UNDERTAKING J1.4

Undertaking

Transcript Reference – pg 140

Determine if any additional information is available to support the statements made in paragraph referred to in the OPG Annual Report.

Response

There are two other documents that are relevant to the referenced statement in the OPG Annual Report.

At the time of the announcement of the OPG prices for the interim period, Ministry of Energy staff provided a technical briefing to interested members of the public in the form of a presentation. This was in addition to the Backgrounder document that was issued.

Page 7 of this presentation explains that the regulated prices for the interim period were developed, in part, based on "forecast output/costs" and that the Ministry of Energy, Ministry of Finance and CIBC World Markets developed the cost and output data working with OPG. The presentation is attached.

Regulation 53/05 (section 5.(1)) makes reference to forecast information provided by OPG that is to be used to measure deviations from forecast for purposes of variance account entries. This forecast information is posted on the OEB website and is a summary of the information provided to the Province when it was establishing the interim rates. If the 10% ROE numbers in the data set are replaced with numbers for a 5% ROE then the resulting prices, when averaged over the three years, approximate the prices announced by the Province.

OPG has used the term "average" in its annual report to describe the fact that the interim payment amounts established by the Province for 2005-2007 were calculated based on an average of three years worth of forecast production volumes and total operating costs.

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Technical Briefing on OPG Pricing Announcement

Ministry of Energy

February 23, 2005

Shane Pospisil,
Assistant Deputy Minister, Energy Supply and Conservation
(416) 314-6190

Rick Jennings
Director, Energy Supply
(416) 325-6545

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Background: Who are the Players?

Ontario Energy Board

- Guarantees public input/fairness and approves prices for price regulated generators
- Develops the Regulated Price Plan for eligible consumers
- Assumes responsibility of Market Surveillance Panel
- Licenses the OPA, its fees, integrated system plan and procurement process

Ministry of Energy

- Determines fuel source mix and goals
- Sets targets for conservation

Ontario Power Authority

- Responsible for adequate, reliable and secure supply of electricity in the medium and long-term
- Prepares system plan and contracts for new supply and DSM

Competitive Generators

Regulated Generators

ieso

Independent Electricity System Operator

- Operates the wholesale market and ensures reliable operation of the power system
- Responsible for short-term forecasting of Ontario's supply

