Empowering Ontario

by operating a healthy, strong and growing electricity market

2001 ANNUAL REPORT

IMO Independent Electricity Market Operator

Letter to the Minister of Energy, Science and Technology of Ontario

I am pleased to submit the 2001 annual report of the Independent Electricity Market Operator (IMO) for the year ended December 31, 2001.

As this is our last annual report before the scheduled opening of Ontario's wholesale electricity market on May 1st, we have taken the opportunity to address the role of the IMO and key issues surrounding the move to a competitive market, along with our view of what we see unfolding in the long term.

Thanks to the cooperation and support of your Ministry throughout this period of great change, the IMO is ready and we are looking forward to market opening.

James C. Baillie
Chairman

March 31, 2002

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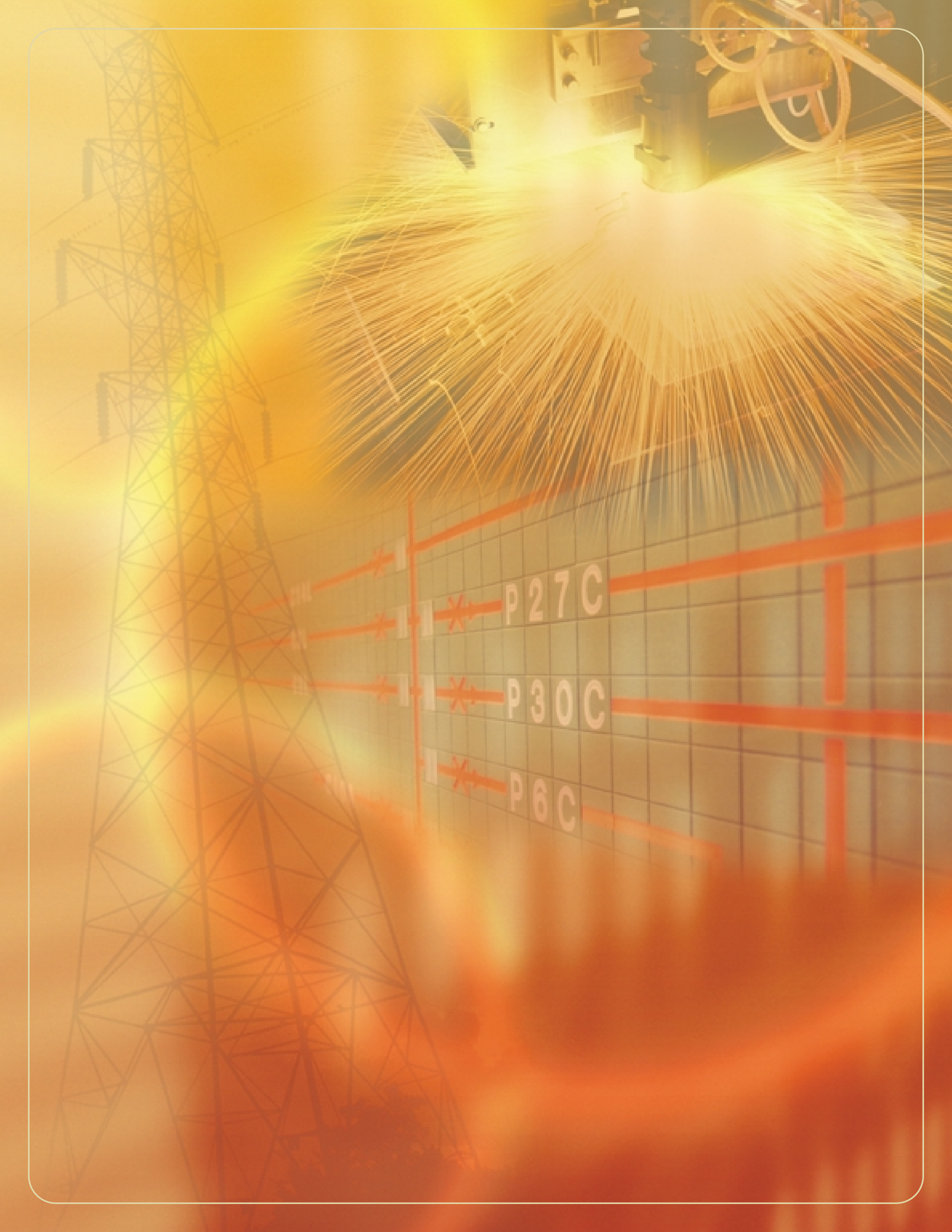
Our job at the IMO is to keep the lights on in Ontario – a job we have been doing for decades – while operating and regulating the new wholesale electricity market to ensure it is fair and effective, and delivers the benefits of a competitive marketplace.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WHO WE ARE AND WHERE WE FIT IN

The IMO (The Independent Electricity Market Operator) is a ***non profit***, corporate entity without share capital – ***independent*** of all other electricity marketplace participants. We have two fundamental roles:

- ***operating Ontario's electricity grid*** – directing the flow of electricity across the transmission system from those who make it to distributors in local communities and major wholesale customers:
- ***operating and regulating the new wholesale electricity market*** – the financial exchange between the producers and wholesale customers – scheduled to open to competition on May 1st, 2002.

We were established in 1998 by the Electricity Act in Ontario as part of the break up of Ontario Hydro – distinct from Ontario Power Generation, which currently owns and operates most of the generators in Ontario, and Hydro One, which owns and maintains most of the transmission lines. ***The IMO was placed on an independent and non-profit footing to ensure impartial operation of Ontario's electricity system and wholesale electricity market***. With a regular staff of 390, the IMO is governed by an independent Board, whose Directors and non-executive Chair are appointed by the Government of Ontario. As a non-profit entity, we operate within a budget based on fees reviewed by the Ontario Energy Board.

With the opening of the electricity market, the IMO is the hub of the new wholesale electricity marketplace, connecting all market participants – including the generators and suppliers who sell electricity into Ontario's market on the supply side, and the major wholesale customers and the distributors who purchase electricity and sell it to consumers on the demand side.

