CEO and to confirm that the compensation package is appropriate given the nature, complexity and risk profile of OPG's business. The Compensation and Human Resources Committee submitted its recommendation to the Board for approval. The approved executive compensation was publicly disclosed.

## Board Committees

The Board has established seven standing committees to focus on areas critical to the Company:

### Audit/Risk Committee

The Committee is responsible for reviewing the Company's regulatory filings including consolidated financial statements, MD&A, and press releases prior to their disclosures to the public. The Committee is also responsible for overseeing the internal audit function, the work of external auditors including their nomination and compensation, that the Company has adequate controls in the financial reporting process and the risk management process, and is in compliance with regulatory and internal policies. The Committee is also responsible for overseeing OPG's policy on ethical behaviour and the Code of Business Conduct, including reports on compliance programs, substantiated cases of fraud and the disposition of such cases including disciplinary action.

### Compensation and Human Resources Committee

This Committee focuses on human resources related areas including compensation practices, CEO objectives and compensation, disclosure on compensation and human resources matters, leadership talent review including succession planning, human resources policies related to employee complaints, diversity and pay equity, organizational design, labour relations, pension plans and policies, and Board compensation, education and evaluation programs.

### Governance and Nominating Committee

The Committee develops governance principles for OPG that are consistent with high standards of corporate governance and reviewing and assessing on an ongoing basis OPG's system of corporate governance with a view to maintaining these high standards. The Committee identifies and recommends candidates for election or appointment to the Board to be put before the shareholder in the event of a vacancy on the Board. Finally, the Committee reviews and recommends OPG's processes for director orientation, assessment, and compensation.

### Investment Funds Oversight Committee

This Committee assists the Board in fulfilling its responsibilities for the OPG Pension Fund, the Used Fuel Fund and the Decommissioning Fund. The Committee provides oversight of the investment of assets, investment-related liabilities and the management of any surplus (deficit) of the funds. Specifically the Committee: reviews the investment policies, risks and the asset mix; approves annual performance objectives for the investment portfolios; and monitors the performance of the funds.

### Major Projects Committee

This Committee assists the Board in providing oversight of major non-nuclear electricity supply projects, including project development, contracting, financing, and construction monitoring.

### Nuclear Generation Projects Committee

This Committee was formed in 2006 following direction from the shareholder to: (i) begin feasibility studies on refurbishing its existing nuclear units, and (ii) to begin a federal approvals process, including an environmental assessment, for new nuclear units at an existing site. This Committee assists the Board in providing oversight of the new nuclear plant projects and the refurbishment and life extension projects for existing nuclear plants.

### Nuclear Operations Committee

This Committee is responsible for oversight of safe and efficient operations of OPG's nuclear business, regulatory compliance of OPG's nuclear facilities, review of reports from independent oversight of OPG's nuclear operations, reviews of OPG's nuclear management and organization matters, security of OPG's nuclear facilities and substances, and oversight of OPG's nuclear waste and decommissioning liabilities and management.

## Assessments

The Governance and Nominating Committee is responsible for the annual process for evaluating the performance of the Board, its Committees and its individual directors. The Board and Committee evaluations are based upon the completion of confidential questionnaires regarding assessment of its performance and the compliance with the Board and Committee Charters. Director evaluations are based on self-assessment questionnaires, which are submitted in confidence to the Board Chair and the Chair of the Governance and Nominating Committee. The annual process is overseen by the Chair of the Governance and Nominating Committee, who reports the results and recommendations for enhancing oversight to the Board.

## Further Information on OPG Governance

OPG provides additional information on OPG's governance on its website (www.opg.com) including:

- Memorandum of Agreement
- Shareholder Directives
- Board and Committee Charters
- Board and Committee Chair Position Descriptions
- Board of Directors Conflict of Interest Policy
- Code of Business Conduct
- Disclosure Policy
- Environment Policy
- Health and Safety Policy
- Dam Safety Policy
- Nuclear Safety Policy

## AUDIT/RISK COMMITTEE INFORMATION

NI 52-110, Audit Committees, has been implemented by Canadian securities regulatory authorities to encourage reporting issuers to establish and maintain strong, effective and independent audit committees, which enhance the quality of financial disclosure and ultimately foster increased investor confidence in Canada's capital markets. Information on OPG's Audit/Risk Committee, which includes the text of the Audit/Risk Committee Charter, is as follows:

## Audit/Risk Committee Charter

### Purpose

The purpose of the Audit/Risk Committee is to assist the Board in fulfilling its oversight responsibilities by reviewing, advising and making recommendations to the Board on:

- The integrity, quality and transparency of the Company's financial information;
- The adequacy of the financial reporting process;
- The systems of internal controls and risk management, and the Company's related principles, policies and procedures which Management have established;
- The performance of the Company's internal audit function and the external auditors;
- The external auditors' qualifications and independence;
- The Company's compliance with related legal and regulatory requirements and internal policies; and
- The promotion of a culture of ethical business conduct and compliance with OPG's Code of Business Conduct.

The function of the Audit/Risk Committee is oversight. Management is responsible for the preparation, presentation and integrity of the consolidated financial statements of the Company. Management of the Company is responsible for maintaining appropriate accounting and financial reporting principles and policies and internal controls and procedures that provide for compliance with accounting standards and applicable laws and regulations.

### Organization

*Members*

The Audit/Risk Committee shall consist of three or more independent Directors appointed by the Board of Directors, none of whom shall be employees of the Company or any of the Company's affiliates. A majority of the members of the Committee, but not less than two, will constitute a quorum. As a venture issuer, OPG is exempt from the statutory requirements of NI 52-110 requiring members of Audit Committees be independent and financially literate. However, OPG considers such independence and financial literacy to be "best practice" and therefore each of the members of the Audit/Risk Committee shall satisfy the applicable independence and financial literacy requirements of the laws and regulations governing Audit Committees.

The Board of Directors shall designate one member of the Audit/Risk Committee as the Committee Chair. Members of the Audit/Risk Committee shall serve at the pleasure of the Board of Directors for such term or terms as the Board of Directors may determine. The Board of Directors shall confirm that each member of the Audit/Risk Committee is financially literate as such qualification is interpreted by the Board of Directors in its business judgment and in compliance with NI 52-110 and its Companion Policy.

*Meetings*

The Committee will meet at least quarterly or more frequently as circumstances require and at any time at the request of a member. The Committee will meet regularly and at least annually with the external auditors, the internal auditors and Management in separate sessions to discuss any matters that the Committee believes should be discussed and to provide a forum for any relevant issues to be raised.

*Reports*

The Committee will report its activities and actions to the Board of Directors with recommendations, as the Committee deems appropriate.

The Committee will provide for inclusion in the Company's financial information or regulatory filings any report from the Audit/Risk Committee required by applicable laws and regulations and stating, among other things, whether the Audit/Risk Committee has:

- Reviewed and discussed the audited consolidated financial statements with Management;
- Discussed pertinent matters with the internal and external auditors;
- Received disclosures from the external auditors regarding the auditors' independence and discussed with the auditors their independence; and
- Recommended to the Board of Directors that the audited consolidated financial statements be included in the Company's Annual Report.

### Authority

While the Audit/Risk Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit/Risk Committee to plan or conduct audits or risk assessments, or to determine that the Company's consolidated financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibility of Management and the external auditor.

In carrying out its oversight responsibilities, the Audit/Risk Committee and the Board will necessarily rely on the expertise, knowledge and integrity of the Company's Management, and internal and external auditors.

The Audit/Risk Committee shall have the authority to set and pay the compensation for any advisors employed by the Committee.

The Audit/Risk Committee shall have the authority to communicate directly with the internal and external auditors.

*Delegation of Authority*
The Committee may delegate to any employee of OPG or a sub-committee the authority to: (i) execute or carry out any decision of the Committee; and/or (ii) exercise any right, power or function of the Committee on such terms and conditions and within such limits as the Committee may establish, except that the Committee may not delegate its oversight responsibilities.

*Access to Management and Outside Advisors*
The Audit/Risk Committee shall have unrestricted access to members of Management and relevant information. The Audit/Risk Committee may retain independent counsel, accountants or other advisors to assist it in the conduct of any investigation, as it determines necessary to carry out its duties.

**Committee Responsibilities and Duties**
The Committee shall:

*General*
- Conduct or authorize investigations into any matters within the Committee's scope of responsibilities; and
- Review and recommend approval to the Board, the appointment or replacement of the CFO and the CRO.

*Risk Management and Internal Controls*
- Review and evaluate the Company's policies and processes for assessing significant risks or exposures and the steps Management has taken to monitor and control such risks to the Company, including the organizational structure and the adequacy of resources;
- Consider and review with the CRO and Management the critical risks to the Company, the potential impact of such risks, and related mitigation;
- Ascertain whether the Company has an effective process for determining risks and exposure from actual and potential litigation and claims relating to non-compliance with laws and regulations;
- Review with Management, reports demonstrating compliance with risk management policies;
- Review with the Company's General Counsel and others any legal, tax, or regulatory matters that may have a material impact on Company operations and the financial statements, including, but not limited to, violations of securities law or breaches of fiduciary duty;
- Review with Management, internal audit, and the external auditors, the scope of review of internal control over financial reporting, significant findings, recommendations and Management's responses for implementation of actions to correct weaknesses in internal controls;
- Review disclosures made by the CEO and CFO during the certification process regarding significant deficiencies in the design or operation of internal controls or any fraud that involves Management or other employees who have a significant role in the Company's internal controls; and
- Review the expenses of the Chairman, Board, President and the President's direct reports on a semi-annual basis, and of any other senior officers and employees the Committee considers appropriate.

*Internal Audit*
- Evaluate the internal audit process and define expectations in establishing the annual internal audit plan and the focus on risk, including the organizational structure and the adequacy of resources;
- Approve the Charter of the internal audit function annually;
- Evaluate the audit scope and role of internal audit; and
- Consider and review with the CRO and Management:
    - Significant findings and Management's response including the timetable for implementation of Management actions to correct weaknesses;
    - Any difficulties encountered in the course of their audit (such as restrictions on the scope of their work or access to information);
    - Any changes required in the planned scope of the audit plan; and
    - The internal audit budget.

*External Auditor*
- Recommend to the Board of Directors the external auditor to be nominated for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the Company, and the compensation of the external auditor;
- Oversee the work of the external auditor engaged for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the Company, including the resolution of disagreements between Management and the external auditor regarding financial reporting;
- Review the independence and qualifications of the external auditor;
- At least annually, obtain and review a report by the external auditor describing the auditing firm's internal quality control procedures, any material issues raised by the most recent internal quality control review or peer review of the auditing firm or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the external auditor and any steps taken to deal with any such issues and all relationships between the external auditors and the Company;
- Review the scope and approach of the annual audit plan with the external auditors;

- Discuss with the external auditor the quality and acceptability of the Company's accounting principles including all critical accounting policies and practices used, any alternative treatments that have been discussed with Management as well as any other material communications with Management;

- Assess the external auditor's process for identifying and responding to key audit and internal control risks;

- Ensure the rotation of the lead audit partner every five years and other audit partners every seven years, and consider regular rotation of the audit firm;

- Evaluate the performance of the external auditor annually and present its findings to the Board of Directors;

- Determine which non-audit services the external auditor is prohibited by law or regulation, or as determined by the Audit/Risk Committee, from providing and pre-approve all services provided by the external auditors. The Committee may delegate such pre-approval authority to a member of the Committee. The decision of any Committee member to whom pre-approval authority is delegated must be presented to the full Audit/Risk Committee at its next scheduled meeting;

- Review and approve all related party transactions; and

- Review and approve the Company's hiring policies regarding partners, employees and former partners and employees of the present and former external auditor of the Company.

*Financial Reporting*

- Review with Management and the external auditors the Company's interim financial information and disclosures under MD&A and earnings press release, prior to filing;

- Satisfy itself that adequate procedures are in place for the review of the Company's public disclosure of financial information extracted or derived from the Company's consolidated financial statements, other than the public disclosure referred to above, and periodically assess the adequacy of those procedures;

- Review with Management and the external auditors, at the completion of the annual audit:

    - The Company's annual financial statements, MD&A, related footnotes and any documentation required by the Securities Act to be prepared and filed by the Company or that the Company otherwise files with the Ontario Securities Commission;

    - The external auditors' audit of the consolidated financial statements and their report;

    - Any significant changes required in the external auditors' audit plan;

    - Any difficulties or disputes with Management encountered during the audit;

    - The Company's accounting principles; and

    - Other matters related to conduct, which should be communicated to the Committee under generally accepted auditing standards.

- Review significant accounting and reporting issues and understand their impact on the consolidated financial statements. These include complex or unusual transactions and highly judgmental areas; major issues regarding accounting principles and financial presentations, including significant changes in the Company's selection or application of accounting principles; and the effect of regulatory and accounting initiatives, as well as off-balance sheet arrangements, on the consolidated financial statements of the Company;

- Review analysis prepared by Management and/or the external auditor detailing financial reporting issues and judgments made in connection with the preparation of financial information, including analysis of the effects of alternative Generally Accepted Accounting Principles methods; and

- Advise Management, based upon the Audit/Risk Committee's review and discussion, whether anything has come to the Committee's attention that causes it to believe that the consolidated financial statements contain an untrue statement of material fact or omit to state a necessary material fact.

*Compliance with Code of Business Conduct*

- Review the administration of and compliance with the Company's Code of Business Conduct to ensure that appropriate codes of conduct and compliance programs are in place, are being enforced and remedial action is being taken, as well as the process for communicating the Code of Business Conduct to Company personnel; and

- Monitor through regular updates from Management regarding compliance matters.

*Treatment of Complaints*

- Establish procedures for the receipt, recording and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters; and

- Establish procedures for the confidential and anonymous submission by employees of concerns regarding accounting or auditing matters of the Company.

### Annual Review and Assessment

The Committee shall conduct an annual review and assessment of its performance, including a review of its compliance with this Charter, in accordance with the evaluation process approved by the Board.

The Committee shall also review and assess the adequacy of this Charter on an annual basis taking into account all legislative and regulatory requirements applicable to the Committee as well as any best practice guidelines recommended by regulators with whom OPG has a reporting relationship, and if appropriate, shall recommend changes to the Board.

### Composition of the Audit/Risk Committee

OPG's Audit/Risk Committee consists of George Lewis, Corbin McNeill, Peggy Mulligan, Ian Ross and David Unruh. As a venture issuer, OPG is not subject to the rules governing the composition and independence of audit committees which are established by NI 52-110. However, OPG's Board of Directors has determined to follow best practices and constitute the Audit/Risk Committee in accordance with the requirements of NI 52-110. The Board of Directors has concluded that all of the members of the committee are financially literate and independent of OPG and its subsidiaries, within the meaning of NI 52-110.

During 2008, Dr. Kugler was a member of the Audit/Risk Committee as a non-independent member as determined by the Board of Directors, in accordance with section 3.3(2) of NI 52-110. Dr. Kugler stepped down from the Audit/Risk Committee on December 12, 2008.

### Relevant Education and Experience

Financially literate means having the ability to read and understand the accounting principles used by OPG to prepare its consolidated financial statements, and the ability to address the breadth and level of complex accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by OPG's consolidated financial statements. Each member had an understanding of internal controls and procedures for financial reporting. The education and experience of each Audit/Risk Committee member that are relevant to his or her performance as an audit committee member may be found in the *Corporate Governance* section.

### Audit/Risk Committee Oversight

There have been no recommendations of the Audit/Risk Committee to nominate or compensate an external auditor which have not been adopted by the Board of Directors.

### External Auditor Service Fees

The following fees were billed by Ernst & Young LLP:

| (thousands of dollars) | **2008** | 2007 |
|---|---|---|
| Audit Fees | **1,308** | 1,253 |
| Audit-Related Fees | **338** | 259 |
| Tax Fees and Other | **146** | 118 |

### Audit Fees

These fees included the audit of OPG's consolidated financial statements, quarterly reviews of the financial statements, and the pension fund audits.

### Audit-Related Fees

These fees included work with respect to internal controls, accounting assistance, French translation of consolidated financial statements and MD&A, and special audits and reviews. During 2008, OPG has employed the services of other professional advisers, particularly in the areas of internal controls and accounting assistance.

### Tax Fees and Other

These fees included tax services related to assistance with matters raised by the Tax Auditors for the 1999 taxation year and a United States state tax review.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING AND DISCLOSURE CONTROLS

Management, including the President and CEO and Chief Financial Officer ("CFO"), are responsible for maintaining disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICOFR"). DC&P is designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the President and CEO and the CFO, on a timely basis so that appropriate decisions can be made regarding public disclosure. ICOFR is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements in accordance with GAAP.

An evaluation of the effectiveness of design and operation of OPG's DC&P and ICOFR was conducted as of December 31, 2008. Management, including the President and the CEO and the CFO, concluded that, as of December 31, 2008, OPG's DC&P and ICOFR (as defined in National Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings, of the Canadian Securities Administrators) were effective.

There were no material changes in OPG's ICOFR for the most recent interim period that have materially affected or are reasonably likely to materially affect OPG's ICOFR.

## FOURTH QUARTER

Discussion of Results

| (millions of dollars) (unaudited) | Three Months Ended December 31 2008 | 2007 |
|---|---|---|
| Regulated generation sales | **1,029** | 681 |
| Spot market sales, net of hedging instruments | **432** | 519 |
| Revenue limit rebate | **(40)** | (51) |
| Variance accounts | **(11)** | 7 |
| Other | **211** | 186 |
| Revenue | **1,621** | 1,342 |
| Fuel expense | **276** | 308 |
| Gross margin | **1,345** | 1,034 |
| Operations, maintenance and administration | **837** | 815 |
| Depreciation and amortization | **246** | 176 |
| Accretion on fixed asset removal and nuclear waste management liabilities | **143** | 126 |
| Earnings on nuclear fixed asset removal and nuclear waste management funds | **(40)** | (89) |
| Property and capital taxes | **26** | 19 |
| Income (loss) before other gains and losses, interest and income taxes | **133** | (13) |
| Other (gains) and losses | **(16)** | (10) |
| Income (loss) before interest and income taxes | **149** | (3) |
| Net interest expense | **45** | 41 |
| Income (loss) before income taxes | **104** | (44) |
| Income taxes (recoveries) | **135** | (163) |
| Net income (loss) | **(31)** | 119 |

### Revenue

Revenue was $1,621 million for the three months ended December 31, 2008 compared to $1,342 million during the same period in 2007. The increase of $279 million was primarily due to a higher average sales price due to the OEB's decision including the impact of the price increases effective December 1, 2008, but applicable retrospective to April 1, 2008. During the fourth quarter of 2008, OPG recorded $214 million of retrospective revenue for the period from April 1, 2008 to November 30, 2008.

Revenue for the three months ended December 31, 2008 compared to the same quarter in 2007 was favourably impacted by higher generation from OPG's nuclear generating stations, which displaced generation from the fossil-fuelled generating stations, and an increase in trading revenue primarily due to higher mark-to-market gains on interconnected market sales, offset by lower generation.

### Fuel Expense

Fuel expense was $276 million for the three months ended December 31, 2008 compared to $308 million during the same period in 2007. The decrease of $32 million was primarily due to lower electricity generation at OPG's fossil-fuelled generating stations partially offset by the effect of higher fossil fuel costs.

### Operations, Maintenance and Administration

OM&A expenses for the three months ended December 31, 2008 were $837 million compared to $815 million for the same quarter in 2007. The increase of $22 million was primarily due to the impact of regulatory accounts and expenditures related to nuclear generation development and nuclear capacity refurbishment activities. The change in the regulatory accounts related to these activities during the fourth quarter was primarily a result of a lower level of costs incurred for new nuclear generation and capacity refurbishment activities than the forecast approved by the OEB in setting the new nuclear payment amounts. The increase in OM&A expense was partially offset by lower pension and OPEB costs.

### Depreciation and Amortization

Depreciation and amortization expenses for the three months ended December 31, 2008 were $246 million compared to $176 million for the same quarter in 2007. The increase in depreciation and amortization for the fourth quarter of 2008 compared to the same quarter in 2007 was primarily due to the recovery of regulatory balances through the new prices, as a result of the OEB's decision being recognized retrospectively to April 1, 2008.

