

**The Australian Gas Association
Convention and Exhibition**

**Address by
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“Convergence and the new corporate model”

Good afternoon.

It seems that we’ve all been talking about convergence in the energy market for some time. So today I want to link the theory with the reality. This afternoon I plan to walk you through how AGL is working to create a new corporate business model to reflect the current and emerging nature of Australia’s energy markets.

But first I want to use this opportunity to outline an agenda for the future of our industry, as I’d like to see it in a few years time.

As Martin Luther King once said - “I have a dream”.

I see a truly national industry, not a gas industry and an electricity industry but a unified energy industry with a comprehensive national energy strategy.

We need just one national specialised energy regulator overseeing a market where the industry participants can look forward to profitable growth and shareholders can reliably expect satisfactory returns, where regulation is light handed, cost efficient and simple to administer.

I envisage an industry where specialist energy management and services organisations will compete in an open market for business and regulators will concentrate on regulating prices for genuine natural monopoly services.

We’ll have a fully competitive retail energy market, all energy networks will provide third party access and most transmission pipelines will be operating in open competition to bring gas from multiple energy sources to the various major markets.

And we’ll have an industry with a highly motivated and skilled workforce striving to eliminate inefficiency, keep costs of energy down and provide excellent levels of service.

The most successful energy companies will have well in excess of two and a half million gas and or electricity customers, they'll have a large investment portfolio of gas and electricity production, transmission or network assets, they will have a highly efficient work force specialised in the business of transporting and delivering energy and they'll have a development arm seeking out complementary businesses which can be integrated into the three main business arms.

They'll be expert at working co-operatively with both government and regulators, they'll be highly efficient service providers, reliable with respected and trusted brand names, great customer contact centres, sophisticated world class information systems, good market research and sound financial and capital management.

However right now we really don't have a national energy market and the way things are shaping at present it could be many years before we do.

Instead of one national energy market, a market which would be small by world standards anyway, we have a series of micro markets, States - even areas of States, fragmented by location, divided by fuel type, separately regulated, or worse still, with duplicated regulators, with different rules guarded by the government of each State.

No, I'm not saying that I'm giving up on my dream! Rather I am acknowledging the energy market is evolving. I recognise that we must work within that reality in order to successfully grow our business so that's the way we must deal with things.

While the full expectation of a converged energy market hasn't been met, the convergence model is still alive and well in some respects.

Right now, the only true multi utility in Australia is ActewAGL and I might add, AGL the ACT Government and, I trust, the residents of Canberra are very satisfied with this unique delivery of energy services. For markets like the ACT, it seems the recipe for full convergence of utility services is a good one.

But I also wish to demonstrate that AGL is also well along the convergence track in another sense.

To remind you, our business has an energy retailing arm with around two million gas and electricity customers in five States we have an experienced wholesale team and sitting in between, a very sophisticated energy trading unit. We view this as a highly integrated business portfolio that enables us to best manage the risks and at times, volatility in the energy market.

Then we have a national portfolio of energy assets comprising gas and electricity networks, gas transmission pipelines, gas fired power stations and LPG infrastructure.

We have a large energy management and services organisation with skilled units specialised across the whole energy infrastructure spectrum.

And we have a sophisticated business development unit with a broad brief to take advantages from opportunities to enhance our three main business streams.

You may think it sounds pretty much like that ideal business I painted earlier? Yes it does, but we're not all the way there yet by any means!

Let me turn to address some of the issues with which we are dealing in those sectors.

I'll begin with the retail energy market. In the retail area the Full Retail Contestability or FRC project as, it is called by the bureaucrats is, to be perfectly honest, still all over the place.

In spite of the goal of a national energy market I'm certain everyone will agree when I say we have a total lack of uniformity in timetables and in systems for the introduction of a competitive market place. In fact, some states have either refused to fully open their energy markets or have yet to recommit to previously agreed timetables.

By the way – at AGL we've renamed FRC by a more appropriate tag, we call it 'customer choice'. After all, isn't that what the national competition policy is all about. We're still expecting to see at least the NSW gas and electricity markets and the Victorian electricity market open for business next January.

As markets open I fully expect the successful competitors will not be competing on price alone – that's a recipe for the commoditisation of the industry and hence a disaster! I believe the whole brand experience, the package of product, service and price offerings, will prove to be the critical success factor. That's why we are putting so much time and effort into operating the best customer contact centres in the country and, if I might boast, our centres are winning lots of awards!

Now let me turn to the all important issue of risk management. It wasn't that long ago that we hardly mentioned this subject and when we did it was in a very different context to the way we all talk about the subject today.

We believe risk must be avoided wherever possible, managed by minimising it where it's not possible to avoid it and built into the selling price if we end up having to accept the risk. Getting that balance right is another critical success factor. Those who do it best will be the biggest winners in the new energy market.

If you're going to be in business, sometimes you just can't avoid risk altogether. But there are things you can do to manage it.

A case in point is our decision to build gas fired peaking plants in Victoria and South Australia to give us a physical insurance hedge against the risk of very high pool prices during times of peak electricity demand. In effect those plants are just part of our overall hedge portfolio.

In fact we can see a real synergy and strategic advantage between energy retailing and having some control over upstream supplies.

Now that doesn't mean we are even remotely thinking about going back into gas production!

I was thinking more of the association of peaking power plants and retail electricity – where pricing changes every five minutes in a highly dynamic and complex wholesale market.