WHAT WE DO

Keeping the lights on in Ontario means managing the balance of supply and demand in one of North America's largest and most diversified electricity systems. And that means successfully directing the flow of electricity – instantly, as it is needed – from generators across the province to local distributors and wholesale users, meeting the minute by minute needs of 12 million people and businesses in Ontario.

Operating the grid

At the ***IMO System Control Centre – the nerve centre of Ontario's electricity system***, experienced system operators and technicians utilize highly sophisticated technology to monitor and direct the flow of electricity through the grid – the transmission system – from those who make it to those who use it, 24 hours a day, seven days a week. To achieve this, the System Control Centre is designed to receive and assess thousands of pieces of information every second – information from remote terminals that report on voltage levels, line flows and the status of equipment. ***By processing and managing this information, we are able to operate the system safely, reliably and efficiently***. This is a highly challenging and complex undertaking, and we do it well: ***Ontario's bulk electrical system is internationally recognized as one of the best and most reliable in the world.***

Forecasting demand and supply

Accurate forecasting is vital, because electricity – unlike other energy products – cannot be stored. It must be generated and delivered on the spot, as it is needed.

To ensure that we can reliably balance supply and demand, we must accurately forecast the many factors that affect the operation of Ontarios' power system. This means analyzing and predicting not just anticipated demand, but other key items such as how much generation will be available or shut down for maintenance, the different limits that affect transmission flows across the Province, and anticipated weather conditions and their seasonal, weekly and hourly effects on electricity use. IMO expert analysts pull all this information together and produce both long and shorter-term assessments. These are made public and communicated regularly to all market participants, helping them plan and prepare, signaling potential investment opportunities, and ultimately, ***ensuring that Ontario's electricity system will meet the needs of the province.***

With market opening set for May 1st, the IMO will integrate its operation of the grid with its operation of the new wholesale electricity market.

Operating the wholesale electricity market

With market opening, the wholesale price of electricity – previously based on an annual set price – will be determined every five minutes through a market-clearing, price-setting mechanism responding to supply and demand. ***The IMO will act as the wholesale exchange***, operating the process that links buyers with sellers while dispatching the electricity, recording and reporting the data that links usage with the market price at a given time, and overseeing settlement, billing and payment.

As part of this process, we have an ongoing role in qualifying ***market participants – the buyers and sellers*** who have also been licensed by the Ontario Energy Board. In this regard, ***the IMO develops the market rules, trains and tests participants, and builds and develops the systems essential to ensuring the flow of data required.***

Ensuring fair competition with market surveillance

While we have structured the market, developed the processes and systems and established the rules to create a competitive wholesale marketplace, ***we must ensure that the marketplace operates as it should and that fair competition prevails.*** To this end, the IMO has an important oversight function – a market surveillance function, whereby we are responsible for ***monitoring the market and participants, and identifying systems flaws, abuses of the market, and non-competitive conduct by participants.*** Key to this critical function is the ***Market Surveillance Panel*** – an arms-length group of experts who are appointed by the independent directors of the IMO, and are independent of all market participants. Supported by the professional staff of the IMO's Market Assessment Unit, which monitors the marketplace on a daily basis, the Market Surveillance Panel is empowered to identify factors that may impede competition and make recommendations to the IMO, the Ontario Energy Board and the Federal Competition Bureau.

CHAIRMAN'S MESSAGE

James C. Baillie
Chairman of the Board

WHAT WE SEE UNFOLDING IN ONTARIO'S ELECTRICITY MARKET

As IMO Chair, I am proud to be associated with an organization whose men and women at every level are so deeply committed to its mission. This sense of commitment has carried the IMO through the major task of developing the structures, rules, processes and oversight for a successful competitive wholesale electricity market in Ontario. All are excited by the prospect of seeing our efforts culminate with market opening on May 1st.

What we see is a market ultimately governed by natural market forces, where prices rise and fall according to the laws of supply and demand, reflecting a competitive marketplace. Monopolies have no incentive to be price competitive, to develop efficiencies, to innovate. A competitive market creates that incentive – and thereby leads to ***greater consumer choice, better service, new and more efficient ways of operating, the lowest prices over the long term, private sector risk and investment which reduces the burden on taxpayers, and healthy growth and expansion of a vibrant industry.***

We have seen this when other monopolies have made the transition – telecommunications services for instance. And we have seen it in electricity markets that have successfully made the transition – in Australia, the U.K. and parts of the United States. ***The process by which Ontario has reached its decisions about restructuring its electricity market has been transparent and consensual, involving all stakeholder constituencies. We at the IMO believe the decisions reached are right for Ontario and will enable us to make a successful transition to a competitive market.***

Introducing competition to wholesale electricity prices is the vital first step. The benefits will increase over time as the market matures, competition strengthens on the supply side, and new participants invest in the industry.

With market opening on May 1st, there will be immediate competition on the demand side from those who distribute and retail electricity. Competition on the supply side will strengthen as Ontario Power Generation (OPG), which now controls over two-thirds of the electricity produced in the province, continues its programme to reduce this dominant position. In the meantime, as the President mentions in his Report, the Market Power Mitigation Agreement and the Market Surveillance Panel administered by the IMO will address the immediate concerns with OPG's dominant position. Supply side competition will also be increased as independent power producers introduce new generation – in response to the demand and pricing evident in the wholesale marketplace.

We are off to a great start. In anticipation of market opening, over 6000 megawatts of new generation projects have been proposed. 3000 megawatts of generating capacity is scheduled to come on stream over the next 18 months – a clear signal of the success of the move to a competitive marketplace.

In the meantime, with the introduction of market pricing, we can and do expect wholesale prices to rise and fall, even over the course of a day. That is natural: there will always be price fluctuations as supply and demand fluctuate.

