



**balancing**pool

**2010** Annual Report



# The Balancing Pool

## Generating value for Alberta's consumers

The Balancing Pool was established in 1998 by the Government of Alberta to help manage the transition to competition in Alberta's electric industry. Our current obligations and responsibilities are governed by the *Electric Utilities Act* (effective June 1, 2003) and the *Balancing Pool Regulation*.

Our legislated duties include:

- To manage generation assets in a commercial manner, specifically any Power Purchase Arrangements (PPAs) held by the Balancing Pool that include the right to exchange electric energy and ancillary services, and any arrangements or agreements derived from these assets;
- To hold the Hydro PPA and manage associated payments;
- To forecast revenues and expenses (incorporating estimates of Pool price volatility and potential expenses related to risk backstop activities) and allocate the forecast surplus or deficiency as evenly as possible through a Consumer Allocation or charge;
- To participate in appropriate regulatory, dispute resolution and other proceedings and processes to protect the interests of the Balancing Pool and the value of its assets; and
- To manage risks prudently in all aspects of its operations.

PPAs are one of the mechanisms used by the Government of Alberta to introduce competition into the supply of thermal electric power from regulated generating units. The PPAs were auctioned in 2000 and provide buyers with the rights to formerly regulated generating capacity. The Balancing Pool assumed the unsold Sheerness, Genesee and Clover Bar PPAs. Through a number of contracts that covered periods to 2006, the Balancing Pool transferred electricity capacity and ancillary services associated with these generation assets into the hands of market participants.

The Balancing Pool may sell the Genesee PPA when market conditions are such that a competitive sale will result in the Balancing Pool receiving fair market value, or may terminate a PPA when it proves to be uneconomical. In 2005 the Balancing Pool sold the Sheerness PPA to TransCanada Energy Ltd. and terminated the uneconomical Clover Bar PPA.

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### Stakeholder Reception

Monday, May 16, 2011  
4:00 p.m. to 7:00 p.m.

Centini Restaurant  
160 – 8th Avenue S.E.  
Calgary, Alberta

## Message to Stakeholders from the Board Chair


Since the Balancing Pool began making annual Consumer Allocation payments in 2006, we have paid out close to \$1 billion to Alberta's electricity consumers. In addition, in 2001 the Balancing Pool paid \$2 billion in electricity rebates to consumers from proceeds of the Power Purchase Arrangements (PPA) auction.

In 2010 alone the Consumer Allocation was more than \$160 million—despite a continuation of softer electricity prices which affected our cash flows and served as the prime basis for setting the payment amount.

These allocations are one of the ways the Balancing Pool generates value for Alberta's electricity consumers. In 2010 our Board and management reviewed our long-term strategy, with a particular focus on liability management associated with our ongoing PPA contractual arrangements and obligations. We continued to closely monitor our risk and exposure assessment on behalf of Alberta's electricity consumers.

My sincere thanks to our Board and management for its dedication and devotion toward ensuring that our mandate was successfully carried out in what proved to be another challenging year of operation.

Thanks also to our government officials and industry stakeholders in working closely with our Board, management and staff in such a constructive, collaborative and positive manner in 2010.



**Thomas Cumming**  
*Chair*

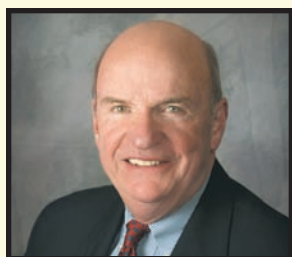


**Thomas Cumming**

**“Since the Balancing Pool began making annual Consumer Allocation payments in 2006, we have paid out close to \$1 billion to Alberta's electricity consumers.”**

## Governance of the Balancing Pool

Adhering to the *Electric Utilities Act (2003)*, the Minister of Energy must appoint as members of the Balancing Pool not more than nine individuals who are independent of any person who has a material interest in the Alberta electric industry. Members are appointed by the Minister on the basis of their cumulative expertise in order to enhance the performance of the Balancing Pool in exercising its powers and carrying out its duties, responsibilities and functions. The term of office of a member is three years; a member is eligible to be appointed for a maximum of three terms of office.



**Thomas Cumming, Chair**, was previously a member of the Power Pool Council, and served as the Market Surveillance Administrator from 2000 to 2003. Tom is also a Director of Pengrowth Corporation. From 1988 to 2000, he was the President and CEO of the Alberta Stock Exchange. Prior to that, he spent 24 years with the Bank of Nova Scotia in Canada, Ireland and England. Tom has a Bachelor of Applied Science degree in Engineering and Business and has been designated a life member of the Association of Professional Engineers, Geologists and Geophysicists of Alberta.



**Peter Flynn** held the Poole Chair in Management for Engineers in the Department of Mechanical Engineering at the University of Alberta. Peter's experience includes senior executive positions in leading telecommunications, energy and industrial management companies. He also has served as Director on several corporate and community boards, including the Board of EPCOR Utilities Inc. for 10 years and Plutonic Power Corporation. Peter holds a Ph.D. in Chemical Engineering from the University of Alberta.



**Mary Ritchie** is President and Chief Executive Officer of Richford Holdings Ltd. an accounting and investment advisory services firm. She is a member of the Board of Directors and Audit Committees of Industrial Alliance Insurance and Financial Services Inc. and Alaris Royalty Corp. She is also a member of the Board of Governors and Chairman of the Audit Committees of RBC Funds Inc. and RBC Advisor Global Fund Inc., as well as a member of the Independent Oversight Committee for RBC Funds and Phillips Hager & North. Mary is a fellow of the Canadian Institute of Chartered Accountants (FCA) and recently completed two terms as a member of the Institute's Accounting Standards Oversight Council.

**Rafi G. Tahmazian** has more than 20 years of experience in the energy sector and financial services industry. He is currently a Managing Director of Canoe Financial LP and holds positions as both director and advisory board member of several private resource entities and energy-specific investment funds. After positions with First Marathon Securities and LL&E Canada, Rafi was a partner from 1996 to 2008 at First Energy Capital Corp., where he also held the positions of Vice-Chairman and Managing Director. He has a Bachelor of Economics from the University of Calgary.



**Stella Thompson** a co-founder and principal of Governance West Inc. from 1996 to 2008, has wide-ranging board experience and currently serves on the Boards of Atomic Energy of Canada Ltd., Calgary Airport Authority, Genome Alberta, the Provincial Audit Committee and First Calgary Financial. She was involved in the deregulation of energy commodities from the early days as a Vice-President at Petro-Canada and has extensive experience in many aspects of the oil and gas and electricity industries. Stella previously served on the Board of ENMAX Corporation for five years. She has a Masters degree in Economics and has been awarded the designation of ICD.D by the Institute of Corporate Directors.



**The Balancing Pool's Audit and Finance Committee is chaired by Dr. Flynn, and the Governance and Human Resources Committee is chaired by Ms. Thompson.**

# Report from the President and CEO



Gary Reynolds

## 2010 Financial Overview

At the end of 2010, the Balancing Pool had net revenues of approximately \$365 million and managed more than \$1.6 billion in assets on behalf of Alberta's electricity consumers. The accompanying chart shows the Balancing Pool's primary sources of revenue or cash inflows as well as major expenses or cash outflows.

Net cash flows from the Power Purchase Arrangements (PPAs) we hold were \$75 million, as compared to \$101 million in 2009. The Genesee and Hydro PPAs generate cash flows from the sale of approximately 950 megawatts (MW) of electricity and ancillary services into the spot and forward electricity markets. This is the largest source of cash inflow for the Balancing Pool.

A continuation of softer electricity prices through most of 2010 was offset with slightly higher prices as the year wound up, marginally improving our cash flow. The beginning of 2010 saw some of the lowest electricity prices in Alberta in the past eight years. In 2010 average electricity prices were \$51 per megawatt hour (MWh) as compared to \$47 per MWh in 2009.

A more stable valuation of the Hydro PPA asset was a primary factor in the Balancing Pool's bottom line improvement. The estimated value of this PPA at year-end was \$628 million as compared to \$693 million in 2009.



## Consumer Allocations Approach \$1 Billion

As noted in our Chair's message, the Balancing Pool's annual allocations to consumers approached a cumulative total of \$1 billion in 2010. Approximately 80% of the annual allocation goes to commercial and industrial electricity consumers, with the remainder to the residential and farm sectors.

As we are required to do annually under the *Electric Utilities Act (2003)*, we announced in 2009 an allocation to power consumers of \$4.00 per MWh of consumption for 2010. We based the allocation on a forecast of 2010 revenues and expenses. By mid-year, however, we adjusted the allocation amount because of lower than expected Balancing Pool cash flows from PPA electricity sales. We paid out \$4.00/MWh from January to June 2010, and \$2.00/MWh from July to December 2010. As a result, the average Consumer Allocation for 2010 was \$3.00/MWh, or more than \$160 million.