I'm not suggesting in any way, that we're seeking to be vertically integrated across all of our business or all of our markets. I see it more as a vertical and horizontal mix of businesses that have been woven together to provide sustainable competitive advantage.

It's a case of identifying opportunities to fill strategic gaps and better manage our whole portfolio to match the opportunities available to us within the micro nature of Australia's current energy market place.

There are of course, many issues to deal with along the way to the realisation of my dream. In the infrastructure sector there is little doubt, that in the eyes of our whole industry, we just have too many regulators. So I'll repeat my plea. Just one is enough. A specialised national energy regulator dedicated to our very large national industry.

And just what sort of regulation would I like to see? Let's look at a very simple model of how regulation might work. The government sets the rules to ensure fair play. The players play the game. The referee keeps an eye on the games and the players to ensure fair play. Too simplistic? Maybe so but we cannot, must not, allow our society to be so stitched up that it assumes everyone playing the game deliberately sets out to cheat! We don't need a corporate cop – all we need is a referee.

Now in the whole infrastructure sector we do need some urgent action. I'll repeat some views expressed recently in the 2001 Australian Infrastructure Report Card published in July this year by 20 industry associations, including the AGA, in conjunction with the Institution of Engineers and I quote

“Our infrastructure needs significant enhancement before it can be said to met Australia's current and future needs. The only way that this will occur is if infrastructure maintenance, planning and development become a priority in Federal, Territory and Local governments.”

And then the report went on specifically for gas; “The Government needs to ensure that the energy policy setting encourages greater use of natural gas, particularly in view of the environmental benefits. In addition, urgent consideration is needed to ensure that the regulatory and taxation settings are genuinely supportive of new development activity.”

Now I’m sure we’d all agree with that, wouldn’t we?

Still on the subject of infrastructure regulation, we trust that the Productivity Commission maintains the stance it has taken in its draft report following a review of the 3rd Party Access Code for Pipelines.

I’m hoping to see words in the final report like “access arrangements should encourage regulators to lean more towards facilitating investment than short term consumption of services when setting terms and conditions” and “a strong in principle case to ‘err’ on the side of investors”.

No, this time I’m not dreaming, these were the views aired earlier this year in the Productivity Commission’s draft findings.

Coming back to the corporate business model, my aim is to make AGL the winning energy company. Our core retail focus will be very clearly on electricity and gas. Our geographic focus will be on the Eastern States markets. And contrary to conventional wisdom, that success in the energy market depends on a global presence, the reality has dawned on us that it is the local market rules and regulatory settings that determine the appropriate business structure and competitive response.

We were an early adopter of ring fencing simply because we believe retail and networks are separate businesses with different economic drivers.

We believe that it is vital that we maintain financial scale and recognise the importance of a robust and pro-actively managed balance sheet and portfolio of energy assets and investments. We’ve come to accept that economic value is derived from having a competitive advantage in each of the micro markets in which we do business.

In my opinion we must develop as a hybrid energy business with interests in both the regulated and market based sectors. This is essential in a market the size of Australia as only in that way can we achieve the critical mass to remain the market leader.

This approach also delivers the diversity we need with reliable earnings coming, on the one hand, from yield based regulated businesses with strong cash flow and on the other, from market based businesses focussed more on delivering capital growth.

I believe the winning formula will have an actively managed portfolio containing only those businesses that have more value in our hands than in the hands of other potential owners and in which we seek to manage the synergies between the various operations within the portfolio.

In retail, success is all about managing margin and controlling costs, in infrastructure its about managing regulatory risk, and both capital and operating efficiency.

The path to success in Australia will be to have a balanced portfolio of interests and a strategic management focus on core strategic assets.

As a publicly listed company we must produce acceptable returns for our shareholders. And I believe that a balanced energy business can deliver that consistently and best.

Australia's retail markets are simply not big enough to be just a specialist energy retailer. Just think about it. About 10 million gas or electricity customers. Maybe the largest retailer could have 3 to 4 million customers, leaving 6 or 7 million for the competitors – you can guess who I'd like to see as that retailer can't you?

Then let me speak of energy delivery assets, the natural monopoly businesses. Inescapably, energy networks are natural monopolies. One can argue that transmission pipelines are not, but today I will not venture into that argument.

The point I will make is that the process of regulation should be focussed on fair pricing rather than getting drawn into the complex area of rate of return on assets.

Suffice to say I really believe we got that right in NSW when the Government of the day adopted incentive based regulation way back in 1990. Regulated energy assets are highly valued assets, but the real key issue here is how they are run and what incentives are provided to grow and develop them. And that leads me on to the management and services sector. We looked at how to attain the right balance between asset ownership and asset operatorship. By creating Agility we are already seeing the benefits of consolidating all that expertise into the one infrastructure management and services business and Mark Harper will speak about that during the convention.

For now however, I can see no justification for regulating all such associated services, from design and construction through operations and maintenance. The regulatory process needs only to focus on the end pricing model to ensure fair and reasonable costs for asset users.

I've already declared my hand – I want AGL to be the winning energy company, the leading energy transportation and marketing company in Australia. And for that AGL must have balance, investment, management, marketing and development, as I said earlier, a mixed business. I see not a 'one stop shop' but a group of separate profitable complementary energy focussed business units.



The Australian Gas Light Company

My guess – there'll only be about three or four really big energy companies and it's my job to make sure AGL is one of them.

So in summary, my way to success in the future is by acting now to succeed in the currently fragmented Australian market, while we continue our efforts to achieve the type of market I can, right now, only dream about.

And that's exactly what we're focussed on doing at AGL.

Thank you.

