origin 18 June 2009

Director & Executive Remuneration Inquiry
Productivity Commission
Locked Bag 2
Collins East Street
Melbourne
VIC
8003

Dear Sir

REGULATION OF DIRECTOR AND EXECUTIVE REMUNERATION IN AUSTRALIA

Thank you for the opportunity to comment on the Productivity Commission Issues paper released by the Commission on 7 April 2009.

On behalf of the Board of Directors of Origin Energy I am providing our submission on the topic of *Regulation of Director and Executive Remuneration in Australia*. This presents the views of this company on the important issues of director and executive remuneration.

We support the inquiry and would encourage the Commission to consider the issues set out in its discussion paper in a holistic and principles-based approach. We believe this will ensure the maintenance of the high levels of corporate governance that currently exist, as well as the continuation of the flexibility companies such as Origin Energy require to remain competitive in the dynamic markets we operate in.

Please do not hesitate to contact me if you wish to discuss the submission or the views of this Board in any more detail.

Yours sincerely

Trevor Bourne
Chairman
Remuneration Committee
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Productivity Commission Inquiry on Executive Pay

1. Executive Summary

- Australia is a diverse country - geographically, industrially and corporately. This diversity is also reflected across the range of companies listed on the Australian Stock Exchange, as well as the diversity of individual companies such as Origin.

- Many of these companies, including Origin, compete internationally - both in terms of their operations and in terms of the attraction and retention of highly skilled and experienced executives and specialist personnel.

- Highly skilled and experienced executives and specialist personnel are important for driving company performance which, in turn, is fundamental to the overall performance and productivity of the Australian economy.

- Origin's experience has demonstrated it is important that Boards retain the flexibility to offer remuneration arrangements that are competitive in what is truly a global market place for key personnel.

- Constraining companies into a single methodology on executive remuneration would adversely impact on their ability to attract and retain key executives and specialists which, in turn, would adversely impact the performance of the companies and, ultimately, the nation's productivity.

- Accordingly, a "one-size-fits-all" prescriptive approach to executive remuneration would not be in the interests of shareholders or the wider community; a "one-size-fits-all" prescriptive approach would prove contrary to the national interest.

- Australia's corporate governance arrangements have key differences with the US; Australia's arrangements have served the nation well and have provided distinctly different outcomes from the US in the current Global Financial Crisis (GFC).

- In Origin's experience the non-binding shareholder vote on remuneration works well and has provided the opportunity for dialogue between the stakeholders to occur and to shape the development of policy and practice.

- Remuneration policy design should be outcomes-based to foster innovation, growth and productivity.

- There is no evidence to support the view that the remuneration of executives or non-executive directors exhibits systemic failure in Australia. Accordingly, excessive focus on a small number of aberrant companies or executives may inhibit the development of good policy. Additionally, it would be inappropriate to make policy recommendations based on the incorrect assumption that all companies have remuneration arrangements that lead to excessive risk taking.

- Remuneration data is a "lagged" indicator. The rapid economic deteriorations associated with the Global Financial Crisis are yet to be fully reflected in Australian remuneration trends. Sections of the community are drawing correlations between corporate performance and remuneration that do not take this timing difference into account. Care must also be taken that policy decisions are not based on misconceptions around such correlations.

2. Introduction - Origin Energy

- Origin is an integrated energy company. Created from a de-merger of Boral Limited in 2000, it has grown substantially over the last decade and ranks in the ASX list of Australia's top 20 companies by market capitalisation. It has many different elements to its business portfolio from gas and oil exploration and production through to retail electricity, from gas-fired electricity generation to renewable energy power generation. While the majority of its current interests are in Australia, it also has significant overseas activities which may be expected to grow in geographic diversity and scale in the future. It is an organisation that has demonstrated growth over the past decade. It has played a fundamental role in driving the development of an important new resource activity, namely the Coal Seam Gas (CSG) industry for domestic use and the planned conversion of CSG to LNG industry in Queensland which will create a major new source of exports for Australia.

- With a market capitalisation of approximately $14 billion and over 4,000 employees, generating and selling energy to over 3 million customers, it is making a major contribution to the national economy.