### Earnings on Nuclear Fixed Asset Removal and Nuclear Waste Management Funds

Losses from the Nuclear Funds in the Regulated – Nuclear Waste Management segment for the fourth quarter of 2008, before the mitigating impact of the Bruce revenues and costs variance account, were $293 million compared to earnings of $89 million for the fourth quarter of 2007, a decrease of $382 million. The decrease in the earnings from the Nuclear Funds was primarily due to lower returns on the Decommissioning Fund as a result of significant reductions in trading levels of global financial markets, which reduced the current market value of the fund investments. The losses from the Nuclear Funds were partially mitigated by the establishment of the Bruce revenues and costs variance account retrospectively to April 1, 2008. OPG recorded a regulatory asset of $333 million in this variance account that reduced the reported losses from the Nuclear Funds.

## Average Sales Prices

The weighted average Ontario spot electricity market price and OPG's average sales prices by reportable business segment, net of the revenue limit rebate for the three months ended December 31, 2008 and 2007, were as follows:

| | Three Months Ended December 31 | |
|---|---|---|
| (¢/kWh) | **2008** | 2007 |
| Weighted average hourly Ontario spot electricity market price | **5.0** | 5.1 |
| Regulated – Nuclear Generation | **6.5** | 4.9 |
| Regulated – Hydroelectric | **4.7** | 3.5 |
| Unregulated – Hydroelectric | **4.8** | 4.7 |
| Unregulated – Fossil-Fuelled | **4.8** | 4.8 |
| OPG's average sales price | **5.6** | 4.6 |

The increase in OPG's average sales price for the Regulated – Nuclear generation and Regulated – Hydroelectric segments for the three months ended December 31, 2008 compared to the same quarter in 2007 primarily reflected the impact of the increase in the regulated prices due to the OEB's decision.

## Electricity Generation

| | Three Months Ended December 31 | |
|---|---|---|
| (TWh) | **2008** | 2007 |
| Regulated – Nuclear Generation | **12.6** | 10.7 |
| Regulated – Hydroelectric | **4.6** | 4.4 |
| Unregulated – Hydroelectric | **3.5** | 3.2 |
| Unregulated – Fossil-Fuelled | **4.5** | 6.4 |
| Total electricity generation | **25.2** | 24.7 |

Total electricity sales volume for the three months ended December 31, 2008 was 25.2 TWh compared to 24.7 TWh during the same period in 2007. The increase was primarily due to higher generation from OPG's nuclear generating stations, which displaced generation from OPG's Unregulated – Fossil-Fuelled segment. The higher generation from OPG's nuclear generating stations for the three months ended December 31, 2008 compared to the same period in 2007 was primarily due to lower outage days.

During the fourth quarter of 2008 and 2007, the primary electricity demand in Ontario was 36.6 TWh and 37.7 TWh, respectively.

## Liquidity and Capital Resources

Cash flow provided by operating activities during the three months ended December 31, 2008 was $35 million compared to cash flow used in operating activities of $323 million for the three months ended December 31, 2007. The increase in cash flow activities was primarily due to lower contributions to the Nuclear Funds, as a result of the one-time contribution to the Used Fuel Fund required by the ONFA in 2007 and higher receipts from generation revenues. This increase was partly offset by higher revenue limit payments in 2008.

Investment in fixed assets during the three months ended December 31, 2008 was $227 million compared with $190 million during the same period in 2007.

Cash flow provided by financing activities during the three months ended December 31, 2008 was $18 million compared to $449 million for the three months ended December 31, 2007. The decrease in cash flow was primarily due to the issuance of long-term debt under the general corporate facilities of $450 million in the fourth quarter of 2007.

### QUARTERLY FINANCIAL HIGHLIGHTS

The following tables set out selected financial information from OPG's unaudited interim consolidated financial statements for each of the 12 most recently completed quarters. This financial information has been prepared in accordance with Canadian GAAP.

| | 2008 Quarters Ended | | | | |
|---|---|---|---|---|---|
| (millions of dollars) (unaudited) | **December 31 2008** | **September 30 2008** | **June 30 2008** | **March 31 2008** | **Total** |
| Revenue, net of revenue limit rebate | **1,621** | **1,513** | **1,385** | **1,563** | **6,082** |
| Net (loss) income | **(31)** | **(142)** | **99** | **162** | **88** |
| Net (loss) income per share | **$(0.12)** | **$(0.55)** | **$0.39** | **$0.63** | **$0.34** |

| | 2007 Quarters Ended | | | | |
|---|---|---|---|---|---|
| (millions of dollars) (unaudited) | December 31 2007 | September 30 2007 | June 30 2007 | March 31 2007 | Total |
| Revenue, net of revenue limit rebate | 1,342 | 1,421 | 1,373 | 1,524 | 5,660 |
| Net income | 119 | 113 | 125 | 171 | 528 |
| Net income per share | $0.46 | $0.44 | $0.49 | $0.67 | $2.06 |

| | 2006 Quarters Ended | | | | |
|---|---|---|---|---|---|
| (millions of dollars) (unaudited) | December 31 2006 | September 30 2006 | June 30 2006 | March 31 2006 | Total |
| Revenue, net of revenue limit rebate | 1,276 | 1,435 | 1,345 | 1,508 | 5,564 |
| Net (loss) income | (19) | 167 | 143 | 199 | 490 |
| Net (loss) income per share | $(0.08) | $0.65 | $0.56 | $0.78 | $1.91 |

| Balance Sheet as at December 31 (millions of dollars) | **2008** | 2007 | 2006 |
|---|---|---|---|
| Total assets | **25,579** | 24,839 | 22,750 |
| Total long-term liabilities | **17,177** | 16,494 | 15,408 |
| Cash dividend declared per share *(dollars)* | **–** | – | $0.50 |
| Common shares outstanding *(millions)* | **256.3** | 256.3 | 256.3 |

OPG's quarterly results are impacted by changes in demand primarily resulting from variations in seasonal weather conditions. Historically, OPG's revenues are 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 and cooling demands in the third quarter.

Additional items which impacted net income (loss) in certain quarters above include the following:

- Decrease in depreciation expense primarily due to the extension of service lives, for accounting purposes, of the Nanticoke generating station, Pickering B generating station and Unit 4 of the Pickering A generating station beginning in the first quarter of 2006;
- Decrease in depreciation expense primarily due to extension of the service life, for accounting purposes, of all coal-fired generating stations to December 31, 2012, beginning in the third quarter of 2006;
- Impairment loss on the Thunder Bay and Atikokan coal-fired generating stations of $22 million, reflecting the carrying value of the stations, during the fourth quarter of 2006;
- Higher OM&A expense in 2007 primarily due to higher outage and other maintenance expenditures at OPG's nuclear and fossil-fuelled generating stations, and expenses related to past grievances by First Nations;

- Decrease in gross margin from electricity sales during the first quarter of 2007 primarily due to lower generation from OPG's nuclear generating stations as a result of an unplanned outage during the first quarter of 2007 at the Pickering B nuclear generation station, caused by an inadvertent release of resin by a third-party contractor from the water treatment plant into the demineralized water system, and the requirement for maintenance related to the recovery of the resin. In addition, nuclear generation was also impacted by an extension to a planned outage during the first quarter of 2007 at the Pickering A nuclear generating station for significant additional repair work required as a result of a component failure during inspection;

- Higher earnings from the Nuclear Funds during the second quarter of 2007 primarily due to a higher Ontario CPI during the second quarter of 2007, which impacted the guaranteed return on the Used Fuel Fund. In addition, the increase in earnings also reflected a reimbursement from the Nuclear Funds for expenditures related to the safe storage of Pickering A Units 2 and 3;

- Lower gross margin primarily due to lower nuclear generation during the three months ended September 30, 2007 as a result of the shutdown of the Pickering A nuclear generating station Units 1 and 4 to perform modifications on a backup electrical system;

- Higher earnings due to a recovery of $20 million related to the re-estimation of costs to complete the remaining work to remediate the Lakeview site during the fourth quarter of 2007;

- Lower income tax expense during the fourth quarter of 2007 largely due to an additional contribution of $334 million to the Nuclear Funds. Contributions are deductible for tax purposes and no offsetting future tax expense is recognized by OPG due to the use of the taxes payable method to account for income taxes in the rate regulated segments;

- Decrease in income tax expense of $85 million and $21 million during the first and second quarters of 2008, respectively, due to the resolution of the tax uncertainties related to the audit of OPG's 1999 taxation year; and

- Decrease in earnings due to lower returns on the Decommissioning Fund, as a result of significant volatility and unfavourable returns in the capital markets during 2008.

## SUPPLEMENTAL EARNINGS MEASURES

In addition to providing net income in accordance with Canadian GAAP, OPG's MD&A, audited consolidated financial statements as at and for the years ended December 31, 2008 and 2007 and the notes thereto, present certain non-GAAP financial measures. These financial measures do not have standard definitions prescribed by Canadian GAAP and therefore may not be comparable to similar measures disclosed by other companies. OPG utilizes these measures in making operating decisions and assessing its performance. Readers of the MD&A, consolidated financial statements and notes thereto utilize these measures in assessing the Company's financial performance from ongoing operations. These non-GAAP financial measures have not been presented as an alternative to net income in accordance with Canadian GAAP as an indicator of operating performance. The definitions of the non-GAAP financial measures are as follows:

(1) **Gross margin** is defined as revenue less revenue limit rebate and fuel expense.

(2) **Earnings** are defined as net income.

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# Statement of Management's Responsibility for Financial Information

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

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

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

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

Management, including the President and CEO and Chief Financial Officer ("CFO"), are responsible for maintaining disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICOFR"). DC&P is designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the President and CEO and the CFO, on a timely basis so that appropriate decisions can be made regarding public disclosure. ICOFR is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements in accordance with GAAP.

An evaluation of the effectiveness of design and operation of OPG's DC&P and ICOFR was conducted as of December 31, 2008. Accordingly, we, as OPG's Chief Executive Officer and Chief Financial Officer, will certify OPG's annual disclosure documents filed with the OSC, which includes attesting to the design and effectiveness of OPG's disclosure controls and procedures and internal control over financial reporting.

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

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

**Jim Hankinson**
President and Chief Executive Officer

**Donn W. J. Hanbidge**
Chief Financial Officer

February 11, 2009

# Auditors' Report

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

We have audited the consolidated balance sheets of Ontario Power Generation Inc. as at December 31, 2008 and 2007 and the consolidated statements of income, changes in shareholder's equity, comprehensive income 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, 2008 and 2007 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

**Ernst & Young LLP**
Chartered Accountants,
Licensed Public Accountants

Toronto, Canada
February 11, 2009

# Consolidated Statements of Income

| Years Ended December 31<br>(millions of dollars except where noted) | 2008 | 2007 |
|---|---|---|
| **Revenue** (Note 19) | | |
| Revenue before revenue limit rebate | 6,359 | 5,887 |
| Revenue limit rebate (Note 17) | (277) | (227) |
| | 6,082 | 5,660 |
| Fuel expense (Note 19) | 1,191 | 1,270 |
| **Gross margin** (Note 19) | 4,891 | 4,390 |
| **Expenses** (Note 19) | | |
| Operations, maintenance and administration | 2,967 | 2,974 |
| Depreciation and amortization (Note 6) | 743 | 695 |
| Accretion on fixed asset removal and nuclear waste management liabilities (Note 10) | 581 | 507 |
| Losses (earnings) on nuclear fixed asset removal and nuclear waste management funds (Note 10) | 93 | (481) |
| Property and capital taxes | 80 | 85 |
| | 4,464 | 3,780 |
| **Income before the following:** | 427 | 610 |
| Other (gains) and losses (Notes 3 and 18) | (9) | (10) |
| **Income before interest and income taxes** | 436 | 620 |
| Net interest expense (Note 9) | 165 | 143 |
| **Income before income taxes** | 271 | 477 |
| Income tax expense (recovery) (Note 11) | | |
| Current | 255 | 1 |
| Future | (72) | (52) |
| | 183 | (51) |
| **Net income** | 88 | 528 |
| **Basic and diluted income per common share** (dollars) | 0.34 | 2.06 |
| **Common shares outstanding** (millions) | 256.3 | 256.3 |

See accompanying notes to the consolidated financial statements

# Consolidated Statements of Cash Flows

| Years Ended December 31 (millions of dollars) | 2008 | 2007 |
|---|---|---|
| **Operating activities** | | |
| Net income | **88** | 528 |
| Adjust for non-cash items: | | |
| Depreciation and amortization (Note 6) | **743** | 695 |
| Accretion on fixed asset removal and nuclear waste management liabilities (Note 10) | **581** | 507 |
| Losses (earnings) on nuclear fixed asset removal and nuclear waste management funds (Notes 10 and 19) | **93** | (481) |
| Pension costs (Note 12) | **187** | 243 |
| Other post employment benefits and supplementary pension plans (Note 12) | **226** | 244 |
| Future income taxes (Note 11) | **(72)** | (52) |
| Mark-to-market on derivative instruments | **(33)** | 1 |
| Provision for used nuclear fuel | **33** | 30 |
| Regulatory assets and liabilities (Note 7) | **44** | (39) |
| Other (gains) and losses (Note 18) | **(9)** | (10) |
| Provision for other liabilities | **–** | 54 |
| Other | **19** | 25 |
| | **1,900** | 1,745 |
| Contributions to nuclear fixed asset removal and nuclear waste management funds (Note 10) | **(454)** | (788) |
| Expenditures on fixed asset removal and nuclear waste management (Note 10) | **(195)** | (200) |
| Reimbursement of expenditures on nuclear fixed asset removal and nuclear waste management (Note 10) | **82** | 119 |
| Contributions to Pension Fund (Note 12) | **(253)** | (268) |
| Expenditures on other post employment benefits and supplementary pension plans (Note 12) | **(81)** | (73) |
| Revenue limit rebate (Note 17) | **(292)** | (167) |
| Expenditures on restructuring | **–** | (2) |
| Net changes to other long-term assets and liabilities | **90** | (56) |
| Changes in non-cash working capital balances (Note 24) | **73** | 69 |
| **Cash flow provided by operating activities** | **870** | 379 |
| **Investing activities** | | |
| Increase in regulatory assets (Note 7) | **(6)** | (30) |
| Investment in fixed assets (Notes 6 and 19) | **(661)** | (666) |
| Net proceeds from sale of long-term assets | **15** | – |
| Cash and cash equivalents transferred to long-term investments (Note 4) | **–** | (58) |
| **Cash flow used in investing activities** | **(652)** | (754) |
| **Financing activities** | | |
| Issuance of long-term debt (Note 8) | **395** | 900 |
| Repayment of long-term debt (Note 8) | **(408)** | (406) |
| Net decrease in short-term notes (Note 9) | **–** | (15) |
| **Cash flow (used in) provided by financing activities** | **(13)** | 479 |
| **Net increase in cash and cash equivalents** | **205** | 104 |
| **Cash and cash equivalents, beginning of year** | **110** | 6 |
| **Cash and cash equivalents, end of year** | **315** | 110 |

See accompanying notes to the consolidated financial statements

# Consolidated Balance Sheets

| As at December 31<br>(millions of dollars) | 2008 | 2007 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | **315** | 110 |
| Accounts receivable (Note 5) | **525** | 315 |
| Fuel inventory | **736** | 604 |
| Prepaid expenses | **32** | 35 |
| Future income taxes (Note 11) | **6** | 12 |
| Materials and supplies (Note 3) | **132** | 125 |
| | **1,746** | 1,201 |
| **Fixed assets** (Notes 6 and 19) | | |
| Property, plant and equipment | **18,333** | 17,772 |
| Less: accumulated depreciation | **5,546** | 4,995 |
| | **12,787** | 12,777 |
| **Other long-term assets** | | |
| Deferred pension asset (Note 12) | **797** | 731 |
| Nuclear fixed asset removal and nuclear waste management funds (Note 10) | **9,209** | 9,263 |
| Long-term investments (Note 4) | **74** | 93 |
| Long-term materials and supplies | **338** | 353 |
| Future income taxes (Note 11) | **62** | – |
| Regulatory assets (Note 7) | **522** | 356 |
| Long-term accounts receivable and other assets | **44** | 65 |
| | **11,046** | 10,861 |
| | **25,579** | 24,839 |

See accompanying notes to the consolidated financial statements

# Consolidated Balance Sheets

| As at December 31<br>(millions of dollars) | 2008 | 2007 |
|---|---|---|
| **Liabilities** | | |
| **Current liabilities** | | |
| Accounts payable and accrued charges | 1,015 | 953 |
| Revenue limit rebate payable (Note 17) | 85 | 100 |
| Long-term debt due within one year (Note 8) | 357 | 407 |
| Deferred revenue due within one year | 12 | 12 |
| Income and capital taxes payable | 104 | 66 |
| | 1,573 | 1,538 |
| **Long-term debt** (Note 8) | 3,483 | 3,446 |
| **Other long-term liabilities** | | |
| Fixed asset removal and nuclear waste management (Note 10) | 11,384 | 10,957 |
| Other post employment benefits and supplementary pension plans (Note 12) | 1,703 | 1,556 |
| Long-term accounts payable and accrued charges | 445 | 184 |
| Deferred revenue | 108 | 120 |
| Future income taxes (Note 11) | – | 217 |
| Regulatory liabilities (Note 7) | 54 | 14 |
| | 13,694 | 13,048 |
| **Shareholder's equity** | | |
| Common shares | 5,126 | 5,126 |
| Retained earnings | 1,752 | 1,664 |
| Accumulated other comprehensive (loss) income | (49) | 17 |
| | 6,829 | 6,807 |
| | 25,579 | 24,839 |

Commitments and Contingencies (Notes 4, 8, 13, and 16)

See accompanying notes to the consolidated financial statements

On behalf of the Board of Directors:

**Honourable Jake Epp**
Chairman

**M. George Lewis**
Director

# Consolidated Statements of Changes in Shareholder's Equity

| Years Ended December 31 (millions of dollars) | 2008 | 2007 |
|---|---|---|
| **Common shares** (Note 15) | **5,126** | 5,126 |
| **Retained earnings** | | |
| Balance at beginning of year | **1,664** | 623 |
| Transition adjustment on adoption of financial instruments accounting standards | **–** | 513 |
| Net income | **88** | 528 |
| Balance at end of year | **1,752** | 1,664 |
| **Accumulated other comprehensive (loss) income, net of income taxes** | | |
| Balance at beginning of year | **17** | – |
| Transition adjustment on adoption of financial instruments accounting standards | **–** | 21 |
| Other comprehensive loss for the year | **(66)** | (4) |
| Balance at end of year | **(49)** | 17 |
| **Total shareholder's equity at end of year** | **6,829** | 6,807 |

# Consolidated Statements of Comprehensive Income

| Years Ended December 31 (millions of dollars) | 2008 | 2007 |
|---|---|---|
| **Net income** | **88** | 528 |
| **Other comprehensive (loss) income, net of income taxes** | | |
| Net (loss) gain on derivatives designated as cash flow hedges[1] | **(52)** | 11 |
| Reclassification to income of gains on derivatives designated as cash flow hedges[2] | **(14)** | (15) |
| Other comprehensive loss for the year | **(66)** | (4) |
| **Comprehensive income** | **22** | 524 |

1 Net of income tax expense of $3 million and $1 million for the years ended December 31, 2008 and 2007, respectively.

2 Net of income tax recoveries of $9 million for each of the years ended December 31, 2008 and 2007.

See accompanying notes to the consolidated financial statements

# Notes to the Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007

## 1. DESCRIPTION OF BUSINESS

Ontario Power Generation Inc. ("OPG" or the "Company") 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

These consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles and presented in Canadian dollars. 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, revenue and expenses, and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

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

Certain of the 2007 comparative amounts have been reclassified from financial statements previously presented to conform to the 2008 financial statement presentation.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

Interest earned on cash and cash equivalents and short-term investments of $13 million (2007 – $5 million) at an average effective rate of 3.0 percent (2007 – 4.4 percent) is offset against interest expense in the consolidated statements of income.