Summary of Consumer Allocations 2006 – 2010		
Year	\$/MWh	(thousands of dollars) Total
2006	1.00	53,814
2007	3.00	161,704
2008	5.00	271,444
2009	6.50	343,729
2010	3.00	160,772
<b>Total</b>		<b>999,463</b>

In November 2010 we announced that the 2011 Consumer Allocation will be \$2.00/MWh of consumption as forecasts for continued soft electricity prices at that time dictated a conservative allocation. Alberta's electricity consumers are expected to receive more than \$100 million in 2011 from the allocation.

**“Effective risk management, implementing a prudent investment strategy and meeting our PPA and contractual obligations are all aspects of the ongoing work our Board and staff undertake on behalf of, and for the benefit of Alberta's electricity consumers.”**

## Stronger Equity Markets Improve Investment Returns

The Balancing Pool realized a 9.6% average return after fees on our investment portfolio in 2010. Stronger performance in Canadian equity markets and to a lesser degree in international equities positively influenced our portfolio balances. Since the 2008 worldwide global recession, by year-end 2010 our equity portfolio had almost recovered to its peak level originally reached in the third quarter of 2008.

Our investment strategy continues to be based on prudent investment standards, and a conservative, diversified asset mix focused on achievement of a fair return on investments with reduced risk. The Balancing Pool's Board and management regularly review our investment strategy and the performance of all external Investment Managers.

	Asset Mix	Balances at Year-End
Cash and Money Market	2%	\$14 million
Fixed Income	32%	\$247 million
Canadian Equities	34%	\$266 million
Non-Canadian Equities	32%	\$243 million
<b>Total</b>		<b>\$770 million</b>

## Future Focus

Effective risk management, implementing a prudent investment strategy and meeting our PPA and contractual obligations are all aspects of the ongoing work our Board and staff undertake on behalf of, and for the benefit of Alberta's electricity consumers.

I appreciate the ongoing guidance of our Board members, the dedication of our management and staff, and the effective working relationships we have with government officials, agencies, and stakeholders.



**Gary Reynolds**

*President and Chief Executive Officer*





## Management's Discussion and Analysis

*Year ended  
December 31, 2010*



**balancingpool**

## Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A"), dated March 22, 2011, should be read in conjunction with the audited financial statements of the Balancing Pool for the years ended December 31, 2010 and 2009. The Audit and Finance Committee reviewed the contents of the MD&A and recommends its approval to the Board.

### Results at a Glance

Year ended December 31 <i>(thousands of dollars)</i>	2010	2009
Revenues and funding	365,492	331,258
Operating income	110,110	57,453
Net results of operations and comprehensive income (loss)	90,157	(12,280)
Consumer Allocation	160,772	343,729
Net change in cash, cash equivalents and investments	(57,523)	(98,320)
Cash, cash equivalents and investments	770,787	828,310
Balancing Pool deferral account balance	898,748	969,363
Total assets/liabilities	1,659,574	1,797,656
<i>Other Information</i>		
Total Volumes (gigawatt hours [GWh])	8,000	8,000
Average Pool price per megawatt hour (MWh)	\$50.89	\$47.81

## Operations

### Revenues and Funding

Details of Revenues and Funding <i>(thousands of dollars)</i>	2010	2009
Sale of electricity – Genesee power purchase arrangement (PPA)	274,494	337,441
Hydro power purchase arrangement	51,370	11,415
Investment income – Interest and dividends	26,180	30,391
Investment income – Realized losses on sale of investments	(4,092)	(66,186)
Payments in lieu of taxes (PILOT)	17,540	18,197
<b>Total revenues and funding</b>	<b>365,492</b>	<b>331,258</b>

## Change in Cash, Cash Equivalents and Investments

<i>(thousands of dollars)</i>	2010	2009
Operations (excluding items listed below)	34,434	143,214
Investment income – Interest and dividends	26,180	30,391
Investment net gains (losses)	42,635	71,804
Consumer Allocation	(160,772)	(343,729)
<b>Net change in cash, cash equivalents and investments</b>	<b>(57,523)</b>	<b>(98,320)</b>

### *Sale of Electricity – Genesee Power Purchase Arrangement*

Revenue from the sale of electricity under the Genesee Power Purchase Arrangement (“PPA”) decreased in 2010 versus 2009 by \$62.9 million largely as a result of lower net realized Pool prices year-over-year. Annual average Power Pool (“Pool”) prices increased year-over-year by approximately 6.4%. Net realized Pool prices include the effect of forward trades settled during the year. 2010 electricity sales include \$12.4 million net realized losses (2009 – \$42.7 million net realized gains) on forward sales transactions; during 2010 30% (2009 – 33%) of total electricity sales volumes were sold at fixed prices with use of forward sale transactions.

### *Hydro Power Purchase Arrangement*

Revenue from the Hydro PPA represents annual accretion of the value of the Hydro PPA asset, the difference between the actual cash receipts or payments and the estimated cash receipts or payments used in the valuation of the Hydro PPA asset at the beginning of the year. Hydro PPA revenues increased in 2010 versus 2009 by \$40.0 million as a result of market price increases as discussed above.

### *Investment Income (Loss)*

#### **a) Interest and Dividends**

<b>Details of Investment Income – Interest and Dividends</b> <i>(thousands of dollars)</i>	2010	2009
Interest income	17,086	19,532
Dividend income	11,492	12,064
Fund management fees	(2,398)	(1,205)
<b>Total investment income</b>	<b>26,180</b>	<b>30,391</b>

The year-over-year decrease in investment income of \$4.2 million is as a result of a \$2.4 million decrease in interest income and, a \$0.6 million decrease in dividend income due to maturities, sales of Fixed Income Investments during 2010 and lower interest rate yields.

## b) Realized Gains and (Losses) on Sale of investments

During 2010, the Balancing Pool sold investments having an original book value of \$108.0 million. Net proceeds from these sales were \$104.0 million (2009 – \$88.0 million) and capital losses of \$4.1 million (2009 – \$66.2 million) were realized.

## *Payments In Lieu of Tax*

During 2010, the Balancing Pool received PILOT instalments from the ENMAX group of companies, City of Medicine Hat and City of Lethbridge. Net funding from payments in lieu of tax ("PILOT") in 2010 was \$17.5 million as PILOT instalment receipts of \$18.3 million (2009 – \$36.8 million) were offset by PILOT refunds and audit costs relating to prior tax years of \$0.8 million (2009 – \$18.6 million). PILOT are based on the taxable income of a municipal entity as defined in the *Payment in Lieu of Tax Regulation of the Act* and are subject to audit by Alberta Revenue. PILOT received in the current year are instalments of 2010 taxes net of adjustments for prior years.

## Expenses

Details of Expenses <i>(thousands of dollars)</i>	2010	2009
Cost of sales	217,127	230,210
Small Power Producer contracts	(1,581)	12,741
Amortization and depreciation	19,680	19,703
Office of the Utilities Consumer Advocate	6,612	6,268
General and administrative	2,730	2,737
Other power purchase arrangement expenses	10,814	2,146
<b>Total expenses</b>	<b>255,382</b>	<b>273,805</b>

## *Cost of Sales*

Cost of sales includes PPA capacity payments, variable operating costs and transmission charges relating to the Genesee PPA. The decrease in cost of sales for 2010 of \$13.1 million is due to decreased capacity and incentive payments. PPA capacity payments which represent more than 90% of costs of sales vary year-over-year as a result of changes in indices and pass-through charges. Changes to Pool price have a minimal impact on the PPA capacity payments.

### *Small Power Producer Contracts*

Under the *Independent Power and Small Power Regulation*, the Balancing Pool is required to make monthly payments to TransAlta Utilities Corporation ("TransAlta"), the utility that administers the Small Power Producer contracts, for the amount by which the Pool price falls below the contracted price for Small Power Producers. If the Pool price is above the contracted price, TransAlta makes a payment to the Balancing Pool. In 2010, the Balancing Pool recorded net income of \$1.6 million (2009 – \$12.7 million net expense), which represents annual accretion of the value of the Small Power Producer contracts and the difference between the actual Pool price and the Pool price used to value the Small Power Producer contracts at the beginning of the year. Annual average Pool prices increased year-over-year by approximately 6.4% which had an impact on Small Power Producer contract results.

At December 31, 2010 there are 10 contracts subject to the *Independent Power and Small Power Regulation* (December 31, 2009 – 10).

### *Office of the Utilities Consumer Advocate ("UCA")*

The Balancing Pool is obligated to make certain payments as directed by the Minister of Energy which are included in Office of the Utilities Consumer Advocate. The Balancing Pool is responsible for 80% of the UCA costs. In 2010, the Balancing Pool accrued \$6.6 million (2009 – \$6.3 million), as directed by the Minister of Energy.