The role of the IMO is to operate the market in such a way as to ensure that it unfolds as it should – that competition is fair, that market power is not abused, that more competitors are able to participate and that the reliability of electricity supply is maintained.

The IMO's job is not complete on market opening. We are considering additional markets such as a capacity reserve market and a forward market and we will work towards continuous improvement of Ontario's wholesale electricity market.

Our commitment – first and foremost – is to the efficiency and reliability of Ontario's electricity system and market.

PRESIDENT'S REPORT

Dave Goulding
President & Chief Executive Officer

KEEPING THE LIGHTS ON: HOW WE ARE MANAGING THE ISSUES

People and businesses in Ontario need to know that we are managing the issues, managing the transition, ensuring that the benefits of competition in the wholesale market are delivered without putting our electricity system at risk.

On the eve of the opening of Ontario's wholesale electricity market, while we look forward to the benefits of moving to a competitive marketplace, people across the Province are, quite naturally, concerned by the well-publicised problems in California – the electricity supply problems, system problems, blackouts, brownouts and price shocks.

This raises the very clear issues of supply, price and access – of the ability of the electricity system to meet the needs of the people and businesses of Ontario. They need to know that there will be enough affordable electricity to meet their growing needs over the long term.

At the IMO, ***we are managing these issues to ensure that the electricity market operates and unfolds as it should*** – as described by the Chairman of our Board in his Message – basing our decisions, processes, rules, actions, technology, and market structure on the best practices of successful markets, not on the failures in markets such as California.

We have studied the lessons of other markets carefully. For example, compared to Ontario, California had severe shortages in supply, inadequate to meet growing demand. As well, wholesale prices in California were deregulated while retail prices were capped, and there have been allegations of market manipulation and abuse of market power by participants in the State. The State government responded to these problems by locking into long term high price contracts that ignored the forces of supply and demand.

Ontario is different, our electricity system is different, and we have developed and structured the market differently. These differences will contribute to the success of Ontario's competitive marketplace.

First, Ontario has adequate supply for the evolution of the market.

Ontario has adequate supply available to meet the needs of our system in the short term and the longer term. More generation capacity is coming on stream: over the next 18 months, over 3000 MW – enough to power three million homes – is being added through investment in new generation projects and returning plants to service. As well, our supply is well diversified, in terms of the type of generation – two thirds is based on nuclear and hydroelectric generation. And, as in the past, our planning takes into account unpredictable but inevitable events that put unusual pressure on supply – severe weather conditions or equipment failure, for instance. When we are faced with such events, our supply, if necessary, can be supplemented from neighbouring markets through our strong interconnections. During the unprecedented heat wave of last summer, for example, when demand hit levels never seen before in Ontario, we met our short term peak needs with the help of imports from the United States.

With a good balance between demand and capacity, Ontario has the ideal conditions for a competitive marketplace. Supply will grow further as power producers respond to evolving demand in Ontario and in our interconnected export markets and invest further in new generating projects.

Second, in association with the Ontario Energy Board and with market participants, we have designed and structured the market and developed the market rules to allow for supply/demand price competition while protecting against market abuses.

We have worked to develop a structure, set of market rules, systems, technology and surveillance functions that provide for a fair, competitive market and protect against market manipulation and abuse. We have tested and re-tested all the elements, simulating a full range of scenarios. And we have benchmarked against other successful systems across North America. Through this benchmarking, we have determined that we are at the leading edge in a number of key areas, such as our settlement system, our bidding structure and our metering system. As the market opens, our structure, rules, processes and technology will be subject to ongoing refinement and advancement – we will respond to the evolution of the market and address any flaws in the structure or rules identified through Market Surveillance.

Third, our market is structured to protect against price shocks – outside of normal supply/demand fluctuations.

A fair and competitive market is the first line of defense against high prices, because competitive markets deliver the lowest prices over time.

We have rules in place to protect against "gaming", abuse of market power, or other conduct by participants that is anti-competitive and detrimental to the fair and efficient operation of the market – and – in coordination with the Ontario Energy Board, the federal Competition Bureau and other government and law enforcement agencies, we have the power to act and protect consumers.

As well, through the ***Market Power Mitigation Agreement***, there is a limit to the profits that Ontario Power Generation can earn through power sales in Ontario – a limit that addresses the fact that OPG is the dominant power producer, potentially constraining full and fair competition on the supply side. This profit limit will be in force for up to four years, declining as OPG's share of generation declines through divestiture or decontrol of generating facilities and as independent power producers open new facilities. The limit does not cap the price established in the wholesale market: buyers will proceed based on the market price. But excess profits taken by OPG according to the agreement will be rebated to consumers. ***The bottom line is that consumers are protected as a fully competitive market emerges on the supply side.***

Fourth, Ontario's needs will be met, because our job is to keep the lights on across the entire system.

The IMO is responsible for directing the required power at all times to all parts of the grid. In times of high demand that may pressure supply, the needs of the Ontario grid will be given priority.

Fifth, we are managing for the healthy development and evolution of the market over the long term by setting the foundations for a broader marketplace – through a broader North American grid.

We are already interconnected with our Canadian and American neighbours – strong interconnections that enhance the security of Ontario's supply on the one hand, while, on the other hand, reducing costs and earning revenues for Ontario producers through export sales. Broadening the marketplace by maintaining our strong interconnections as a core part of a larger North American grid will support the healthy evolution for Ontario's electricity market and industry. ***Strong interconnections increase the reliability, efficiency and cost effectiveness of our system, and a broadening market provides the best engine for long term growth.*** That is why we are participating in discussions with other North American market operators to ensure that Ontario's interests are represented in the evolution of regional electricity markets.

As we move to market opening, the elements for a successful transition to competitive markets are in place – as are the protections for consumers and for our electricity system. Moving forward – while we continue to manage the complex and challenging job of keeping the lights on – the IMO will continue to respond to the issues and we will work to ensure that the full benefits of a competitive marketplace are realized.