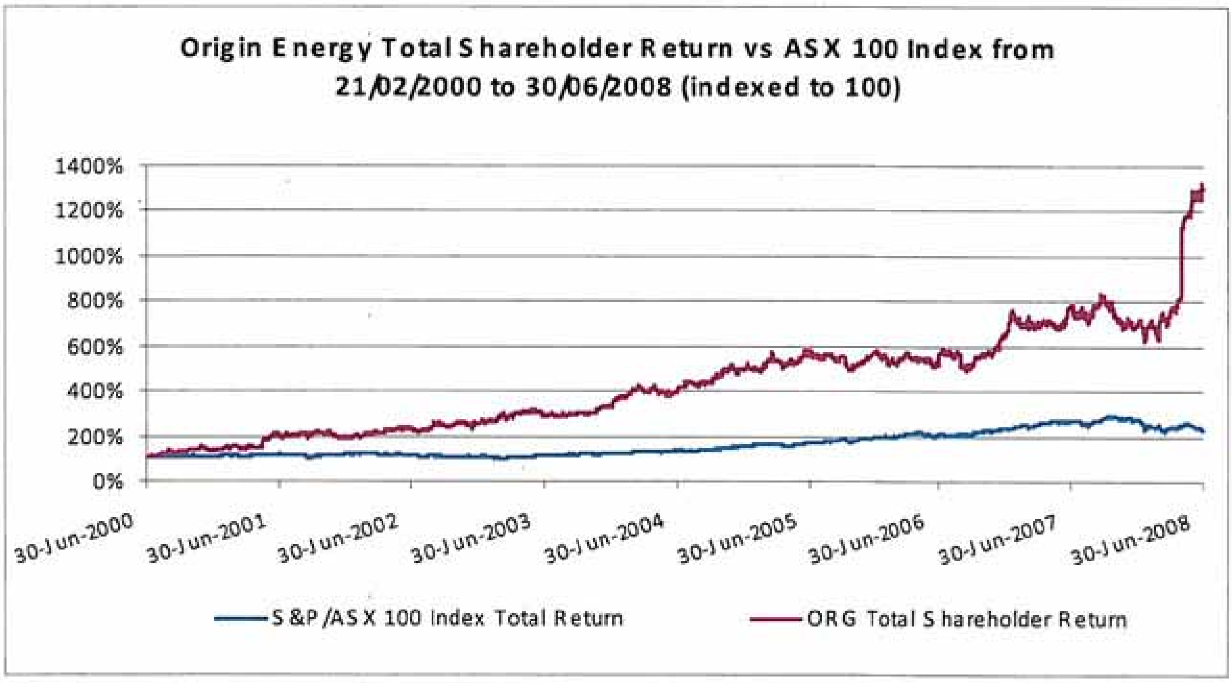
- The nature of the business requires a diverse range of skills and competencies. The requirement for a highly skilled executive team and workforce that is frequently in short supply places resourcing pressures on the organisation that at times can only be resolved by recruiting internationally. It is equally important to retain these executives and skilled personnel (whether Australian or expatriate) in a highly competitive global market.

- It is a highly capital intensive business with very long-life assets - with a consequential need to measure the success of investments and decision making over a long time frame.

- The Coal Seam Gas projects underway are examples of the types of risks undertaken by organisations such as Origin, projects that would not have eventuated without companies like Origin being able to put together the right people with the right skill sets to chart long-term developments such as these. Such capacity is fundamental to the future productivity of the nation and community living standards.

- **Company Performance**

  The Company's strong performance has been reflected in strong growth in its share price over the past ten years and good alignment with shareholders.



- The table below illustrates the strong growth of the company over the past five years. This has been achieved through long term strategies, stable management, and performance measures that are appropriately linked to its business drivers.

PERFORMANCE INDICATOR	2005	2006	2007	2008	Average Annual Increase %
EARNINGS					
Net profit after tax	$266m	$332m	$457m	$517m	25%
Earnings per share	34.9c	41.9c	54.7c	59.0c	19%
OCAT/PC* ratio	12.9%	15.0%	13.7%	12.3%	
TOTAL SHAREHOLDER RETURNS					
Dividends	15.0c	18.0c	21.0c	25.0c	19%
Share Price 30 June	$7.61	$7.36	$9.94	$16.12	31%
Annual shareholder return	42%	-1%	38%	66%	

*Operating Cash Flow After Tax as a percentage of Productive Capital. This is Origin's key performance measure of capital efficiency.

