

**IN THE AUSTRALIAN COMPETITION TRIBUNAL
AGL ENERGY LIMITED**

ACT 1 of 2014

**RE: PROPOSED ACQUISITION OF MACQUARIE GENERATION (A CORPORATION
ESTABLISHED UNDER THE ENERGY SERVICES CORPORATIONS ACT 1995
(NSW))**

ANNEXURE CERTIFICATE

This is the annexure marked "**RB2**" annexed to the statement of **ROSS MURDOCH BUNYON
AM** dated 25 March 2014

Annexure RB2

Filed on behalf of (name & role of party) AGL Energy Limited
Prepared by (name of person/lawyer) Liza Carver
Law firm (if applicable) Ashurst Australia
Tel +61 2 9258 5897 Fax +61 2 9258 6999
Email Liza.Carver@ashurst.com
Address for service Level 35, 225 George Street, Sydney, NSW, 2000
(include state and postcode) DX 388 Sydney

[Form approved 01/08/2011]



RB2

Reference: EA301190


Mr Lucio Di Bartolomeo
Chairman
Macquarie Generation
34 Griffiths Road
LAMBTON NSW 2299

Dear Mr Di Bartolomeo

Thank you for submitting the Statement of Corporate Intent (SCI) and Business Plan for Macquarie Generation. We have executed these documents in our capacity as Voting Shareholders under the State Owned Corporations Act.

We note that the business is subject to a transaction process, however in accordance with convention, the document has been prepared on a business as usual basis.

Yours sincerely



MIKE BAIRD MP
Treasurer
Minister for Industrial Relations



GREG PEARCE MLC
Minister for Finance and Services

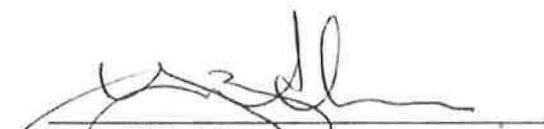
**NEW SOUTH WALES
GOVERNMENT TRADING ENTERPRISES**

STATEMENT OF CORPORATE INTENT

ORGANISATION: MACQUARIE GENERATION

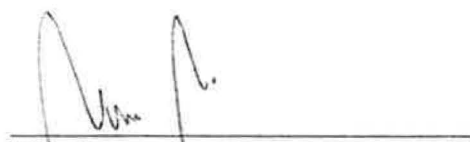
PERIOD: COMMENCING 1ST JULY 2012

This Statement of Corporate Intent has been agreed between:



Lucio Di Bartolomeo
Chairman
Macquarie Generation
on behalf of the Board

and




The Honourable Mike Baird MP
Shareholder



Russell Skelton
Chief Executive and Managing Director
Macquarie Generation

and



The Honourable Gregory Pearce MLC
Shareholder

Dated:

Macquarie *Generation*

Statement of Corporate Intent

2012/13

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1. OBJECTIVES OF THE CORPORATION

Macquarie Generation is focused on being a successful business and maximising the net worth of the State's investment in the Corporation.

Since the completion of the New South Wales Energy Reform Project, which resulted in the sale of retailers and some generator trading rights Macquarie Generation is operating in a different business environment to previously. The key differences are that Macquarie Generation is now the only significant merchant generator in NSW and the number of retailers has reduced significantly. Importantly these retailers are largely vertically integrated which was not the case previously. Combined with falling demand for electricity and increasing supply, the Corporation is facing lower average prices and lower price volatility for generation in the Wholesale sector of the National Electricity Market.

Macquarie Generation has not had the ability to expand or transition the business in the light of the changing market environment. As a result the focus of the business remains managing a portfolio of existing, aging coal fired generators with a major exposure to the Carbon tax. The falling value of the business is currently being addressed by a range of initiatives designed to return value to pre Carbon Tax levels within five years.

Macquarie Generation will deliver on the objective of being a successful business and maximising net worth by:

- Minimising production and maintenance costs,
- Maximising the margin created by selling electricity into the National Electricity Market,
- Managing assets to ensure that they provide reliable and safe production,
- Maintaining a skilled and motivated workforce, and
- Delivering ongoing and timely Shareholder communication.

By meeting these objectives the Corporation will strive to provide:

- The State of New South Wales with a predictable dividend stream and improved Shareholder value,
- Its employees with meaningful and rewarding jobs demonstrating industry best levels of productivity and participation,
- Industry leading safe workplaces,
- The creation of mutually advantageous business alliances with industry suppliers,
- Pro active improvement in environmental performance, and
- Sustainable practice and demonstrated Corporate Social Responsibility.

