MEMORANDUM OF UNDERSTANDING
BETWEEN
THE STATE OF WASHINGTON
AND
TRANSALTA CENTRALIA GENERATION LLC

This Memorandum of Understanding ("MOU") is entered into this 26th day of April, 2010 by and between the State of Washington ("State") and TransAlta Centralia Generation LLC ("TransAlta"), as the parties to this MOU.

WHEREAS:

A. On May 21, 2009, Governor C. Gregoire signed Executive Order 09-05, which directs the Department of Ecology to work with TransAlta Centralia Generation LLC ("TransAlta") to establish an agreed order that will apply the greenhouse gas ("GHG") emissions performance standards in RCW 80.80.040(1) to TransAlta's Centralia coal-fired power plant ("Centralia") by no later than December 31, 2025;

B. **Objectives**. TransAlta and the State are committed to finding ways to achieve an agreed order as contemplated by Executive Order 09-05 by reducing Centralia's GHG emissions, maintaining Westside power generation and grid stability, and protecting TransAlta's local jobs and investments in Washington state;

C. **Principles**. To meet the above objectives, the parties propose to negotiate a legally binding agreement (the "Agreement") to define a clear path for this transition based on the following principles:

(a) TransAlta would phase out and then shut down its coal-fired power plant no later than December 31, 2025 on a defined schedule beginning in 2012. The schedule would also provide for development of a portfolio of generation that meets or exceeds Washington State GHG performance standards ("Replacement Generation");

(b) The State would take the necessary steps to allow timely development of the Replacement Generation facilities by TransAlta;

(c) Any acceptable Agreement must ensure that TransAlta recovers its cost and a fair and adequate return for its coal-fired power plant and Replacement Generation investments;

(d) The State would need to apply existing policies, create targeted and durable policy changes and assume other significant roles, as needed to achieve an effective transition plan;

(e) The transition would be structured to ensure that the cost of Replacement Generation is fair and reasonable for Washington citizens and the State;

(f) The transition would also be structured to protect the residents near Centralia by minimizing the adverse impacts to the local economy and tax base;

(g) TransAlta would be able to maintain its participation in the State's electricity generation industry over the long term; and

(h) The State would take those actions necessary to facilitate and give effect to the Agreement. The Governor and state executive agencies would take those actions allowed under their existing authorities, and would propose necessary changes in law for review and approval by the State Legislature, including proposing legislation to amend the state's contracting standards related to greenhouse gas emissions performance standards;

NOW THEREFORE, based on these mutual understandings, the parties enter into this MOU as follows:

Article 1

Mutual Understandings

1.1 Good Faith Negotiations

The State and TransAlta agree to negotiate in good faith towards concluding the terms of the Agreement, based on the aforementioned principles, as further detailed in this MOU.

1.2 Binding Schedule and Contingencies

The parties agree to develop a schedule for the transition of generation at Centralia from coal to other energy sources. The schedule would be included in the Agreement and would be legally binding on both parties. The parties would develop a contingency process where, upon the occurrence of certain agreed significant events, the Agreement would include a mechanism to address the impact of the event and how to effect any resulting changes to the Agreement.

1.3 Agreement in Principle

Consistent with the Principles set out in Paragraph C above, the parties agree to begin their negotiations towards an Agreement that provides:

(a) For TransAlta to phase out its coal-fired generation no later than the end of 2025 and develop, construct, own and operate the Replacement Generation in accordance with an agreed schedule. The current schedule being considered includes decreasing coal-fired generation, with significant steps to implement Replacement Generation beginning in 2012 with ultimate retirement of the use of coal no later than the end of 2025; AND,

(b) For the State to provide a mechanism to ensure that TransAlta recovers its operating and capital costs, and a fair and adequate return on its investments, for both the existing coal-fired facilities and the Replacement Generation throughout their operating lives. Such mechanisms may include long-term power purchase agreements or other power contracts, durable policy changes, financial incentives, mitigation of risk for future changes in federal and state laws, state assistance in the regulatory process including permitting processes to construct, own and operate the

Replacement Generation, or other mechanisms as needed to secure the interests of the parties.

Pending execution of the formal Agreement, the beginning proposals identified in paragraphs 1.3.a and 1.3.b are not binding on the parties, and do not limit consideration of other options that meet the Principles established in Paragraph C above.