WHAT WE ACHIEVED IN 2001

In our role as operators of the grid:

- We continued to run Ontario's bulk electricity system without major incident – meeting or exceeding once again the performance targets of the North American Electric Reliability Council.

- ***We met the challenge of record peak demand.*** In the unprecedented and sustained heat wave of the summer of 2001, electricity demand soared and we set seven different consumption records – with an all time 20-minute peak of 25,269 MW set on August 8th. This compares to the normal summer peak demand of about 22,500 MW – and to the previous peak of 24,007, set in the extreme and sustained cold snap of January 1994. The difference between those peaks – close to 1300 MW – is enough to power over one million homes. We met this heightened demand through careful forecasting, utilization of all available capacity and acquiring power from other provinces and from U.S. states.

In preparing for market opening:

- We ran a limited, simulated dry run of the market in the Spring of 2001 – providing us with better understanding of the needs and challenges of market participants as we further developed our systems and processes.

- We tested our systems, programs and the readiness of wholesale participants comprehensively and extensively through the year.

- We worked with the Ontario Energy Board to help establish retail readiness.

- We refined market rules and procedures – with a final baseline for market opening.

- We worked with market participants to ensure readiness – through extensive training programs, heightened communications and information, ability testing, and streamlining our connection readiness processes.

- We built settlement systems and completed a financial dry run.

- We strengthened relations with regulators in Ontario, the U.S. and our neighbouring provinces in Canada.

- And, with the historic Announcement on December 18th, 2001 by the Ontario Government establishing May 1st 2002 as the market opening date, we began focused market opening preparations – for the IMO and for participants.

While getting ready for the momentous move to a competitive wholesale electricity market, we have kept firmly focused on the future – the goals of a competitive market, the benefits it should bring, the structures, rules, process and oversight we need in place.

OUR PRIORITIES FOR 2002

As a company:

- We will increase our effort toward becoming a truly ***customer-focused*** company.
- We will foster ***employee commitment*** to the pursuit of IMO priorities and goals.
- We will reinforce relationships with all industry stakeholders, including government, regulators, and the public.
- We will manage company financial matters with prudence and efficiency, delivering promised results at a cost to electricity consumers of less than $1/10^{th}$ of a penny per kilowatt hour.

In our role as operator of the grid:

- We will continue to reliably direct the operation of Ontario's integrated electricity system to meet or exceed industry standards.

- We will invest in infrastructure improvements to support ***continued excellence in system operation.***

In our role as operator of the wholesale electricity market:

- We will complete the Coupled Operational Dry Run – the final, full testing phase that commences April 1st and concludes with market opening.

- We will ***successfully launch*** and operate Ontario's first competitive marketplace for electricity.

- We will be responsible and vigilant in addressing the performance of the market and the conduct of market participants to ***ensure a fair and efficient market.***

- We will provide ***vision and leadership*** in the continuing development of competitive energy markets.

The IMO is ready for market opening, and we are confident of the success of a competitive wholesale electricity market in Ontario. We are committed to that success – and we are focused on the future.

FINANCIAL STATEMENTS 2001

Management's Discussion and Analysis

Overview of 2001 Financial Results:

Net income for the year ended December 31, 2001 was $1.0 million as compared with the net income for the year ended December 31, 2000 of $10.2 million. Revenues increased by $30.9 million offset by an increase in expenses and interest of $40.1 million.

During 2001 the IMO continued to make significant capital expenditures to complete the development of the systems, processes, and procedures for the operation of the wholesale competitive electricity market in Ontario. Capital spending in the year ended December 31, 2001 was $57.8 million compared with $112.1 million in the year ended December 31, 2000. On July 1, 2001 substantially all assets under development were deemed to be ready for use and were placed in service in anticipation of market opening.

Revenues:

Systems fees, which are approved annually by the Ontario Energy Board are derived from the revenue pool shared between the successor entities of Ontario Hydro, increased to $120.4 million in 2001 compared with $93.4 million in 2000. The increase in fees was approved to cover the incremental expenses of the IMO in 2001.

Revenues received for ancillary services, rural rate assistance, and remote subsidies were agreed to be equivalent to the related expenses of providing these services, resulting in no net income or loss to the IMO.

Operating Expenses:

Expenses increased to $357.8 million in 2001 from $324.6 million in 2000, predominantly due to increased labour ($13.0 million), computer services and support ($10.3 million) and amortization ($17.5 million). Labour and computer services and support expenses increased primarily as a result of incremental activities associated with the new market. Amortization expenses increased because amortization of market systems commenced on July 1, 2001. Offsetting the increase of these expenses, transition costs fell from $19.0 million in 2000 to $6.9 million in 2001 reflecting reduced activity in developing rules, processes and procedures for the new market.

Interest:

The IMO ceased capitalizing interest associated with borrowings which financed the development of market systems with effect from July 1, 2001. Long-term debt increased by $41.7 million during 2001. As a result of these changes, net interest expense increased to $11.7 million in 2001 compared with $4.7 million in 2000.

Cash and Cash Equivalents:

As at December 31, 2001 the IMO had $116.1 million in cash and cash equivalents, in comparison to $105.6 million as at December 31, 2000. The increased balance in cash and cash equivalents of $10.5 million was as a result of positive cash flow from operations of $26.6 million and increased borrowings of $41.7 million offset by capital expenditures of $57.8 million.

Capital Expenditures:

Capital spending on systems, applications, infrastructure and other assets relating to the opening of the market as at December 31, 2001 reached $220.9 million, an increase of $52.6 million in the year. These costs reflect the capital portion of the infrastructure project, which generally relate to the cost of physical facilities, as well as hardware and software required for the operation of the market.

The following table summarizes the components of the infrastructure project in dollars and as a percentage of the total costs.