Electricity Market

- Composed of both competitive generators and regulated generators

Background: Electricity Sector Reform and Today's Announcement

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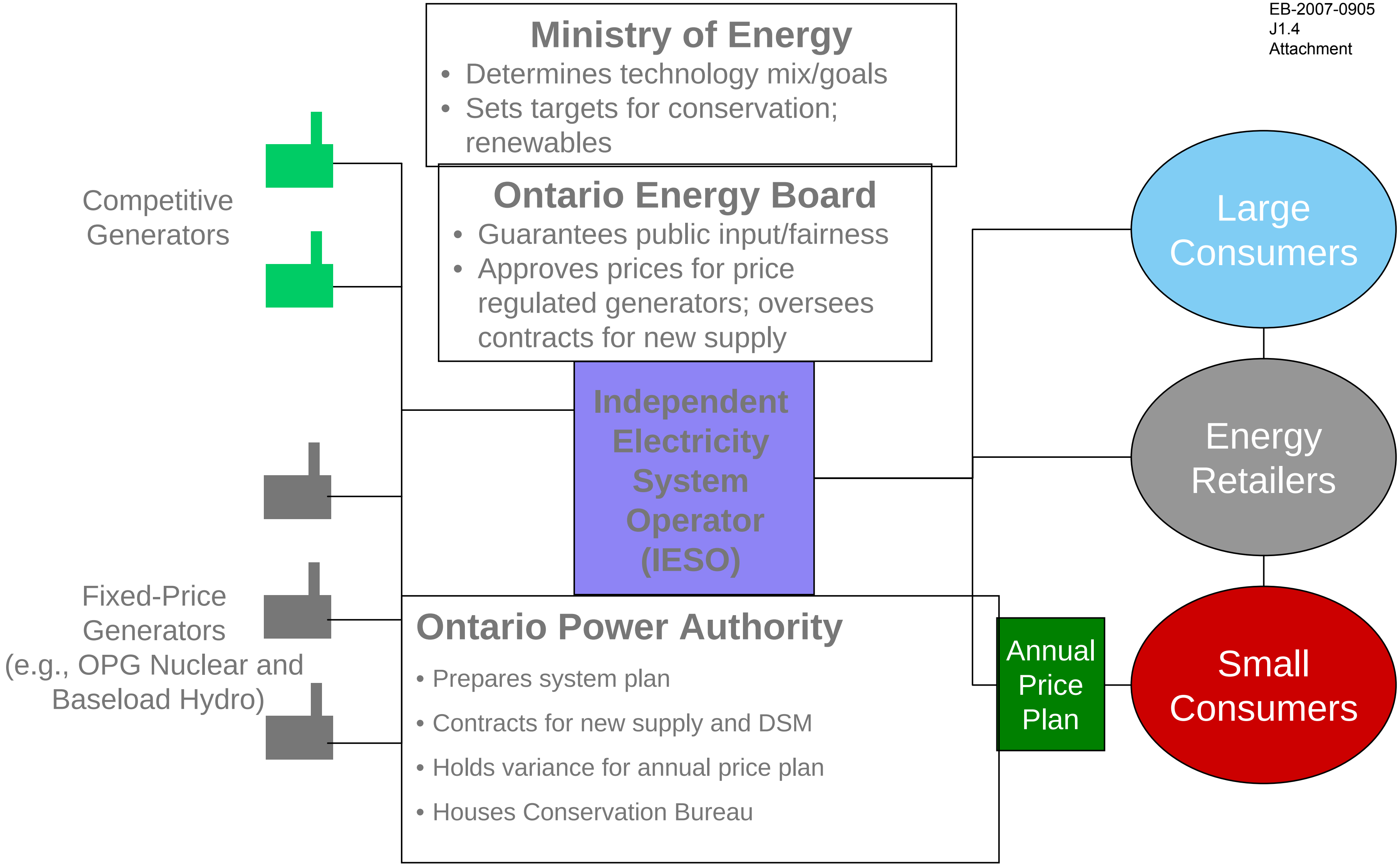

All consumers would benefit from the increased stability that this blended supply mix would provide.

Fixed prices for a large part of the energy consumed in the province would keep overall prices stable.

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Prices for OPG’s Regulated and Non-Regulated Assets

- Better reflect the true cost of producing electricity;
- Relieve taxpayers of the burden of subsidizing a financially unsustainable rebate;
- Protect Ontario’s medium and large businesses by ensuring prices are stable and competitive;
- Provide an incentive for OPG to contain costs and to maximize efficiencies;
- Allow OPG to better service its debt while earning a rate of return that balances the needs of customers with the need for a fair return for taxpayers; and,
- Ensure a reliable, sustainable and diverse supply of power in Ontario.

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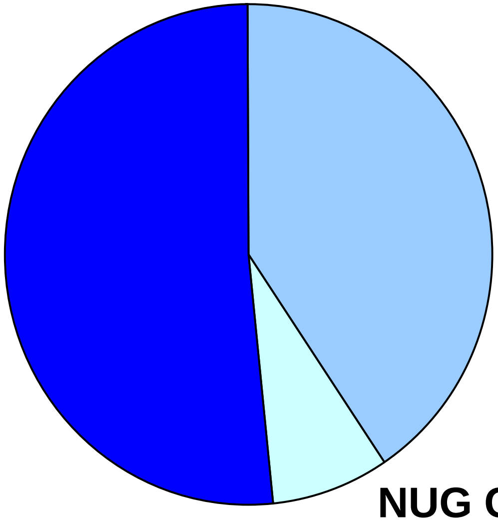
New Market Structure

Spot Market Price
51% of supply

(e.g., OPG Non-regulated – 30 - 33%
Other, including Bruce 18 - 21%)



