Investment Stewardship Group

Voting Bulletin: AGL Energy Ltd.

As part of our fiduciary duty, BlackRock's Investment Stewardship team (BIS) advocates for sound corporate governance and business practices that are aligned with long-term sustainable financial performance. This objective underpins all our engagements and votes at company meetings.

We engage company leadership on key topics emphasizing governance practices including management of environmental and social factors that potentially have material economic, operational or reputational ramifications for the company.

We determine our engagement priorities based on our observation of market developments and emerging governance themes and evolve them year over year as necessary. The BIS team's key engagement priorities include:

1. Board quality
2. Environmental risks and opportunities
3. Corporate strategy and capital allocation
4. Compensation that promotes long-termism
5. Human capital management

We are committed to enhancing the transparency of our stewardship practices. Where we believe it will help to understand our voting decisions on key votes at shareholder meetings, we will publish a Voting Bulletin explaining the rationale for how we have voted on select resolutions, and (where relevant) provide information around our engagement with the issuer.

Company	**AGL Energy Ltd.**
Market	Australia
Meeting Date	7th Oct 2020
Key Resolutions[1]	**Item 7b:** Approve Coal Closure Dates
Board Recommendation	The board recommended voting AGAINST the proposal
BlackRock Vote	BlackRock Investment Stewardship voted FOR this proposal because we believe the company, and its shareholders, would benefit from a continued focus on long-term strategic planning covering several decades.

[1] Meeting information can be accessed at: https://www.agl.com.au/agm

Overview

AGL Energy Ltd. (AGL) is Australia's largest power producer, generating energy through thermal power, natural gas, wind power, hydroelectricity, solar energy, gas storage and coal seam gas sources. It operates through the following segments: Customer Markets; Wholesale Markets; Group Operations; and Investments. The company was founded in 1837 and is headquartered in Sydney, Australia.

On the ballot at its 2020 annual general meeting (AGM), the company received two shareholder proposals submitted by the Australian Center for Corporate Responsibility (ACCR): (7a) An Amendment to the Constitution, (7b) Coal Closure Dates. There were also management items to approve the remuneration report and to approve the grant of performance rights under the AGL Long Term Incentive Plan to the CEO.

Item 7a: Approve the Amendments to the Company's Constitution (AGAINST)

> Special Resolution – Amendment to the Constitution a. To consider, and if thought fit, to pass the following resolution as a special resolution: "To amend the constitution to insert a new clause 32.4: Member resolutions at general meeting - The Members in general meeting may by ordinary resolution express an opinion or request information about the way in which a power of the company partially or exclusively vested in the directors has been or should be exercised. However, such a resolution must relate to an issue of material relevance to the company or the company's business and cannot either advocate action which would violate any law or relate to any personal claim or grievance. Such a resolution is advisory only and does not bind the directors or the company".

As required under Australian voting rules, a resolution calling for an amendment to the company's constitution is first necessary to allow for the subsequent non-binding resolution (7b). A group of shareholders owning 5% of voting shares or 100 shareholders (with no minimum holding size or length of holding period) may file a resolution.

Item 7b: Approve Coal Closure Dates (FOR)

> Subject to and conditional on the resolution in Item 7(a) being passed by the required majority, to consider and, if thought fit, to pass the following resolution as an ordinary resolution: "Shareholders affirm our company's commitment to decarbonization and welcome the FY20 scenario analysis. Shareholders request that our company align the closure dates of the Bayswater and Loy Yang A coal-fired power stations with a strategy to limit the increase in global temperatures to 1.5°C above pre-industrial levels. Nothing in this resolution should be read as limiting the Board's discretion to take decisions in the best interests of our company."

Rationale for BlackRock's vote

Item 7a: Approve the Amendments to the Company's Constitution (AGAINST)

BlackRock is generally not supportive of constitutional amendment resolutions as the relative ease of filing risks potentially distracting and time-consuming proposals being submitted by shareholders whose interests are not necessarily aligned with those of the broader shareholder base.

Item 7b: Approve Coal Closure Dates (FOR)

While we recognize the various regulatory challenges and energy generation requirements that AGL faces, our support for this proposal is intended to encourage the company in its efforts to proactively and ambitiously manage the climate risk in its business model. We expect that doing so would help offset the potential financial risks, and capture some of the opportunities of the global energy transition, thus protecting the long-term economic interest of shareholders.

We supported this proposal because we believe the company, and its shareholders, would benefit from a continued focus on long-term strategic planning covering several decades. AGL's 1.5-degree scenario analysis, aligned with the recommendations of the Taskforce on Climate-related Financial Disclosure (TCFD), implies it is possible to close the coal-fired Loy Yang plant twelve years ahead of the current scheduled closure. The proposal, and our support of it, affords the AGL board and executives the discretion to manage that timing to ensure an effective and safe closure at the appropriate time.

AGL is both Australia's largest electricity generator and Australia's largest carbon emitter (~8% of the country's total emissions in 2019).[2] The AGL board has an appropriate level of oversight of climate risk, demonstrates strong corporate governance practices, and reports in line with the TCFD. AGL has been responsive to investor feedback and has steadily improved its disclosures, including updating its most recent TCFD reporting to include a 1.5-degree scenario framework, based on relatively strident criteria.[3] The company has also recently incorporated carbon transition performance metrics into its remuneration policy.[4] That said, as our support for this proposal suggests, we believe there is room for improvement.