	As at Dec. 31/01		*As at Dec. 31/00*	
Vendor Costs	$ 137.9 million	62%	$111.3 million	66%
External Labour	$ 51.6 million	23%	$ 36.1 million	21%
Internal Labour	$ 14.7 million	7%	$ 9.7 million	6%
Expenses	$ 6.1 million	3%	$ 4.9 million	3%
Interest & Foreign Exchange	$ 10.6 million	5%	$ 6.3 million	4%

Financing Activities:

As at December 31, 2001 notes payable to establish the business and fund capital spending totaled $353.2 million, an increase of $41.7 million in the year. The $353.2 million was comprised of $275 million in a note payable to the Province of Ontario, and $78.2 million in a note payable to Ontario Electricity Financial Corporation. The note to the Province of Ontario bears interest at 6.24% and the repayment terms require the IMO to repay the $275 million on November 3, 2003 subject to the IMO having obtained a credit rating of a specified level.

The IMO issued a note in the amount of $78.2 million to the Ontario Electricity Financial Corporation to acquire net assets from Ontario Hydro on April 1, 1999. The assets were acquired at net book value. The note bears interest at 7.9% and is repayable May 1, 2009.

At December 31, 2001 the IMO had a committed extendible credit facility for general working purposes in the amount up to $20 million. In addition, the IMO established a $100 million line of credit to fund shortfalls in amounts owed to the IMO by Market Participants for payment to other Market Participants prior to their recovery under the provisions of the market rules. No balance was drawn on either credit facility as of December 31, 2001.

Management Report

Management's Responsibility for Financial Reporting

The accompanying financial statements of the Independent Electricity Market Operator are the responsibility of management and have been prepared in accordance with accounting principles generally accepted in Canada. The significant accounting policies followed by the Independent Electricity Market Operator are described in the Summary of Significant Accounting Policies contained in Note 3 in the financial statements. The preparation of financial statements necessarily involves the use of estimates based on management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been prepared within reasonable limits of materiality and in light of information available up to February 22, 2002.

Management maintained a system of internal controls designed to provide reasonable assurance that the assets were safeguarded and that reliable information was available on a timely basis. The system included formal policies and procedures and an organizational structure that provided for the appropriate delegation of authority and segregation of responsibilities.

These financial statements have been examined by PricewaterhouseCoopers LLP, a firm of independent external auditors appointed by the Board of Directors. The external auditors' responsibility is to express their opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles in Canada. The Auditors' Report, which follows, outlines the scope of their examination and their opinion.

INDEPENDENT ELECTRICITY MARKET OPERATOR

On behalf of management,

Dave Goulding
President & Chief Executive Officer

Gary Sherkey
Vice President, Finance, CFO and Treasurer

Toronto, Canada
February 22, 2002

Auditors' Report

To the Board of Directors of the Independent Electricity Market Operator ("IMO")

We have audited the statement of financial position of the IMO as at December 31, 2001 and the statements of operations and accumulated surplus (deficit) and cash flows for the year then ended. These financial statements are the responsibility of the IMO's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we 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 principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the IMO as at December 31, 2001, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Toronto, Canada
February 22, 2002

Statement of Operations and Accumulated Surplus (Deficit)

(in thousands of Canadian dollars)	For the Year Ended December 31, 2001	For the Year Ended December 31, 2000
	$	$
REVENUES (Note 3(b))		
System fees	120,398	93,355
Ancillary services, rural rate assistance and remote subsidies	250,104	246,204
TOTAL REVENUES	**370,502**	**339,559**
EXPENSES		
Cost of ancillary services, rural rate assistance and remote subsidies	250,104	246,204
Labour	43,075	30,079
Transition costs	6,928	18,987
Computer Services and Support	14,044	3,787
Telecommunications	7,631	8,336
Other costs	10,005	8,838
Amortization	25,982	8,446
TOTAL EXPENSES	**357,769**	**324,677**
Net Income Before Interest	**12,733**	**14,882**
Interest income	3,072	1,450
Interest expense	(14,757)	(6,168)
NET INCOME FOR THE YEAR	**1,048**	**10,164**
ACCUMULATED SURPLUS (DEFICIT) - BEGINNING OF YEAR	8,556	(1,608)
ACCUMULATED SURPLUS - END OF YEAR	**9,604**	**8,556**

See accompanying notes to Financial Statements.

Statement of Financial Position

(in thousands of Canadian dollars)	As at December 31, 2001	As at December 31, 2000
	$	**$**
ASSETS		
Current Assets		
Cash & cash equivalents	116,109	105,622
Amount due under Transitional Revenue Allocation Agreement	33,468	28,827
Prepaid expenses & receivables	5,735	5,093
	155,312	**139,542**
Property & Equipment *(Note 4)*		
In service	251,072	58,554
Construction-in-progress	6,689	168,337
	257,761	**226,891**
Other Assets		
Prepaid operating expenses	440	2,100
Prepaid pension expense *(Note 7)*	24,103	21,323
	24,543	**23,423**
TOTAL ASSETS	**437,616**	**389,856**
LIABILITIES		
Current Liabilities		
Accounts payable & accrued liabilities *(Note 5)*	50,146	47,821
Accrued interest	3,702	2,812
	53,848	50,633
Long-term Debt *(Note 6)*	353,200	311,534
Accrual for Employee Future Benefits Other than Pensions *(Note 7)*	20,964	19,133
TOTAL LIABILITIES	**428,012**	**381,300**
ACCUMULATED SURPLUS	**9,604**	**8,556**
TOTAL LIABILITIES & ACCUMULATED SURPLUS	**437,616**	**389,856**

See accompanying notes to Financial Statements.