### **Other Income (Expense)**

<b>Details of Other Income (Expense)</b> <i>(thousands of dollars)</i>	<b>2010</b>	<b>2009</b>
Revaluation of Hydro power purchase arrangement	<b>(44,205)</b>	(174,328)
Revaluation of Small Power Producer contracts	<b>(9,114)</b>	(41,445)
Unrealized gains on financial investments	<b>59,626</b>	137,990
Unrealized change on financial derivative instruments	<b>(8,699)</b>	6,872
Reclamation and abandonment	<b>(17,708)</b>	1,742
Other income (expense)	<b>147</b>	(564)
<b>Total other income (expense)</b>	<b>(19,953)</b>	(69,733)

### ***Revaluation of Hydro Power Purchase Arrangement***

The Hydro PPA asset is recorded as a financial instrument calculated as the net present value of estimated cash receipts based on notional energy and reserve (ancillary service) volumes using management's best estimate of Pool price forecast, less PPA obligations over the remaining term of the PPA to 2020. The value of the Hydro PPA is estimated annually. The year-end valuation of the Hydro PPA resulted in a \$44.2 million (2009 – \$174.3 million) revaluation loss. Estimated forward market Pool prices used in the net present value model dropped by approximately 6% from 2009 to 2010 and the discount rate of 4% (2009 – 4%) was used to present value the estimated cash flows.

In 2010 the Balancing Pool received, net of PPA obligations and settlement of derivative contracts, \$72.6 million (2009 – \$51.1 million). The Hydro PPA receipts are the amount by which notional energy and reserve (ancillary service) volumes priced at Pool prices exceed PPA obligations. In 2010 there was no hedging activity related to the Hydro PPA (2009 – \$nil).

### ***Revaluation of Small Power Producer Contracts***

The Small Power Producer contracts are recorded as a financial instrument calculated as the net present value of payments or receipts based on the difference between the Small Power Producers' contract price and management's best estimate of Pool price forecast. The value of the Small Power Producer contracts asset or liability is estimated annually. The year-end valuations for 2010 were a net liability of \$40.9 million and 2009 \$41.4, therefore the valuation adjustment during 2010 was recorded as a loss of \$9.1 million.

In 2010 the Balancing Pool received \$1.6 million (2009 – paid \$12.7 million) under these contracts. An amount paid or received by the Balancing Pool in a given year depends upon the difference between the contract price for the Small Power Producer and the Pool price. Estimated forward market Pool prices used in the net present value model dropped by approximately 6% from 2009 to 2010 and the discount rate of 4% (2009 – 4%) was used to present value the estimated cash flows.

### ***Reclamation and Abandonment***

The reclamation and abandonment provision reflects a provision of \$17.7 million (2009 – reduction of \$1.7 million). Estimates for reclamation and abandonment costs for the Isolated Generation sites have increased significantly from 2009 giving rise to the significant 2010 provision. 2010 reclamation and abandonment expenditures were \$6.3 million (2009 – \$10.6 million).

### *Gains and Losses on Financial Investments*

The economic environment in the second half of 2008 proved challenging and much of the global economy was affected by the global credit crisis. Global markets experienced sharp declines and the valuation of investments at December 31, 2008 resulted in an unrealized loss of \$185.5 million (unrealized losses of \$178.6 million and realized losses of \$6.9 million) which reflects the impact of these financial market issues. During 2009, there was a recovery in the financial markets resulting in reversals of unrealized losses in the amount of \$71.8 million (unrealized gains of \$138.0 million net of realized losses of \$66.2 million). During 2010, there was a further recovery in the financial markets resulting in reversals of unrealized losses in the amount of \$55.5 million (unrealized gains of \$59.6 million net of realized losses of \$4.1 million).

### *Unrealized Change on Financial Derivatives*

During 2010 the Balancing Pool realized \$12.4 net losses (2009 – \$42.7 million net gains) on settlements of financial derivatives and at the end of the year has \$1.1 million in recorded unrealized losses related to forward swaps in place at December 31, 2010.

## **Assets**

### *Cash and Cash Equivalents*

Cash and cash equivalents decreased by \$13.2 million during the year, resulting in an ending balance of \$14.2 million.

### *Investments*

The Balancing Pool continued to invest in fixed-income securities, Canadian and global equities in 2010.

The Balancing Pool's Board has approved a long-term investment strategy to manage the investment funds. The investment strategy is based on prudent investment standards and generally focuses on achievement of a fair return on investments with diversification of the portfolio to reduce risk. The major sources of our investment income include interest, capital gains and dividend income. The strategy, reviewed on a regular basis by the Board, is proving to be effective in meeting our objectives of attaining a fair return over the long-term.

The ranges for asset allocation within the investment portfolio are as follows:

Fixed Income	35-45%
Canadian Equities	25-35%
Global Equities	20-40%

### *Property, Plant and Equipment*

The Genesee PPA is accounted for as a capital lease. At December 31, 2001, based on estimated future electricity market prices at the time, the net book value of the Genesee PPA was written down. At December 31, 2010, the net book value of property, plant and equipment was \$196.8 million (2009 – \$216.4 million). The decline in the net book value from 2010 reflects current year amortization of the Genesee PPA and other assets.

### *Deferred Charges*

Deferred charges include amounts with respect to commercial disputes and various claims of force majeure relief from various Plant Owners. These issues are in the dispute resolution process and expected to conclude in 2011. Until the claim is resolved, these amounts will be recorded as a deferred charge. Deferred charges are carried net of a \$2.5 million provision for doubtful deferred charges. During 2010 there were \$14.9 million of deferred charges recoveries due to satisfactory resolution of the related disputes.

### *Hydro Power Purchase Arrangement*

The estimated value of the Hydro PPA asset at December 31, 2010 was \$628.1 million (2009 – \$693.5 million). The Hydro PPA is valued at the present value of estimated amounts to be received by the Balancing Pool, net of estimated PPA obligations, over the remaining term of the PPA to 2020. The Hydro PPA is recorded as a financial asset due to the fact that TransAlta, the owner of the hydro plants, retains operational control of the hydro assets under the terms of this PPA.

## **Liabilities**

### *Power Purchase Arrangement Lease Obligation*

As counterparty to the Genesee PPA, the Balancing Pool is required to make monthly payments to the owner of the generating unit intended to cover fixed and variable costs. The capital component of the monthly payment is accounted for as a capital lease. The year-end balance of \$611.8 million (2009 – \$669.6 million) represents the sum of the capital component of the payments required over the remaining term of the Genesee PPA.



### ***Small Power Producer Contracts***

The Balancing Pool's legislated obligation related to Small Power Producer contracts is recorded at the net present value of estimated amounts to be received or paid by the Balancing Pool over the remaining terms of the contracts. This is recorded as a financial asset as the Balancing Pool does not have operational control of the assets. The estimated value of the Small Power Producer contracts at December 31, 2010 was a net liability of \$40.9 million (2009 – \$41.4 million).

### ***Reclamation and Abandonment Provision***

The reclamation and abandonment liability at December 31, 2010 of \$47.1 million (2009 – \$35.7 million) represents estimated costs to decommission the H.R. Milner generating station, as well as estimated reclamation costs associated with the Isolated Generation sites. Wabamun decommissioning was completed during 2009.

In 2010 the Balancing Pool paid \$6.3 million (2009 – \$4.9 million) for reclamation costs of the Isolated Generation sites and \$nil million (2009 – \$5.6 million) for decommissioning costs related to Wabamun. At December 31, 2010, the reclamation of 98 of 103 Isolated Generation sites was complete, however, a few large sites still require reclamation. As per Energy Utilities Board ("EUB") Decisions 2002-102 and 2003-036, costs for the Isolated Generation sites are approved by the Remediation Review Committee. The Balancing Pool is not a member of the Remediation Review Committee. The Remediation Review Committee is comprised of representatives of various consumer groups who were signatories to the Negotiated Settlement Agreement.

### ***Balancing Pool Deferral Account***

The deferral account liability at December 31, 2010 was \$898.7 million (2009 – \$969.3 million). The changes in the deferral account in the current year include a net assignment from equity of \$90.2 million income (2009 – \$12.3 million loss) and Consumer Allocation payments of \$160.8 million (2009 – \$343.7 million).

### ***Consumer Allocation***

Under the *Electric Utilities Act*, the Balancing Pool is mandated to allocate any forecasted cash surplus (or deficit) to electricity consumers in Alberta in annual amounts. In 2010 the Balancing Pool made allocations of its surplus to electricity consumers in Alberta in the average of \$3.00 per megawatt hour ("MWh") of consumption (2009 – \$6.50). For the year ending December 31, 2010, this allocation was \$160.8 million (2009 – \$343.7 million). For 2011, this allocation was decreased to \$2.00 per MWh of consumption; this allocation will continue to be reviewed on an annual basis.

## *Commitments and Contingencies*

See discussion of force majeure claims in deferred charges above as well as PILOT.