3. Trends in Remuneration (ToR 1)

Origin's Board has developed a strong principles-based approach to remuneration since the Company's inception. They are:

- To attract, retain and motivate employees to deliver superior performance
- To ensure that performance is aligned with shareholders' interests and is consistent with the Origin commitments, principles and values
- To target fixed remuneration at the market median
- To target aggregate remuneration (fixed + "at risk") at the upper quartile for superior performance
- "At risk" remuneration is clearly linked to the achievement of a transparent set of performance objectives: specific company and business unit performance objectives, as well as personal financial and non-financial objectives
- In recognition that Origin is operating in a tight labour market with skills shortages, ensure that the board has the flexibility to pay market rates to ensure remuneration remains competitive. We note that until the impact of the Global Financial Crisis the

labour market for executives in the Energy sector (particularly in CSG) was extremely competitive - the market remains competitive albeit at a less overheated level.

The following observations can be made on the basis of these principles:

- With Origin's strategy to develop a range of world class energy fuels - including renewable energy solutions and the Coal Seam Gas/LNG project referred to earlier - it is necessary to compete in the global market for the skills and experience required. The necessity "to attract retain and motivate employees" from around the world calls for flexibility in the way that executive remuneration is delivered.

- Origin considers that the total remuneration of an executive should primarily reflect corporate performance. Fixed remuneration is set at a market competitive level, but this generally accounts for only around one third of aggregate target remuneration. The remaining quantum should be earned by the achievement of clearly defined performance goals.

- Origin's approach is consistent with other large Australian corporates. Remuneration therefore comprises of two key components: fixed and "at risk".

    - The "at risk" component is broken down into two elements driven by different measures - one on the basis of internal measures (Short Term Incentive or STI) and the other on a relative external measure (Long Term Incentive or LTI).

    - The requirement to achieve defined levels of performance to earn any portion of the "at risk" reward is designed to ensure alignment with shareholders interests in the growth and continued strengthening of the organisation.

    - "At risk" remuneration is therefore clearly linked to the achievement of specific company, business unit and personal objectives. The personal objectives are both financial and non-financial.

- The performance measures used by the Company include Operating Cashflow After Tax against productive capital (OCAT/PC), Total Shareholder Returns (TSR), non financial measures and safety measures. The Company also believes it is appropriate to have the flexibility to pay additional amounts where formulas fail to recognise the contribution of an executive to Company performance or shareholder wealth creation. There is a strong direct link between remuneration and company performance which is evidenced by STI payments which, despite year on year double digit profit growth, have not paid out at maximum levels as OCAT/PC performance is the key measure.

- In practice at Origin the target remuneration mix for the Managing Director is Fixed (49%), STI (29.5%) and LTI (29.5%), and at superior performance outcomes the mix becomes - Fixed (29.4%), STI (35.3%) and LTI (35.3%). The difference between these alternative levels of remuneration is driven by the achievement of various levels of corporate performance. The proportion of pay that is Fixed increases with lower levels of seniority.

- In the STI plan OCAT/PC is the key measure as it defines the appropriate performance for the Origin business with its long term investment in assets. An individual executive's award is dependent on the further achievement of business unit and personal goals agreed at the commencement of the year.

- For the LTI plan the relative performance of Origin's Total Shareholder Returns against the top 100 listed companies on the ASX over a three year period determines the quantum of the equity which vests. No vesting occurs unless the Company achieves better returns than the median. Full vesting occurs only if Origin's performance reaches or exceeds the 75th percentile.

We also offer the following comments:

- As the Chairman of the Commission has observed, different sectors of the economy require different approaches to remuneration. The nature of our Company is different from others (eg financial services or retail) and we operate in a global market place for a number of our senior executives and skilled personnel (eg oil and gas executives, project and petroleum engineers etc). Australia has a shortage in these areas due to rapid expansion of CSG and hydrocarbon development in recent years. It is a capital-intensive business with long time horizons for investment and operations decisions; keys to success include retaining key skills (tenure and stability), security and performance measures that relate to the success of investments and decision making over the extended timeframe. Our business context is quite different to organisations operating in labour-intensive areas and/or with shorter-term investment horizons.

- We believe the consistency of management, performance measures and Board oversight has been the foundation for the strong performance of Origin over many years. This is an aspect that may be lacking in some companies where a primary focus on the achievement of short-term profit growth can lead to executive churn.

