Speakers notes made by The Honorable Jake Epp at the Ontario Energy Network Luncheon, October 19, 2004

Introduction

It's a pleasure to be here today. The Ontario Energy Network collectively makes up a large part of Ontario's electricity sector. With so many changes occurring in the electricity industry, it's healthy that we have opportunities like this to keep each other informed.

I have spent many years involved in energy issues and energy companies – as a Federal Energy Minister, a senior executive with a major gas company, a participant on two OPG review panels, and now as Chairman of OPG. My experience has taught me that electricity is vital to economic growth, job creation and investment.

Considering that Ontario represents roughly 40 per cent of Canada's economy, having a reliable and reasonably priced electricity supply in Ontario benefits not just this province but Canada as a whole.

Many of you have provided input to the Ontario government on the restructuring of Ontario's electricity sector. Ontario's pivotal position in Canada's economy makes it imperative that we get this process right.

All OPG employees have worked hard over the past nine months to get the company back on track. Our immediate priorities are that we demonstrate we are a cost-efficient and dependable electricity producer, and that we deliver on our supply projects. In that context, I would like to speak about three subjects:

1. Our continuing focus on reducing our costs;

2. Corporate governance at OPG; and

3. The status of our various supply initiatives – Pickering A Unit 1, the Niagara Tunnel project, and the Portlands project here in downtown Toronto.

Cost Management

I'll begin with the subject of cost management at OPG.

Our ability to closely manage our costs, and to demonstrate effective cost management, will be very important to the company when we participate in the regulatory processes that the province is putting into place.

When the new Board and management took over in December 2003, we were confronted with a business plan for 2004 that we did not accept and that needed scrubbing. Three months later the Board approved a revised business plan which reduced the overall OM&A and capital expenditures by $178 million.

During the first half of this year, we also reduced our executive ranks – vice presidents and above – by 20 per cent. The total executive payroll has declined year-over-year by 23 per cent. The long term incentive plan for senior executives was eliminated, and their base salaries were frozen. The annual incentive plan for non unionized staff and the goalsharing plan for unionized staff were reduced. As well, we have cut travel and accommodation costs across the company by 18 per cent.

These are costs that are immediately within our control. However, it's important to understand that many of the annual costs within our budget are much less discretionary. Let me give you some examples.

First, there is the market power mitigation rebate. In 2003, we paid out $1.5 billion. Since the market opened OPG has, on average, paid out $100 million a month back to customers. This cost has had a huge impact on our bottom line.

A second example is commodity costs. The cost of coal, gas, oil and uranium – as well as the tax we pay on water used for hydroelectric production – amounted to $1.7 billion last year. These commodity costs have risen relatively steeply.

The spot price for Central Appalachian coal, for example, has risen by 72 per cent from September 2003 until September 2004. Likewise, the price of Northern Appalachian coal has risen by 75 per cent during this period. We use these coals for about half of our coal-fired production.

While our contracting strategy has insulated us from much of this increase to date, it still costs us more than a million dollars extra to generate a terawatt hour of coal-fueled power now compared to a year ago.

Gas prices have also risen. The average 2003 price was up 63 per cent over 2002 at Henry Hub. It now costs us $43 million more to generate a terawatt hour using gas compared to 2002.

We are all aware of the rise in oil prices, with highs of $US 54 a barrel last week. Even spot market uranium prices have increased over the past year from about $12 a pound to $20 a pound.

A third example is the increase in depreciation expense. This is one of the significant factors that has contributed to the decrease in OPG's earnings. In 2003 we recorded an impairment loss on the coal-fired stations of $473 million after tax, due to the Government's decision to close down the coal-fired stations by 2007. To the end of September 2004, depreciation expense has increased by approximately $130 million when compared to the same period in 2003, of which approximately $70 million relates to the decision on the coal-fired stations. In total, depreciation expense is expected to increase by about half a billion dollars during the period 2004 to 2007, compared to what would otherwise have been recorded if the coal-fired stations remained in service.

Let me be clear that I am not second-guessing the decision on the coal plants. I am only noting that it has a financial impact on OPG's bottom line, which our critics sometimes fail to acknowledge.

A fourth example is that regulatory costs are also increasing – for example, the cost of environmental compliance, and the cost of additional security at our generating facilities since 9/11.

Effective regulation is important to maintaining the public trust. Yet, we must also acknowledge that regulation comes with a certain financial cost. In terms of environmental compliance, for example, we currently pay a premium of about $65 million a year for low sulphur coal to meet Ontario's sulphur dioxide emission regulation. To meet OPG's regulated nitrogen oxide allowance allocation – which declined from 35 gigagrams in 2003 to 25 gigagrams in 2004 – we invested a total of $250 million in selective catalytic reduction technology at our Nanticoke and Lambton coal-fired stations. We did not disagree with these regulations. My point is that such improvements cost money.

