Ontario Electricity Financial Corporation

Annual Report

April 1, 1999 to March 31, 2000

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Message from the Chair and Chief Executive Officer

We are pleased to present the first Annual Report of the Ontario Electricity Financial Corporation (OEFC). The report provides an overview of Ontario's electricity sector restructuring, with a particular focus on the OEFC's responsibilities, policies, accomplishments and financial results for the year April 1, 1999 to March 31, 2000.

The past few years have been marked by changes in Ontario's electricity sector, culminating with the restructuring of Ontario Hydro into five successor entities on April 1, 1999. As part of the legislative framework for the restructuring, the *Electricity Act, 1998* established the OEFC as the legal continuation of the former Ontario Hydro.

As outlined in the *Electricity Act, 1998,* the OEFC's mandate is to ensure that the outstanding debt and derivatives and certain other assets and liabilities of the former Ontario Hydro are managed efficiently and prudently and are ultimately retired. The OEFC is also responsible for the administration of the OEFC Pension Plan until its assets and liabilities can be transferred to pension plans of the other successor entities. The Ontario Financing Authority (OFA), Ontario Electricity Pension Services Corporation (OEPSC) and Ministry of Finance provide the OEFC with the staff and expertise needed to fulfill its mandate.

The seamless transition of Ontario Hydro into its successor companies, and the related financial restructuring, was one of the most significant accomplishments in the history of Ontario's electricity sector. The establishment of the OEFC was a coordinated effort among the staff of several government ministries and agencies along with their advisors. Without their vision and dedication, the largest corporate restructuring in Canadian history would have never come to fruition.

Although the restructuring of Ontario Hydro marks a significant step towards restoring the financial soundness of Ontario's electricity industry, there is still much work to be done. Once competition is introduced into the marketplace, Ontario Hydro's successor companies, including the OEFC, will face new challenges and opportunities. With operating policies and practices now in place, the OEFC is well prepared to carry out its mandate and build on the accomplishments of the past year.

Bob Christie
Chair
(Appointed Sept. 20, 2000)

Gadi Mayman
Vice-Chair and Chief Executive Officer
(Interim)
(Appointed Aug. 23, 2000)

Management's Discussion and Analysis

Overview of Ontario Hydro Restructuring

The 1997 White Paper "Direction for Change: Charting a Course for Competitive Electricity and Jobs in Ontario" along with its enabling legislation, the *Energy Competition Act, 1998,* set out the Government of Ontario's plan to restructure Ontario's electricity industry. The plan called for the restructuring of Ontario Hydro and the elimination of its longstanding monopoly on electricity production with the introduction of competition to Ontario's electricity sector.

The guiding principle behind the restructuring is the belief that a competitive market environment is the key to restoring the financial soundness and viability of Ontario's electricity sector. The restructuring of Ontario Hydro is intended to ensure that:

- electricity prices are kept as low as possible;
- the commercial successor companies are provided with a solid financial footing and investment-grade capital structures;
- maximum value is retained within the electricity sector until Ontario Hydro's debt is retired or defeased; and
- any residual stranded debt is recovered from the electricity sector, without recourse to Ontario's taxpayers.

New Financial Structure

The new financial structure was announced on April 1, 1999, at which time Ontario Hydro ceased operations and its assets and liabilities were transferred to five successor corporations together with their subsidiaries.

As the legal continuation of Ontario Hydro, the Ontario Electricity Financial Corporation (OEFC) became responsible for ensuring the prudent and efficient management of $38.1 billion (as of April 1, 1999) in debt, derivatives and other liabilities of the former Ontario Hydro.

With the assistance of its subsidiary, the Ontario Electricity Pension Services Corporation (OEPSC), the OEFC is also responsible for administering the former Ontario Hydro Pension and Insurance Plan (now called the Ontario Electricity Financial Corporation Pension Plan) and the Pension Fund under the OEFC Pension Plan through the transition phase. Upon receipt of regulatory approval, the assets of the OEFC Pension Fund will be transferred to pension funds established by the other successor corporations.

Debt Repayment Plan

Pursuant to the *Electricity Act, 1998* and consistent with the principles of electricity sector restructuring, the government has a long-term plan to retire debt from within the electricity industry. The OEFC's obligations of $38.1 billion will be repaid by cash flows from the following sources:

- *Notes receivable* from the Province ($8.9 billion), OPG ($3.4 billion), HOI ($4.8 billion), and IMO ($0.1 billion), for a total of $17.2 billion;

- *Payments-in-lieu (PILs)* of corporate income, property and capital taxes, made by OPG, HOI and municipal electric utilities (MEUs);

- *A Debt Retirement Charge (DRC),* to be paid by electricity consumers;

- *Electricity Sector Dedicated Income.* Consistent with the government's commitment to keep electricity income in the electricity sector, the combined net incomes of OPG and HOI in excess of the Province's cost of its investment in its electricity subsidiaries will be set aside for the retirement of OEFC's debt.

Two commercial companies, Hydro One Inc. (HOI), formerly the Ontario Hydro Services Company Inc., and Ontario Power Generation Inc. (OPG), together with their subsidiaries, received the majority of Ontario Hydro's assets and in return issued $17.1 billion of debt to the OEFC. To ensure fairness, reliability and safety in the new electricity market, the Independent Electricity Market Operator (IMO) and the Electrical Safety Authority (ESA) were also established. The IMO issued $0.1 billion of debt to OEFC in return for Ontario Hydro's central market operator and regulatory assets.