1.4 Negotiation Process

To facilitate the negotiation and approval of the Agreement, the parties agree to commence bi-weekly meetings to develop a complete and mutual draft Agreement by the end of June 2010. The parties will identify and schedule the major steps and decision points in the process leading to final execution of the Agreement, including public hearing processes or other stakeholder processes. It is the intent of the parties to reach agreement and execute a final Agreement by the end of November 2010.

(a) Negotiating Team

Each party will form a negotiating team composed of members appointed by that party, which members may include advisors and consultants for that party.

Each negotiating team will include a lead member who has the authority and responsibility to coordinate both the logistics of the negotiating process and flow of information between the parties. Each negotiating team will ensure at least one member has the power to negotiate and commit his appointor within the mandate of the negotiating team.

The parties will attempt to ensure that their negotiating team is of a size that facilitates productive meetings in the manner and frequency set out in this MOU.

(b) Disputes

Any matter discussed by the negotiating team where the negotiating team is unable to reach agreement, shall be referred to the dispute resolution process set forth in Article 4.

(c) Location

All meetings of the negotiating team will be held in Olympia, Washington or Calgary, Alberta or in any other locations that the parties may mutually determine from time to time;

(d) Scheduled Meetings

Scheduled meetings will commence in April 2010 and occur every two weeks through June and thereafter as determined by the negotiating team. Meetings may take place either in person or through telephone link-up or by other audio or audio visual telecommunication link-up.

(e) Agenda

In order to facilitate effective meetings, the parties will in advance, agree on an agenda and supporting documents for each meeting.

(f) Meeting Records

The lead members will take turns preparing and circulating a meeting record that identifies the required actions arising out of each meeting of the negotiating team, as soon as practicable after each meeting.

Article 2
Term and Effect of Termination

2.1 Term

This MOU shall commence on the date set out above and shall continue until the occurrence of the earliest of the following:

(a) December 31, 2010;

(b) The execution of the Agreement; or

(c) Termination of this MOU by either the State or TransAlta, provided thirty (30) days prior written notice of the same is provided from the terminating party to the other party.

Article 3
Confidentiality and Communications

3.1 Confidentiality

Any and all information and knowledge relating to this MOU and the discussions contemplated by it shall be governed by the confidentiality agreement between the State and TransAlta executed on April 26, 2010.

3.2 Communications

The parties agree to jointly prepare a communications plan that ensures the coordination of content and timing of oral or written public communications or documents, including press releases, fact sheets and announcements regarding the matters provided for in this MOU. The plan shall be consistent with the confidentiality agreement identified in paragraph 3.1. The plan shall designate a member from each negotiating team to be responsible for securing final review and approval of external communications related to this MOU.

The communication plan shall not prevent any party from making announcements that it is required to make by any applicable law or competent judicial, governmental or other authority or in accordance with the requirements of any recognized stock exchange. Where possible, the parties agree to provide prior notice of any such required announcement. Where prior notice does not occur, the parties agree to provide notice in the same time frame as the public announcement.

Article 4
Dispute Resolution

4.1 Dispute Resolution Process

Should a dispute arise that the parties cannot resolve satisfactorily after efforts to resolve it have failed at the negotiating team level, then the parties' senior officials shall meet and confer as often as they deem reasonably necessary in good faith negotiations to resolve the dispute amicably.

Article 5
General

5.1 Non Binding Nature

This MOU expresses the intent of the parties to cooperate during the term but shall not be, with the exception of the provisions in Paragraph 3.1, construed so as to bind any of the parties legally or otherwise. Neither party is obligated, and no binding obligation is hereby created by anything in this MOU to enter into any further or other agreements relating the subject matter of this MOU, unless and until the terms and conditions of such agreements have been negotiated in good faith, executed and delivered.

5.2 Governing Law

This MOU and the transactions contemplated by this MOU are governed by the law in force in the State of Washington, including the federal laws of the United States of America applicable therein.

5.3 Counterparts

This MOU may be executed by facsimile and in any number of identical counterparts, each of which shall be deemed an original, and all of which taken together shall constitute one and the same instrument.

IN WITNESS WHEREOF the parties have executed this MOU as of the day and year first above written.

CHRISTINE O. GREGOIRE
Governor, State of Washington

Chris Gregoire

WASHINGTON DEPARTMENT OF ECOLOGY

TRANSALTA CENTRALIA GENERATION LLC

Per: _____