As for security at our nuclear stations, OPG agrees with the need for the security enhancements which the Canadian Nuclear Safety Commission understandably mandated for all nuclear plants in Canada following 9/11. However, the cost of implementing these measures will total more than $300 million for the 2002 to 2007 period.

While there is not a lot that OPG can do with respect to costs that are less discretionary, such as the examples I have just cited, let me emphasize that we will continue to aggressively manage those costs that are more directly within our control.

Since we revised our business plan earlier this year, management has instituted rigorous quarterly financial and performance reviews. This has been particularly important given the cool, wet summer we experienced and the resultant low prices in the market, which have reduced our sales margins. Our belt tightening throughout the year has helped significantly offset the loss of revenues. As a result of our continuing and aggressive reviews, I am pleased to say that we are managing our OM&A costs such that they should be about another $100 million below our revised business plan by year end.

Governance

The second subject that I want to discuss with you today is the Board and our employees.

Over the past two weeks OPG has announced the addition of seven new Board members. The new members are:

- Donald Hintz, the retired President of Entergy Corporation;
- Gary Kugler, who has recently retired as Senior Vice President and International Adviser at Atomic Energy of Canada Ltd.;
- David J. MacMillan, non-executive director of Killingholme Power Ltd.;
- Corbin McNeill Jr., the retired Chairman and Co-CEO of Exelon Corporation;
- Marie Rounding, past President and CEO of the Canadian Gas Association and former Chair of the Ontario Energy Board;
- Bill Sheffield, the former CEO of Sappi Fine Papers; and
- David G. Unruh, Vice-Chairman and Director of Westcoast Inc.

Collectively, the new Board members are seasoned business professionals who have substantial experience in restructuring large business enterprises, managing and operating nuclear stations, managing capital intensive businesses, and overseeing regulatory affairs, government relations and public affairs. The Board includes distinguished Canadians and two very capable and experienced Americans with significant nuclear operating experience. In adding the nuclear expertise of Donald Hintz, Corbin McNeil and Gary Kugler to the Board, we have addressed one of the recommendations of the OPG Review Committee, which was that we bring to the Board skills and experience in the area of nuclear electricity generation – a recommendation we consider very important.

The new Board members join Jim Hankinson and Ian Ross, who are continuing on the Board. I would also like to pay tribute to Kathryn Bouey, the Deputy Minister of Management Board in the Province of Ontario. Kathryn joined the Board in December 2003 and recently stepped down. I have worked with a number of deputy ministers through my political career, and I believe that OPG was very fortunate to have someone of her skills, experience and overall competence helping to guide the company through a difficult transition period.

Going forward, OPG's Board is committed to upholding the highest standards of corporate governance. It will continue to focus on providing stewardship to the company, as well as helping the government to make decisions about the future direction, structure and role of the company.

I would also like to take this opportunity to say a few words about OPG's employees.

Since becoming Chairman, I have made a point of getting out to talk candidly to OPG employees. I've met with employees at almost all of our sites right across the province.

I've learned a lot during these visits, but what's impressed me the most is the professionalism and performance of our employees. They are very dedicated to helping meet Ontario's electricity needs. Our employees staff three nuclear, six fossil-fuelled, and 65 hydroelectric stations. These facilities operate 24/7, every day of the year, to produce about 70 per cent of the power used by Ontario. When machinery breaks down, it has to be repaired quickly, especially during times of high demand. During a crisis, like last year's blackout, our employees rose to the occasion to quickly and safely reconnect our stations as the grid was being restored. Our employees are a key contributor to the reliability of our electricity system, and I am very proud to be associated with them.

I believe that OPG has a major role to play in supplying the province with electricity going forward. In that respect, I would now like to update you on the status of the supply initiatives we have underway.

Pickering A Unit 1

I'll begin with the Pickering A Unit 1 project.

On July 7 the Ontario government accepted the recommendation from the OPG Board to complete the return to service of our Unit 1 reactor at Pickering A. The Unit 1 project has three major benefits:

- First, it is economical over its lifetime against other generation alternatives.
- Second, it is the quickest way to provide additional power to the province.
- And third, it will generate power with virtually no emissions leading to smog or global warming.

Having said that, a number of significant and challenging tasks remain to be done if we are to hit the June 1 schedule date for lifting the Guaranteed Shutdown State and begin commissioning the unit. We continue to work diligently and closely with our contractors in order to meet the target date.

As I have stated many times before, this is an extraordinarily complex construction project. All in, it involves the completion of almost 20,000 tasks involving 1.7 million person-hours of work. It also entails the purchase of almost two million individual parts, ranging from quarter inch bolts to 20 foot heat exchangers.

