



**balancingpool**

October 25, 2005

## Balancing Pool's Credit Rating Upgraded to AA from AA (low)

We are pleased to advise you that Dominion Bond Rating Service ("DBRS") has upgraded the Balancing Pool's Credit Rating to AA from AA (low) on October 17, 2005. As per the attached Press Release, this rating upgrade is mainly due to the addition of two credit facilities totaling \$100 million and the termination of the Clover Bar Power Purchase Arrangement on October 1, 2005.

We have attached the Press Release dated October 17, 2005 and the DBRS Credit Report for your information.

Yours truly,

Gloria Fournier, CA  
Chief Financial Officer



Oct 19, 2005

P R E S S   R E L E A S E

Balancing Pool

Upgrades to AA from AA (low)

Date Of Release: October 17, 2005

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Please click on the Issuer name below to see all Research for that Issuer.

Issuer	Debt Rated	Rating Action	Rating	Trend	Notes	Latest Event
Balancing Pool	Issuer Rating	Upgraded	AA	Stb	last rpt. 2004-07-22	Oct 17, 2005

Dominion Bond Rating Service (“DBRS”) has today upgraded the rating on the Balancing Pool to AA from AA (low), with a Stable trend. The upgrade is largely based on the improvement of the Balancing Pool’s financial flexibility with: (1) the addition of two credit facilities totalling Cdn\$100 million, which provides the Balancing Pool with a means to fund operating deficits on a short-term basis until a customer charge can be levied to collect the shortfall, and (2) the termination of the money-losing Clover Bar power purchase arrangement (“PPA”) on October 1, 2005.

The Balancing Pool’s rating is based on the rating of the Province of Alberta (the “Province”) (currently rated AAA), given that the Balancing Pool is a creation of the Province and receives its powers through provincial legislation and regulation. Included in its powers is the regulated right to recover from electricity consumers any cash shortfalls arising from its operations, without recourse to, or permission from, any other legislation or entity. However, the Balancing Pool’s rating remains lower than the Province’s rating due to the following factors: (1) No explicit guarantee from the Province, (2) the risk of simultaneous “extraordinary events” exceeding the Balancing Pool’s risk management capabilities, (3) the risk of political intervention in the Balancing Pool’s operations, and (4) an untested cost recovery mechanism.

As expected, the Balancing Pool generated an EBIT loss and a gross free cash flow deficit for the 12 months ended June 30, 2005. The deficit has been the result of the carrying costs of the Balancing Pool’s PPAs being higher than the revenues received from the sale of generating capacity under the MAP II contracts. One of the main contributors to this deficit has been the contracted sale of power from the Clover Bar PPA, which has been losing about Cdn\$50 million a year and led to the Balancing Pool’s decision to close the plant.

The cash flow deficit in 2004 was funded with the Balancing Pool’s cash balance, which had reduced to Cdn\$41.2 million at December 31, 2004, from Cdn\$138.4 million a year earlier. A positive change in

working capital during the first six months of 2005 improved the Balancing Pool's cash position to Cdn\$61.3 million at June 30, 2005.

With the continuation of operating losses associated with the MAP II contracts and a termination payment of about Cdn\$80 million associated with the Clover Bar PPA, the Balancing Pool is expected to generate a significant cash flow deficit for 2005. This cash flow deficit will be funded with the Balancing Pool's remaining cash balance and a significant draw down on its credit facilities.

In September 2005, the Balancing Pool determined that it would not be necessary to levy a customer charge for 2006, despite the expectation of a significant balance outstanding on its credit facilities at the end of 2005. The decision to not levy a customer charge in 2006 is largely based on the expected outcome of the MAP III process (the contracted sale of output from the PPAs associated with the Genesee and Sheerness generating plants). Based on current market prices, these PPAs are in-the-money and would generate sufficient cash flow for the Balancing Pool such that, together with other sources of revenue and no longer incurring a loss on the Clover Bar PPA, the outstanding balance on the credit facilities could be paid down by the end of 2006.