We have a long and constructive history of engagement with AGL. In our continuous dialogue with company leadership we have discussed a range of topics, including climate risk, corporate governance, remuneration, human capital management and risk oversight processes. We recognize AGL's thorough assessment of climate risk and its significant investment in renewables to date. Further, based on the company's disclosures and our engagement, we anticipate that AGL will continue to strengthen its approach to managing the climate risk inherent in its business, including considering future plant closures as discussed in its own TCFD scenario analysis:

> *"The results of the scenario analysis allow AGL to consider a series of options of what might happen over the next three decades. This in turn provides AGL with the ability to adjust our strategy to ensure continued resilience. AGL's commitment to not extend the life of our coal-fired power stations remains unchanged."[5] The company has already publicly stated that "it will work responsively and responsibly to harness the power of these three forces – customers, community and technology – to support and enable the transition."[6]*

We encourage AGL to continue to develop its strategy to transition its business model to operating under a 1.5-degrees scenario and position itself to respond to the continued evolution of the energy sector and policy environment in Australia longer term. This is particularly relevant given the potential for the Loy Yang A plant to operate until 2048, when it would be over sixty years old, as operational concerns in relation to reliability and safety increase. Another significant factor is the capital expenditure needed to maintain this plant, which has been growing and will likely continue to increase as the plant ages.

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[2] See https://www.agl.com.au/-/media/aglmedia/documents/about-agl/investors/results-centre/2020/pathways-to-2050_130820.pdf?la=en&hash=9DC5D8FE10577CA5061ECF3A047892CB

[3] See https://www.agl.com.au/-/media/aglmedia/documents/about-agl/investors/results-centre/2020/pathways-to-2050_130820.pdf?la=en&hash=9DC5D8FE10577CA5061ECF3A047892CB

[4] See page 83: https://www.agl.com.au/-/media/aglmedia/documents/about-agl/asx-and-media-releases/2020/2097212_annualreport.pdf?la=en&hash=82E8FF1E819275718B654F3B19C7862F

[5] See https://www.agl.com.au/-/media/aglmedia/documents/about-agl/investors/results-centre/2020/pathways-to-2050_130820.pdf?la=en&hash=9DC5D8FE10577CA5061ECF3A047892CB

[6] See https://www.agl.com.au/-/media/aglmedia/documents/about-agl/asx-and-media-releases/2020/climate-statement-and-commitments-300620.pdf?la=en&hash=EBDA051D480ABE11F5C5D29B96D7276F

Additional Ballot Items[7]

The company received mixed support from proxy advisors on its remuneration report (Item 2), mainly around the short-term incentive plan (STIP) outcomes, and inclusion of climate metrics for a grant to the CEO (Item 4) under the Long-Term Incentive Plan (LTIP).

Item 2: Remuneration report (FOR)

For the financial year 2020, AGL's financial performance was reasonably strong. Underlying profit after tax, while significantly reduced from the prior year, remained within guidance and was not adjusted despite the impact of the extensive bushfires across Australia and COVID-19 (absent these two events, underlying profit would have been at the higher end of the range forecast). This was accomplished without government subsidies. AGL maintained a dividend payment and demonstrated disciplined balance sheet management. The company also performed strongly against the strategic measures component of the performance scorecard, particularly customer metrics and employee engagement.[8] Given the above considerations, BIS supported the remuneration report.

Beginning in fiscal year 2020, AGL restructured its remuneration policy to shift reward outcomes away from short-term cash incentives toward longer-term share awards in order to better align with shareholder interests. It did this by reducing the maximum amount of the STIP opportunity, decreasing the proportion payable in cash, increasing the proportion in restricted shares and extending the vesting period to two years. The company increased the LTIP opportunity and extended the performance period to 4 years to offset the aforementioned changes. The STIP award is assessed using a performance scorecard comprising financial measures (50-60%), strategic measures (30%) and individual performance metrics (10-20%) and AGL provides adequate transparency as to how it assesses the outcomes in its annual report.[9]

Item: 4: Grant of performance rights to CEO (FOR)

One of the concerns raised by proxy advisors with the CEO's share-based award is the inclusion of carbon transition metrics in the performance criteria underpinning the LTIP. As mentioned above, BIS supports companies including climate risk metrics in remuneration structures provided they align with the company's strategic goals and the interests of long-term shareholders. As we believe this to be the case, we supported the grant of performance rights to the CEO.[10] Another consideration is that, if shareholder approval is not provided, the equivalent value of LTIP awards will be paid in cash at the end of the relevant performance period, subject to the achievement of the relevant performance and service conditions. We believe that a share-based award creates better alignment between the interests of executives and shareholders than the cash payment that would be the result of a vote against this resolution.

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[7] See https://www.agl.com.au/-/media/aglmedia/documents/about-agl/asx-and-media-releases/2020/notice-of-meeting-210820.pdf?la=en&hash=DA9E3B2A199A6BE5ADC5E89382CE03C2

[8] Positive NPS result for June of +2.3, an improvement of 13.4 points from the FY19 score of -11.1. AGL FY20 employee engagement score is 73%, up from 68% in FY19

[9] See https://www.agl.com.au/about-agl/investors/annual-reports

[10] AGL has strong controls in place governing capital allocation, including a published hurdle rate on new investments of 300 basis points above AGL's weighted average cost of capital (disclosed as 7.1% in the 2020 Annual Report). http://www.aspecthuntley.com.au/asxdata/20200813/pdf/02266148.pdf