OPG Initial Regulated Price
41% of supply

NUG Contract Prices
8% of supply

- The new market structure under Bill 100 will have consumers bills reflect the wholesale market price adjusted for regulated and contracted prices.
- The adjustment will reflect OPG regulated prices, NUG contract prices and future contract payments.
- NUG contract prices passed through effective January 1, 2005

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Prescribed OPG Generators and Facilities

- Facilities covered:
  - Niagara River plants
  - St. Lawrence River plant
  - Pickering Generating Station (A and B)
  - Darlington Generating Station

- Baseload facilities, designed to operate whenever available, do not ramp up and down in response to changes in demand.

- Total output from these facilities represents 41% of total Ontario generation (est. 2005).

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How Prices Were Developed

- Methodology:
  - Prices set to recover allowed costs and return on assets;
  - Based on forecast output/ costs, no true-up for over/ under return;
  - Approved capital expenditures to these facilities to extend operation or increase output added to the rate base;
  - Price to be energy-based per kWh;
  - Some incentive for maximizing output during peak periods; and,
  - Variance and deferral accounts to be established, OPG to track expenditures and revenue, OEB to determine treatment when it takes over rate setting.

- Ministry of Energy, Ministry of Finance, CIBC World Markets developed cost and output data working with OPG in setting the regulated prices.

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Design of the Regulated Prices

- Regulated price set for each of the baseload hydro plants and the nuclear plants.
- Earnings from the Bruce Nuclear Lease incorporated in the setting of the regulated price for nuclear.
- Capital structure for the regulated assets 55% debt/ 45% equity.
- Interim Rate set by regulation to last 3 years.
- Treatment of the Non- prescribed OPG assets.

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OPG Price Regulation

- Regulation sets price for next 3 years at:
  - $33/MWh for baseload hydro; and
  - $49.50/MWh for nuclear.
- This is expected to result in a weighted average price of $45/MWh for the price regulated generation.
- OPG should be able to achieve a return of 5% on equity for its regulated assets.
- Earnings on these assets expected to be $150 million. If OPG cost and output performance exceeds planned levels, OPG could earn more.
- Ontario Energy Board is to take over responsibility for setting these prices for April 1, 2008 or earlier if possible.
- OPG can maintain deferral account for Pickering A expenditures and variance accounts. Variance accounts treatment will be reviewed by the OEB before recoverable.

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Non-Prescribed OPG Generators and Facilities

- Intermediate and Peaking Hydroelectric Facilities including plants:
  - In Northwestern Ontario;
  - On the Ottawa River;
  - Northeastern Ontario – Madawaska, Abitibit, Mattagami Rivers
  - Other rivers

- Fossil generating stations including Lambton, Nanticoke, Atikokan, Thunder Bay, and Lennox.

- Total output from these facilities represents 30 - 33% of total Ontario generation (est. 2005).

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How Was Revenue Cap Determined

- Target to limit OPG earnings from the non-prescribed assets to $200 million.
    - Revenue of $47 /MWh and output of 50 TWh should allow OPG to earn $200 million on an annual basis.
    - Needed to exempt facilities with operating costs above the revenue cap to remove disincentive to ever run.
    - Needed to exempt output sold under Transitional Rate Option contracts and forward contracts.
    - Needed to design the revenue cap so that OPG would retain an incentive to maximize availability of power during high cost periods.

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MPMA replacement

- OPG's non-prescribed assets could account for one-third of Ontario generation in 2005 (50 TWh), coal, intermediate and peaking hydro, Lennox.
- A revenue cap of $47/MWh has been established to apply to most of the output of OPG's non-prescribed assets. The revenue cap runs from April 1, 2005 to April 30, 2006. The rebate would flow to customers after this time.
- Exemptions from the revenue cap – Lennox output, Transitional Rate Option volumes, forward contract volumes.
- 85% of OPG output in each hour is subject to the revenue cap, this should provide OPG with the incentive to operate based on price and market signals.
- It is expected that with the revenue cap on non-prescribed assets OPG would have earnings of $200 million on these assets.