Factors affecting the Balancing Pool's external cash requirements going forward will depend heavily on the outcome of future MAP auctions, as well as on spot electricity prices from one year to the next. Despite these uncertainties, the Balancing Pool's financial profile is expected to remain relatively stable over the medium term given that it has the regulated right to recover from electricity consumers any cash shortfalls arising from its operations.

DBRS will publish a full report shortly that will provide additional analytical detail on this rating action. If you are interested in receiving this report, contact us at: [info@dbrs.com](mailto:info@dbrs.com).

Matthew Kolodzie, CFA, P.Eng.  
416-593-5577 x2296  
Senior Vice President  
[mkolodzie@dbrs.com](mailto:mkolodzie@dbrs.com)

Nick Dinkha, CFA, MBA  
416-593-5577 x2314  
Assistant Vice President  
[ndinkha@dbrs.com](mailto:ndinkha@dbrs.com)

Issuers in This Press Release  
Balancing Pool

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**Balancing Pool**

Report Date: October 21, 2005  
 Press Released: October 17, 2005  
 Previous Report: July 22, 2004

**RATING**

Rating	Trend	Rating Action	Debt Rated Issuer Rating
AA	Stable	Upgraded	

Matthew Kolodzie, CFA/Nick Dinkha, CFA  
 416-593-5577 x2296/x2213  
 mkolodzie@dbrs.com

(All figures in Canadian dollars, unless otherwise noted.)

<b>RATING HISTORY</b>	<u>Current</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Issuer Rating	AA	AA (low)	AA (low)	AA (low)	NR	NR

**RATING UPDATE**

The rating on the Balancing Pool is being upgraded to AA from AA (low), with a Stable trend. The upgrade is largely based on the improvement of the Balancing Pool’s financial flexibility with: (1) the addition of two credit facilities totalling \$100 million, which provides the Balancing Pool with a means to fund operating deficits on a short-term basis until a customer charge can be levied to collect the shortfall; and (2) the termination of the money-losing Clover Bar power purchase arrangement (“PPA”) on October 1, 2005.

The Balancing Pool’s rating is based on the rating of the Province of Alberta (the “Province”) (currently rated AAA), given that the Balancing Pool is a creation of the Province and receives its powers through provincial legislation and regulation. Included in its powers is the regulated right to recover from electricity consumers any cash shortfalls arising from its operations, without recourse to or permission from any other legislation or entity. However, the Balancing Pool’s rating remains lower than the Province’s rating due to the following factors: (1) no explicit guarantee from the Province; (2) the risk of simultaneous “extraordinary events” exceeding the Balancing Pool’s risk management capabilities; (3) the risk of political intervention in the Balancing Pool’s operations; and (4) an untested cost recovery mechanism.

As expected, the Balancing Pool generated an EBIT loss and a gross free cash flow deficit in 2004 and for the 12 months ended June 30, 2005. The deficit has been the result of the carrying costs of the Balancing Pool’s PPAs being higher than the revenues received from the sale of generating capacity under the MAP II contracts. One of the main contributors to this deficit has been the contracted sale of power from the Clover Bar PPA, which has been losing about \$50 million a year and led to the Balancing Pool’s decision to terminate the PPA.

The cash flow deficit in 2004 was funded with the Balancing Pool’s cash balance, which had reduced to \$41.2 million at December 31, 2004, from \$138.4 million a year earlier. While,

a positive change in working capital during the first six months of 2005 improved the Balancing Pool’s cash position to \$61.3 million at June 30, 2005.

With the continuation of operating losses associated with the MAP II contracts and a termination payment of about \$80 million associated with the termination of the Clover Bar PPA, the Balancing Pool is expected to generate a significant cash flow deficit for 2005. This cash flow deficit will be funded with the Balancing Pool’s remaining cash balance and a significant draw down on its new credit facilities. DBRS notes that the addition of the credit facilities mitigates one of the key challenges highlighted by DBRS in previous reports.

In September 2005, the Balancing Pool determined that it would not be necessary to levy a customer charge for 2006, despite the expectation of a significant balance outstanding on its credit facilities at the end of 2005. The decision to not levy a customer charge in 2006 is largely based on the expected outcome of the MAP III process (the contracted sale of output from the PPAs associated with the Genesee and Sheerness generating plants). Based on current market prices, these PPAs are in-the-money and would generate sufficient cash flow for the Balancing Pool such that, together with other sources of revenue (the Hydro PPA and payments in lieu of taxes received) and no longer incurring a loss on the Clover Bar PPA, the outstanding balance on the credit facilities could be paid down by the end of 2006.