### Sales of Accounts Receivable

Asset securitization involves selling assets such as accounts receivable to independent entities or trusts, which buy the receivables and then issue interests in them to investors. These transactions are accounted for as sales, given that control has been surrendered over these assets in return for net cash consideration. For each transfer, the excess of the carrying value of the receivables transferred over the estimated fair value of the proceeds received is reflected as a loss on the date of the transfer, and is included in net interest expense. The carrying value of the interests transferred is allocated to accounts receivable sold or interests retained according to their relative fair values on the day the transfer is made. Fair value is determined based on the present value of future cash flows. Cash flows are projected using OPG's best estimates of key assumptions, such as discount rates, weighted average life of accounts receivable and credit loss ratios.

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

### Inventories

Fuel inventory is valued at weighted average cost.

Materials and supplies are valued at the lower of average cost and net realizable value. The determination of net realizable value of materials and supplies takes into account various factors including the remaining useful life of the related facilities in which the materials and supplies are expected to be used.

### Fixed Assets and Depreciation

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

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

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

| | |
|---|---|
| Nuclear generating stations and major components | 15 to 55 years[1] |
| Fossil generating stations and major components | 25 to 40 years[2] |
| Hydroelectric generating stations and major components | 25 to 100 years |
| Administration and service facilities | 10 to 50 years |
| Computers, and transport and work equipment assets – declining balance | 9% to 40% per year |
| Major application software | 5 years |
| Service equipment | 5 to 10 years |

1 The end of station life for depreciation purposes for the Darlington, Pickering A, Pickering B, Bruce A, and Bruce B nuclear generating stations ranges between 2014 and 2035. Major components are depreciated over the lesser of the station life and the life of the components. The Bruce A nuclear generating station was fully depreciated in 2003, however Bruce Power L.P. decided to refurbish the Bruce A generating station contributing to an increase in the asset retirement obligation and an increase in the carrying value of the Bruce A station. Changes to the end of station life for depreciation purposes are described under the heading *Changes in Accounting Policies and Estimates*.

2 The end of station life for depreciation purposes disclosed above excludes the impact of life extensions commencing January 1, 2008, which are described under the heading *Changes in Accounting Policies and Estimates*.

### Impairment of Fixed Assets

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

### Rate Regulated Accounting

A regulation pursuant to the *Electricity Restructuring Act*, *2004* (Ontario) provides that, effective April 1, 2005, OPG receives regulated prices for electricity generated from most of its baseload hydroelectric facilities and all of the nuclear facilities that it operates. This includes electricity generated from Sir Adam Beck 1, 2 and Pump generating stations, DeCew Falls 1 and 2, and R.H. Saunders hydroelectric facilities, and Pickering A and B, and Darlington nuclear facilities. The regulation established regulated prices up to April 1, 2008. The Ontario Energy Board ("OEB") determined the new prices in the fourth quarter of 2008 effective April 1, 2008 using a forecast cost of service methodology. This methodology establishes regulated prices based on a revenue requirement taking into account a forecast of production volumes and total operating costs, and a return on rate base. Rate base is a regulatory construct that represents the average net level of investment in regulated fixed assets and an allowance for working capital. Regulated prices prior to April 1, 2008 were established by the Province of Ontario (the "Province") using the forecast cost of service methodology. The impact of the regulation and the OEB's decision on OPG's revenue recognition policies is described under the heading, *Revenue Recognition*.

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

The regulation pursuant to the *Electricity Restructuring Act, 2004* (Ontario) required OPG to establish certain variance and deferral accounts for the period up to April 1, 2008. In its decision on OPG's new regulated prices, the OEB ruled on the disposition of the balances recorded in these accounts as at December 31, 2007. The OEB also authorized the continuation and establishment of certain existing and new variance and deferral accounts effective April 1, 2008.

The balances in variance and deferral accounts are recognized as regulatory assets and liabilities in OPG's consolidated financial statements, as Canadian accounting standards recognize that rate regulation can create economic benefits and obligations that are required by the regulator to be obtained from, or settled with, the ratepayers. When the regulator provides assurance that incurred expenses will be recovered in the future, then OPG may defer those expenses and report them as a regulatory asset. If current recovery is provided for expenses expected to be incurred in the future, then OPG reports a regulatory liability. Similarly, if the regulator provides for lesser or greater than planned revenue to be received or returned by OPG through future regulated prices, then OPG recognizes a regulatory asset or liability, respectively. The measurement of regulatory assets and liabilities is subject to certain estimates and assumptions, including assumptions made in the interpretation of the regulation and the OEB's decisions.

Regulatory asset and liability balances approved by the regulator for inclusion in regulated prices are amortized based on approved recovery periods. Disallowed balances, including associated interest, are charged to operations in the period that the regulator's decision is issued. OPG applies interest to regulatory balances as prescribed by the regulation or the OEB, in order to recognize the cost of financing amounts to be recovered from, or repaid to, ratepayers.

See Notes 7 and 11 to these consolidated financial statements for additional disclosure related to regulatory assets and liabilities and rate regulated accounting.

### Investments in OPG Ventures

In accordance with Accounting Guideline 18, *Investment Companies* ("AcG-18"), investments owned by the Company's wholly owned subsidiary OPG Ventures Inc. ("OPGV") are recorded at fair value, and changes to the fair value of the investments are included in revenue in the period in which the change occurs. The fair values of these investments are estimated using a methodology that is appropriate in light of the nature, facts and circumstances of the respective investments and considers reasonable data and market inputs, assumptions and estimates.

### Fixed Asset Removal and Nuclear Waste Management Liability

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

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

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

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

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

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

The Nuclear Funds are invested in fixed income and equity securities. Effective January 1, 2007, OPG adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3855, *Financial Instruments – Recognition and Measurement*. As a result of the adoption of this new section, the investments in the Nuclear Funds and the corresponding payables to the Province are classified as held-for-trading. Accordingly, the Nuclear Funds and the corresponding payables to the Province are measured at fair value based on the bid prices of the underlying securities with gains and losses recognized in net income.

### Revenue Recognition

All of OPG's electricity generation is sold into the real-time energy spot market administered by the Independent Electricity System Operator ("IESO"). Effective April 1, 2005, the generation from most of OPG's baseload hydroelectric facilities and all of the nuclear facilities that OPG operates became rate regulated. As a result, energy revenue generated from the nuclear facilities up to April 1, 2008 was recognized based on a regulated price of 4.95¢/kWh. The regulated prices for nuclear generation increased to 5.50¢/kWh retrospectively to April 1, 2008, based on the OEB's decision issued in the fourth quarter of 2008. This price includes a rate rider of 0.20¢/kWh for recovery of approved nuclear variance and deferral account balances. The regulated price received by OPG up to April 1, 2008 for the first 1,900 megawatt hours ("MWh") of production from the regulated hydroelectric facilities in any hour was 3.3¢/kWh. The OEB increased the price to 3.67¢/kWh for the first 1,900 MWh of regulated hydroelectric production for the period April 1, 2008 to November 30, 2008. Any production from these regulated hydroelectric facilities above 1,900 MWh in any hour for the period April 1, 2005 to November 30, 2008 received the Ontario electricity spot market price. Following the OEB's decision, effective December 1, 2008, the threshold of 1,900 MWh no longer applies. Effective December 1, 2008, the actual average hourly net energy production from these hydroelectric facilities in the month receives the regulated price of 3.67¢/kWh. In the hours when the net actual energy production in Ontario is greater or less than the average hourly net volume in the month, OPG's revenues are adjusted by the difference between the average hourly net volume and the actual net energy production multiplied by spot market price. The retrospective increase in the regulated prices for production from regulated facilities for the period from April 1, 2008 to November 30, 2008 was recognized in the period that the OEB's decision was issued.

The production from OPG's remaining hydroelectric, fossil-fuelled and wind generating stations remains unregulated and continues to be sold at the Ontario electricity spot market price. However, 85 percent of the generation output from OPG's other generating assets, excluding the Lennox generating station, stations whose generation output is subject to a Hydroelectric Energy Supply Agreement ("HESA") with the Ontario Power Authority ("OPA") pursuant to a ministerial directive, and forward sales as of January 1, 2005, is subject to a revenue limit. The output from a generating unit where there has been a fuel conversion and the incremental output from a generating station where there has been a refurbishment or expansion of these assets are also excluded from the output covered by the revenue limit.

The revenue limit, which was originally established for a period of 13 months ending April 30, 2006, was subsequently extended for an additional three years. Starting May 1, 2006, the revenue limit decreased to 4.6¢/kWh from the previous limit of 4.7¢/kWh. On May 1, 2007, the revenue limit returned to 4.7¢/kWh and increased to 4.8¢/kWh effective May 1, 2008. In addition, beginning April 1, 2006, volumes sold under a Pilot Auction administered by the OPA are subject to a revenue limit that is 0.5¢/kWh higher than the revenue limit applicable to OPG's other generating assets. Revenues above these limits are returned to the IESO for the benefit of consumers. The term of the revenue limit rebate ends on May 1, 2009.

OPG also sells into, and purchases from, interconnected markets of other provinces and the U.S. northeast and midwest. All contracts that are not designated as hedges are recorded in the consolidated balance sheets at market value with gains or losses recorded in the consolidated statements of income. Gains and losses on energy trading contracts (including those to be physically settled) are recorded on a net basis in the consolidated statements of income. Accordingly, power purchases of $177 million in 2008 and $120 million in 2007 were netted against revenue.

OPG derives non-energy revenue under the terms of a lease arrangement with Bruce Power L.P. ("Bruce Power") related to the Bruce nuclear generating stations. This includes lease revenues and revenues for engineering analysis and design, technical and ancillary services.

Prior to April 1, 2008, OPG accounted for lease revenue from Bruce Power using the cash basis of accounting. Under the cash basis of accounting, OPG recognized lease income as stipulated in the lease agreement to the extent that the lease payments were expected to be included in future regulated prices charged to customers. Pursuant to the OEB's decision during the fourth quarter of 2008, certain lease payments from Bruce Power were included in the determination of regulated prices effective April 1, 2008 on a straight-line basis over the term of the lease. Accordingly, OPG recognized these lease payments on a straight-line basis over the term of the lease effective April 1, 2008.

OPG also earns revenue from its joint venture share of the Brighton Beach Power Limited Partnership ("Brighton Beach") related to an energy conversion agreement between Brighton Beach and Coral Energy Canada Inc. ("Coral"). In addition, non-energy revenue includes isotope sales and real estate rentals. Revenues from these activities are recognized as services are provided or as products are delivered.

### Financial Instruments

On January 1, 2007, OPG adopted three new accounting standards that were issued by the CICA: Handbook Section 1530, *Comprehensive Income*; Handbook Section 3855, *Financial Instruments – Recognition and Measurement*; and Handbook Section 3865, *Hedges*.

Under the new standard, for accounting purposes, financial assets are classified as one of the following: held-to-maturity, loans and receivables, held-for-trading or available-for-sale, and financial liabilities are classified as held-for-trading or other than held-for-trading. Financial assets and liabilities held-for-trading are measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables, and financial liabilities other than those held-for-trading, are measured at amortized cost. Financial assets available-for-sale are measured at fair value with unrealized gains and losses due to fluctuations in fair value recognized in accumulated other comprehensive income. Financial assets purchased and sold, where the contract requires the asset to be delivered within an established timeframe, are recognized on a trade-date basis. All derivatives, including embedded derivatives that must be separately accounted for, generally must be classified as held-for-trading and recorded at fair value in the consolidated balance sheets. Transaction costs are expensed as incurred for financial instruments classified or designated as held-for-trading.

The new standard permits designation of any financial instrument as held-for-trading (the fair value option) upon initial recognition. This designation by OPG requires that the financial instrument be reliably measurable, and eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities.

### Hedges

The new standard specifies the criteria under which hedge accounting can be applied and how hedge accounting is to be executed for each of the permitted hedging strategies: fair value hedges, cash flow hedges and hedges of a foreign currency exposure of a net investment in a self-sustaining foreign operation. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in other comprehensive income. The ineffective portion is recognized in net income. The amounts recognized in accumulated other comprehensive income are reclassified to net income in the periods in which net income is affected by the variability in the cash flows of the hedged item.

### Derivatives

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

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

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

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

Hedge accounting is applied when the derivative instrument is designated as a hedge and is expected to be effective throughout the life of the hedged item. The fair value of such derivative instrument is included in accumulated other comprehensive income ("AOCI") on a net of tax basis and changes to the fair value are recorded on the consolidated statements of comprehensive income. When a derivative hedging relationship is expired, the designation of a hedging relationship is terminated, or a portion of the hedging instrument is no longer effective, any associated gains or losses included in AOCI are recognized in the current period's consolidated statement of income.

## Foreign Currency Translation

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

## Research and Development

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

## Pension and Other Post Employment Benefits

OPG's post employment benefit programs include a contributory defined benefit registered pension plan, a defined benefit supplementary pension plan, group life insurance, health care and long-term disability benefits. OPG accrues its obligations under pension and other post employment benefit ("OPEB") plans. The obligations for pension and OPEB costs are determined using the projected benefit method pro-rated on service. The obligation for long-term disability benefits is determined using the projected benefit method on a terminal basis. Pension and OPEB obligations are impacted by factors including interest rates, adjustments arising from plan amendments, changes in assumptions, experience gains or losses, salary levels, inflation, and cost escalation. Pension and OPEB costs and obligations are determined annually by independent actuaries using management's best estimate assumptions.

Assumptions are significant inputs to actuarial models that measure pension and OPEB obligations and related effects on operations. Two critical assumptions—discount rate and inflation—are important elements of benefit costs and obligations. In addition, the expected return on assets is a critical assumption in the determination of pension costs. These assumptions, as well as other assumptions involving demographic factors such as retirement age, mortality and employee turnover are evaluated periodically by management in consultation with an independent actuary. During the evaluation process, the assumptions are updated to reflect actual experience and expectations for the future. Actual results in any given year will often differ from actuarial assumptions because of economic and other factors, and in accordance with Canadian GAAP, the impact of these differences are accumulated and amortized over future periods.

The discount rates used by OPG in determining projected benefit obligations and the costs for the Company's employee benefit plans are based on representative AA corporate bond yields. The respective discount rates enable OPG to calculate the present value of the expected future cash flows on the measurement date. A lower discount rate increases the present value of benefit obligations and increases benefit plan costs. The expected rate of return on plan assets is based on current and expected asset allocation, as well as the long-term historical risks and returns associated with each asset class within the plan portfolio. A lower expected rate of return on plan assets increases pension cost.

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

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

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

### Taxes

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

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

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

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

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

### Changes in Accounting Policies and Estimates

#### Depreciation of Long-Lived Assets

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

Effective January 1, 2008, the service life of the Darlington nuclear generating station, for the purposes of calculating depreciation, was extended by two years to 2019 after a review of the technical analysis of the station's life limiting components. The life extension reduced depreciation expense by $18 million annually.

Effective January 1, 2009, the service life of fossil-fuelled stations, for the purpose of calculating depreciation, was extended by two years to 2014 based on the Province of Ontario's announcement to phase out coal generation by 2014. The life extension will reduce depreciation expense by $31 million annually.

The Company extended the service life of Bruce B nuclear generating station to 2014 for depreciation purposes effective January 1, 2008 after reviewing future capacity plans in the OPA's Integrated Power System Plan ("IPSP"), and historical information regarding the service lives of major life limiting components of the station. As a result of the extension, depreciation expense decreased by $7 million annually. In addition, effective January 1, 2008, OPG extended the service life of Bruce A nuclear generating station to 2035 for depreciation purposes after the review of future capacity plans filed with the OPA and other publicly available information. The extension of the service life of the Bruce A nuclear generating station for depreciation purposes decreased depreciation expense by $8 million annually.

**Financial Instruments and Capital Disclosures – Disclosure and Presentation**

On January 1, 2008, OPG adopted three new presentation and disclosure standards that were issued by the CICA: Handbook Section 3862, *Financial Instruments – Disclosures*, Handbook Section 3863, *Financial Instruments – Presentation*, and Handbook Section 1535, *Capital Disclosures*.

Handbook Section 3862, *Financial Instruments – Disclosures*, outlines disclosure requirements for financial instruments and places increased emphasis on disclosure about the risks associated with recognized and unrecognized financial instruments and how these risks are managed.

Handbook Section 3863, *Financial Instruments – Presentation*, carries forward the presentation requirements from Section 3861, *Financial Instruments – Disclosure and Presentation*.

Handbook Section 1535, *Capital Disclosures*, requires the disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate a company's objectives, policies and processes for managing capital.

**Reportable Segments**

Commencing in the fourth quarter of 2008, OPG separated the Regulated – Nuclear segment into two reportable segments identified as Regulated – Nuclear Generation segment and Regulated – Nuclear Waste Management segment. The revised segment reporting is consistent with OPG's strategic business unit and reporting structure, and reflects the manner in which operating decisions are made and performance is assessed, given the magnitude and significant growth in nuclear decommissioning and waste management activities, assets and liabilities. Results for the comparative periods have been reclassified to reflect the revised disclosure.

**Inventories**

The CICA issued Handbook Section 3031, *Inventories*, in March 2007, which is based on International Accounting Standard ("IAS") 2. The section replaced the existing Handbook Section 3030, *Inventories*. Under this section, inventories are required to be measured at the lower of cost and net realizable value, which is different from the previous guidance of lower of cost and market. This section also allows the reversal of any write-downs previously recognized. Further, due to the changes in the section and the consequential amendments, some of OPG's critical spare parts, which were previously reported as materials and supplies on OPG's consolidated balance sheets, are now accounted for as property, plant and equipment. The accounting standard and the consequential amendments were effective for OPG beginning January 1, 2008. OPG reclassified significant critical spare parts of $19 million, net of accumulated depreciation, to property, plant and equipment in 2008. This accounting standard and the consequential amendments did not have a significant impact on OPG's financial position or results of operations for the year ended December 31, 2008.

## Future Changes in Accounting Policies

**Accounting for Regulated Operations**

In December 2007, the CICA revised its guidance on accounting for rate regulated operations. The revision resulted in amendments to Handbook Sections 1100, *Generally Accepted Accounting Principles*, and 3465, *Income Taxes*, and Accounting Guideline 19 ("AcG-19"), *Disclosures by Entities Subject to Rate Regulation*, as follows:

- to remove the temporary exemption pertaining to the application of Section 1100 to rate regulated operations, including the elimination of the opportunity to use industry practice as an acceptable basis for recognition and measurement of assets and liabilities arising from rate regulation;
- to amend Section 3465 to require the recognition of future income tax assets and liabilities as well as a separate regulatory asset or liability for the amount of future income taxes expected to be included in future rates and recovered from or paid to customers; and
- to amend AcG-19, as necessary, as a result of amendments to Sections 1100 and 3465.

As a result of the changes to Section 3465, OPG is required to recognize future income taxes associated with its rate regulated operations in the same manner as it currently recognizes future income taxes for its unregulated operations. OPG applied the changes prospectively to interim and annual consolidated financial statements beginning January 1, 2009. Accordingly, on January 1, 2009, OPG recorded a future income tax liability of $466 million and a corresponding regulatory asset. The future income tax liability of $466 million includes future income taxes resulting from regulatory assets and liabilities of $126 million that are required to be recorded due to amendments to Section 3465.

### Intangible Assets

In February 2008, the CICA issued Handbook Section 3064, *Goodwill and Intangible Assets*, which replaces Handbook Section 3062, *Goodwill and Other Intangible Assets*, and establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. This section applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. The adoption of this standard resulted in a reclassification of $42 million from fixed assets to intangible assets on January 1, 2009.

## 4. INVESTMENTS IN ASSET-BACKED COMMERCIAL PAPER

In August 2007, the Asset-Backed Commercial Paper ("ABCP") market experienced a liquidity event when paper sponsored by third-party non-bank conduits could not be refinanced as it matured. At that time, OPG's total ABCP investment was $103 million. Of that amount, $45 million was restructured, with OPG receiving payment of approximately 98.7 percent of the face value of the notes in December 2007, which resulted in a loss of $1 million. Of the remaining $58 million, OPG recorded an impairment loss of $9 million as at December 31, 2007, plus an additional $14 million impairment loss during 2008. The impairment loss was recorded in other gains and losses. OPG's remaining holdings of third-party ABCP are recorded as long-term investments.

