

# A N N U A L R E P O R T 2 0 0 0



OPG In Motion

**ONTARIOPOWER**  
GENERATION

## FINANCIAL ACHIEVEMENTS FOR THE YEAR ENDED DECEMBER 31, 2000

- ▶ Sales of 139.8 terawatt-hours (TWh) of electricity
- ▶ Revenues of \$5,978 million
- ▶ Net income of \$605 million
- ▶ Earnings per share of \$2.36
- ▶ Cash flow from operating activities of \$1,281 million
- ▶ Return on equity of 10.8%

## CORPORATE PROFILE

Ontario Power Generation Inc. (OPG) is a major North American electricity generator. OPG's principal business is the generation and sale of electricity to the Ontario wholesale market, and to the interconnected markets of Quebec, Manitoba and the northeast and midwest regions of the United States.

As of December 31, 2000, the company owned five nuclear generating stations, six fossil-fueled generating stations and 69 hydroelectric stations. Total available capacity was approximately 25,800 megawatts (MW), consisting of 7,300 MW of hydroelectric capacity, 9,700 MW of fossil-fueled capacity and 8,800 MW of nuclear capacity. In addition, there is 5,100 MW of nuclear capacity currently laid up. Customers in Ontario at the end of 2000 included local distribution companies and municipal utilities, large direct industrial customers and Hydro One. The local distribution companies and the municipal utilities supplied more than three million customers, while Hydro One supplied about 930,000 customers.

\* One megawatt is one million watts. Megawatts are a measure of electricity demand at a point in time. A city with a population of one million people would have a peak demand of about 1,000 megawatts on an average Ontario winter day. Other measures of demand used in this annual report include: a kilowatt (1,000 watts); a gigawatt (one billion watts); and a terawatt (one trillion watts).

## FINANCIAL HIGHLIGHTS

RESULTS OF OPERATIONS FOR THE PERIOD ENDED DECEMBER 31

<i>(\$ millions unless otherwise stated)</i>	12 MONTHS 2000	12 MONTHS PRO FORMA* 1999	APRIL 1- DEC. 31 1999
Electricity sold (TWh**)	139.8	136.9	102.0
Revenues	5,978	5,795	4,338
Operating income	1,198	1,010	749
Net income	605	446	326
Earnings before interest, taxes, depreciation and amortization (EBITDA)	2,008	1,816	1,353
Earnings per share (dollars per share)	2.36	1.74	1.27
Capital expenditures	585	485	450
As at December 31:			
Total assets	16,791	15,610	15,610
Long-term debt	3,219	3,422	3,422
Shareholder's equity	5,817	5,417	5,417

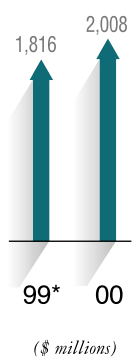
\* The 1999 pro forma financial information reflects the operations of the generation business of Ontario Hydro for the three months ended March 31, 1999 and OPG's actual operating results for the nine months ended December 31, 1999.

\*\* 1 kilowatt-hour (KWh) is the energy expended by ten 100 watt lights burning for one hour. A megawatt-hour (MWh) is 1,000 KWh, a gigawatt-hour (GWh) is 1 million KWh, and a terawatt-hour (TWh) is 1 billion KWh.

### REVENUES



### EBITDA



### NET INCOME



## POSITIONING FOR GROWTH AND SUCCESS

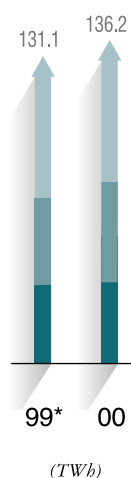
During 2000, Ontario Power Generation:

- negotiated a long-term lease agreement (subject to approvals) with Bruce Power L.P., a subsidiary of British Energy plc, for the Bruce A and B nuclear stations
- established necessary infrastructure for an open market, including the implementation of technologically advanced dispatch and trading operations
- progressed towards returning the Pickering A nuclear units to service, which will result in an additional 2,000 megawatts of smog-free, low-cost electricity supply
- improved our nuclear performance index from 81 per cent to 83.3 per cent
- improved our environmental performance in all key areas
- announced our intention to spend over \$250 million to improve air quality and reduce fossil emissions
- implemented goalsharing and new collective agreements
- successfully implemented partnership initiatives for our research and development and information technology businesses
- obtained investment grade credit ratings from Canadian rating agencies
- announced our intention to decontrol the Lakeview and Lennox fossil-fueled stations
- filled key management positions

EARNINGS  
PER SHARE



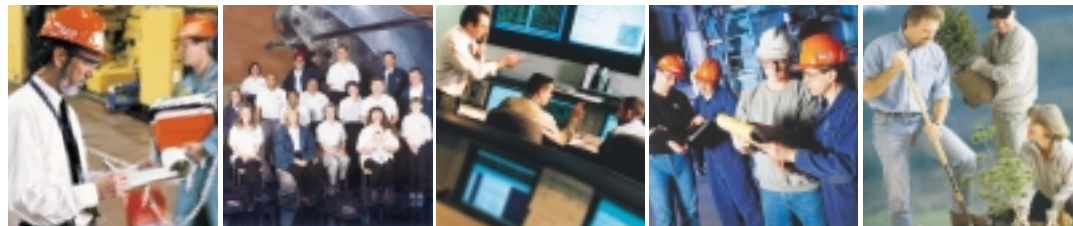
ELECTRICITY  
GENERATED



	1999	2000
Nuclear	61.4	59.8
Fossil	36.1	42.4
Hydro	33.6	34.0
	131.1	136.2

## OPG IN MOTION

At the end of 2000, OPG has significant momentum as it prepares for competition in a deregulated Ontario electricity market. We are re-engineering and realigning every aspect of our business – our workforce, business processes, asset configuration and technology platforms. We remain firmly committed to safe operations, environmental protection, and meeting the needs of our customers and the communities in which we operate. We have clear goals and the resolve to be successful in a new and exciting market. OPG is “in motion.”



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*Bill Farlinger,  
Chairman*

*Ron Osborne,  
President & CEO*

## A Message from the Chairman and the President

Ontario Power Generation completed its first full year of operations with robust performance from its operations and solid momentum for future growth.

We are focused on achieving competitive success as Ontario transitions to an open electricity market. The performance of our generation assets is improving. We continue to make advances in our environmental performance. We are building credibility with investors, working closely with customers and strengthening relationships with communities in which we operate. We are transforming our culture into one based on performance excellence, customer commitment, continuous safety improvements and career satisfaction.

We are pleased with the company's healthy financial results for 2000. Revenues were \$5,978 million, up from our pro forma 1999 results of \$5,795 million. Net income for the year was \$605 million, up 36% over our 1999 pro forma results of \$446 million. This increase in earnings was primarily driven by cost reductions and a 2% growth in sales volume.

OPG is motivated by one goal: to become a premier North American energy company focused on low-cost power generation and wholesale energy sales. To achieve this, we continue to focus on our key building blocks for success, which remain unchanged from last year. We must create a high-performance organization;

structure our business for market readiness and competitive success; optimize our asset performance; and become a sustainable energy company to deliver superior shareholder value. Throughout 2000, we achieved improvements in each of these areas. Our financial results demonstrate that we are on the right track.

### **A High-Performance, People-Centred Organization**

OPG is building a high-performance, customer-focused company, driven by experienced employees who are committed, team-oriented, and who are valued and rewarded for their contributions. We made significant progress toward this goal through the expansion of our groundbreaking Partnership Agreement with the unions; the roll out of our GoalSharing incentive program; introduction of recruitment, retention and leadership programs; and new employee safety initiatives. Our progress is enhanced by a professionally diverse senior management team that blends energy industry experience with perspectives brought from other sectors.

### **Focus on Competitive Success**

OPG's success depends on our ability to manage our asset decontrol program, ensure access to capital and emerge as an industry leader. Within 10 years of the market being opened, we are required to reduce control of our generating capacity to 35% of capacity available in Ontario.

We will accelerate decontrol so that we can better focus our attention on our North American growth strategy. Accelerated decontrol will also facilitate the development of competition in Ontario.

With these objectives in mind, in July 2000 we announced the long-term lease of our 6,200 megawatt Bruce A and B nuclear stations to Bruce Power, a subsidiary of British Energy. Expected to close by mid-2001, this agreement is one of the largest and most complex transactions of its kind in our industry.

We also announced our intention to decontrol two major fossil-fueled generating stations. At the provincial government's request, this plan is on hold pending a review of their environmental regulations on fossil-fueled generation. The decontrol process will resume once this review is complete.

OPG is building credibility within the investment community, spurred by the investment grade debt ratings we received from Canadian rating agencies in 2000 and by the launch of a \$600 million commercial paper program.

To serve customers better in a new marketplace, we opened a technologically-advanced OPG Energy Markets facility offering real-time dispatching and trading of electricity as well as the marketing of structured and customized risk management products and solutions. While a decision has yet to be made on when the market will open to competition, we must and will be ready.

We are also partnering with innovative companies to leverage our research and development and information technology businesses. These partnerships will enable us to concentrate on our core competencies – the generation and marketing of reliable power. They will also provide significant career opportunities for affected employees.

### **Continuous Performance Improvement**

While OPG's generating fleet is one of the lowest-cost generators in our market region, we improved this advantage throughout 2000 while continuing to operate in a safe, open and environmentally responsible manner.

OPG's nuclear stations have made significant performance gains over the past three years. As a virtually smog-free, low-cost power source, nuclear energy is a critical part of our portfolio, accounting for 44% of our production. Its role will be strengthened by the planned return to service of our 2,000 megawatt Pickering A Generating Station, with the four units scheduled to return to service in 2002 and 2003. In February 2001, the Canadian





Nuclear Safety Commission accepted the conclusions and recommendations of the environmental assessment for this project.

Our fossil-fueled and hydroelectric generation assets demonstrated exceptional reliability in 2000. When added to our nuclear generation, these stations give OPG one of the most flexible portfolios in our market region. This diversified mix enables us to meet Ontario's electricity demands as well as to make additional sales to the U.S., contributing to our strong financial results.

### A Sustainable Energy Company

OPG is committed to becoming a sustainable energy company. We intend to achieve sustainability through our environmental performance, our community involvement and our ability to create sustained shareholder value. In 2000, we made progress toward our goal by improving performance over 1999 in each of our six key environmental areas – regulatory compliance, air emissions, spills, energy efficiency, total radiation emissions, and waste management. All of our generating stations are now ISO 14001



• Mark Pretty,  
Ken Roberts and  
Craig Wardrop  
in the control  
room at Lambton  
Generating  
Station

• At work in the  
Trading Room:  
Hasnain Tayabali,  
Terri Melendy  
and Erica Cheung

certified for their environmental management systems. To improve air quality, we made significant investments in clean-air technologies; participated in emissions-reduction credit trading; announced an expansion of our green power portfolio; and committed to planting 1.6 million native trees and shrubs over the next five years. We were equally active in protecting land and waterways near our stations.

We also contributed to the quality of life in the communities in which we operate through numerous corporate and employee-led initiatives, including our annual Charity Campaign and our support of community initiatives.

### Growth Strategy

We have a focused growth plan to ensure competitive success and build shareholder value. In addition to supplying our home market of Ontario, we plan to apply for a U.S. Federal Energy Regulatory Commission licence to generate and market power in the U.S.

We have significant competitive strengths at our disposal:

- a portfolio of generation assets with low system-wide emissions that is diversified in terms of technology, fuel type, market and dispatch flexibility;
- extensive operating and performance improvement experience; and
- accumulated knowledge of the electricity system, its costs and pricing patterns, both in Ontario and in adjacent markets.

We will assess selective growth opportunities in U.S. markets. We will also explore opportunities such as those in the gas sector and in emerging power technologies such as distributed generation. Additionally, we will continue to build strategic partnerships which can maximize value for our shareholder, allow us to focus on our core business and leverage our existing core competencies.

Our management team and employees know that our ability to execute our growth strategy depends on our success today in continuing to improve our operating performance and meet customer needs. With their ongoing commitment, we are confident that OPG will reach its goal of becoming a leading North American energy company and in the process deliver higher levels of value, service and benefits to our shareholder, customers and the communities in which we operate.

*Bill Farlinger, Chairman*

*Ron Osborne, President & CEO*



Employees Greg Pruss, Dave Stafford and Gary Murphy make sure a scheduled work area is safe at the Pickering B Nuclear Generating Station.







Community Ambassadors: some of the hundreds of employee volunteers\* who visited over 16,000 households as part of OPG's Pickering Neighbourhood Walk program.



\* The names of employees in this photo are listed on page 62.

## Creating a High-Performance, People-Oriented Company



High performance companies recognize the vital role people play in their success. OPG is no exception. We are engaging all employees in our quest to fashion a new, performance-driven corporate culture – where excellence, respect, teamwork, customer service and safety are not just words, but values to be lived every day.

### ► Partnering with Employees

The cornerstone of our culture change is our partnership initiative with the unions – a pioneering and jointly-designed framework to help meet the challenges of competing in an open market. Since about 90% of OPG's workforce is unionized, this is a critical initiative for us.

A partnership approach has benefits for management and the unions. Issues are resolved cooperatively, grievances are reduced, and all employees are more aligned towards achieving corporate objectives.

During 2000, new collective agreements designed to speed marketplace success were reached in a cooperative manner with the Power Workers' Union and The Society of Energy Professionals, the two unions that represent the majority of our employees. Tripartite teams consisting of representatives from management and the two unions were also established to reinforce the partnership ethic across all levels of the organization.

A promising sign that the partnership spirit has taken root was the finalization of a corporate-wide GoalSharing program, an incentive plan that we believe to be the most extensive in our industry. As a result of this initiative, virtually all employees shared in OPG's 2000 operating profits. This program will contribute significantly to employee understanding of our business drivers while fostering innovation, flexibility and a continuous raising of the performance bar.



## Corporate Officers and Senior Management

*OPG's senior management team combines talented executives drawn from outside OPG with experienced company veterans to form one of the most diversified and able management teams in the industry.*



**Bill Farlinger**  
*Chairman*

**Ron Osborne**  
*President &  
Chief Executive Officer*

**Gene Preston**  
*Executive Vice President &  
Chief Nuclear Officer*

**Pierre  
Charlebois**  
*Senior Vice President &  
Chief Nuclear Engineer*

**Giselle Branget**  
*Vice President-  
Treasurer*

**Wayne Bingham**  
*Executive Vice President &  
Chief Financial Officer*

### ► Unlocking Employee Excellence

To reinforce and support our culture change efforts, OPG launched a new leadership development program focused on supporting and enhancing the management and leadership skills of our senior managers. The program is part of an extensive and integrated process aimed at identifying, developing and retaining high-performing, committed employees across the organization.

Our other leadership and learning initiatives include: first line manager academies for our nuclear employees; enhanced marketing and trading-skills programs for OPG Energy Markets staff; a new employee recognition program for outstanding employee contributors; and financial and commercial orientation seminars for all employees. We are also bringing new competencies into the company through a strong recruitment program.

These initiatives are complemented by an extensive program of employee round-table discussions, led by senior management, to discuss business strategy and listen to employees. More than a thousand of our employees took part in these meetings in 2000.



**David Drinkwater**  
Executive Vice President-  
Law & Corporate  
Development

**Richard Dicerni**  
Executive Vice President &  
Corporate Secretary

**Jim Burpee**  
Senior Vice President-  
Pickering A Generating  
Station

**Graham Brown**  
Chief Operating Officer

**Bruce Boland**  
Senior Vice President-  
OPG Energy Markets

**John Murphy**  
Executive Vice President-  
Human Resources

**John Mather**  
Executive Vice President &  
Chief Information Officer

## ► Making the Workplace Safe

To be a high-performance company, we must be a safety leader. During 2000, workplace safety performance at OPG improved compared to our 1999 performance. Challenges remain, however, before we achieve the level of excellence we seek in this all-important area. Our objective is to ensure employee safety and achieve a safety record within the top quartile of our industry.

While there is still much to be done, we are on the path to realizing this goal – as evidenced by the many generating stations and crews that set new records in 2000 for days and years worked without lost-time injuries. For example, the “E” crew at our Pickering B station went 15 years without a lost-time accident. In addition, three hydroelectric production centres – at Cameron Falls, Ear Falls and Thunder Bay – achieved five years without a lost-time accident, and our coal-fueled Thunder Bay Generating Station went three years without such an accident. We attribute these safety results to the shared responsibility our supervisors and employees have placed on workplace safety and on building a safety culture which this supports. We will continue to build on this performance improvement through implementation of safety management systems across OPG.