Factors affecting the Balancing Pool’s external cash requirements going forward will depend heavily on the outcome of future MAP auctions, as well as on spot electricity prices from one year to the next. Despite these uncertainties, the Balancing Pool’s financial profile is expected to remain relatively stable over the medium term given that it has the regulated right to recover from electricity consumers any cash shortfalls arising from its operations. The key risk in this respect is political intervention, particularly if the customer levy was significant.

**RATING CONSIDERATIONS**

*Strengths:*

- Regulated right to collect shortfalls or distribute excess revenues to electricity consumers in Alberta
- Alberta’s relatively stable electricity market
- Alberta’s strong and stable underlying demand for electricity
- Credit facilities of \$100 million
- Good risk management controls and procedures

*Challenges:*

- Risk of political intervention
- The Balancing Pool acts as a “risk backstop” for a variety of events
- Untested cost recovery (“true-up”) mechanisms
- Risks associated with PPA management

**THE COMPANY**

The Balancing Pool is a not-for-profit corporation that was established in 1999 by the Province of Alberta to help manage the transition to a competitive electricity market in Alberta. Its primary roles are to manage the financial accounts arising from the transition to a competitive electricity market on behalf of electricity consumers, and to meet any obligations and responsibilities related to both sold and unsold PPAs.

**Energy**

**DOMINION BOND RATING SERVICE**

**RATING CONSIDERATIONS**

*Strengths:* (1) The fundamental strength of the Balancing Pool is based on its ability to levy charges on Alberta's electricity ratepayer base until 2021. This ability was provided to Balancing Pool via the *Electric Utilities Act*. Under the *Electric Utilities Act*, the Balancing Pool: (a) forecasts revenues and costs over the life of the Balancing Pool; and (b) determines whether a cash shortfall will result. If a shortfall is likely, Balancing Pool has the right to collect the additional amounts necessary from ratepayers. In addition, the Balancing Pool has the right to make a final adjustment charge in 2021 as part of its winding-up activities.

(2) The Province of Alberta has a relatively stable electricity market and political environment. The current provincial government is conducive to business activities and its mandate extends until March 2006. The government that initiated the electricity industry's deregulation remains in power and, therefore, retains a significant political interest in ensuring the success of the deregulation process. The provincial government has signalled its commitment to the continuance of a competitive electricity market by passing various supportive regulations and legislation since 1995 and has intervened on a very limited basis, despite the high prices in late 2000 and early 2001.

(3) Alberta has a strong and stable underlying demand for electricity, largely due to its economic fundamentals and characteristics. Demand for electricity has grown at an average annual rate of about 5% over the past five years. Alberta's solid economic growth in recent years has fuelled the strong demand for electricity. The demand has been especially strong in the area of natural resources processing and associated industries. In addition, Alberta is a "load pocket" with limited access to outside sources of electricity. As such, the majority of demand requirements must be met with domestic supply.

(4) In February 2005 and August 2005, the Balancing Pool finalized its two unsecured credit facilities totalling \$100 million. These credit facilities provide the Balancing Pool with additional financial flexibility to fund operating deficits on a short-term basis until a customer charge can be levied to collect the shortfall.

(5) The Balancing Pool has good risk management controls and procedures in place to manage the risks associated with the collection of shortfalls, energy marketing, and counterparty risk. The Balancing Pool currently relies on the Alberta Electric System Operator ("AESO") for the direct collection of shortfalls from ratepayers via the AESO transmission tariff.

*Challenges:* (1) Although Alberta's deregulated electricity market is designed to run without government intervention, it is possible the government could intervene in such a way that it would have a negative impact on the functioning of the electricity market or on the Balancing Pool's financial flexibility. Depending on the degree and type of government intervention, it could result in significant deterioration of the Balancing Pool's credit quality and ability to service its obligations.