In order to meet the needs of the Shareholders and to meet the operating objectives of the Corporation, the following major risks have to be actively managed:

- Strategic risk including the impact of the Carbon price regime, and the associated consideration of the economic useful lives of Liddell and Bayswater.

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- Market risk created by movements in market prices that results from lower overall demand, higher levels of generation supply and greater levels of retailer/generator integration.
- Supply risk including coal and water. When combined with the balance of Macquarie Generation's forward purchases, and the anticipated Development Approval of the Cobbora Coal Project, the Corporation is well placed to receive competitively priced fuel supplies to 2027.
- Skills risk due to the Corporation's ageing workforce and an increasingly competitive labour market.
- Production risk including maintenance cost increases, plant failure, industrial relations, asset security and environmental compliance. In July 2012 the Corporation was due to have renewed its Enterprise Agreement with staff under Fairwork Australia arrangements instigated by the Federal Government. Negotiations are currently underway on this issue.
- Profit risk created by downward pressure on future revenues resulting from reducing demand growth and increasing generation competition and increased operating costs.
- Compliance risk including legal, regulatory and Occupational Health & Safety compliance.
- Last year, the New South Wales State Government completed the New South Wales Energy Reform Project. This has changed the business environment in which Macquarie Generation must compete resulting in greater generation supply, reduced merchant plant operation, lower levels of strategic bidding, reduced numbers of retailers in the market. In aggregate, Macquarie Generation has struggled to maintain Shareholder value in these circumstances.

2. NATURE AND SCOPE OF OPERATIONS

Macquarie Generation has as its core business the production, marketing and sales of electricity from Liddell Power Station and Bayswater Power Station into the wholesale segment of the National Electricity Market.

Thus the main undertakings of the Corporation are the physical generation, supply and trading of electricity.

The National Electricity Market provides the mechanism for trading electricity in Queensland, New South Wales, Victoria, the Australian Capital Territory, South Australia and Tasmania.

Macquarie Generation owns and operates the Bayswater and Liddell Power Stations, which are located in the Hunter Valley of New South Wales. The location of the Power Stations provides access to large quantities of coal from local and remote mines, which will be capable of supplying coal for at least the remaining useful lives of the Corporation's Power Stations. The Corporation also owns and operates two 25 MW oil fired gas turbines.

The Corporation has also invested in a demonstration solar plant that provides auxiliary steam to the Liddell coal fired Power Station. This plant is believed to be the first of its type in the world, and is designed to produce 4,400 MWh of energy per annum. Further expansion of the demonstration plant is currently being undertaken following the offer of funding support from the NSW Government.

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The combined generating capacity of Macquarie Generation's operating assets is 4,640 MW. In 2011/2012 the Corporation provided around 13% of the National Electricity Market demand for electricity.

A Corporate office, providing executive management, finance, information technology, commercial, human resources, fuel and environment, and marketing and trading services is located in the Newcastle suburb of Lambton.

Macquarie Generation recognises that in the longer term, the useful economic lives of the existing power generation plant at Bayswater and Liddell in particular, will be impacted by emerging environmental regulation and the introduction of a carbon price. With this in mind, the Corporation is continuing to review opportunities to optimise the useful economic lives of Bayswater and Liddell and to participate in new generation technologies using gas, biomass, and solar energy sources.

The useful lives of the Power Stations has been extended by continuing predictive maintenance programs, capacity improvement programs and the improvement of thermal efficiency to reduce costs and greenhouse intensity. A life extension study at Liddell has identified required upgrades and maintenance to allow for an extension of the engineering useful life from the current 50 years to 60 years ending in 2032. However, no decision has been made on the extension of Liddell's accounting useful life from the current end date in 2022. It is apparent from work done to date that engineering considerations will not terminate operations at Liddell and instead any decision on life extension will be dependent on the economic viability of Liddell in the National Electricity Market.

3. STRATEGIC DIRECTION

The market in which Macquarie Generation operates has changed significantly following the completion of the NSW Energy Reform Project. Key features of the new operating environment are as follows:

- Private ownership of all significant retailers operating in New South Wales.
- Apart from Delta East and Macquarie Generation, all New South Wales generation is traded by the private sector.
- As a result of the owners of the Gentrader rights being significant retailers, the level of vertical integration in New South Wales and the National Electricity Market (NEM) has increased to a significant level and reducing the number of channels to market available to Macquarie Generation..
- The Gentraders in New South Wales, who are Macquarie Generation's close competitors, have a very different set of strategic options available to them than when these assets were traded by Delta Electricity and Eraring Energy. They have a much wider range of options and the ability to shift between these rapidly.
- A carbon tax of \$23 per tonne was introduced on 1 July 2012. This more than doubles Macquarie Generation's and other coal generators' variable costs. It is also important to note that based on a wide range of modelling undertaken for the carbon tax, it is expected that it will only be possible to pass through from 60% to 80% of this cost increase in the long run.
- Macquarie Generation is also exposed to a range of other additional regulatory imposts in areas such as energy efficiency opportunities and NSW Wages Policy which will require solutions to allow the Corporation to achieve improved value targets.