To achieve commercially viable capital structures, HOI and OPG entered into debt-for-equity swaps with the Province of Ontario. In exchange for $3.8 billion of equity in HOI and $5.1 billion of equity in OPG, the Province of Ontario assumed $8.9 billion of the debt issued to the OEFC by the successor corporations. The Province is the sole shareholder of the two commercial companies.

Stranded Debt and Residual Stranded Debt

Stranded debt is defined by the *Electricity Act, 1998* as "the amount of debt and other liabilities of the OEFC, that, in the opinion of the Minister of Finance, cannot reasonably be serviced and retired in a competitive electricity market."

At April 1st 1999, the OEFC assumed approximately $38.1 billion in total liabilities from the former Ontario Hydro. The OEFC received a total of $17.2 billion represented by notes owing to it from the Province, OPG, HOI, and the IMO. The difference of approximately $20.9 billion represents "stranded debt", defined under the *Act* as the amount of debt and other liabilities of the OEFC that cannot reasonably be serviced and retired in a competitive electricity market. The opening Unfunded Liability ("stranded debt") of $19.4 billion of the OEFC is comprised of these liabilities of $38.1 billion less notes receivable above of $17.2 billion, less other loans receivable of $200 million, less other assets of $1.3 billion.

The *Electricity Act, 1998* requires that dedicated electricity revenues must be paid by the successor entities and municipal electric utilities (MEUs) to the OEFC to service stranded debt. As of April 1, 1999, the present value of these revenue streams was estimated at $13.1 billion, resulting in an estimated $7.8 billion of residual stranded debt. The *Electricity Act, 1998* also provides for a Debt Retirement Charge (DRC) to be paid to the OEFC to retire residual stranded debt.

The restructuring plan implemented on April 1, 1999 met the government's objectives of providing Ontario Hydro's successor companies with a solid financial footing while ensuring a structure that will allow electricity prices to remain as low as possible in a competitive market. The establishment of the OEFC ensures that the debt and liabilities of the former Ontario Hydro can be serviced and retired efficiently and prudently.

Year-in-Review

As 1999-00 was the first year of operation for the OEFC, its corporate objectives focused on implementing the operational processes necessary to fulfill its responsibilities as set out in the *Electricity Act, 1998*. The 1999-00 corporate objectives included:

- Finalizing all issues associated with the establishment of the OEFC as the successor corporation to Ontario Hydro;
- Ensuring that the debt and derivatives of the OEFC are managed in a cost-effective manner;
- Managing the power purchase agreements with non-utility generators (NUGs), including:
  - Assessing the options for the financial restructuring of the power purchase agreements; and
  - Retaining an external manager to deal with the day-to-day administration as well as the energy hedging requirements associated with the power purchase agreements.
- Ensuring the effective administration of the OEFC Pension Plan and negotiating an agreement with the successor corporations that would provide for the division and transfer of the assets and liabilities of the plan among the pension plans of the successor organizations.

Establishment of the OEFC

As of April 1, 1999, Ontario Hydro was continued as the OEFC. The OEFC, an agency of the Province, is a statutory, non-share capital company with the responsibility for servicing and retiring Ontario Hydro's debt and managing certain other assets and liabilities of the former Ontario Hydro. In addition, the OEFC is responsible for administering the former Ontario Hydro Pension Plan, which is now known as the OEFC Pension Plan, until the plan's assets and liabilities can be transferred to the pension plans of Ontario Hydro's successor corporations.

The Board of Directors of the OEFC is responsible for supervising the OEFC's operations. As the OEFC does not have staff, it retained the Ontario Financing Authority (OFA) and the Ministry of Finance and established the Ontario Electricity Pension Services Corporation (OEPSC) in order to carry out day-to-day operations.

The OFA is an agency of the Province of Ontario responsible for provincial borrowing and debt management activities. Accordingly, the OFA is well suited to manage the OEFC's debt and derivative portfolios, as well as provide cash management, accounting and other support to the corporation.

The OEPSC is an OEFC subsidiary. It provides all the necessary administration and asset management services for management of the OEFC Pension Plan until its assets and liabilities can be transferred to the pension plans of Ontario Hydro's successor organizations.

The OEFC relies on a stream of dedicated revenues from the electricity sector to service its outstanding debt obligations. The Ministry of Finance is responsible for the administration and collection of the payments-in-lieu of taxes on behalf of the OEFC.

During 1999-00, the OFA, OEPSC and Ministry of Finance were successful in establishing the key processes to manage the OEFC's functions in an efficient, cost-effective manner.

Financing and Debt Management

The OEFC receives debt servicing payments from HOI, OPG, IMO and the Province (through its debt-for-equity swap with HOI and OPG) as well as dedicated revenue streams and a Proxy Debt Retirement Charge (DRC) from the Revenue Pool. This proxy amount will be replaced, after open access, with a charge to electricity consumers. Consistent with the government's commitment to keep electricity income in the electricity sector, the combined net incomes of OPG and HOI in excess of the Province's cost of its investment in its electricity subsidiaries will be set aside for the retirement of OEFC's debt.

