25 January 2011

Mr Geoff Miller
General Manager
Corporations and Financial Services Division
Treasury Building
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PARKES ACT 2600

By email: executiveremuneration@treasury.gov.au

Dear Mr Miller

EXPOSURE DRAFT – Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011

On behalf of the Board of Directors of Origin Energy Limited (**Origin**) I welcome the opportunity to provide a submission on the above exposure draft, as released by the Parliamentary Secretary to the Treasurer on 20 December 2010.

On 16 April 2010, the Federal Government responded to the Productivity Commission (**Commission**) inquiry into executive recommendation by accepting 16 of the Commission's 17 recommendations. The majority of the recommendations involve changes to the *Corporations Act 2001* (**Act**).

As Origin noted in its submission to the Commission, its final recommendations followed a thorough and balanced review. However, the draft Bill, in its current form, deviates from the Commission's approach and in some cases proceeds against its counsel. As a result, the proposed implementation creates several practical problems and unintended consequences, some of them quite serious.

In addition the Bill, in its current form, and beyond the guidance of the Commission's recommendations, shifts the responsibilities of Non-executive Directors (**NEDs**) away from the strategic oversight and direction of the business and onto administrative tasks. Some of the proposed tasks are not simply administrative but run counter to established governance principles and appear to assume remuneration to be the most important issue facing companies. Overall the draft Bill establishes new and disproportionate priorities for NEDs that will impact negatively on the discharge of their overall responsibilities.

These problems are illustrated through our comments below.

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3	**Definition of remuneration consultant** The proposed definition in the draft is too broad and it should be confined to those consultants who are contracted to provide advice on the *setting or changing* of actual remuneration for KMPs. Further, it should exclude general advice on the company's overall remuneration policies and practices where the application to KMPs is on the same terms as other employees. Alternatively, the approach taken by legislation in the UK, incorporating a "materiality" qualification, would achieve the same outcome. The drafting is so wide that an actuary contracted to undertake, for example, a fair valuation of proposed or actual equity rights would be considered a remuneration consultant. Auditors, lawyers, executive search firms, tax and superannuation advisers all provide advice that relates to the nature or the value of remuneration for a variety of purposes (e.g. reporting or analysis, decisions around packaging and insurance, valuation, benchmarking and market position). The definition also operates to preclude the Managing Director of Origin seeking advice from a search consultant on the market salaries for a KMP member, yet this is information he will require when determining the salary-benefits range. Share registries also provide advice that relates to the remuneration values required by a company for reporting on tax statements and employee share summaries. All of these consultants will be captured as remuneration consultants under the proposed legislation. They will therefore be prohibited by law from dealing with the company's management, bringing multiple processes to a standstill. Potentially two consultants would be required for every process: one to provide management with advice on non-KMP employees, and one to provide NEDs with advice on KMPs that the NEDs would then have to deal with in order to determine what it could "flow through" to management to combine with management's advice for non-KMPs.
5	**Advice of remuneration consultants (sections 206K(1)(a) and 206L(1))** The words "advice relating to the nature and amount or value" are too broad for the reasons above and should refer to "the setting or changing of the remuneration level or nature". There are numerous instances where the company needs advice as to valuations of remuneration that has already been set or approved by the Board, and the advice has no bearing on setting or changing remuneration quantum or nature. Again, this should exclude general advice where it only applies to KMPs in their capacity as employees of the company.
5	**Execution of contracts with remuneration consultants (section 206K(1)(b))** With remuneration advisers defined so broadly (as identified above), NEDs will be required to execute a range of contracts without the administrative and governance support and normal due diligence and assistance of the company secretary. It implies that NEDs will have to execute all contracts that potentially will provide any kind of advice that touches on the value of a remuneration element of a KMP, and to ring-fence those from all other contracts held by the company through the company secretariat. It is unclear as to what extent a NED can rely on executives of Origin for administrative assistance.
6	**Receipt of remuneration advice (section 206L(2)-(6))** The definition of remuneration consultants is so wide that some consultants working on activities such as valuation of equity instruments may not even know that they have become classified as remuneration consultants simply because the equity instruments involved may include those of a KMP. Section 206L(1) should only apply where the consultant has been appointed under a contract signed in accordance with section 206K(2), and again, should exclude remuneration related advice concerning the company's employee base as a whole. During deliberations on mergers and acquisitions, it is often important to compare and contrast executive remuneration arrangements. Under the proposed legislation,