On January 21, 2009, the Pan-Canadian Investors Committee for third-party ABCP announced the restructuring Plan (the "Plan") affecting $32 billion of third-party ABCP had been fully implemented. Pursuant to the terms of the Plan, OPG's short-term commercial paper has been exchanged for longer term notes equal to approximately $58 million. OPG received five classes of notes, which are supported by margin funding facilities from third-party asset providers, Canadian banks, and governments. OPG also received a partial payment of the accrued interest totalling $2 million for its short-term commercial paper held over the past 17 months.

During the fourth quarter of 2008, as a result of the continuing deterioration in credit conditions, OPG concluded that an additional impairment loss of $5 million was required. The loss was determined using the previously developed valuation methodology updated for credit spread and discount rate information.

The restructured notes are expected to have a maturity of eight to nine years. The exact maturity will be impacted by the release of collateral as underlying swap trades mature. The stated maturity of the notes is 2056. OPG continues to monitor the development of a secondary market to assess the fair value of its remaining holdings.

OPG has sufficient credit facilities to satisfy its financial obligations as they come due and does not expect any material adverse impact on its operations as a result of this current third-party ABCP liquidity issue.

## 5. SALE OF ACCOUNTS RECEIVABLE

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

OPG reflected the initial transfer to the trust of the co-ownership interest, and subsequent transfers required by the revolving nature of the securitization, as sales in accordance with CICA Accounting Guideline 12, *Transfer of Receivables*. In accordance with this Guideline, the proceeds of each sale to the trust were deemed to be the cash received from the trust, net of the undivided co-ownership interest retained by the Company. For 2008, OPG has recognized pre-tax charges of $12 million (2007 – $15 million) on such sales at an average cost of funds of 3.9 percent (2007 – 5.1 percent). As at December 31, 2008, OPG had sold receivables of $300 million from its total portfolio of $507 million (as at December 31, 2007 – $479 million).

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

| | Principal amount of receivables as at December 31 | | Average balance of receivables for the year ended December 31 | |
|---|---|---|---|---|
| (millions of dollars unless otherwise stated) | **2008** | 2007 | **2008** | 2007 |
| Total receivables portfolio[1] | **507** | 479 | **471** | 454 |
| Receivables sold | **300** | 300 | **300** | 300 |
| Receivables retained | **207** | 179 | **171** | 154 |
| Average cost of funds | | | **3.9%** | 5.1% |

1 Amount represents gross IESO receivables outstanding, including receivables that have been securitized, which the Company continues to service.

An immediate 10 percent or 20 percent adverse change in the discount rate would not have a material effect on the current fair value of the retained interest. There were no credit losses for the years ended December 31, 2008 and 2007.

Details of cash flows from securitizations for the years ended December 31, 2008 and 2007 are as follows:

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Collections reinvested in revolving sales[1] | **3,600** | 3,600 |
| Cash flows from retained interest | **2,020** | 1,759 |

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

## 6. FIXED ASSETS, DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense consists of the following as at December 31, 2008 and 2007:

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Depreciation and amortization | **626** | 587 |
| Amortization of regulatory assets and liabilities (Note 7) | **111** | 96 |
| Nuclear waste management costs | **6** | 12 |
| | **743** | 695 |

Fixed assets consist of the following as at December 31, 2008 and 2007:

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Property, plant and equipment | | |
| Nuclear generating stations | **6,615** | 6,466 |
| Regulated hydroelectric generating stations | **4,425** | 4,411 |
| Unregulated hydroelectric generating stations | **3,559** | 3,525 |
| Fossil-fuelled generating stations | **1,618** | 1,553 |
| Other fixed assets | **844** | 867 |
| Construction in progress | **1,272** | 950 |
| | **18,333** | 17,772 |
| Less: accumulated depreciation | | |
| Generating stations | **5,182** | 4,636 |
| Other fixed assets | **364** | 359 |
| | **5,546** | 4,995 |
| | **12,787** | 12,777 |

Interest capitalized to construction in progress at six percent during the years ended December 31, 2008 and 2007 was $56 million and $42 million, respectively.

### 7. REGULATORY ASSETS AND LIABILITIES AND SUMMARY OF RATE REGULATED ACCOUNTING

Under a regulation pursuant to the *Electricity Restructuring Act*, *2004* (Ontario), OPG was required to establish certain variance and deferral accounts for the period April 1, 2005 to March 31, 2008. The OEB's determination of new regulated prices effective April 1, 2008 included the disposition of OPG's regulatory asset and liability balances as at December 31, 2007 as well as the authorization of certain variance and deferral accounts effective subsequent to March 31, 2008. During 2008, OPG recorded additions to its regulatory balances up to March 31, 2008 pursuant to the regulation and in accordance with the OEB's decision subsequent to that date. OPG also began amortizing regulatory balances approved for recovery effective April 1, 2008. Regulatory balances disallowed by the OEB were charged to operations upon the issuance of its decision in the fourth quarter of 2008. OPG also recorded interest on its regulatory balances at the interest rate of six percent for the period up to March 31, 2008 as per the regulation, and starting on April 1, 2008, at the interest rate prescribed by the OEB from time to time for variance and deferral accounts of entities it regulates. This interest rate fluctuated in the range of three to four percent during the nine months ended December 31, 2008. OPG will apply for recovery of regulatory balances recorded subsequent to December 31, 2007 in its next application to the OEB.

The regulatory assets and liabilities recorded as at December 31, 2008 and 2007 are as follows:

| (millions of dollars) | **2008** | 2007 |
|---|---|---|
| Regulatory assets | | |
| Bruce revenues and costs variance | **260** | – |
| Pickering A return to service costs | **123** | 183 |
| Nuclear liabilities deferral account | **132** | 131 |
| Nuclear generation development costs – Capacity refurbishment | **–** | 16 |
| Nuclear generation development costs – New nuclear development | **–** | 12 |
| Hydroelectric production variance | **–** | 7 |
| Ancillary services revenue variance | **–** | 5 |
| Other | **7** | 2 |
| Total regulatory assets | **522** | 356 |
| Regulatory liabilities | | |
| Nuclear generation development costs – Capacity refurbishment | **6** | – |
| Nuclear generation development costs – New nuclear development | **21** | – |
| Hydroelectric production variance | **22** | – |
| Ancillary services revenue variance | **4** | – |
| Other | **1** | 14 |
| Total regulatory liabilities | **54** | 14 |

The changes in the regulatory assets and liabilities for 2008 and 2007 are as follows:

| (millions of dollars) | Bruce Revenues and Costs Variance | Pickering A Return to Service Costs | Nuclear Liabilities Deferral Account | Nuclear Generation Development Costs – Capacity Refurbishment | Nuclear Generation Development Costs – New Nuclear Development | Hydro -electric Production Variance | Ancillary Services Revenue Variance | Other (net) |
|---|---|---|---|---|---|---|---|---|
| Regulatory assets (liabilities), January 1, 2007 | – | 249 | – | – | – | (4) | – | (5) |
| Increase (decrease) during the year | – | – | 127 | 15 | 12 | 10 | 5 | (6) |
| Interest | – | 30 | 4 | 1 | – | 1 | – | (1) |
| Amortization during the year | – | (96) | – | – | – | – | – | – |
| Regulatory assets (liabilities), December 31, 2007 | – | 183 | 131 | 16 | 12 | 7 | 5 | (12) |
| Increase (decrease) during the year | 259 | – | 31 | (6) | (30) | (25) | (7) | 5 |
| Interest | 1 | 6 | 6 | – | – | – | – | – |
| Amortization during the year | – | (66) | (36) | – | (3) | (4) | (2) | – |
| Other charges | – | – | – | (16) | – | – | – | 13 |
| Regulatory assets (liabilities), December 31, 2008 | **260** | **123** | **132** | **(6)** | **(21)** | **(22)** | **(4)** | **6** |

### Bruce Revenues and Costs Variance

As per the requirements of the regulation, the OEB required OPG to include the difference between OPG's revenues and costs associated with its ownership of the two nuclear stations on lease to Bruce Power in the determination of the regulated prices for production from OPG's regulated nuclear facilities. The OEB also established a variance account, effective April 1, 2008, that captures differences between the forecast revenues and costs associated with the Bruce generating stations that are included in the approved regulated nuclear prices, and the actual amounts. In 2008, OPG recorded a regulatory asset of $260 million in this variance account, including $1 million of interest on the balance. The regulatory asset includes a $333 million variance from forecast as a result of losses from the Nuclear Funds related to the Bruce generating stations since April 1, 2008, partially offset by a related variance in income tax expense of $95 million. The remaining net variance of $21 million includes variances for lease revenues, and accretion expense related to Nuclear Liabilities associated with the Bruce generating stations.

### Pickering A Return to Service Costs

Effective January 1, 2005, in accordance with the regulation, OPG was required to establish a deferral account in connection with non-capital costs incurred on or after January 1, 2005 that were associated with the planned return to service of all units at the Pickering A nuclear generating station. As at December 31, 2008, the balance in the deferral account was $123 million, including interest of $43 million and net of accumulated amortization of $191 million. As at December 31, 2007, the balance in the deferral account was $183 million, including interest of $37 million and net of accumulated amortization of $125 million. No additional costs were deferred in the account in the years ended December 31, 2008 and 2007. OPG commenced amortization of the deferral account balance for the period November 2005, when Unit 1 of the Pickering A nuclear generating station was returned to service, to March 31, 2008 in accordance with the terms of the regulation. In its decision, the OEB authorized the recovery of the unamortized balance in the account as at December 31, 2007 over a 45-month period ending December 31, 2011. Therefore, effective retrospectively to April 1, 2008, OPG amortizes the balance of the account on a straight-line basis over this period.

### Nuclear Liabilities Deferral Account

In February 2007, the Province amended the regulation pursuant to the *Electricity Restructuring Act*, *2004* (Ontario) to direct OPG to establish a deferral account in connection with changes to its liabilities for nuclear used fuel management and nuclear decommissioning and low and intermediate level waste management. The deferral account represents the revenue requirement impact associated with the changes in the nuclear liabilities arising from an approved reference plan, approved after April 1, 2005, in accordance with the terms of the ONFA.

On December 31, 2006, OPG recorded an increase in its nuclear liabilities of $1,386 million arising from an update to the approved reference plan in accordance with the terms of the ONFA. Therefore, commencing January 1, 2007 and up to March 31, 2008, OPG recorded a regulatory asset associated with this increase in the nuclear fixed assets removal and nuclear waste management liabilities ("Nuclear Liabilities") arising from the approved reference plan. During the year ended December 31, 2008, OPG recorded additions to the deferral account of $37 million, including $6 million of interest. During the year ended December 31, 2007, OPG recorded additions to the account of $131 million, including $4 million of interest. In its decision in 2008, the OEB authorized the recovery of the balance recorded in the account as at December 31, 2007 over a 33-month period ending December 31, 2010. Accordingly, OPG began amortizing the approved balance retrospective to April 1, 2008 in the fourth quarter of 2008 on a straight-line basis over the 33-month period.

### Nuclear Generation Development Costs

In accordance with its interpretation of the regulation, OPG recorded regulatory assets related to non-capital costs for nuclear generation development initiatives up to March 31, 2008. Specifically, the costs recorded were those made in the course of planning and preparing for the development of proposed new nuclear facilities incurred on or after June 13, 2006, as well as those related to the potential refurbishment of the Pickering B and Darlington nuclear stations to the extent that they had not been previously included in the forecast provided to the Province for the purposes of establishing regulated prices for the period up to March 31, 2008.

OPG deferred costs totalling $4 million related to new nuclear generation development initiatives during the three months ended March 31, 2008 and $12 million during the year ended December 31, 2007. OPG did not record any costs related to the potential refurbishment of existing stations during the three months ended March 31, 2008 and recorded $16 million, including $1 million of interest, during the year ended December 31, 2007. The OEB's decision authorized the recovery of the costs recorded up to December 31, 2007 related to new nuclear development over a 33-month period ending December 31, 2010. Accordingly, OPG began amortizing the approved balance retrospective to April 1, 2008 in the fourth quarter on a straight-line basis over this period. The OEB determined that it did not have jurisdiction to approve the recovery of the costs recorded prior to April 1, 2008 for capacity refurbishment. Therefore, the associated regulatory asset in the amount of $16 million was charged to operations in the fourth quarter of 2008.

The OEB also established variance accounts effective April 1, 2008 for new nuclear generation development and capacity refurbishment costs for deviations from the forecast costs approved by the OEB in setting the new regulated prices. Accordingly, OPG recorded additional operations, maintenance and administration ("OM&A") expenses of $34 million for new nuclear generation development costs and $6 million for capacity refurbishment costs during the nine months ended December 31, 2008.

# Notes to the Consolidated Financial Statements

(for the years ended December 31, 2008 and 2007)

### Hydroelectric Production and Ancillary Services Revenue Variances

The OEB's decision authorized the continuation of previously existing variance accounts effective April 1, 2008 for the difference in hydroelectric electricity production due to differences between forecast and actual water conditions, as well as the difference between forecast and actual ancillary services revenue. Forecast water conditions and ancillary services revenues refer to those approved by the OEB in setting the new regulated prices. Prior to April 1, 2008, variances were determined by reference to the forecast information previously provided to the Province for the purposes of establishing regulated prices. OPG recorded a decrease in revenue during the year ended December 31, 2008 of $32 million reflecting actual water conditions and ancillary services revenue that were favourable compared to those approved by the OEB, or included in the forecast provided to the Province for the purposes of establishing regulated prices, as appropriate. OPG recorded an increase in revenue during the year ended December 31, 2007 of $15 million reflecting actual water conditions and ancillary services revenue that were unfavourable compared to the forecast provided to the Province for the purposes of establishing regulated prices.

The OEB's decision authorized the recovery of balances in these variance accounts related to regulated hydroelectric operations recorded up to December 31, 2007 over a 21-month period ending December 31, 2009. Accordingly, OPG began amortizing the approved balances in the fourth quarter on a straight-line basis retrospective to April 1, 2008.

### Other Regulatory Assets and Liabilities

Other regulatory assets include $5 million recorded in the fourth quarter of 2008 for the under-recovery of approved regulatory balances during the period April 1, 2008 to December 31, 2008. The under-recovery results from the collection of approved balances based on actual production, which varies from the forecast production approved by the OEB. The OEB's decision stated that OPG is entitled to recover and is obligated to repay through future regulated prices any under or over-recovery of approved regulatory balances resulting from variances from the forecast production. Other regulatory assets also include the variance account related to transmission outages and transmission restrictions recorded prior to April 1, 2008.

The other regulatory liability of $1 million, as at December 31, 2008, represents the balance in the nuclear fuel variance account approved by the OEB effective April 1, 2008. The other regulatory liability as at December 31, 2007 includes a portion of segregated mode of operations and water transactions net revenues and related interest, which the OEB determined OPG should not refund to ratepayers in its decision. As such, OPG reversed a regulatory liability of $13 million to income in the fourth quarter of 2008 when the OEB's decision was issued.

### Summary of Rate Regulated Accounting

The following tables summarize the impact of applying rate regulated accounting for selected income statement information:

| Years Ended December 31 | 2008 | | | 2007 | | |
|---|---|---|---|---|---|---|
| (millions of dollars) | **As Stated** | **Impact of Rate Regulated Accounting** | **Financial Statements without Rate Regulated Accounting** | As Stated | Impact of Rate Regulated Accounting | Financial Statements without Rate Regulated Accounting |
| Revenue | **6,082** | **(4)** | **6,078** | 5,660 | 9 | 5,669 |
| Fuel expense | **1,191** | **(3)** | **1,188** | 1,270 | (5) | 1,265 |
| Operations, maintenance and administration | **2,967** | **(52)** | **2,915** | 2,974 | 27 | 3,001 |
| Depreciation and amortization | **743** | **(102)** | **641** | 695 | (42) | 653 |
| Losses (earnings) on segregated funds | **93** | **333** | **426** | (481) | – | (481) |
| Accretion on fixed asset removal and nuclear waste management liabilities | **581** | **28** | **609** | 507 | 75 | 582 |
| Property and capital taxes | **79** | **1** | **80** | 85 | 3 | 88 |
| Net interest expense | **165** | **11** | **176** | 143 | 33 | 176 |
| Income taxes | **183** | **(95)** | **88** | (51) | – | (51) |

## 8. LONG-TERM DEBT

Long-term debt consists of the following:

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Notes payable to the Ontario Electricity Financial Corporation | **3,660** | 3,665 |
| Share of non-recourse limited partnership debt | **180** | 188 |
| | **3,840** | 3,853 |
| Less: due within one year | | |
| Notes payable to the Ontario Electricity Financial Corporation | **350** | 400 |
| Share of limited partnership debt | **7** | 7 |
| | **357** | 407 |
| Long-term debt | **3,483** | 3,446 |

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

The maturity dates as at December 31, 2008 for notes payable to the OEFC are as follows:

| | | Principal Outstanding (millions of dollars) | | |
|---|---|---|---|---|
| Year of Maturity | Interest Rate (%) | Senior Notes | Subordinated Notes | Total |
| 2009 | 6.01% | 350 | – | 350 |
| 2010 | 6.00% | 595 | 375 | 970 |
| 2011 | 6.65% | – | 375 | 375 |
| 2012 | 5.72% | 400 | – | 400 |
| 2016 | 4.91% | 270 | – | 270 |
| 2017 | 5.35% | 900 | – | 900 |
| 2018 | 5.27% | 395 | – | 395 |
| | | 2,910 | 750 | 3,660 |

Debt financing for the Niagara Tunnel, the Portlands Energy Centre ("PEC") and the Lac Seul hydroelectric generating station projects is provided by the OEFC. As at December 31, 2008, debt financing for these projects consists of the following:

| (millions of dollars) | Niagara Tunnel | Portlands Energy Centre | Lac Seul Hydroelectric Generating Station |
|---|---|---|---|
| Debt financing, as at December 31, 2007 | 240 | 210 | 20 |
| New borrowing | 100 | 95 | – |
| Debt financing, as at December 31, 2008 | **340** | **305** | **20** |

In September 2005, OPG reached an agreement with the OEFC to provide debt financing for the Niagara Tunnel project. The funding, which is up to $1 billion over the duration of the project, will be in the form of 10-year notes, which will be issued quarterly to meet the project's obligations. Interest will be fixed for each note issued at the time of advance at a rate equal to the prevailing Benchmark Government of Canada 10-Year Bond, plus a credit spread determined by the OEFC based on a survey of market rates. As at December 31, 2008, OPG issued $340 million against this facility, which included new borrowing of $100 million under the facility in 2008.

In December 2006, OPG reached an agreement with the OEFC to provide debt financing for the Lac Seul Hydroelectric Generating Station and the PEC projects. There will be up to $50 million available for the Lac Seul project and up to $400 million available for the PEC project under each credit facility. The credit facilities will be drawn as needed to fund the respective projects over the construction period. The funding will be in the form of 10-year notes with interest rates fixed for each note issued at the time of advance at a rate equal to the prevailing Benchmark Government of Canada 10-Year Bond, plus a credit spread determined by the OEFC based on a survey of market rates. As at December 31, 2008, OPG issued $20 million against the Lac Seul project credit facility and $305 million against the PEC credit facility, which included new borrowing of $95 million under the PEC facility in 2008.

In 2007, OPG reached an agreement with the OEFC for a $500 million general corporate facility and for a $950 million credit agreement to refinance senior notes as they mature over the period September 22, 2007 to September 22, 2009. As of December 31, 2008, OPG borrowed $500 million under its general corporate facility and refinanced $400 million senior notes under the $950 million credit facility, which included new refinancing of $200 million in 2008.

The non-recourse limited partnership debt is secured by a first charge on the assets of one of the joint venture limited partnerships, an assignment of the joint venture's bank accounts, and an assignment of the joint venture's project agreements. OPG's share of the total assets was $275 million as at December 31, 2008 (December 31, 2007 – $284 million). The minimum principal repayments of the non-recourse limited partnership debt for the next five calendar years range from $14 million to $19 million annually. OPG's share of the non-recourse limited partnership debt included a note payable of $127 million at an interest rate of 6.9 percent, with an effective interest rate of 7.0 percent. This note payable is repayable in quarterly payments commencing March 31, 2006 to March 31, 2024. The remaining non-recourse limited partnership debt is at various floating rates. The interest rates of the floating rate debt are referenced to various interest rate indices, such as the bankers' acceptance rate and the London Interbank Offered Rate, plus a margin. The joint venture has entered into floating-to-fixed interest rate hedges to manage the risks arising from fluctuation in interest rates.

