6 November 2009

Director & Executive Remuneration Inquiry
Productivity Commission
Locked Bag
Collins Street East
MELBOURNE VIC 8003

Dear Sir

DISCUSSION DRAFT - EXECUTIVE REMUNERATION IN AUSTRALIA

On behalf of the Board of Directors of Origin Energy, I welcome the opportunity to comment on the above Discussion Draft issued on 30 September 2009.

In doing so, Origin congratulates the Commission on the comprehensiveness of the report and the analysis contained in it. I am confident that the final report will serve as a landmark reference domestically and internationally.

The particular areas on which Origin now provides comment are:

Recommendation 1

Recommendation 1 is that the Corporations Act 2001 be amended such that only a general meeting of shareholders can set the maximum number of directors who may hold office at any time (within the limits of the company's constitution).

Because the ASX Listing Rules requires there to be an election of directors at each Annual General Meeting and the Corporations Act requires nominations to proceed to a vote, there is always opportunity for non-board candidates to be considered by the shareholders, albeit they may be required to compete with a board endorsed candidate for a position. The fact that a candidate is competing with another does not diminish the right they have to nominate and be considered. In fact, the competition will ensure that the person preferred by the largest percentage of shareholders will be elected to fill the position, rather than simply adding another person to the board room.

In our experience, nominations to the boards of public companies do not often achieve a greater than 50% vote in favour. The analysis in the Discussion Draft does not cite any examples indicating that our experience is unusual.

The Recommendation is likely to result in corporations seeking to entrench the maximum number of directors in their constitutions and then seek shareholder agreement whenever an increased board size is appropriate. Directors will ensure that vacancies are always filled. This will simply reduce flexibility to appoint additional directors when suitable candidates become available.

A more effective approach to encourage diversity of board representation may be to build on ASX Corporate Governance Council guidelines for the operation of Nomination Committees and to encourage greater transparency to shareholders of the selection principles used by the Nomination Committee.

We submit that Recommendation 1 will not enhance diversity in boards. No evidence has been provided to justify the loss of flexibility for boards to make appointments and therefore Recommendation 1 should not be implemented.

Recommendation 4

Recommendation 4 seeks to prohibit Key Management Personnel, and directors and their associates, from voting on any Remuneration Report or remuneration matter.

The Corporations Act provides multiple definitions for an associate. As a minimum, clarification of the definition of associate would be required to promote certainty.

Since non-executive directors have their aggregate remuneration or fees approved directly by shareholders, and recommend the Remuneration Report, there is no logical basis on which non-executive directors should be prohibited from voting their own shares in the manner contemplated by Recommendation 4.

The effect of this proposal is to disenfranchise a particular group of shareholders, executives and executive directors from voting on particular types of matters. The justification for this disenfranchisement appears to be simply to "send a message". In our view, this is not a sufficient justification to deny a shareholder from exercising a right attaching to their investment in the company, which is encouraged to promote alignment with other shareholders.

Recommendation 6

Recommendation 6 proposes that the Corporations Act 2001 and relevant ASX listing rules be amended to prevent Key Management Personnel and all directors (and associates) from voting undirected proxies on remuneration reports or remuneration issues.

Origin's concern with this recommendation is that its primary effect is to disenfranchise retail shareholders. It is a legitimate choice for shareholders to express confidence in and support for their board by giving their undirected proxies to the Chair or another person, including a member of management or a director.

The ASX listing rules currently allow undirected proxies to be voted on matters in which a director or the Chairman is interested, provided that the shareholder does so consciously by indicating on the proxy form. A similar approach could be adopted in relation to this Recommendation.

Recommendation 13

Recommendation 13 proposes that the cessation of employment trigger for taxation of equity-based payments should be removed, with the taxing point (for equities or rights that qualify for tax deferral) being the earliest of:

- where ownership of, and free title to, the shares or rights is transferred to the employee; or
- seven years after the employee acquires the shares.

This recommendation is in line with Origin's earlier submission and, in our view, is consistent with longer-term shareholder alignment. It is noted that APRA has indicated it has reached similar conclusions.

Origin endorses this recommendation and suggests that it be vigorously pursued in the Commission's final report.

It is noted that similar problems are associated with the government's proposals to shift taxing points from the point of exercise to point of vesting. While the Financial Stability Board, APRA and others have re-affirmed and emphasized that equity remuneration should be focused on long term sustainability rather than short-term considerations, these measures (whether taxing at cessation of employment or at vesting) encourage behaviours focused on precisely the opposite. The creation of a tax liability without a matching asset or benefit will force the employee to sell early and thereby encourages short-termism and potentially distort markets.

Therefore the Commission is encouraged to expand its commentary to emphasise that the existing problems associated with imposing a taxing point at cessation of employment are similar to the problems that will be created by new proposals to shift the taxing point for continuing employees from the exercise of rights to the vesting date. In both cases the effect runs counter to the thrust of both international and Australian regulatory recommendations (eg FSB, APRA) to design remuneration plans and regulatory frameworks that encourage long-term focus and long-term sustainability, and to discourage short-termism.

Recommendation 15

Recommendation 15 proposes a "two-strike" arrangement for shareholder voting on the Remuneration Report.

In its earlier submission Origin noted that the current advisory non-binding vote was working well, and in its Discussion Draft the Commission makes similar observations (eg pp236-237).

Origin is respectful of and has always taken into account its shareholders' views through regular engagement. We find it profoundly disappointing that drivers for the change proposed turn on the small minority of companies that do not.