(2) The Balancing Pool is designed to manage any extraordinary event associated with PPAs. Such extraordinary events include force majeure, unit destruction, and buyer or owner default. These activities all contain implicit risks related to the operating environment, PPA and trading counterparties, and market economics. In addition, the definitions of such events are not contained within the legislation, but are determined by the individual contracts and PPAs to which the Balancing Pool is a party. As a result, the Balancing Pool could experience catastrophic losses related to such events, notwithstanding its risk mitigation and control procedures.

(3) Cost recovery systems such as the "true-up" mechanism, which allows for the collection of anticipated shortfalls on an annual basis, remain untried. So far, such systems have only been used to distribute the proceeds of PPA sales back to consumers, rather than to collect outstanding amounts.

(4) As a result of its responsibility to manage the unsold PPAs, the Balancing Pool is exposed to a number of risks, including: (a) commodity price risk; (b) volume risk; (c) fuel price risk; and (d) counterparty risk. However, various risk management policies and procedures should act to limit the financial exposure from these risks.

## EARNINGS AND OUTLOOK

Income Statement (\$ millions)	12 months ended		Six months ended		For the year ended December 31	
	June 30, 2005	June 30, 2005	June 30, 2004	2004	2003	2002
<b>Revenue:</b>						
Sale of electricity	0.1	0.0	0.0	0.1	116.4	610.6
Sale of electricity capacity contracts	466.4	219.1	244.5	491.8	455.7	46.6
Cost of sales (power purchased and transmission)	(524.7)	(241.5)	(278.1)	(561.4)	(584.1)	(609.6)
Net revenue from thermal generation	(58.2)	(22.3)	(33.5)	(69.4)	(11.9)	47.7
Hydroelectric PPA	52.3	20.3	27.2	59.3	41.9	64.5
Payments in lieu of tax	83.7	32.5	15.5	66.8	39.2	29.9
Investment/interest income	3.6	2.5	1.6	2.6	5.6	5.5
Total net revenues	81.4	33.0	10.8	59.3	74.8	147.7
<b>Expenses:</b>						
Depreciation & amortization	(59.0)	(29.5)	(29.5)	(59.0)	(59.2)	(58.4)
(Inc.)/dec. in liability for small power prod. contracts	(2.3)	(2.1)	(0.3)	(0.6)	(4.2)	9.1
Other PPA charges	(10.3)	(2.2)	(2.5)	(10.6)	(4.2)	(12.0)
General and administrative (1)	(5.1)	(3.6)	(4.6)	(6.0)	(5.2)	(3.0)
Other regulatory expenses	(11.2)	-	-	(11.2)	(3.1)	-
Total operating expenses	(87.9)	(37.4)	(36.9)	(87.4)	(75.8)	(64.2)
<b>Operating Income (EBIT)</b>	(6.4)	(4.4)	(26.1)	(28.2)	(1.0)	83.5
Revaluation of Hydro PPA & small power prod. contracts	(40.9)	-	-	(40.9)	4.6	-
Revaluation of electricity rebates payable	-	-	-	-	-	109.0
Revaluation of reclamation, abandon., & deferral payable	(32.1)	(19.6)	-	(12.5)	(1.2)	1.4
Common facilities on new generating units	24.1	24.1	-	-	-	-
Discontinued operations (H.R. Milner)	-	-	-	-	(0.9)	(25.3)
Gain/(loss) from discontinued operations	12.5	-	4.8	17.4	-	-
Other	0.3	-	-	0.3	6.6	-
<b>Net Change in Balancing Pool Deferral Account</b>	(42.5)	0.1	(21.3)	(63.9)	8.1	168.6

(1) Includes administrative costs associated with the Office of the Utilities Consumer Advocate.