We have incorporated the lessons learned from returning Unit 4 to service into the Unit 1 project. As you may recall, last year I undertook, in co-operation with Peter Barnes and Robin Jeffrey, a comprehensive review of what happened on Unit 4. Of the changes we subsequently built into the Unit 1 project, first and foremost are solid management information tracking systems that allow us to monitor developments as they are occurring. This data permits us to intervene and where necessary to recalibrate and reprioritize our activities.

Secondly, the front-end work – specifically, the engineering as well as planning and assessing of all of the tasks, has been done. Last July we had set as a milestone having all of the assessing done by October 15. I'm pleased to report that we have met this milestone. On Unit 4 this front-end work was not completed at the appropriate time.

Thirdly, we have the benefit of independent oversight on the Unit 1 project. The external auditors provide regular input to the OPG Board, to assist management and the Board in monitoring progress on the project. The auditors concur with the achievement of the assessing milestone.

In summary, our use of tracking systems, our completion of the preparatory work, and our engagement of independent oversight are some of the major changes that we have put into place to enhance our ability to manage this complex project.

In terms of substantive achievement on the project, we have:

- Completed all of the engineering and the assessing.
- Installed new digital control computers to control the reactor.
- Inspected feeder tubes, to demonstrate their integrity; inspected the 12 boilers in Unit 1; and completely overhauled the unit's turbine generator.
- Trained staff to demonstrate to the regulator that OPG has adequate numbers of qualified personnel to operate and maintain the reactor once it is back in service.
- Replaced six bus-sized brass condenser tube bundles and installed more environmentally-friendly stainless steel replacements, as in Unit 4.
- Installed and tested extremely sensitive fire detection panels in the turbine and reactor auxiliary bays and in the control equipment room. As well, we are about 60 per cent complete on the installation of 3,000 sprinkler heads and 10 kilometres of pipe in the turbine building, which is part of the fire suppression system at the unit.

To date, we have spent over $500 million. In terms of regulatory milestones, we have completed 27 of 61 license conditions for the removal of the Guaranteed Shutdown State. Nineteen of these have been approved by the Canadian Nuclear Safety Commission; the remainder are being reviewed by the regulator. We will do a full update on the remaining licence conditions when we appear before the commission at our scheduled February hearing for licence renewal.

Looking ahead, the next three or four months are extremely important both in terms of key activities as well as the amount of work to be done. We are heading into the heaviest part of our construction schedule. This is a critical period in terms of our keeping to the June 1 deadline.

Our newly appointed Board will take stock of the progress of the project. We will continue to provide regular updates.

Niagara Tunnel

I would now like to turn to a second supply project – the Niagara Tunnel project. The project will result in the construction of a third tunnel under the City of Niagara Falls to divert additional water from the Niagara River to the Sir Adam Beck 1 and 2 hydroelectric generating stations. When complete, the 10 kilometre tunnel will increase the output of these stations by 1.6 terawatt hours – enough to meet the yearly needs of a city twice the size of Niagara Falls.

We recently received a number of Expressions of Interest from an international group of companies and consortiums. We are currently evaluating the submissions. In parallel, we are working with the Ministry of the Environment on the environmental assessment conditions that apply to this project as well as finalizing the Statement of Work and the Geotechnical report. Tunnel construction is expected to start by mid 2005 and be completed by 2009. We'll provide additional information on next steps in the near future.

Portlands

A third supply initiative that I would like to discuss is our joint effort with TransCanada Pipelines to build a 550 megawatt combined cycle gas plant at the site of the former Hearn generating station in downtown Toronto. We were heartened by the recent decision by the Minister of the Environment on the Portlands Energy Centre environmental assessment. The EA approval, which was granted with conditions, would allow us to proceed once the conditions are fulfilled.

This project is important to the stability of the electricity delivery system in the Greater Toronto Area, and especially the downtown core, and will help satisfy additional electricity demand resulting from the city's waterfront development plans.

We are currently preparing, with our partner TransCanada, a proposal that will be submitted to the Government of Ontario in response to their request for proposals for 2,500 megawatts of additional generation.

Before closing, let me give one final note on electricity generation. I would like to confirm, so that there are no misunderstandings, that we are proceeding, as per the government's direction, with the shutdown of the Lakeview coal-fired generating station. This plant and its employees have made, over the years, a significant contribution to the energy needs of the Province and particularly the GTA, but it is now time to turn the page. By April 30, 2005, Lakeview will stop generating electricity.

Conclusion

I’ll conclude by saying, on behalf of the management team and on behalf of the 11,000 employees at OPG, that we are committed to adding to the province’s supply of electricity and to effectively managing our costs. We are also committed to providing to the people of Ontario, through our Shareholder, the government of Ontario, a fair return on the assets that they have entrusted to us.

We recognize our stewardship responsibilities and we are resolved to continue earning the trust of our stakeholders and the public at large.

Thank you for the opportunity to speak to you today.