On behalf of the Board:

James C. Baillie

Barry E. Chuddy

Statement of Cash Flows

(in thousands of Canadian dollars)	For the Year Ended December 31, 2001	For the Year Ended December 31, 2000
	$	**$**
OPERATING ACTIVITIES		
Net income for the year	1,048	10,164
Adjustments for non-cash items:		
Amortization	25,982	8,446
Increase in prepaid pension expense	(2,780)	(5,545)
Increase in accrual for employee future benefits other than pensions	1,831	1,146
	26,081	14,211
Changes in non-cash balances related to operations:		
Increase in accounts payable and accrued liabilities	3,855	1,773
(Increase)/Decrease in prepaid expenses and receivables	1,018	(1,860)
Increase in amounts due under Transitional Revenue Allocation Agreement	(4,316)	(1,524)
	557	(1,611)
Cash provided from operations	**26,638**	**12,600**
INVESTING ACTIVITIES		
Net sale of temporary investments	-	34,172
Investment in property & equipment	(57,817)	(112,142)
Cash used in investing	**(57,817)**	**(77,970)**
FINANCING ACTIVITIES		
Issue of long-term debt	41,666	150,000
Cash provided from financing	**41,666**	**150,000**
NET CHANGE IN CASH & CASH EQUIVALENTS	10,487	84,630
CASH & CASH EQUIVALENTS - BEGINNING OF YEAR	105,622	20,992
CASH & CASH EQUIVALENTS - END OF YEAR	**116,109**	**105,622**

See accompanying notes to Financial Statements.

Supplementary Information: *(in thousands of Canadian dollars)*		
Interest Paid	**21,454**	**13,831**

Notes to Financial Statements

1. Restructuring of the Ontario Electricity Industry

The North American electrical utility industry has undertaken initiatives to move away from traditional monopolies towards competitive models that are more conducive to customer choice. On October 30, 1998 the Government of Ontario enacted the Energy Competition Act, 1998 to restructure the business carried on by Ontario Hydro and introduce competition.

Prior to the restructuring, Ontario Hydro was a vertically integrated, rate-regulated electricity utility. On April 1, 1999, Ontario Hydro was restructured into a number of successor entities, as follows:

- Ontario Power Generation Inc. (OPG), a generation company;
- Ontario Hydro Services Company Inc., subsequently renamed Hydro One (HO1), a rate regulated transmission and distribution business, which operates certain energy services businesses in an unregulated business environment;
- Independent Electricity Market Operator (IMO), a non-profit organization which is the independent system co-ordinator;
- Electrical Safety Authority (ESA), a non-profit organization, which carries out electrical inspections previously conducted by Ontario Hydro; and
- Ontario Electricity Financial Corporation (OEFC), the continuing Ontario Hydro entity which has the objectives of managing debt, administering assets, liabilities, rights and obligations not transferred to a successor entity, and until July 3, 2001 acted as administrator of the OEFC Pension Plan.

2. Nature of Operations

Independent Electricity Market Operator was created by statute effective on April 1, 1999 pursuant to Part II of the *Electricity Act, 1998*. As set out in the *Electricity Act*, the IMO operates pursuant to a license granted by the Ontario Energy Board.

The IMO is a not-for-profit, non-taxable corporation without share capital whose objects are set out in Part II, sub-section 5(1) of the Electricity Act as follows:

- to exercise and perform the powers and duties assigned to the IMO under the *Electricity Act, 1998*, the market rules and license;
- to enter into agreements with transmitters giving the IMO the authority to direct the operations of their transmission systems;
- to direct the operations and maintain the reliability of the IMO-controlled grid to promote the purposes of the *Electricity Act, 1998*;
- to establish and operate the IMO-administered markets to promote the purposes of the *Electricity Act, 1998*;
- to collect and provide to the public information relating to the current and future electricity needs of Ontario and the capacity of the integrated power system to meet those needs;
- to participate in the development by any standards authority of standards and criteria relating to the reliability of the transmission systems;
- to work with the responsible authorities outside Ontario to co-ordinate the IMO's activities with their activities.

As specified in the *Electricity Act*, any surplus generated shall be used by the IMO for the purposes of carrying out its objects. The IMO expects to recover any deficits in future system fees, subject to approval by the Ontario Energy Board.

The IMO substantially completed development and testing of the necessary systems, processes and other requirements of the IMO-administered markets in June 2001. The Government of Ontario has announced that the competitive electricity market will open on May 1, 2002. Following market opening, the IMO will derive fees from administering the market.

3. Summary of Significant Accounting Policies

a) Basis of financial statement preparation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

b) Revenue recognition

In accordance with an agreement ("Transitional Revenue Allocation Agreement") between the IMO and the other successor entities of Ontario Hydro, the IMO receives system fees and ancillary service fees. The Transitional Revenue Allocation Agreement covers the transition period up to market opening.

c) Transition costs and construction-in-progress

The IMO plays a key role in conjunction with future market participants and other stakeholders in the development of the wholesale competitive electricity market in Ontario. As part of this role, the IMO is charged with developing and implementing the systems, including hardware and software, processes and procedures required to operate the competitive marketplace.

Costs relating to this initiative are capitalized to construction-in-progress, based on the expected future benefit, or charged to current operations as transition costs. Capitalized costs generally relate to the costs of physical facilities, hardware and software required for the operation of the market and include costs paid to vendors, internal and external labour, consultants, an applicable share of overhead, and an allocation of interest related to funds borrowed to finance the project. Costs relating to construction-in-progress are transferred to property and equipment in service when the asset under construction is deemed to be ready for use. Transition costs generally relate to the design of market rules, market and internal processes and procedures, and training and include costs for internal and external labour, consultants, and an applicable share of overhead.

d) Property and equipment in service
Property and equipment are capitalized at cost, which comprises materials, labour, external support, overheads, and interest applicable to capital activities.

e) Amortization
The capital cost of property and equipment in service is amortized on a straight-line basis over their estimated service lives.

The estimated service lives in years, from the date the assets were transferred from Ontario Hydro or subsequently acquired, are:

Class	Estimated Average Service Life
Facilities	41
Data Acquisition and Computer Systems	4
Market Systems and Applications	4 to 7
Infrastructure and Other Assets	4 to 10

Gains and losses on sales of property and equipment and losses on premature retirements are charged to operations as adjustments to amortization expense. Removal costs are charged to amortization expense as incurred.