### Summary:

- EBIT fell again in 2004 to a greater deficit than in 2003, which had been expected given that the cost of sales associated with the Clover Bar, Genesee, and Sheerness PPAs are higher than the revenue generated under the MAP II contracts.
  - The majority of the Balancing Pool's operating revenues currently come from the sale of capacity contracts rather than from electricity sales given that most of its generating capacity has been sold to third parties through the MAP II process.
- While still in a deficit position, EBIT improved for the 12 months ended June 30, 2005, as earnings from payments in lieu of taxes increased.
  - Payments in lieu of taxes are dependent on income at certain unregulated businesses in Alberta.
- Also contributing to the EBIT deficits were the following unexpected expenses:
  - Force majeure claims of \$5.7 million, mainly associated with the Battle River PPA, and
  - An \$11.2 million payment directed by the Minister of Energy for post-final settlement market adjustments.
- Lower revenues from the sale of electricity were somewhat offset by:
  - Higher revenues from the Hydro PPA, which represents annual accretion of the value of the Hydro PPA asset, and
  - The gain on the sale of the H.R. Milner plant.
- As a result of the negative EBIT and certain revaluations (see table above), the Balancing Pool recorded a negative net change in its deferral account of

\$63.9 million in 2004, and \$42.6 million for the 12 months ended June 30, 2005.

- Despite the deficit in 2004 and an expected deficit in 2005, no levy was administered to customers for 2005.

### Outlook:

- The Balancing Pool is expected to record negative net changes in its deferral account until the end of 2005, primarily due to: (1) the revenues from the sale of electricity capacity under the MAP II contracts being insufficient to cover the costs associated with the underlying PPAs, and (2) an approximately \$80 million termination payment in Q4 2005 associated with the termination of the Clover Bar PPA.
  - Remaining MAP II contracts expire at the end of 2005 and on March 31, 2006.
- The Balancing Pool is expecting to be in a positive cash position late in 2006 and in 2007, based on:
  - The expected outcome of the MAP III process and receiving up-front payments from the sale of new PPA strips, and
  - No longer generating a loss on the Clover Bar PPA.
- The Balancing Pool's financial results from one year to the next will continue to be influenced by spot power pool prices as they affect:
  - Unsold generation capacity;
  - Market prices for ancillary services;
  - Payments in lieu of taxes received; and

- Forward power pool prices and the annual valuations of the Hydro PPA and small power producer contracts.
- The Balancing Pool remains financially responsible for any extraordinary events associated with PPAs such as
  - force majeure, unit destruction, and buyer or owner default.
  - However, the longer term financial impact of all of the above-mentioned risks on the Balancing Pool is mitigated by the ability to levy customer charges on ratepayers to cover any shortfalls.

## FINANCIAL PROFILE

(\$ millions)	12 months ended		Six months ended		For the year ended December 31		
	June 30, 2005	June 30, 2005	June 30, 2004	2004	2003	2002	
Net change in Balancing Pool deferral acc't	(42.5)	0.1	(21.3)	(63.9)	8.1	168.6	
Depreciation	59.0	29.5	29.5	59.0	59.2	58.4	
Other non-cash items (1)	19.6	19.6	(4.8)	(4.9)	15.8	(81.6)	
Adj. to convert mark-to-market items to cash	35.2	(11.8)	3.0	50.0	16.1	8.5	
<b>Cash Flow from Operations</b>	<b>71.2</b>	<b>37.4</b>	<b>6.4</b>	<b>40.2</b>	<b>99.2</b>	<b>153.8</b>	
Capital expenditures	(0.1)	(0.0)	(0.0)	(0.1)	(0.2)	(0.1)	
PPA lease payments	(110.4)	(56.6)	(53.8)	(107.7)	(102.4)	(96.7)	
<b>Gross Free Cash Flow</b>	<b>(39.3)</b>	<b>(19.2)</b>	<b>(47.5)</b>	<b>(67.6)</b>	<b>(3.4)</b>	<b>57.1</b>	
Working capital changes	11.9	39.4	8.0	(19.5)	(4.8)	(127.6)	
<b>Free Cash Flow</b>	<b>(27.4)</b>	<b>20.2</b>	<b>(39.5)</b>	<b>(87.1)</b>	<b>(8.2)</b>	<b>(70.5)</b>	
Sale of property, plant, & equipment	0.1	-	5.2	5.3	-	-	
Other investments	(9.2)	(0.1)	(5.4)	(14.6)	(12.2)	(5.0)	
Electricity rebates	(0.8)	-	-	(0.8)	4.7	(34.8)	
Debt financing	-	-	-	-	-	-	
Net change in cash	<b>(37.3)</b>	<b>20.1</b>	<b>(39.8)</b>	<b>(97.1)</b>	<b>(15.7)</b>	<b>(110.3)</b>	
Cash balance (\$ millions)	61.3	61.3	98.6	41.2	138.4	154.1	
PPA lease obligations	1,732.7	1,733	1,843	1,789.3	1,896.9	1,999.4	
Cash flow/PPA lease obligations	4.11%	n/a	n/a	2.25%	5.23%	7.69%	
Cash flow/annual lease payments (times)	0.65	0.66	0.12	0.37	0.97	1.59	