Recognizing that safety performance is but one measure of a healthy workplace, we also launched a major wellness program focusing on broader health issues. We are determined to reach top industry levels in this important performance measure.



OPG Energy Markets employees Rob Coulbeck, Marty Kelly and Barry Sidock in OPG's control room.



## Positioning for Competitive Success



Reconfiguring our assets, reducing costs, establishing financial credibility and continuing to work closely with our customers – these are prerequisites for success as OPG prepares for the opening of Ontario's electricity market.

### ► Managing Decontrol

OPG is committed to expanding its position as a successful North American energy company. To do so, we are decontrolling selected generating assets as required by our generating licence. The decontrol process will occur in two phases. The first phase requires us to divest control of 4,000 megawatts of price-setting fossil-fueled generation capacity, with the option of substituting up to 1,000 megawatts of hydroelectric generation, within 42 months of market opening. In the second phase, we must reduce our effective control of generation capacity in Ontario to 35% or less within 10 years of market opening. OPG is committed to meeting its decontrol obligations well in advance of these deadlines.

Accordingly, we announced in July our most noteworthy decontrol initiative to date – the lease of our 6,200 megawatt Bruce A and Bruce B nuclear stations for an initial period of 18 years to Bruce Power, a subsidiary of British Energy, with lease options to extend up to an additional 25 years. The transaction will provide a fair return for these assets to our shareholder, the Ontario government; free up valuable resources for continued improvements at our Pickering and Darlington nuclear stations; and strengthen Canada's nuclear industry with the presence of an important new participant. Subject to regulatory approvals and the usual closing conditions, we expect to complete this transaction by mid-2001.

Earlier, in February 2000, we announced our intention to decontrol two fossil-fueled stations, the Lakeview and Lennox generating stations, representing a combined capacity of almost 3,300 megawatts. While this initiative has been postponed as the provincial government completes its review of its environmental regulations governing fossil-fueled generation, we expect to resume the decontrol of these stations once the review has been finalized. The effect of the proposed decontrol of the Lakeview and Lennox

stations will result in meeting the greater part of the first phase of the decontrol requirement.

Overall, our decontrol initiatives will facilitate both competition and consumer choice in Ontario, while enabling OPG to put increased emphasis on our North American growth strategy. We will emerge from decontrol with a generating fleet every bit as competitive, reliable, safe and clean as our current fleet.

### ► **F o r m i n g   S t r a t e g i c   P a r t n e r s h i p s**

Concurrent with decontrol, OPG embarked on a dynamic program of strategic partnerships throughout the year.

In August 2000, OPG and C-SAT Technologies Inc. created Kinectrics Inc., forming a new,

independent science and engineering services company. OPG currently owns 90% of Kinectrics, whose projects include building and testing the largest pre-commercial solid oxide fuel cell power plant in the world.

In November 2000, we announced a 10-year, \$1 billion information technology agreement with New Horizon System Solutions Inc., a joint venture between OPG (49%) and Cap Gemini Ernst & Young (51%). The new company plans to offer information technology services to OPG and throughout the North American electricity industry.

Both partnerships help OPG to reduce costs and stay focused on our core activities of competitive power generation and marketing, while at the same time ensuring that our research and development and our information technology service needs are effectively met.

### ► **A d d i n g   V a l u e   T h r o u g h   O P G   E n e r g y   M a r k e t s**

In preparing for open competition, OPG is also committing resources to areas such as portfolio management, bidding strategies, integrated outage management, and specialized risk management products and energy services through our OPG Energy Markets group.

During 2000, OPG Energy Markets installed and started testing the technologies and established business processes required for OPG's participation in the new market. We also expanded our expertise in such key areas as product structuring, trading, market analysis and customer care. In September, we officially opened our OPG Energy Markets facility, which includes one of Canada's most advanced energy-trading floors.

Consistent with our long-term strategy, OPG will be applying for a licence from the U.S. Federal Energy Regulatory Commission, which will permit us to sell directly to U.S. customers once the Ontario market is open.

### ► **S t a y i n g   C l o s e   t o   C u s t o m e r s**

To help customers address their power needs in a competitive market, we held meetings involving OPG senior executives and more than 100 wholesale municipal and direct industrial customers. We also continued to inform customers about the coming challenges and opportunities in the marketplace through more than 30 special seminars as well as through information available on our customer Web site. Customer input from these and other sources enabled us to develop new risk management products and services that we began offering to customers during the year.

For the second consecutive year, our customer satisfaction index registered a significant gain, surpassing our annual performance objective. Our goal is to achieve "best in class" customer satisfaction within the next three years.



• Maria Grino, IT technician in New Horizon System Solutions

• Nanticoke Generating Station (view of turbine hall), a station essential for meeting customer electricity demands

## ► Setting the Pace in Supply Management and E-Commerce

In the area of procurement, we are committed to a total corporate-wide savings target of \$100 million. As part of this effort, our new Supply Chain program realized an estimated savings of \$40 million during 2000.

To further manage costs, OPG became an investor and member of Pantellos Corporation, a consortium of 21 major North American utility and energy companies. Pantellos will operate an online business-to-business marketplace for the electricity, natural gas and other energy sectors – a global portal for purchasing anything from transformers and wire to turbines and equipment repairs.

Another e-commerce joint venture saw OPG and Toronto Hydro Corporation form EBT Express in October 2000. This company will be among the first in North America to provide centralized electronic data management and transaction services to local distribution companies and energy retailers. Within its first six weeks of operation, EBT Express had captured over 24% of Ontario's meter base of 3.6 million customers.



## ► Enhancing Financial Credibility


To establish and strengthen financial credibility, OPG filed a Non-Offering Prospectus with Canadian securities commissions in March as a first step in becoming a reporting issuer.

In May, the company received investment-grade credit ratings for both long-term debt and commercial paper programs. Both agencies noted OPG's sound balance sheet, strong cash flows, improving operational performance and its flexible, diversified portfolio of low-cost operating assets. Soon after receiving these ratings, OPG launched its inaugural \$600 million Commercial Paper program in November 2000.

• Ontario's lumber and pulp and paper industry is the largest sector of OPG's industrial customers

• OPG customer seminars share information about how a competitive electricity market will affect customers





Employees Craig Wardrop, Rhys Jenkins, Ken Roberts and Wyatt Williams hold a pre-job briefing prior to servicing one of the generating units at the Lambton Generating Station.

- Turbine runner awaiting installation at water-powered R.H. Saunders Generating Station
- Turbine hall at the Darlington Nuclear Generating Station

## Optimizing Our Assets



OPG generates electricity from a diversified and competitive portfolio of nuclear, hydroelectric and fossil-fueled stations. Over the past five years, our nuclear and hydroelectric stations have averaged more than 75% of our annual generation, in addition to having very competitive operating costs and producing virtually no emissions contributing to acid rain, smog or global warming. All of our fossil-fueled and major hydroelectric stations have achieved certification under the ISO 9002 quality management system standard.

Our nuclear stations conform to a quality standard established by the Canadian Standards Association.

### ► Improved Nuclear Performance

Nuclear power contributed 59.8 terawatt-hours of electricity production in 2000, compared to 61.4 terawatt-hours generated in 1999. The reason for this decline was an extensive scheduled outage program, including a once-a-decade Vacuum Building outage at our Pickering Generating Stations. Our outage program should result in higher capacity levels going forward.

Through our Nuclear Performance Improvement program, OPG has made significant strides over the past three years to narrow the performance gap with industry-leading U.S. nuclear units. At the end of 1997, OPG's Nuclear Performance Index, which is based on indicators adopted by the World Association of Nuclear Operators (WANO), stood at 58%, compared with an industry average of 82%. Our Index score is now more than 83% compared to average performance scores of just over 90% in the U.S. While much remains to be accomplished, OPG has achieved clear performance improvements since we began the Nuclear Performance Improvement program.

Eight of the 11 WANO indicators relate primarily to employee and public safety performance. It is a



credit to our entire nuclear workforce that every one of these eight safety indicators has either shown a major improvement, reaching top performance levels over the past two years, or has remained stable where we had already attained top industry performance.

In November 2000, the Canadian Nuclear Safety Commission (CNSC) renewed the Darlington Generating Station's operating licence for 27 months.

During the year, OPG completed two major maintenance outages at Darlington Generating Station significantly ahead of schedule, as well as the Vacuum Building outage at our Pickering site. In addition to higher production levels, well-executed nuclear outages also result in lower overall system generation costs and lower system-wide air emissions.

Progress was also made this year in our plans to return Pickering A to service.

The CNSC held public hearings to review our environmental assessment in support of our plan. Following the hearings, the CNSC in February 2001 accepted the conclusions and recommendations of the environmental assessment. Assuming we attain all remaining regulatory approvals, we will restart the first of the station's four units in early 2002 and should have all four units back in operation by the end of 2003.

*The restart of the four-unit Pickering A Nuclear Generating Station provides economic and environmental benefits. The station's capacity of more than 2,000 megawatts is the lowest-cost incremental source of electricity generation available to Ontario, with enough capacity to meet the electricity needs of a city with a population of two million. Moreover, it has the potential to displace up to 80,000 tonnes of acid gases and 13 million tonnes of greenhouse gas annually. This is equivalent to the greenhouse gas emissions of about three million cars.*

## ► Hydroelectric Generation

Our lowest-cost power source, hydroelectric generation, produced 34.0 terawatt-hours this year. Despite low Great Lakes water levels, we made the most of this resource by optimizing water storage and bettering availability and reliability targets for all of our hydroelectric stations. Forced outage rates were the lowest in 20 years, further testimony to the outstanding reliability achieved by these facilities.

OPG continues to invest in its hydroelectric plants to increase their output and extend their service lives. Major upgrading initiatives have already increased hydroelectric capacity by 175 megawatts since 1995 and will add another 140 megawatts by 2005. In November, a rehabilitation program at the Sir Adam Beck No. 2 station reached the halfway mark – with eight of 16 units now completed. Both capacity and energy output from the refurbished units have exceeded targets, and project costs remain well below budget.

Concurrent with these upgrading efforts, as part of our Dam Safety Program, we completed the first round of a thorough safety assessment on each of our 258 dams. Updated emergency plans were also put in place for all of our large dams to ensure effective response in the unlikely event of a dam emergency.

## ► Fossil-Fueled Generation

The strength of our fossil-fueled stations is their flexibility to supply both baseload and peaking electricity. This is critical for commercial success in an open marketplace where demand fluctuates and generators must respond quickly to capture market opportunities. During the Pickering Nuclear Generating Station Vacuum Building outage, our fossil-fueled stations were vital in helping us maintain supply



• Ralph Fedyk and Peter Johnson at the Pickering Nuclear Generating Station simulator

• Sir Adam Beck Generating Stations at Niagara Falls, Ontario



reliability. Fossil-fueled generation also proved essential to maintaining reliability in Ontario during seasonal peak periods such as the summer of 2000, when demand in August reached over 23,000 megawatts – a new record for that month. OPG not only met this demand, but we were also able to export surplus power into interconnected markets in the U.S., which were also experiencing high electricity demands.

OPG generated a record of 42.4 terawatt-hours of electricity from our fossil-fueled stations in 2000, compared to 36.1 terawatt-hours in 1999. This is significantly more fossil-fueled energy than we produced during our previous high-production period in the early 1980s.

Through our continued focus on reducing emissions, we were able to generate this record amount of fossil-fueled power with almost 60% lower emissions of sulphur dioxide and nitrogen oxide compared to emission levels in the early 1980s. Measures taken to achieve emission reductions include: installation of sulphur dioxide scrubbers at Lambton Generating Station; paying a premium for low sulphur fuel; and the conversion of the Lennox Generating Station to burn natural gas as well as oil. In 2000, as part of our emission reduction efforts, we completed the installation of low-nitrogen oxide burners on the last of our eight Nanticoke Generating Station units and on two Lakeview Generating Station units, reducing the nitrogen oxide emissions from these units by an average of 30%.

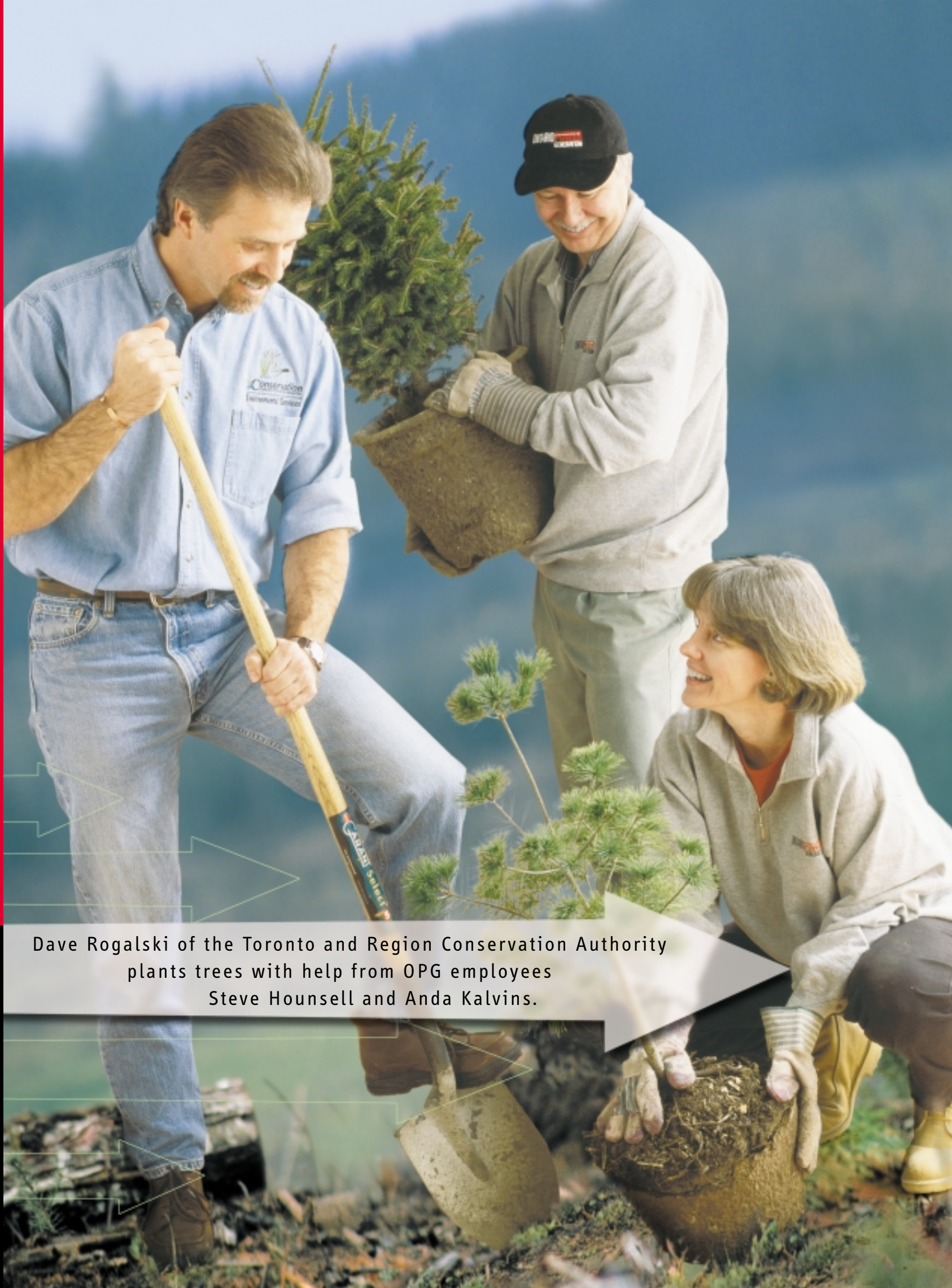
OPG is committed to maintaining its fossil-fueled stations at exceptional levels of reliability. In June, we completed a two-year \$160 million restoration program at Nanticoke Generating Station. The project greatly improved plant reliability and environmental performance.

OPG fossil-fueled stations combine with our hydroelectric and nuclear stations to create a portfolio of generating assets that is flexible, reliable, competitive and clean.



• Des Joachims  
Generating Station

• Lee Cowper and  
Brian Town  
performing  
rehabilitation  
at the Nanticoke  
Generating Station



Dave Rogalski of the Toronto and Region Conservation Authority plants trees with help from OPG employees Steve Hounsell and Anda Kalvins.