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- Retail electricity prices are increasing rapidly and are expected to continue to do so. This is having an impact on the size of the wholesale market with demand in NSW reducing since 2007 while supply growth has continued. As a consequence future sales prices and market share are under strong pressure.
- In the short term Macquarie Generation's response has been to reduce production and stockpile coal, thereby increasing gross trading margins. In the medium term the challenge will be to commence higher consumption of purchased and stockpiled coal as power station stockpiles reach their physical limits.

A number of strategic issues arise from this environment in addition to those that Macquarie Generation already faces as a result of ongoing operational issues. The strategic issues include:

- Margin squeeze as revenue is under pressure due to a combination of lower demand growth and greater competition from gas and other generators.
- The number of retailers available to Macquarie Generation to trade with has fallen as a result of the Gentrader transaction with AGL remaining as the only significant non aligned retailer. Other non aligned retailers are new entrants to the NSW market.
- As a result, Macquarie Generation might need to become a more active trader of the forward production of the Corporation in order to reduce the margin squeeze arising from lower prices and restricted avenues to market.
- Macquarie Generation is essentially fully hedged for future coal supply until at least 2025 but requires timely development of the Cobbora Coal Project and the negotiation of periodic price reopeners on existing long term contracts.
- Plant performance and operating costs have been comparable to similar plant within Australia and internationally. However, in light of the margin squeeze it is increasingly a requirement to rebalance operating costs, including maintenance against plant performance.
- The introduction of a carbon constrained economy will require reassessment of the economic lives of the power stations. This will require a careful examination of the economics of both power stations under a wide range of market, regulatory and operational scenarios. As a result of the imposition of the carbon tax, the Corporation wrote down the value of its power stations by \$1 billion before tax at December 2011.

The Corporation's plans in this area are dealt with in the Commercial in Confidence Business Plan for 2012/13.

4. FINANCIAL PERFORMANCE

Performance Target	2011/12 Actual	2012/13 SCI	2013/14 Forecast	2014/15 Forecast	2015/16 Forecast
Earnings before, Interest, Tax and Depreciation	\$372 m	\$248 m	\$185 m	\$165 m	\$242 m
Operating Profit before Tax ¹	\$171 m	\$85 m	\$21 m	\$1 m	\$82 m
Operating Profit after Tax	\$120 m	\$60 m	\$15 m	\$1 m	\$57 m
Return on Assets (%)	7.9%	4.9%	2.8%	2.1%	5.1%
Return on Equity (%)	16.6%	8.3%	2.1%	0.1%	8.0%
Target Dividend Payout Ratio (%)	100%	100%	100%	100%	100%

The target dividend is derived from the target payout ratio and can be renegotiated between the business and shareholders prior to 30 June 2013.

In relation to 2011/12 the Corporation will pay a dividend amounting to \$124 million. This dividend is as agreed with the Shareholders via the Corporation's Dividend Policy and will be made up of 100% of 2011/12 Net Profit after Tax after allowing for unrealised, non cash gains and losses on financial instruments and superannuation resulting from compliance with Australian Accounting Standards AASB 139 and AASB 119.

The calculation of the dividend in this manner is in accordance with New South Wales Treasury's *Impact of AEIFRS on Financial Distribution Policy*.

The budgeted results of trading in the coming three years are below current results and occur due to the pressure on revenue resulting from reduced demand growth, increased supply combined with increased cost of fuel and higher operating costs and the introduction of a carbon price. The Corporation has estimated that financial returns will reduce dramatically due to under recovery of carbon costs as more carbon efficient generation comes on line.

However the Board and Management have commenced a series of initiatives designed to improve the value of the Corporation from the current \$2 billion to \$3 billion within five years.

¹ EBDIT and operating profit excludes the impact of accounting adjustments for the impact of Australian Equivalents to International Financial Reporting Standards

5. CAPITAL WORKS PROGRAM

Macquarie Generation's capital works program continues to focus on efficiency improvements, capacity upgrades to existing generation plant and stay in business projects.