(1) Re-evaluation of assets and liabilities and depreciation from discontinued items.

(2) Other investments include reclamation and abandonment charges, deferred charges, and regulatory deferral.

n/a = not applicable.

### Summary:

- Cash flow from operations has been insufficient to fully fund the Balancing Pool's PPA lease payments for the last two and a half years.
  - This shortfall, together with working capital requirements and other investments (mainly reclamation and abandonment expenditures) resulted in a \$97.2 million drawdown of the Balancing Pool's cash balances in 2004 to \$41.2 million at December 31, 2004.
  - Positive changes in working capital resulted in an increase in the Balancing Pool's cash balance to \$61.3 million at June 30, 2005.
- As a result of the \$63.9 million negative net change in the Balancing Pools's deferral account in 2004, the overall deficit increased to \$232.5 million at December 31, 2004, and was at \$232.4 million at June 30, 2005.
  - This deficit represents the amount by which liabilities exceed assets, and will ultimately have to be funded prior to the wind up of the Balancing Pool in 2021.

### Outlook:

- The operating deficit for 2005 is expected to exceed the Balancing Pool's cash balances; hence, short-term financing will be required to cover the shortfall.
  - During 2005, the Balancing Pool finalized two unsecured credit facilities to borrow up to an aggregate amount of \$100 million.
  - It is expected that roughly \$85 million of these credit facilities will be utilized by the end of 2005.
- In September 2005, the Balancing Pool determined that, based on its projected cash needs for 2006, it will not levy a customer charge for 2006.
- Balancing Pool's financial profile is expected to remain stable in the medium to longer term, given the current regulatory support.

## BANK LINES

- The Balancing Pool has the following unsecured credit facilities to fund operating deficits on a short-term basis:
  - A \$50 million committed extendible operating loan with a 364-day term, to a two-year term out, and
  - A \$50 million 364-day committed revolving extendible operating credit facility.
- The credit facilities are mainly to fund operating deficits on a short-term basis until a customer charge can be levied to collect the shortfall.
- The Balancing Pool has drawn a total of \$43 million on these credit facilities, as at September 30, 2005.
- No term debt issuance is expected in the medium term.

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## REGULATORY AND OPERATIONAL FRAMEWORK

