

Notes for Remarks by

Ronald W. Osborne

President and CEO
Ontario Power Generation

To the Canadian Club

Toronto, Ontario

February 14, 2000

Subject to change upon delivery

<http://www.ontariopowergeneration.com>

Good afternoon, ladies and gentlemen. It's a pleasure to be here.

As most of you know, Ontario Power Generation is a new company. We were created just 10 months ago, as part of the provincial government's decision to deregulate Ontario's electricity industry and allow open competition into the marketplace. The new market is scheduled to open this November.

The electricity sector is undergoing major changes. I want to talk today about these changes, Ontario Power Generation's role in the new market, and why we believe we are in a good position to succeed.

Electricity industry restructuring follows that of other major industrial sectors – such as telecommunications, natural gas and financial services.

Other countries – the U.K., Australia and New Zealand come to mind – are well advanced in deregulating their electricity industries.

And in the U.S., the pace of deregulation is increasing. Five years ago, fewer than 10 states were restructuring their electricity sectors. Today, there are at least 40.

We're also seeing electricity industry consolidation on a massive scale. The proposed merger of Unicom and PECO in the U.S. represents combined assets of \$31.8 billion (U.S.), and brings together two companies with major nuclear programs. And the planned \$30 billion (U.S.) merger of American Electric Power with Central and South West Corp. will create one of the largest generators in North America at 38,000 megawatts. These would be major energy powers stretching across large parts of the continent.

As in financial services, as in telecommunications, as in media and entertainment... size matters in the electricity business and will increasingly be a key success factor for serious players.

In some cases, electricity isn't even a core business for newer competitors. If you thought Caterpillar in the U.S. was just a bulldozer company, you'd be only partially correct. It's also in the power generation business. Honeywell, a world leader in control systems for aerospace and other industries, has just registered in the U.S. to compete as an electricity retailer.

New competitors have already declared their interest in the Ontario retail electricity market. Duke Energy – one of the largest electricity companies in the U.S. – has acquired an energy services company here in Toronto. Enron, the largest U.S. energy marketer, is here as well.

All this new competition promises to bring higher levels of innovation ... more choice ... and more customized products and services. Competition will be good for customers – wholesale and retail.

Ontario Power Generation's focus is on the wholesale side of the electricity business, as a result of how our industry has been restructured. The retail side of the industry has historically been the responsibility of the municipalities, while the transmission business and a rural retail business lies with Ontario Hydro Services Company.

The Ontario wholesale market for electricity promises to be very competitive.

Over the past year or so, in response to the government's announcement that the electricity market would be deregulated, a number of companies have announced new electricity generation projects here in Ontario. The most recent was Sithe Inc., which is planning to build two 800 megawatt plants in Mississauga and Brampton. They will join TransAlta's 525 megawatt generating station planned for Sarnia, and a number of other announced projects totalling an additional 600 megawatts.

We look forward to competing with these companies on a level playing field where all participants are subject to the same market rules.

New players will also emerge as Ontario Power Generation reduces its presence in the Ontario market.

Currently we have an 85 per cent share of the market for electricity generation. To ensure competition in generation, we must reduce our control over electricity generation in two phases over the next 10 years.

The first phase involves the decontrol of 4000 megawatts of mostly fossil-fuelled generation by 2004. This is roughly the amount of generation that Toronto would need on a day like today.

The second phase, to be completed by 2010, involves the additional decontrol of our assets so that we will represent no more than 35 per cent of the supply options available to the province.

We have many decontrol options. We could swap generation, lease our facilities, or sell assets. The result will be more players and more choice for electricity customers.

In response to the request of Jim Wilson, Minister of Energy, Science and Technology that we accelerate the schedule for decontrol, we will provide within the next month to the Minister and to the province's SuperBuild Corporation our plan for meeting the first phase objective. We are targeting roughly 4000 megawatts of hydroelectric and fossil generation including our 2100 megawatt Lennox station near Kingston, and our 1100 megawatt Lakeview station in Mississauga.

Our goal is to meet our phase 1 objective of decontrolling 4000 megawatts prior to the market's scheduled opening in November. This would be more than three years earlier than required.

I say that this is our "goal" because any deals we make must protect the value of these investments and our shareholder's interests. As the Minister has said in the past, there will be no fire sale of assets.

We are also moving quickly on another front. Last fall we began seeking public-private partnerships for our Bruce Nuclear facility near Kincardine. This includes 3000 megawatts at the temporarily laid up Bruce A station, and a similar amount of operating capacity at our Bruce B station. We have already met with several potential partners and expect to report soon to our shareholder on these discussions.

So by the end of the first quarter, we hope to have 7,000 megawatts of operating generating capacity in play.

When added to the 2700 megawatts of planned independent generation in Ontario, the 1700 megawatts that independent generators supply today, and the 4000 megawatts that can be brought into the province through interconnections with other jurisdictions, by this time next year we could see up to 15,000 megawatts provided by other companies.

Another way of looking at these numbers is that non-Ontario Power Generation sources could control more than 40 per cent of the electricity generation available to the province.