Interest paid in 2008 was $242 million (2007 – $224 million), of which $225 million (2007 – $203 million) relates to interest paid on long-term corporate debt. Interest on the notes payable to the OEFC is paid semi-annually.

## 9. SHORT-TERM CREDIT FACILITIES AND NET INTEREST EXPENSE

OPG maintains a $1 billion revolving committed bank credit facility which is divided into two tranches – a $500 million 364-day term tranche and a $500 million five-year term tranche. OPG renewed and extended the maturity date of the 364-day term tranche to May 20, 2009 and the five-year term tranche to May 20, 2013. The total credit facility will continue to be used primarily as credit support for notes issued under OPG's commercial paper program. As at December 31, 2008, no commercial paper was outstanding, and OPG had no other outstanding borrowings under the bank credit facility. In the second quarter of 2008, OPG entered into a $100 million five-year revolving committed bank credit facility in support of the Upper Mattagami Project. As at December 31, 2008, there was no borrowing under this credit facility.

OPG also maintains $25 million (2007 – $25 million) of short-term uncommitted overdraft facilities and $276 million (December 31, 2007 – $238 million) of short-term uncommitted credit facilities, which support the issuance of Letters of Credit. OPG uses Letters of Credit to support its supplementary pension plans and for other purposes. At December 31, 2008, there was a total of $243 million of Letters of Credit issued (December 31, 2007 – $205 million), which included $212 million for the supplementary pension plans (December 31, 2007 – $175 million) and $16 million related to the construction and operation of the PEC (December 31, 2007 – $16 million).

The following table summarizes the net interest expense for the year ended December 31, 2008 and 2007:

| (millions of dollars) | **2008** | 2007 |
|---|---|---|
| Interest on long-term debt | **231** | 205 |
| Interest on short-term debt | **18** | 19 |
| Interest income | **(13)** | (6) |
| Capitalized interest | **(56)** | (42) |
| Interest applied to regulatory assets and liabilities | **(13)** | (33) |
| Other | **(2)** | – |
| Net interest expense | **165** | 143 |

## 10. FIXED ASSET REMOVAL AND NUCLEAR WASTE MANAGEMENT

The liability for fixed asset removal and nuclear waste management on a present value basis consists of the following for the years ended December 31:

| (millions of dollars) | **2008** | 2007 |
|---|---|---|
| Liability for nuclear used fuel management | **6,213** | 5,938 |
| Liability for nuclear decommissioning and low and intermediate level waste management | **5,020** | 4,843 |
| Liability for non-nuclear fixed asset removal | **151** | 176 |
| Fixed asset removal and nuclear waste management liabilities | **11,384** | 10,957 |

The changes in the fixed asset removal and nuclear waste management liabilities for the years ended December 31, 2008 and 2007, are as follows:

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Liabilities, beginning of year | **10,957** | 10,520 |
| Increase in liabilities due to accretion | **608** | 582 |
| Increase in liabilities due to nuclear used fuel and nuclear waste management variable expenses | **47** | 76 |
| Liabilities settled by expenditures on waste management | **(195)** | (200) |
| Decrease in the liabilities for non-nuclear fixed asset removal | **(33)** | (21) |
| Liabilities, end of year | **11,384** | 10,957 |

OPG's fixed asset removal and nuclear waste management liabilities are comprised of expected costs to be incurred up to and beyond termination of operations and the closure of nuclear and fossil-fuelled generating plant facilities. Costs will be incurred for activities such as dismantling, demolition and disposal of facilities and equipment, remediation and restoration of sites and the ongoing and long-term management of nuclear used fuel and low and intermediate level waste material. Nuclear station decommissioning consists of original placement of stations into a safe store condition followed by a nominal 30-year store period prior to station dismantling.

The following costs are recognized as a liability:

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

The determination of the accrual for fixed asset removal and nuclear waste management costs requires significant assumptions, since these programs run for many years. The most recent update of the estimates for the nuclear used fuel management and nuclear decommissioning and low and intermediate level waste management liabilities was performed as at December 31, 2006. The update resulted in an increased estimate of costs mainly due to additional used fuel and waste quantities resulting from station life extensions, experience in decommissioning reactors, and changes in economic indices. The increase was partially offset by the impact of later end of life dates for some stations, which results in later decommissioning dates and a reduced present value of decommissioning costs. The change in the cost estimate resulted in an updated Reference Plan, the 2006 Approved Reference Plan, which was approved by the Province in accordance with the terms of the ONFA.

As a result of the approval of the 2006 Approved Reference Plan, OPG recognized additional expenses including accretion on the fixed asset removal and nuclear waste management liabilities and depreciation of the carrying value of the related fixed assets starting on January 1, 2007. The impact of these additional expenses for the period up to March 31, 2008 was reduced by the recognition of a regulatory asset, as prescribed by the regulation pursuant to the *Electricity Restructuring Act*, *2004* (Ontario). OPG began recovering this regulatory asset through regulated prices effective April 1, 2008, as per the OEB's decision. This is discussed in Note 7 to the consolidated financial statements.

For the purposes of calculating OPG's fixed asset removal and nuclear waste management liabilities, nuclear and fossil-fuelled plant closures are projected to occur over the next 6 to 28 years. End of life dates may change as decisions on life extensions are made. The 2006 Approved Reference Plan includes cash flow estimates for decommissioning nuclear stations for approximately 40 years after station shutdown and to 2065 for placement of used fuel into the long-term disposal repository followed by extended monitoring. The undiscounted amount of estimated future cash flows associated with the liabilities is approximately $24 billion in 2008 dollars. The discount rate used to calculate the present value of the liabilities was 5.75 percent for liabilities established prior to December 31, 2006. The increase in cost estimates related to the 2006 Approved Reference Plan and subsequent increases to the value of the undiscounted estimated cash flows for OPG's liability for nuclear waste management and decommissioning are discounted at 4.6 percent. The cost escalation rates ranged from 1.8 percent to 3.6 percent. Under the terms of the lease agreement with Bruce Power, OPG continues to be responsible for the nuclear fixed asset removal and nuclear waste management liabilities associated with the Bruce nuclear generating stations.

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

### Liability for Nuclear Used Fuel Management Costs

The liability for nuclear used fuel management represents the cost of managing the highly radioactive used nuclear fuel bundles. The federal Nuclear Fuel Waste Act ("NFWA") released in 2002 required that Canada's nuclear fuel waste owners form a Nuclear Waste Management Organization ("NWMO") and that each waste owner establish a trust fund for used fuel management costs. To estimate its liability for nuclear used fuel management costs, OPG has adopted a conservative approach consistent with the Adaptive Phased Management concept approved by the Government of Canada, which assumes a deep geologic repository in-service date in 2035.

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

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

The life cycle costs of low and intermediate level waste management include the costs of processing and storage of such radioactive wastes during and following the operation of the nuclear stations, as well as the costs of ultimate long-term management of these wastes. The current assumptions used to establish the accrued low and intermediate level waste management costs include a disposal facility for low and intermediate level waste with a targeted in-service date of year end 2017. Agreement has been reached with local municipalities for OPG to develop a deep geologic repository for the long-term management of low and intermediate level waste adjacent to the Western Waste Management Facility. A federal environmental assessment in respect of this proposed facility is in progress.

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

The liability for non-nuclear fixed asset removal is based on third-party cost estimates after an in-depth review of active plant sites and an assessment of required clean-up and restoration activities. This liability represents the estimated costs of decommissioning fossil-fuelled generating stations at the end of their service lives. The estimated retirement date of these stations is between 2014 and 2034.

In addition to the $87 million liability for active sites, OPG also has an asset retirement obligation liability of $64 million for decommissioning and restoration costs associated with plant sites that have been divested or are no longer in use.

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

### Ontario Nuclear Funds Agreement

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

The Decommissioning Fund was established to fund the future costs of nuclear fixed asset removal and long-term low and intermediate level nuclear waste management and a portion of used fuel storage costs after station life. As at December 31, 2008, the Decommissioning Fund was in an underfunded position. The Decommissioning Fund was in an overfunded position as at December 31, 2007. OPG bears the risk and liability for cost estimate increases and fund earnings in the Decommissioning Fund.

The Used Fuel Fund will be used to fund future costs of long-term nuclear used fuel waste management. OPG is responsible for the risk and liability for cost increases for used fuel waste management, subject to graduated liability thresholds specified in the ONFA, which limit OPG's total financial exposure at approximately $10.1 billion in December 31, 2008 dollars based on used fuel bundle projections of 2.23 million bundles consistent with the station lives included within the initial financial reference plan. The graduated liability thresholds do not apply to additional used fuel bundles beyond 2.23 million as projected in the 2006 Approved Reference Plan.

OPG makes quarterly payments to the Used Fuel Fund over the life of its nuclear generating stations, as specified in the ONFA. Required funding for 2008 under the ONFA was $454 million, including a contribution to The Ontario NFWA Trust (the "Trust") of $100 million.

In 2007, OPG made a one-time contribution of approximately $334 million to the Used Fuel Fund to satisfy the extraordinary payment specified within the ONFA and related to the Bruce Lease transaction with Bruce Power as discussed in Note 19. This payment constituted a Triggering Event under the ONFA, which has subsequently resulted in an Amended Payment Schedule. The Amended Payment Schedule was approved by the Ontario Financing Authority in March 2008. The Amended Payment Schedule requires contribution amounts of $454 million in 2008 and from $339 million to $240 million over the years 2009 to 2012 (Note 16).

The NFWA was proclaimed into force in November 2002. As required under the NFWA, OPG established the Trust in November 2002 and made an initial deposit of $500 million into the Trust. The NFWA requires OPG to make annual contributions of $100 million to the Trust. These contributions are to be deposited into the Trust no later than the November anniversary of the NFWA. In accordance with the NFWA, the NWMO proposed a funding formula to address the future financial costs of implementing the Adaptive Phased Management approach in its 2007 Annual Report. The proposed funding formula is under review by the Federal Government. The NFWA specifies that contributions to the Trust are to continue at the present rate of $100 million until the funding formula is approved by the Minister of Natural Resources. The Trust forms part of the Used Fuel Fund, and contributions to the Trust as required by the NFWA are applied towards the ONFA payment obligations.

As required by the terms of the ONFA, the Province has provided a Provincial Guarantee to the Canadian Nuclear Safety Commission ("CNSC") since 2003, on behalf of OPG. The *Nuclear Safety and Control Act* (Canada) requires OPG to have sufficient funds available to discharge the current nuclear decommissioning and waste management liabilities. The Provincial Guarantee will supplement the Used Fuel Fund and the Decommissioning Fund until they have accumulated sufficient funds to cover the accumulated liabilities for nuclear decommissioning and waste management. The value of this guarantee is for $1,545 million for years 2009 to 2012. The guarantee, taken together with the Used Fuel Fund and Decommissioning Fund, are in satisfaction of OPG's nuclear licensing requirements with the CNSC. OPG pays the Province an annual guarantee fee of 0.5 percent of the amount guaranteed by the Province. In 2008, OPG paid the annual guarantee fee of $3.8 million based on a Provincial Guarantee amount of $760 million (2007 – $8 million on a Provincial Guarantee amount of $1,510 million).

Effective January 1, 2007, OPG adopted the CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement*. As a result of the adoption of this new section, the investments in the Nuclear Funds and the corresponding payables to the Province are classified as held-for-trading and are measured at fair value with realized and unrealized gains and losses recognized in OPG's consolidated financial statements.

### Decommissioning Fund

Upon termination of the ONFA, the Province has a right to any excess funding in the Decommissioning Fund, which is the excess of the fair market value of the Decommissioning Fund over the estimated completion costs as per the most recently approved ONFA Reference Plan. When the Decommissioning Fund is overfunded, OPG limits the earnings it recognizes in its consolidated financial statements, through a charge to the Decommissioning Fund with a corresponding payable to the Province, such that the balance of the Decommissioning Fund would equal the cost estimate of the liability based on the most recently approved ONFA Reference Plan. The payable to the Province could be reduced in subsequent periods in the event that the Decommissioning Fund earns less than its target rate of return or in the event that a new ONFA Reference Plan is approved with a higher estimated decommissioning liability. When the Decommissioning Fund is underfunded, the earnings on the Decommissioning Fund reflect actual fund returns based on the market value of the assets.

The Province's right to any excess funding in the Decommissioning Fund upon termination of the ONFA results in OPG capping its earnings at 5.15 percent, which is the rate of growth in the liability for the estimated completion cost, as long as the Decommissioning Fund is in an overfunded status. If the Decommissioning Fund were underfunded, the earnings for the Decommissioning Fund would reflect actual fund returns based on the market value of the assets.

The Decommissioning Fund's asset value on a fair value basis was $4,325 million at December 31, 2008, which was less than the liability per the approved 2006 Approved ONFA Reference Plan. At December 31, 2007, the Decommissioning Fund's asset value on a fair value basis was $5,075 million, which exceeded the value of the liability as per the 2006 Approved Reference Plan. As a result of the overfunded status, OPG reported a payable to the Province of $3 million, reflecting an amount due to the Province if the Decommissioning Fund were terminated under the ONFA. Under the ONFA, if there is a surplus in the Decommissioning Fund such that the liabilities, as defined by the most recently approved ONFA Reference Plan, are at least 120 percent funded, OPG may direct up to 50 percent of the surplus over 120 percent to be treated as a contribution to the Used Fuel Fund, and the OEFC would be entitled to a distribution of an equal amount.

The investments in the Decommissioning Fund include a diversified portfolio of equities and fixed income securities that are invested across many geographic markets. The Nuclear Funds are invested to fund long-term liability requirements, and as such, the portfolio asset mix is structured to achieve the required return over a long-term horizon. While short-term fluctuations in market value will occur, managing the long-term return of the Nuclear Funds remains the primary goal.

### Used Fuel Fund

Under the ONFA, the Province guarantees OPG's annual return in the Used Fuel Fund at 3.25 percent plus the change in the Ontario Consumer Price Index ("committed return") for funding related to the first 2.23 million used fuel bundles. OPG recognizes the committed return on the Used Fuel Fund and includes it in the earnings on the nuclear fixed asset removal and nuclear waste management funds. The difference between the committed return on the Used Fuel Fund and the actual market return, based on the fair value of the Used Fuel Fund's assets, which includes realized and unrealized returns, is recorded as due to or due from the Province.

As at December 31, 2008, the Used Fuel Fund asset value on a fair value basis was $4,424 million. The asset value included a receivable from the Province of $460 million related to the committed return adjustment. As at December 31, 2007, the Used Fuel Fund asset value on a fair value basis was $4,702 million. The asset value was offset by a payable to the Province of $511 million related to the committed return adjustment.

Under the ONFA, the Province is entitled to any surplus in the Used Fuel Fund, subject to a threshold funded ratio of 110 percent compared to the value of the associated liabilities.

The nuclear fixed asset removal and nuclear waste management funds as at December 31, 2008 and 2007 consist of the following:

| | Fair Value | |
|---|---|---|
| (millions of dollars) | **2008** | 2007 |
| Decommissioning Fund | **4,325** | 5,075 |
| Due to Province – Decommissioning Fund | **–** | (3) |
| | **4,325** | 5,072 |
| Used Fuel Fund[1] | **4,424** | 4,702 |
| Due from (to) Province – Used Fuel Fund | **460** | (511) |
| | **4,884** | 4,191 |
| | **9,209** | 9,263 |

1 The Ontario NFWA Trust represented $1,386 million as at December 31, 2008 (December 31, 2007 – $1,244 million) of the Used Fuel Fund on a fair value basis.

The fair value of the securities invested in the Nuclear Funds, which include the Used Fuel Fund and Decommissioning Fund, as at December 31, 2008 and 2007, are as follows:

| | Fair Value | |
|---|---|---|
| (millions of dollars) | **2008** | 2007 |
| Cash and cash equivalents and short-term investments | **503** | 833 |
| Marketable equity securities | **4,451** | 5,391 |
| Bonds and debentures | **3,805** | 3,559 |
| Administrative expense payable | **(10)** | (6) |
| | **8,749** | 9,777 |
| Due to Province – Decommissioning Fund | **–** | (3) |
| Due from (to) Province – Used Fuel Fund | **460** | (511) |
| Total | **9,209** | 9,263 |

The bonds and debentures held in the Used Fuel Fund and the Decommissioning Fund as at December 31, 2008 and 2007 mature according to the following schedule:

| | Fair Value | |
|---|---|---|
| (millions of dollars) | **2008** | 2007 |
| 1 – 5 years | **1,618** | 1,631 |
| 5 – 10 years | **962** | 879 |
| More than 10 years | **1,225** | 1,049 |
| Total maturities of debt securities | **3,805** | 3,559 |
| Average yield | **4.6%** | 4.9% |

The change in the Nuclear Funds for the years ended December 31, 2008 and 2007, are as follows:

| | Fair Value | |
|---|---|---|
| (millions of dollars) | **2008** | 2007 |
| Decommissioning Fund at beginning of year | **5,072** | 4,875 |
| (Decrease) increase in fund due to return on investments | **(681)** | 5 |
| Decrease in fund due to reimbursement of expenditures | **(69)** | (99) |
| Decrease in Due to Province | **3** | 291 |
| Decommissioning Fund, end of year | **4,325** | 5,072 |
| Used Fuel Fund, beginning of year | **4,191** | 3,238 |
| Increase in fund due to contributions made | **454** | 788 |
| (Decrease) increase in fund due to return on investments | **(719)** | 55 |
| Decrease in fund due to reimbursement of expenditures | **(13)** | (20) |
| Decrease in Due to Province | **511** | 130 |
| Increase in Due from Province | **460** | – |
| Used Fuel Fund, end of year | **4,884** | 4,191 |

The earnings (losses) from the Nuclear Funds during 2008 were partially mitigated by the establishment of a variance account for revenues and costs associated with the Bruce nuclear stations, as a result of the OEB's decision. The earnings on the Nuclear Funds for 2008 and 2007 are as follows:

| (millions of dollars) | **2008** | 2007 |
|---|---|---|
| Decommissioning Fund | **(678)** | 296 |
| Used Fuel Fund | **252** | 185 |
| Bruce Variance Account | **333** | – |
| Total earnings (losses) | **(93)** | 481 |

## 11. INCOME TAXES

Commencing April 1, 2005, OPG accounts for income taxes related to the rate regulated segments of its business using the taxes payable method. Under the taxes payable method, OPG does not recognize future income taxes related to the rate regulated segments of its business to the extent that the future income taxes are expected to be recovered or refunded through future regulated prices charged to customers.

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

| (millions of dollars unless otherwise stated) | **2008** | 2007 |
|---|---|---|
| Income before income taxes | **271** | 477 |
| Combined Canadian federal and provincial statutory income tax rates, including surtax | **33.5%** | 36.1% |
| Statutory income tax rates applied to accounting income | **91** | 172 |
| Increase in income taxes resulting from: | | |
| Income tax component of the Bruce variance account | **95** | – |
| Lower future tax rate on temporary differences | **(33)** | (10) |
| Non-taxable income items | **(15)** | (7) |
| Unrecorded future income tax related to regulated operations | **151** | (127) |
| Change in income tax positions | **(106)** | (13) |
| Changes in future tax rate | **–** | (66) |
| | **92** | (223) |
| Income tax expense (recovery) | **183** | (51) |
| Effective rate of income taxes | **67.5%** | (10.7%) |

In the third quarter of 2006, OPG received a preliminary communication from the Provincial Tax Auditors ("Tax Auditors") with respect to their initial findings from their audit of OPG's 1999 taxation year. Many of the issues raised through the audit were unique to OPG and related either to start-up matters and positions taken on April 1, 1999 upon commencement of operations, or matters that were not adequately addressed through the *Electricity Act*, *1998*. In 2008, all outstanding tax matters related to the 1999 tax audit were resolved. As a result, OPG reduced its income tax liability by $106 million.

The audit of OPG's taxation years subsequent to 1999 is expected to commence in 2009. Should the ultimate outcome materially differ from OPG's recorded income tax liabilities, the Company's effective tax rate and its earnings could be affected positively or negatively in the period in which the matters are resolved.