- *Joshua Terry, student, examining a birdhouse at the Pickering Nuclear Generating Station*
- *OPG employees Brian Jarvis and Roger Daly, with student Kristen Lockwood, at the Waterfront Trail near the Darlington Nuclear Generating Station*

## Strengthening Our Commitment to Sustainable Development



Sustainable development is a long-term goal for OPG. We support the World Business Council on Sustainable Development's definition of sustainable development as the balancing of environmental leadership, social responsibility and financial growth. We believe that real benefits will accrue from our commitment. The benefits include: reducing environmental impacts; meeting our voluntary environmental commitments; managing our environmental risks and liabilities; becoming a supplier and employer of choice; and securing the trust of communities, the confidence of investors and the respect of legislators. These benefits are key components of our brand and create shareholder value.

OPG's drive towards sustainability is played out on three fronts:

- improving the environmental performance of our operations;
- partnering with our stakeholders and increasing our value to site communities; and
- delivering maximum shareholder value.

### ► Improving Environmental Performance

OPG is committed to environmental improvement. As part of that commitment, all OPG generating stations and plant groups have achieved and continue to maintain ISO 14001 certification, the international standard for environmental management systems.

Our commitment is both constant and significant. In September, President and CEO Ron Osborne announced a quarter billion dollar investment in Selective Catalytic Reduction technology to further reduce nitrogen oxide emissions at the Lambton and Nanticoke stations. OPG will also equip the remaining two unmodified units at both Lakeview and Lambton stations with low-nitrogen oxide burners. Together, these initiatives will reduce nitrogen oxide emissions by a further 40%, or 18,000 tonnes, by 2004.

We also met a long-standing commitment to stabilize our net carbon dioxide emissions at their 1990



• Niagara District Girls Hockey Association team, sponsored by OPG's Niagara Plant Group

• OPG providing support during the Walkerton water crisis – local resident Burrell Gailing and Dave Kieffer of OPG

levels by the end of 2000 through initiatives such as in-house energy efficiency improvements and improvements in nuclear performance. OPG also continued its industry-leading role by purchasing more than 13 million tonnes of carbon dioxide credits, offsetting our emissions with verifiable reductions by others.

Going forward, we will continue to reduce greenhouse gas and other emissions by returning to service the Pickering A Nuclear Generating Station, quadrupling our green energy portfolio to 500 megawatts of production capability by 2005, and by continuing to meet aggressive energy efficiency targets at our stations.

As part of our biodiversity initiatives and also to further offset carbon dioxide emissions, OPG has pledged to plant 1.6 million native trees and shrubs in southern Ontario over the next five years. Approximately 240,000 trees were planted in 2000.

OPG also contributed \$428.6 million in 2000 to a segregated fund to provide for long-term nuclear waste management and station decommissioning. Since our inception in April 1999, we have made contributions of over \$830 million to this fund.

*OPG was the lead corporate sponsor of Radiance, the Queen's University-developed solar car that set a new world distance record of 6,800 kilometres in July. The futuristic-looking one-person vehicle traveled across Canada at about 75 kilometres per hour using just 1,000 watts, the amount of power used to run a toaster.*

## ▶ Working with Stakeholders and Communities

Our commitment includes listening and responding to community concerns, engaging communities and other stakeholders in constructive dialogue, and enhancing the quality of life in the areas where we operate.

Our nuclear stations have information centres open to the public, and our larger stations regularly hold open houses. In September, for example, an open house at our Darlington station drew 1,700 visitors.

We also regularly communicate with local residents and elected officials to keep them informed about our stations' operations. During our innovative Pickering Neighbourhood Walk, OPG employees visited more than 16,000 households in the Pickering and Ajax areas.

OPG's community outreach is sometimes spontaneous – with employees themselves taking charge. Bruce employees raised over \$13,000 in 90 minutes to help residents in Walkerton, Ontario, after a tragic outbreak of E. coli.

We contributed to the quality of life in Ontario communities by supporting over 400 environmental, educational and community organizations during 2000. This is in addition to the more than \$2.1 million raised by employees for Ontario communities and charities through our annual Charity Trust Campaign.

## ▶ Creating Value for Ontario

Another aspect of our sustainable development commitment is to deliver maximum value to our shareholder, the province and people of Ontario. In 2000, this included strategic investments in areas such as energy efficiency and recycling and recovery initiatives. These activities alone delivered over \$14 million to OPG's bottom line.

OPG's contribution to Ontario also included:

- about \$1 billion in annual purchases of goods and services;
- about \$1 billion in annual employee salaries; and
- more than \$1.2 billion in taxes, dividends and other payments to the province in 2000.

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# Ontario Power Generation Inc.

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

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

### The Corporation

OPG is one of the largest electricity generators in North America with 69 hydroelectric, six fossil and five nuclear generating stations forming a complementary mix of generating assets. At December 31, 2000, total generating capacity of these stations was approximately 30,900 megawatts ("MW"), consisting of 7,300 MW of hydroelectric generation capacity, 9,700 MW of fossil-fueled generation capacity and 13,900 MW of nuclear generation capacity, of which 5,100 MW is currently laid up.

OPG's principal business is the generation and sale of electricity in the Ontario wholesale market and in the interconnected markets of Quebec, Manitoba and the United States ("U.S.") northeast and midwest. In 2000, OPG supplied approximately 89% of the electricity consumed in Ontario through its own generation and purchases from the interconnected markets.

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

OPG was incorporated on December 1, 1998 pursuant to the *Business Corporations Act 1998* (Ontario). As part of the reorganization of Ontario Hydro and the related restructuring of the electricity industry in Ontario, OPG and its subsidiaries purchased and assumed certain assets, liabilities, employees, rights and obligations of the electricity generation business of Ontario Hydro (the "Acquired Business") on April 1, 1999 and commenced operations on that date.

In consideration of the transfer of assets, liabilities, employees, rights and obligations of the electricity generation business of Ontario Hydro, OPG issued to Ontario Electricity Financial Corporation ("OEFC") notes payable in the aggregate principal amount of \$8,526 million, including a note in the principal amount of \$5,126 million (the "Equity Note") and assumed a capital lease obligation of Ontario Hydro in the amount of \$30 million on April 1, 1999. The Province of Ontario (the "Province") has assumed all of OPG's obligations under the Equity Note and OEFC has released OPG from its obligations thereunder. In connection therewith, OPG issued to the Province 256,300,000 common shares as fully paid and non-assessable shares. OEFC has agreed that without the consent of OPG, it will not sell its remaining \$3,400 million of notes, of which \$2,650 million are senior notes and \$750 million are subordinated notes of OPG.

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

	Fair value as at April 1, 1999
<i>(millions of dollars)</i>	
<b>ASSETS</b>	
Current assets	1,465
Fixed assets	12,872
Other assets	598
	<u>14,935</u>
<b>LIABILITIES</b>	
Current liabilities	1,073
Liabilities and capital leases	5,336
	<u>6,409</u>
<b>NET ASSETS ACQUIRED</b>	<u>8,526</u>

The purchase price of \$8,526 million was determined based on the present value of estimated future operating results and cash flows of the Acquired Business in a deregulated market. The purchase of the Acquired Business from the related party, OEFC, was recorded at the exchange amount of \$8,526 million



in view of the substantive change in ownership interests arising from the transaction. The aggregate value of the net assets acquired was allocated to assets and liabilities based on their estimated fair values. Included within the net assets acquired by OPG was a deferred pension asset of \$555 million that is reflective of the surplus in OPG's pension plan administered through OEFC.

The results of operations and cash flow presented in OPG's Consolidated Financial Statements for the three months ended March 31, 1999 represent the operations of Ontario Hydro pertaining to the Acquired Business now conducted by OPG. These financial statements have been prepared through specific identification of assets, liabilities (other than debt), revenues and expenses relating to the Acquired Business, and through an allocation of certain common financial statement accounts and items of Ontario Hydro. In particular, a portion of Ontario Hydro's revenues and debt, and a corresponding portion of related interest and other financial expenses, have been allocated to the Acquired Business.

As part of the restructuring of the Ontario electricity industry, four other successor entities to Ontario Hydro were created in addition to OPG. The other successor entities include the following:

- Hydro One Inc. (formerly Ontario Hydro Services Company Inc.) ("Hydro One") purchased and assumed the transmission, distribution and retail energy services businesses formerly operated by Ontario Hydro;
- The Independent Electricity Market Operator ("IMO") is the centralized independent electricity system co-ordinator responsible for the balance of supply and demand, control of the provincial grid, the operation of energy and ancillary markets, including a spot market, and settlement of financial transactions;
- The Electrical Safety Authority ("ESA") carries out electrical equipment and electrical wiring installation inspection functions in Ontario; and
- OEFC is responsible for managing and retiring Ontario Hydro's outstanding debt and other obligations and administration of the OPG pension plan.

## Financial Highlights

For the year ended December 31, 2000, OPG earned a net income of \$605 million based on revenues of \$5,978 million. On a pro forma basis, which reflects the results of operations as if the purchase of net assets had occurred on January 1, 1999, the net income for 1999 was \$446 million based on revenues of \$5,795 million. Total volume of electricity sales in the Ontario and interconnected markets during the years ended December 31, 2000

<i>(millions of dollars, except as noted)</i>	Year ended December 31	
	2000	Pro forma 1999
Revenues	5,978	5,795
Operating income	1,198	1,010
Net income	605	446
Electricity sales volume (TWh)	139.8	136.9

and 1999 were 139.8 TWh and 136.9 TWh, respectively.

Significant factors contributing to higher earnings in 2000 compared to 1999 included an increase in electricity revenues in both the Ontario and interconnected markets, lower operating costs which reflected a reduction in pension expense and a decrease in the effective income tax rates.

## Ontario's New Electricity Market

The restructuring of the electricity market in Ontario is being accomplished in two stages. The first stage, the Transition Period, began on April 1, 1999, with the reorganization of Ontario Hydro and will end with the introduction of a competitive market for electricity through the opening of access to the electricity transmission and distribution systems in Ontario. The second stage, Open Access, is expected to begin in the fall of 2001 or spring of 2002.

The Ontario electricity industry continues to operate during the Transition Period generally as it has in the past from the perspective of consumers, although the successor entities of Ontario Hydro now operate their businesses separately. Until Open Access, customers will continue to be billed on a bundled basis. OPG receives the bundled payments and distributes the funds to the successor entities of Ontario Hydro under the terms of revenue allocation arrangements. The revenue allocation arrangements provide relatively fixed amounts to the other successor businesses. The revenue allocation arrangements were designed so the undistributed balance of funds would provide OPG with planned revenue of 4¢/kilowatt-hour (kWh) based on forecast energy demand and customer mix, together with a fixed amount for ancillary services provided during the year. Variations in revenue, resulting from changes in forecast demand and customer mix, will change OPG's revenue per kWh.

After Open Access, there will be significant changes in the way the industry operates. Generators, suppliers and marketers, both from within and outside Ontario, will compete to sell electricity to the spot market and to wholesale market participants including municipal electric utilities (also

referred to as local distribution companies, or "LDCs"), large commercial and industrial customers, and aggregators, brokers and marketers. Consumers will have access to the electricity supplier of their choice. Consumers will pay for the electricity purchased, as well as transmission and distribution services and "uplift" charges assessed by the IMO in respect of transmission losses and other costs to operate the system. In addition, a debt retirement charge will be levied to service the portion of OEFC's debt that cannot be serviced by payments in lieu of taxes made by OPG, Hydro One and the LDCs and other sources of revenue.

In order to ensure an orderly and gradual transition to a competitive electricity industry after Open Access, the Province has adopted a framework for market power mitigation designed to address issues regarding OPG's market position in Ontario. The first market power mitigation measure is a revenue cap mechanism. For the first four years after Open Access, the significant majority of OPG's expected energy sales in Ontario will be subject to an average annual revenue cap of 3.8¢/kWh. The amount of energy production subject to the revenue cap has been predetermined for the entire four-year period on an annual basis and will be reduced with the approval of the Ontario Energy Board ("OEB") as OPG reduces its control of generation capacity in Ontario. At the end of each one-year period following Open Access, OPG will be required to pay a rebate to the IMO equal to the difference between the average spot market price and 3.8¢/kWh for the amount of energy sales subject to the revenue cap. The IMO will pass this rebate on to Ontario consumers who draw energy from the IMO market.

The second market power mitigation measure is a requirement for OPG to relinquish control to an independent third party of some of its generating capacity. This can be accomplished through the outright sale or lease of power stations or by entering into other arrangements transferring control of the timing, quantity and bidding of energy produced by OPG's stations. OPG is required to relinquish effective control of at least 4,000 MW of fossil generating capacity within 42 months after Open Access, with the option of substituting up to 1,000 MW of hydroelectric generating capacity for an equal amount of fossil operating capacity. Further, within 10 years of Open Access, OPG must reduce its effective control over total generation capacity to a level that is no more than 35% of the overall Ontario market's supply.

In addition, in order to ease the transition to Open Access, the Province has passed a regulation which requires OPG to continue to offer the terms of certain of its tariffs to approximately 80 large power consumers for a maximum of four years after Open Access begins.

Elements of the restructuring of Ontario's electricity market, including certain regulations and market rules established by the OEB and IMO, are still in a state of transition.

## Analysis of Operating Results

The following discussion and analysis provides a comparison of the operating results for the year ended December 31, 2000 to pro forma operating results for the year ended December 31, 1999. Pro forma operating results for 1999 have been provided to enhance the comparability of results for 1999 and 2000, given the significant differences in the business and regulatory environment, as well as the significant change in OPG's capital structure that occurred effective April 1, 1999. The 1999 pro forma statement of income reflects the operations of the Acquired Business for the three months ended March 31, 1999 and OPG's actual operating results for the nine months ended December 31, 1999.

The pro forma statement of income reflects the purchase of the Acquired Business as if the purchase of net assets had occurred on January 1, 1999. The historical results prior to April 1, 1999 have been restated to reflect the acquisition related adjustments including the allocation of the acquisition price to the assets and the liabilities of the generation business of Ontario Hydro. The assumptions and adjustments underlying the pro forma income statement are disclosed in Note 17 to the Consolidated Financial Statements. Some of the more significant financial statement effects of the purchase that occurred on April 1, 1999 include the following:

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

(millions of dollars)	Year Ended December 31	
	2000	Pro forma <sup>(1)</sup> 1999
<b>REVENUES</b>	<b>5,978</b>	<b>5,795</b>
<b>OPERATING EXPENSES</b>		
Operation, maintenance and administration	2,186	2,337
Fuel	1,271	1,116
Power purchased	180	198
Depreciation and amortization	764	765
Property and capital taxes	379	369
	<b>4,780</b>	<b>4,785</b>
<b>OPERATING INCOME</b>	<b>1,198</b>	<b>1,010</b>
Interest expense	140	179
Income before income taxes	1,058	831
Income taxes	453	385
<b>NET INCOME</b>	<b>605</b>	<b>446</b>

(1) The pro forma results are not necessarily indicative of the results that would have occurred had the transactions occurred on the relevant dates, because of the significant changes in the business and regulatory environments, financing and other factors.

### Net Income

The net income for 2000 was \$605 million compared to pro forma net income of \$446 million in 1999. The increase in earnings from 1999 was primarily due to an increase in electricity revenues in both the Ontario and interconnected markets, lower operating costs that reflected a reduction in pension expense and a decrease in the effective income tax rates.

### Revenues

Total revenues for 2000 were \$5,978 million compared with \$5,795 million in 1999, an increase of \$183 million or 3%. Of the total, Ontario energy revenues were \$5,576 million (1999 - \$5,446 million), interconnected market revenues were \$279 million (1999 - \$233 million) and non-energy revenues amounted to \$123 million (1999 - \$116 million).

Ontario energy revenues are earned from the generation and sale of electricity to the wholesale market. Customers in Ontario include approximately 214 LDCs and municipal electrical utilities, that in turn serve more than three million customers, over 100 large direct industrial customers, and Hydro One which serves a further 930,000 customers. Ontario revenues in 2000 were \$5,576 million compared with \$5,446 million in 1999, an increase of \$130 million. The higher rev-

enues were primarily due to a 3.4 TWh increase in the volume of electricity sales from 132.4 TWh in 1999 to 135.8 TWh in 2000. The increase in volume was due to increased economic activity which contributed to higher demand from municipal and industrial customers, partially offset by the impact of warmer winter weather and cooler summer weather in 2000 which reduced the demand for heating and air conditioning compared to 1999. On a weather-normalized basis, electricity sales would have been 137.0 TWh in 2000 compared to 132.2 TWh in 1999. The average revenue rate was 4.03¢/kWh in 2000 compared to 4.04¢/kWh in 1999.

