

Speaking Notes
“Transforming Ontario’s Power Generation Company”
The Canadian Club of Toronto
March 29, 2004

Mandate

The Committee was asked to make recommendations on:

- The role of OPG in the Ontario electricity market
- The appropriate future structure of OPG
- Corporate governance and senior management structures and
- Whether to continue refurbishment of the Pickering “A” units 1, 2, and 3

Review Process

Received advice from a broad range of individuals and organizations:

- **presentations** from generators, distributors, industry consultants, labour organizations, financial community, regulatory authorities, OPG, government and environmental groups
- **a roundtable meeting** with energy sector associations, environmental groups, major industrial consumers and small business consumers
- **submissions** from major industrial associations and **email** from interested citizens

Sector Challenges

The sector is faced with significant challenges:

Electricity supply system **destabilized** by more than a decade of

policy swings.

Ontario faces potential **supply shortage** by 2007.

OPG, the dominant supplier is **underperforming**:

- Frequent senior management change
- Weak accountability and governance, corporate culture issues
- Cost overruns and delays on refurbishments
- Financial strain resulting from rate freeze

Vision for the Sector

Although it was not part of our mandate to look at overall electricity sector design, we made a number of observations in order to provide context for our recommendations on OPG:

- Ontario should be self-sufficient in electricity, including reserve margin, over the long term.
- Electricity costs must be competitive.
- There should be a diversity of fuel sources.
- There should be new private investment in electricity generation.
- Ontario should promote conservation.
- Regulation should be effective.

Supply Issues

Like the broad electricity sector issues, we also made observations about Ontario's supply situation, since it is the over-arching electricity problem that the province needs to deal with.

Coal

Improving air quality is an important and valid goal.

Majority of experts believe meeting 2007 target date will present challenges and will result in significant cost increases.

Coal needs to be replaced in an orderly fashion with gas or other sources to minimize supply and cost impacts.

Nuclear

Ontario's nuclear future should include refurbishing existing plants and building new projects:

- Nuclear is a cost-effective source of baseload.

Other strategies are problematic:

- Little opportunity for new major hydroelectric projects.
- Gas is risky given price volatility and current high prices; Ontario is phasing out coal.
- Renewables and conservation cannot fully fill supply gap.

Nuclear performance can be improved:

- Technology is vastly improved over that used in first generation plants.
- Other jurisdictions prove that effective operation can be achieved.
- Nuclear generation does not contribute to air emissions.

Ontario's Nuclear Future

To ensure a sound nuclear future:

- It should be driven by what is best for Ontario's electricity sector not by a broader industrial development strategy.

- It should not be biased towards Canadian technology, but seek out the best, worldwide.
- There should be a rigorous competitive process for nuclear projects drawing on the best expertise worldwide to build, operate and maintain Ontario's plants.
- Financial risks from cost overruns should be managed and shared with those involved in the project, so ratepayers and taxpayers are protected.

Obstacles Affecting OPG

- OPG and its predecessor were used to carry out public policy goals.
- OPG and its predecessor subject to interference by governments of the day.
- OPG senior management not held accountable for decisions and performance.

Committee Findings: Key Principles

Three key principles help define best outcome:

- OPG should remain publicly owned.
- OPG should be given tools and mandate to become effective steward of public assets.
- OPG should be one of many suppliers to the grid.

Recommendations on OPG: Role

OPG and its predecessors have had an unfocussed past. Their roles have shifted between commercial entity and public policy instrument.

We envision OPG's role to be that of a steward of Ontario's publicly owned generating assets.

For OPG to be an effective steward:

- OPG should be rate-regulated on an effective, transparent and independent basis.
- OPG should actively pursue the best available means to operate its assets efficiently. This could include using joint ventures, partnerships, and other arrangements if those are better ways to achieve good results.
- OPG should focus on its existing major operating assets, i.e. big hydro, nuclear, and fossil.
- OPG's role as a builder of new capacity should not be exercised in a way that is a disincentive to new investors.
- OPG should focus on Ontario's needs, not growing in the North American market

In essence, OPG's mission is to be a top Ontario electricity utility focussed on optimizing the value and output from its core assets.

