

March 31, 2003

**ONTARIO POWER GENERATION REPORTS 2002 EARNINGS**

**[Toronto]:** Ontario Power Generation Inc. (“OPG”) today reported its financial and operating results for the year ended December 31, 2002. Earnings for the year were \$47 million or \$0.18 per share, compared with earnings for the year ended December 31, 2001, of \$152 million or \$0.59 per share.

OPG’s 2002 results are below those of the same period last year due to a number of factors. These included a provision for transitional price relief to certain power customers upon market opening of \$140 million, staff restructuring charges of \$101 million, and additional expenditures related to the Pickering A return to service project of \$82 million. These factors were partially offset by higher energy prices of \$97 million and the gain on sale of the Mississagi River stations and other investments of \$128 million.

“In Ontario, the electricity market opened to competition on May 1, 2002. OPG’s generating assets played a significant part in meeting record Ontario demand levels in the summer.” said OPG President and CEO, Ron Osborne.

“Throughout the year, OPG maintained its focus on its core strategies. We successfully met the challenges of the opening of Ontario’s electricity marketplace. We continued to pursue our strategy of operational excellence by increasing electricity production at existing facilities and moved forward with the sale of four hydroelectric stations as part of our mandated decontrol requirements. Organizational structure was further optimized by implementing a corporate restructuring initiative and outsourcing a number of non-core activities. We undertook environmental improvement initiatives including the installation of emission reduction technologies at two fossil stations. OPG is confident that its core strategies are realistic and attainable and will deliver long-term shareholder value,” said Osborne.

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

## **ONTARIO POWER GENERATION INC.**

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**ONTARIO POWER GENERATION INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

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

**THE CORPORATION**

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

As at December 31, 2002, OPG's electricity generating portfolio consisted of three nuclear stations, six fossil-fuelled generating stations, 36 hydroelectric generating stations, and a green energy portfolio consisting of 29 hydro and two wind generating stations. Two of the other nuclear generating stations, formerly operated by OPG, are leased on a long-term basis to Bruce Power L.P. ("Bruce Power"), an entity unrelated to OPG. The Company's Pickering A nuclear generating station, representing 2,060 megawatts ("MW") of capacity, has been laid up since 1997. OPG has commenced the return to service of the first unit of this four unit station.

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

**HIGHLIGHTS**

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

Net income for the year ended December 31, 2002 was \$47 million compared with \$152 million for the year ended December 31, 2001. Total revenues in 2002 were \$5,746 million compared to \$6,239 million in 2001. Total volume of electricity sales from the Generation and Energy Marketing segments for the years ended December 31, 2002 and 2001 were 125.3 TWh and 140.2 TWh, respectively.

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

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

### Change in Earnings

*(millions of dollars – after tax)*

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

### ONTARIO ELECTRICITY MARKET

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

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

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

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

- Effective December 1, 2002 and until April 30, 2006, electricity commodity prices are set at 4.3¢/kWh for low volume consumers (consumers using less than 150,000 kWh annually) and other designated consumers including those who have a demand of 50 kW or less.
- Refunds will be provided to these consumers for the difference between the 4.3¢/kWh and the amount actually paid by these consumers since market opening.
- The rates for transmission and distribution, and the fees for the operation of the IMO are capped at current levels.
- IMO market uplift charges to distributors and low volume and designated consumers are capped at 0.62¢/kWh.
- The Minister of Energy has been given increased powers including the ability to review market rules made by the IMO to ensure that the new rules do not unduly and adversely affect the interests of consumers, with respect to prices or the reliability or quality of electricity service. The Minister has also been given powers to control rates approved by the Ontario Energy Board (“OEB”) and to require certain orders to be amended.
- Tax incentives are provided to promote conservation, use of alternate fuels and support for clean energy production through a variety of mechanisms.