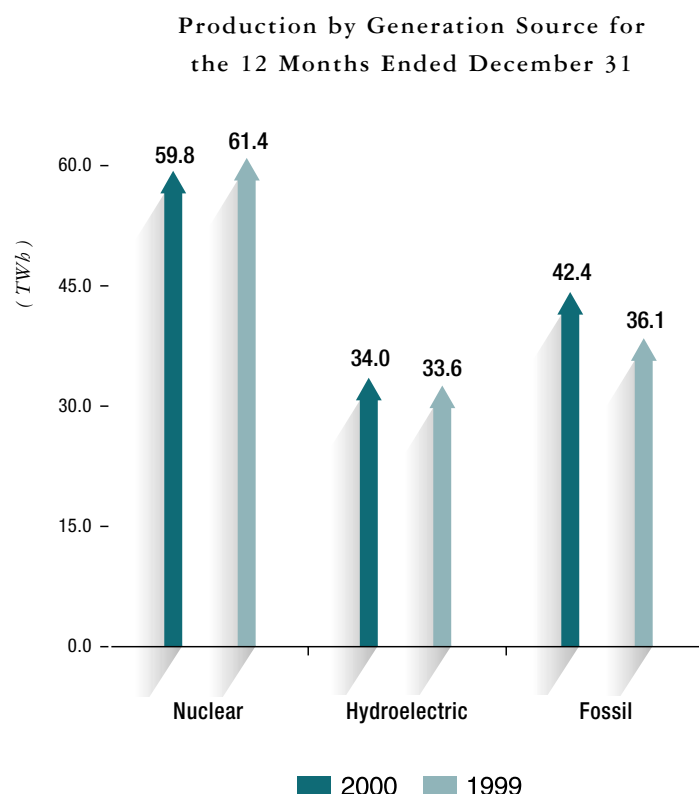
Revenues from interconnected markets were \$279 million in 2000 compared with \$233 million in 1999, an increase of \$46 million. The increase in interconnected revenue was due to higher spot market prices in 2000 (\$50 million) and an increase in other revenues from U.S. customers (\$20 million), partially offset by a decrease in sales volumes primarily due to a cooler summer season. The interconnected sales volumes in 2000 were 4.0 TWh, a decrease of 0.5 TWh from the 1999 sales volume of 4.5 TWh. The average sales prices, excluding the other revenues, were 6.05¢/kWh in 2000 compared to 4.80¢/kWh in 1999.

Non-energy revenues include sales of engineering and technical expertise, by-product sales such as flyash, cobalt and other nuclear isotopes, heavy water sales, foreign exchange gains and losses, and the sale of services to the other successor companies to Ontario Hydro in respect of facility and space management, information technology and other support services. Non-energy revenues for 2000 were \$123 million compared with \$116 million in 1999. The increase was due primarily to higher sales of engineering and technical expertise, the sale of surplus assets, higher isotope and by-product sales and an increase in foreign exchange gains, partially offset by a reduction in the sale of services to other successor companies of Ontario Hydro.

### Operating Expenses

Operation, maintenance and administrative (OM&A) expenses consist of labour, materials and administrative support. OM&A expenses in 2000 were \$2,186 million compared with \$2,337 million in 1999, a decrease of \$151 million or 6%. The decrease was due primarily to lower pension expense (\$170 million), a decrease in costs resulting from the completion of the Year 2000 computer systems remediation efforts (\$39 million) and lower rehabilitation costs at the Nanticoke and Lambton generating stations (\$32 million). While the current service pension cost remained relatively constant between the years, the lower pension expense in 2000 was primarily due to higher returns on pension fund assets in 1999, a

change in discount rates and other economic factors. The impact of these reductions was partially offset by higher spending on nuclear-related projects (\$57 million), including an increase in activity related to the Pickering A generating station return to service, costs related to voluntary severance programs (\$18 million), and other increases in operating costs (\$15 million).



Fuel is comprised of costs for coal, uranium, oil, natural gas, water rental payments and a provision for used nuclear fuel disposal based on actual fuel consumed. Fuel expenses during 2000 were \$1,271 million compared with \$1,116 million in 1999, an increase of \$155 million or 14%. Higher fuel expenses were a result of an increase in production in 2000 to 136.2 TWh from 131.1 TWh in 1999 and an increase in higher cost fossil production relative to other sources of generation, partially offset by the impact of lower coal prices in 2000.

Power purchase costs represent electricity purchases from interconnected markets. Power purchased during 2000 was \$180 million compared with \$198 million in 1999, a decrease of \$18 million or 9%. The decrease was primarily due to a reduction in volume of power purchased from U.S. sources resulting from OPG's increased production of electricity, partially offset by higher spot market prices in the U.S. market. The power purchased in 2000 was 3.3 TWh, a reduction of

1.8 TWh from 1999.

Depreciation and amortization charged to operations in 2000 was relatively unchanged at \$764 million compared with \$765 million in 1999. The depreciation and amortization expense includes depreciation of fixed assets in service based on their estimated service lives, and a charge related to the increase in the accrued costs for low and intermediate level nuclear waste from waste produced during the period. The depreciation and amortization related to nuclear waste items was \$21 million in 2000 compared to \$26 million in 1999.

The depreciation and amortization expense also includes revalorization. Revalorization arises because liabilities for used nuclear waste disposal and future fixed asset removal costs are stated in the balance sheet on a net present value basis. The revalorization charge is the adjustment that results from restating the liabilities to reflect the effect of inflation on the cost estimates and the time value of money effect on the future liabilities. The revalorization charge is sensitive to movements in both interest and inflation rates. The revalorization charge was \$202 million in 2000 compared with \$223 million during 1999. The revalorization charge includes a credit that reflects the growth of segregated funds directly set aside to discharge these obligations, including the provincial receivable. This credit amount was \$181 million in 2000 compared with \$108 million in 1999.

OPG is required to make payments to OEFC in lieu of property and school taxes on its generating assets representing the amount it would be required to pay if the assets were privately owned. Property and capital taxes in 2000 were \$379 million compared with \$369 million in 1999.

### **Interest Expense**

Interest expense represents interest and other financing costs associated with OPG's debt. Interest charged to operations represents the gross interest costs reduced by capitalized interest and interest earned on surplus cash and short-term investments. Interest expense in 2000 was \$140 million compared with \$179 million in 1999, a decrease of \$39 million. The decrease in interest expense was primarily due to higher investment income resulting from an increase in cash balances and short-term investments.

### **Income Taxes**

OPG is currently exempt from taxation under the *Income Tax Act* (Canada) and *Corporations Tax Act* (Ontario) as a result of being a 100% provincially-owned corporation. However, OPG is required to make payments to OEFC in lieu of federal and provincial income taxes. These payments are calculated in accordance with the rules and other related provisions

contained in the federal and provincial tax legislation and the regulations made under the *Electricity Act, 1998*.

Effective January 1, 2000, OPG changed its method of accounting for income taxes from the deferral method to the liability method of tax allocation as required by The Canadian Institute of Chartered Accountants' Handbook, Section 3465, *Accounting for Income Taxes*. The cumulative effect as at January 1, 2000 of adopting these recommendations was not material. Therefore, prior year financial statements have not been restated. For the nine months ended December 31, 1999, the deferred income tax component of income tax expense is disclosed in the financial statements as future income taxes.

Income taxes in 2000 were \$453 million compared with \$385 million in 1999. The increase in income taxes of \$68 million was due primarily to a higher income before tax in 2000, partially offset by a decrease in the effective income tax rate from 47.0% in 1999 to 42.8% in 2000.

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

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

Effective April 1, 1999, as a result of the purchase of the generating assets of Ontario Hydro, OPG recognized a liability equal to the committed value of nuclear and fossil liabilities, representing the total present value of the costs of dismantling the nuclear and fossil production facilities at the end of their useful lives, the total fixed cost of nuclear waste management programs, and the variable cost portion of nuclear waste management programs associated with actual waste volumes incurred up to April 1, 1999. At December 31, 2000, the liability for nuclear waste management and asset removal was \$7,104 million (1999 - \$6,715 million), of which \$6,978 million (1999 - \$6,591 million) related to nuclear decommissioning and waste liabilities and \$126 million (1999 - \$124 million) related to non-nuclear decommissioning liabilities.

On April 1, 1999, the Province agreed that the Province or its agent would fund certain nuclear waste management and asset removal liabilities that were incurred prior to April 1, 1999. Details of which liabilities will be funded are being finalized with the Province. The provincial receivable of \$2,622 million represents the Province's liability of \$2,480 million as at January 1, 2000, as well as interest in the amount of \$142 million accrued during the year ended December 31, 2000 based on a rate of 5.75% (nine months ended December 31, 1999 - 5.75%). The interest rate is under negotiation with the Province and is subject to change. The impact of the finalization of the interest rate for 2000 is

not expected to result in a material difference to the liability balance.

### ***Segregated Funds***

OPG is contributing to segregated funds to provide for or discharge the remaining unfunded nuclear liabilities. It is OPG's intent that these funds be held outside of OPG and be used solely for nuclear waste management and nuclear fixed asset removal. Until such time as the legal nature of the segregated funds are finalized, OPG is setting aside funds internally and is managing their investment and growth distinct from its other cash holdings. The funds are invested in high grade, interest-bearing instruments. The nuclear waste management and asset removal fund increased by \$414 million during 2000 through the funding and interest earned on the segregated fund, net of current year expenditures. OPG plans to contribute to the segregated funds over the estimated remaining lives of its nuclear generating stations.

### ***Nuclear Risk-Sharing***

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

In addition to a nuclear liability agreement, the Province has also agreed to provide to the Canadian Nuclear Safety Commission ("CNSC", formerly the Atomic Energy Control Board), as required by federal regulation, a guarantee that there will be funds available to discharge 100% of the nuclear decommissioning and waste liabilities that exist at any point in time within OPG. This guarantee relates to the portion of the liabilities that are not funded. In return, OPG will pay to the Province a fee of 0.5% of the value of that guarantee. This guarantee is expected to commence in 2001, once the nuclear liability agreement is finalized.

### ***Proposed Waste Management Organization***

In response to a December 1998 policy statement by the Federal Government, OPG continues its discussions with both the Province and the Federal Government regarding the estab-

lishment of a Waste Management Organization ("WMO") to manage all future operating expenditures for the life cycle management of nuclear waste. The exact structure and mandate of the WMO is under review.

The WMO would have the benefits of centralization of technical and management skills, would aid in the development of Canadian wide solutions to nuclear waste issues and would be in line with corporate structures adopted across the world for management of radioactive wastes. The Federal Government is considering introducing draft legislation within the next year that would establish the role of a WMO and define government oversight responsibilities.

### **Nuclear Recovery Program**

An important element underlying OPG's commercial and financial success is improved nuclear performance. OPG's expectation of improving financial performance is dependent on increasing production of low cost nuclear energy to compete in Ontario and the interconnected markets. This includes the return to service of the four units at the Pickering A generating station.

A comprehensive nuclear recovery plan was developed in the fall of 1997 by Ontario Hydro. The nuclear recovery plan was designed to improve the operating performance of the nuclear generating stations. The projects within the nuclear recovery program include standardizing operations and implementing initiatives to improve accountability, management and operational control systems, maintenance and inspection programs, regulatory compliance, performance standards and employee training.

Expenditures related to the nuclear recovery plan during the period from 1997 to 2004 are expected to total \$1,400 million. This estimate excludes future costs related to the Bruce nuclear facilities subsequent to completing the transaction to lease the Bruce A and Bruce B generating stations to Bruce Power L.P. The new operators of the Bruce site will be responsible for any improvement expenditure on the site after the transaction closes. Spending on the nuclear recovery program was \$267 million during the 2000 year and \$308 million during 1999. Total expenditures since the start of the program in 1997 were \$853 million. The planned expenditures on these projects are expected to total approximately \$250 million in 2001.

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

of Darlington, Pickering B and Bruce B.

With the staffing, planning and execution of the program well underway, attention is now focused on returning the Pickering A station to service. The current plans call for the return to service of the four Pickering A units at approximately six-month intervals commencing at the start of 2002. The total project cost of returning the Pickering A units to service is expected to be approximately \$1,100 million. Total expenditures since the decision in 1999 to return Pickering A to service were \$197 million. An environmental assessment ("EA") was required to determine the effect that Pickering A's return to service will have on the environment. The CNSC held two public hearings on the EA. Following the hearings, the CNSC in February 2001 accepted the conclusions and recommendations of the EA. Pickering A return to service licensing hearings are tentatively scheduled for the summer of 2001.

### **Liquidity and Capital Resources**

Cash flow from operating activities during the year ended December 31, 2000 amounted to \$1,281 million (nine months ended December 31, 1999 - \$549 million). Sufficient cash was generated from operations in 2000 to finance working capital requirements and invest in fixed assets and pay dividends. Cash and cash equivalents increased by \$322 million to \$565 million at December 31, 2000 from \$243 million at December 31, 1999. In addition OPG had short-term investments of \$335 million at December 31, 2000.

OPG continues to invest in fixed assets to improve operating efficiencies, increase generating capacity of its existing plant and maintain and improve service, reliability, safety and environmental performance. The investment in fixed assets of \$585 million for the year ended December 31, 2000 compared with \$450 million for the nine months ended December 31, 1999 and \$35 million during the three months ended March 31, 1999. OPG's contribution to the nuclear waste management and asset removal fund of \$414 million in 2000 was in addition to the Company's investment in fixed assets.

OPG's planned capital expenditures for 2001 are approximately \$725 million. This amount includes sustaining capital expenditures to support the continued operations of current generating capacity such as expenditures to meet expected emission reduction regulations, and capital expenditures to expand generating capacity such as the Pickering A return to service project and the nuclear recovery program. Of the total capital plan for 2001, OPG estimates that \$460 million represents expenditures for sustaining operations. For 2002, OPG's



planned capital expenditures are approximately \$800 million, of which \$430 million represent sustaining expenditures.

In the future, OPG expects to seek external sources of capital such as debt in the Canadian capital market to obtain funds required to carry out its capital program, refinance existing debt and provide other flexibility in the funding of future operations. In June 2000, OPG obtained investment-grade credit ratings of A for its long-term debt from both Canadian Bond Rating Services ("CBRS", subsequently purchased by Standard & Poor's, "S & P") and Dominion Bond Rating Services (DBRS) and A-1 and R-1 (low) for its short-term debt from CBRS and DBRS, respectively. As a result of the purchase of CBRS, S & P will be reviewing OPG's rating as part of its strategy to harmonize its rating to conform to an S & P standard.

OPG has access to funds through a \$600 million credit facility with certain Canadian chartered banks to fund working capital requirements and for general corporate purposes. This facility may be drawn upon in either Canadian or U.S. dollars at varying rates based on certain benchmark rates, including a prime rate, a bankers' acceptance rate, and a LIBOR rate.

OPG initiated a commercial paper (CP) program in 2000. Under the CP program, OPG has the authority to issue short-term promissory notes up to a maximum outstanding principal amount of \$600 million in Canadian currency, or the equivalent thereof in United States currency. Notes issued under the CP program are backed by the above-noted credit facility. As at December 31, 2000, OPG had \$150 million of promissory notes issued and outstanding under this CP program. This program, coupled with obtaining investment grade ratings, were part of the financing liquidity strategy to expand OPG's capital sources in the public market. OPG will be using these funds for working capital and general corporate purposes.

OPG's long-term debt of \$3,423 million, as at December 31, 2000 consists of \$200 million of senior notes due within one year, \$2,450 million of senior notes due in the years 2002 to 2009, \$750 million of subordinated notes due in the years 2010 and 2011 and \$23 million in capital lease obligations. Certain covenants applicable to any public debt issued by OPG in the future will automatically become applicable to the notes.

## **Risk Management**

### *Overview*

OPG's risk management activities involve identifying, assessing and controlling the risk associated with its portfolio of generation assets in an effort to optimize asset returns. The Board of Directors approves all risk management policies

prior to implementation. OPG undertakes an assessment of its risk exposures in order to characterize such exposures and the effects of risk management activities, including avoidance, reduction, transfer and substitution. Executive management and the Board of Directors review OPG's residual exposure to ensure it is consistent with overall strategy and corporate risk tolerance levels.

Upon Open Access, OPG will be subject to increased risk, including market and credit risk inherent in a deregulated market. A Risk Oversight Committee which consists of senior officers from OPG has been established to approve transactions under the direction of the Board of Directors, monitor policies and compliance issues, and ensure overall corporate governance specifically related to market activity for OPG.