Revenue in 1999-00 totalled $3,330 million, including $1,118 million of interest payments from HOI, OPG, IMO and the Province, $889 million from payments-in-lieu of tax, $383 million in electricity sector dedicated income (described above), $741 million from power sales and $172 million from the proxy debt retirement charge. Expense totalled $3,884 million, including $2,785 million in interest on debt and nuclear risk funding, $180 million of amortization of deferred debt costs, $744 million for power purchases, $156 million for a debt guarantee fee and $19 million for operating costs. Consistent with generally accepted accounting principles, the excess of expense over revenue of $554 million has been added to the unfunded liability.

Cash flows required by operations totalled $869 million in 1999-00. This cash requirement, combined with maturing debt of $1,670 million, was financed by total borrowing of $2,522 million in 1999-00. The cash shortfall was anticipated and is consistent with the Province's electricity sector restructuring plan. The plan provides for sufficient revenues from the electricity sector to defease OEFC's debt within a reasonable timeframe.

As the OEFC does not have its own credit rating, the Province, through the OFA, borrows on OEFC's behalf. In turn, the OEFC issues debt to the Province. To meet its 1999-00 financing requirements, the OEFC raised $1,827 million in long-term debt and increased short-term debt by $695 million. In 1999-00, the Province raised all of the OEFC's long-term financing in the Canadian dollar market, including $0.4 billion from two Euro-Canadian issues and $0.3 billion from short-term Ontario treasury bills that were swapped to long-term fixed-rate financing. The OEFC also bought back $0.1 billion of debt and replaced it with more cost-effective issues.

After adjustments for unrealized foreign exchange and derivative gains of $127 million in 1999-00, total debt outstanding increased by $852 million, rising to $31.3 billion as of March 31, 2000. This increase was largely due to the deferral of a maturing $650 million note due from HOI. The $650 million was repaid in 2000-01, once HOI began to borrow in the public capital markets.

With maturing debt and planned redemptions of $3.2 billion along with a projected cash surplus of $0.7 billion in 2000-01 as a result of maturities in notes receivable, total financing requirements as of March 31, 2000 are projected at $2.5 billion. Total debt outstanding is projected to decrease to $30.6 billion at March 31, 2001.

The Province will continue to borrow on behalf of the OEFC in 2000-01.

Management of Power Purchase Contracts

In the late 1980s and early 1990s, the former Ontario Hydro entered into a number of long-term power purchase and loan agreements with non-utility generators (NUGs) located in Ontario. There are approximately 90 power purchase contracts representing a combined capacity of about 1,600 megawatts. As the continuation of Ontario Hydro, the OEFC is responsible for these contracts.

Currently, the power purchased from NUGs under these contracts is sold at cost into the power pool managed by OPG. However, once competition is introduced into the marketplace, this power will be sold at market prices that may be greater or less than cost.

In May 1999, the Ministry of Finance established an advisory committee composed of industry and financial experts to advise on the management and disposition of the NUG contracts. In October 1999, the committee presented its recommendations. Based in part on these recommendations, the OEFC announced that it would not proceed with the Request for Expressions of Interest issued previously by Ontario Hydro. In addition, the OEFC has decided to issue a Request for Proposals to engage a commercially oriented manager(s) to manage the contracts.

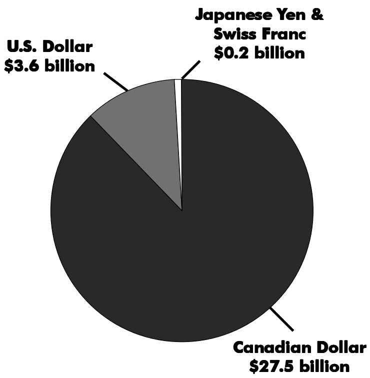
The contract manager(s) will undertake a wide range of activities on behalf of the OEFC pertaining to the management and integration of the NUG contracts into the competitive market.

OEFC Pension Plan

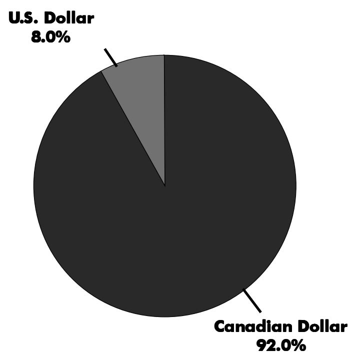
The OEFC is the administrator of the OEFC Pension Plan (formerly the Ontario Hydro Pension and Insurance Plan), including the pension fund.

The Ontario Electricity Pension Services Corporation (OEPSC) was established as a subsidiary of the OEFC to act as the OEFC's agent in the administration and day-to-day operations of the OEFC Pension Plan until the assets and liabilities can be transferred to the pension plans of the other Ontario Hydro successor corporations.

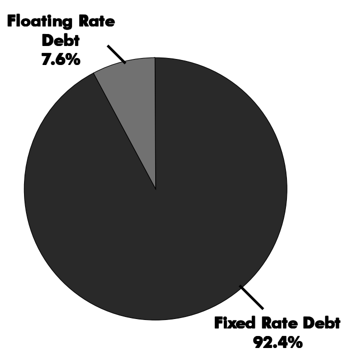
OEFC Debt Outstanding By Currency (as of March 31, 2000)



Foreign Currency Exposure (as of March 31, 2000)



Floating Rate Exposure (as of March 31, 2000)



The *Electricity Act, 1998* provides for the transfer of assets and liabilities from the OEFC Pension Plan to the successor companies' pension plans in accordance with a transfer agreement to be entered into by OEFC with the administrators of each successor company pension plan. OEPSC is responsible for preparing the transfer agreement in accordance with the guidelines set out in the *Electricity Act, 1998* and under the supervision of OEFC's pension committee and in consultation with the successor corporations. This division of assets provided for in the transfer agreement must be approved by the Ontario Superintendent of Financial Services.

