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Independent Power Producers Society of Alberta (IPPSA)
Check Against Delivery

"Important Conversations in Building a Competitive Alberta Power Market"

Thank you, Stephen for the opportunity to speak today about the conversations we believe are important as we evolve the Alberta power market. Congratulations to the IPPSA organizers for continuing to provide a valuable forum here in Alberta to discuss important issues about our power market. This conference is not only important for the understanding that is required to evolve the Alberta power market, but it's a great gathering place for electricity experts from around the world to share insights and also take away concepts from our conversations for their markets.

At TransAlta, we enter into the discussion about the Alberta market by looking at both the present and the future. When it comes to investing in power infrastructure, we have no choice but to take an 8 to 10 year view. Quite simply, today to obtain the social license to operate requires 2 to 3 years for development and permitting work and up to 4 years for construction, depending on the technology. At TransAlta, this 8 to 10 year view is essential as we allocate capital over 3 markets and 5 technologies and our shareholders expect a return that is fairly stable and predictable. Alberta is a central market for us, and because of our positioning in this market, we spend almost as much time thinking about 2020 as we do thinking about the next quarter in 2013.

My remarks today will give you some sense of how we think about the future and the various scenarios that need to be examined to make good investment decisions here in Alberta and across Canada. It will also give you some insight into the questions that we believe need to be explored now to ensure the power market stays ahead of infrastructure needs of a growing province. Finally, I will touch on what we hear from our customers on their needs and how this impacts our thinking on our company's strategy and the markets we invest in.

What you will hear from me today is that we believe the current market structure has delivered many benefits to Albertans and it will continue to do so in the short term. You will also hear that as we evolve over the next 10 years, many questions will have to be answered so that our sector can stay ahead of growth in Alberta, and continue to build a strong foundation for what is to come.

Let me start by outlining what we view is the current baseline scenario for growth here in Canada and in Alberta.

Alberta is among the provinces that will deliver the economic bench strength of the nation for at least the next two decades. The broadest scenario that we see for Canada includes growth for LNG development in British Columbia; oil sands investment in Alberta; uranium, potash and oil and gas investment in Saskatchewan; hydro investment in Manitoba; a re-tooling of the manufacturing base in Ontario; hydro and mining investment in Quebec; refinery investment potentially in New Brunswick; hydro and transmission investment in Newfoundland and Nova Scotia with the investments in lower Muskrat Falls and the Maritime link; plus offshore oil and gas investment on the east coast. As Canadians, who are the owners of Canada.inc – with this array of investment opportunities – we should all be pretty pleased about the chances for building a strong future for our children and grandchildren. This is definitely the place to be!

When we stand back, what we see is Canada working hard to compete internationally to supply markets with resources, whether they be oil, natural gas, wood fibre, electricity, food, potash, uranium or coal. In this room, we know that to compete – it takes an advantage. In some countries, the advantage has come from labor costs – that is the legacy of the Chinese and also something that is changing. In other countries, it is about technology - the legacy of the Americans. For Canada – our resources at first glance are our key advantage, but we cannot forget how the multiplier of innovation and technology is needed to overcome distance from markets. It is no coincidence that horizontal drilling and fracking are Canadian technologies. Resources are also the legacy of Western Australia where the iron ore sits on the top of the ground waiting to be scooped up and sent to market where they have an advantage from proximity to markets. In a world with an international market for money – access to cheap capital is no longer an advantage for anyone. However, a strong balance sheet is a competitive advantage as economies and companies with weak balance sheets cannot attract the capital at low enough rates to make incremental investments for the future. For Canada, the ability to attract low cost capital and the competitiveness of the strong balance sheet of the Canadian economy and of many of the provinces is indeed a critical competitive advantage. When you compare Canada to countries with too much debt and too few advantages, we have in our hands, the opportunity to participate in the wealthy creation that will come as the global economy expands. The starting balance sheet of our country, our province and our industry should never be taken for granted and is a great competitive advantage for Canada.

Canada and Alberta do face challenges in the light of competitive advantages. We see a lot of growth ahead, but a dwindling labor force – which means even more pressure on wages. But we have a well-educated and innovative labor force – which means we can use technology to gain an edge. What worries me most about our work force when I look over the next decade is how the pressure for labor across Canada will make it even more difficult here in Alberta to get our work done competitively. Whether we are executing annual turnarounds at our power plants or building new power plants. For over 2 decades, labor has been flying here from all over the country to do the physical work. If Canada develops along the growth track that I've outlined, this model will experience significant pressures. The federal government is working hard to change immigration policy to help here. But we are in a race for human capital. What we see is that countries like Australia are already well ahead of us on this front, and we need to find a way to do more [Perth Airport].

