

# AGL Energy Limited

## Wholesale Energy Risk Management Policy (Summarised)



### 1. Purpose

- 1.1 This Policy describes the risk management principles that shall apply to the production, procurement and internal wholesale sale of energy and green commodities.

The purpose of the Policy is to preserve the ability of the business to deliver budgeted outcomes by:

- Establishing the internal governance structure and management philosophy for managing specific risks;
- Delegating authority to enable the Policy objectives to be met;
- Establishing the management structure to administer the Policy;
- Setting global limits and controls on the business' exposure to specific risks, including limits on energy exposures in current and future years;
- Defining the AGL Board's policy for recognising, measuring, managing and reporting the risks arising from AGL's wholesale energy activities;
- Ensuring that the policy for management and control of wholesale energy risks is adequately documented, thus enabling compliance to be independently verified.

### 2. Scope

- 2.1 This Policy is one of a number of policies established by the AGL Board to manage risks in the company. The Policy fits under the umbrella of the *AGL Risk Management Policy*, but is nevertheless a separate instrument of the AGL Board.

This Policy covers the management of energy price and related financial risks associated with the wholesale energy activities undertaken by AGL including:

- generation, procurement and internal wholesale sale of electricity;
- generation, procurement and internal wholesale sale of Green Commodities;
- procurement and internal wholesale sale of gas; and
- procurement and sale of oil.

This Policy applies primarily to the activities of Merchant Energy, but it also applies to the activities of Retail Energy insofar as they affect management of wholesale energy risk.

This Policy applies to the activities described above undertaken in the name of, or on behalf of AGL Group companies.



The specific risks covered the Policy include:

- Market Risk;
- Credit Risk;
- Contract and Legal Risk;
- Regulatory Risk; and
- Operational Risk.

### **3. Risk Management Objectives**

3.1 The objectives of the Policy and Framework are to ensure that:

- A focus on risk exists across AGL Merchant Energy and Retail Energy businesses;
- There are internal governance structures which maintain a segregation of relevant functions;
- All relevant information related to wholesale energy exposure is communicated and understood;
- Suitable procedures are in place to measure and report risks;
- There are delegations of authorities for activities which create exposure to specific risks;
- Accountabilities and responsibilities are assigned and understood;
- Initiatives are taken to identify and remedy operational risks associated with AGL wholesale energy activities;
- Ongoing development and training is provided to all employees ensuring required competencies are maintained;
- Consistent performance measures are in place supported by measurement and reporting tools; and
- Adequate audit and review processes are in place to assess compliance, provide a mechanism for corrective action and identify improvements.

### **4. Risk Management Committee**

4.1 The role of the Risk Management Committee (RMC) is to oversee the risk management operations of any AGL entity with wholesale energy market exposures. This includes setting, supplementary to this Policy, trading limits within its delegated limits where they further reduce risk; and ensuring compliance with the Policy. The RMC is responsible for approving and amending the Framework.

The Risk Management Committee will comprise the following core members:  
Chief Financial Officer (Chair), Head Wholesale Energy Risk Management (Secretary), Company Secretary & Head of Corporate Support Services (or their delegate), Group General Manager Merchant Energy, General Manager Merchant Power, General Manager Gas Development and Head of Major Customers

Additional members of the RMC are to be approved by the Chair. Attendees are to be approved by the Secretary.

## 5. Delegations

### 5.1 Risk Management Committee & Managing Director

The Board delegates to the Managing Director and RMC responsibility for overseeing the risk management operations of all AGL entities with wholesale energy market exposures, with the RMC achieving this objective by overseeing the implementation of the Policy. The Board delegates to the RMC responsibility for setting individual trader limits.

### 5.2 Authorities to Transact, Confirm and Settle

The Board authorises the Managing Director, on behalf of all AGL Group companies, to sign authorisations for trading-related activities. The Board further authorises the Managing Director to delegate to certain persons authority, on behalf of AGL Group companies, to sign authorisations for trading-related activities.

As authorised, the Managing Director and/or their delegates may in turn authorise appropriate staff of AGL to perform, subject to this Policy, various activities appropriate to managing trading-related functions including without limitation:

- (a) Sign ISDA Master Agreements;
- (b) Negotiate contracts (including derivative and procurement contracts) for Approved Commodities;
- (c) Confirm and execute contracts for Approved Commodities;
- (d) Settle contracts for Approved Commodities;
- (e) Settle payments with the NEM and the gas markets;
- (f) Settle payments for network charges and with brokers;
- (g) Offer generation capacity into the NEM;
- (h) Schedule and nominate in the gas markets;
- (i) Sign contracts with brokers;
- (j) Sign contracts with regulators and market operators;
- (k) Issue collateral for prudential requirements in the physical energy markets (NEMMCO and VENCORP);
- (l) Notify other parties of lists of persons authorised to carry out related activities on behalf of AGL companies; and
- (m) Notify other parties of payment and contact arrangements.