Risk Management

The OEFC has a number of policies and practices in place to address the financial risks to which it is exposed through its borrowing and debt management activities.

Market Risk

The Market Risk Policy provides a framework for the management of foreign exchange and interest rate risks to which the OEFC is exposed through the borrowing and debt management programs.

Foreign Exchange Exposures: The OEFC target for unhedged foreign currency exposure by the end of fiscal 2000-01 is 5 per cent of outstanding debt. When the OFA took over the management of the OEFC's debt portfolio, total debt exposed to fluctuations in foreign currencies was 14.5 per cent. The OFA has reduced the OEFC's exposure to 8.0 per cent as of March 31, 2000. The OFA will continue to reduce the level of exposure towards the 5 per cent target in a prudent manner.

Floating Rate Exposure: The limit on the OEFC's floating interest rate exposure, net of liquid reserves is 20 per cent of debt outstanding. Actual floating interest rate exposure was 7.6 per cent as of March 31, 2000.

Loss Limits: In addition to exposure limits, the OEFC has a loss limit for annual financing charges in place. The loss limit was $50 million in 1999-00.

Debt Maturity Profile: When issuing new debt, the OFA, on behalf of the OEFC, will aim for a smooth debt maturity profile to diversify the interest rate risk for the refinancing of maturing and floating rate debt. Details of the maturity profile can be found in Note 7 to the Financial Statements.

Credit Risk

Credit risk arises when the OEFC undertakes financial and derivatives transactions with a counterparty. This risk is of the counterparty not meeting or defaulting on its obligations. The minimum credit rating of a counterparty for a new swap transaction is A- and the resulting exposure is capped at pre-set mark-to-market limits depending on the counterparty's credit rating.

Credit risk also arises from money market investments. Money market investments are restricted to instruments issued by the federal or provincial governments or by non-government counterparties with a credit rating of R-1 Mid or better.

Use of Financial Instruments and Derivatives

The use of derivatives and financial instruments is authorized under the OEFC's by-laws, which are approved by the Minister of Finance. All derivatives are used only to advance the OEFC's objective of managing financing and liquidity requirements in a prudent and cost-effective manner. Furthermore, risks that arise with the use of derivatives are identified, evaluated, reported, monitored and managed prudently. New instruments can be used only after approval by the OEFC Board of Directors.

Risk Management Reporting

The OEFC Board of Directors is informed about positions and risk exposures through three types of reports:

- CEO's report;
- Regular exposure and performance report; and
- Exception report by the Director of Risk Control, OFA.

The first two reports are presented to the Board of Directors directly or through the Chair of the Audit Committee at all of its regularly scheduled meetings while exception reports are provided to the Board of Directors immediately if policy limits are breached.

The CEO provides the Board of Directors with a progress report on the implementation of the financing and risk management plan, staffing and other administrative and operational matters. The CEO also reports on the OEFC's compliance with applicable government directives.

The OEFC legal counsel and the Director of Risk Control, OFA, report additional details on the OEFC's exposure, performance, obligations and other developments to the Board of Directors.

Exposures to market and credit risk are reported daily. The OEFC's Annual Financing and Debt Management Plan, which shows how the OFA will ensure that risk exposures and losses remain within the approved exposure and loss limits, is approved by the Board of Directors.

Corporate Governance and Board of Directors

Appointed by the Lieutenant Governor in Council, the Board of Directors is responsible for supervising the OEFC's operations, which are carried out by the Ontario Financing Authority, Ministry of Finance and Ontario Electricity Pension Services Corporation on a day-to-day basis. The Board of Directors meets at least quarterly.

The OEFC Audit Committee supports the Board of Directors with the review and approval of the OEFC's financial statements. The Audit Committee also recommends the annual internal audit plan and reviews the findings of the internal auditors regarding the adequacy of internal controls.

The OEFC Pension Committee is a committee of the Board of Directors that makes decisions concerning the OEFC Pension Plan and oversees the activities of the OEPSC.

MINISTRY OF FINANCE

The Honourable Ernie Eves, Q.C.
Minister of Finance

BOARD OF DIRECTORS

Bob Christie
Chair and Deputy Minister of Finance
(appointed Sept. 20, 2000)

Gadi Mayman
(Interim) CEO and Vice-Chair and CEO and Vice-Chair of the Ontario Financing Authority
(appointed Aug. 23, 2000)

Bryne Purchase
Deputy Minister, Energy, Science and Technology

Brian Fitzgerald
Fellow of the Canadian Institute of Actuaries

Tom Sweeting
Assistant Deputy Minister
Office of the Budget and Taxation
Ministry of Finance

Bruce Macnaughton
Director
Pension and Income Security Policy Branch
Ministry of Finance

ONTARIO ELECTRICITY FINANCIAL CORPORATION PENSION COMMITTEE

ONTARIO ELECTRICITY FINANCIAL CORPORATION AUDIT COMMITTEE

ONTARIO ELECTRICITY PENSION SERVICES CORPORATION

OEFC Financial Statements

Responsibility for Financial Reporting

The accompanying financial statements of the Ontario Electricity Financial Corporation have been prepared in accordance with accounting principles generally accepted in Canada and are the responsibility of management. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to May 26, 2000.