## **Subsequent Event**

On February 8, 2011 TransAlta (PPA Owner) issued notice of termination for destruction of the Sundance 1 and 2 units under the terms of the PPA. On February 18, 2011 TransCanada (PPA Buyer) has disputed TransAlta's determination and the issue will be resolved using the dispute resolution procedure under the terms of the PPA. If the arbitration panel were to determine that the Sundance 1 and 2 units are terminated for destruction the Balancing Pool would be responsible to pay Termination Payments to TransAlta Corporation for the Net Book Values of the units and to TransCanada for the Residual Balancing Pool Amount, both as defined in the PPA. The likelihood of loss is not determinable at this time and therefore the Balancing Pool has not made any provision for contingent loss related to this issue.

## **Accounting Policy Changes**

### *Future Accounting Changes*

### **International Financial Reporting Standards ("IFRS")**

In 2005, the Accounting Standards Board ("AcSB") announced that accounting standards in Canada are to converge with IFRS. On February 13, 2008 the AcSB confirmed that the use of IFRS for publicly accountable enterprises will be required on January 1, 2011 with appropriate comparative financial data for 2010.

As a publically accountable enterprise, the Balancing Pool has developed an IFRS convergence plan which takes into consideration, among other things:

- identification of differences in Canadian GAAP and IFRS accounting policies and their impact;
- selection of our continuing IFRS accounting policies;
- changes in financial statement notes disclosures;
- information technology and data system requirements;
- disclosure controls and procedures and internal controls over financial reporting;
- financial reporting expertise and training; and
- impacts on other business activities that may be influenced by GAAP measures.

The Balancing Pool has completed the identification of differences in Canadian GAAP and IFRS accounting policies and their impact. A diagnostic assessment was prepared by management, discussed with our external auditors and reviewed by the Audit and Finance Committee.

The next phases of IFRS conversion includes management's recommendation and Audit and Finance Committee and Board decision on selection of IFRS accounting policies, the quantification of the impact of changes on our existing accounting policies, on our opening IFRS balance sheet, and the development of draft IFRS financial statements.

## Critical Accounting Estimates

Since a determination of some assets, liabilities, revenues and expenses is dependent upon future events, the preparation of these financial statements requires the use of estimates and assumptions which have been made using careful judgment. Actual results will differ from these estimates. In particular, there were significant accounting estimates in relation to the following items:

**Reclamation and Abandonment Provision** – Engineering estimates are used to calculate the anticipated future costs of reclamation and abandonment.

**Hydro Power Purchase Arrangement and Small Power Producer Contracts** – The net present value of future cash flows is estimated using:

- forward market electricity prices, discounted for risk of volatility;
- escalated costs as per contract term; and
- future cash flows discounted to net present value at 4% (2009 – 4%).

**Deferred Charges** – Deferred charges include amounts with respect to commercial disputes which are in the dispute resolution process and expected to conclude in 2011 or later. Until the matters are resolved, the payments are recorded as deferred charges. Deferred charges also include payments made to Plant Owners under force majeure claims under various PPAs. As required under the *Balancing Pool Regulation*, the Balancing Pool paid Capacity Payments to Plant Owners for the Force Majeure claims; however the Balancing Pool subsequently reviewed and rejected the claims. These deferred charges are presented net of a provision for doubtful deferred charges.

In the opinion of management, these financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies.

## Outlook

Based on forecasted cash flow and expected financial position for 2010, effective January 1, 2011, the Balancing Pool decreased the allocation of its surplus to electricity consumers in Alberta to \$2.00 per MWh of consumption, estimated at approximately \$100 million during the year. The Consumer Allocation is reviewed on an annual basis.

Under the *Electric Utilities Act*, the Balancing Pool is mandated to sell generation assets when market conditions are such that a fair market value will be obtained in a competitive sale process. At present, there continues to be a major area of uncertainty due to the pending federal legislation with respect to greenhouse gas emission standards that may impact the cost structure of the Genesee PPA. Given this element of high uncertainty, the Balancing Pool deems it inappropriate to conduct any PPA auction process until these major issues are finalized.

## Forward-Looking Information

Certain information in this MD&A is forward-looking information and relates to, among other things, anticipated financial performance, operational prospects and strategies. Forward-looking information typically contains statements with words such as “anticipate,” “believe,” “expect,” “target” or similar words suggesting future outcomes. By their nature, such statements are subject to various risks and uncertainties that could cause the Balancing Pool’s actual results and experience to differ materially from the anticipated results. Such risks and uncertainties include, but are not limited to: availability and price of energy commodities; regulatory decisions; the ability of the Balancing Pool to successfully implement the initiatives referred to in this MD&A; and electricity market factors.



**Financial  
Statements**

*Year ended  
December 31, 2010*



**balancingpool**

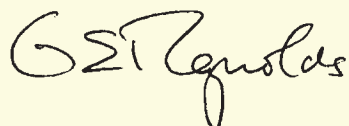
## Management's Responsibility for Financial Reporting

The financial statements included in the Annual Report are the responsibility of management and have been approved by the Board members of the Balancing Pool. These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP) and include the use of estimates and assumptions. Estimates and assumptions have been made using careful judgment and with all information available up to March 22, 2011. Financial information contained elsewhere in this Annual Report is consistent with that in the financial statements.

To discharge its responsibility for financial reporting, management maintains a system of internal controls designed to provide reasonable assurance that the Balancing Pool's assets are safeguarded, that transactions are properly authorized and that financial information is relevant, accurate and available on a timely basis.

The Balancing Pool Board members have appointed an Audit and Finance Committee that reviews the financial statements with management and the external auditors before the financial statements are submitted to the Balancing Pool Board members for approval. The external auditors have full and open access to the Audit and Finance Committee without obtaining prior management approval.

The financial statements have been examined by PricewaterhouseCoopers LLP, the Balancing Pool's external independent auditors. The responsibility of these external auditors is to examine the financial statements and to express an opinion on the fairness of the financial statements in accordance with Canadian GAAP. The independent auditor's report outlines the scope of their examination and states their opinion.



**Gary Reynolds**

*President and Chief Executive Officer*

**March 22, 2011**

## Independent Auditor's Report

To the Board Members  
of the Balancing Pool

We have audited the accompanying financial statements of the Balancing Pool, which comprise the balance sheets as at December 31, 2010 and 2009 and the statements of operations and comprehensive income (loss), equity and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

### Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Balancing Pool as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

### Chartered Accountants

March 22, 2011  
Calgary, Alberta

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate legal entity.

## Balance Sheets

<i>As at December 31 (in thousands of dollars)</i>	2010	2009
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	14,194	27,386
Accounts receivable	49,663	38,858
Current portion of Hydro power purchase arrangement (Note 4 b i)	58,158	48,975
Risk management asset (Note 4 b iii)	–	7,599
	<b>122,015</b>	<b>122,818</b>
<b>Investments (Note 5)</b>	<b>756,593</b>	<b>800,924</b>
<b>Property, plant and equipment (Note 6)</b>	<b>196,762</b>	<b>216,439</b>
<b>Deferred charges (Note 9)</b>	<b>14,266</b>	<b>12,915</b>
<b>Hydro power purchase arrangement (Note 4 b i)</b>	<b>569,938</b>	<b>644,560</b>
	<b>1,659,574</b>	<b>1,797,656</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	59,942	81,491
Risk management liabilities (Note 4 b iii)	1,100	–
Current portion of power purchase arrangement lease obligation (Note 6 b)	58,874	57,844
Current portion of Small Power Producer contracts (Note 4 b ii)	10,633	11,362
Current portion of reclamation and abandonment provision (Note 7)	10,000	7,000
	<b>140,549</b>	<b>157,697</b>
<b>Genesee power purchase arrangement lease obligation (Note 6 b)</b>	<b>552,929</b>	<b>611,803</b>
<b>Small Power Producer contracts (Note 4 b ii)</b>	<b>30,222</b>	<b>30,083</b>
<b>Reclamation and abandonment provision (Note 7)</b>	<b>37,126</b>	<b>28,710</b>
<b>Balancing Pool deferral account (Note 1, 8)</b>	<b>898,748</b>	<b>969,363</b>
	<b>1,659,574</b>	<b>1,797,656</b>
<b>Equity (Note 1)</b>	<b>–</b>	<b>–</b>
<b>Contingencies and commitments (Note 9)</b>		
<b>Subsequent event (Note 10)</b>		
	<b>1,659,574</b>	<b>1,797,656</b>

On behalf of the Balancing Pool:



