

"We've suffered some setbacks, but there is a clear way forward"

M John Phillips AM  
Chairman



MRG Johnson  
Deputy Chairman



GJW Martin  
Managing Director



DCK Allen AO



**Dear Proprietor**

This is not the Report for 2000/2001 I had hoped to bring you. A number of unexpected situations meant the result for the year fell well short of being a good one for Proprietors.

Profit attributable to Proprietors was \$115.4 million compared with \$450 million in 1999/2000.

The earlier year's profit was boosted by an abnormal amount of \$201 million from significant once-only transactions, mainly from the sale of the transmission pipelines to the Australian Pipeline Trust. In the past year we had the opposite experience. Significant once-only transactions produced an after tax loss of \$192.3 million. The major item was a \$245.8 million write-down of the Company's 66% investment in Natural Gas Corporation Holdings Limited (NGC) in New Zealand. More on that later!

Operating profit (including significant items) before borrowing costs and tax was \$295.3 million, down 53.7% from the previous year, reflecting the New Zealand situation, and lower gas and electricity distribution revenue in NSW and Victoria following reviews by the Regulators in October 2000 and January 2001 respectively.

These are disappointing figures and the Company has been making strenuous efforts to protect its revenues from similar shocks in the years ahead.

The Board is recommending a final dividend of 27 cents per share, franked to 16 cents (59.3% of final dividend). This would bring the total dividend for the year to 52 cents, franked to 23 cents per share (44.2%).

There are no Foreign Dividend Account (FDA) credits attached to dividends for the year.

The Dividend Reinvestment Plan will again be available in respect of the final dividend. The discount rate will be unchanged at 2.5%.

As mentioned above a major problem faced in 2000/2001 occurred in New Zealand and involved AGL's 66%-owned subsidiary NGC. The details are covered elsewhere in this Report so I will restrict myself to a brief overview.

The basis of a well-functioning electricity market is that retailers contract with their customers, formally or informally, to provide power at certain prices. In turn the retailers contract to acquire power from generators. Part of that power they buy is at spot prices, thus taking a risk that the price may rise. However, the bulk of their needs is purchased under forward contracts. By doing this the retailers hedge their risks.



Sir Ronald Brierley



GJ Reaney



CJ Hewson



AB Daniels OAM

## The board of directors

That was NGC's experience until the end of May 2001. At that time a series of things happened:

- New Zealand experienced a drought, casting doubts on the generators' (mainly hydro-based) capacity to continue to meet the market's needs;
- for the main winter period NGC was unable to secure hedge contracts from the country's major generators, to cover all of its retail commitments. In other words NGC was unable to have certainty of future supply of power at a known price. The generators, many of which are government-owned, were also NGC's main competitors in the retail market;
- NGC was forced to purchase the large percentage of its power requirements for the period of June and July from these same generators via the spot market, with prices on offer being at very high levels, in fact levels unprecedented in the history of the New Zealand electricity market;
- with the onset of winter, the chance of rain relieving the situation became more remote since most precipitation then occurred as snow; and
- despite the rise in the wholesale price of power by a factor of five times, some generator/retailers announced they would not increase their retail prices.

In these circumstances NGC was between a rock and a hard place. It could defend its position but at a considerable cost to revenue – or it could exit the market. After a detailed review it elected to sell its customer base and withdraw from the electricity

retail market, a decision fully supported by AGL. Even so, it suffered significant losses, both from its retail activities and from the need to reassess the value of its electricity customer base in the changed circumstances. Despite the strong performance of its other operations, NGC suffered a net loss for the year of NZ\$301.6 million, which has flowed in due proportion to AGL's profit and loss account.

However, NGC's remaining businesses in gas transmission and distribution, wholesale and retail natural gas and LPG sales, together with electricity generation, metering and infrastructure management and services, are performing well and will give NGC a solid profitable base for the future.