Management maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit Committee of the Board of Directors.

The Board of Directors, through the Audit Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Audit Committee meets periodically with management, the internal auditors and the external auditor to deal with issues raised by them and to review the financial statements before recommending approval by the Board of Directors.

The financial statements have been audited by the Provincial Auditor. The Provincial Auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. The Auditor's Report, which appears on the following page, outlines the scope of the Auditor's examination and his opinion.

On behalf of Management:

Gadi Mayman
Vice-Chair and
Chief Executive Officer
(Interim)

Auditor's Report

Office of the
Provincial Auditor
of Ontario

Bureau du
vérificateur provincial
de l'Ontario

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(416) 327-2381 Fax: (416) 327-9862

Auditor's Report

To the Ontario Electricity Financial Corporation
and to the Minister of Finance

I have audited the consolidated balance sheet of the Ontario Electricity Financial Corporation as at March 31, 2000 and the consolidated statements of revenue, expense and unfunded liability and of cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at March 31, 2000 and the results of its operations and its cash flows for the year then ended, in accordance with generally accepted accounting principles.

Erik Peters

Toronto, Ontario
May 26, 2000

Erik Peters, FCA
Provincial Auditor

Ontario Electricity Financial Corporation

Consolidated Balance Sheet as at March 31, 2000

(with comparative figures at April 1, 1999)

($ Millions)

	March 31 2000	April 1 1999
ASSETS		
Current Assets (Note 3)		
Cash and temporary investments (Note 4)	$ 2	$ 19
Accounts receivable	134	76
Interest receivable	119	
Current portion of notes receivable (Note 6)	1,533	650
	1,788	745
Electricity sector dedicated income due from Province (Note 5)	383	
Notes and loans receivable (Note 6)	15,894	16,756
Deferred debt costs	914	1,157
	$ 18,979	$ 18,658
LIABILITIES		
Current Liabilities		
Accounts payable	$ 101	$ 197
Interest payable	726	744
Short-term notes payable (Note 7)	3,446	2,751
Current portion of long-term debt (Note 7)	2,226	1,569
	6,499	5,261
Long-term debt (Note 7)	25,666	26,166
Power purchase contracts (Note 8)	4,286	4,286
Nuclear risk funding (Note 8)	2,515	2,378
UNFUNDED LIABILITY (Note 9)	(19,987)	(19,433)
	$ 18,979	$ 18,658

Approved on behalf of the Board of Directors:

Bob Christie
Chair

Gadi Mayman
Vice-Chair

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation
Consolidated Statement of Revenue, Expense and Unfunded Liability
for the Year Ended March 31, 2000
($ Millions)

	Year Ended March 31 2000
REVENUE	
Proxy debt retirement charge	$ 172
Payments-in-lieu of tax	889
Interest	1,118
Power sales (Note 8)	741
Electricity sector dedicated income (Note 5)	383
Other	27
Total Revenue	3,330
EXPENSE	
Interest - short-term debt	158
- long-term debt	2,490
Interest on nuclear risk funding	137
Amortization of deferred debt costs	180
Power purchases (Note 8)	744
Debt guarantee fee	156
Operating	19
Total Expense	3,884
Excess of expense over revenue	554
Unfunded Liability, April 1, 1999	19,433
Unfunded Liability, March 31, 2000	$ 19,987

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation
Consolidated Statement of Cash Flows
for the Year Ended March 31, 2000
($ Millions)

	Year Ended March 31 2000
CASH FLOWS USED IN OPERATING ACTIVITIES	
Excess of expense over revenue	$ 554
Adjustments for:	
Amortization of deferred debt costs	(180)
Interest on nuclear risk funding	(137)
Electricity sector dedicated income	383
Net change in balance sheet accounts	249
Net cash requirement in operations	869
CASH FLOWS FROM FINANCING ACTIVITIES	
Long-term debt issues	1,827
Net short-term debt issued	695
	2,522
Less long-term debt retired	1,670
Net cash provided from financing activities	852
Decrease in cash and temporory investments	17
Cash and temporary investments, beginning of year	19
Cash and temporary investments, end of year	$ 2

See accompanying notes to financial statements.

Notes to Financial Statements

1. Restructuring of the Ontario Electricity Industry

Effective April 1, 1999, pursuant to the *Electricity Act, 1998,* Ontario Hydro was continued as a corporation without share capital under the name Ontario Electricity Financial Corporation (OEFC). OEFC is a corporation established under the laws of Ontario. It is exempt from federal and provincial income taxes under paragraph 149(1)(d) of the Income Tax Act of Canada. OEFC is a Crown agency created to manage the debt and administer the assets, liabilities, rights and obligations of Ontario Hydro not transferred to other successor entities. These other successor entities include:

- Ontario Power Generation Inc. (OPG), an electricity generation company;
- Hydro One Inc. (HOI) (formerly Ontario Hydro Services Company Inc.), a regulated electricity transmission and distribution business that operates certain energy service businesses in an unregulated, competitive environment;
- The Independent Electricity Market Operator (IMO), the regulated centralized independent system coordinator responsible for directing system operations and operating the electricity market; and
- The Electrical Safety Authority (ESA), which performs a regulatory function related to electrical inspections.