The estimated service lives of property and equipment and the significant assumptions underlying the estimates of removal costs are subject to periodic review. The impacts of changes in the estimated lives of property and equipment are amortized on a prospective basis. The most recent review was completed in fiscal 2001.

f) Cash and cash equivalents
Cash and cash equivalents comprise cash, term deposits and other short term investments with original maturity dates of less than 90 days.

g) Temporary investments
Short-term money market investments with original maturities of 90 days or longer are classified as temporary investments and valued at amortized cost. Premiums and discounts are amortized to income using the constant yield method over the period to maturity.

h) Pension and other post-employment benefits
The IMO's post-employment benefit programs include pension, group life insurance, health care, long-term disability and workers compensation benefits.

The IMO accrues obligations under pension and other post-employment benefit ("OPEB") plans and the related costs, net of plan assets. Pension fund assets are valued using market related values for equities, whereby fund assets are calculated using a five-year moving average of year-end market values, and market values for fixed income securities. Pension and OPEB expenses and obligations are determined annually by independent actuaries using the projected benefit method and management's best estimates using a measurement date of September 30.

Pension and OPEB expenses consist of current service costs, interest and adjustments arising from plan amendments, changes in assumptions, and experience gains or losses, which are amortized on a straight line basis over the expected average remaining service life of the employees covered by the plan. Pension and OPEB expenses are recorded during the year in which employees render services.

i) Fair value of financial instruments
The carrying amounts reported in the statements of financial position for financial instruments, comprising current assets and current liabilities approximate to their fair values. The fair value of the long-term debt is not readily available.

j) Foreign exchange
Transactions denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the statements of financial position date are translated in Canadian dollars at the rate prevailing at that date. Exchange gains and losses arising on settlement of foreign exchange transactions are reported in the statement of operations at the date at which the transactions are settled.

k) Use of estimates
The preparation of the financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements. Actual results could differ from those estimates.

4. Property and Equipment

(in thousands of Canadian dollars)	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE As at December 31, 2001	NET BOOK VALUE As at December 31, 2000
Property and equipment in service	$	$	$	$
Facilities	41,533	2,844	38,689	39,556
Data Acquisition and Computer Systems	26,515	19,498	7,017	14,081
Market Systems and Applications	164,719	12,676	152,043	1,560
Infrastructure and Other Assets	60,977	7,654	53,323	3,357
	293,744	42,672	251,072	58,554
Construction-in-progress	6,689	-	6,689	168,337
	300,433	**42,672**	**257,761**	**226,891**

Substantially all assets relating to construction-in-progress were deemed to be ready for use on July 1, 2001. At this time, all of the IMO's asset classes were reviewed, resulting in a regrouping of property and equipment into the classes identified above. In addition, adjustments were made to reflect management's estimates of remaining asset service lives. The impact of these changes in estimates was an increase in amortization expenses of $1,290,000 in the year.

Interest capitalized to construction-in-progress during 2001 was $5,591,124 (2000 - $6,148,510).

5. Accounts Payable & Accrued Liabilities

(in thousands of Canadian dollars)	*As at December 31, 2001*	*As at December 31, 2000*
	$	$
Relating to Transitional Revenue Allocation Agreement	20,842	20,517
Relating to property and equipment	11,589	12,554
Relating to operations	17,715	14,750
	50,146	**47,821**

6. Long-term Debt

(in thousands of Canadian dollars)	*As at December 31, 2001*	*As at December 31, 2000*
	$	$
Notes Payable To		
Ontario Electricity Financial Corporation (OEFC)	78,200	78,200
The Province of Ontario	275,000	233,334
	353,200	**311,534**

Note Payable to OEFC

The long-term note payable to Ontario Electricity Finance Corporation (OEFC) is unsecured, bears interest at 7.9% per annum and is repayable in full on May 1, 2009. Interest accrues daily and is payable in arrears, in equal semi-annual payments on May 1 and November 1 of each year.

Note Payable to the Province of Ontario

The long-term note payable to the Province of Ontario is unsecured, and bears interest at 6.24%. Interest accrues daily and is payable in arrears, in equal semi-annual payments on May 3 and November 3 of each year. The loan is repayable in full on November 3, 2003.

The loan agreement provides for an extension of the repayment date if on or before October 27, 2003, the IMO is unable to obtain a credit rating, or has obtained a credit rating below a specific level, to the earlier of March 31, 2005 or six months after which a credit rating is either received or revised to a specific level. The loan will bear interest during the period of extension equal to the floating Bankers Acceptance rate plus 50 basis points.

Credit Facility

IMO has a revolving credit facility agreement with a Canadian chartered bank. As at December 31, 2001 no balance was drawn on the credit facility (as at December 2000, $158,000 was drawn and included in cash and cash equivalents). The agreement provides for the bank to make available to the IMO a committed extendible 364-day revolving credit facility of $20 million for general working purposes. The credit agreement is unsecured. Advances under this facility are available in Canadian dollars by way of prime rate loans or relevant Bankers Acceptances rates. Unused portions of this credit facility are subject to a commitment fee of 5 basis points per annum. Upon acceptance of each Bankers' Acceptance of the IMO by the bank, the IMO shall pay a Stamping Fee of 15 basis points per annum to the Bank.

Additionally, the IMO has an agreement with the bank under which the bank will make available to the IMO a committed, unsecured 364-day revolving credit facility in an amount up to $100 million. This facility will mainly be used to fund shortfalls in amounts owed to the IMO by Market Participants for payment to other Market Participants prior to their recovery under the provisions of the market rules.

7. Benefit Plans

The IMO provides pension and other employee future benefits, comprising group life insurance, long-term disability and group medical and dental plans, for the benefit of current and retired employees.