- Alberta's electricity market has evolved substantially since 1995.
- The *Electric Utilities Act*, the original legislation concerning market deregulation, was passed in May 1995.
- In June 1995, the Power Pool Council (a not-for-profit corporation) was formed to:
  - Operate Alberta's electricity market; and
  - Oversee the real-time coordination of the provincial transmission grid.
- In 1998, an independent Transmission Administrator, Power Pool Administrator, and Power Pool Council were appointed to facilitate the process of deregulation.
- The Balancing Pool was created in late 1999 primarily:
  - To meet the obligations and responsibilities associated with both the sold and unsold PPAs; and
  - To manage the financial accounts arising from the transition to a competitive generation market on behalf of electricity consumers.
- As part of the deregulation process, all generation capacity in service as of December 31, 1995, was sold by the Province in August 2000 under PPAs.
  - Five bidders received rights to 4,249 MW of generating capacity for up to 20 years, commencing on January 1, 2001.
  - The Balancing Pool became the recipient of the resulting auction funds, and became the counterparty to the remaining unsold PPAs.
- Generation capacity in service after December 31, 1995, was automatically considered non-regulated.
- The PPAs were structured so the plant owners could recover sunken costs resulting from management assumptions concerning the continuance of a regulated electricity market.
  - The rate of return is based on deemed equity of 45% and forecast ten-year Government of Canada bond yields plus 450 basis points.
  - Fuel and other cost escalators are passed on to PPA purchasers in order to ensure the continued long-term economic viability of these facilities.
  - The system was designed to inhibit potential market manipulation by plant owners while increasing the number of market participants and gradually creating a more competitive market for the generation of electricity.
- The unsold PPAs were offered to market participants by the Balancing Pool at a second auction in December 2000 (the MAP I auction), wherein 2,800 MW of forward electricity contracts were sold for terms varying in length from one to three years.
  - Following the MAP I auction, the Balancing Pool retained 44% of the original generating capacity offered for sale.
- As at January 1, 2001, the Balancing Pool was responsible for the unsold PPAs related to the Clover Bar generating station (gas), Genesee (coal) generating plant, and Sheerness generating station (coal), having a total capacity of 2,146 MW.
  - The Balancing Pool was also the counterparty to the hydroelectric PPA and assumed the commercial operations of the H.R. Milner generating station (144 MW).
- In 2002 and 2003, the Balancing Pool sold the remaining 2,146 MW of capacity through the MAP II sale process, for terms ranging from one to three years (maturity dates of contracts range from December 2004 to March 2006) and sold the H.R. Milner plant (144 MW), effective January 1, 2004.
  - The Balancing Pool remains the counterparty to the hydroelectric PPA.
- On June 1, 2003, the new *Electric Utilities Act* was proclaimed.
- The only changes in the *Electric Utilities Act* that impacted the Balancing Pool were the changes in its governance structure and the responsibility for funding the new Office of the Utilities Consumer Advocate.
  - The Balancing Pool now reports directly to its own board of directors appointed by the Government of Alberta and is completely separate from the AESO (previously the Transmission Administrator and the Power Pool).
- Early in 2004, the Alberta Minister of Energy also directed the Balancing Pool to provide funding for an electricity consumer education program.
- On April 1, 2005, the Balancing Pool announced the planned termination of the Clover Bar PPA, which took effect on October 1, 2005, coinciding with the last maturity date of the MAP II contracts associated with Clover Bar.
  - The decision to terminate the Clover Bar PPA was the result of the Balancing Pool losing about \$50 million per year from the sale of output from this plant.

- Clover Bar was an inefficient (high heat rate) facility with very high operating costs.
- The Balancing Pool is currently in the final stages of its MAP III process, which will involve the sale of the output from the PPAs associated with the Genesee and

Sheerness generating plants once the MAP II contracts expire on December 31, 2005, and March 31, 2006.

- MAP III contracts will range in size from 25 MW and up, and
- Range in terms of duration from one to 15 years.

## LEGAL FRAMEWORK/RISK MANAGEMENT POLICIES

- The Balancing Pool’s financial strength principally resides in its regulatory ability to effect cost recovery (if necessary) from Alberta’s electricity ratepayer base.
  - Any PPA-related costs resulting from “extraordinary events” associated with force majeure, unit destruction, and buyer or owner default are recoverable via surcharges placed on each customer’s electricity bill.
  - This flexible cost recovery mechanism is provided by the governing regulation, and specific amounts or recovery events do not require further regulatory or legislative approval.
  - Should specific customers change or disappear, cost recovery amounts will be spread over the remaining ratepayer base.
- The Balancing Pool’s mandate is to be in a cash-neutral position at the end of its existence in 2021.
  - The “true-up” mechanism allows the Balancing Pool to project its cash needs by December 1 for future years, and is designed to ensure adequate funding for the period.
  - If a cash shortfall is projected for the upcoming year, a consumer charge may be levied.
  - Any cash shortfalls resulting from unforeseen events are temporarily funded by a combination of cash reserves and credit facilities, and may be subsequently recovered the following year through a consumer charge.
  - While the Balancing Pool may experience temporary swings in funding, these are likely to be eliminated in upcoming financial periods.