**Thomas Cumming**  
Chair



**Peter Flynn**  
Audit and Finance Committee Chair

*The accompanying notes are an integral part of these financial statements.*



## Statements of Operations and Comprehensive Income (Loss)

<i>For the year ended December 31 (in thousands of dollars)</i>	2010	2009
<b>Revenues and funding</b>		
Sale of electricity	274,494	337,441
Hydro power purchase arrangement (Note 4 b i)	51,370	11,415
Investment income – interest and dividends	26,180	30,391
Investment income – realized gains (losses) on sale of investments	(4,092)	(66,186)
Payments in lieu of tax	17,540	18,197
	<b>365,492</b>	<b>331,258</b>
<b>Expenses</b>		
Cost of sales	217,127	230,210
Small Power Producer contracts (Note 4 b ii)	(1,581)	12,741
Amortization and depreciation	19,680	19,703
Office of the Utilities Consumer Advocate	6,612	6,268
General and administrative	2,730	2,737
Other power purchase arrangement expenses	10,814	2,146
	<b>255,382</b>	<b>273,805</b>
<b>Operating income</b>	<b>110,110</b>	<b>57,453</b>
<b>Other income (expense)</b>		
Revaluation of Hydro power purchase arrangement (Note 4 b i)	(44,205)	(174,328)
Revaluation of Small Power Producer contracts (Note 4 b ii)	(9,114)	(41,445)
Unrealized gains (losses) on financial investments (Note 5)	59,626	137,990
Unrealized change on financial derivative instruments (Note 4 b iii)	(8,699)	6,872
Reclamation and abandonment provision (Note 7)	(17,708)	1,742
Other income (expense)	147	(564)
	<b>(19,953)</b>	<b>(69,733)</b>
<b>Net results of operations and net comprehensive income (loss)</b>	<b>90,157</b>	<b>(12,280)</b>

## Statements of Equity

<i>For the year ended December 31 (in thousands of dollars)</i>	2010	2009
Equity, beginning of year	–	–
Net results of operations	90,157	(12,280)
Assigned to Balancing Pool deferral account (Note 8)	(90,157)	12,280
Equity, end of year (Note 1)	–	–

*The accompanying notes are an integral part of these financial statements.*

## Statements of Cash Flows

<i>For the year ended December 31 (in thousands of dollars)</i>	2010	2009
<b>Operating activities</b>		
Net results of operations	90,157	(12,280)
Items not affecting cash		
Amortization and depreciation	19,680	19,703
Reclamation and abandonment provision	17,708	(1,742)
Decrease in Small Power Producer contracts	7,532	54,186
(Increase) decrease in Hydro power purchase arrangement	(7,165)	162,913
Unrealized gains (losses) on financial derivative instruments	8,699	(6,872)
Unrealized gains on financial investments	(59,626)	(137,990)
Reclamation and abandonment expenditures	(6,292)	(10,560)
Net change in non-cash working capital	(32,353)	65,155
	<b>38,340</b>	<b>132,513</b>
<b>Investing activities</b>		
Sale of investments	103,957	87,972
Deferred charges, net of recoveries	(1,351)	(5,103)
Net additions to property, plant and equipment	(3)	–
	<b>102,603</b>	<b>82,869</b>
<b>Financing activities</b>		
Net Hydro power purchase arrangement receipts (Note 4 b i)	72,604	51,058
Power purchase arrangement lease obligation	(57,844)	(58,309)
Net Small Power Producer contracts outflows	(8,123)	(12,741)
Consumer Allocation (Note 8)	(160,772)	(343,729)
	<b>(154,135)</b>	<b>(363,721)</b>
<b>Change in cash and cash equivalents</b>	<b>(13,192)</b>	<b>(148,339)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>27,386</b>	<b>175,725</b>
<b>Cash and cash equivalents, end of year</b>	<b>14,194</b>	<b>27,386</b>

*The accompanying notes are an integral part of these financial statements.*

# Notes to Financial Statements

## 1. Nature of Operations

### Formation and Duties of the Balancing Pool

The Balancing Pool was created by the Government of Alberta to help manage certain assets, revenues and expenses arising from the transition to competition in Alberta's electric industry. The Balancing Pool was originally established in 1998 as a separate financial account of the Power Pool Council ("the Council") and commenced operations in 1999. The Council was a statutory corporation established under the *Electric Utilities Act of Alberta (1995)*. The requirement to establish the Balancing Pool was set out in the *Balancing Pool Regulation*.

With the proclamation of the *Electric Utilities Act (2003)* (the "Act") on June 1, 2003 the Balancing Pool was established as a separate statutory corporation (the "corporation"). The assets and liabilities of the Council that related to the duties, responsibilities and powers of the Balancing Pool were transferred to the Balancing Pool.

Under the Act the corporation is required to operate with no profit or loss and no share capital for the corporation has been issued. The Balancing Pool Board consists of individual members independent of persons having a material interest in the Alberta electric industry. The members of the Board are appointed by the Minister of Energy of the Government of Alberta.

The Balancing Pool acted as Buyer of the Power Purchase Arrangements ("PPAs") that were not sold at the public auction held by the Government of Alberta in August 2000, assuming all rights and obligations of a buyer of these PPAs. Under the Act the Balancing Pool is required to manage generation assets in a commercial manner. The Balancing Pool is also required to respond to certain extraordinary circumstances during the operating period of all of the PPAs such as force majeure, unit destruction, buyer or owner default or a change in law resulting in termination of a PPA. In situations resulting in termination of a PPA, the Balancing Pool will assume all remaining rights and obligations pursuant to the PPA.

During 2009, the Alberta Government enacted amendments to the *Electric Utilities Act (2003)* that removed the requirement for the winding-up of the Balancing Pool by June 30, 2021.

### Activities of the Balancing Pool

The initial allocation of assets and liabilities to the Balancing Pool was charged to the deferral account. Differences between annual revenues and expenditures are also charged or credited to the Balancing Pool deferral account. The Act requires that the Balancing Pool forecast its revenues and expenses. Any excess or shortfall of funds in the accounts is to be allocated to, or provided by, electricity consumers in annualized amounts.

## Use of Estimates

The timely preparation of the financial statements in conformity with Canadian generally accepted accounting principles ("GAAP") requires that management make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Such estimates represent management's best estimate of future events as of the date of the financial statements. Accordingly, actual results will differ from estimated amounts as future confirming events occur. (See Note 2 for a discussion of significant estimates.)

## Revenue and Funding

The Balancing Pool has five primary sources of revenue and funding:

### *1) Sale of electricity*

The Balancing Pool earns revenue from the sale of electricity.

Electricity that is not otherwise contracted is sold into the spot market. Ancillary services from the Genesee PPA are sold to the Alberta Electric System Operator ("AESO") through a competitive exchange.

### *2) Hydro PPA*

Under the terms of government legislation, the Balancing Pool has obtained the right to a stream of payments from the owner of certain hydro plants in the province of Alberta. These payments are calculated based on the Pool price multiplied by a notional amount of production as outlined in the PPA less PPA obligations. The net present value of these estimated payments is recorded as an asset on the Balance Sheet and any revaluation adjustment included in net results of operations.

### *3) Investment income*

Cash, cash equivalents and investments held by the Balancing Pool generate investment income consisting of interest, dividends and realized capital gains and losses.

### *4) Payments in lieu of tax ("PILOT")*

Pursuant to Section 147 of the Act, the Balancing Pool collects from electricity companies controlled by municipalities a notional amount of tax that would otherwise be payable if these entities were subject to tax. The Balancing Pool does not calculate instalment payments and it does not audit PILOT findings. PILOT instalments are calculated by the payor and are subject to audit by Alberta Revenue; adjustments, if any, arising from audits will be recorded in the current year.

### *5) Small Power Producer ("SPP") contracts*

Under the *Independent Power and Small Power Regulation*, any surplus or deficit from contracts that a utility company entered into with Small Power Producers pursuant to the *Small Power Research and Development Act* will be paid to or received from the Balancing Pool. The net present value of these estimated payments is recorded as a liability on the Balance Sheet and any revaluation adjustment included in net results of operations.

## Expenses and Disbursements

The Balancing Pool has expenditures which include:

### *i) Cost of sales*

The Balancing Pool is obligated to pay certain fixed and variable costs to the owner of the generation asset that is operated under the terms of the Genesee PPA. Transmission costs are included in cost of sales. Under the terms of government legislation, the Balancing Pool is obligated to make payments to certain entities for such matters as force majeure.

### *ii) Other costs*

Under the terms of government legislation, the Balancing Pool is obligated to make payments to certain entities for such matters as reclamation and abandonment costs which are included in Other Income (Expense). The Minister of Energy may direct the Balancing Pool to fund specific payments under Section 148 of the Act which are included in Office of the Utilities Consumer Advocate.

## 2. Significant Accounting Policies

The financial statements of the Balancing Pool have been prepared by management in accordance with Canadian GAAP. Certain comparative figures have been reclassified to conform to the current year's presentation. Since a determination of some assets, liabilities, revenues and expenses is dependent upon future events, the preparation of these financial statements requires the use of estimates and assumptions which have been made using careful judgment. Actual results will differ from these estimates. In particular, there were significant accounting estimates in relation to the following items:

- i) Hydro power purchase arrangement (Note 4 b i)*
- ii) Reclamation and abandonment provision (Note 7)*
- iii) Small Power Producer contracts (Note 4 b ii)*
- iv) Investments (Note 5)*
- v) Risk Management Assets and Liabilities (Note 4 b iii)*

In the opinion of management, these financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

## Revenue Recognition

### *a) Sale of electricity*

Revenues from the sale of electricity and ancillary services are recognized on an accrual basis in the period in which generation occurred. Amounts settled under financial derivative contracts are recorded in sale of electricity.

