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London Economics International LLC

for information contact A.J. Goulding or Richard Chin, 617-494-8200

OPG behavior to be driving factor determining Ontario electricity market prices, despite market power agreement, according to London Economics study

With market opening in Ontario only days away, a new study by London Economics suggests that prices will largely be determined by the behavior of Ontario Power Generation (OPG), the province's dominant electricity generation company. While OPG is subject to the terms of a Market Power Mitigation Agreement, the agreement essentially serves to quantify rebates to customers based on open market price levels, rather than constraining OPG's bidding behavior. "OPG's large market share and diverse plant mix mean that there is the potential for prices to diverge from competitive levels," notes A.J. Goulding, president of London Economics. "This suggests that OPG behavior must be considered when forecasting revenues for generation assets in Ontario."

The Ontario marketplace is set to open May 1, 2002 after several years of planning. OPG has announced an ongoing divestiture process intended to dilute its market share; it has already leased the Bruce nuclear station to a group led by British Energy and has announced its intent to sell its Mississagi hydro stations to Great Lakes Power, a subsidiary of Brascan Corporation. Other plants are also for sale.

According to the London Economics study, market prices in Ontario will be primarily determined by OPG's strategic behavior and the timing of nuclear recovery. OPG is expected to remain a dominant player in the Ontario marketplace indefinitely, though new build and intertie capacity and pricing may gradually moderate OPG's influence. The report notes several other important factors to consider:

- Variations in rainfall are not expected to have a large impact on hydro plant revenues due to the system composition and the relationship between prices and volume;
- Transmission rights may have substantial value in Ontario. Due to the high volatility and peak price trends in the US Midwest as compared to Ontario, especially in the summer season, the projected value of transmission rights values along the Ontario-Midwest interconnect have implied substantially higher valuations than what has been traded in monthly auctions in New York and PJM;
- Natural gas-fired capacity represents less than 10% of Ontario generating capacity, but strong export demand and higher gas prices could exceed the 3.8 cents Cdn./kWh threshold above which customers may be entitled to rebates under the Market Power Mitigation Agreement.

The London Economics report is entitled ***Entering the New World: Evaluating the Ontario Power Market***, and provides an in-depth analysis of potential market dynamics in Ontario. An optional 5 year price forecast is available to accompany the report. Other sections describe the road to deregulation, the emergence of IPP players, transmission issues, the new retail and distribution environment, environmental regulations, performance-based rate-making, transmission rights, and other issues of importance to potential investors in Ontario.

for more information contact:

London Economics International LLC

350 Massachusetts Avenue, Suite 330

Cambridge, Massachusetts 02139

tel: 617-494-8200 fax: 617-494-4746

www.londoneconomics.com

info@londoneconomics.com