So an alternative scenario that we explore is one where labor is a constraint and labor productivity makes us even higher cost and potentially uncompetitive.

There are other issues with Canadian competitiveness that includes access to markets for some of our commodities such as bitumen. There has been a lot discussed and written on this constraint and of course the recent Alberta fiscal budget is a good reflection of this reality. We are all taking these realities into consideration when thinking about the scenario's for growth. Lack of access to markets and the crowding out of bitumen investment by shale oil could reduce the future needs for electricity in our province by as much as 1% a year.

But there is a very important competitive advantage that we have today that I think we must protect and even strengthen. That is that we have relatively strong public policy processes with solid institutions – something we need to protect almost as much as our resources. We need to protect and build on the integrity of these systems that we've built and resist the temptation to allow short term pressures by special interest groups that are outside the process to change an outcome. Our discussion at this conference about strengthening the integrity of the Alberta institutions in the power sector is perhaps among the most important for keeping Alberta and Canada competitive.

For TransAlta, these are the scenarios we examine when thinking about capital allocation to 2020. It's in the context of Canada competing globally that we think about electricity development. In all scenarios, Canada and Alberta will need significant investment in electricity infrastructure. Our partnership announced in 2012 with Mid-American was about ensuring that we could bring the capital to markets here in Canada, where we as a company have a strong advantage. Alberta's power market has evolved over time and will continue to evolve as we move forward. We are the province that has often led the way, reliably and sustainably. To date, the power market has produced competitive pricing for customers. Supply has kept pace with demand, the playing field is level, customers have their choice of supplier, and the market has a mix of generation including coal, hydro, gas and wind. In fact, Alberta has the highest percentage of wind in the grids across Canada and we did this without imposing a renewable portfolio standard or offering feed in tariffs. Most importantly, all of the investment in the industry is privately financed and our government does not carry any debt for the sector. We also have so far delivered high reliability and companies continue to compete for the next generation spot.

So far, we've been able to stay ahead of a fast growing economy with only a few small hiccups that haven't been significant.

As we look out on the horizon we do see changes fast approaching that will require evaluation, conversation and continued evolution of our system. There are 2 changes that warrant some significant attention.

First, the power purchase arrangements with the heritage regulated assets have been slowly running off. By the end of 2020, all of these long term contracts, which have been providing stability in cash flows to both the generation owners and the PPA buyers and allow some of us to use balance sheets to take on modest merchant positions here in the market, will be entirely gone. These PPA's not only allowed customers to benefit from affordable, stable pricing, but they provided a transition period from regulation to de-regulation. So far, Alberta customers have not experienced a truly de-regulated market.

For TransAlta, the PPA's allowed us with our partner Capital Power to make significant investments in 2 merchant coals plants, something that we could not have done without the long term contracting base the PPA's provided. The MSA in its recent state of the market report outlined that the risk in an energy only market is borne solely by the investors. Much of the investment in the past 10 years in Alberta has either been through brownfield expansions, on site co-generation and by companies with balance sheets. As the report commented it's virtually impossible to use project finance in Alberta due to the absence of long term contracts.

A second factor is the new federal regulations for coal fired power plants in Canada. These regulations ensure that coal plants that do not retro-fit with CCS by the end of approximately 48 years, must shut down and be replaced with plants that do not emit more than a combined cycle gas fired plant. In Alberta to meet capacity growth we need 200 to 300 MW a year to keep up with demand and by 2030, depending on the competitiveness of CCS technology, we may need to replace over 5000 MW of coal. The current estimates are that the province will need $10 to $15 billion in power infrastructure and it's critical that we do our part to ensure the replacement power does not reduce the competitiveness of our economy. High cost power won't cut it if we want to ensure that Alberta's resources are competitive over the long term.

Competitive and predictable priced power is essential for economic growth. A key driver of the cost of power is the cost of financing the significant investments in power plants. Fully contracted or highly contracted plants attract cheaper sources of capital that reflect the stable cash flows provided by long term contracts. The cost of financing a fully merchant plant vs a fully contracted power plant are substantially different. A fully merchant power plant would attract virtually no debt and its investors would require returns similar to what we see in the mining or oil and gas sectors.

Our view is that Alberta customers, whether they be households, coffee shops or oil sands plants, cannot afford and don't want to afford more expensive generation because of the cost of capital.

So as we think about our scenarios for growth and the factors that are affecting the future, we think there are 4 key conversations that need to take place here in Alberta about our power market.