- The Board has deliberated at length to ensure that the performance measures are tailored to Origin's business; the measures chosen have proved stable and a key component in driving success over timeframes longer than three years; they have been constantly re-visited and fine-tuned to adapt to business requirements; they are aligned with Origin's ultimate goals. A prescriptive approach to remuneration would hinder this Board process, not help it.

- The Board has also put in place rigorous risk-management structures which govern activities such as hedging and trading. Further, the executives and senior staff working in these areas have variable remuneration opportunity levels that are the same as the wider organization and subject to the same overall corporate performance assessments. The components relating to personal performance are based on both financial and non-financial objectives, and represent a modest component of the total remuneration of the executives and senior staff working in these areas. Together the risk-management structures and appropriate reward structures provide a strong framework to prevent excessive risk-taking.

- While remuneration is a critical element to executive motivation, there are other factors that can play an important role - the opportunity and challenges of the role, the leadership team, the culture of the organisation, the international scope of the role and further career opportunities are all additional factors which can influence performance.

- It is recognised that there have been occasions in Australia where companies have made incentive payments to executives which were not warranted and directly conflicted with the performance of the Company. It is absolutely right that these should be criticised and subject to rescinding or clawback where practicable. However, these are exceptions in Australia. The shaping of regulations to address aberrant behaviour can lead to compliance-driven and inefficient policy, and unintended consequences that impose a far greater cost to the nation's productivity.

4. Effectiveness of Regulatory Arrangements (ToR 2)

Origin believes that the current regulatory framework that operates in Australia has the appropriate balance between the responsibility of the board to oversee the company, including the appointment and remuneration arrangements of a Managing Director, and shareholder responsibilities in their lobbying and voting on key elements of governance (binding vote on Directors' appointments and their remuneration (fee) cap, and the non-binding vote on the Remuneration Report, which includes executive remuneration and non-executive director fees).

We would reiterate the differences between jurisdictions and note that Australian failure rates in the area of remuneration are less concerning than in other jurisdictions. Financial institutions have not been "acquired" by the government here as they have been in the US and the UK. It is submitted that the examples of failure and major excesses in executive remuneration in the USA have drawn attention to an issue that in Australia has been managed effectively through legislation and guidelines over the past decade. The Australian model has features that, quite demonstrably, work well:

- The management of a company is ultimately the responsibility of the board of directors. While invariably this is delegated to the Chief Executive (subject to board oversight) the board of directors retains overall supervision of executive remuneration. This position was recently re-iterated by APRA in the discussion paper released on 28 May 2009 on the Proposed Extensions to Governance Requirements.

- Boards operate under a legal obligation to act in the best interest of shareholders. Onerous sanctions apply for breaches of this obligation.

- The Chairman of the Commission has cited US material which suggests that boards are captured by management in the area of executive remuneration. There is a clear difference between the governance model currently operating in the USA and Australia. In Australia:

    - The independence between the role of Chairman and Chair of the Remuneration Committee
    - The independence between the role of Chairman and the Chief Executive Officer
    - Board members are elected by shareholders and not appointed by the Chairman; the shareholders' vote on the re-election of directors is binding
    - Comprehensive remuneration disclosure has existed for the last five years; but is relatively new in the USA
    - A non-binding vote has been in place in Australia for the past five years, but is only coming into contemplation in the USA now.

- The Remuneration Committee is made up of independent and very experienced directors with skills, knowledge and understanding to determine the appropriate remuneration policy and practices, as well as actual levels of remuneration for key management personnel. The Origin Committee in fact comprises three members who are Chair or are members of other major listed company Remuneration Committees who bring considerable knowledge of remuneration levels in other companies.

- The Remuneration Chair retains and instructs independent consultants and bodies that have strong reputations and are themselves independent.

- Advisers report directly to the Remuneration Committee independently of management.

- The role of the remuneration advisors is to provide the Remuneration Committee/Board with the relevant analysis, market data and remuneration design and development advice. Generally this is sourced from data that is available through public disclosures and survey information. Some are global firms with excellent databases and experience in global trends.

We also offer the following points:

- The Commission has the opportunity to produce a simple, consistent approach to corporate governance in Australia. For example, the inconsistency between Corporations Act 300A requiring remuneration disclosures for "the 5 named relevant group executives who receive the highest remuneration for that year" and the "5 named company executives who receive the highest remuneration for that year" does not align with the requirements of the AASB 124 which applies to the "key management personnel" (those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly).