Pension Plans

From April 1, 1999 to December 31, 1999, the IMO participated in the OEFC Pension Plan, a contributory defined benefit, registered pension plan formerly known as the Pension and Insurance Fund of Ontario Hydro. As part of the restructuring of the electricity industry in Ontario, the assets, liabilities and a share of the OEFC Pension Plan's surplus was notionally allocated to each of the successor entities of Ontario Hydro on April 1, 1999.

The Independent Electricity Market Operator Pension Plan (the Plan) commenced on December 31, 1999 and assumed the IMO's share of the pension liabilities of the OEFC Pension Plan on January 1, 2000. The Plan received assets from the OEFC Pension Plan on July 3, 2001.

In addition to the funded, registered, pension plan, the IMO provides certain non-registered defined benefit pensions through an unfunded, non-registered plan.

Other Employee Future Benefits

The group life insurance, long-term disability and group medical and dental benefits are provided through unfunded, non-registered defined benefit plans.

Summary of Accrued Benefit Obligations and Plan Assets

(in thousands of Canadian dollars)	2001 Pension Benefits	2000 Pension Benefits	2001 Other Benefits	2000 Other Benefits
	$	$	$	$
Accrued benefit obligation	193,401	173,209	25,863	24,580
Fair value of plan assets	216,499	249,295	-	-
Funded status	23,098	76,086	(25,863)	(24,580)
Prepaid (accrued) benefit cost recognized in the statements of financial position	24,103	21,323	(21,689)	(19,858)

Summary of Principal Assumptions Used to Calculate Benefit Costs and Obligations

(in thousands of Canadian dollars)	2001 Pension Benefits	2000 Pension Benefits	2001 Other Benefits	2000 Other Benefits
Discount rate	7.0% - 7.25%	7.0% - 7.45%	7.0% - 7.25%	7.0% - 7.45%
Expected return on plan assets	7.25%	7.25%	-	-
Rate of compensation increase	3.5%	3.5%	3.5%	3.5%
Rate of benefit increases	2.5% - 3.0%	2.5%	-	-
Expected average remaining service life of employees	12 years	12 years	12 years	12 years

Hospital and drug costs are assumed to increase by 7.0% in 2002, 6.0% in 2003, and by 5.0% per annum thereafter. Dental costs are assumed to increase by 5.0% per annum.

Summary of Benefit Costs and Plan Contributions

(in thousands of Canadian dollars)	2001 Pension Benefits	2000 Pension Benefits	2001 Other Benefits	2000 Other Benefits
	$	$	$	$
Benefit cost (income)	(2,759)	(5,545)	2,604	2,084
Employer contributions	14	2	749	669
Plan participant's contributions	1,422	813	-	-
Benefits paid	7,049	4,848	795	576

8. Segmented Information

IMO consists of a single business engaged in the operation of the wholesale electricity system in Ontario.

9. Commitments

Operating Commitments

The obligations of the IMO with respect to non-cancellable operating leases over the next five years are as follows:

(in thousands of Canadian dollars)

2002	2003	2004	2005	2006
$	$	$	$	$
1,874	1,346	1,215	797	826

Capital Commitments

As at December 31, 2001, the IMO had non-cancellable capital commitments of $10,141,994.

Board of Directors

James C. Baillie (Chair)
Counsel
Torys, LLP

Dave Goulding
President and CEO
Independent Electricity Market Operator (IMO)

Carl Anderson
Independent Director

Bruce Boland
Senior Vice President
Customer Solutions
Ontario Power Generation Inc.

John Brooks
President and CEO
Toronto Hydro Electric System Limited

Peter Budd
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Power Budd LLP

Glenna Carr
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Carr-Gordon Limited

Barry Chuddy
General Manager of Power Development
Emera Energy Inc.

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Maxxcap Corporate Finance Inc.

Dale Struthers
Principal
Dalmar Associates

Rod Taylor
Executive Vice President
Planning & Development
Hydro One Inc.

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Middle Row: Peter Jones, Glenna Carr, Robert McGavin, Carol S. Perry, Peter Budd, Bruce Boland
Front Row: James C. Baillie, Dave Goulding

Technical Panel

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Chief Operating Officer,
Market Operations & Forecasts
IMO

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Independent Consultant
Representing Sithe Energies, Inc.

Julie Girvan
Independent Consultant

Randy J. Heaton
Manager, Emerging Markets - Rules, Compliance and Market Readiness
Ontario Power Generation Inc.

Michael John McGee, P.Eng.
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Energy Profiles Ltd.

Larry Murphy
President
Henley International Inc.

Andy Poray
Director, Pricing and Strategic Support Strategic Planning
Hydro One Networks Inc.

James B. Richardson
General Manager
Innisfil Hydro

William C. Rupert
Partner
Ernst & Young

Peter Sergejewich
Director, Market Development
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Don Thorne
General Manager & Secretary
Milton Hydro-Electric Commission

Andrew C. Vallas
Vice-President
Sempra Energy Trading

Market Surveillance Panel

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Director, Financial Services Program
Schulich School of Business
York University

Don McFetridge
Professor, Economics
Carleton University

Tom Rusnov
Independent Consultant

IMO Senior Management Team

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President and CEO

Bruce Campbell
Vice President
Corporate and Legal Affairs

Derek Cowbourne
Vice President
Market Services

Bill Limbrick
Vice President
Information Technology & Infrastructure

Paul Murphy
Chief Operating Officer
Market Operations and Forecasts

Gary Sherkey
Vice President
Finance, CFO and Treasurer

Harry Chandler
Director
Market Assessment and Compliance

Yvonne Murray
Manager
Internal Audit

Norm Thomas
Director
Human Resources

Audit Committee

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Dale Struthers

Human Resources Committee

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John Brooks
Peter Budd
Glenna Carr
John Grant
Ed Houghton

Committee of Independent Directors

James C. Baillie (Chair)
Carl Anderson
Glenna Carr
John Grant
Peter Jones
Robert McGavin
Carol S. Perry

Ad Hoc Committee of Stakeholder Directors

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