The Bruce variance account authorized by the OEB in its decision on OPG's application for new regulated prices for its regulated production effective April 1, 2008 is discussed in Note 7 to these consolidated financial statements. In its decision, the OEB also approved a taxation variance account effective April 1, 2008. The scope of the account with respect to income taxes includes variances in the income tax expense for the Company's rate regulated segments caused by changes in tax rates or rules under the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario), as modified by the *Electricity Act*, *1998*, as well as variances caused by reassessments due to audits of OPG's taxation years subsequent to 1999. Variances are to be determined with respect to the forecast to be approved by the OEB. OPG did not record any amounts in the account for the year ended December 31, 2008.

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

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Current income tax expense (recovery): | | |
| Current payable | **169** | 1 |
| Change to income tax position | **86** | – |
| | **255** | 1 |
| Future income tax expense (recovery): | | |
| Change in temporary differences | **25** | (2) |
| Change to income tax position | **(192)** | – |
| Changes in future tax rate | **–** | (30) |
| Income tax component of the Bruce variance account | **95** | – |
| Other | **–** | (20) |
| | **(72)** | (52) |
| Income tax expense (recovery) | **183** | (51) |

The income tax effects of temporary differences that give rise to future income tax assets and liabilities as at December 31, 2008 and 2007 are presented in the table below:

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Future income tax assets: | | |
| Fixed asset removal and nuclear waste management liabilities | **30** | 22 |
| Other liabilities and assets | **163** | 125 |
| Future recoverable Ontario minimum tax | **–** | 87 |
| | **193** | 234 |
| Future income tax liabilities: | | |
| Fixed assets | **(56)** | (263) |
| Other liabilities and assets | **(69)** | (176) |
| | **(125)** | (439) |
| Net future income tax assets (liabilities) | **68** | (205) |
| Represented by: | | |
| Current portion – asset | **6** | 12 |
| Long-term portion – asset (liability) | **62** | (217) |
| | **68** | (205) |

The following table summarizes the difference in the consolidated statements of income and consolidated statements of comprehensive income under the taxes payable method used by the Company to account for income taxes for the regulated businesses compared to what would have been reported had OPG applied the liability method for the regulated businesses for 2008 and 2007:

| (millions of dollars) | **2008** | 2007 |
|---|---|---|
| As stated: | | |
| Future income tax expense | **(72)** | (52) |
| Future income tax: Other comprehensive income – upon transition | **–** | 16 |
| Future income tax: Other comprehensive income – for the year | **(6)** | (8) |
| Liability method[1]: | | |
| Future income tax expense | **(50)** | 75 |
| Future income tax: Other comprehensive income – upon transition | **–** | 12 |
| Future income tax: Other comprehensive income – for the year | **(19)** | (6) |

1 OPG accounted for certain lease revenues relating to the regulated businesses for the three months ended March 31, 2008 and for the year ended December 31, 2007 using the cash basis of accounting. The related future income tax impact is excluded from the above.

The following table summarizes the difference in the consolidated balance sheet amounts under the taxes payable method used by the Company to account for income taxes compared to what would have been reported had OPG applied the liability method for the regulated business as at December 31, 2008 and 2007. The amounts of future income taxes not recorded do not include the future income taxes resulting from regulatory assets and liabilities that are required to be recorded effective January 1, 2009 due to amendments to the CICA Handbook Section 3465, *Income Taxes*.

| | **2008** | | 2007 | |
|---|---|---|---|---|
| (millions of dollars) | **As Stated[1]** | **Liability Method[1,2]** | As Stated | Liability Method[2] |
| Current future income tax recoverable (liabilities) | **6** | **47** | 12 | 39 |
| Long-term future income tax liabilities | **62** | **(319)** | (217) | (680) |

1 The future income tax asset and liability balances above include adjustments during 2008 related to changes in income tax positions resulted from the resolution of the 1999 income tax audit. In addition, the income tax component of the Bruce variance account was reflected in the Bruce Regulatory Asset account and not in the future income tax asset (liability) balance above.

2 OPG accounted for certain lease revenues relating to the regulated businesses for the three months ended March 31, 2008 and for the year ended December 31, 2007 using the cash basis of accounting. The related future income tax impact is excluded from the above.

The amount of cash income taxes paid for 2008 was $49 million (2007 – $64 million).

## 12. PENSION AND OTHER POST EMPLOYMENT BENEFIT PLANS

The pension and OPEB obligations, and the pension fund assets, are measured at December 31, 2008. Details of OPG's pension and OPEB obligations, pension fund assets and costs are presented in the following tables:

| | Registered and Supplementary Pension Plans | | Other Post Employment Benefits | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| **Weighted Average Assumptions – Benefit Obligation at Year End** | | | | |
| Rate used to discount future benefits | **7.50%** | 5.60% | **7.46%** | 5.59% |
| Salary schedule escalation rate | **3.00%** | 3.25% | **–** | – |
| Rate of cost of living increase to pensions | **2.00%** | 2.25% | **–** | – |
| Initial health care trend rate | **–** | – | **6.58%** | 6.91% |
| Ultimate health care trend rate | **–** | – | **4.69%** | 4.68% |
| Year ultimate rate reached | **–** | – | **2018** | 2014 |
| Rate of increase in disability benefits | **–** | – | **2.00%** | 2.25% |

| | Registered and Supplementary Pension Plans | | Other Post Employment Benefits | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| **Weighted Average Assumptions – Cost for the Year** | | | | |
| Expected return on plan assets net of expenses | **7.00%** | 7.00% | **–** | – |
| Rate used to discount future benefits | **5.60%** | 5.25% | **5.59%** | 5.22% |
| Salary schedule escalation rate | **3.25%** | 3.00% | **–** | – |
| Rate of cost of living increase to pensions | **2.25%** | 2.00% | **–** | – |
| Initial health care trend rate | **–** | – | **6.91%** | 7.34% |
| Ultimate health care trend rate | **–** | – | **4.68%** | 4.68% |
| Year ultimate rate reached | **–** | – | **2014** | 2014 |
| Rate of increase in disability benefits | **–** | – | **2.25%** | 2.00% |
| Average remaining service life for employees (years) | **11** | 11 | **11** | 11 |

| | Registered Pension Plan | | Supplementary Pension Plans | | Other Post Employment Benefits | |
|---|---|---|---|---|---|---|
| (millions of dollars) | **2008** | 2007 | **2008** | 2007 | **2008** | 2007 |
| **Changes in Plan Assets** | | | | | | |
| Fair value of plan assets at beginning of year | **8,924** | 8,829 | **–** | – | **–** | – |
| Contributions by employer | **253** | 268 | **10** | 7 | **71** | 66 |
| Contributions by employees | **75** | 66 | **–** | – | **–** | – |
| Actual return on plan assets net of expenses | **(1,566)** | 159 | **–** | – | **–** | – |
| Benefit payments | **(432)** | (398) | **(10)** | (7) | **(71)** | (66) |
| Fair value of plan assets at end of year | **7,254** | 8,924 | **–** | – | **–** | – |
| **Changes in Projected Benefit Obligation** | | | | | | |
| Projected benefit obligation at beginning of year | **9,603** | 9,313 | **162** | 152 | **2,064** | 2,067 |
| Employer current service costs | **217** | 224 | **6** | 6 | **59** | 70 |
| Contributions by employees | **75** | 66 | **–** | – | **–** | – |
| Interest on projected benefit obligation | **540** | 493 | **9** | 8 | **116** | 109 |
| Benefit payments | **(432)** | (398) | **(10)** | (7) | **(71)** | (66) |
| Net actuarial (gain) loss | **(2,563)** | (95) | **(25)** | 3 | **(577)** | (116) |
| Projected benefit obligation at end of year | **7,440** | 9,603 | **142** | 162 | **1,591** | 2,064 |
| Funded Status – Deficit at end of year | **(186)** | (679) | **(142)** | (162) | **(1,591)** | (2,064) |

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

| | **2008** | 2007 |
|---|---|---|
| Registered pension plan fund asset investment categories | | |
| Equities | **60%** | 60% |
| Fixed income | **37%** | 35% |
| Cash and short-term investments | **3%** | 5% |
| Total | **100%** | 100% |

Based on the most recently filed actuarial valuation, as at January 1, 2008, there was an unfunded liability on a going-concern basis of $239 million and a deficiency on a wind-up basis of $2,846 million. In the previously filed actuarial valuation, as at January 1, 2005, there was an unfunded liability on a going-concern basis of $465 million and a deficiency on a wind-up basis of $1,979 million. The deficit disclosed in the next filed funding valuation, which must have an effective date no later than January 1, 2011, could be significantly different.

The supplementary pension plans are not funded, but are secured by Letters of Credit totalling $212 million (2007 – $175 million).

| (millions of dollars) | Registered Pension Plan 2008 | 2007 | Supplementary Pension Plans 2008 | 2007 | Other Post Employment Benefits 2008 | 2007 |
|---|---|---|---|---|---|---|
| **Reconciliation of Funded Status to Accrued Benefit Asset (Liability)** | | | | | | |
| Funded status – deficit at end of year | **(186)** | (679) | **(142)** | (162) | **(1,591)** | (2,064) |
| Unamortized net actuarial loss (gain) | **937** | 1,346 | **(3)** | 22 | **(70)** | 538 |
| Unamortized past service costs | **46** | 64 | **2** | 3 | **16** | 20 |
| Accrued benefit asset (liability) at end of year | **797** | 731 | **(143)** | (137) | **(1,645)** | (1,506) |
| Short-term portion | **–** | – | **(6)** | (7) | **(79)** | (80) |
| Long-term portion | **797** | 731 | **(137)** | (130) | **(1,566)** | (1,426) |

| (millions of dollars) | Registered Pension Plan 2008 | 2007 | Supplementary Pension Plans 2008 | 2007 | Other Post Employment Benefits 2008 | 2007 |
|---|---|---|---|---|---|---|
| **Components of Cost Recognized** | | | | | | |
| Current service costs | **217** | 224 | **6** | 6 | **59** | 70 |
| Interest on projected benefit obligation | **540** | 493 | **9** | 8 | **116** | 109 |
| Expected return on plan assets net of expenses | **(623)** | (569) | **–** | – | **–** | – |
| Amortization of past service costs | **18** | 18 | **1** | – | **4** | 5 |
| Amortization of net actuarial loss | **35** | 77 | **–** | 1 | **31** | 45 |
| Cost recognized | **187** | 243 | **16** | 15 | **210** | 229 |

| (millions of dollars) | Registered Pension Plan 2008 | 2007 | Supplementary Pension Plans 2008 | 2007 | Other Post Employment Benefits 2008 | 2007 |
|---|---|---|---|---|---|---|
| **Components of Cost Incurred and Recognized** | | | | | | |
| Current service costs | **217** | 224 | **6** | 6 | **59** | 70 |
| Interest on projected benefit obligation | **540** | 493 | **9** | 8 | **116** | 109 |
| Actual return on plan assets net of expenses | **1,566** | (159) | **–** | – | **–** | – |
| Net actuarial (gain) loss | **(2,563)** | (95) | **(25)** | 3 | **(577)** | (116) |
| Cost incurred in year | **(240)** | 463 | **(10)** | 17 | **(402)** | 63 |
| Differences between costs incurred and recognized in respect of: | | | | | | |
| Actual return on plan assets net of expenses | **(2,189)** | (410) | **–** | – | **–** | – |
| Past service costs | **18** | 18 | **1** | – | **4** | 5 |
| Net actuarial loss (gain) | **2,598** | 172 | **25** | (2) | **608** | 161 |
| Cost recognized | **187** | 243 | **16** | 15 | **210** | 229 |

A one percent increase or decrease in the health care trend rate would result in an increase in the service and interest components of the 2008 OPEB cost recognized of $33 million (2007 – $37 million) or a decrease in the service and interest components of the 2008 OPEB cost recognized of $24 million (2007 – $29 million), respectively. A one percent increase or decrease in the health care trend rate would result in an increase in the projected OPEB obligation at December 31, 2008 of $213 million (2007 – $328 million) or a decrease in the projected OPEB obligation at December 31, 2008 of $170 million (2007 – $256 million).

## 13. FINANCIAL INSTRUMENTS

OPG's Board of Directors has approved, and management has implemented, a risk management governance structure designed to effectively identify, measure, monitor and report on key risks across the Company. Risk management activities are coordinated through a centralized risk management group, separate and independent from operational management. Risk information from the business units is independently assessed and aggregated by the Risk Services Group, and is reported by the Chief Risk Officer to the Executive Risk Committee and to the Audit/Risk Committee of the Board. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities.

OPG is exposed to risks related to changes in electricity prices associated with a wholesale spot market for electricity in Ontario, changes in interest rates, and movements in foreign currency that affect its assets, liabilities, and forecast transactions. Select derivative instruments are used to limit such risks. Derivatives are used as hedging instruments, as well as for trading purposes.

The following is a summary of OPG's financial instruments as at December 31, 2008:

| Financial Instruments[1] (millions of dollars) | Designated Category | **Fair Value** |
|---|---|---|
| Cash and cash equivalents | Held-to-maturity | **315** |
| Long-term investments[2] | Held-to-maturity | **35** |
| Nuclear fixed asset removal and nuclear waste management funds | Held-for-trading | **9,209** |
| Long-term debt (including current portion) | Other liabilities | **3,828** |
| Other commodity derivative instruments included in current and long-term accounts receivable[3] | Held-for-trading | **49** |
| Other commodity derivative instruments included in current and long-term accounts payable[3] | Held-for-trading | **(19)** |

1 The carrying value of other financial instruments included in accounts receivable and accounts payable and accrued charges approximates their fair value due to the immediate or short-term maturity of these financial instruments.

2 Excludes investments of $39 million owned by the Company's wholly-owned subsidiary, OPGV, that are recorded at fair value in accordance with AcG-18.

3 Derivative instruments not qualifying for hedge accounting.

### Risks Associated with Financial Instruments

#### Credit Risk

Credit risk is the risk that a counterparty to a financial instrument might fail to meet its obligation under the terms of a financial instrument. To manage credit risk, the Company enters into transactions with creditworthy counterparties, limits the amount of exposure to each counterparty where possible, and monitors the financial condition of counterparties.

The following table provides information on credit risk from energy trading activities (excluding fuels) as at December 31, 2008:

| | | | Potential Exposure for Largest Counterparties | |
|---|---|---|---|---|
| Credit Rating[1] | Number of Counterparties[2] | Potential Exposure[3] | Number of Counterparties | Counterparty Exposure |
| | | (millions of dollars) | | (millions of dollars) |
| Investment grade | 28 | 118 | 4 | 84 |

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 OPG's counterparties are defined by each master agreement.

3 Potential exposure is OPG's assessment of maximum exposure over the life of each transaction at a 95 percent confidence interval.

The majority of OPG's revenues are derived from sales through the IESO administered spot market. Net credit exposure to the IESO at December 31, 2008 was $207 million (Note 5). Although the credit exposure to the IESO represents a significant portion of OPG's accounts receivable, the Company's management accepts this risk due to the IESO's primary role in the Ontario electricity market. The remaining receivables exposure was a diverse group of generally high quality counterparties. OPG's allowance for doubtful debts at December 31, 2008 was less than $1 million.

OPG also enters into financial transactions with highly rated financial institutions in order to hedge interest rate and currency exposures. The potential credit exposure with these counterparties was less than $10 million at December 31, 2008. Other credit exposures include the investing of excess cash.

*Investments*
The Company limits its exposure to credit risk by investing in reasonably liquid (i.e., in normal circumstances, capable of liquidation within one month) securities that are rated by a recognized credit rating agency in accordance with a minimum investment quality standards. In regard to derivative contracts, the Company limits its exposure to credit risk by engaging with high credit-quality counterparties.

Current exposure to credit risk has changed due to the Company's exposure to the restructuring of the ABCP market in Canada. Additional details with respect to OPG's exposure to the restructuring program are described in Note 4.

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

### Liquidity Risk
Liquidity risk arises through excess financial obligations over available financial assets, due at any point in time. The Company's approach to managing liquidity is to continuously monitor its ability to maintain sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses.

The table below summarizes the maturity profile of the Company's long-term debt at December 31, 2008:

| (millions of dollars) | 2009 | 2010 | 2011 | 2012 | 2013 and Thereafter |
|---|---|---|---|---|---|
| Long-term debt | 357 | 978 | 383 | 409 | 1,713 |
| Interest on long-term debt | 215 | 183 | 134 | 106 | 465 |

Non-recourse limited partnership debt is secured by a first charge on the assets of one of the joint venture limited partnerships, an assignment of the joint venture's bank accounts, and an assignment of the joint venture's project agreements.

### Market Risk
Market risk is the risk that changes to market prices, such as foreign exchange rates, interest rates, electricity prices and equities, will affect OPG's income or the value of the Company's holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The Company manages its exposure to market risks using forwards and various derivative products in the ordinary course of business. All such transactions are carried out within the guidelines set by the Executive Risk Committee.

*Foreign Exchange Risk*
OPG's foreign exchange exposure is attributable to two primary factors: United States dollar ("USD") denominated transactions such as the purchase of fossil fuels; and the influence of USD denominated commodity prices on Ontario electricity spot market prices. OPG enters into derivative contracts with major financial institutions to manage the Company's exposure to foreign currency movements.

*Interest Rate Risk*
Interest rate risk is the risk that the value of OPG's assets and liabilities can decrease and increase respectively because of a change in the related interest rates. OPG considers interest rate risk related to cash and cash equivalents and short-term borrowings to be low because of their short-term nature. Changes in interest rates do not currently have a significant impact on the Company's interest expense, since long-term borrowings are on a fixed rate basis.

The Company is exposed to interest rate risk on its long-term borrowings expected to be issued in the future. The Company manages the exposure to changes in market interest rates on anticipated issuance of long-term borrowings by entering into forward start interest rate contracts and floating-to-fixed interest rate swap contracts.

*Electricity Price Risk*

Electricity price risk for the Company is the potential for adverse movements in the market price of electricity. Exposure to electricity price risk is reduced as a result of regulated prices for a significant portion of OPG's business, and is also affected by the revenue limit rebate mechanism that applies to generation from OPG's unregulated generating stations. To manage this risk, the Company seeks to maintain a balance between the commodity price risk inherent in its electricity production and electricity forward sales contracts to the extent that trading liquidity in the electricity commodity market provides the economic opportunity to do so.

The table below summarizes a sensitivity analysis for significant unsettled market risk exposures with respect to the Company's financial instruments as at December 31, 2008, with all other variables held constant. It shows how net income and other comprehensive income before tax would have been affected by changes in the relevant risk variable that were reasonably possible, at that date, over the year.

| (millions of dollars except where noted) | A Change of: | Impact on Net Income Before Tax | Impact on Other Comprehensive Income Before Tax |
|---|---|---|---|
| Foreign exchange – USD | +/- 0.04 | – | 1 |
| Interest rate[1] | +/- 35 basis points | – | 7 |
| Electricity price – Hedge[2] | | n/a | 7 |
| Electricity price – Trading[2] | | 1 | n/a |

1 The interest rate sensitivity analysis was determined based on the exposure to interest rates for derivative instruments designated as hedges at the date of the consolidated balance sheets.

2 The sensitivity analysis around electricity prices was constructed using forward price volatilities that were based on historical daily forward electricity contract prices. The analysis considered contracts of varying time frames, traded in Ontario and neighbouring electricity markets.

**Nuclear Funds Equity Price Risk**

Equity price risk is the risk of loss or unexpected volatility due to a decline in the values of individual equities and/or equity indices. The Company is exposed to equity price risk primarily related to equity investments held in the Nuclear Funds that are classified on the consolidated balance sheets as held-for-trading and measured at fair value. To manage this risk, OPG has established investment policies and procedures that set out an investment framework for the funds, including the investment assumptions, permitted investments, and various investment constraints for the Nuclear Funds. Such policies and procedures are approved annually by OPG and the Province in the case of the Decommissioning Fund, and by the Province in the case of the Used Fuel Fund.

Under the ONFA, the annual return in the Used Fuel Fund is guaranteed by the Province for funding related to the first 2.23 million used fuel bundles. Therefore, OPG is not currently exposed to equity price risk in the Used Fuel Fund. OPG is, however, exposed to equity price risk in the Decommissioning Fund. Due to the long-term nature of the Decommissioning Fund's liabilities, the target asset mix of the fund was established with the goal of meeting the long-term liabilities. As such, the Company is prepared to accept shorter term market fluctuations with the expectation that equity securities will provide adequate returns over the long-term.