- Implementation of further ad hoc legislation without regard to the broader picture will only serve to add additional layers of compliance (ie tax on equity remuneration and termination payments).

- Reported remuneration has become increasingly more detailed and it is considered highly unlikely that any further detail will generate either increased understanding or improved clarity to shareholders. While open disclosure is key to transparent governance, additional requirements are considered to be counter-productive by creating undue complexity, increased technical terminology and greater length to the remuneration reports (ie details of prior options awards may comprise layers of details of little utility to a shareholder). We would prefer a principles and not prescriptive based approach to remuneration disclosure.

- An illustration of the complexity and misunderstanding can be found in the disclosure values for Long Term Incentives (LTI). It is appropriate that a value is given in order for shareholders to be aware of the accounting value of these awards (AASB 124). However shareholders and commentators often mistakenly assume that an executive receives this value each year. Ascribing an artificial accounting value to LTI awards masks the fact that when hurdles are not met, or when share prices drop below exercise prices, they can be without any value.

- It is fundamental that shareholders obtain meaningful information from the Remuneration Report. However, excessive prescription has made these Reports lengthy and often unfathomable, particularly where the stated value of equity is divorced from its realisable value. Effective communication with stakeholders regarding remuneration requires a much simpler and more meaningful framework than currently exists.

- The basis of remuneration of directors is quite different from executives. Fees are paid for the responsibilities directors are required to fulfil. There is not and should not be an at-risk element to their remuneration. This facilitates a clear separation from management and enables good governance and corporate decision making without the entanglement of immediate financial outcomes.

5. The Role of Institutional and Retail Shareholders (ToR 3)

- Institutional shareholders have always had the opportunity to discuss areas of concern with the Chairman and the Board of Directors.

- Input from Governance Advisors is welcomed and heeded. The role of organisations such as RiskMetrics, Corporate Governance International or the Australian Shareholders Association has been to draw the attention of institutional and retail shareholders to deviations from standard practice or areas of perceived excess. The voice of these organizations has been louder in recent years and this has served well to draw attention to concerns. This is a strong element in the positive debates that are held regarding key issues of executive remuneration presented to shareholders and has been influential upon a number of companies in recent years.

- The Chairman meets with the Australian Shareholders' Association on an annual basis.

- Shareholder non-binding vote has proved very successful. We and others take notice. The non-binding model is supported by the Financial Stability Board under the auspices of the G20. It has created an environment where shareholders have an opportunity to express concerns regarding all aspects of reported remuneration. In the case of Origin it has shown consistent support for the executive remuneration policies and practices as the table below demonstrates.

Year	For	Against	Abstain	Open	% For
2008	396.6m	23.6m	2.4m	14.5m	90.7%
2007	414.0m	9.4m	2.2m	18.3m	93.3%
2006	345.9m	20.6m	2,2m	14.6m	90.3%
2005	375.0m	7.0m	1.7m	14.2m	94.3%

Further action can be taken by shareholders where they do not believe their interests are being upheld by not returning a director when standing for re-election. At this point directors are ultimately accountable to shareholders and if shareholders do not agree with the way the company has been managed by the board, they can appoint alternative directors and not re-elect current incumbents.

6. Aligning Interests (ToR 4)

- The increased utilisation of equity plans has had a positive impact on executive remuneration. It has shifted the balance of remuneration from the majority being "fixed remuneration" and increased the balance of remuneration towards the "at risk" component. The alignment with shareholders interests in making LTI awards in the form of an equity grant (either share options or performance share rights) drives the executive focus on long term share price growth. That growth needs to be sustained and to significantly outperform the chosen peer group to achieve value from the LTI awards. With annual grants, key management personnel and other executives have a clear, continuous focus on consolidating, maintaining and growing shareholder value.

- The recent Federal Budget has resulted in much uncertainty around the future of employee share plans. The proposal to pay tax up-front would create an environment where executives will be reluctant to participate in LTI plans as there is a probability that the equity may never vest. This will lead to cash plans or other alternatives (eg, the re-introduction by some of non-recourse loans) and the alignment between executives and shareholders will be consequently diminished. This approach is inconsistent with the tax treatment prevalent in most OECD countries on employee share plans, thus placing disadvantages on Australian companies seeking to be competitive in the global talent market.

- Under current taxation legislation an equity award becomes taxable on cessation of employment. This defeats the object of the award and the intent of the plan design. It serves to encourage short-termism and runs counter to "hold-through-retirement" philosophies.

