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Cross Sector - Canada

Alberta emissions program has limited impact on credit quality

On November 22, 2015 the Province of Alberta (Aaa stable) provided an overview of its long term emissions strategy. This strategy will have a limited near term effect on credit quality on rated industrial sectors including oil and gas, power and provincial credit quality. The announcement coincides with the publication of the final report from the Alberta Climate Change Advisory Panel and introduces new policies on coal and electricity, carbon pricing, capping oil sands emissions and reducing methane emissions. We expect clarity on implementation to be provided over time.

The Alberta government's new climate change strategy will have minimal impact on medium term oil sands development. The government pushed the proposed carbon tax increase out one year with 2016 now at C$15/tonne and 2017 at C$20/tonne. The tax will then increase to C$30/tonne in 2018 and will increase each year after that. At C$30/tonne, the incremental cost to the majority of oil sands facilities will be less than C$1/bbl, compared to the current C$15/tonne carbon tax. The newest feature of the Alberta government's climate change strategy is to cap total greenhouse gas (GHG) emissions at 100 Megatonnes per year for the oil sands, which is about 40% more than what is produced today. Growth, besides what is currently being completed, has stopped in the oil sands due to the low oil price environment, and the GHG limit will likely not be reached for the foreseeable future.

The strategy also includes the total phase out of coal emissions in Alberta by 2030, going beyond existing federal greenhouse gas legislation that has already placed an effective limit on the life of coal plants. TransAlta Corporation (Baa3 Under review down) has the largest and oldest fleet, and the announcement means that 8% of its current generation capacity will be phased out early. By comparison, Capital Power Corp (not rated), with a much younger fleet will see about 40% of its current generation capacity affected. The timeframe provides the opportunity for generators with coal fired assets to prepare for the transition away from coal and towards renewables - a fuel source that the government expects will replace about 2/3 of the lost coal production. The government has also indicated that it will not try to “unnecessarily strand assets” which opens the door to the possibility of compensation for companies that will have their units closed prior to the end of their useful life. Under federal rules some plants would have operated for decades past 2030, for example Keephills 3 (jointly owned by TransAlta and Capital Power) could have operated until 2061.

The carbon tax will generally drive the price of power upwards because coal is typically baseload and its emissions costs will be reflected in the price at which power from coal is sold. The higher power price will ultimately be borne by power customers in Alberta. For companies that sell power under existing Alberta power purchase agreements these costs will typically be borne by the offtaker. TransAlta sells the vast majority of its coal fired generation under the form of these contracts and, as a result, has more limited exposure to emissions standards. TransCanada Corporation (Baa1 stable) is a significant offtaker of coal power under these PPA's, and has some exposure, however as noted we expect the carbon tax to lead to increases in prices, and not have an ongoing material effect on coal margins. Generators with less carbon intensive generation and merchant exposure will likely benefit from a higher power price.

While introducing a price on carbon emissions will raise Alberta's revenue, the province's strategy is designed to ensure that large emitters do not shift their investments to other jurisdictions that do not have a carbon tax in place. While this will ensure that emitting industries remain in the province, and therefore protect the revenue streams from these industries, the province will also focus on the relative competitiveness of these industries in a global context. As such, we expect that the net revenue, once allocations for emissions rights are applied, will reach C$3 billion by 2018 once the strategy is fully phased in. Of this revenue, the province expects to use a significant portion for new program offerings to help offset the carbon tax, including offsets to low and middle income households and support transition to affected workers. The net fiscal impact of the carbon tax will be minimal on the fiscal position of the province, which we currently project to record deficits of C$6.1 billion in 2015-16 and C$5.4 billion in 2016-17.