#### ***b) Payments in lieu of tax***

Payments in lieu of tax ("PILOT") are accrued based on the payors' instalments for a particular tax year. PILOT payments are calculated by payors and are subject to assessment and audit by Alberta Revenue.

#### ***c) Hydro power purchase arrangement***

The Hydro PPA is recorded at the present value of the estimated future net payments to be received under this PPA. The increase in value of this asset with the passage of time (accretion) is recognized on an accrual basis. Any change in valuation as a result of changes in underlying assumptions is recognized in net results of operations.

#### ***d) Investment income***

Investment income from interest and dividends is recorded on an accrual basis when there is reasonable assurance as to its measurement and collectability. Investment income also includes realized gains and losses on investments sold and realized foreign currency exchange rate gains and losses on sale of foreign investments.

#### ***e) Small Power Producer contracts***

Small Power Producer contracts are recorded at the present value of the estimated future net payments to be received (or paid) under these contracts. The change in value of this liability with the passage of time (accretion) is recognized on an accrual basis. Any change in valuation as a result of changes in underlying assumptions is recognized in net results of operations.

### **Income Taxes**

No provision has been made for income tax as under the Act the Balancing Pool is required to operate so that no profit or loss results.

### **Cash and Cash Equivalents**

Cash and cash equivalents are comprised of cash and highly liquid short-term investments with maturities of three months or less that are classified as held-for-trading and are measured at fair value, which approximates carrying value, due to the short-term nature of these investments.

### **Accounts Receivable and Prepaid Expenses**

Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest method. At each balance sheet date, the Balancing Pool assesses whether loans and receivables are impaired and any impairment is recognized.

## **Electricity Price Risk Management and Financial Instruments**

### **Risk Management Assets and Liabilities**

The Balancing Pool utilizes swap contracts to manage its exposure to electricity price fluctuations which require payments to (or receipts from) counterparties based on the differential between fixed and variable prices for electricity and other contractual arrangements. The estimated fair value of all derivative instruments is based on reported values in the electricity forward market. Amounts settled under these contracts are recorded as sale of electricity.

Derivative financial instruments are classified as held-for-trading and are recorded on the balance sheet at fair value. All changes in fair value are included in other income (expense).

### **Investments**

For 2010 fixed income securities are classified as held-for-trading and recorded in the financial statements at estimated fair value, as of the balance sheet date, measured based on the bid price in active markets, and unrealized gains or losses resulting from changes in fair value are recorded in net results of operations. For 2009 fixed income securities are classified as held-to-maturity and valued at amortized cost where cost includes the amortization of the discount or premium using the effective interest rate method over the life of the investment and initial purchase transaction costs.

Equity securities are classified as held-for-trading and recorded in the financial statements at estimated fair value, as of the balance sheet date, measured based on the bid price in active markets, and unrealized gains or losses resulting from changes in fair value are recorded in net results of operations.

Should any investments be determined to be impaired, any unrealized loss would be recognized in net results of operations.

### **Genesee Power Purchase Arrangement (“Genesee PPA”) and Related Capital Lease Obligation**

The Genesee PPA transfers to the Balancing Pool substantially all the benefits and risks of ownership and is therefore treated as if the asset had been purchased outright. The asset is included in property, plant and equipment at an amount not exceeding the estimated net future cash flows arising from operations over the remaining life of the PPA. At December 31, 2001 based upon estimated future electricity prices at the time, the net book value of the Genesee PPA was written down to \$426.8 million. The asset is depreciated over the term of the Genesee PPA. The capital element of the leasing commitment is shown as a Genesee PPA lease obligation.

## Reclamation and Abandonment

The Balancing Pool has recorded an estimate of the cost to remediate certain Isolated Generating Unit sites in Alberta. Actual costs incurred to remediate these sites will reduce this liability and any increase in this liability will be charged to expense when estimated costs are known to exceed the remaining liability balance. An amount has also been provided for the decommissioning of the H.R. Milner generating station which is being accreted annually; revisions to this estimate will be charged or credited to income. During 2009 the decommissioning of the Wabamun plant Units 1, 2, and 3 was completed.

## 3. Significant Accounting Policy Changes

### Future Accounting Changes

#### International Financial Reporting Standards ("IFRS")

In 2005, the Accounting Standards Board ("AcSB") announced that accounting standards in Canada are to converge with IFRS. On February 13, 2008 the AcSB confirmed that the use of IFRS for publicly accountable enterprises will be required on January 1, 2011 with appropriate comparative financial data for 2010.

As a publicly accountable enterprise, the Balancing Pool has assessed the impact of the differences in the accounting standards on its future financial reporting requirements. Decisions on IFRS accounting policy choices are anticipated to be made by the Audit and Finance Committee and Board during 2011. The IFRS conversion plan will continue to be administered for planned IFRS conversion and reporting for the year ending December 31, 2011.

## 4. Accounting for Financial Instruments

### 4. a) Risk Management Overview

The Balancing Pool is exposed to a number of business risks including:

***ij) PPA Risk:*** Under terms of the PPAs the Balancing Pool is exposed to longer term risks including change in law, force majeure and PPA termination risks. Risks under change in law could include new provincial and federal legislation relating to environmental emission standards, which if enacted, may result in the PPA becoming unprofitable to the buyer, in which case the PPA could then be terminated and consequently returned to the Balancing Pool. Pursuant to Section 96 of the *Electric Utilities Act (2003)* where a PPA is terminated by the plant owner ("Owner"), except for total destruction of a unit or plant, the PPA is deemed to have been sold to the Balancing Pool. Owner-initiated termination would generally be as a result of a default by the PPA Buyer in performing its obligations; in this instance, the Balancing Pool would be entitled to receive a termination payment from the Buyer equal to the amount of net profit the Buyer would have lost by continuing to hold the PPA until the end of the effective term. Buyer-initiated termination could be as a result of a change



in law making the PPA uneconomic for the Buyer, an event of force majeure lasting greater than six months, Owner default in performing its obligations, or Buyer buyout of the PPA. Termination under these provisions would result in the immediate transfer of the PPA to the Balancing Pool. Identifying, quantifying and devising strategies for mitigating these risks are an ongoing responsibility of the Balancing Pool.

**ii) Fluctuating Market Prices:** Changes in the market price for electricity and ancillary services affect the amount of income that the Balancing Pool receives from the Genesee and Hydro PPAs. Changes in the market price for electricity also affect the amounts paid or received by the Balancing Pool under the Small Power Producer contracts. Electricity prices are highly volatile, and are affected by supply and demand, which in turn are influenced by fuel costs (e.g. natural gas prices), weather patterns, plant availability and power imports or exports. Market price risk can be managed through the use of purchase and sales contracts for electricity.

**iii) Currency and Interest Rate Risk:** The Balancing Pool is exposed to currency risk and interest rate risk in that there is the possibility that investments will change in value due to fluctuations in foreign currency exchange rates and market interest rates. A \$0.01 change in the Canadian Dollar exchange rate versus the United States Dollar would have an estimated \$0.7 million impact on investment valuations and a \$0.01 change in the Canadian Dollar exchange rate versus the Euro would have an estimated \$0.6 million impact on investment valuations. Likewise a 1% change in floating rate interest investments would have an estimated \$0.1 million impact on investment annual returns and an estimated \$9.1 million impact on Genesee PPA capacity payments.

**iv) Plant Availability:** Changes in plant availability can impact the expected generation and associated revenues of the Balancing Pool. If the plant output managed by the Balancing Pool is sold forward and the plants are not available to supply delivery obligations, the Balancing Pool would be required to purchase energy at the prevailing market price to cover the shortfall in generation.

**v) Counterparty Credit Risk:** The Balancing Pool is exposed to counterparty credit risk. In the event of a default on payments from counterparties to the Hydro PPA, Small Power Producer contracts or forward sale contracts, a financial loss may be experienced by the Balancing Pool. Credit risk is managed in accordance with the Credit Policy which requires that all counterparties be investment grade level and is regularly monitored by management and the Audit and Finance Committee.

**vi) Liquidity Risk:** Liquidity risk is the risk that the Balancing Pool will not be able to meet its financial obligations as they fall due. To manage this risk, management forecasts cash flows for a period of 12 months and beyond and could make adjustments to the Consumer Allocation and/or liquidate investments as required.