Our chairman, and myself as chair of our Remuneration Committee, engage with shareholders and with proxy advisory groups on remuneration matters on a regular basis. The resulting dialogue is a two-way process. On occasion the shareholder or proxy firm amends its position once it has a better understanding of the purpose behind remuneration decisions, and on other occasions the views expressed assist directors in the development of (for example) incentive plans. The results of this two-way process are evident from Origin's last three Remuneration Reports – the Reports are not the same and they show continuous development. The strong shareholder endorsements received at each AGM (votes in favour of 98%, 95% and 95% in 2007, 2008 and 2009 respectively) bear testament to the value of the process. Similarly, the award of Long Term Incentives to two Executive Directors at the 2009 AGM received shareholder endorsements of 94% and 95%.

Such a process demonstrably works, and it works because the directors are following a process in which they consider the representations made by groups of shareholders or their advisors in the context of representing all shareholders; and it works because the board is able to experiment to develop the solutions most effective for the company at points in time.

The shareholder support that Origin receives on remuneration matters is typical of the vast majority of companies in Australia. It is understandable that the media focus is elsewhere on the handful of cases where high "no" votes have been registered, and such "naming and shaming" serves to address issues where they arise. Where shareholder views go unheeded, shareholders can go further and vote against directors at the AGM. But it is not appropriate to formulate corporate regulation based around punishing a handful of outlier companies.

A Remuneration Report is partly a historical record and partly an amalgam of strategic intent that addresses a wide variety of issues. The creation of a situation where a minority of shareholders can cause a spill of the entire board over the Report, against the wishes of the majority, leads to unacceptable and unintended consequences, including:

- Shareholders are not required to act in the best interests of the company when casting their vote. Therefore, a significant minority shareholder, or group of like-minded shareholders, could use their vote on the Remuneration Report for purposes entirely unrelated to the Report. For example, they could vote against the Report simply to destabilize the board and management of the company to suit their own interests.
- The process will involve considerable cost and disruption, especially difficult for smaller companies.
- Perversely, some institutional shareholders, recognising the cost and disruption that will flow from negative votes, will actually be less likely to express disagreement with the Remuneration Report, so as to avoid those consequences. They understand the serious implications that a wholesale spill of the entire board would have on their investment and

would be faced with voting to avoid those consequences as opposed to voting on the merits of the resolution.

- The measure is likely to lead to ever greater homogeneity of executive pay, and less willingness by boards to adopt innovative approaches to create the best arrangements to suit the individual organization. The proposal will make directors more risk-averse and more reluctant to manage "without fear or favour" of short-term fashion or trends which may take more than one cycle to demonstrate value. This will deny companies with individual circumstances and needs from taking action appropriate to those circumstances and needs. The most common market practices will become increasingly dominant at the expense of appropriately targeted approaches that may be better for the organisation and, ultimately, shareholder wealth creation.

- Public listed companies are likely to be further disadvantaged in the competition for talent by conservative remuneration policies that are developed to appease minority shareholders rather than focus on shareholder value creation in line with their strategic direction and policies. We encourage the Commission to recognize that working for a public listed company should not require employees to accept disadvantage or sacrifice compared to comparable positions with unlisted, overseas or private competitors. It is not in the interests of the Australian investor base or the economy as a whole for the public listed employer to be handicapped in attracting and retaining talent.

- The potential influence of proxy advisory organisations will become magnified and disproportionate, as shareholders (particularly large institutional) tend to follow their voting recommendations. In Origin's case, our top 20 shareholders represent 59% of the shareholding of the company. Therefore the decision of a proxy organisation will determine whether a board spill occurs. While Origin works well with those organisations, we do have points of difference with them from time to time. Recommendation 15 creates a real risk that they will effectively dictate to companies their remuneration policy – furthering the homogenization of remuneration and further limiting the ability of the board to act in the best interests of the company if the board believes that is inconsistent with the proxy firm's view.

- It is not uncommon for a proxy firm to recommend against a Remuneration Report but to support the re-election of the directors recommending it. This properly allows the expression of a view confined to specifics of Remuneration matters. Recommendation 15 would tend to reduce the expression of advisory views because of the draconian and disproportionate potential consequences. Such limitation of advisory views would inhibit rather than enhance the ability for shareholders to shape remuneration practice.

- A spill of 100% of the board will be enormously disruptive. It will create issues about finding replacements and may well challenge the maintenance of knowledge, continuity of business as well as the retention of trust and confidence of employees, investors and counterparties and stakeholders. Such a drastic response would seriously weaken and damage a company, despite the fact that not even a

majority of shareholders have sought it. In our view, the Recommendation metes out punishment on both the directors and the company. At least in the case of the company, that punishment does not fit the supposed crime.

Boards should properly respond to majority rather than minority votes. Origin remains of the view that the current advisory vote mechanism provides a way for boards to take account of views expressed by various shareholders or groups of shareholders while maintaining the focus of serving the interests of all shareholders.

We believe that Recommendation 15 significantly challenges the fiduciary duty of boards to act in the interests of all shareholders. Except where those shareholder interests are best served by sale or merger, this duty includes the obligation to guide the company toward its long-term sustainability. Shareholders elect directors to run the corporation as representatives of the owners.

Our view is that a negative vote of 25% or more should trigger an obligation on directors to outline their response to the issues raised. From there the process of "naming and shaming" will assist to drive behaviours, and if shareholders remain dissatisfied then they can exercise their votes against directors. Such a process would address the Commission's concerns without the unintended and adverse consequences that would arise from an implementation of Recommendation 15.

Concluding Comments

In conclusion, Origin again acknowledges the depth and comprehensiveness of the work represented in the Discussion Draft. As set out above, we strongly endorse Recommendation 13 and suggest that it be taken further to address the issue of moving taxing points from exercise to vesting; and our submissions with respect to Recommendations 1, 4, 6 and 15 are as set out above.

We look forward to the Commission's Final Report.

Yours sincerely

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Remuneration Committee
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