In anticipation of increased levels and complexity of market activities, OPG is implementing a comprehensive trade capture and risk management system with related processes and controls. These processes will include a segmentation of portfolio activities to facilitate effective identification and measurement of risks, and the application of appropriate position and risk limits. The methodology used to measure these risks will involve the use of consistent and recognized risk measures for the monitoring of trading activities and the generation portfolio.

### *Industry Restructuring*

Certain regulations and market rules established by the IMO and the OEB that will govern the competitive wholesale and retail electricity markets, including technical provisions dealing with participants in the markets and the procurement of certain ancillary services are still in a state of transition. The Minister of Energy, Science and Technology, the Minister of Finance, the IMO and the OEB are each continuing to assess and develop policy positions on various matters that could affect OPG.

### *Nuclear Recovery Program*

The successful implementation of the nuclear recovery program will depend on many factors, including the discovery of any unanticipated deficiencies or greater than anticipated deterioration to its nuclear generating assets, the ability to operate effectively within the new regulatory framework governing nuclear generation, the ability to hire and retain qualified personnel, the ability to increase productivity and the ability to implement management and operational changes. The nuclear recovery program includes a rigorous framework for managing risks associated with nuclear operations and processes. This framework addresses the major risk areas, related exposures and impacts, and mitigation strategies in the nuclear business.

### *Environmental Compliance*

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

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

OPG utilizes emission reduction credits (ERCs) to manage emission levels of oxides of nitrogen (NOx) and carbon dioxide (CO<sub>2</sub>) within the prescribed regulatory limits and voluntary caps. ERCs are purchased and sold with trading partners in Canada and the United States. ERCs are created when a source reduces emissions below the lower of previous actual emissions or the level required by government regulation.

### *Electricity Price Risk*

Electricity price risk is the risk that changes in the market price of electricity will adversely impact OPG's earnings and cash flow. Once the market opens, OPG will face price risk directly related both to the demand and supply of generation in the open market and transmission constraints. OPG's production will be exposed to spot market prices, however derivative instruments and related risk management products may be used to mitigate its exposure to electricity prices upon Open Access.

### *Generation Risk*

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

### *Credit Risk*

Credit risk is the risk of non-performance by contractual counterparties. Following Open Access, substantially all of OPG's revenues will be derived from sales through the IMO-administered spot market. Participants in the IMO spot market must meet IMO-mandated standards for credit-worthiness with the result that OPG's risk for these sales is effectively managed. OPG's other revenues will be derived from several sources, including the sale of financial risk management products to third parties.

OPG has a counterparty credit policy, and has implemented credit evaluation and collection procedures to monitor its credit exposures. OPG manages counterparty credit risk by monitoring and limiting its exposure to counterparties with lower credit ratings, evaluating its counterparty credit exposure on an integrated basis, and by performing periodic reviews of the credit-worthiness of all counterparties, including obtaining credit security for all transactions beyond approved limits.

### *Foreign Exchange and Interest Rate Risk*

OPG's foreign exchange risk exposure is attributable primarily to U.S. dollar denominated transactions such as the purchase of fossil fuel and the purchase and sale of electricity in U.S. markets. OPG currently manages this exposure by periodically hedging its net U.S. dollar cash flows according to approved risk management policies.

Interest rate exposure for OPG is limited by the fixed rates on its long-term debt. Interest rate risk will arise with the need to undertake new financing and with the addition of variable rate debt. The interest rates for future financing requirements may be hedged using derivative instruments. The management of these risks will be undertaken by selectively hedging in accordance with corporate risk management policies.

## **Market Outlook**

### *The Marketplace*

OPG's vision is to be a premier North American energy company focused on low-cost power generation and wholesale energy sales. OPG's initial focus will be primarily in Ontario's electricity marketplace. In the short term, OPG will concentrate on increasing the productivity, capacity and cost competitiveness of its existing generating fleet. The restoration of OPG's nuclear generating facilities to top tier operational performance is an integral part of this objective. As well, the initiative to return the Pickering A generating station to service will restore 2,060 MW of nuclear capacity

and significantly lower OPG's overall system average production costs. OPG is also focusing in the short term on identifying and developing the market capabilities necessary to maximize customer relationships and enhance the products and services it provides, as well as expanding the markets for its energy and related products and services once the market opens.

Over the medium to longer term, OPG intends to selectively expand its activities into regional markets, particularly in the U.S. northeast and midwest, and to secure generating capacity in U.S. interconnected market areas close to Ontario. OPG will proceed on these new fronts in a balanced and staged manner. OPG will rely on its operating experience and performance improvements in its home market, and its expertise in the sale and wheeling of power into interconnected markets to increase revenues and to utilize acquired assets to optimize production and performance.

OPG's ability to compete successfully in the U.S. interconnected markets will depend upon numerous factors, including the pace of regulatory restructuring, the level of access to these markets through regulatory licensing requirements, limitations imposed by transmission capacity to the U.S. and a variety of other factors including the price of electricity in these markets, transmission costs to reach these markets and environmental matters.

OPG expects that net income in 2001 will be affected by such factors as increased expenditures to return to service the Pickering A generating station, the loss of contribution of the Bruce facility after its decontrol, a higher pension cost due to economic and actuarial factors, the capping of a significant portion of OPG's electricity sales at 3.8¢/kWh upon Open Access and the potential impact related to the availability and price of fuel sources. OPG believes that its ability to improve net income over time depends largely on the success of the nuclear recovery strategy, in particular the return to service of the Pickering A generating station, the realization of savings in operating expenses consistent with the completion of the nuclear recovery strategy and the completion of decontrol transactions, and the successful implementation of OPG's growth strategies.

### *Open Access*

Open Access, which is expected to begin in late 2001 or early 2002, will result in significant changes in the way the industry operates. Ontario electricity consumers will have access to their electricity supplier of choice. Generators and other market participants will compete with each other on the basis of price, service quality and other differentiating factors. Opportunities for new products and services will be

created, including those for managing the risk associated with market price fluctuations.

After Open Access, OPG expects competitive pressures in the Ontario market to come from companies which control generation capacity decontrolled by OPG, intermediaries that offer new products and services, including financial risk management products, imports of electricity from the interconnected markets, generation by independent power producers in Ontario and self generation by wholesale customers. An important aspect of the marketplace is the extent to which new generation is built in Ontario. This will depend on a number of factors including actual and anticipated price levels for electricity and natural gas, the ability of parties to structure economic transactions, technological advances and regulatory developments.

Demand for electricity in the marketplace is expected to increase through continued economic and population growth, and through increasing demand for heating, air conditioning and electronic infrastructure.

### *Market Power Mitigation*

OPG expects to meet its decontrol commitments through asset sales, asset or energy swaps, or other arrangements. While market power mitigation effectively limits the market share OPG can exercise in the Ontario market in terms of generating capacity, it does allow for OPG to grow its business through export sales and energy trading arrangements.

OPG is committed to decontrolling selected generating assets in advance of the deadlines required under market power mitigation. In July 2000, OPG entered into an agreement to lease its Bruce A and Bruce B generating stations to Bruce Power L.P., an entity controlled by British Energy plc. The objective of the agreement is consistent with OPG's plans for meeting the requirement to reduce generating supply within 10 years of open market access to no more than 35% of the overall Ontario market's supply. The operating lease will have an initial lease term of approximately 18 years and will include options to extend the lease for up to another 25 years. The completion of the transaction, which is expected to take place in 2001, is subject to usual closing conditions, including the necessary licences from the CNSC and the OEB.

The lease agreement requires an initial payment of \$625 million, payable in three installments. This includes \$400 million, subject to closing adjustments, payable to OPG on closing, and \$225 million payable in two equal installments of \$112.5 million no later than four and six years from the date the transaction is completed. Bruce Power will also

make annual lease payments during the initial lease term that will consist of both fixed and variable payments. In aggregate, the initial payment and annual lease payments to OPG are estimated at \$3.1 billion. OPG will continue to be responsible for nuclear waste and decommissioning liabilities at the Bruce site.

In early 2000, OPG announced its plans for accelerated decontrol of a total of approximately 4,000 MW of hydro-electric and fossil generating capacity, including the 2,100 MW oil/natural gas-fueled Lennox generating station and the 1,100 MW coal-fired Lakeview fossil generating station. The Province subsequently placed a moratorium on the sale of coal-fired generating plants while it continues to assess the potential environmental impacts of their future operation. As a result, OPG's plans for decontrol of both the Lennox and Lakeview stations are on hold until such time as the Province completes its review of environmental policies on fossil-fueled generation.

## **Other Initiatives**

### ***Information Technology Initiative***

In November, OPG entered into an agreement to form a joint venture with Business Transformation Services Inc. ("BTS"), a wholly-owned subsidiary of Cap Gemini Ernst & Young, to transfer OPG's Information Services Group ("ISG") to New Horizon System Services Inc. ("New Horizon"), a joint venture that will be owned 51% by BTS and 49% by OPG. Approximately 600 employees within ISG will transfer to New Horizon. The 10-year agreement is expected to close in early 2001 and includes provisions that allow BTS to re-assess the joint venture agreement up to 2002.

### ***Kinectrics Inc.***

In August 2000, OPG and C-SAT Technologies Inc. ("C-SAT") announced the establishment of a new independent science and engineering services company operating under the name of Kinectrics Inc. This initiative marks an important stage in the development of the former Ontario Power Technologies division. OPG owns 90% of Kinectrics Inc. and C-SAT owns and holds the remaining 10% non-controlling interest with an option to increase its investment to 50% by 2002.

### ***Pantellos Corporation***

In May, OPG joined twenty-one other North American energy companies to form Pantellos Corporation, a provider of e-commerce-based supply chain solutions. Pantellos will

require an initial capitalization of \$100 million for the purpose of developing and delivering a broad suite of technologies to create and operate an Internet-based electronic marketplace for the energy industry and its suppliers. OPG's share of this initial capitalization is \$5 million.

## **Labour Negotiations**

During the first quarter of 2000, OPG negotiated renewal collective agreements with both major unions. The Power Worker's Union agreement was effective April 1, 2000, and runs to March 31, 2002. OPG and The Society of Energy Professionals re-opened negotiations six months prior to expiration of the contract and negotiated renewal collective agreements effective January 1, 2001 and running to December 31, 2003.

Provisions related to the mobility of labour are included within these agreements to allow OPG to facilitate decontrol of its generating capacity. Negotiations also resulted in wage escalations and pension enhancements, a blanket Purchased Services Agreement to facilitate Pickering A re-start and an opportunity to tie staff compensation to performance.

## Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of Ontario Power Generation Inc. are the responsibility of management and have been prepared in accordance with Canadian generally accepted accounting principles. Ontario Power Generation Inc. chooses accounting principles appropriate to the circumstances. The significant accounting policies followed by Ontario Power Generation Inc. are described in the summary of significant accounting policies contained in Note 3 to the consolidated financial statements. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The consolidated financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to January 30, 2001.

Management maintained a system of internal controls designed to provide reasonable assurance that the assets were safeguarded and that reliable financial information was available on a timely basis. The system included formal policies and procedures and an organizational structure that provided for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluated the effectiveness of these internal controls on an ongoing basis and reported its findings to management and the Audit Committee of the Ontario Power Generation Inc. Board of Directors.

The consolidated financial statements have been examined by Ernst & Young LLP, independent external auditors appointed by the Board of Directors. The external auditors' responsibility is to express their opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditors' Report outlines the scope of their examination and their opinion.

For the year ended December 31, 2000, the Ontario Power Generation Inc. Board of Directors, through the Audit Committee, was responsible for ensuring that management fulfilled its responsibilities for financial reporting and internal controls. The Audit Committee met periodically with management, the internal auditors and the external auditors to satisfy itself that each group had properly discharged its respective responsibility, and to review the financial statements before recommending approval by the Board of Directors. The external auditors had direct and full access to the Audit Committee, with and without the presence of management, to discuss their audit and their findings as to the integrity of Ontario Power Generation Inc.'s financial reporting and the effectiveness of the system of internal controls.

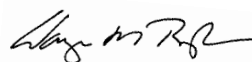
January 30, 2001



**Ronald W. Osborne**

*President and*

*Chief Executive Officer*



**Wayne M. Bingham**

*Executive Vice President and*

*Chief Financial Officer*



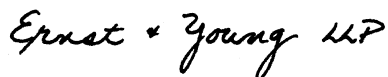
## Auditors' Report

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

We have audited the consolidated balance sheets of Ontario Power Generation Inc. as at December 31, 2000 and 1999, the consolidated statements of income (loss), retained earnings (deficit of assets over liabilities) and cash flows of Ontario Power Generation Inc. for the year ended December 31, 2000 and for the nine months ended December 31, 1999, and the consolidated statements of income (loss), retained earnings (deficit of assets over liabilities) and cash flows of the electricity generating business of Ontario Hydro (the Acquired Business) for the three months ended March 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of Ontario Power Generation Inc. as at December 31, 2000 and 1999, the consolidated results of the operations and cash flows of the Company for the year ended December 31, 2000 and nine months ended December 31, 1999 and the consolidated results of operations and cash flows of the Acquired Business for the three months ended March 31, 1999 in accordance with Canadian generally accepted accounting principles.



**Chartered Accountants**

*Toronto, Canada*

*January 26, 2001*

## Consolidated Statements of Income (Loss)

			Acquired Business (notes 1 and 3)
	Year ended December 31 2000	April 1 to December 31 1999	January 1 to March 31 1999
<i>(millions of dollars except earnings per share)</i>			
<b>REVENUES</b>	5,978	4,338	1,769
<b>OPERATING EXPENSES</b>			
Operation, maintenance and administration	2,186	1,770	551
Fuel	1,271	816	335
Power purchased	180	153	45
Depreciation and amortization (notes 6 and 7)	764	573	385
Property and capital taxes	379	277	7
	4,780	3,589	1,323
<b>OPERATING INCOME</b>	1,198	749	446
<b>INTEREST EXPENSE</b>	140	134	545
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	1,058	615	(99)
<b>INCOME TAXES</b> (note 4)			
Current	310	214	—
Future	143	75	—
	453	289	—
<b>NET INCOME (LOSS)</b>	605	326	(99)
<b>EARNINGS PER COMMON SHARE</b>	2.36	1.27	
<b>COMMON SHARES OUTSTANDING</b> (millions)	256.3	256.3	
<i>See accompanying notes to financial statements</i>			

## Consolidated Statements of Retained Earnings (Deficit of Assets over Liabilities)

			Acquired Business (notes 1 and 3)
	Year ended December 31 2000	April 1 to December 31 1999	January 1 to March 31 1999
<i>(millions of dollars)</i>			
<b>RETAINED EARNINGS (DEFICIT OF ASSETS OVER LIABILITIES), beginning of period</b> (note 1)	291	—	(442)
Net income (loss)	605	326	(99)
Dividends	(205)	(35)	—
<b>RETAINED EARNINGS (DEFICIT OF ASSETS OVER LIABILITIES), end of period</b>	691	291	(541)
<i>See accompanying notes to financial statements</i>			

## Consolidated Balance Sheets

(millions of dollars)

### ASSETS

#### CURRENT ASSETS

Cash and cash equivalents (note 5)	565	243
Short-term investments	335	—
Accounts receivable	968	930
Fuel	288	424
Materials and supplies	229	201
	<b>2,385</b>	<b>1,798</b>

#### FIXED ASSETS (note 6)

Property, plant and equipment	13,842	13,285
Less: accumulated depreciation	910	383
	<b>12,932</b>	<b>12,902</b>

#### OTHER ASSETS

Deferred pension asset (note 16)	641	516
Fixed asset removal and nuclear waste management fund (note 7)	781	367
Long-term accounts receivable and other assets	52	27
	<b>1,474</b>	<b>910</b>
	<b>16,791</b>	<b>15,610</b>

See accompanying notes to financial statements

## Consolidated Balance Sheets

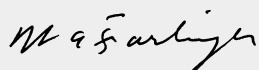
(millions of dollars)

	December 31 2000	December 31 1999
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued charges	1,406	1,145
Short-term notes payable (note 9)	150	—
Long-term debt due within one year (note 8)	204	4
	1,760	1,149
<b>LONG-TERM DEBT</b> (note 8)	3,219	3,422
<b>OTHER LIABILITIES</b>		
Fixed asset removal and nuclear waste management (note 7)	4,482	4,235
Other post employment benefits (note 16)	997	959
Long-term accounts payable and accrued charges	298	353
Future income tax liability (note 4)	218	75
	5,995	5,622
<b>SHAREHOLDER'S EQUITY</b>		
Common shares (note 11)	5,126	5,126
Retained earnings	691	291
	5,817	5,417
	16,791	15,610