Competition in electricity generation will be a reality. In the meantime, we are getting ready. We intend to be very competitive, and we look forward to proving it. I'll speak for a few moments about our state of readiness in terms of our operational performance, our environmental record, and other programs we have underway.

In terms of overall performance, we had a satisfactory first year.

- Our nuclear stations generated eight per cent more electricity than planned. Last year, nuclear power satisfied almost half of the province's need for electricity – that's all the power needed by the large industrial users in Ontario plus all the residential, commercial and industrial customers in the cities of Toronto, Ottawa, Hamilton and Mississauga.
- Our hydroelectric production almost hit plan, in spite of dry conditions last year. We carefully husbanded the water available to us while respecting the needs of other users.
- Our fossil-fuelled stations consistently rose to the occasion, doing what they do best – ensuring that customers are reliably served during high daily and seasonal demand periods. And we are very careful to minimize any negative environmental impacts produced by those plants – a point I will return to later on.

We were especially successful in meeting customer demand last summer, when many U.S. jurisdictions experienced power shortages and very high prices. Despite high temperatures and seven new summer customer demand records, OPG was able to meet the needs of the province without any disruption in service.

During 1999, we made progress towards our goal of world class nuclear performance. Our nuclear plants used to be mired in the bottom quartile of the nuclear power industry. Over the past two years they have moved up slowly, making headway against a North American nuclear industry that is also registering performance improvements.

There is still a gap to bridge. Our regulator, the Atomic Energy Control Board, has identified a number of priority areas for improvement. We are working to meet their expectations, which match our own.

Our nuclear improvement progress has been slower than we hoped. This reflects the enormity of the task. We remain committed to reaching our overall nuclear performance objective of top quartile performance by 2003.

I want to emphasize that the issue here is not whether our nuclear stations are safe. They have always been operated safely. The issue is to become an industry leader in this area.

On a related nuclear subject, we also plan to return to service the four units of our Pickering A nuclear plant. This project is subject to all regulatory approvals, including the approval of an environmental assessment. We are also having our cost estimates analysed independently, to confirm the soundness of our approach. The Pickering re-start would add 2000 megawatts of what promises to be, without exception, the lowest cost energy in the province on an incremental basis.

Our operating results for 1999 had a favourable impact on our financial results, which we will release later this quarter. In general, we were well ahead of target in the key areas of electricity sales, revenues, net income after taxes, and return on equity. And we made payments to the province of about \$1 billion on an annualized basis in the form of dividends, payments in lieu of taxes, and water rentals.

Our environmental performance is another competitive strength.

Over 99 per cent of our installed generation has received ISO 14001 certification – the international standard of excellence in environmental management. Our environmental management systems are subject to regular external audits. We are one of the first generating companies in North America to have all its major facilities registered under this standard.

Collectively, our electricity production facilities produce some of the cleanest power in our airshed – which stretches from Tennessee to Michigan and into Ontario.

Let's look at our nuclear stations, which produce virtually no acid gases or greenhouse gases of any kind. Thanks to nuclear energy, our air is considerably cleaner than it otherwise would have been. Between 1971 and 1999, use of nuclear power in this province has avoided:

- 11 million tonnes of sulphur dioxide, which causes acid rain;
- 2.5 million tons of nitrogen oxide, which contributes to acid rain and smog; and
- 1.2 billion tonnes carbon dioxide, which is a greenhouse gas that contributes to global warming.

Nuclear energy is making a major contribution to our environment. If we as a nation are really serious about meeting Canada's greenhouse gas emission targets as set by the Kyoto Conference on Global Warming, then I submit that one of the best ways to do that lies right here in this province – with the 9,000 megawatts of nuclear power OPG currently operates and the 2000 megawatts of additional clean, competitively priced power from our proposed restart of Pickering A... Not to mention our 7,000 megawatts of hydroelectric power, which also has no emissions.

And if our laid up Bruce A station can be brought back into service either by us or a new investor, this would also contribute another 3,000 megawatts of clean electricity.

I'm also proud of the environmental record of our fossil-fuelled stations and of our ongoing efforts to reduce air emissions.

Through continuing investments in technology, such as sulphur dioxide emission scrubbers, improved low nitrogen oxide burners, and our use of low sulphur coal, our coal-fired plants produce the same amount of energy they did 15 years ago, but with 60 per cent fewer emissions of acid gas.

Our generation mix is cleaner than that of any power company in our future market area. Electricity generated to serve Ontario produces significantly less air pollution than electricity that powers states such as Michigan, Illinois, Indiana, and others to the south, which rely mostly on coal-fired generation.

In fact, these states contribute much more to southern Ontario smog than do our facilities. Various studies show that our fossil stations add between 2 per cent and 8 per cent of the nitrogen oxide that leads to smog. Even under the worst case scenario it is clear that most of the pollutants originate from U.S. sources upwind of us, as well as from vehicles and industries here in the province. I know that there is a higher level of expectation attached to us, and we will strive to live up to these expectations. But the reality is that we are only a small part of the smog problem.