**vii) Risk Management Policy:** The Balancing Pool has developed Risk Management and Credit Policies that define the organization's tolerance for risk and set out procedures for quantifying and monitoring exposures. Exposures and compliance with the Policy are regularly monitored by management, the Audit and Finance Committee and the Board.

## 4. b) Analysis of Financial Instruments

### *i) Hydro Power Purchase Arrangement*

The Balancing Pool is the counterparty to the Hydro PPA, a financial arrangement recorded as an asset at the present value of estimated amounts to be received, net of Hydro PPA obligations, over the remaining term of the Hydro PPA. The Balancing Pool has no responsibility for the operational control of the hydro generating units and receives from (or pays to) the owner of the hydro plants revenues based on Pool prices and notional energy and reserve (ancillary service) volumes defined in the Hydro PPA, less the Hydro PPA fixed and variable costs.

The notional production of electricity under the Hydro PPA is 1,650 gigawatt hours per annum until 2013 and 1,620 gigawatt hours per annum from 2014 to 2020. Hydro PPA receipts or payments are settled on a monthly basis.

The remaining term of the Hydro PPA is 10 years to 2020. At December 31, 2010, the net present value of the Hydro PPA was estimated at \$628 million (December 31, 2009 – \$694 million). Key assumptions in this valuation are a discount rate of 4% (2009 – 4%) and a management's best estimate of market prices for electricity.

Hydro PPA <i>(in thousands of dollars)</i>	2010	2009
Hydro power purchase arrangement, opening balance	693,535	907,506
Accretion and current year change	51,370	11,415
Net cash receipts	(72,604)	(51,058)
Revaluation of Hydro power purchase arrangement asset	(44,205)	(174,328)
	628,096	693,535
Less: Current portion	(58,158)	(48,975)
	569,938	644,560

The estimated value of this asset varies significantly based on the assumptions used and there is a high degree of measurement uncertainty. For example, if the forecasted market price of electricity is decreased by 10% the value is reduced to \$501 million; if the discount rate is reduced to 3% the value is increased to \$664 million.

### *ii) Small Power Producer Contracts*

Under the *Independent Power and Small Power Regulation of the Act*, any surplus or deficit from contracts that a utility company entered into with Small Power Producers pursuant to the *Small Power Research and Development Act* will be paid to or received from the Balancing Pool.

There are 10 (2009 – 10) contracts with total allocated capacity of 82 (2009 – 82) megawatts ("MW"). Contract prices range from \$63.30/megawatt hour ("MWh") to \$79.70/MWh. Contract completion dates range between 2012 and 2019. Under these contracts the price that the Small Power Producer receives from the utility company is either fixed or fixed plus an escalation factor. If the market price is below the contract price, the Balancing Pool must pay the difference to the utility company. If the market price exceeds the contract price, the utility company must pay the difference to the Balancing Pool.

At December 31, 2010, the net present value of cash flows to or from the Balancing Pool for these contracts was estimated to be \$40.9 million liability (2009 – \$41.4 million liability). The estimated value of this liability varies significantly based on the assumptions used and there is a high degree of measurement uncertainty. Key assumptions in this valuation are a discount rate of 4% (2009 – 4%) and management's best estimate of market prices for electricity.

<b>Small Power Producer Contracts</b> <i>(in thousands of dollars)</i>	<b>2010</b>	<b>2009</b>
Small power purchase contracts, opening balance	(41,445)	–
Accretion and current year change	1,581	(12,741)
(Revenues) expenses	8,123	12,741
Revaluation of Small Power Producer contracts	(9,114)	(41,445)
Small power producer contracts, ending balance	(40,855)	(41,445)
Less: Current portion	10,633	11,362
	(30,222)	(30,083)

The valuation of these contracts varies significantly depending on the assumptions used. For example, if the forecast market price of electricity is decreased by 10% the value is increased to a \$51.7 million liability; if the discount rate is reduced to 3% the value change is not significant.

### *iii) Financial Derivatives – Electricity Price Risk Management Activities*

At December 31, 2010, the Balancing Pool had derivative swap contracts outstanding to manage its exposure to changes in electricity prices with a net unrealized fair value loss of \$1.1 million (2009 – \$7.6 million gain). These swap contracts require payments to (or receipts from) counterparties based on the differential between the fixed contract price and variable Pool prices as published by the AESO. The swap contracts require the Balancing Pool to pay a variable price and the counterparty to pay a fixed price. The estimated volume in MWh and weighted average fixed price per MWh is provided below:

<b>Effective Term</b>	<b>MWh</b>	<b>Weighted Average Fixed Price</b>
Q1, 2011	92,280	\$59.33

The following table provides disclosure on the movements in the fair value of the Balancing Pool's net risk management current assets and current liabilities:

<b>Risk Management Assets and Liabilities</b> <i>(in thousands of dollars)</i>	<b>Assets</b>	<b>Liabilities</b>	<b>Net</b>
Outstanding at December 31, 2008	2,039	1,312	727
Changes in value attributable to:			
Market changes	60,415	18,413	42,002
New contracts entered during the year	7,599	–	7,599
Net realized gains on contracts settled during the year <sup>a</sup>	(62,454)	(19,725)	(42,729)
Net changes in value during 2009	5,560	(1,312)	6,872
Outstanding at December 31, 2009	7,599	–	7,599
Changes in value attributable to:			
Market changes	(27,591)	(32,393)	4,802
New contracts entered during the year	–	1,100	(1,100)
Net realized gains on contracts settled during the year <sup>a</sup>	19,992	32,393	(12,401)
Net changes in value during 2010	(7,599)	1,100	(8,699)
Outstanding at December 31, 2010	–	1,100	(1,100)

*(a) Amounts settled under financial derivative contracts are recorded on an accrual basis in revenue against the applicable exposure. During 2010, the Balancing Pool realized \$12.4 million in financial derivatives losses (2009 – \$42.7 million in financial derivatives gains) which have been included in sale of electricity.*

#### 4. c) Fair Value Hierarchy

Financial Instruments carried at fair value are categorized as follows:

<i>(in thousands of dollars)</i>	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobserv- able inputs	Total
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Cash and cash equivalents	14,194	–	–	14,194
Investments – Fixed Income Securities	247,441	–	–	247,441
Investments – Equity Securities	509,152	–	–	509,152
Hydro PPA	–	–	628,096	628,096
	770,787	–	628,096	1,398,883
<b>Liabilities</b>				
SPP Contracts	–	–	40,855	40,855
Risk management liabilities	–	1,100	–	1,100
	–	1,100	40,855	41,955
	770,787	(1,100)	587,241	1,356,928

Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than Level 1 quoted prices for which all significant inputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. Changes in valuation methods may result in transfers into or out of an assigned level.

***Cash and cash equivalents*** – are comprised of cash and highly liquid short-term investments with maturities of three months or less and are measured at fair value, which approximates carrying value, due to the short-term nature of these investments.

***Risk management assets and liabilities*** – the estimated fair value of all derivative instruments is based on reported values in the electricity forward market as at December 31, 2010. Derivative financial instruments can result in exposure to credit risk being the risk a counterparty will default on its contractual obligations. Derivative financial instruments transactions are entered only with institutions that are rated investment grade by recognized credit ratings agencies.

***Investments – Fixed Income Securities*** – for 2010 are recorded in the financial statements at estimated fair value, as of the balance sheet date measured based on bid price in active markets and unrealized gains or losses resulting from changes in fair value are recorded in net results of operations. Should the investment be determined to be impaired, any unrealized loss would be recognized in net results of operations. For 2009 fixed income securities were valued at amortized cost where cost includes the amortization of the discount or premium using the effective interest rate method over the life of the investment and initial purchase transaction costs.

***Investments – Equity Securities*** – are recorded in the financial statements at estimated fair value, as of the balance sheet date measured based on the bid price in active markets and unrealized gains or losses resulting from changes in fair value are recorded in net results of operations. Should the investment be determined to be impaired, any unrealized loss would be recognized in net results of operations.

***Hydro power purchase arrangement (PPA) and Small Power Producer contracts*** – are recorded at the present value of the estimated future net payments to be received or paid under the contracts and reflect management's best estimates based on generally accepted valuation techniques or models and supported by observable market prices and rates when available. Given the long-term nature of these contracts, observable market prices are not available beyond the first few years. Methodologies have been developed to determine the fair value for these contracts based on extrapolation of observable future prices and rates.

## 5. Investments

<i>(in thousands of dollars)</i>	2010		2009	
	Market Value		Amortized Cost	
Fixed income securities	247,441		345,687	

	Market Value	Cost	Market Value	Cost
Canadian equities	266,216	247,987	226,016	240,786
Global equities	242,936	262,243	229,221	262,256
	509,152	510,230	455,237	503,042
Total investments	756,593		800,924	

Fair value of fixed income securities investments is estimated to be \$360.9 million as at December 31, 2009.

In March, April and May 2010 certain fixed income investments that were valued at amortized cost were sold. As a result the Balancing Pool has classified its entire fixed income securities portfolio as held-for-trading and valued it at fair value.