### CONTINGENCIES AND COMMITMENTS (notes 7 and 15)

See accompanying notes to financial statements

**On behalf of the Board of Directors,  
January 30, 2001:**



**William A. Farlinger**

Chairman  
Toronto, Canada



**Ronald W. Osborne**

President and Chief Executive Officer  
Toronto, Canada

## Consolidated Statements of Cash Flows

			Acquired Business (notes 1 and 3)
	Year ended December 31 2000	April 1 to December 31 1999	January 1 to March 31 1999
<i>(millions of dollars)</i>			
<b>OPERATING ACTIVITIES</b>			
Net income (loss)	605	326	(99)
Adjust for non-cash items:			
Depreciation and amortization	764	573	385
Deferred pension asset	(125)	39	5
Other post employment benefits	38	111	(72)
Future income taxes	143	75	—
Used nuclear fuel provisions	27	14	33
Other	38	(16)	(4)
	1,490	1,122	248
Fixed asset removal and nuclear waste management fund	(414)	(367)	—
Expenditures on nuclear waste management provisions	(43)	(33)	(10)
Changes to other long term assets and liabilities	(83)	(102)	87
Non-cash working capital increase (decrease) due to:			
Accounts receivable	(38)	(154)	(134)
Fuel	136	(50)	81
Materials and supplies	(28)	(32)	20
Accounts payable and accrued charges	261	165	206
	1,281	549	498
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>			
<b>INVESTING ACTIVITIES</b>			
Expenditures for property, plant and equipment	(585)	(450)	(35)
Purchases of short-term investments	(335)	—	—
Proceeds from sales of property, plant and equipment	16	33	—
	(904)	(417)	(35)
<b>CASH FLOW BEFORE FINANCING ACTIVITIES</b>	377	132	463
<b>FINANCING ACTIVITIES</b>			
Short-term notes issued	150	—	—
Cash from acquired business (note 1)	—	146	—
Dividends	(205)	(35)	—
Net other financing activities	—	—	(440)
	(55)	111	(440)
<b>INCREASE IN CASH AND CASH EQUIVALENTS DURING PERIOD</b>	322	243	23
<b>CASH AND CASH EQUIVALENTS, beginning of period (note 1)</b>	243	—	123
<b>CASH AND CASH EQUIVALENTS, end of period</b>	565	243	146

*See accompanying notes to financial statements*



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

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

In consideration for the transfer of assets, liabilities, employees, rights and obligations of the electricity generation business of Ontario Hydro, OPG issued to OEFC notes payable in the aggregate principal amount of \$8,526 million, including a note in the principal amount of \$5,126 million (the "Equity Note") and assumed a capital lease obligation of Ontario Hydro in the amount of \$30 million on April 1, 1999. The Province of Ontario (the "Province") has assumed all of OPG's obligations under the Equity Note and OEFC has released OPG from its obligations thereunder. In connection therewith, OPG issued to the Province 256,300,000 common shares as fully paid and non-assessable shares. OEFC has agreed that without the consent of OPG, it will not sell its remaining \$3,400 million of notes, of which \$2,650 million are senior notes and \$750 million are subordinated notes of OPG.

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

(millions of dollars)		Fair value as at April 1, 1999
<b>ASSETS</b>		
Current assets		1,465
Fixed assets		12,872
Other assets		598
		14,935
<b>LIABILITIES</b>		
Current liabilities		1,073
Liabilities and capital leases		5,336
		6,409
<b>NET ASSETS ACQUIRED</b>		<b>8,526</b>

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

The results of operations and cash flows presented in these financial statements for the three months ended March 31, 1999 represent the operations of Ontario Hydro pertaining to the Acquired Business now conducted by OPG. These financial statements have been prepared through specific identification of assets, liabilities (other than debt), revenues and expenses relating to such businesses, and through an allocation of certain common financial statement accounts and items of Ontario Hydro.

In particular, a portion of Ontario Hydro's revenues and debt, and corresponding portion of related interest and other financial expenses, have been allocated to the Acquired Business. The financial position and operating results of OPG differ significantly from those of the Acquired Business prior to April 1, 1999 because of changes in the regulatory environment, financing and other factors.

## **2. Restructuring of the Ontario Electricity Industry**

The restructuring of the electricity market in Ontario is being accomplished in two stages. The first stage, the Transition Period, began on April 1, 1999 with the reorganization of Ontario Hydro and will end with the introduction of a competitive market for electricity. The second stage, Open Access, is expected to begin in the fall of 2001 or spring of 2002. After Open Access, customers will have access to the electricity supplier of their choice. The transmission and distribution system in Ontario will be open to all users in a competitive marketplace.

The Province has adopted a framework for market power mitigation designed to address issues regarding OPG's market position in Ontario. Under these arrangements, OPG must reduce its control over specified sources of electricity generating capacity. OPG must relinquish effective control of at least 4,000 MW of fossil generating capacity within 42 months of Open Access, with the option of substituting up to 1,000 MW of hydroelectric generating capacity for an equal amount of fossil generating capacity. Within 10 years of Open Access, OPG must reduce its effective control over generation capacity to a level that is no more than 35% of the overall Ontario market's supply.

## **3. Summary of Significant Accounting Policies**

### ***Basis of Accounting***

The financial statements of OPG are prepared in accordance with Canadian generally accepted accounting principles which requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities.

Prior to April 1, 1999, Ontario Hydro was governed by the *Power Corporation Act* (Ontario), which provided it with broad power to generate, supply and deliver electricity throughout Ontario. Ontario Hydro's Board of Directors had the authority, for rate setting purposes, to specify that an amount be included in its results of operations for a period that differed from the period in which it would be recognized under generally accepted accounting principles for enterprises operating in a non-rate regulated environment. In such cases, the accounting treatment was the same as its treatment for rate setting purposes.

### ***Consolidation***

The consolidated financial statements include the accounts of Ontario Power Generation Inc. and its subsidiaries. Ontario Power Generation Inc. accounts for its interests in jointly controlled entities using the proportionate consolidation method.

### ***Inventories***

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

Materials and supplies are valued at the lower of average cost or net realizable value with the exception of specific replacement parts which are unique to one of the nuclear or fossil generating stations. The cost of the unique replacement parts inventory is charged to operations on a straight-line basis over the remaining life of the related facilities.

### ***Fixed Assets and Depreciation***

Property, plant and equipment acquired by OPG on April 1, 1999 were recorded at fair values. Additions to property, plant and equipment subsequent to April 1, 1999 are recorded at cost. Interest costs incurred during construction are capitalized as part of the cost of the asset.

Depreciation rates for the various classes of assets are based on their estimated service lives. Assets are depreciated on a straight-line basis except for computers and transport and work equipment, which are depreciated on the declining balance basis.

Generating stations are depreciated on a straight-line basis over estimated service lives ranging from 25 to 40 years for nuclear generating stations, 40 to 50 years for fossil generating stations and 100 years for hydroelectric generating stations.

Administration and service facilities are depreciated on a straight-line basis over five to 50 years. Computers and transport and work equipment assets are depreciated at rates varying between 9% and 40%. Any asset removal costs that have not been specifically provided for in current or previous periods are also charged to depreciation expense.

Major application software acquisition costs are capitalized when future benefits are reasonably assured. These costs are amortized over the useful life of the application software.

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

OPG recognizes a liability for fixed asset removal and nuclear waste management taking into account the time value of money since it is able to estimate both the amount and timing of future cash expenditures on these activities. On April 1, 1999, when the Acquired Business was transferred to OPG, the following costs were recognized as a liability:

- The present value of the costs of dismantling the nuclear and fossil production facilities at the end of their useful lives.
- The present value of the fixed cost portion of any nuclear waste management programs that are required regardless of volume of waste generated.
- The present value of the variable cost portion of any nuclear waste management program to take into account actual waste volumes incurred up to April 1, 1999.

Waste generated after April 1, 1999 will result in an increase to this liability with the corresponding amounts charged to operations through depreciation and amortization expense or fuel expense. OPG funds the fixed asset removal and nuclear waste management liability based on a pre-determined payment stream. This funding is segregated and used only for fixed asset removal or nuclear waste management. It is OPG's intent to have these funds held outside of OPG. Actual costs incurred to operate waste management programs are applied against the segregated funds.

Revalorization arises because liabilities for used nuclear waste disposal and future fixed asset removal costs are stated in the balance sheet on a net present value basis. The revalorization charge is the adjustment that results from restating the liabilities to reflect the effect of inflation on the cost estimates and the time value of money effect on the future liabilities. The revalorization charge is sensitive to movements in interest and inflation rates. Revalorization is disclosed in the financial statements as part of depreciation and amortization.

Ongoing operating costs incurred for temporary storage of used nuclear fuel in wet fuel bays and dry storage containers during station operating life are reflected as ongoing operating and capital expenditures.

Prior to April 1, 1999, the Acquired Business recognized decommissioning and nuclear waste liabilities over the expected operating lives of the nuclear and fossil plants or as quantities of waste were produced. As a result, the liability as stated under the Acquired Business was substantially lower than the liability recognized by OPG.

### ***Revenue***

Revenues are earned primarily through the sale of electricity to wholesale and large industrial customers in Ontario and to inter-connected markets in the United States, Quebec and Manitoba. During the Transition Period, the average wholesale electricity prices charged to Ontario customers remain fixed and customers are billed on a bundled basis. OPG distributes the funds to the successor entities of Ontario Hydro under the terms of revenue allocation arrangements. The revenue allocation arrangements provide relatively fixed amounts to the other businesses. The revenue allocation arrangements were designed so the undistributed balance of funds would provide OPG with planned revenue of 4¢/kWh based on forecasted energy, together with a fixed amount for ancillary services. Changes in forecast demand and customer mix will vary OPG's actual revenue per kWh.

Prior to April 1, 1999, the Acquired Business operated in a rate-regulated environment. The electricity rates to customers were established to provide power at cost. The revenues disclosed for the three months ended March 31, 1999 were determined by an internal revenue allocation mechanism used by Ontario Hydro.

Non-energy revenues include earnings from services provided by OPG such as project management, engineering analysis and design, construction and field maintenance of power generation facilities, the sale of various nuclear isotopes and generation by-products, and foreign exchange gains and losses. OPG uses the percentage of completion method to recognize revenue on fixed price contracts with a defined scope of work. For other contracts, revenue is recognized as services are provided or products are delivered. Price escalation adjustments are recognized when they are established by specific contract terms. Commissions are recognized as earned.

### ***Foreign Currency Translation***

Current monetary assets and liabilities in foreign currencies are translated into Canadian currency at year-end rates of exchange. Any resulting gain or loss is reflected in other revenue. Gains and losses on translation of foreign currency long-term liabilities are deferred and amortized over the period to maturity.

### ***Derivatives***

OPG enters into various hedging instruments in order to manage foreign exchange risk through derivatives such as forward rate agreements. When derivatives are used to manage OPG's exposure to foreign currency movements, the revenue or expense is recognized over the life of the transaction in other revenue. Where the derivatives have been designated as a hedge, the realized gains or losses are deferred and amortized over the life of the hedged assets or liabilities in other revenue.

### ***Short-Term Investments***

OPG enters into short-term purchases of securities under reverse repurchase agreements. Under these agreements, OPG commits to resell the securities back to the original counterparty at a specified price and on a specified date. These securities are carried on the balance sheet at their original cost. Reverse repurchase agreements conducted with the same counterparty are reported on a net basis. Interest earned on reverse repurchase agreements is netted against interest expense in the Income Statement.

### ***Income and Other Tax***

OPG is responsible under the *Electricity Act, 1998* for making payments in lieu of taxes (proxy taxes) to OEFC. These payments are calculated in accordance with the *Income Tax Act* (Canada) and *Corporations Tax Act* (Ontario), and are modified by regulations made under the *Electricity Act, 1998*. Prior to April 1, 1999 the Acquired Business was not required to pay income or capital taxes.

Effective January 1, 2000, OPG changed its method of accounting for income taxes from the deferral method to the liability method of tax allocation as required by The Canadian Institute of Chartered Accountants' Handbook Section 3465, *Accounting for Income Taxes*. Under the liability method, future income taxes reflect the net tax effects of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and amounts used for income tax purposes. The deferral method uses an income statement approach and records deferred taxes using current tax rates with no adjustment for subsequent tax rate changes. The cumulative effect as at January 1, 2000 of adopting these recommendations was not material. Therefore, prior year financial statements have not been restated. For comparative 1999 periods, the deferred income tax component of income tax expense is disclosed in the financial statements as future income taxes.

OPG is also required to make payments in lieu of property and school taxes on its generating assets. The amount is equal to the difference between the amount it would be required to pay if the assets were privately owned and the amount of such taxes that OPG actually pays on those assets.

### ***Research and Development***

Development costs related directly to the design or construction of a specific fixed asset are capitalized as part of the cost of the asset. Research and development costs, which are incurred to discharge long-term obligations such as the nuclear waste management liabilities, for which specific provision has already been made, are charged to the related liability. All other research and development costs, which do not qualify for deferral, are charged to operations in the year incurred.

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

OPG's post employment benefit programs include pension, group life insurance, health care, long-term disability and workers' compensation benefits.

OPG accrues its obligations under pension and other post employment benefit (OPEB) plans. Pension fund assets are valued using current market values. Pension and OPEB expenses and obligations are determined annually by independent actuaries using management's best estimates.

Pension and OPEB expenses consist of current service costs, interest and adjustments arising from plan amendments, changes in assumptions, and experience gains or losses, which are amortized on a straight-line basis over the expected average remaining service life of the employees covered by the plan. Pension and OPEB expenses are recorded during the year in which employees render services.



#### 4. Income Taxes

OPG became obligated to make payments in lieu of taxes on April 1, 1999. There were no income or capital taxes in the periods prior to April 1, 1999 related to the Acquired Business.

The liability method of tax allocation was adopted by OPG effective January 1, 2000.

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

<i>(millions of dollars)</i>	Year ended December 31 2000	April 1 to December 31 1999
Income before income taxes	1,058	615
Combined Canadian federal and provincial statutory income tax rates, including surtaxes	43.9 %	44.6 %
Statutory income tax rates applied to accounting income	464	274
Increase (decrease) in income taxes resulting from:		
Large corporation tax in excess of surtax	25	19
Manufacturing and processing credit	(7)	(9)
Other	4	5
Reduction in future income taxes resulting from reduction in tax rates	(33)	–
	(11)	15
Provision for income taxes	453	289
The provision for income taxes consists of:		
Current	310	214
Future income tax expense relating to temporary differences	143	75
Provision for income taxes	453	289
Effective rate of income taxes	42.8 %	47.0 %

The sources of temporary differences and their tax effects on future income taxes were: the carrying value of fixed assets in excess of tax value – \$1,609 million (nine months ended December 31, 1999 – capital cost allowance in excess of depreciation – \$66 million) and the tax value of other items in excess of carrying value – \$1,391 million (nine months ended December 31, 1999 – other items deducted for tax purposes in advance of accounting purposes – \$9 million).

The amount of taxes paid for the year ended December 31, 2000, was \$136 million (nine months ended December 31, 1999 – \$237 million).

## 5. Cash and Cash Equivalents

Cash and cash equivalents include cash on account and short-term money market instruments of \$616 million (1999 – \$255 million) with yields ranging from 5.55% to 5.96% and maturities of less than three months.

## 6. Fixed Assets and Depreciation and Amortization

The depreciation and amortization expense consists of the following:

<i>(millions of dollars)</i>			Acquired Business
	Year ended December 31 2000	April 1 to December 31 1999	January 1 to March 31 1999
Depreciation and amortization	540	383	299
Revalorization (5.75% rate)	202	165	45
Liability for fixed asset removal and nuclear waste management	21	20	37
Asset removal costs	1	5	4
	764	573	385

The fixed assets consist of the following:

<i>(millions of dollars)</i>	December 31 2000	December 31 1999
Property, plant and equipment		
Generating stations	12,361	12,093
Other fixed assets	706	530
Construction in progress	775	662
	13,842	13,285
Less: accumulated depreciation		
Generating stations	744	339
Other fixed assets	166	44
	910	383
	12,932	12,902

Interest capitalized at 6% during the year ended December 31, 2000 was \$19 million (nine months ended December 31, 1999 – \$11 million, three months ended March 31, 1999 – \$8 million).

## 7. Fixed Asset Removal and Nuclear Waste Management

OPG's nuclear generating stations produce nuclear waste in the form of radioactive nuclear fuel bundles along with low and intermediate level radioactive waste. In addition, certain components of the plants become contaminated and therefore need to be safely decommissioned. OPG is also required to decommission its non-nuclear facilities.