On April 1, 1999, the respective business units, including assets, liabilities, employees, rights and obligations of the former Ontario Hydro were transferred to OPG and HOI (and their subsidiaries) and the IMO for $8.5 billion, $8.6 billion and $78 million respectively in exchange for debt payable to OEFC. On the same day, the Province exchanged equity of $5,126 million and $3,759 million in OPG and HOI respectively for debt payable to OEFC.

OEFC's debt, liabilities and associated financing costs will be repaid from interest on notes receivable from the Province and successor entities, and, as provided under the *Energy Competition Act, 1998*, from dedicated electricity revenues in the form of payments-in-lieu (PILs) of corporate income, capital and property taxes made by the successor entities. Any residual debt will be serviced through a Debt Retirement Charge (DRC). OEFC is a party to a revenue-allocation agreement among successor entities and is entitled to the residual amount in the revenue pool after costs of OPG, HOI and the IMO are paid. This amount is reflected as a proxy DRC.

OEFC is the administrator of the Ontario Electricity Financial Corporation Pension Plan and Fund. It is responsible for negotiating an agreement with each of the successor corporations for the division and transfer of the assets and liabilities of the OEFC pension plan to the pension plans of the successor corporations. The Ontario Electricity Pension Services Corporation (OEPSC), a wholly owned subsidiary of OEFC, acts as agent for OEFC to carry out the required administrative, investment and other responsibilities of the OEFC Pension Plan and Fund. Costs associated with the administration of the OEFC Pension Plan and Fund amounting to approximately $17 million in calendar 1999 are charged to and payable by the pension fund.

2. Summary of Significant Accounting Policies

Basis of Accounting

These financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as recommended in the *Handbook* of the Canadian Institute of Chartered Accountants.

Measurement Uncertainty

Uncertainty in the determination of the amount at which an item is recognized in the financial statements is known as measurement uncertainty. Such uncertainty exists when it is reasonably possible that there could be a material variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used. Measurement uncertainty in these financial statements exists in the estimated liability for power purchase agreements (see Note 8 for additional details). In addition, the amount of the nuclear risk funding liability is dependent on an agreement currently under negotiation between the Province and OPG. Estimates are based on the best information available at the time of preparation of the financial statements and will be adjusted annually to reflect new information as it becomes available.

Consolidation

These financial statements include the accounts of OEFC's wholly owned subsidiary, Ontario Electricity Pension Services Corporation.

Deferred Debt Costs

Deferred debt costs includes the unamortized amounts related to unrealized foreign exchange gains or losses resulting from the translation of long-term debt issued in foreign currencies, discounts or premiums arising from the issuance of debt or the acquisition of debt prior to maturity and payments or receipts related to foreign currency hedges and swaption contracts.

Revenue Recognition

Revenues are recognized in the period in which they are earned. Amounts received prior to being earned are reflected as deferred revenues.

Foreign Currency Translation

Debt is comprised of short-, medium- and long-term bonds, notes and debentures. Debt denominated in foreign currencies which has been hedged is recorded at the Canadian dollar equivalent using the rates of exchange established by the terms of the hedge agreements. Other foreign currency debt, liabilities and assets are translated to Canadian dollars at period-end rates of exchange and any exchange gains or losses are deferred and amortized over the remaining term to maturity.

3. Economic Dependence

OEFC does not have its own credit rating and is, therefore, dependent on the Province to borrow and on-lend the funds required to refinance maturing debt and to cover any cash shortfalls in the Corporation. It is also dependent on the long-term plan to defease the unfunded liability described in Note 9. Based on the Province's support in refinancing maturing debt and the long-term plan, OEFC is considered a going concern.

4. Cash and Temporary Investments

Cash and temporary investments includes cash on deposit and short-term investments with maturities of less than three months. They are recorded at cost, which approximates current market value.

5. Electricity Sector Dedicated Income

The Province has committed to dedicate the combined net income of OPG and HOI in excess of the Province's cost of its investment in its electricity subsidiaries to OEFC. To March 31, 2000, OPG and HOI earned an aggregate amount of $903 million, $383 million in excess of the Province's $520 million interest cost of the equity investments in those companies. The $383 million amount has been reflected as income in OEFC and as a receivable from the Province.

6. Notes and Loans Receivable

($ millions)

	Interest rate	Interest payable	Amount	Maturity date
Province of Ontario	5.85	Monthly	$ 8,885	2039 - 2041
OPG	5.3 to 6.65	Semi-annually	3,400	2001 - 2011
HOI	5.4 to 14.3	Semi-annually	4,845	2000 - 2007
IMO	7.90	Semi-annually	78	2009
			17,208	
Less: current portion of notes receivable			1,533	
			15,675	
Loans receivable from non-utility generators (NUGs) (See Note 8)			219	
			$ 15,894	

OEFC has agreed with OPG, HOI and IMO not to sell notes owing from these successor entities without their prior approval.

7. Debt

Debt at March 31, 2000 is set out below by maturity and by original currency of issue.

