14 July 2009

Mr J Hawkins
Secretary
Senate Economics Legislation Committee
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Dear Mr Hawkins

Inquiry into: Corporations Amendment (Improving Accountability on Termination Payments) Bill

Thank you for your invitation to make a submission to the Senate Inquiry above.

Origin Energy has previously provided comment on the Exposure Draft Bill to The Treasury, and welcomes the opportunity to convey those views to the Senate Inquiry.

Introduction

In overview, the draft Bill raises issues with three key principles:

First, as noted by APRA in its discussion paper released on 28 May 2009 (page 8), the "Board is ultimately responsible and accountable for decisions taken on remuneration matters". It is the Board that is best placed to determine appropriate termination payments to executives (including redundancy payments) in the interests of all stakeholders. The draft Bill in its current form unduly restricts Boards from exercising this function.

Second, whilst Australia shows significantly lower rates of systemic failure than other jurisdictions, and arguably has significantly superior governance practices, the draft Bill seeks to impose restrictions that far exceed those adopted elsewhere and, in doing so, creates unintended and adverse consequences that place Australian-based commerce at a disadvantage to global companies.

Third, the draft Bill requires an approval process with shareholders when there is already a consultation process through the non-binding vote process. The non-binding vote process has generally helped Boards to strike the right balance in determining appropriate termination arrangements.

Specific comments are as follows:

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Part 1 Section 9 - Definitions

"*Base salary* has the meaning generally accepted within the accounting profession".

Our view is that the term base salary does not have a generally accepted meaning in the accounting or any other profession, and has increasingly been replaced by the term "Fixed Remuneration". Fixed Remuneration is generally understood to include cash salary, plus employer superannuation, plus salary sacrifices, plus fixed allowances, and excluding bonus and incentive payments. It is the term most commonly encountered in the Compensation Tables lodged in the Remuneration Reports of corporations.

Section 29 Subsection 200F (3&4), 200G (2&3) – Averaging Methodology

An employment contract that provides for a termination payment of one-times base salary (or Fixed Remuneration) in the event of termination will not trigger a shareholder approval requirement if the incumbent has service of one year. The averaging methodology means that the current (terminating) base salary is the same as the averaged base salary. Where service is longer (eg 3 years or more), or where it less than one year, the averaged base salary will be less than the current base salary. In those circumstances shareholder approval would be required. Such outcomes are counter-intuitive and illogical.
The averaging methodology should be varied and should incorporate an escalator (such as the increase in Average Weekly Ordinary Times Earnings index) to remove the distortion.

Regulations – Division 2D.2.2 Meaning of Termination Payments

Origin is concerned that the Meaning of "Termination Payments" (Division 2D.2.2) is relegated to Regulation. The subject matter concerns arrangements put in place on a long-term basis, and it is essential that there be certainty and clarity associated with the provisions of the Act by incorporating fundamental definitions within it.

In terms of Section 2D.2.02, specifically sections (a) and (b) dealing with automatic or accelerated vesting of options, there is no recognition that death or total and permanent disablement are treated as a termination. The notion of having such vesting in these circumstances subject to shareholder approval is wholly inappropriate and would cause unnecessary distress to affected executives or families of impaired/deceased executives. Additionally, in the case of death or total and permanent disablement, it is likely that other insurance payments would arise or be passed on to the family or estate. It is therefore important that payments resulting from death or total and permanent disablement are explicitly excised from the definition of "termination payments".

Origin notes that the Federal Government announced on 12 May 2009 an intention to tax equity awards "up-front". Under those conditions it may become necessary to allow early vesting in order to meet the tax liability. Any action with respect to accelerated vesting must await the final details of other legislation that may change the inherent assumptions on which the Draft Bill is based.

Origin Energy also notes that further clarity is required on the term "deferred bonus". The explanatory memorandum indicates that this refers to bonuses earned but not yet paid. A clearer expression of that intent would be to make reference to bonuses earned in relation to service prior to termination. The term "deferred" is likely to lead to

confusion and uncertainty, as practice is sometimes to defer a portion of an earned bonus such that there may be two elements which have not yet been paid, only one element of which is commonly referred to as “deferred”.

Superannuation [2D.2.01 (1)(b)]

The regulatory limits referred to in this section are expressed over calendar periods and not simply as payments at a point of time. It is unclear how this provision would operate in practice.