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	executive directors and senior management will be restricted from seeking expert advice. The proposed change also effectively transfers a significant HR function from management to the NEDs. HR executives would ordinarily have close contact with external advisors on routine matters related to remuneration and other employee benefits, such as taxation, superannuation contributions, valuations, employee share plans and incentive schemes. HR executives also often liaise closely with remuneration advisors in providing important company information and data, so that their advice to the board or Remuneration Committee is company-specific, meaningful and relevant. The current provision will mean that the NEDs will have to take on this role, which is inappropriate. As mentioned earlier, the limitations placed on a CEO receiving advice regarding relativities in the market of those reporting to the CEO means that he or she can no longer monitor the market or take pulse checks, and will become reliant on the NEDs doing this on the CEO's behalf. Such a provision works against the interests of the company and its shareholders, and will significantly increase the procedural workload on NEDs. The difficulties described above could be mitigated by ensuring that the prohibition applies only in respect of advice that goes to the *setting or changing* of KMP remuneration or nature, and does not cover simple factual market commentary or day to day operational implementation of existing board approved remuneration policies or practices. Further, our submission is that executive directors should only be prohibited from receiving advice which specifically pertains to their own remuneration.
14	**Remuneration consultant disclosures in remuneration report (section 300A(1)(h))** This proposed section requires the disclosure of the names of the NEDs who signed contracts with remuneration consultants, the names of each person to whom the consultant directly provided the advice, a summary of the nature of the advice and the principles on which it was based, the consideration that the consultant was paid for the advice, the nature of all other work performed by the consultant during the financial year and payments received. Origin has no difficulty with the objective of the Commission's original recommendation and already discloses much of the information suggested by the Commission. However the draft Bill expands the recommendation to an onerous and unnecessary level of detail i.e. the identity of the director signing the contract is a level of disclosure not required elsewhere in the Act. Also why are individual directors who received the advice to be identified and not others to whom it was conveyed? The distinction is without logic. This level of detail will not provide useful information to shareholders and will add to the already lengthy and cluttered content of remuneration reports. The proposed provision is far more onerous than that which applies to external auditors and their independence, and as such represents an inversion of the principles of proportionality, namely that the receipt of remuneration advice is more important than the overall direction of the enterprise. The draft needs to be re-drafted to require a high-level and consolidated summary of advice so that shareholders can determine the level and appropriateness of advice the Board obtained over the relevant year.
4	**Hedging of incentive remuneration** The draft legislation prohibits KMPs and their closely related parties to hedge the KMP's incentive remuneration. Origin supports the prohibition on the hedging of **unvested** incentive remuneration and this is already incorporated into Origin's Dealing in Securities Policy.

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	The draft legislation should be amended to specifically exclude **vested** incentive remuneration not the subject of holding locks, as executives should be free to deal with equity remuneration (including entering into hedging arrangements), after performance conditions have been satisfied and the awards have vested. This is consistent with the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*. Under the current drafting, some income protection insurance arrangements (e.g. for illness or incapacity) would become illegal. This is a serious unintended consequence and needs to be rectified.
7	**Prohibition on KMP from voting on remuneration matters** The draft legislation prohibits KMPs appointed as proxies to vote undirected proxies on all remuneration-related resolutions. The definition of KMP includes a non-executive chairman and the NEDs. This provision constrains the ability of shareholders to exercise their right to vote and also disenfranchises those shareholders who appoint the chair of the meeting as their proxy. Invariably the majority of undirected proxies lodged are in favour of the chair of the meeting. By not allowing the chair to vote these undirected proxies, the rights of those shareholders to vote are effectively disregarded. The notice of meeting and proxy form already specify the chair's intention on how undirected proxies will be voted on each resolution. This provides shareholders with clarity as to how their votes will be cast should they wish to appoint the chair as their proxy but do not specify how the votes must be cast. An alternative approach would be to introduce a "chairman's box" similar to ASX Listing Rule 14.2.3B for all KMPs, which allows undirected proxies to be cast by a person otherwise prohibited from voting if the shareholder nominates that the votes may be cast as the proxy decides.
3,8	**Definition of closely related party and section 250R(4)** While the Commission considered the prohibition on voting of "associates", and then "close associates", it concluded: *"Extending this prohibition to the 'associates' of directors and key management personnel appears infeasible in practice. ……. Even a tighter definition such as 'close associate' — defined in s. 9 of the Corporations Act — could inappropriately exclude relatives of directors or key management personnel who independently purchased shares in the company"* (p371 of final report). The draft Bill defines a closely related party so widely that it includes, for example, a financially independent adult child, in addition to parents and siblings. This is an extraordinary deprivation of private property rights for which there is no justification. An alternative approach would be to use the definition of 'associates' in the context of the voting exclusion statement requirement under ASX Listing Rule 14.11. This will effectively serve to limit those with a material personal interest in a resolution to vote on that resolution, without interfering with the legitimate exercise of shareholder rights by those who have made independent investment decisions. Alternatively, the definition could be clarified to apply only to dependants of the KMP.