**"The new gas-fired generating capacity we have committed to installing should put us in good shape over coming years."**

The second potentially difficult situation occurred in South Australia where a succession of well-reported decisions by Government and Regulators meant that the State had potentially insufficient electricity generating capacity and inappropriate connections to obtain supply from other states. In those circumstances the price of electricity sky-rocketed during the summer peak demand period, creating a dangerous environment for retailers and their clients.

Happily, AGL was able to adjust to these circumstances reasonably quickly, though not without some pain. Some losses were

experienced initially but, subsequently, we were able to put in place innovative hedging arrangements. These, plus the new gas-fired generating capacity we have committed to installing, should put us in good shape over coming years.

Events in New Zealand and in Australia, particularly South Australia, beg the question whether a 'California-type' situation could occur in our country.

There are some differences in the various examples. In California the problem stemmed from inappropriate legislation. In New Zealand the issue is an inadequate wholesale market and an unbalanced retail market. In South Australia we have a paucity of supply arising from earlier official decisions, exacerbated by an inappropriate regulatory regime.

The common factor is that all result in unnecessary financial distress to market participants and less than adequate service to wholesale and retail power users.

The challenge for Australia will be to learn the lessons of recent events. Governments and Regulators must ensure that market settings and rules are appropriately balanced and structured.

You are aware from my previous Reports to you that the Board of AGL has concerns about the regulatory environment with which the energy industry is currently burdened. We believe there should be a regulatory framework to inhibit monopolistic practices, to encourage genuine competition and to protect the end-users. However, that framework should be equitable, fair to all parties, designed to encourage investment and innovation, and 'light-handed' in application.

In particular, we would argue that:

- regulation should be consistent across the whole of Australia. This applies not only to the rules imposed but also to the timetables for open access etc;
- pricing models should be consistent across all market segments. The present difference in arrangements for electricity wholesale and retail pricing is in neither the consumers' nor the nation's interests; and
- greater recognition should be given to market realities in regulating rates of return on investment in the energy industry (if that mode of regulation can be justified at all).

We look forward to the results of the current review by the Productivity Commission on aspects of the national framework for access to infrastructure facilities.

I know that many Proprietors are wondering what has happened to our review of AGL's gas and electricity infrastructure assets. I announced in May 2001 that we had deferred a decision for the time being.

The uncertainties surrounding energy regulation and competition make it difficult to form a clear view on the best way to structure these assets in the interests of Proprietors. The Company has done

considerable work on exploring the various options but some important questions have yet to be clarified. I hope the situation may become clearer during the current financial year.

In April this year the Company and the NSW Government jointly announced that AGL's 164-year-old Constituent Documents would be modernised and that the 5% shareholding limit would be removed. The target date for introduction of the necessary legislation is not later than 1 July 2002. It is likely that a meeting of Proprietors will be needed before that date to adopt the new Constitution.

**"We believe there should be a regulatory framework to inhibit monopolistic practices, to encourage genuine competition and to protect the end-users."**

During the year we farewelled Len Bleasel, who had occupied the position of Managing Director for a decade. He had guided the Company through its transition from a NSW-based gas utility to the largest energy distribution and marketing company in Australia.

During that period the Company's market capitalisation grew from \$417 million to \$3.7 billion. Len made an outstanding contribution to AGL and to the broader energy industry. On behalf of the Board, I acknowledge and thank him for this and wish him well as he moves to the next stage of his life and career.

The events of the year put considerable pressure on the executive and staff. It has also been a 'baptism of fire' for the Managing Director, Greg Martin. Greg succeeded Len Bleasel on 1 March 2001. On behalf of the Board, I would like to convey to Greg and his team our thanks for the way they handled the issues which arose and the efforts they made to protect the Proprietors' interests and to form a solid base for next year and those to follow.

I would also like to convey my personal appreciation to my fellow Board members for their support and dedication. It is our sincere hope and belief that next year's Report will tell a much better story.



M John Phillips, Chairman, 23 August 2001

**"NGC's remaining businesses... are performing well and will give NGC a solid profitable base for the future."**