### Risk Management:

- Commodity price risk, including fuel price risk for those PPAs that the Balancing Pool continues to hold, is managed through the use of forward hedging strategies.
- Volume risk (or plant availability risk) applies only to those PPAs that the Balancing Pool continues to hold.
  - This is mitigated by selling the electricity generated into the spot market rather than selling the electricity forward.
- Counterparty risk is managed by limiting the Balancing Pool’s exposure to market participants according to creditworthiness. In March 2005, these limits were increased in order to lower the cost of credit to potential MAP buyers as follows:

Senior Debt Rating	Maximum Exposure Limit	
	Previous	Revised
AAA	\$25 million	\$50 million
AA	\$20 million	\$40 million
A	\$15 million	\$25 million
BBB	\$10 million	\$20 million
BBB - or Less	Nil	\$10 million

- Collateral is required if the Balancing Pool’s total exposure exceeds these limits.
  - Collateral consists of letters of credit or cash to cover security deposits.
  - Credit exposure is calculated once per month, and a monthly report is prepared and sent to the audit and finance committee.
  - Trading is only used to hedge positions and not for speculative purposes.
  - In addition, the Balancing Pool uses conservative estimates of electricity prices and gas prices as a basis for its forecasts.
- Collection risk is relatively limited, as all MAP II participants are required to provide prudential security in the amount of: (1) 90 days of MAP II capacity payments, and (2) 75 days of energy and pass-through charges.

### Balancing Pool

**Balance Sheet**

(\$ millions)

	As at June 30, 2005	As at December 31				
	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	
<b>Assets</b>						
Cash & short-term investments	61.3	41.2	138.4	154.1	264.4	1,191.8
Accounts receivable and prepaid expenses	45.5	109.5	77.3	107.0	96.9	7.4
Current portion of hydro PPA	38.9	24.0	53.0	35.5	20.3	-
<b>Current Assets</b>	<u>145.7</u>	<u>174.7</u>	<u>268.6</u>	<u>296.6</u>	<u>381.6</u>	<u>1,199.2</u>
Long-term receivable	7.1	9.6	-	-	-	-
Hydro PPAs	614.7	620.0	636.0	699.7	742.9	735.0
Net thermal PPAs	891.2	919.9	977.4	1,034.9	1,092.4	2,188.0
Other net fixed assets	0.3	0.3	0.3	21.1	48.8	76.5
Deferred charges	1.5	2.1	7.9	4.3	17.6	0.9
Balancing Pool deferral account	232.4	232.5	168.6	176.7	345.3	329.8
<b>Total</b>	<u>1,892.8</u>	<u>1,959.2</u>	<u>2,058.8</u>	<u>2,233.2</u>	<u>2,628.6</u>	<u>4,529.3</u>
<b>Liabilities and Equity</b>						
Due to entity under common control	-	-	-	0.4	0.4	0.1
Accounts payable and accrued liabilities	64.2	91.4	81.1	112.3	227.9	64.6
Deposits from MAP participants	-	-	1.1	4.0	5.9	7.2
Electricity rebates	-	-	-	-	143.8	2,127.7
Current portion of PPA lease obligations	98.6	113.2	107.7	102.4	96.7	109.2
Current portion of regulatory deferral payable	-	-	5.8	6.8	24.6	61.4
Current portion of reclamation & abandonment prov.	21.7	11.8	12.3	9.9	28.1	5.3
Current portion of small power producer contracts	8.3	8.0	8.0	10.0	11.3	0.0
<b>Current Liabilities</b>	<u>192.7</u>	<u>224.3</u>	<u>216.0</u>	<u>245.8</u>	<u>538.8</u>	<u>2,375.6</u>
PPA lease obligations	1,634.1	1,676.1	1,789.3	1,896.9	1,999.4	2,078.8
Regulatory deferral payable	-	-	-	-	-	19.0
Reclamation and abandonment provision	32.5	22.8	22.5	31.3	13.1	24.8
Small power producer contracts	33.5	36.0	31.0	59.2	77.3	31.2
<b>Total liabilities</b>	<u>1,892.8</u>	<u>1,959.2</u>	<u>2,058.8</u>	<u>2,233.2</u>	<u>2,628.6</u>	<u>4,529.3</u>
Equity	-	-	-	-	-	-
<b>Total</b>	<u>1,892.8</u>	<u>1,959.2</u>	<u>2,058.8</u>	<u>2,233.2</u>	<u>2,628.6</u>	<u>4,529.3</u>