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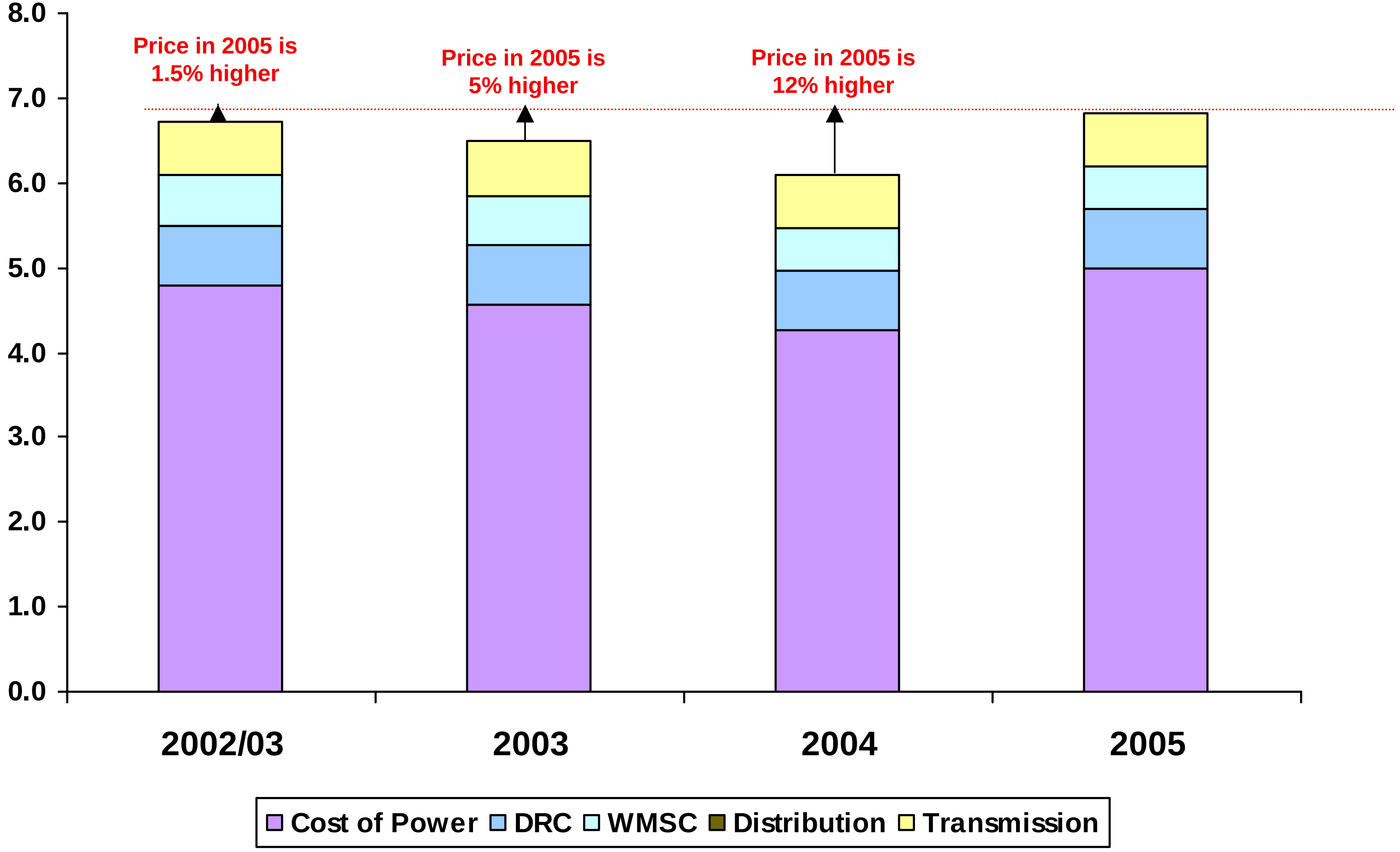
Direct Large User ¢/kWh: comparative price changes



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LDC Large User ¢/kWh: comparative price changes