Increasingly however, the capital spend is also being evaluated to minimise the value implications of an early closure of Liddell power station due to carbon regulation, should this be necessary.

Projects that are essential for the future delivery of coal and the quantity and quality of power station cooling water have been completed.

Notable projects that take place in 2012/13 include the following:

- Continuation of the continuous dry ashing project at Liddell with a total cost of \$4 million.
- \$8 million for remediation of ash dams at the power stations and movement of an ash disposal pipeline at Bayswater
- \$5 million for scheduled IT upgrades and hardware replacements
- balance is for minor stay in business work.

The total capital budget for the 2012/13 financial year is \$32.0 million.

CAPEX – Overview and Financing	2012/13 SCI	2013/14 Forecast	2014/15 Forecast	2015/16 Forecast
Component of Works:				
Required for Business growth	-	-	-	-
Stay in Business	32,000	25,000	21,000	24,000
Regulatory compliance	-	-	-	-
Source of Funds:				
Borrowings				
Internal Funds	32,000	25,000	21,000	24,000

6. ACCOUNTING POLICIES

The Corporation has a policy of striving for best practice in relation to all operations including accounting and finance.

In adopting such practice the Corporation complies with relevant Australian Accounting Standards and New South Wales Treasury Circulars and Mandates on accounting policy.

Following the harmonisation of Australian Accounting Standards with International Financial Reporting Standards, the Corporation's published financial results are significantly impacted by a range of unrealised gains and losses arising mainly from mark to market movements in the valuation of a range of financial derivatives used in the Corporation's trading and marketing of electricity.

7. SOCIAL PROGRAMS AND NON-COMMERCIAL ACTIVITIES

The Board and Management of Macquarie Generation have resolved to adopt improved sustainable practice as a basic demonstration of good corporate social responsibility. The Corporation has adopted a philosophy of sustainable practice that embodies:

- Healthy employees and contractors.
- Safe workplaces.
- A commitment to improved environmental performance.
- Social responsibility.
- Economic contribution.
- Sound governance.
- A Corporate Diversity Policy and implementation program.

The Corporation can demonstrate strong sustainable practice in the form of power station efficiency improvements, solar heating integration with Liddell, improved salt extraction and water treatment capacity, a commitment to safety, staff and community developments including wide ranging apprentice and engineering undergraduate scholarship programs.

The Corporation continues to provide funding of around \$200,000 each year for community based activities in the Hunter Valley. In addition, the Corporation operates a safety incentive program, which on the basis of progressive and cumulative lost time injury free durations, the Corporation makes donations to the Newcastle based Hunter Rescue Helicopter.

8. FINANCIAL ASSET AND LIABILITY MANAGEMENT

The Corporation has contracted the management of the Corporation's debt portfolio and cash reserves as they exist from time to time, to the New South Wales Treasury Corporation.

The New South Wales Treasury Corporation won the contract as part of a competitive tender in 1996. The contract has been renewed on a number of occasions in the intervening period and the Board of the Corporation has elected to continue contracting with New South Wales Treasury Corporation.

Macquarie Generation has a policy of maintaining sufficient cash reserves to meet working capital requirements. Cash reserves surplus to these requirements have traditionally been used to retire debt especially where accounting losses on the repaid and prepaid debt can be avoided.

The New South Wales Treasury Corporation manages the Corporation's debt and cash in accordance with the Macquarie Generation Treasury Risk Management Policy, which is the subject of at least annual review and amendment as necessary by the Board of Directors. The current Policy was last reviewed in December 2011.

The Policy imposes specific limits on New South Wales Treasury Corporation, which are monitored and reported monthly to the Corporation. The Policy has been developed in accordance with the New South Wales Treasury guidelines for treasury management by State Owned Corporations.

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The Corporation's gearing remains manageable and provides an opportunity for future borrowings to fund investments in lower carbon intensity generation as the Corporation's current black coal portfolio becomes progressively compromised by the introduction of a carbon reduction scheme.

9. RISK OVERVIEW AND IMPACTS

Each year Macquarie Generation completes a comprehensive review of the risks facing the Corporation as it participates in the National Electricity Market.

Annually, the Management prepares an update to the Corporation's Enterprise Risk Register to allow the Corporation's Board Audit and Assurance Committee to assure itself that all business risks have been identified, and there exists a process for providing assurance on the adequacy of risk management.

The Corporation has also completed the development of a Fraud Risk Management Framework.