Clarification is required to ensure that it does not inadvertently capture prior compulsory superannuation payments or contributions by the employer in Australia or under a foreign fund. It also requires clarification to exclude payments prior to termination from other employers that may be housed in the employee’s superannuation fund.

The section should be re-drafted to identify that only additional payments made to superannuation at the time of, or in connection with, the termination are to be included.

Unintended Consequences – Imposing Additional Costs to Compete

Origin is concerned that the grandfathering arrangements for existing contracts and the "one-times" limit will have a number of unintended consequences that will prove negative for both the performance of individual companies and the overall performance of the economy which, in turn, will prove contrary to the national interest.

The "one-times" limit is lower than that applying in jurisdictions in which many Australian companies seek to recruit and source talent. For example Origin sources specialist skills and talent from Europe and the United States, where the corresponding limits are either two to three times higher or where no limit is imposed (eg Canada). There does not appear to be any rationale for setting the limit at a level that is significantly lower than elsewhere and placing Australia at a recruiting disadvantage as a result.

Furthermore it will make it harder for Origin to recruit employees in overseas jurisdictions where local practice is to pay higher termination payments than those proposed in the draft Bill.

The introduction of such a low limit will also cause difficulty where an Australian company seeks to place an employee on a subsidiary board. An employee placed in this position will automatically move from a grandfathered arrangement to one in which their termination payments may be subject to shareholder approval.

Similarly, the cost of recruiting domestically will increase as it will become more difficult to recruit employees from grandfathered positions in other companies to new contracts with significantly more limiting termination arrangements.

The setting of the limit at a “one times” level will reduce Origin’s negotiating position with respect to sourcing talent both internationally and domestically. It is vital that the Australian organisations remain able to attract the best people. The setting of the limit at a “one times” level will hinder them in this endeavour and, as a consequence, result in additional time and cost barriers on Australian companies seeking to source talent.

Another related and unintended consequence will be to drive prospective candidates toward employing entities that are not subject to the provisions of the draft Bill, for example enterprises with global operations. This will further disadvantage companies such as Origin Energy.

We suggest that the limit is varied to be comparable with other OECD jurisdictions.

Unintended Consequences – Downward Pressure on Established Redundancy Protection for All Employees

In diverse organisations such as Origin which has 70 subsidiaries, it is a common practice to appoint staff as Directors to associated companies, subsidiaries and joint ventures.

As noted above, the draft Bill is a disincentive for an employee to accept an appointment to a subsidiary or related board. Appointments at this level are often at less senior levels in the organisation. In Origin's case, such employees are covered by a company-wide redundancy policy that provides for a maximum severance payment of 18 months Fixed Remuneration. That policy has been developed taking into account court judgements concerning reasonable payments in the context of factors such as length of service, and it is by no means an unusual policy in the market.

Therefore a further unintended consequence of the draft Bill will be that such redundancy policies will need to be amended with reduced maximum limits, to avoid placing employees who happen to accept a position on a subsidiary board from breaching the limit simply by being made redundant. Inevitably this will create a flow-on effect that places downward pressure on employee protection overall.

Unintended Consequences – Increasing Fixed Costs

An inevitable consequence of limiting exit payments through prescriptive regulation will be to transfer or front-load remuneration into fixed costs and sign-on arrangements, contrary to the principles enunciated by the Financial Stability Board and other regulatory authorities.

Conclusions

In summary, Origin Energy submits that there are a number of specific recommendations to address significant unintended consequences with the Bill in its current form. We are particularly concerned with the setting of the limit at the proposed "one-times" level as this would have the effect of imposing additional time and cost barriers on Australian companies seeking to recruit externally. Our submission includes a suggestion that this limit be more closely aligned with those operating in Europe and North America to avoid the many unintended consequences identified above.

We are concerned that the overall effect of the Bill will be to adversely affect the ability of companies such as Origin to attract the best people available to fill important executive roles. These people are important for helping to drive more productive and effective business performance outcomes which, in turn, is important for increasing

economic growth and community living standards. As a result, we believe the effect of the Bill as it currently stands would be contrary to the national interest.

Yours sincerely

Trevor Bourne
Chairman, Remuneration Committee