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

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

## **BUSINESS SEGMENTS**

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

### **Generation Segment**

With the opening of the Ontario electricity market to competition on May 1, 2002, all of OPG’s electricity generation is sold into the real-time energy spot market administered by the IMO. As such, the majority of OPG’s revenue is derived from spot market sales for which OPG receives a variable price based on supply and demand dynamics. Revenue is also earned through offering available capacity as operating reserve and through the supply of other ancillary services including voltage control/reactive support, black start capability and automatic generation control. Prior to market opening, OPG sold electricity at fixed rates directly to wholesale electricity customers in Ontario, including local distribution companies and large

industrial customers, and to customers in the interconnected markets of Quebec, Manitoba and the northeast and midwest regions of the United States.

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

### **Energy Marketing Segment**

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

### **Non-Energy and Other**

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

## **DISCUSSION OF OPERATING RESULTS**

### **Generation Segment**

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

#### *Gross Margin*

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

## Revenue

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

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

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

### *Market Power Mitigation Agreement Rebate*

In order to address the potential for OPG to exercise market power in Ontario, OPG is required under its generating licence to comply with prescribed market power mitigation measures, including a rebate mechanism. Under the rebate mechanism, for the first four years after market opening, a significant majority of OPG's expected energy sales in Ontario are subject to an average annual revenue cap of 3.8¢/kWh. OPG is required to pay a rebate to the IMO (for ultimate distribution to certain customers) equal to the excess, if any, of the average hourly spot energy price over 3.8¢/kWh for the amount of energy sales subject to the rebate mechanism. At each balance sheet date, OPG computes the average spot energy price that prevailed since the beginning of the current settlement period and recognizes a liability if the average price exceeds 3.8¢/kWh, based on the amount of energy subject to the rebate mechanism.

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

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

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

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

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

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

#### *Volume*

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

#### *Fuel and Power Purchases*

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

<sup>1</sup> Represents generation from Bruce nuclear generating stations prior to decontrol.

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

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

Power purchased during 2002 was \$290 million compared to \$879 million in 2001, based on purchases of 7.4 TWh and 19.1 TWh for 2002 and 2001, respectively. The decrease was primarily due to lower purchases of electricity from Bruce Power, and the elimination of OPG's requirement to purchase electricity to meet Ontario market demand after market opening. OPG purchased 6.8 TWh of electricity from Bruce Power during the period from January 1 to April 30, 2002, compared to 15.4 TWh from May 11 to December 31, 2001.

#### *Operating Expenses*

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

#### *Depreciation and Amortization*

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

#### **Energy Marketing Segment**

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

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

Beginning fourth quarter 2002, interconnected purchases and sales (including those to be physically settled) and mark-to-market gains and losses (realized and unrealized) on energy trading contracts, are disclosed on a net basis in the consolidated statements of income. Previously, OPG reported physically settled interconnected transactions on a gross basis in operating revenues, and the associated costs in operating expenses, in accordance with prevailing industry practice. The amounts in the second and third quarter 2002 interim consolidated statements of income have been reclassified to conform to the fourth quarter and 2002 year end presentation. The change from gross to net presentation for energy trading activities reduced OPG's revenues and cost of power purchases for the year ended December 31, 2002 by \$91 million, with no impact on net income.

### Non-Energy and Other

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

#### *Revenue*

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

#### *Bruce Nuclear Generating Stations*

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

In December 2002, British Energy plc. entered into an agreement to dispose of its entire 82.4 per cent interest in Bruce Power. The transaction was completed on February 14, 2003. Upon closing, the \$225 million note receivable was repaid and lease payments commenced to be paid monthly. In addition, for 2004 through 2008, minimum payments under the lease will, subject to limited exceptions, be \$190 million. The remaining terms of the operating lease agreement remain substantially unchanged.

### *Operations, maintenance and administration*

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

### *Depreciation and Amortization*

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

### *Loss on Transition Rate Options*

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

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

### *Other Income*

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

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

### *Restructuring Costs*

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

## **Income Tax**

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

## **LIQUIDITY AND CAPITAL RESOURCES**

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

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

OPG continues to invest in plant and technologies to improve operating efficiencies, increase generating capacity of its existing plant and maintain and improve service, reliability, safety and environmental performance. Capital expenditures during 2002 were \$869 million compared with \$739 million in 2001. The increase in capital expenditures was primarily due to higher activity related to the return to service of the Pickering A nuclear generating station and expenditures related to the installation of selective catalytic reduction equipment for the purpose of emissions reductions at OPG's Lambton and Nanticoke fossil generating stations.