($ millions) Currency	Canadian Dollar	U.S. Dollar	Swiss Franc	Japanese Yen	Total
Maturing Before					
March 31, 2001	4,785	737	150	—	5,672
March 31, 2002	2,000	708	—	—	2,708
March 31, 2003	2,848	—	—	—	2,848
March 31, 2004	1,748	—	—	65	1,813
March 31, 2005	2,000	—	—	—	2,000
1-5 years	13,381	1,445	150	65	15,041
6-10 years	5,699	1,088	—	—	6,787
11-15 years	1,786	1,090	—	—	2,876
16-20 years	500	—	—	—	500
21-25 years	3,133	—	—	—	3,133
26-50 years	3,001	—	—	—	3,001
Total	27,500	3,623	150	65	31,338

The effective rate of interest on the debt portfolio is 8.29% before considering the effect of derivative instruments used to manage interest rate risk. Bonds and notes payable are either held, or guaranteed as to principal and interest, by the Province as set out below:

	March 31, 2000			April 1, 1999		
($ millions)	Held by the Province	Guaranteed by the Province	Total	Held by the Province	Guaranteed by the Province	Total
Short-term debt	3,446	—	3,446	—	2,751	2,751
Current portion of long-term debt	500	1,726	2,226		1,569	1,569
Long-term debt	5,701	19,965	25,666	4,248	21,918	26,166
	$9,647	$21,691	$31,338	$4,248	$26,238	$30,486

Fair value of debt issued approximates amounts at which debt instruments could be exchanged in a current transaction between willing parties. In valuing OEFC's debt, fair value is estimated using discounted cash flows and other valuation techniques and is compared to public market quotations where available. These estimates are affected by the assumptions made concerning discount rates and the amount and timing of future cash flows.

The estimated fair value of OEFC debt at March 31, 2000 is $35.4 billion (April 1, 1999 - $34.4 billion). This is higher than the book value of $31.3 billion (April 1, 1999 - $30.5 billion) because current interest rates are generally lower than the interest rates at which the debt was issued and because of exchange rate movements. The fair value of debt does not reflect the effect of related derivative contracts.

8. Long-Term Liabilities

Power purchase contracts and related loan agreements were entered into by Ontario Hydro with non-utility generators (NUGs) located in Ontario. These contracts, expiring on various dates to 2048, provide for the purchase of power at prices that are expected to be in excess of the market price. This liability has been valued at $4,286 million on a discounted cash-flow basis. As the continued Ontario Hydro, OEFC is the counterparty to these contracts. Currently, the power purchased from NUGs is resold at cost to the power grid managed by OPG. However, after open access, this power will be sold at market prices which may be greater or less than cost.

During the year, OEFC purchased power in the amount of $741 million and sold this power to the power grid for the same amount. Hydro One manages the NUG power purchase contracts and the related loans on behalf of OEFC for an annual fee of $3 million, which cost is included in the power purchases expense item of $744 million. Loans to NUGs increased during the year by $21 million to $219 million at March 31, 2000.

Nuclear risk funding - OEFC as the continued Ontario Hydro received a liability in the amount of $2,378 million representing nuclear waste management and asset removal liabilities that were incurred prior to April 1, 1999. The interest liability has been accrued at an estimated 5.75 per cent to a total value of $2,515 million as at March 31, 2000. The interest rate is still under negotiation with the Province and is subject to change. The impact of the finalization of the interest rate for the fiscal year is not expected to result in a material difference to the liability balance.

9. Unfunded Liability

The opening unfunded liability of $19.4 billion is composed of $ 38.1 billion in liabilities assumed from old Ontario Hydro less the value of assets transferred to OEFC at April 1, 1999 including $17.4 billion in notes and loans receivable and $1.3 billion in other assets. Pursuant to the *Electricity Act, 1998* and consistent with the principles of electricity restructuring, the government has a long-term plan in place to retire OEFC's liabilities, from within the electricity industry. The Plan includes cash flows from the following sources:

Notes receivable from the Province of $8.9 billion, OPG of $3.4 billion, HOI of $4.8 billion and IMO of $0.1 billion for a total of $17.2 billion as a result of the transfer of assets to successor companies,

Payments-in-lieu of corporate income, property and capital taxes made by OPG, HOI and municipal electric utilities,

A Debt Retirement Charge to be paid by ratepayers based on the consumption of electricity, and

Electricity Sector Dedicated Income - Consistent with the Government's commitment to keep electricity income in the electricity sector, the combined net income of OPG and HOI in excess of the Province's cost of its investment in its electricity subsidiaries will be set aside for the retirement of OEFC's debt.

The long-term plan supports estimates that OEFC's obligations will be defeased in a reasonable time.

10. Risk Management and Derivative Financial Instruments

OEFC employs prudent risk management strategies and operates within strict risk exposure limits to ensure exposure to risk is well managed. A variety of strategies are used, including the use of derivative financial instruments ("derivatives").

Derivatives are financial contracts, the value of which is derived from underlying assets. OEFC uses derivatives for the purpose of hedging and to minimize interest costs. Hedges are created primarily through swaps, which are legal arrangements under which OEFC agrees with another party to exchange cash flows based upon one or more notional amounts during a specified period. This allows OEFC to offset its existing obligations and thereby effectively convert them into obligations with more desirable characteristics. Other derivative instruments used by OEFC include forward foreign exchange contracts, forward rate agreements, futures and options.