The table below approximates the potential dollar impact on OPG's pre-tax profit, associated with a one percent change in the specified equity indices. This analysis is based on the market values of the Decommissioning Fund's equity holdings at December 31, 2008, as well as on the assumption that when one equity index changes by one percent, all other equity indices are held constant.

| (millions of dollars) | December 31, 2008 |
|---|---|
| S&P/TSX Capped Composite Index | 9 |
| S&P 500 | 4 |
| MSCI EAFE Index | 4 |
| MSCI World Index | 5 |

## Derivatives and Hedging

At the inception of a hedging relationship, OPG documents the relationship between the hedging instrument and the hedged item, its risk management objective and its strategy for undertaking the hedge. OPG also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the derivatives that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items.

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 a derivative instrument hedge 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.

### Derivative Instruments Qualifying for Hedge Accounting

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 in net income upon settlement when the underlying transactions occur.

OPG holds financial commodity derivatives primarily to hedge the commodity price exposure associated with changes in the price of electricity.

| | **Notional Quantity** | **Terms** | **Fair Value** | Notional Quantity | Terms | Fair Value |
|---|---|---|---|---|---|---|
| (millions of dollars except where noted) | **December 31, 2008** | | | December 31, 2007 | | |
| Electricity derivative instruments | **0.9 TWh** | **1 year** | **20** | 1.8 TWh | 1-3 yrs | 35 |
| Foreign exchange derivative instruments | **USD $35** | **July/09** | **6** | USD $48 | Sep./08 | (1) |
| Floating-to-fixed interest rate hedges | **40** | **1-11yrs** | **8** | 43 | 1-11 yrs | (2) |
| Forward start interest rate hedges | **272** | **1-12yrs** | **(50)** | 692 | 1-12 yrs | (6) |

Foreign exchange derivative instruments are used to hedge the exposure to anticipated USD denominated purchases. The weighted average fixed exchange rate for contracts outstanding at December 31, 2008 and December 31, 2007 was USD $0.95 and $0.99, respectively, for every Canadian dollar.

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

Net losses of $14 million and $15 million related to derivative instruments qualifying for hedge accounting were recognized in net income during the years ended December 31, 2008 and 2007, respectively. This amount was previously recorded in other comprehensive income. Existing net gains of $8 million deferred in accumulated other comprehensive income at December 31, 2008 are expected to be reclassified to net income within the next 12 months.

In the third quarter of 2008, OPG de-designated certain forward start interest rate hedges as the previously anticipated future borrowings associated with these instruments were no longer expected to occur. As a result of the de-designation, a net loss of $3 million was reclassified to net income in the third quarter of 2008.

**Derivative Instruments Not Qualifying for Hedge Accounting**
The carrying amount (fair value) of derivative instruments not designated for hedging purposes is as follows:

| (millions of dollars except where noted) | Notional Quantity | Fair Value | Notional Quantity | Fair Value |
|---|---|---|---|---|
| | **December 31, 2008** | | December 31, 2007 | |
| Foreign exchange derivative instruments | **–** | **–** | USD $14 | (2) |
| Commodity derivative instruments | | | | |
| Assets | **6.9 TWh** | **49** | 9.9 TWh | 14 |
| Liabilities | **2.2 TWh** | **(19)** | 1.2 TWh | (10) |
| | | **30** | | 2 |
| Market liquidity reserve | | **(4)** | | (2) |
| Total | | **26** | | – |

Foreign exchange derivative instruments that are not designated as hedges had a weighted average exchange rate of USD $0.86 at December 31, 2007.

## Fair Value
Fair value is the value that a financial instrument can be closed out or sold, in a transaction with a willing and knowledgeable counterparty. The fair value of financial assets and liabilities, including exchange traded derivatives and other financial instruments for which quoted prices are available in an active market, are determined directly from those quoted market prices.

For financial instruments which do not have quoted market prices directly available, fair values are estimated using forward price curves developed from observable market prices or rates which may include the use of valuation techniques or models based, wherever possible, on assumptions supported by observable market prices or rates prevailing at the dates of the consolidated balance sheets. This is the case for over-the-counter derivatives and securities, which include energy commodity derivatives, foreign exchange derivatives, interest rate swap derivatives, and ABCP issued by third-party trusts. Valuation models use general assumptions and market data and therefore do not reflect the specific risks and other factors that would affect a particular instrument's fair value. The methodologies used for calculating the fair value adjustments are reviewed on an ongoing basis to ensure that they remain appropriate.

Forward pricing information is inherently uncertain so that fair values of derivative instruments may not accurately represent the cost to enter into these positions. To address the impact of some of this uncertainty on trading positions, OPG established liquidity reserves against the mark-to-market gains or losses of these positions. These reserves decreased trading revenue by $2 million during the year ended December 31, 2008 (December 31, 2007 – no change).

## 14. CAPITAL MANAGEMENT
The Board of Directors' objectives when managing capital are to safeguard the Company's assets and its ability to operate on a commercial basis, while undertaking future development projects that provide an adequate return to the shareholder, and benefits to other stakeholders. The Company attempts to maintain an optimal capital structure and minimize the cost of capital.

The Company is owned 100 percent by the Province. To minimize its cost of capital, the Company targets financial metrics consistent with an investment grade credit rating. This provides the Company with access to capital markets in the future, while targeting a low cost of debt financing.

The Company monitors capital on the basis of the ratio of total debt to total capitalization. Debt is calculated as total borrowings, including long-term debt due within one year, long-term debt and the amount of the Letters of Credit. Total capitalization is calculated as total debt plus total shareholder's equity as shown in the consolidated balance sheets. A financial covenant in OPG's $1 billion revolving committed bank credit facility requires OPG to maintain, on a fully consolidated basis, a ratio of debt to total capitalization of not greater than 0.65:1.0 at any time.

As per the OEB's decision in November 2008, the deemed capital structure for the regulated business is 53 percent debt and 47 percent equity.

The table below summarizes OPG's debt to total capitalization position as at December 31, 2008 and 2007:

| (millions of dollars unless otherwise noted) | 2008 | 2007 |
|---|---|---|
| Long-term debt due within one year | **357** | 407 |
| Long-term debt | **3,483** | 3,446 |
| Letters of Credit | **243** | 205 |
| Total debt | **4,083** | 4,058 |
| Total shareholder's equity | **6,829** | 6,807 |
| Total capitalization | **10,912** | 10,865 |
| Total debt to total capitalization | **37%** | 37% |

There were no changes in the Company's approach to capital management during the year ended December 31, 2008.

## 15. COMMON SHARES

As at December 31, 2008 and 2007, 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. Any issue of new shares is subject to the consent of all of OPG's shareholders.

## 16. COMMITMENTS AND CONTINGENCIES

### Litigation

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

On August 9, 2006, a Notice of Action and Statement of Claim in the amount of $500 million (the "Claim") was served on OPG and Bruce Power L.P. by British Energy Limited and British Energy International Holdings Limited ("British Energy"), claiming that OPG is liable to them for breach of contract and negligence. OPG leased the Bruce nuclear generating stations to Bruce Power L.P. in 2001. British Energy was an investor in Bruce Power L.P. In 2003, British Energy sold its interest in Bruce Power L.P. to a group of investors (the "Purchasers"). The Purchasers are claiming that British Energy is liable to them with respect to this purchase transaction. Their claim is currently the subject of an arbitration proceeding (the "Arbitration"). British Energy is therefore suing OPG in order to preserve any similar claim it may have against OPG pursuant to the 2001 lease transaction. British Energy has indicated that it does not require OPG to actively defend the Claim at this point in time as British Energy is defending the Arbitration commenced by the Purchasers. The Arbitration is scheduled to proceed in September 2009. It may narrow or eliminate the claims or damages British Energy has, so as to narrow or eliminate the need to continue the Claim against OPG. British Energy has reserved the right to require OPG to defend the Claim prior to the conclusion of the Arbitration should British Energy at some point believe there is some advantage in doing so.

On September 2, 2008, a certain First Nation served a Notice of Action against the Government of Canada, the Province of Ontario, OPG and the OEFC claiming damages in the amount of $200 million arising from breach of contract, fiduciary duty, trespass to property, negligence, nuisance, misrepresentation, breach of riparian rights and unlawful and unjustifiable infringement of the aboriginal and treaty rights and $0.5 million in special damages. A Notice of Arbitration was served at the same time upon OPG pursuant to an agreement between OPG and the said First Nation to address OPG's role in the sharing of benefits related to hydro development. OPG assessed the merits of the litigation, and neither the arbitration nor the claim is likely to have any material impact on the Company's financial position, and therefore, OPG has minimal exposure with respect to this claim.

Certain First Nations have commenced actions for interference with reserve and traditional land rights. The claims by some of these First Nations involve joint and several liabilities with other parties and total approximately $45 million and claims by others are for unspecified amounts.

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

### Environmental
OPG was required to assume certain environmental obligations from Ontario Hydro. A provision of $76 million was established as at April 1, 1999 for such obligations. As at December 31, 2008, the remaining provision was $41 million (December 31, 2007 – $45 million).

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

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

### Contractual and Commercial Commitments
The Company's contractual obligations and other significant commercial commitments as at December 31, 2008, are as follows:

| (millions of dollars) | 2009 | 2010 | 2011 | 2012 | 2013 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Contractual obligations: | | | | | | | |
| Fuel supply agreements | 743 | 626 | 265 | 217 | 157 | 309 | 2,317 |
| Contributions under the ONFA | 339 | 264 | 250 | 240 | 157 | 852 | 2,102 |
| Long-term debt repayment | 350 | 970 | 375 | 400 | – | 1,565 | 3,660 |
| Interest on long-term debt | 204 | 172 | 124 | 96 | 82 | 323 | 1,001 |
| Unconditional purchase obligations | 17 | 16 | 12 | 13 | 12 | 156 | 226 |
| Long-term accounts payable | – | – | – | – | – | – | – |
| Operating lease obligations | 23 | 25 | 25 | 26 | 27 | 1 | 127 |
| Operating licence | 30 | 30 | 33 | 36 | 39 | – | 168 |
| Pension contributions[1] | 260 | 270 | – | – | – | – | 530 |
| Other | 47 | 35 | 30 | 22 | 15 | 84 | 233 |
| Significant commercial commitments: | 2,013 | 2,408 | 1,114 | 1,050 | 489 | 3,290 | 10,364 |
| Niagara Tunnel | 113 | 260 | – | – | – | – | 373 |
| Other hydroelectric projects | 140 | 58 | – | – | – | – | 198 |
| Total | 2,266 | 2,726 | 1,114 | 1,050 | 489 | 3,290 | 10,935 |

1 The pension contributions include additional funding requirements towards the deficit and ongoing funding requirements in accordance with the actuarial valuation as at January 1, 2008. The contributions are affected by various factors including market performance, changes in actuarial assumptions, plan experience, and the timing of funding valuations. Funding requirements after 2010 are excluded due to significant variability in the assumptions required to project the timing of future cash flows.

### Niagara Tunnel
As of December 31, 2008, the tunnel boring machine had advanced 3,306 metres. The progress of the tunnel boring machine continues to be slower than anticipated under the original contractor schedule primarily due to excess overbreak of the Queenston shale in the tunnel crown. To minimize further excavation in the Queenston shale, a change in the vertical alignment has been initiated.

A dispute review hearing process was initiated earlier in 2008 to assess, among other things, whether the actual subsurface conditions encountered are materially different from those that were anticipated as part of the design-build contract. The Dispute Review Board issued its non-binding recommendations in late August 2008. OPG and the contractor are using the Dispute Review Board recommendations as a basis for negotiating revisions to the design-build contract. These revisions are expected to have significant impacts on the project completion schedule and the cost estimate of the project. The negotiations are underway and are targeted for completion in the first quarter of 2009. Uncertainties will continue with respect to cost and schedule.

The capital project expenditures for the year ended December 31, 2008 were $132 million and life-to-date capital expenditures were $435 million. The project is debt financed through the OEFC.

### Lac Seul

The Lac Seul hydroelectric generating station is expected to be declared in-service in February 2009. The station has a capacity of 12.5 MW. The project was originally expected to be in-service by the end of the third quarter of 2007. However, it was delayed as a result of various contractor difficulties. A settlement in principle has been negotiated to compensate the contractor for recovery of certain additional costs.

At December 31, 2008, life-to-date expenditures were $54 million. The final project cost is expected to be $55 million. The project is debt financed through the OEFC.

OPG has entered into a partnership agreement with the Lac Seul First Nations ("LSFN"). The partnership is a first for OPG and the LSFN, who will own 25 percent of the new facility.

### Portlands Energy Centre

OPG entered into a partnership with TransCanada Energy Ltd., through the Portlands Energy Centre L.P., to pursue the development of a 550 MW gas-fired, combined cycle generating station on the site of the former R.L. Hearn generating station, near downtown Toronto. OPG has a 50 percent ownership interest in the joint venture.

In May 2008, the construction for the simple cycle mode of operations for the PEC was completed. The station was available to operate in a simple cycle mode as needed during the summer of 2008.

In September 2008, the simple cycle mode of operations for the PEC ended and the plant was returned to the custody of the contractor for completion of the combined cycle plant. Final system commissioning and preparation for the guarantee performance testing and the demonstration runs were conducted during the last two months of 2008. The PEC is expected to be in-service in a combined cycle mode in the first quarter of 2009, earlier than its contractual in-service date of June 1, 2009.

OPG's share of capital expenditures for the year ended December 31, 2008 was $87 million, and life-to-date expenditures were $360 million. Total project costs continue to be within the $730 million approved budget, excluding capitalized interest. A significant proportion of the capital cost relates to an engineer-procure-construct contract to construct the facility. OPG's share of the project is debt financed through the OEFC.

### Upper Mattagami and Hound Chute

In December 2007, OPG's Board of Directors approved the replacement of four existing hydroelectric generating stations. Three of the generating stations are on the Upper Mattagami River (Wawaitin, Sandy Falls and Lower Sturgeon) and the fourth (Hound Chute) is located on the Montreal River. The project includes the demolition and decommissioning of the four existing powerhouses that are at the end of their useful lives. Upon completion of the project, the total installed capacity of the four stations will increase from 23 MW to 44 MW, and the annual energy will increase from 134 gigawatt hours ("GWh") to 223 GWh.

Design and construction activities are in progress at all four sites. Sandy Falls and Lower Sturgeon have been demolished to make way for construction of the new stations.

Life-to-date expenditures as of December 31, 2008 were $62 million and total project costs are expected to be $300 million. A significant proportion of this capital cost relates to a design-build contract to construct the facilities.

### Other Commitments

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

The Company maintains labour agreements with the Power Workers' Union and The Society of Energy Professionals; the agreements are effective until March 31, 2009 and December 31, 2010, respectively. As at December 31, 2008, OPG had approximately 12,000 regular employees and approximately 90 percent of its regular labour force is covered by the collective bargaining agreements.

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

## Proxy Property Taxes

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

### 17. REVENUE LIMIT REBATE

Eighty-five percent of the generation output from OPG's unregulated generating assets, excluding the Lennox generating station, stations whose generation output is subject to a HESA with the OPA pursuant to a ministerial directive, and forward sales as of January 1, 2005, is subject to a revenue limit. The output from a generating unit where there has been a fuel conversion and the incremental output from a generating station where there has been a refurbishment or expansion of these assets are also excluded from the output covered by the revenue limit.

The revenue limit, which was originally established for a period of 13 months ending April 30, 2006, was subsequently extended for an additional three years. Starting May 1, 2006, the revenue limit decreased to 4.6¢/kWh from the previous limit of 4.7¢/kWh. On May 1, 2007, the revenue limit returned to 4.7¢/kWh and increased to 4.8¢/kWh effective May 1, 2008. In addition, beginning April 1, 2006, volumes sold under a Pilot Auction administered by the OPA are subject to a revenue limit that is 0.5¢/kWh higher than the revenue limit applicable to OPG's other generating assets. Revenues above these limits are returned to the IESO for the benefit of consumers. The revenue limit rebate is expected to terminate effective May 1, 2009.

The changes in the revenue limit rebate liability for 2008 and 2007 are as follows:

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Liability, beginning of year | 100 | 40 |
| Increase to provision during the year | 277 | 227 |
| Payments made during the year | (292) | (167) |
| Liability, end of year | 85 | 100 |

### 18. OTHER GAINS AND LOSSES

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| Change in estimated cost required to decommission fossil-fuelled generating stations | (21) | (20) |
| Impairment loss on investments in ABCP (Note 4) | 14 | 10 |
| Other | (2) | – |
| Other gains and losses | (9) | (10) |

In 2007, OPG recorded a recovery of $20 million to reflect a change in the estimated costs required to complete decommissioning of the Lakeview generating station. The demolition of the Lakeview generating station was substantially completed during 2007.

Other gains and losses of $21 million were recognized in 2008 to reflect a change in estimated costs to decommission the other fossil-fuelled generating stations, including the expected costs associated with environmental and site remediation work.

### 19. BUSINESS SEGMENTS

Prior to the fourth quarter of 2008, OPG had four reportable business segments. The business segments were Regulated – Nuclear Generation, Regulated – Hydroelectric, Unregulated – Hydroelectric, and Unregulated – Fossil-Fuelled.

Commencing in the fourth quarter of 2008, OPG separated the Regulated – Nuclear segment into two reportable segments identified as Regulated – Nuclear Generation segment and Regulated – Nuclear Waste Management segment. Results for the comparative periods have been reclassified to reflect the revised disclosure.

#### Regulated – Nuclear Generation Segment

OPG's Regulated – Nuclear Generation business segment operates in Ontario, generating and selling electricity from the nuclear generating stations that it owns and operates. The business segment includes electricity generated by the Pickering A and B, and Darlington nuclear generating stations. This business segment also includes revenue under the terms of a lease arrangement with Bruce Power related to the Bruce nuclear generating stations. This arrangement includes lease revenue and revenue from engineering analysis and design, technical and other services. Revenue is also earned from isotope sales and ancillary services. Ancillary revenues are earned through voltage control and reactive support.

### Bruce Nuclear Generating Stations

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

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

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

In December 2002, British Energy plc. entered into an agreement to dispose of its entire 82.4 percent interest in Bruce Power. The transaction was completed in February 2003 and a consortium of Canadian companies assumed the lease of the Bruce A and Bruce B nuclear generating stations that was formerly held by British Energy plc. The Bruce facilities will continue to be operated by Bruce Power. Upon closing of the transaction, a $225 million note receivable was paid to OPG, and lease payments commenced to be paid monthly. Proceeds from the note and applicable interest were to be applied by March 2008 against OPG's funding requirements with respect to the nuclear fixed asset removal and nuclear waste management liabilities. OPG made an extraordinary contribution of $334 million to the Used Fuel Fund in December 2007.

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

During 2008, OPG recorded lease revenue related to the Bruce generating stations of $258 million (2007 – $253 million). In late 2008, OPG re-evaluated the Bruce lease for accounting purposes due to a modification to the lease. As a result of the re-evaluation, the timing in which certain of the lease revenues are recognized for accounting purposes has been revised. The revision will result in reductions to the lease revenue for accounting purposes during initial years of the remaining lease term, and increases in lease revenue for accounting purposes during the later years of the remaining lease term. The impact of these timing changes on the amount of lease revenue recognized during 2008 was offset by the impact of the Bruce variance account described in Note 7 to these consolidated financial statements. The net book value of fixed assets on lease to Bruce Power at December 31, 2008 was $1,140 million (2007 – $1,201 million).

## Regulated – Nuclear Waste Management

OPG's Regulated – Nuclear Waste Management segment engages in the management of used nuclear fuel and low and intermediate level waste, the decommissioning of OPG's nuclear generating stations (including the stations on lease to Bruce Power), the management of the Nuclear Funds, and related activities including the inspection and maintenance of the waste storage facilities. Accordingly, accretion expense on the Nuclear Liabilities and losses (earnings) from the Nuclear Funds are reported under this segment.