The net liability for fixed asset removal and nuclear waste management is as follows:

<i>(millions of dollars)</i>	December 31 2000	December 31 1999
Liability for nuclear waste management		
Used fuel disposal	3,320	3,295
Used fuel storage	937	719
Low level waste	223	213
Intermediate level waste	81	77
	4,561	4,304
Liability for nuclear fixed asset removal	2,417	2,287
	6,978	6,591
Liability for non-nuclear fixed asset removal	126	124
	7,104	6,715
Less: provincial receivable	2,622	2,480
Fixed asset removal and nuclear waste management	4,482	4,235

The accrual of fixed asset removal and nuclear waste management costs requires significant assumptions in their calculations, since these programs run for several decades. The decommissioning of nuclear stations requires cash flow estimates to 2071. The interest rate used for discounting was 5.75% (1999 – 5.75%) and cost escalation rates ranged from 2% to 3% (1999 – 2% to 4%).

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

### *Liability for Nuclear Waste Management Costs*

The liability for nuclear waste management costs represents the cost of managing the highly radioactive used nuclear fuel bundles as well as the cost of managing other low and intermediate level radioactive wastes generated by the nuclear stations. The current assumptions that have been used to establish the accrued used fuel costs include: long-term management of the spent fuel bundles through deep geological disposal; an in-service date of 2025 for used nuclear fuel disposal facilities; and an average transportation distance of 1,000 kilometres between nuclear generating facilities and the disposal facilities. Alternatives to deep geological disposal may be technically feasible and will be explored. The increase in the accrued costs for used nuclear fuel from current period operations is charged to fuel costs for the period.

The costs of low and intermediate level waste management include both the costs of managing such wastes during the operation of the nuclear stations as well as the costs of ultimate long-term disposal of these wastes. The current assumptions used to establish the accrued low and intermediate level waste management costs include: construction of a disposal facility for low level waste to be in place by 2015; co-locating some of the intermediate level waste with low level waste starting in 2015; and co-locating the remainder of the intermediate level waste with used fuel starting in 2034. The increase in the

accrued costs for low and intermediate level waste due to the waste produced during the period are charged to depreciation and amortization for the period.

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

Accrued nuclear fixed asset removal costs are the costs of decommissioning nuclear generating stations after the end of their service lives. The significant assumptions used in estimating future nuclear fixed asset removal costs include: decommissioning of nuclear generating stations in the 2028 to 2058 period on a deferred dismantlement basis (reactors will remain safely shut down for a 30 year period prior to dismantlement) and an average transportation distance of 1,000 kilometres between nuclear generating facilities and disposal facilities.

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

Accrued non-nuclear asset removal costs are primarily the costs of decommissioning fossil generating stations and the heavy water production facility after the end of their service lives. The significant assumption used in estimating future fossil generating station removal costs is that the estimated retirement date of these stations is in the period 2005 to 2025.

OPG does not provide for the removal costs associated with its hydroelectric generating facilities as the costs cannot be reasonably estimated because of the long service life of these assets. With either maintenance efforts or rebuilding, the water control structures are assumed to be required for the foreseeable future.

#### ***Provincial Receivable for Nuclear Waste Management***

On April 1, 1999, the Province agreed that the Province or its agent would fund certain fixed asset removal and nuclear waste management liabilities that were incurred prior to April 1, 1999. Details of which liabilities will be funded are being finalized with the Province. The balance of the provincial receivable of \$2,622 million represents the Province's liability of \$2,480 million as at January 1, 2000, as well as interest in the amount of \$142 million accrued during the year ended December 31, 2000 based on a rate of 5.75% (nine months ended December 31, 1999 – 5.75%). The interest rate is under negotiation with the Province and is subject to change. The impact of the finalization of the interest rate for 2000 is not expected to result in a material difference to the liability balance.

#### ***Segregated Funds***

OPG is contributing to segregated funds to provide for or discharge the remaining unfunded nuclear liabilities. It is OPG's intent that these funds be held outside of OPG and be used solely for nuclear waste management and nuclear fixed asset removal. Until such time as the legal nature of the segregated funds is finalized, OPG is setting aside these funds internally and is managing their investment and growth distinct from its other cash holdings. The annual contribution to segregated funds is approximately \$429 million per year for the next five years. OPG plans to contribute to the segregated funds over the estimated remaining lives of its nuclear generating stations. The fixed asset removal and nuclear waste management fund consists of the following:

<i>(millions of dollars)</i>	December 31 2000	December 31 1999
Nuclear fixed asset removal fund	462	215
Nuclear waste management fund	319	152
	781	367

Included in the segregated fund is interest earned of \$39 million (1999 – \$6 million) on the balance in the fund during 2000.



### *Nuclear Risk-Sharing*

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

In addition to a nuclear liability agreement, the Province has also agreed to provide to the Canadian Nuclear Safety Commission ("CNSC", formerly the Atomic Energy Control Board), as required by federal regulation, a guarantee that there will be funds available to discharge 100% of the nuclear decommissioning and waste liabilities that exist at any point in time within OPG. This would represent that portion of the liabilities that are not funded. In return, OPG will pay to the Province a fee of 0.5% of the value of that guarantee. This guarantee is expected to commence in 2001, once the nuclear liability agreement is finalized.

### *Role of External Parties in the Management of Nuclear Wastes and Impact on Liabilities*

In response to a December 1998 policy statement by the Federal Government, OPG continues its discussions with both the Province and the Federal Government regarding the establishment of a Waste Management Organization ("WMO") to manage all future operating expenditures for the life cycle management of nuclear waste. The exact structure and mandate of the WMO is under review.

Segregated funds would likely be held independent of OPG with access to those funds managed and monitored by several parties, including the CNSC. OPG has a requirement to contribute to those segregated funds in a pre-determined manner that will be established based on estimates and assumptions calculated by external bodies. The Federal Government will likely introduce draft legislation within the next year that would establish the role of a WMO and define government oversight responsibilities.

## 8. Long-Term Debt

The long-term debt consists of the following:

(millions of dollars)	Principal Outstanding (\$ Canadian)	
	December 31 2000	December 31 1999
Notes payable to OEFC	3,400	3,400
Capital lease obligations	23	26
	3,423	3,426
Less: payable within one year		
5.35% senior notes payable to OEFC	200	—
Capital leases	4	4
	204	4
Long-term debt	3,219	3,422

Details of OPG's long-term notes outstanding as at December 31, 2000 are as follows:

Year of Maturity	Interest Rate %	Principal Outstanding (\$ Canadian)		
		Senior Notes	Subordinated Notes	Total
2001	5.35	200	—	200
2002	5.44	200	—	200
2003	5.49	200	—	200
2004	5.62	300	—	300
2005	5.71	300	—	300
2006	5.78	300	—	300
2007	5.85	400	—	400
2008	5.90	400	—	400
2009	6.01	350	—	350
2010	6.60	—	375	375
2011	6.65	—	375	375
		2,650	750	3,400

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. OPG's exposure to interest rate risk is limited by the fixed rates on the long-term debt.

Interest paid during the year ended December 31, 2000 was \$206 million (nine months ended December 31, 1999 – \$95 million; three months ended March 31, 1999 – \$588 million).

## 9. Short-Term Credit Facilities

OPG maintains a credit facility for \$600 million with certain Canadian chartered banks (Bank Credit Agreement) to fund working capital requirements and for general corporate purposes. This facility may be drawn upon in either Canadian or U.S. dollars at varying rates based on certain benchmark rates, including a prime rate, a bankers' acceptance rate, and a LIBOR rate.

OPG implemented a commercial paper (CP) program in 2000. Under the CP program, OPG has the authority to issue short-term promissory notes up to a maximum outstanding principal amount of \$600 million in Canadian currency, or the equivalent thereof in United States currency. Notes issued under the CP program are secured under the Bank Credit Agreement. As at December 31, 2000, OPG had issued \$150 million of commercial paper at yields ranging from 5.81% to 5.89%.

## 10. Fair Value of Financial Instruments, Credit Risk, and Risk Management Instruments

### Fair Value

The following table presents the carrying amounts and fair values of OPG's financial instruments:

(millions of dollars)	2000		1999	
	Carrying Value	Fair Value(1)	Carrying Value	Fair Value(1)
<b>FINANCIAL ASSETS</b>				
Cash and cash equivalents	565	565	243	243
Short-term investments	335	335	—	—
Accounts receivable	968	968	930	930
Fixed asset removal and nuclear waste management fund	781	803	367	367
Long-term accounts receivable and other assets	52	52	27	27
<b>FINANCIAL LIABILITIES</b>				
Accounts payable and accrued charges	1,406	1,406	1,145	1,145
Short-term notes payable	150	150	—	—
Long-term debt due within one year	204	204	4	4
Long-term debt	3,219	3,188	3,422	3,270
Long-term accounts payable and accrued charges	298	298	353	353

(1) Year-end quoted market prices for specific or similar instruments are used to estimate the fair value of each class of financial instrument for which it is practical to estimate that value. For derivative financial instruments, the fair value is determined using pricing models that take into account the current value of the underlying instruments, the time value of money, and mid-market yield curve and volatility factors. The carrying values of cash, short-term investments, accounts receivable, bank indebtedness, short-term notes payable and accounts payable approximate fair value because of the short maturity of those instruments.

### *Credit risk*

Credit risk relates to the risk of loss as a result of non-performance of contractual obligations by counterparties. OPG has established and enforced credit policies that minimize credit risk through a continuous evaluation of its counterparties.

OPG's diverse portfolio of counterparties in the Ontario and interconnected markets is made up of industrial, commercial and electric utility organizations. OPG's customers are primarily derived from the Ontario market where the credit risk is minimized mainly through a combination of OPG policies and transitional market rules. OPG accepts counterparties to forwards and other derivative contracts primarily through investment grade entities and through credit enhancements. Of the total credit extended in 2000, approximately 72% related to municipal utilities. Based on OPG's policies and the current market and regulatory environment, OPG does not expect any material credit losses.

### *Risk Management Instruments*

OPG makes purchases and sales denominated in United States dollars, which give rise to a risk that its earnings and cash flows may be adversely impacted by changes in foreign exchange amounts. In order to reduce OPG's exposure to fluctuations in the value of the Canadian dollar, OPG hedges anticipated commitments for purchases and sales using risk management instruments such as forward foreign exchange contracts. All of the forward contracts entered into during the year were short-term in nature. OPG had no forward contracts outstanding as at December 31, 2000.

## **11. Common Shares**

OPG is authorized to issue an unlimited number of common shares without nominal or par value. Common shares issued and outstanding at December 31, 2000 and December 31, 1999 are as follows:

	Shares	(\$ millions)
Issued to the Province upon incorporation on December 1, 1998	10	–
Issued to the Province in settlement of debt on April 1, 1999	256,300,000	5,126
	256,300,010	5,126

## 12. Related Party Transactions

OPG, the Province, and the other successor entities of Ontario Hydro, which include Hydro One Inc. ("Hydro One"), Independent Electricity Market Operator ("IMO"), OEFC, and Ontario Electricity Pension Services Corporation ("OEPSC"), which manages the pension fund on behalf of OPG, became related parties as of April 1, 1999. Prior to April 1, 1999, the Province was a related party to Ontario Hydro and its fully integrated business units.

The transactions between OPG and related parties are in the normal course of business under normal trade terms. These transactions are summarized below:

(millions of dollars)	Year ended December 31, 2000		April 1 to December 31, 1999	
	Revenues	Purchases	Revenues	Purchases
<b>HYDRO ONE</b>				
Electricity sales	867	–	640	–
Services	16	92	45	40
<b>IMO</b>				
Ancillary services	102	–	75	–
<b>OEPSC</b>				
Services	16	–	10	–
	1,001	92	770	40

For the year ended December 31, 2000, payments to the Province for water rentals were \$117 million (nine months ended December 31, 1999 – \$90 million, three months ended March 31, 1999 – \$30 million). Payments to the Province for the debt guarantee fee were nil for the year ended December 31, 2000 (nine months ended December 31, 1999 – nil, three months ended March 31, 1999 – \$31 million).

As at December 31, 2000, OPG had \$93 million of related party receivables due from Hydro One (1999 – \$90 million), \$9 million of related party receivables due from the IMO (1999 – \$8 million) and \$2 million of related party receivables due from OEPSC (1999 – \$1 million). Related party payables due to Hydro One were \$15 million as at December 31, 2000 (1999 – \$13 million).

## 13. Research and Development

For the year ended December 31, 2000, \$39 million (nine months ended December 31, 1999 – \$19 million, three months ended March 31, 1999 – \$15 million) of research and development expenses were charged to operations, and there were no charges to accrued liabilities (nine months ended December 31, 1999 – \$10 million, three months ended March 31, 1999 – \$2 million). Development costs of \$6 million were capitalized (nine months ended December 31, 1999 – \$2 million, three months ended March 31, 1999 – nil).

## 14. Segmented Information

OPG operates as a single segment business generating electricity in Ontario. Substantially all sales are in Canada. Electricity sales to the United States were \$273 million for the year ended December 31, 2000 (nine months ended December 31, 1999 – \$200 million; three months ended March 31, 1999 – \$10 million). Sales to two customers represent 31% of total revenue for the year ended December 31, 2000 (nine months ended December 31, 1999 – 30%) and 26% of accounts receivable as at December 31, 2000 (nine months ended December 31, 1999 – 25%).



## 15. Contingencies and Commitments

### *Municipal Electric Utilities (MEU)*

On April 24, 1997, three MEUs (the "Applicants") issued a notice of application against Ontario Hydro in the Ontario Court (General Division) (the "MEU Litigation"). The MEU Litigation has been certified as a class proceeding on behalf of all MEUs in Ontario. The Applicants seek declarations that certain rates and pricing options offered by Ontario Hydro to corporations contravened the provisions of the *Power Corporation Act*, (Ontario) and that these rates and pricing options improperly increased costs to the MEUs that purchase their power from OPG. They seek recovery of the increased costs in the amount of approximately \$145 million and a declaration that Ontario Hydro improperly diverted, from miscellaneous revenues, monies, in an indeterminate amount, which should have been used to reduce the cost of power supplied to these MEUs. The Applicants are also seeking declarations that Ontario Hydro breached legislative provisions prescribing the operation of the Reserve for Stabilization of Rates and Contingencies and an equity account of Ontario Hydro known as the accumulated debt retirement appropriation (the "ADR account"), and an order requiring repayment to the ADR account in the amount of \$5,050 million. The Province will indemnify OPG from and against all claims relating to the creation, treatment, payment to or from or other dealings with the ADR account, and the financial statements of Ontario Hydro in relation to the ADR account including any amount relating to any judgment, settlement or other payment in connection with the MEU Litigation, subject to a \$20 million deductible amount.

### *Request for Judicial Review*

In May 1999, an application was commenced by the Inverhuron & District Ratepayers Association ("IDRA") in the Federal Court Trial Division, requesting judicial review of the decisions of the federal Minister of the Environment, the Minister of Fisheries and Oceans and the CNSC with regard to the Bruce used fuel dry storage facility project. The goal of the application was to overturn the decisions pursuant to the *Canadian Environmental Assessment Act* ("CEAA") that would allow the project to proceed. The application also sought to have the project referred to a review panel or mediator.

In May 2000, the Federal Court Trial Division refused the application. The IDRA appealed the Court's decision. Until the Appeal Court renders its decision, OPG is unable to ascertain the impact of this application on its business, results of operations, financial condition or prospects. The Bruce used fuel storage facility is required within the next two to three years to allow for the continued generation of nuclear power at the Bruce Nuclear site, given the remaining vacant storage available for used fuel bundles.

### *Environment*

OPG inherited legacy environmental obligations from the Acquired Business. A provision of \$76 million was established as at April 1, 1999 for such obligations. Charges of \$3 million were made against this provision during the year ended December 31, 2000 (nine months ended December 31, 1999 – \$6 million). Also, OPG's current operations are subject to regulation with respect to air, soil and water quality and other environmental matters by federal, provincial and local authorities. The cost of obligations associated with current operations is provided for on an ongoing basis. Management believes it has made adequate provision in its financial statements to meet OPG's current environmental obligations.