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

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

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

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

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

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

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

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

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

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

### *Benefit Plans*

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

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

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

### **PICKERING A RETURN TO SERVICE**

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

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

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

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

## CRITICAL ACCOUNTING POLICIES

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

### Recoverability of Fixed Assets

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

The accounting estimates related to asset impairment require significant management judgement to identify factors such as short and long term forecasts for future sales prices, the supply of electricity in Ontario, the return to service dates of laid-up generating stations, inflation, fuel prices and station lives. The amount of the future cash flow that OPG will ultimately realize with respect to these assets could differ materially from the carrying values recorded in the financial statements.

### Nuclear Cost Estimate Changes

The estimate of nuclear fixed asset removal and nuclear waste management costs requires significant assumptions in the calculations since the programs run for several decades. Significant assumptions underlying operational and technical factors are used in the calculation of the accrued liabilities and are subject to periodic review. Changes to these assumptions, including changes in the timing of programs, technology employed, inflation, and discount rate, could result in significant changes in the value of the accrued liabilities.

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

### Benefit Plans

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

#### *Pensions*

Increase (decrease) in costs for a 0.25% change in the following:

	Increase	Decrease
Expected long-term rate of return	(17)	17
Discount rate	(25)	27
Inflation	38	(36)
Salary increases	6	(7)

### *Other Post Employment Benefits*

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

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

### **RISK MANAGEMENT**

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

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

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

### **Risk Classification**

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

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

## Risk Management Tools

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

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

## Commodity Price Risk

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

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

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

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

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

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

Open trading positions are subject to measurement against VaR limits, which measure the potential change in the portfolio's market value due to price volatility over a one-day holding period, with a 95 per cent confidence interval. OPG's approved VaR limit is \$5 million. The VaR limits ranged between \$0.7 million to \$1.9 million during 2002.

## Credit Risk

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

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

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

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

<i>(millions of dollars)</i>			
Credit Rating <sup>1</sup>	Potential Exposure <sup>2</sup>	Number of Counterparties	Potential Exposure for 10 Largest Counterparty Exposures <sup>2</sup>
AAA to AA	31	10	17
A+ to A-	210	46	128
BBB+ to BBB-	118	72	29
BB+ to BB-	55	30	0
B+ to B-	18	10	9
Total	432	168	183
IMO	601	1	601
Total	1,033	169	784

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

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

## Liquidity Risk

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

OPG has liquidity requirements over the next 18 months which exceed its current banking facilities. In order to meet these liquidity requirements, OPG must successfully access the mid-term note market under its shelf program, as well as defer certain debt maturities and other obligations to the Province. In February 2003, OPG reached agreement with the Province to defer \$700 million of debt maturities.

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

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

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

### **Foreign Exchange and Interest Rate Risk**

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

OPG has interest rate exposure on its short-term borrowings and investment programs. The majority of OPG's debt is fixed on a long-term basis. Interest rate risk arises with the need to undertake new financing and with the potential addition of variable rate debt. Interest rate risk may be hedged using derivative instruments. The management of these risks is undertaken by selectively hedging in accordance with corporate risk management policies.

### **Generation Risk**

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

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

### **Environmental Risk**

OPG incurs substantial capital and operating costs to comply with environmental laws and its voluntary environmental programs. The regulatory requirements relate to discharges to the environment; the handling, use, storage, transportation, disposal and clean-up of hazardous materials, including both hazardous and non-hazardous wastes; and the dismantlement, abandonment and restoration of generation facilities at the end of their useful lives.

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

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

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

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

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

### **Ownership and Regulation**

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

OPG's operations are subject to government regulation that may change. Matters that are subject to regulation include: structure of the electricity market, nuclear operations including regulation pursuant to *Nuclear Safety and Control Act* (Canada), the *Nuclear Liability Act* (Canada) and the *Emergency Plans Act* (Ontario), nuclear waste management and decommissioning, water rentals, environmental matters including air emissions, and proxy tax payments. Because legal requirements can be subject to change and are subject to interpretation, OPG is unable to predict the impact of such changes on the Company and its operations.