As the nuclear generating stations operate over time, OPG incurs variable costs related to nuclear used fuel and low and intermediate level waste generated. These costs increase the Nuclear Liabilities through the generation of additional used nuclear fuel bundles and other waste. These variable costs are charged to current operations in the Regulated – Nuclear Generation segment in order to appropriately reflect the cost of producing energy and the earning of revenues under the lease arrangement with Bruce Power that are recorded in this segment. Since variable costs increase the Nuclear Liabilities in the Regulated – Nuclear Waste Management segment, OPG records an inter-segment charge between the Regulated – Nuclear Generation and the Regulated – Nuclear Waste Management segments. The impact of the inter-segment charge between these segments is eliminated on OPG's consolidated statements of income and balance sheets.

The Regulated – Nuclear Waste Management segment is considered regulated because the costs associated with the Nuclear Liabilities are included in the OEB's determination of regulated prices for production from OPG's regulated nuclear facilities by the OEB.

# Notes to the Consolidated Financial Statements
(for the years ended December 31, 2008 and 2007)

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

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

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

## Other
OPG earns revenue from its joint venture share of Brighton Beach related to an energy conversion agreement between Brighton Beach and Coral. The Other category also includes OPG's share of joint venture revenues and expenses from the PEC gas-fired generating station. In addition, the Other category includes revenue from real estate rentals.

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

OM&A expenses of the generation business segments include an inter-segment service fee for the use of certain property, plant and equipment of the Other category. The total service fee is recorded as a reduction to the Other category's OM&A expenses. For the year ended December 31, 2008, the service fee was $29 million for Regulated – Nuclear Generation, $3 million for Regulated – Hydroelectric, $4 million for Unregulated – Hydroelectric and $9 million for Unregulated – Fossil-Fuelled, with a corresponding reduction in OM&A expenses of $45 million for the Other category. For the year ended December 31, 2007, the service fee was $33 million for Regulated – Nuclear Generation, nil for Regulated – Nuclear Waste Management, $2 million for Regulated – Hydroelectric, $4 million for Unregulated – Hydroelectric and $11 million for Unregulated – Fossil-Fuelled, with a corresponding reduction in OM&A expenses of $50 million for the Other category.

| **Segment Income (Loss) for the Year Ended December 31, 2008** (millions of dollars) | **Regulated** Nuclear Generation | **Regulated** Nuclear Waste Management | **Regulated** Hydro-electric | **Unregulated** Hydro-electric | **Unregulated** Fossil-Fuelled | **Other** | **Elimination** | **Total** |
|---|---|---|---|---|---|---|---|---|
| Revenue | **2,987** | **46** | **754** | **974** | **1,491** | **153** | **(46)** | **6,359** |
| Revenue limit rebate | **–** | **–** | **–** | **(72)** | **(205)** | **–** | **–** | **(277)** |
| | **2,987** | **46** | **754** | **902** | **1,286** | **153** | **(46)** | **6,082** |
| Fuel expense | **167** | **–** | **254** | **111** | **659** | **–** | **–** | **1,191** |
| Gross margin | **2,820** | **46** | **500** | **791** | **627** | **153** | **(46)** | **4,891** |
| Operations, maintenance and administration | **2,098** | **50** | **108** | **198** | **552** | **7** | **(46)** | **2,967** |
| Depreciation and amortization | **462** | **–** | **70** | **76** | **94** | **41** | **–** | **743** |
| Accretion on fixed asset removal and nuclear waste management liabilities | **–** | **573** | **–** | **–** | **8** | **–** | **–** | **581** |
| Losses on nuclear fixed asset removal and nuclear waste management funds | **–** | **93** | **–** | **–** | **–** | **–** | **–** | **93** |
| Property and capital taxes | **25** | **–** | **12** | **9** | **21** | **13** | **–** | **80** |
| Income (loss) before other gains and losses | **235** | **(670)** | **310** | **508** | **(48)** | **92** | **–** | **427** |
| Other (gains) and losses | **–** | **–** | **–** | **–** | **(23)** | **14** | **–** | **(9)** |
| Income (loss) before interest and income taxes | **235** | **(670)** | **310** | **508** | **(25)** | **78** | **–** | **436** |

| Segment (Loss) Income for the Year Ended December 31, 2007 (millions of dollars) | Regulated Nuclear Generation | Regulated Nuclear Waste Management | Regulated Hydro-electric | Unregulated Hydro-electric | Unregulated Fossil-Fuelled | Other | Elimination | Total |
|---|---|---|---|---|---|---|---|---|
| Revenue | 2,581 | 76 | 695 | 763 | 1,713 | 135 | (76) | 5,887 |
| Revenue limit rebate | – | – | – | (64) | (163) | – | – | (227) |
| | 2,581 | 76 | 695 | 699 | 1,550 | 135 | (76) | 5,660 |
| Fuel expense | 133 | – | 244 | 81 | 812 | – | – | 1,270 |
| Gross margin | 2,448 | 76 | 451 | 618 | 738 | 135 | (76) | 4,390 |
| Operations, maintenance and administration | 2,053 | 84 | 123 | 207 | 573 | 10 | (76) | 2,974 |
| Depreciation and amortization | 426 | – | 68 | 68 | 82 | 51 | – | 695 |
| Accretion on fixed asset removal and nuclear waste management liabilities | – | 499 | – | – | 8 | – | – | 507 |
| Earnings on nuclear fixed asset removal and nuclear waste management funds | – | (481) | – | – | – | – | – | (481) |
| Property and capital taxes | 31 | – | 11 | 10 | 21 | 12 | – | 85 |
| (Loss) income before other gains and losses | (62) | (26) | 249 | 333 | 54 | 62 | – | 610 |
| Other (gains) and losses | (4) | – | – | 4 | (20) | 10 | – | (10) |
| (Loss) income before interest and income taxes | (58) | (26) | 249 | 329 | 74 | 52 | – | 620 |

# Notes to the Consolidated Financial Statements

(for the years ended December 31, 2008 and 2007)

| **Selected Consolidated Balance Sheet Information As at December 31, 2008** (millions of dollars) | **Regulated** Nuclear Generation | **Regulated** Nuclear Waste Management | **Regulated** Hydro-electric | **Unregulated** Hydro-electric | **Unregulated** Fossil-Fuelled | **Other** | **Total** |
|---|---|---|---|---|---|---|---|
| Segment fixed assets in service, net | **3,845** | **–** | **3,823** | **2,971** | **396** | **480** | **11,515** |
| Segment construction work in progress | **227** | **–** | **444** | **190** | **29** | **382** | **1,272** |
| Segment property, plant and equipment, net | **4,072** | **–** | **4,267** | **3,161** | **425** | **862** | **12,787** |
| Segment materials and supplies inventory, net: | | | | | | | |
| Short-term | **77** | **–** | **–** | **–** | **55** | **–** | **132** |
| Long-term | **336** | **–** | **–** | **1** | **1** | **–** | **338** |
| Segment fuel inventory | **301** | **–** | **–** | **–** | **435** | **–** | **736** |
| Fixed asset removal and nuclear waste management liabilities | **–** | **(11,233)** | **–** | **–** | **(117)** | **(34)** | **(11,384)** |
| Nuclear fixed asset removal and nuclear waste management funds | **–** | **9,209** | **–** | **–** | **–** | **–** | **9,209** |

| Selected Consolidated Balance Sheet Information As at December 31, 2007 (millions of dollars) | Regulated Nuclear Generation | Regulated Nuclear Waste Management | Regulated Hydro-electric | Unregulated Hydro-electric | Unregulated Fossil-Fuelled | Other | Total |
|---|---|---|---|---|---|---|---|
| Segment fixed assets in service, net | 4,030 | – | 3,871 | 2,996 | 422 | 508 | 11,827 |
| Segment construction work in progress | 210 | – | 299 | 88 | 49 | 304 | 950 |
| Segment property, plant and equipment, net | 4,240 | – | 4,170 | 3,084 | 471 | 812 | 12,777 |
| Segment materials and supplies inventory, net: | | | | | | | |
| Short-term | 73 | – | 1 | – | 51 | – | 125 |
| Long-term | 346 | – | – | 3 | 4 | – | 353 |
| Segment fuel inventory | 231 | – | – | – | 373 | – | 604 |
| Fixed asset removal and nuclear waste management liabilities | – | (10,781) | – | – | (141) | (35) | (10,957) |
| Nuclear fixed asset removal and nuclear waste management funds | – | 9,263 | – | – | – | – | 9,263 |

| Selected Consolidated Cash Flow Information (millions of dollars) | Regulated: Nuclear Generation | Regulated: Nuclear Waste Management | Regulated: Hydroelectric | Unregulated: Hydroelectric | Unregulated: Fossil-Fuelled | Other | Total |
|---|---|---|---|---|---|---|---|
| Year ended December 31, 2008 | | | | | | | |
| Investment in fixed assets | **184** | **–** | **160** | **149** | **59** | **109** | **661** |
| Year ended December 31, 2007 | | | | | | | |
| Investment in fixed assets | 206 | 1 | 80 | 66 | 94 | 219 | 666 |

## 20. RELATED PARTY TRANSACTIONS

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

These transactions are summarized below:

| (millions of dollars) | 2008 Revenue | 2008 Expenses | 2007 Revenue | 2007 Expenses |
|---|---|---|---|---|
| Hydro One | | | | |
| Electricity sales | **35** | **–** | 28 | – |
| Services | **–** | **7** | – | 12 |
| Province of Ontario | | | | |
| GRC, water rentals and land tax | **–** | **151** | – | 129 |
| Guarantee fee | **–** | **4** | – | 8 |
| Used Fuel Fund rate of return guarantee | **–** | **(971)** | – | (130) |
| Decommissioning Fund excess funding | **–** | **(3)** | – | (291) |
| OEFC | | | | |
| GRC and proxy property tax | **–** | **215** | – | 199 |
| Interest income on receivable | **–** | **–** | – | (6) |
| Interest expense on long-term notes | **–** | **215** | – | 187 |
| Capital tax | **–** | **36** | – | 35 |
| Income taxes | **–** | **88** | – | (51) |
| Indemnity fees | **–** | **–** | – | – |
| IESO | | | | |
| Electricity sales | **5,330** | **127** | 5,094 | 104 |
| Revenue limit rebate | **(277)** | **–** | (227) | – |
| Ancillary services | **155** | **–** | 145 | – |
| Other | **–** | **–** | – | 1 |
| | **5,243** | **(131)** | 5,040 | 197 |

At December 31, 2008, accounts receivable included nil (2007 – $2 million) due from Hydro One and $207 million (2007 – $179 million) due from the IESO. Accounts payable and accrued charges at December 31, 2008 included $1 million (2007 – $2 million) due to Hydro One.

# Notes to the Consolidated Financial Statements

(for the years ended December 31, 2008 and 2007)

## 21. JOINT VENTURES

Significant joint ventures include Brighton Beach and PEC, which are 50 percent owned by OPG.

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

| (millions of dollars) | 2008 | 2007 |
|---|---|---|
| **Proportionate joint venture operations** | | |
| Revenue | **41** | 43 |
| Expenses | **(31)** | (36) |
| Net income | **10** | 7 |
| **Proportionate joint venture cash flows** | | |
| Operating activities | **33** | 1 |
| Investing activities | **(76)** | (165) |
| Financing activities | **50** | 164 |
| Share of changes in cash | **7** | – |
| **Proportionate joint venture balance sheets** | | |
| Current assets | **31** | 38 |
| Long-term assets | **585** | 533 |
| Current liabilities | **(18)** | (24) |
| Long-term liabilities | **(183)** | (185) |
| Share of net assets | **415** | 362 |

## 22. INVESTMENT COMPANY

The Company applied AcG-18 for all investments owned by OPGV. OPGV is a wholly owned subsidiary of the Company and its results are included in the Company's consolidated financial statements. The carrying amount of OPGV's investments was $39 million (2007 – $45 million) and the amount was included as long-term accounts receivable and other assets on the consolidated balance sheets.

As a result of the application of this policy, the Company's net income and other assets for 2008 decreased by $6 million (2007 – $13 million). The net realized gains and losses for OPGV was $3 million in 2008 (2007 – nil).

The gross unrealized gains and losses on the investment held by OPGV as at December 31, 2008 were $17 million and $19 million, respectively. The gross unrealized gains and losses on the investment held by OPGV as at December 31, 2007 were $19 million and $15 million, respectively.

## 23. RESEARCH AND DEVELOPMENT

For the year ended December 31, 2008, $75 million (2007 – $93 million) of research and development expenses were charged to operations.

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

| (millions of dollars) | **2008** | 2007 |
|---|---|---|
| Accounts receivable | **(171)** | (97) |
| Prepaid expenses | **3** | (9) |
| Fuel inventory | **(132)** | 65 |
| Materials and supplies | **(7)** | (13) |
| Revenue limit rebate payable | **277** | 227 |
| Accounts payable and accrued charges | **65** | (42) |
| Income and capital taxes payable | **38** | (62) |
| | **73** | 69 |

# Officers

**Jake Epp**
Chairman

**Jim Hankinson**
President and CEO

**Robert Boguski***
Senior Vice President,
Business Services and
Information Technology

**Bruce Boland**
Senior Vice President,
Corporate Affairs

**David Brennan**
Senior Vice President,
Law and General Counsel

**Jim Burpee**
Executive Vice President,
Corporate Development

**Pierre Charlebois**
Executive Vice President
and Chief Operating Officer

**Frank Chiarotto****
Senior Vice President, Fossil

**Janice Dunlop**
Senior Vice President,
Human Resources and
Chief Ethics Officer

**Donn Hanbidge**
Senior Vice President and
Chief Financial Officer

**Catriona King**
Vice President,
Corporate Secretary

**Tom Mitchell**
Chief Nuclear Officer

**John Murphy**
Executive Vice President,
Hydro

**Ken Nash*****
Senior Vice President,
Nuclear Waste
Management

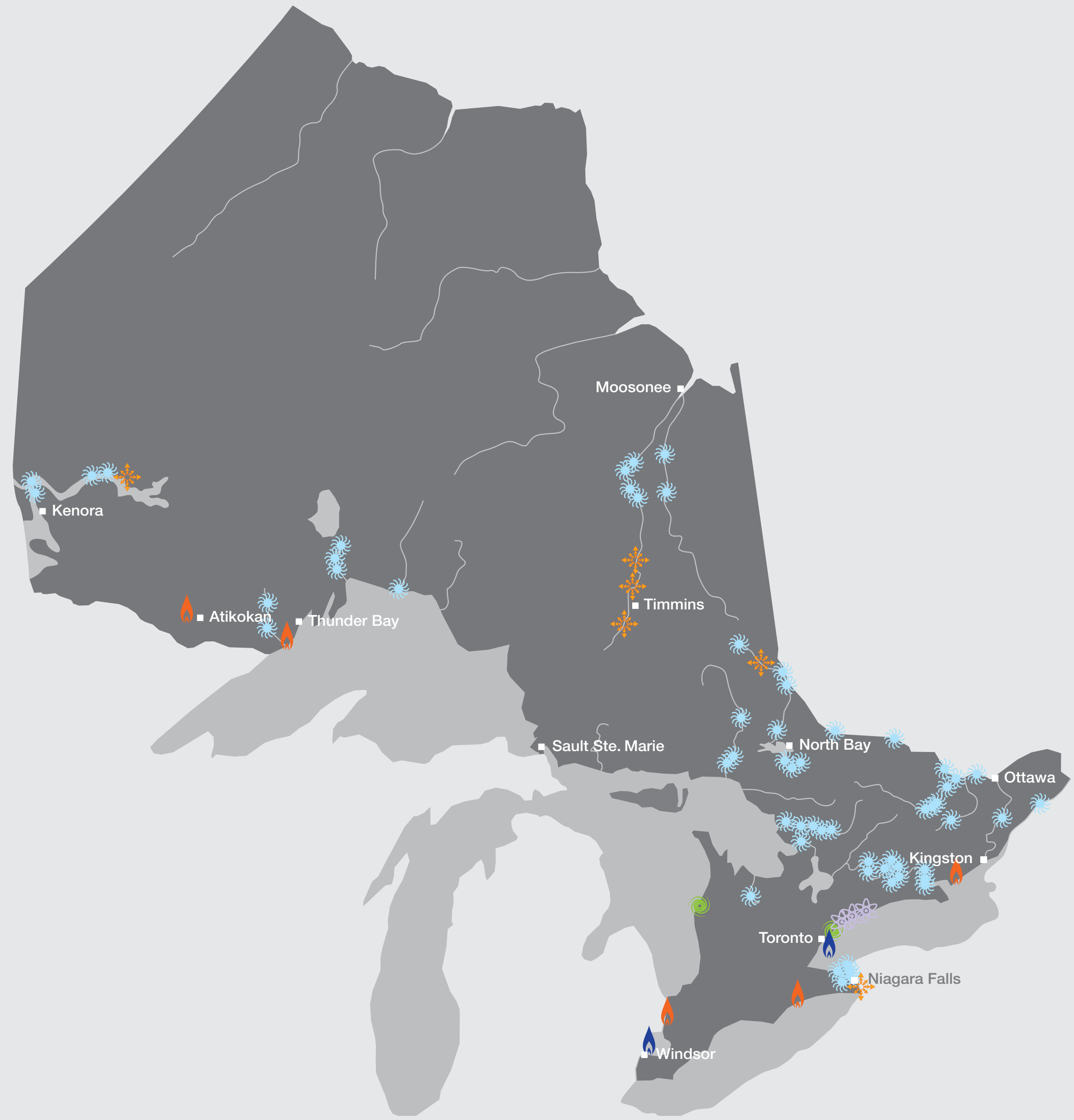
**Colleen Sidford**
Vice President, Treasurer

**Jim Twomey*****
Executive Vice President,
Fossil

* Appointed, May 22, 2008.
** Appointed December 1, 2008.
*** Retired, December 31, 2008.

# Ontario Power Generation Facilities

OPG's electricity generating portfolio as of December 31, 2008 had a total in-service capacity of 21,748 MW.




| Nuclear Stations | Fossil-Fuelled Stations | Co-owned Gas-Fired Stations* | Hydroelectric Stations** | Wind Power Turbines | New Generation Projects*** |
|---|---|---|---|---|---|
| 3 | 5 | 2 | 64 | 2 | 3 |

* The 550 MW Portlands Energy Centre gas-fired generating station in Toronto (co-owned by OPG and TransCanada Energy Ltd.) and the 580 MW Brighton Beach gas-fired generating station, co-owned by OPG, ATCO Power Canada Ltd. and ATCO Resources Ltd.

** Includes four hydroelectric stations in northeastern Ontario under redevelopment (Wawaitin, Sandy Falls, Lower Sturgeon, and Hound Chute).

*** Consists of three hydroelectric projects – the Lac Seul generating station in northwestern Ontario (in service, February 2009); the Niagara Tunnel, near Niagara Falls; and the Upper Mattagami/Hound Chute redevelopment in northeastern Ontario, consisting of the Wawaitin, Sandy Falls, Lower Sturgeon, and Hound Chute generating stations.

This annual report is also available in French on our website –
ce rapport est également publié en français – at **www.opg.com.**

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The head office of Ontario Power Generation Inc. is located at
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PICTURED ON THE FRONT COVER:
(CLOCKWISE, FROM LARGE PHOTO)

- Darren Porter, Northeast Plant Group
- Bob Quinn, Lambton GS
- Roma Kopechanski, Northwest Plant Group
- Gerry Martineau (l) and John Armstrong (r), Darlington Nuclear GS

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- OPG employees Norma Siroski (l) and Mario Durepos (r), with local artist Gayle Ballantyne at the Abitibi Hydroelectric GS – 75th anniversary
- Sidra Abid, Engineering Trainee, Nuclear
- OPG employees and volunteers at the R.H. Saunders Hydroelectric GS 50th anniversary
- Dwayne Korchack, Hydro
- Jeff Veenbaas, Kathy Hoard and Shawn Anderson, Atikokan GS

PAGE 2

- Adam Cochrane and Ransford Peacock, Pickering B Nuclear GS
- Thunder Bay Fossil GS, 45th anniversary
- Dave Jarrell, Niagara Plant Group

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- Victor Kabuga, Nuclear Refurbishment
- Larry Jankovic, Nanticoke GS
- Darlington Nuclear GS
- Andre LeClerc, Northeast Plant Group
- Katya Milanoski and Richard Baker, OPG Nuclear Security
- Sir Adam Beck 1, Unit 7 upgrade

ONTARIO POWER GENERATION