The following table provides disclosure on the movements in the fair value of the investments in equity securities:

<b>Unrealized Gains (Losses)</b> <i>(in thousands of dollars)</i>	<b>Fixed Income Securities</b>	<b>Canadian Equities</b>	<b>Global Equities</b>	<b>Totals</b>
Unrealized market gain (loss), Dec. 31, 2008	–	(76,342)	(109,453)	(185,795)
Change during the year	–	53,013	18,791	71,804
Realized (gains) losses on sales of investments	–	8,559	57,627	66,186
Net change during the year	–	61,572	76,418	137,990
Unrealized market loss, Dec. 31, 2009	–	(14,770)	(33,035)	(47,805)
Change during the year gains	13,014	33,738	8,897	55,649
Realized (gains) losses on sales of investments	(115)	(739)	4,831	3,977
Net change during the year	12,899	32,999	13,728	59,626
Unrealized market gain (loss), Dec. 31, 2010	12,899	18,229	(19,307)	11,821

## 6. Property, Plant and Equipment and Related Lease Obligation

### a) Property, Plant and Equipment

<i>(in thousands of dollars)</i>	2010	2009
Power purchase arrangement	426,819	426,819
Less: Accumulated amortization	(230,152)	(210,485)
	196,667	216,334
Other assets	467	464
Less: Accumulated amortization	(372)	(359)
	95	105
	196,762	216,439

### b) Genesee Power Purchase Arrangement Lease Obligation

Under the terms of the Act, the Balancing Pool assumed the role of the counterparty to the Genesee PPA, which has been accounted for as a capital lease. The estimated future annual lease payments (capital component of the Genesee PPA payments) are as follows:

<i>(in thousands of dollars)</i>	
2011	58,874
2012	59,948
2013	60,081
2014	59,244
2015	61,145
Thereafter	312,511
	611,803
Less: Current portion	(58,874)
	552,929

## 7. Reclamation and Abandonment Provision

<b>Reclamation and Abandonment Provision</b> <i>(in thousands of dollars)</i>	2010	2009
Isolated Generation sites <sup>a</sup>	29,318	18,910
H.R. Milner generating station <sup>b</sup>	17,808	16,800
	47,126	35,710
Less: Current portion	(10,000)	(7,000)
	37,126	28,710

A reconciliation of the opening and closing reclamation and abandonment provisions is provided below:

<b>Reclamation and Abandonment Provision</b> <i>(in thousands of dollars)</i>	<b>2010</b>	<b>2009</b>
Balance, beginning of year	<b>35,710</b>	48,012
Net increase (decrease) in liability provision	<b>16,700</b>	(2,642)
Liabilities paid in period	<b>(6,292)</b>	(10,560)
Accretion expense	<b>1,008</b>	900
<b>Balance, end of year</b>	<b>47,126</b>	35,710

#### **a) Isolated Generation Sites**

Under the *Isolated Generating Units and Customer Choice Regulations of the Act*, the Balancing Pool is liable for certain amounts relating to the reclamation costs associated with Isolated Generation units. In 2010 \$6.3 million (2009 – \$5.0 million) expenditures were incurred.

<i>(in thousands of dollars)</i>	<b>2010</b>	<b>2009</b>
Isolated Generation sites	<b>29,318</b>	18,910
Less: Current portion	<b>(10,000)</b>	(7,000)
	<b>19,318</b>	11,910

Pursuant to the Negotiated Settlement Agreements approved by the Alberta Utilities Commission, the ultimate payment of these costs must be reviewed and approved by the Remediation Review Committee.

#### **b) H.R. Milner Generating Station**

Under the Negotiated Settlement Agreement for the H.R. Milner generating station in 2001, the Balancing Pool assumed liability for the costs of decommissioning the station at the end of the contract period. When the asset was sold in 2004, the Balancing Pool retained the liability for decommissioning the generating station.

## **8. Capital Management**

The Balancing Pool's objective when managing capital is to operate as per the requirements of the *Electric Utilities Act (2003)* which requires the Balancing Pool to operate with no profit or loss and no share capital and forecast its revenues, expenses, and cash flows. Any excess or shortfall of funds in the accounts is to be allocated to, or provided by, electricity consumers in annual amounts. During 2009, the Alberta Government enacted amendments to the *Electric Utilities Act (2003)* that have removed the requirement for the winding-up of the Balancing Pool by June 30, 2021.



A reconciliation of the opening and closing Balancing Pool deferral account is provided below:

<b>Balancing Pool Deferral Account</b> <i>(in thousands of dollars)</i>	<b>2010</b>	<b>2009</b>
Deferral account, beginning of year	<b>969,363</b>	1,325,372
Assigned from equity	<b>90,157</b>	(12,280)
Consumer Allocation	<b>(160,772)</b>	(343,729)
<b>Deferral account, end of year</b>	<b>898,748</b>	969,363

Effective for 2011, the Balancing Pool decreased the allocation to Alberta's electricity consumers to \$2.00 per MWh of consumption, an estimated \$100 million per annum (2010 – averaged \$3.00 per MWh, \$161 million per annum, 2009 – \$6.50 per MWh, \$344 million per annum). The Consumer Allocation is reviewed and approved by the Board of Directors of the Balancing Pool on an annual basis.

## 9. Contingencies and Commitments

### Other Power Purchase Arrangements

Pursuant to Section 96 of the Act, where a PPA is terminated by the Plant Owner ("Owner"), except for total destruction of a unit or plant, the PPA is deemed to have been sold to the Balancing Pool. Owner-initiated termination would generally be as a result of a default by the Buyer in performing its obligations. Buyer-initiated termination could be as a result of a change in law making the PPA uneconomic for the Buyer, an event of force majeure lasting greater than six months, Owner default in performing its obligations, or Buyer buyout of the PPA. Termination under these provisions would result in the immediate transfer of the PPA to the Balancing Pool.

### Decommissioning Costs

Pursuant to Section 7 of the *Power Purchase Arrangements Regulation of the Act*, the owner of a generating unit who applies to the Alberta Utilities Commission ("AUC") to decommission a unit within one year of the termination of the PPA is entitled to receive from the Balancing Pool the amount by which the decommissioning costs exceed the amount the owner collected from consumers before January 1, 2001 and subsequently through a PPA, provided that the unit has ceased generating electricity and subject to AUC approval.

### Deferred Charges

Deferred charges of \$14.3 million include amounts with respect to commercial disputes which are in the dispute resolution process and expected to conclude in 2011. Until the matters are resolved, the payments are recorded as deferred charges.

Deferred charges also include payments made to Plant Owners under force majeure claims under various PPAs. As required under the *Balancing Pool Regulation*, the Balancing Pool paid \$12.8 million of capacity payments to Plant Owners for the force majeure claims; however the Balancing Pool subsequently reviewed and rejected the claims.

A reconciliation of the opening and closing Deferred Charges is provided below:

<b>Balancing Pool Deferred Charges</b> <i>(in thousands of dollars)</i>	<b>2010</b>	<b>2009</b>
Deferred charges, beginning of year	<b>12,915</b>	7,812
Deferred charges, incurred during the year	<b>16,621</b>	5,103
Deferred charges, recovered during the year	<b>(15,270)</b>	–
<b>Deferral charges, end of year</b>	<b>14,266</b>	12,915

These deferred charges are presented net of a \$2.5 million provision for doubtful deferred charges (2009 – \$2.3 million).

### Payments In Lieu of Tax

In 2010, Alberta Finance, Tax and Revenue Administration issued Notice of Reassessments to ENMAX related to its 2003 – 2006 taxation years. The reassessments required a payment to the Balancing Pool of \$89.2 million. The Balancing Pool has not received any amounts payable under these Notices of Reassessment and ENMAX has filed a Notice of Objection related to these taxation years. Due to the uncertainty of the outcome of the appeal process, no amount has been recorded in the financial statements in this regard.

### Credit Facility

At December 31, 2010, the Balancing Pool had \$6 million of unsecured Letters of Credit issued and an uncommitted credit facility available to issue Letters of Credit up to a maximum of \$90 million.

## 10. Subsequent event

On February 8, 2011 TransAlta Corporation (PPA Owner) issued notice of termination for destruction of the Sundance 1 and 2 units under the terms of the PPA. On February 18, 2011 TransCanada Corporation (PPA Buyer) has disputed TransAlta's determination and the issue will be resolved using the dispute resolution procedure under the terms of the PPA. If the arbitration panel were to determine that the Sundance 1 and 2 units are terminated for destruction the Balancing Pool would be responsible to pay Termination Payments to TransAlta Corporation for the Net Book Values of the units and to TransCanada for the Residual Balancing Pool Amount, both as defined in the PPA. The likelihood of loss is not determinable at this time and therefore the Balancing Pool has not made any provision for contingent loss related to this issue.

# Corporate Information

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