Nobody with an authorisation to negotiate contracts may have authorisation for contract confirmation or contract settlement. Individuals with contract confirmation authorisation can only complete authorisation for contract settlement with a co-signatory.

An Authorisation must be signed by the Managing Director or comply with his sub-delegation process.

## 6. Roles and Responsibilities

### 6.1 Risk Management Committee

The Managing Director is responsible through the Risk Management Committee (RMC) for giving effect to this Policy.

Responsibilities include:

- Monitoring of wholesale energy activities that create an exposure to risk;
- Monitoring the separation of duties across wholesale energy activities;
- Allocation of tasks and responsibilities for managing and monitoring wholesale energy risk;
- Allocation of the Wholesale Energy Economic Risk limits across the wholesale energy activities;
- Setting risk limits in addition to those stated in this Policy, where they are within delegations and further reduce risk;
- Approval of the methodologies for preparing the economic risk measures;
- Setting trader limits;
- Approval of all derivative instruments that can be traded;
- Approval of the guidelines for preparing demand forecasts;
- Approval of the guidelines for preparing market price forecasts;
- Approval of the methodology for preparing wholesale transfer prices.

The Risk Management Committee will provide a quarterly report to the Managing Director summarising key issues.

## 6.2 Front Office

Merchant Energy is responsible for managing energy purchase cost and wholesale risks according to the requirements of the Policy and the Framework.

The group therefore is responsible for:

- Procurement, including hedging and trading for electricity, gas, green commodities and oil sales;
- Generation and gas supply operations including purchasing fuel for generation, planning outages and balancing competing demands for gas supply; and
- Physical market operations including offering generation capacity to the NEM, gas scheduling/nominations, financial representation of generation capacity for financial forecasting systems; demand forecasting and ongoing monitoring and reporting, market price forecasting and ongoing monitoring and reporting; and wholesale transfer pricing to retail.

## 6.3 Middle Office

To ensure separation from the Front Office, Finance is responsible for the Middle Office function, which is performed by the Wholesale Energy Risk Management group. Responsibilities of the Middle Office include:

- Development, implementation and promulgation of this Policy and the Framework;
- Compliance reporting on this Policy and the Framework;
- Measuring, monitoring and reporting risk, with monthly reports to the RMC;
- Confirmation of derivative transactions and other transactions used for managing AGL's wholesale energy procurement risks;
- Monitoring and validating transfer pricing methodologies and processes; and
- Monitoring and validating price forecasting and load forecasting estimates that are used by Middle Office and Merchant Energy.

Whilst Middle Office plays a role in identifying and monitoring risks and the recommendation of risk reducing strategies, it is not responsible for managing risk.



#### 6.4 Back Office

The Back Office is part of the Finance function. This ensures separation of responsibilities between trade negotiation & execution and trade settlement. Activities of the Back Office include:

- Reconciliation & settlement of market invoices (eg NEMMCO invoices, VENCORP invoices), hedge contracts and other wholesale energy contracts;
- Settlement of certain network charges and other miscellaneous market charges;
- Accounting for wholesale electricity transactions (including monthly accruals of hedge difference payments); and
- Ensuring NEMMCO & VENCORP prudential requirements are met.

#### 6.5 Retail

This policy sets down some specific requirements in relation to the retail sales units where Merchant Energy price risk is affected by the actions of these retail sales units. In particular:

- The general terms of contracts for retail sales must be approved by the Head of Middle Office prior to being offered to customers. Where new retail energy sales products or changes to the commercial terms for existing products are proposed they must be approved by the RMC.
- Where new or changed terms for specific customers are required and affect the risk profile of AGL's retail sales position, these changes must be referred to and signed off by Head of Middle Office and AGL Legal.
- The energy price in retail sales contracts is set via the transfer pricing process from Wholesale to Retail. Retail is to maintain a record of the wholesale transfer price used in the preparation of retail prices.
- Retail sales units must provide accurate data to Merchant Energy on all outstanding offers and completed sales. Merchant Energy will specify to retail sales units the information that is required.
- Where Merchant Energy is required to provide a transfer price for a customer load, retail sales units must provide the most accurate and up to date information available on request.

## 7. **Specific Risk Management Strategies**

- 7.1 This Policy document summarises the key governance aspects in managing AGL's Wholesale Energy Trading risks. While a detailed in-house Policy and Framework exist, such detail is considered commercially sensitive and as such is not available for external or public disclosure.

**August 2008**