## **OTHER DECONTROL ACTIVITIES**

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

## **NORTH AMERICAN ELECTRICITY MARKET**

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

## **VISION, CORE BUSINESS AND STRATEGY**

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

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

## **Key Performance Drivers and Initiatives**

### *Improved Efficiencies and Cost Competitiveness*

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

OPG continues to improve the operating performance of its nuclear generating stations. OPG's goal is to achieve top quartile performance among North American nuclear generators based on a nuclear performance index used by the North American members of the Institute of Nuclear Power Operators and the World Association of Nuclear Operators. This index is designed to measure the degree by which a nuclear generator is providing safe and reliable nuclear performance.

OPG's fossil plants operate both as base load and peaking stations depending on the particular stations. Plant efficiency, productivity and reduction of airborne emissions are key factors in enhancing competitiveness of these plants. Significant additional improvements to these stations are in progress, such as the installation of selective catalytic reduction equipment on four units, two at Lambton and two

at Nanticoke by the end of 2003, at a cost of approximately \$285 million. OPG is also pursuing a broad range of other initiatives, including operational changes, emission reduction credit trading and further developing emission control technologies. The successful implementation of these initiatives is intended to maintain the cost competitiveness of OPG's fossil operations relative to other fossil generators in its regional market area and to ensure continued compliance with environmental performance standards in Ontario.

#### *Pickering A Return to Service*

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

#### *Energy Marketing and Sales Opportunities*

OPG has developed and enhanced its marketing, sales and trading capabilities, with a focus on three key growth areas of the new marketplace: (i) spot market energy sales and trading; (ii) the sale of financial risk management products; and (iii) sales of energy-related products and services to meet customer needs for energy solutions. The successful implementation of this strategy is predicated on factors such as sophisticated product structuring and risk management skills to correctly price and manage complex structured products, marketplace recognition and brand equity to facilitate customer acquisition and retention, and the capability to deliver risk management products that meet customer needs.

#### *Focus on Core Business Operations*

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

OPG has also continued the strategic outsourcing of non-core activities and the reorganization of corporate services, internally or with partners. This included the sale of its share of the New Horizon System Solutions information technology services joint venture to Business Transformation Services Inc., a wholly owned subsidiary of Cap Gemini, effective March 2002, and outsourcing certain of its research and development activities with the sale of its interest in Kinectrics Inc. to AEA Technology plc., effective January 2002. In 2002, OPG also finalized the sale of its Nuclear Safety Analysis Division to Nuclear Safety Systems, a subsidiary of NNC Holdings Ltd., an international provider of nuclear safety analysis services. OPG is in the process of inviting qualified industry experts to propose business opportunities with respect to its Inspection Services Division. The Inspection Services Division provides essential specialized inspection maintenance services both within OPG and to other nuclear generating facilities in Canada.

### *Sustainable Development Initiatives*

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

### *Other Initiatives*

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

The Ontario Government announced in November 2002 that it would direct OPG to develop the Niagara Tunnel Project, a project designed to more fully utilize water available at the Sir Adam Beck Generating Station at Niagara Falls. Further, the Ministry of Energy is proceeding with an independent study on the feasibility of moving forward with the Beck 3 generating project in Niagara Falls.

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

### **QUARTERLY RESULTS OF OPERATIONS**

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

<i>(millions of dollars)</i>	<b>2002 Quarters Ended</b>				<b>Total Year</b>
	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>	
Revenues	<b>1,550</b>	<b>1,270</b>	<b>1,612</b>	<b>1,314</b>	<b>5,746</b>
Gross margin	<b>932</b>	<b>863</b>	<b>1,200</b>	<b>851</b>	<b>3,846</b>
Operating expenses	<b>1,018</b>	<b>841</b>	<b>798</b>	<b>944</b>	<b>3,601</b>
Operating income (loss) before Restructuring	<b>(86)</b>	<b>22</b>	<b>402</b>	<b>(93)</b>	<b>245</b>
Net income (loss)	<b>(217)</b>	<b>63</b>	<b>215</b>	<b>(14)</b>	<b>47</b>

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

## FORWARD-LOOKING STATEMENTS

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

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

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

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