A Business Continuity Plan and Business Impact Analysis are regularly reviewed and updated to ensure that the Corporation can respond efficiently to business continuity risk and events. The Plan is updated if required following any event that requires the Business Continuity Plan to be invoked.

Due to the confidential nature of the information contained in these reports, their contents are not disclosed in this public Statement of Corporate Intent.

10. QUARTERLY AND HALF YEARLY REPORTS TO SHAREHOLDERS

The Corporation will continue to submit a quarterly report on operations and financial performance to the Shareholders on a timely basis at the end of each quarter. This timing allows Management to prepare the report and to allow the Board of Directors to provide input.

Historically, the quarterly Shareholders report has been submitted within five weeks of the end of the quarter and includes information on the following issues:

- Executive summary,
- An overall assessment of business performance,
- Major variances to budgets and forecasts,
- A capital project analysis and update,
- Marketing and trading analysis including forward pricing and contracting estimates,
- Fuel supply and environmental performance analysis,
- Governance disclosure reports, and
- Detailed financial and operational performance analysis on both a quarterly and a full year basis.

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The *State Owned Corporations Act 1989* requires the Board of Directors to deliver to the voting Shareholders, one month after the end of December each year, a report of the operations of the Corporation and any subsidiaries during that half year.

The half yearly report includes a Special Purpose set of financial statements based on accounting standards applicable at the time of publication. The half yearly report is also prefaced with a statement by the Chairman and the Chief Executive on the financial performance of the business for the half year and will also include an outlook for the full financial year.

The special purpose accounts are not subject to external audit. However, the accounts are reviewed by the Board Audit and Assurance Committee and subsequently submitted to the Board for approval along with appropriate assurances from Management.

The Corporation also regularly submits other financial information and capital expenditure information to the Shareholders to allow timely preparation of the State Budget annually. This information includes forecast financial statements and forecast financial distributions and tax equivalents.

11. REPRESENTATION AND COMMITMENT STATEMENT

The Board and Management of Macquarie Generation confirm the following:

- The performance targets within the Statement of Corporate Intent are based on and supported by the Corporation's Business Plan.
- The Corporation's Bayswater Power Station and Liddell Power Station Asset Management Plans are as far as practicable, consistent with the principles of the Total Asset Management (TAM) Policy issued by New South Wales Treasury (TPP 08-02), and the NSW Government Procurement Policy (TPP 04-1). The asset maintenance policies and processes are adequate and appropriate to manage and control risks associated with the operation of the Corporation's physical assets.
- Macquarie Generation is aware of the requirements of *Ministerial Memorandum No. 2005-9, Major Infrastructure Coordination and Delivery* and will comply with these requirements if not contrary to the objectives of the Corporation.
- Macquarie Generation is aware of the requirements of *Ministerial Memorandum No. 2012-8, Use of Biofuels* and will comply with these requirements where it is practicable, available and cost effective.
- Where relevant and applicable to the Corporation, Projects of State Significance have been identified in accordance with the criteria set down in the *Guidelines on the Assessment of Projects of State Significance*. In-principle approval from Cabinet Standing Committee on the Budget ("Budget Committee") and final approval from the Voting Shareholders will be obtained for any projects planned to commence in 2012/13. At this time no such projects are planned.
- The requirements of the *Financial Appraisal Guidelines* have been complied with for capital expenditure projects proposed to commence in 2012/13 where the projects are not required to comply with regulations or stay in business requirements.
- To the best of management's knowledge, all known key risks and major emerging contingent liabilities, which could materially impact the current and future results of Macquarie Generation have been disclosed.
- The Corporation is aware of the internal audit and risk management policy and regulatory framework outlined in the *Performance Review: Internal Audit Capacity in NSW Public Sector (Final Report)* and has demonstrated practices consistent with the framework requirements.
- The requirements of the *Treasury Management Policy* have been complied with and related party interests, which may represent a possible conflict of interest for Directors have been disclosed.
- The Corporation's Chief Executive has an employment contract and performance agreement. The Chief Executive's performance is appraised annually in August.
- The Corporation's Board agrees to provide the Voting Shareholders with financial and other information, including major capital projects, on a quarterly basis to assess the performance against commitments in this Statement of Corporate Intent and to assess the value of the Shareholders' investment in the Corporation.
- The Corporation's Board agrees to comply with Section 3.4 *Continuous Disclosure* of the *Reporting and Monitoring Policy* of the New South Wales Treasury.

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- The Corporation will comply with the Treasury Circulars on accounting policy matters as detailed in Attachment 1 of New South Wales Treasury's *Guidelines for the Development of the 2012/2013 Statement of Corporate Intent*.