Foreign exchange or currency risk is the risk of debt servicing costs and principal payments varying due to fluctuations in foreign exchange rates. To minimize currency risk, OEFC uses derivative contracts to convert foreign currency cash flows into Canadian dollar denominated cash flows. The current policy allows unhedged foreign currency cash flows to reach a maximum of 20 per cent of total debt. At year end, 8.0 per cent of this debt was unhedged, with most of the currency exposure to US dollars.

Interest rate risk is the risk of debt servicing costs varying due to changes in interest rates. OEFC reduces its exposure to rate changes by entering into derivative contracts that convert floating interest payments to fixed interest payments. The current policy allows unhedged floating rate debt, net of liquid reserves, to reach a maximum of 20 per cent of total debt. At year end, OEFC's floating rate debt as a percentage of total debt was 7.6 per cent.

The table below presents a maturity schedule of OEFC's derivatives, by type, outstanding at March 31, 2000, based on the notional amounts of the contracts. Notional amounts represent the volume of outstanding derivative contracts and are not indicative of credit or market risk. Notional amounts are not representative of actual cash flows.

Derivative Portfolio Notional Value
($ millions)
As at March 31, 2000

Maturity in Fiscal Year		2001	2002	2003	2004	2005	6-10 Years	Over 10 Years	Total
Cross-currency swaps		150	284	-	593	-	280	-	1,307
Interest rate swaps		553	797	448	1,814	157	1,047	1,363	6,179
Forward foreign exchange contracts		692	459	-	-	-	-	-	1,151
Options		872	203	-	-	-	-	-	1,075
Forward rate agreements		370	-	-	-	-	-	-	370
Total	$	2,637	1,743	448	2,407	157	1,327	1,363	10,082

Entering into derivatives contracts results in credit risk, which is the risk of a counterparty defaulting on contractual derivative obligations in which OEFC has an unrealized gain. The table below presents the credit risk associated with the derivative financial instrument portfolio, measured through the replacement value of derivative contracts, at March 31, 2000.

Credit Risk Exposure
($ millions)
As at March 31, 2000

Interest rate contracts:	Swaps	$	2,409
Foreign exchange contracts:	Swaps		1,289
	Other[1]		1,152
Gross credit risk exposure			4,850
Less: Netting agreements[2]			(5,019)
Net credit risk exposure		$	(169)

Note:
1 Other includes credit exposure on options, futures, forward rate agreements and forward foreign exchange agreements

2 Contracts do not have coterminous settlement dates. Netting agreements use generally accepted forms and terms developed by the International Swaps and Derivatives Association (ISDA). Based on ISDA definitions, total exposure to counterparties with positive exposure was $67 million (meaning that counterparties owed OEFC) and total exposure to counterparties with negative exposure was $236 million (meaning that OEFC owed counterparties) for a total net credit exposure to ($169) million on March 31, 2000.

OEFC manages its credit risk exposure through daily monitoring compliance with credit limits and by dealing with counterparties with good credit ratings of A- or higher. Counterparties for money market and other short-term transactions must have at least an R1-mid rating by Dominion Bond Rating Service or an A-1 or P-1 rating by Standard and Poor's or Moody's respectively.

OEFC also limits its credit risk exposure on derivatives by entering into contractual netting agreements with virtually all of its counterparties, which enables it to settle derivative contracts on a net basis in the event of a counterparty default. The gross credit risk exposure represents the amount of loss that OEFC would suffer if every counterparty to which OEFC was exposed were to default at the same time and no netting of negative exposures was allowed. The net credit risk exposure includes the mitigating impact of these netting agreements.

11. Guarantees

Subject to a $10 million and $20 million deductible respectively, OEFC has agreed to indemnify HOI and OPG in respect of any adverse claim to title to any asset, right or thing transferred or intended to be transferred to the companies at April 1, 1999, any failure of the transfer order to transfer such assets, rights or things and with respect to payment to or from or other dealing with any equity account of Ontario Hydro, including certain related litigation. The Province of Ontario has guaranteed any liability arising from these indemnifications.

In connection with the transfer of assets at April 1, 1999, OEFC has agreed to provide certain levels of working capital and total assets to OPG and HOI respectively. In aggregate, the amount of these adjustments will not be more than $374 million. However, the exact amount of the adjustments is the subject of ongoing discussions between the parties, the outcome of which is not currently known.

OEFC is contingently liable under guarantees given to third parties that have provided long-term financing to certain independent power producers in connection with the power purchase agreements described in Note 8. These guarantees total approximately $146 million at March 31, 2000 ($157 million at April 1, 1999).

Sources of Additional Information

INTERNET:

Ontario Electricity Financial Corporation: www.oefc.on.ca

- Provides information on the OEFC's debt, pension plan, board of directors and contains major publications pertaining to the OEFC.

Ontario Financing Authority (OFA): www.ofina.on.ca

- Provides a description of the OFA's activities, Ontario debt issues and retail products and contains major publications from the OFA and the Ontario Ministry of Finance.

Other Links:

Ministry of Finance:	www.fin.gov.on.ca
Ministry of Energy Science and Technology:	www.est.gov.on.ca
Ontario Power Generation Inc.:	www.ontariopowergeneration.com
Hydro One Inc.:	www.hydroone.com
Ontario Electrical Safety Authority:	www.esainspection.net
Independent Electricity Market Operator:	www.iemo.com

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ISSN 1492-7551