### ***Fuel Supply Agreements***

OPG has entered into firm fuel supply agreements, some of which extend beyond 2001. The future obligation of \$1,464 million (1999 – \$727 million) under these agreements for each of the next five years and 2006 and beyond are as follows:

(millions of dollars)

<b>DUE IN:</b>	
----------------	--

2001	851
2002	256
2003	156
2004	34
2005	32
2006 and beyond	135

<b>TOTAL</b>	<b>1,464</b>
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## **16. Benefit Plans**

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

The pension information presented in the financial statements is derived from the OPG pension plan including OPG's proportionate share of the OEFC pension plan assets and liabilities taking into account actual employees and pensioners. Other post employment benefit information presented in the financial statements is also based on OPG's actual employees and pensioners. Prior to April 1, 1999, such information was based on the Acquired Business's proportionate share of Ontario Hydro's payroll, resulting in allocation adjustments.

OPG amended its benefit plans during 2000, resulting in pension and other post employment obligations for past service.

### ***Pension Plan***

The pension plan is a contributory, defined benefit plan covering all regular employees. OPG's pension plan was established effective December 31, 1999. Until that date, employees and pensioners continued as members of the OEFC pension plan, formerly the Ontario Hydro Pension and Insurance Plan.

Pension fund assets held with OEFC principally include marketable equity securities, and corporate and government debt securities, which are selected by professional investment managers. The fund does not invest in equity or debt securities issued by the Province, Hydro One, IMO, ESA, OEFC, or OPG.

The pension plan has a substantial excess of assets over obligations ("Surplus"). OPG has suspended contributions to the plan as permitted under the *Pension Benefits Act* (Ontario) and the *Electricity Act, 1998*.

Information about OPG's pension plan is as follows:

(millions of dollars)		
	December 31 2000	December 31 1999
<b>PENSION PLAN ASSUMPTIONS</b>		
Expected return on plan assets	7.75 %	7.25 %
Rate used to discount future pension benefits	6.75 %	7.25 %
Salary schedule escalation rate	3.25 %	3.50 %
Rate of cost of living increase to pensions	2.50 %	2.50 %
Average remaining service life for employees (years)	11	12
<b>CHANGE IN PENSION PLAN ASSETS</b>		
Fair value of plan assets at beginning of year	7,274	7,908
Contributions by OPG	–	–
Contributions by the employees	33	49
Actual return on plan assets	527	1,018
Benefit payments	(181)	(245)
Administrative expense	(11)	(13)
Allocation adjustment	–	(1,443)
Fair value of plan assets at end of year	7,642	7,274
<b>CHANGE IN PROJECTED PENSION BENEFIT OBLIGATION</b>		
Projected benefit obligation at beginning of year	5,174	7,098
Current service cost	184	218
Past service costs	189	–
Interest on projected benefit obligation	389	359
Benefit payments	(160)	(192)
Net actuarial (gain) loss	440	(1,098)
Allocation adjustment	–	(1,211)
Projected benefit obligation at end of year	6,216	5,174
<b>PENSION PLAN SURPLUS</b>		
	1,426	2,100
<b>RECONCILIATION OF PENSION PLAN SURPLUS</b>		
Pension plan surplus	1,426	2,100
Unamortized net actuarial (gain) loss	(957)	(1,584)
Unamortized past service costs	172	–
Deferred pension asset	641	516

<i>(millions of dollars)</i>			Acquired Business
	Year ended December 31 2000	April 1 to December 31 1999	January 1 to March 31 1999
<b>COMPONENTS OF PENSION (CREDIT)/EXPENSE</b>			
Current service cost	154	124	42
Interest on projected benefit obligation	389	269	106
Expected return on plan assets	(540)	(339)	(142)
Amortization of past service costs	17	–	–
Amortization of net actuarial (gain) loss	(145)	(15)	(1)
Pension (credit)/expense	(125)	39	5

### *Other Post Employment Benefits*

Payments for OPEB benefits during 2000 are \$49 million (nine months ended December 31, 1999 – \$35 million, three months ended March 31, 1999 – \$15 million). The long-term annual increase in the per capita cost of the major benefits ranges between 2.5% and 4.5% (1999 – between 2.5% and 4.5%), depending on the nature of the benefit. The discount rate used in determining the actuarial present value of the OPEB obligation ranges between 6.25% and 7.00% at December 31, 2000 (1999 – between 7.0% and 7.5%).

Information about OPG's OPEB is as follows:

<i>(millions of dollars)</i>	December 31 2000	December 31 1999
<b>CHANGE IN PROJECTED OPEB OBLIGATION</b>		
Projected OPEB obligation at beginning of year	828	1,088
Current service cost	37	41
Interest on projected benefit obligation	65	56
Benefit payments	(42)	(40)
Net actuarial (gain) loss	71	(180)
Past service costs	42	–
Allocation adjustment	–	(137)
Projected OPEB obligation at end of year	1,001	828
<b>RECONCILIATION OF OPEB OBLIGATION</b>		
Accrued OPEB obligation at end of year		
Long-term obligation	997	959
Short-term obligation	46	43
Unamortized net actuarial (gain) loss	(79)	(174)
Unamortized past service costs	37	–
Projected OPEB obligation at end of year	1,001	828

(millions of dollars)	Acquired Business		
	Year ended December 31 2000	April 1 to December 31 1999	January 1 to March 31 1999
<b>COMPONENTS OF OPEB EXPENSE</b>			
Current service cost	37	32	12
Interest on projected benefit obligation	65	42	16
Amortization of net actuarial (gain) loss	(17)	(3)	—
Amortization of past service costs	4	—	—
OPEB expense	89	71	28

## 17. Pro Forma Consolidated Statements of Income (Unaudited)

A pro forma consolidated statement of income has been prepared to reflect the purchase of the Acquired Business as if the purchase of net assets had occurred on January 1, 1999.

(millions of dollars)	1999			
	Acquired Business			Year ended December 31 Pro Forma
	April 1 to December 31 Actual	January 1 to March 31 Actual	Adjustments	
<b>REVENUES</b>	4,338	1,769	(312)	5,795
<b>OPERATING EXPENSES</b>				
Operation, maintenance and administration	1,770	551	16	2,337
Fuel	816	335	(35)	1,116
Power purchased	153	45	—	198
Depreciation and amortization	573	385	(193)	765
Property and capital taxes	277	7	85	369
	3,589	1,323	(127)	4,785
Interest expense	134	545	(500)	179
Income taxes	289	—	96	385
<b>NET INCOME</b>	326	(99)	219	446



### ***Basis of Presentation and Pro Forma Assumptions and Adjustments***

The pro forma consolidated statement of income for the year ended December 31, 1999 is comprised of the consolidated statement of income for OPG for the nine months ended December 31, 1999 and a pro forma consolidated statement of income for the three months ended March 31, 1999 based on the consolidated statement of income of the Acquired Business. The pro forma consolidated statement of income is not necessarily indicative of the results of operations that would have occurred had the transactions taken place on the relevant dates, because of significant changes in the business and regulatory environments, financing and other factors.

OPG is an unregulated commercial enterprise, whereas the Acquired Business was a rate-regulated entity. Since accounting policies followed by rate regulated enterprises differ in some respects from those followed by non-rate regulated enterprises, certain of the liabilities and expenses recorded by the Acquired Business would have been recorded differently by OPG.

The pro forma consolidated statement of income for the year ended December 31, 1999 includes the following assumptions and adjustments to the historical results of the Acquired Business:

**Revenues:** During the Transition Period of the Ontario electricity industry, all consumers will continue to pay their electricity bills on a bundled basis. OPG's share of revenue out of this bundled pool in 1999 was planned to be 4¢/kWh for Ontario sales, based on estimated demand for 1999, together with a fixed amount for ancillary services. The impact of this new revenue allocation arrangement is a reduction in revenue of \$336 million for the three months ended March 31, 1999. Revenues were increased by \$24 million to reflect other adjustments including the reclassification of revenues that were previously recognized as internal revenues and credited to operations, maintenance and administration expenses (OM&A), and foreign exchange losses previously recorded as interest expense.

**OM&A:** OM&A expenses for the three months ended March 31, 1999, have been adjusted by \$16 million which includes the reclassification of revenues previously recognized as internal revenues and an adjustment for certain grants in lieu of property taxes that were previously included in OM&A expense.

**Fuel:** As part of the restructuring of Ontario Hydro, the obligation to fund the future costs of nuclear waste disposal and nuclear plant decommissioning was transferred to OPG. OPG recognized the full committed liability of \$6,317 million as at April 1, 1999. As a result, the amount charged to operations for these periods with respect to the future obligation for these liabilities, is less than the amount formerly charged to operations. Accordingly, for the three months ended March 31, 1999, fuel expense has been adjusted by \$35 million with respect to nuclear waste disposal.

**Depreciation and amortization:** The net book value of the fixed assets of the Acquired Business, which amounted to \$26,850 million, was adjusted by an amount of \$13,978 million, reducing the net book value of fixed assets to their fair value of \$12,872 million as at April 1, 1999. As a result of the new asset base, depreciation and amortization expense has been reduced by \$177 million for the three months ended March 31, 1999. Other adjustments include a reduction in depreciation of \$30 million for the three months ended March 31, 1999, to reflect lower charges to current operations resulting from the recognition of the full committed liability for nuclear plant decommissioning and an increase of \$14 million related to revalorization.

**Interest expense:** Interest expense includes interest on debt financing. As a result of the new capitalization of OPG and lower interest rates for OPG's long-term debt, interest expense decreased by \$484 million for the three months ended March 31, 1999. The Province no longer guarantees OPG's debt to third parties after April 1, 1999. Accordingly, OPG will not incur the provincial debt guarantee fee previously included in interest expense. The elimination of this guarantee fee, which had an impact of \$31 million for the three months ended March 31, 1999, is reflected in the net reduction in interest expense. An adjustment of \$15 million for the three months ended March 31, 1999, was made to reclassify certain foreign exchange losses to other revenue.

**Income, property and capital taxes:** The Acquired Business was exempt from tax under the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario). However, pursuant to the *Electricity Act, 1998* OPG is required to pay to OEFC an amount referred to as a "proxy tax". The proxy tax is generally equal to the amount of income and capital taxes OPG would be liable to pay under the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario) if it were not exempt. The *Electricity Act, 1998* also provides that OPG is required to make additional payments in lieu of property tax each year to OEFC on its electricity generating assets. Accordingly, the pro forma adjustments reflect the recognition of property and capital taxes of \$85 million for the three months ended March 31, 1999. In addition, proxy taxes in lieu of federal and Ontario income taxes plus the federal large corporations tax was recognized in the amount of \$96 million for the three months ended March 31, 1999.

## 18. Decontrol, Joint Ventures and Partnerships

### *Leasing of Bruce Nuclear Generating Stations*

On July 11, 2000, OPG entered into an agreement to lease its Bruce A and Bruce B nuclear generating facilities to Bruce Power L.P. as part of OPG's decontrol commitment whereby it is required to reduce its share of generating capacity available in Ontario. Bruce Power is an entity controlled by British Energy plc. The operating lease will have an initial lease term of approximately 18 years and will include options to extend the lease for up to an additional 25 years. The completion of the transaction, which is expected to take place in 2001, is subject to usual closing conditions, including obtaining the necessary licences from the CNSC and the Ontario Energy Board.

The lease agreement requires an initial payment of \$625 million, payable in three installments. This includes \$400 million, subject to closing adjustments, payable to OPG on closing and \$225 million payable in two equal installments of \$112.5 million, no later than four and six years from the date the transaction is completed. Bruce Power will also make annual lease payments during the initial lease term that will consist of both fixed and variable payments. In aggregate, the initial payment and annual lease payments to OPG are estimated at \$3.1 billion. OPG will continue to be responsible for nuclear waste and decommissioning liabilities at the Bruce site.

### *Information Technology Initiative*

In November, OPG entered into an agreement to form a joint venture with Business Transformation Services Inc. ("BTS"), a wholly-owned subsidiary of Cap Gemini Ernst & Young to transfer OPG's Information Services Group ("ISG") to New Horizon System Services Inc. ("New Horizon"), a joint venture that will be owned 51% by BTS and 49% by OPG. Approximately 600 employees within ISG will be transferred to New Horizon. The 10-year agreement is expected to close in early 2001 and includes provisions that allow BTS to re-assess the joint venture agreement up to 2002.

## 19. Comparative Figures

Certain of the 1999 comparative figures have been reclassified to conform to the 2000 financial statement presentation.

The Board of Ontario Power Generation consists of 12 directors. Ten directors are independent of management, including the Chairman, Bill Farlinger, who is a non-executive chair. Ron Osborne, President and CEO, and Graham Brown, Chief Operating Officer, are members of the Board of Directors.

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

### **Audit Committee**

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

### **Human Resources and Corporate Governance Committee**

The Human Resources and Corporate Governance Committee is responsible for advising the Board and making recommendations regarding the appointment, annual review and remuneration of the President and Chief Executive Officer; succession planning; annual assessment of company performance and incentive payments under the corporate Annual Incentive Plan; pension plan strategy, including amendments and benefits; and the annual review and remuneration, conducted by the President and Chief Executive Officer, of senior executives. The Committee is also responsible for the Board's governance of the company, including recommending individuals for

appointment to the Board of Directors, the terms of reference and membership for Board committees, and other initiatives as required to ensure the Board delivers exemplary corporate governance. The Committee meets four times a year. Additional meetings may be held if necessary. Members: Lynton Wilson (Chair), Paul Godfrey, Arthur Sawchuk and Bill Farlinger.

### **Environment, Health and Safety Committee**

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

### **Nuclear Review Committee**

The Nuclear Review Committee is responsible for monitoring the nuclear performance of the company, particularly with respect to safety issues, and advising the Board on policies and strategies that ensure the safe and efficient operation of the nuclear facilities; continual performance improvement as measured against best practices in the international nuclear community; compliance with existing laws and regulations that govern the nuclear facilities, including Canadian Nuclear Safety Commission commitments; and the scope of nuclear audit programs and the appointment of external advisers and assessors. The Committee meets four times a year. Additional meetings may be held if necessary. Members: Arthur Sawchuk (Chair), Mark DeMichele, Paul Godfrey and Brian Robbins.

Ontario Power Generation Inc.

Board of Directors



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



**DANIEL BRANDA**  
*President,  
INTRIA-HP Corporation*



**GRAHAM BROWN**  
*Chief Operating Officer,  
Ontario Power Generation*



**MARK DeMICHELE**  
*Chairman & CEO,  
Urban Realty Partners*



**BILL FARLINGER**  
*Chairman,  
Board of Directors  
Ontario Power Generation*



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



**DAVID KERR**  
*President & CEO,  
Noranda Inc.*



**RON OSBORNE**  
*President & CEO,  
Ontario Power Generation*



**BRIAN ROBBINS**  
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Manulife Financial  
Corporation*



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The Toronto-Dominion Bank*



**LYNTON WILSON**  
*Chairman,  
CAE Inc.*

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S e n i o r   M a n a g e m e n t

**BILL FARLINGER**  
*Chairman*

**WAYNE BINGHAM**  
*Executive Vice President &  
Chief Financial Officer*

**JOHN MATHER**  
*Executive Vice President &  
Chief Information Officer*

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

**GISELLE BRANGET**  
*Vice President,  
Treasurer*

**JOHN MURPHY**  
*Executive Vice President,  
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**GRAHAM BROWN**  
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**RICHARD DICERNI**  
*Executive Vice President &  
Corporate Secretary*

**GENE PRESTON**  
*Executive Vice President &  
Chief Nuclear Officer*

**BRUCE BOLAND**  
*Senior Vice President,  
OPG Energy Markets*

**DAVID DRINKWATER**  
*Executive Vice President,  
Law & Corporate Development*

**JIM BURPEE**  
*Senior Vice President,  
Pickering A Generating Station*

**PIERRE CHARLEBOIS**  
*Senior Vice President &  
Chief Nuclear Engineer*



*\* Shown in Pickering Neighbourhood Walk photo on page 6 of Annual Report:*

*Back Row*

Maria Razo, *Pickering Nuclear*, Mohinder Grover, *Pickering Nuclear*, John Marczak, *Pickering Nuclear*, Andy Schwabe, *Pickering Nuclear*

*Middle Row*

Vanessa Hughes, *Pickering Nuclear*, Lawrence Celestin, *Pickering Nuclear*, Shabiki Celestin (*Daughter of Lawrence Celestin*), Vikas Suri, *Darlington Nuclear*, Kathy Peck, *Pickering Nuclear*, Dave Wallace, *Pickering Nuclear*, Vince Chacinski, *Pickering Nuclear*, Katie Chacinski (*Daughter of Vince Chacinski*)

*Seated*

Yvonne Sauvé, *Pickering Nuclear*, Cindy Kaye, *Corporate Head Office*, Eva Marczak, *Pickering Nuclear*, Jackie Wallace, *Corporate Head Office*, Amanda Wallace (*Daughter of Dave and Jackie Wallace*)

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