    - As previously expressed the focus for the executive should be on consolidating, maintaining and growing shareholder value. The current approach is inappropriate and encourages short-term behaviours at the expense of long-term actions.

    - To overcome the difficulties of cash-flow problems from the tax liability on retained equity grants on the termination of employment, company boards are in some situations waiving vesting periods enabling executives to sell shares. This further distances the executive from the long-term focus of the equity grant.

    - Origin recommends that the tax legislation should facilitate the "hold through retirement" concept, ensuring that those awarded LTIs are always focused on creating long-term shareholder value and that they remain at risk for a period post retirement.

- The proposed legislation on termination arrangements raises concerns for Origin and we believe there are a number of unintended consequences resulting from the proposal.

    - The setting of the limit at the proposed "one times base salary" level ignores that "base" for senior executives may be one-third of remuneration. Also Australian companies may be uncompetitive in local markets or when seeking to attract executives to Australia.

    - The overall impact of the Bill would be to adversely impact the ability of companies like Origin to attract the best people available to fill important executive roles. These people are key to helping drive more productive and effective business performance outcomes which, in turn, is important for increasing economic growth and community living standards.

  - A consequence of limiting appropriate exit payments 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.

- The ideal approach would be for the Commission to work with the "Review into Australia's Future Tax System" Inquiry under the chairmanship of Dr Ken Henry to develop a holistic and comprehensive approach to all taxation elements of executive remuneration (cash and equity). The current piecemeal approach and subsequent attempts to redress accidental and unintended consequences issues has resulted in uncertainties, inconsistencies, and unnecessary complexity. The quest for containing "tax leakage" has been at the expense of coherent and good policy.

7. International Developments (ToR 5)

Origin, as expressed earlier, believes that Australia has been at the forefront of good governance, with effective linkages between remuneration and performance, and appropriate depth of disclosure. The evidence of the strength of the Australian economy post the Global Financial Crisis would indicate that other countries would do well to follow the principles practiced in Australia.

We continue to operate in a global marketplace and will always be cognisant of events, practices and resourcing issues that are impacted by international trends.

8. Focus on Public Listed Companies

The media and political concerns are focused on Australian listed companies. Proposals to regulate or cap remuneration or introduce prescriptive requirements will make them less competitive with unlisted foreign competitors such as branches of foreign companies, private equity, partnerships or large local private companies. It will make it harder for them to compete globally in foreign jurisdictions if Australian rules are out of harmony with global markets.

9. Conclusion

Origin's experience has demonstrated that:

- Boards of public companies are best placed to decide the structure and content of Remuneration arrangements that are aligned with the best interest of all the stakeholders
- The systems in place for shareholder input are robust and two-way dialogue has improved significantly since the introduction of the shareholder non-binding remuneration vote
- A prescriptive arrangement for remuneration in public companies would be contrary to maximising growth and productivity
- Successful, vibrant and growing companies are very important to the wider community as they help drive strong economic growth and increased living standards
- The current public company structures and remuneration practices have facilitated these desired outcomes
- A prescriptive and inflexible approach to executive remuneration is not in the interests of shareholders, the community or the nation as it would adversely impact Company performance and national productivity. It would operate against the maximisation of economic growth and community living standards, and thus prove contrary to the national interest.

The Commission will report at a time when changes are being implemented in the areas of executive remuneration at termination, and on taxation arrangements for share plans. It would appear that these matters have been dealt with in isolation rather than in a holistic and strategic context. It would be appropriate for the Commission to bring a wider perspective on the issues involved and integrate its recommendations and perspectives from a holistic view of executive remuneration, notwithstanding that some decisions on those matters may have been taken while the Commission process has been underway.

It is noted that the Treasury, in its June 2009 Consultation Paper on the Reform of Employee Share Schemes, has quoted APRA's May 2009 Prudential Practice Guide on Remuneration in support of the re-introduction of limited deferral of taxing points for employee share schemes that were abolished less than a month earlier in the May 2009 Budget. This serves as a case example of the pitfalls associated with isolated policy-making, and it underlines the necessity for Australia to establish a coherent, consistent and strategic principles-based framework for remuneration policy within which regulation can then be sensibly formulated.

We look forward to the Commission's role in providing this framework and, thus, facilitating both good policy and good practice in Director and Executive Remuneration in Australia.