We will obviously respond to the recent emission regulations introduced by the province and we will do whatever is necessary to comply with them.

In terms of comparisons with the U.S., we will meet the new U.S. Clean Air Act emission rate standards for sulphur dioxide and nitrogen oxide this year. And with planned technology improvements, we will better the standard for nitrogen oxide emissions by 10 per cent in 2001.

Our emissions performance, and our adoption of the ISO 14001 standard, will help set us apart from the competition in the eyes of electricity customers.

In the area of nuclear waste, our commitment is absolute. Our nuclear plants produce small amounts of waste. In fact, all 12 of our operating nuclear power units generate only 600 cubic meters of waste annually – you could fit it all in three suburban garages. Every ounce of that waste is captured, accounted for and stored safely.

We accept that the nuclear industry must be responsible for long term management of reactor waste. To this end, last year we allocated more than \$400 million to segregated funds for long-term nuclear waste disposal and decommissioning of nuclear reactors. This year, and in future years, we will set aside similar amounts. When the time comes to decommission our nuclear units, and to permanently deal with their wastes, we will have the funds available. We continue to work closely with the federal Department of Natural Resources to develop an industry-wide approach to managing nuclear waste over the long term.

Finally, I want to briefly address some recent initiatives that highlight how we are preparing to compete and win in the new marketplace.

One of the most important is labour relations. It's no secret that our relations with our unions were poor under Ontario Hydro. That's history now.

With the co-operation of our union leaders, we have struck a partnership agreement with both of our large unions to foster a more collaborative relationship. This partnership approach will be important to our decontrol process as we seek to ensure that we maximize value to the province and protect the interests of our employees.

And we are exploring the possibility of introducing gainsharing to all employees, so that a portion of their compensation is tied to performance. Last year, 6,000 of our employees were eligible.

Real cultural change will only occur when everyone has a stake in the performance of the company. While there is obviously room for further improvements in this area, much progress has been made.

We are also forming new partnerships in key business areas, again with the active support of our unions.

In information technology, we plan to set up a joint venture with a major IT company to create a new stand-alone company that will provide information technology services to Ontario Power Generation and to other energy companies.

On the R&D front, Ontario Power Technologies – our technical-innovation and development arm – is forming a partnership with AEA Technology of the U.K., Scientech of the U.S., and CANATOM in Canada. Upon closing the deal, the three new partners will have a 10 per cent stake in Ontario Power Technologies and options on a further 40 per cent. They bring considerable marketing and technology development capabilities to the venture.

We are working closely with current and prospective customers. Some of you may have attended one of the many customer meetings we have hosted across the province in the last year, to listen to customer concerns and to help customers understand the alternatives and opportunities available to them in the new market.

And in the area of strategic procurement, we have achieved nearly \$40 million in annualized savings so far and expect to eventually save at least \$100 million per year.

These are all new ways of doing business for us. They are essential to our preparations for a competitive Ontario market.

I want to conclude by looking at our longer term strategy, which is to become a major North American competitor.

Our immediate priorities are to improve our financial position, enhance our nuclear performance, accomplish our decontrol objectives, and return Pickering A to service.

Once these objectives are secure, our plan is to move more aggressively into the U.S.

Ontario will always be our home market and a major focus for our business endeavours. But as competition accelerates, we also need to look at growth opportunities beyond our borders – specifically in the U.S. According to the U.S. Department of Energy, over the next two decades there will be a need for about 400,000 megawatts of new electrical generation in the U.S.

In addition to opening new opportunities to us, expansion into the U.S. will offer benefits to our shareholder, and the people of Ontario.

The contribution we make to the province now is already considerable.

We employ 15,000 highly skilled employees, and we pay out over \$1 billion in annual salaries – which go towards personal taxes, major purchases like houses and cars, consumer goods of all kinds, and investments in companies here and across Canada.

We purchase \$1 billion a year from suppliers, 80 per cent of whom are based in Ontario.

In addition, our head office in Toronto attracts and supports a wide range of professionals in the GTA, adding significantly to the city's critical mass of knowledge workers.

These benefits will grow...and grow substantially -- as we grow within a larger market, as a major North American competitor.

The revenues we earn in Ontario, will stay in Ontario...and much of the money we earn abroad will be repatriated to the province -- in the form of R&D, salaries, capital investment, pension contributions, environmental and community initiatives and corporate taxes. Not to mention helping to pay down the historical debt of Ontario Hydro.

In addition...as an Ontario based, North American competitor our head office presence will remain strong. There will be plenty of room for investment from all parts of the world. But we want to ensure that there will be at least one strong Ontario-based generator whose focus is on benefiting the province. We intend to be that company.

Our prospects for success in a larger North American market are excellent.

We have one of the most flexible, reliable, and clean generation mixes on the Continent.

And we have one of the lowest marginal cost structures in our market area, which will allow us to deliver very competitive prices.

We will leverage all of these strengths to the advantage of our shareholder, the people of Ontario.

We have the performance, the people, the expertise, and the plan to succeed.

We will succeed...for the benefit of our employees, our customers, and Ontario.

Thank you.