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18	**No-vacancy rule (section 201P(2))** The draft Bill requires annual approvals to be obtained from shareholders for a declaration that there are no vacant positions, should the board wish to maintain a particular limit less than the maximum specified in the constitution. Such continuous annual renewal is not a requirement for matters of gravity such as proportional takeover provisions, and did not form part of the Commission's proposals. We submit that the current drafting imposes onerous and disproportionate requirements. The need for contingent resolutions in the notice of meeting is likely to cause confusion for shareholders.
18	**Explanatory statement to no-vacancy rule (section 201Q(a))** The drafting of the Bill currently requires directors individually to make an explanatory statement regarding board limits. The Commission did not recommend such a provision, and it runs contrary to general principles that the board acts as a whole and not through individual directors. The provision will require the same statement to be made by directors several times, leading to awkward, repetitive and confusing notices. The drafting should be amended such that the Board issues a single statement.
19	**Maintenance of no-vacancy voting records (section 201R(4))** The draft spells out a seven-year records retention requirement for records of board limit polls. There is no reason that the records retention requirements should vary for different types of resolutions, and the existing record retention obligations on companies should apply rather than Parliament creating a multiplicity of retention requirements for specific resolutions.
20	**Lodgement of intention of no-vacancy resolution with ASIC (section 201S)** On the assumption that its meaning is correctly expressed in the explanatory memorandum that companies will be required to lodge a notice setting out the text of the intended board limit resolution within 14 days of the **board** resolution to put the motion, we submit that this is unnecessary. There is no requirement under the Act for any other directors' resolution to be so notified, and the mechanism already exists for the proposed resolution to be included with the notice of meeting sent to all shareholders and lodged with ASX under the minimum notice requirements (28 days) already set out in the Act. The proposed provision is unnecessary for the implementation of the Commission's no-vacancy recommendation.
23	**Cherry-picking (section 250A(4)(c))** The current draft requires a proxy holder to attend a meeting and vote all directed proxies. Shareholders are free to appoint anyone as a proxy and there is no requirement for them to notify or seek the approval of the proxy to the appointment. This may result in the proxy failing to vote. The provision fails to recognise a range of other practical considerations such as illness of the proxy, the meeting continuing later than expected and the proxy having to leave prior to a resolution being considered. Alternative mechanisms could provide that if the proxy holder is absent or unaware of their appointment as a proxy, the proxies revert to the chair of the meeting, who has an existing statutory obligation to vote all directed proxies. Active measures in the Act to facilitate direct voting would also be a solution as it removes the intermediary between the shareholder and their votes being applied, and there is no uncertainty as to whether their votes will be cast.

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13	**Persons named in the remuneration report (section 300A(1)(c)(iii) and (iv))** The proposed Bill will only require remuneration disclosure for the KMP of the consolidated entity. Origin supports this proposal and believes that it will simplify the disclosures and improve readability of the remuneration report.
9-13	**Two-strikes proposal (sections 250U-250Y)** The issues identified above illustrate a range of problems and unintended consequences that flow from the drafting of the Bill as it seeks to implement the Commission's recommendations, and in many cases venture outside the considered confines of those recommendations. On the issue of the two-strikes proposal it had been hoped that precise and practical drafting of the implementing legislation would resolve or mitigate some of the problems and difficulties associated with the Commission's recommendation 15 itself. As this has not proved to be the case, we make some comments on the workability of the draft section 250U-250Y provisions. The provisions require companies with one strike to include a spill motion to remove the whole board at the following AGM, which will be triggered immediately if a second strike is recorded at that meeting. Proxy voters are then presented with a complicated set of contingent or conditional votes relating to the spill motion both in the notice of meeting and the proxy form. This, coupled with the alternate resolutions required under the no-vacancy resolution, will mean that the notice of meeting and proxy forms will become significantly more complex and potentially confusing to shareholders. The explanatory memorandum notes that dissatisfied shareholders already have the power to remove a director under current law but note that this is "a somewhat extreme response, particularly if the director is having a positive impact on the value of the company". We agree strongly with that observation, and yet the draft Bill fails to recognise the point made. If the directors are not re-elected at the extraordinary general meeting (**EGM**) that is required to be held within 90 days of the spill motion being passed, then the company is left without an effective board, which in the case of a listed company is a serious situation as it takes time to replace directors with the appropriate skills and experience. This will cause significant instability for the company and have negative effects on shareholder value, arguably disproportionate to the level of dissatisfaction shareholders may have over the company's remuneration arrangements that triggered the spill of the Board in the first place. Another consequence of the 25% vote threshold is that minority and special interest groups may use the remuneration voting mechanism to achieve objectives they are unable to achieve by simple majority.

Conclusion

In the short time that was made available to review the draft legislation, it is clear that the drafting is deeply flawed, and in many cases flaws and adverse unintended consequences arise because of departures from the considered recommendations of the Commission.

If the draft Bill proceeds in its current form, containing disproportionate measures and sanctions that go beyond the Commission's final recommendations, NED's workloads will increase and priorities will be distorted. The range of problems and unintended consequences identified above will lead boards to favour accepted standard remuneration structures, instead of considering innovative proposals which benefit the enterprise in its specific circumstances.

In order to form a holistic view of an organisation's executive remuneration, a consultant will often need to confer with management to understand the mechanics of plans, performance outcomes and ranges, packaging arrangements, corporate policy and so forth. The provisions in the draft Bill will prohibit a relationship between the board's adviser and management, and the quality and depth of advice the consultant is able to provide the board will be diminished.

The Bill needs to be re-drafted to confine the limitations to the principles articulated in the Commission documents and to remove those elements that are counterproductive to the efficient operation of the board and the enterprise. Both NEDs and management will be adversely affected unless significant changes are made to the current draft Bill.

Please do not hesitate to contact me if you wish to discuss any of these matters in more detail.

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