Recommendations on OPG: Future Structure

Given our view on the role OPG, our next question was what structure would allow it to make the most of its assets.

We weighed all options, and looked at the likely business outcome of each. How much would it improve performance? What risk would it entail?

In the end, we saw substantial risk in a break up that would:

- Force a huge restructuring onto a company already struggling and a sector in the midst of major change.

- Divert senior management time and attention while the company also needs to deal with the Pickering refurbishment.
- Keep OPG from showing its true potential – the period from its creation in 1999 has been marked by policy changes and intervention.

Hence, we recommend that:

- OPG remain a single, commercially oriented company under the Business Corporations Act (Ontario).
- OPG be divided internally into two distinct operating divisions: the nuclear division and the hydro/fossil division.
- A separate management team led by a divisional Chief Executive Officer, accountable to the CEO of OPG, operate each division.
- The OPG Board present a plan, with timeframes, to the shareholder for reorganizing the company and winding down non-core business units.

Recommendations on OPG: Governance

The motivation to build an organization committed to excellence must begin at the top. The chair and CEO, working with the board, must spread this culture by example throughout management and the workforce.

The starting point is that the government must put in place a board and leadership structure with the right skills and competencies, and mandate this leadership to build a competent, commercially oriented company free of political interference and subject to clear public oversight.

From that will flow the stronger governance, greater accountability and more positive culture that OPG needs.

To improve accountability, create greater transparency, and strengthen the role of the board and leadership, we recommend that:

- The OPG board consist of up to 12 directors appointed by the Province.
- Directors bring in skills and experience in areas such as nuclear generation, finance, the environment and HR.
- For new board appointments, the board establishes the skill requirements and a roster of nominees from which the stakeholder chooses.
- Shareholder instructions to OPG, are in writing and are a matter of public record.
- The board holds management strictly accountable for pursuing and achieving company goals, and tie rewards to performance.
- OPG prepare for board and shareholder approval rolling five-year business plans, and that a summary of such plan be made public.
- OPG develop control systems around major capital expenditure and/or O&M programs.
- Management of divisions be based in the field at or near the assets for which the division is responsible.
- The number at head office be reduced as much as possible as functions are moved to the two key operating divisions.

Recommendations on OPG: Pickering

To make a recommendation on whether to restart Pickering A, units 1, 2 and 3, we had to address two key questions:

- Does the project make economic sense?
- Can the project be done on time and on budget?

During the time we carried out our work, the interim board of directors of OPG decided to stop all planning activities on Units 2 and 3 so that they could concentrate resources on Unit 1. We agree with this. Further work on Units 2 and 3 should not proceed until it is clear that OPG will be able to succeed on Unit 1.

Hence, our review focused on Unit 1.

On the first question of economics, the analysis is that proceeding with Pickering A unit 1 would result in electricity that will cost less than alternatives.

There is also a strong business case for proceeding with the project. Projected revenues will be sufficient to repay the required investment. The details are in the report.

Achieving the business case obviously requires completing the project on time and on budget, which takes us to the second question. This was the issue of biggest concern given past history of cost overruns.

After intensive review, which is detailed in our report, we concluded that the OPG board and management and the Unit 1 project team have learned the lessons from the disastrous Unit 4 project, and have a plan to reduce or eliminate the delays and cost overruns that have occurred on Unit 4.

All large construction projects carry risk. We believe that the risk on this project has been managed down to a reasonable level.

The refurbishment of Pickering A Unit 1 is the quickest and least costly source of additional electricity supply available to Ontario.

Hence we recommend that:

- OPG proceed with the project to return Pickering A Unit 1 to service.
- The board maintain the highest level of oversight for the duration

of the project.

- The government as shareholder should have regular independent reports on how the project is progressing and whether milestones are being met.
- The board wait until there is clear evidence of success on the Unit 1 Project before proceeding with any further development work on Unit 2 or 3.
- The same level of due diligence applied on the decision to proceed with Unit 1, be applied to any decision on Units 2 and 3.

Closing Remarks

Ontario is facing looming supply pressures.

OPG needs to be part of the solution.

To succeed, it must be given the mandate and the tools to become a first rate electricity focussed on driving the best performance possible from its core assets.