First – how do we maximize the benefits from our existing power infrastructure? The existing assets have been important contributors to a competitive power market and have provided the base to finance new developments. How do we ensure that those assets continue to provide this value? In Alberta, it is relatively unknown that our coal is low sulfur, that we control Mercury and particulate matter, that we have no air shed issues, and as of 2012 we now have regulated greenhouse gas limits and timelines. Regulations for coal plants that put Canada ahead of all other jurisdictions in meeting world leading greenhouse gas standards; standards that no other country in the world has signed up for - and that we do all this and operate at high levels of availability and efficiency. Albertan's need to be proud of their environmental record on coal, the diversification of the existing grid and a regulatory framework that has kept prices low and we need to ensure that the access to these resources continues as we build the next round of infrastructure. Our existing assets are a key feature of the competitiveness of the Alberta economy today and we need to not be shy about promoting our sector and how we have been and continue to be responsible.

A second question is how do we continue to ensure the strength of the companies that invest here. Most of Alberta's power companies are global players. TransAlta, ATCO, Capital Power, TransCanada, AltaLink, to name a few. All invest here, at home, and abroad. The success of our company is absolutely rooted in our heritage here in Alberta. Our market here needs to be efficient and fair and at the same time, should not unfairly disadvantage us as incumbent players. The Alberta companies, who started here, should also have the best chance to balance all stakeholder concerns to ensure competitive developments.

Third, how do we finance generation after the PPAs roll off? Most generation that has been built in the last decade has been financed utilizing the balance sheet of the generation owners. The PPAs have provided an important underpinning to the balance sheets of the companies who have invested in power plants. As the MSA state of the market report notes long term contracts with industrial customers or long term PPAs with load-serving entities are not a feature of this market and will not be available to mitigate the risk of power plant investments. Today it suggests that balance sheet financing is the answer; something that our shareholders would not support once the PPAs are gone. Given the lead times required to meet the changes coming, we need to turn our mind to this challenge. How we work together to answer this question has important implications for power pricing in the future.

Finally, How Do We Sustain Our Social Licence to Continue to Build and Operate Power Generation Facilities?

Overall, Albertans have supported the industrial growth of the province and the expansion of the power infrastructure to meet the essential needs for growth. Power systems can be intrusive and it can dominate and change skylines. The companies behind the energy of the province are also a big part of the communities we operate within. In addition, the public is increasingly concerned about responsible operating measures and environmental issues in which the political system responds to meet these concerns. Whether as an industry or as individual companies we need to work with the public, stakeholders, governments, communities and regulators in a proactive manner that is collaborative and solution-oriented. We only need to look to the challenges of the power sector in the US and the pipeline industry in Canada and the US to understand that challenges get greater when constructive dialogue is not established. We also need to be respectful of First Nations and their aspirations to be beneficiaries of sustainable economic growth. The strength of our institutions and the strength our companies to work proactively in our development, is another great determiner of our competitiveness as a province and as a country.

Before I end my comments I would like to take a minute or two to talk to you about what I hear from our customers. Whether they are municipalities, oil sands companies, or retailers they are all concerned about price and volatility. Price stability is their number one concern. Customers almost never talk about reliability. They don't know that it's a 'feature' of the power market. It's just expected. They all now talk about environmental attributes. They want power at an affordable price and those companies who can supply them low prices will gain their support and attract more market share.

TransAlta has worked in many jurisdictions across Canada, in Washington State, in California and in Western Australia. All markets go through cycles. In good times, power bills are not top of mind for customers and prices often rise reasonably without creating a significant amount of concern. Since 2008, everywhere that we have worked, competitiveness is top of mind, especially for our customers. Whether it's an oil sands producer, an iron ore mine, a gold mine, a nickel mine or a retailer of consumer goods – the world is increasingly competitive and the race to be the supplier to global markets is increasingly tough. Countries and regions that have low cost resources, find transportation routes, have solid regulatory regimes, strong balance sheets both with their governments and with the businesses, have smart and educated labor forces, access to technology and the entrepreneurial mindset to make those investments will win. Those who have low costs, environmentally sensitive and reliable electricity systems, will outpace their competitors. Those that can make these investments in a socially and environmentally responsible way will grow wealth over the long term. That's what Canadians, and Albertans in particular, have been doing for decades. It's important that we are more aggressive about our competitiveness in the future and even more about telling our story.

We have much that is good to build on here in Alberta – both in how we've developed our resources and particularly how we've built our power system. I'm looking forward to the conversations that will build on the success and position us for an even more competitive future as we move our business towards 2020.

Thank you.