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Mr David Swift
Executive General Manager
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By email: david.swift@aemo.com.au

Dear David

re: AEMO Governance Review

ElectraNet welcomes the opportunity to comment on AEMO's Governance Review discussion paper (the Paper).

It is not clear whether this internal review conducted by AEMO somehow purports to represent the review required to be undertaken by SCER or whether it is merely a review initiated by AEMO and passed to SCER, but without any real status.

If it is the former, it is most disconcerting as it lacks independence being in the form of a self-review without any appropriate consultation with shareholders and seems to continue the history of poor or ineffectual consultation on governance matters by AEMO.

If it is the latter, the lack of supporting information, regarding what recommendations were submitted to SCER, any independent assessment as to whether these proposals are consistent with good corporate governance principles and any commentary as to whether there is any acceptance or otherwise by SCER of these recommendations, is of major concern.

The Paper proposes changes to several Constitutional processes. ElectraNet has reviewed the proposed changes and considers that a number of them would be inconsistent with AEMO's special character and role within the energy market.

In the case of an entity with the special character of AEMO, ElectraNet considers that a particularly strong mechanism for ensuring a wide range of Board candidates is appropriate.

However, ElectraNet is of the view that industry members should exclusively appoint 40% of the Board membership and that only Members appointed by governments be subject to the Selection Panel arrangements. The comments following are in relation to the Government or Panel-appointed Members only.

Review body and process

As the Paper notes:

- AEMO was created by the Council of Australian Governments (COAG) and developed under the guidance of the Ministerial Council on Energy (MCE); and
- AEMO's membership structure was set up as a 60/40 split between government and industry with the MCE committing to review this arrangement after three years of operation.

The Paper also states that AEMO recently:

“carried out an internal review of aspects of its corporate governance, which built on feedback received from members and gained through operational experience, with recommendations noted by the [Council] earlier this year. [The Paper] sets out a series of minor amendments AEMO considers will improve the effectiveness of its existing governance processes”.

AEMO's key roles in the energy market makes it important that any process for contemplating changes to its governance arrangements is transparent to its Members, the Council and other interested stakeholders. To this end, ElectraNet considers that, consistent with the MCE's original intention, its successor body, the Council, should conduct the review, not AEMO itself.

In addition, the Paper is also unclear regarding the process by which AEMO provided recommendations to the Council and what those recommendations and the Council's feedback to AEMO were. ElectraNet considers that Members' (and other stakeholders') ability to meaningfully participate in any governance review process is limited without that information.

Board appointments and re-appointments

AEMO's Directors are appointed by the Council. AEMO's Constitution provides that the Council establishes a Board Selection Panel to identify and recommend to it candidates for appointment. When the Council is satisfied with the Panel's recommendations, the Council may appoint the recommended candidates as Directors.

AEMO's Constitution further provides that the Chair is to review all Directors whose terms are due to expire and consider whether they ought to be reappointed. If the Chair considers that all such Directors merit reappointment then Members' approval is to be sought to recommend to the Council that all Directors be reappointed. However, if the Chair decides that at least one Director among those whose terms are about to expire does not merit reappointment, then any such Director can be reappointed only through the process run by the Board Selection Panel. Similarly, if the Members don't approve a proposal by the Chair to recommend to the Council that all such directors be reappointed, then all of those Directors must be re-considered through the Board Selection Panel process.

The Paper proposes that the Board Selection Panel be abolished and that AEMO's Board undertake the selection process itself and make recommendations for appointments directly to the Council.

It is a well understood principle of good governance that the boards of significant public companies should consider a wide range of candidates for directorships. This is to mitigate the risk that Directors drawn from a narrow range may lead to poor quality decision making. Over the last ten years a range of measures has been imposed through the Australian Securities Exchange ("ASX") and the Corporations Act with the objective of broadening the background from which board candidates are drawn. This development has occurred even though these companies exist for the principal reason of growing their own value.

In the case of an entity with the special character of AEMO, ElectraNet considers that a particularly strong mechanism for ensuring a wide range of Board candidates is appropriate. However, ElectraNet is of the view that industry members should exclusively appoint 40% of the Board membership and that only Members appointed by governments be subject to the Selection Panel arrangements. The comments following are in relation to the Government or Panel-appointed Members only.

The Board Selection Panel's independent provision of advice to the Council on the composition of the Board ensures consideration of the broadest possible range of candidates. ElectraNet notes that the Panel's role does not prevent AEMO's Board making its own informal suggestions for new appointments to directorships. ElectraNet therefore supports the retention of the Board Selection Panel in its current constitutional role.

The Paper also proposes that any Directors, among those whose terms are about to expire, whom the Chair recommends for reappointment be considered without the Panel's involvement. Presumably any directors not recommended by the Chair but seeking reappointment would need to be considered through the Panel's process. ElectraNet is concerned that, given Directors were appointed initially through a rigorous process, a Chair's recommendation for reappointment of only some directors might be an indicator of issues other than performance. The expiration of Directors' terms therefore presents an important opportunity to review the performance of AEMO's Board where the Chair cannot support reappointment of all affected Directors. ElectraNet cannot, without further consideration of measures to increase AEMO's accountability to Members, including assessments of the performance of the whole Board, support the Paper's proposal.

Directors' terms

The Paper notes that the Constitution currently limits a Director to a maximum of two terms of three years duration each. It then asserts the desirability of extending the number and/or length of those terms to a combined duration of up to nine years. The two rationales given for this assertion are that "directors usually require time to fully understand all aspect of the company's operations" and that doing so would "provide additional stability in the Board composition". Extending the terms doesn't appear to be a formal recommendation of the Paper. Were it to become so, ElectraNet would expect to see clearer evidence that the benefits of additional familiarity and stability outweigh the reduction in both flexibility and inclusion of new and worthwhile perspectives arising from the current term limits.

Board skills matrix

The Paper recommends that the Board skills matrix contained in the Constitution should be amended to incorporate skills and experience relating to the interests of customers. The Paper justifies this proposal by referencing the Council's decision to create the Australian Energy Consumer Organisation (AECO) to represent the interests of small end-use energy consumers and recommendations made by the Productivity Commission in light of its inquiry into electricity network regulation.

The Australian Energy Regulator, network businesses and consumer representatives are currently putting considerable effort into enhancing the participation of small end-use consumers in economic regulation and planning processes, and no doubt the AECO will play an important role in this respect in the future. However, the Paper isn't clear why AEMO, as wholesale market and system operator, needs to acquire expertise in end-use consumer matters. While not against the proposal, ElectraNet would prefer to have confidence that the inclusion wouldn't be at the expense of expertise in the Board's core skills.

Directors' independence

AEMO's Constitution requires that a majority of the Board comprise independent Directors. Schedule 2 to the Constitution provides that a director will not be independent if, among other things, the Director has within the three years preceding appointment been an executive of AEMO or a Member, or a principal of an advisory or consulting firm to AEMO or a Member. The Paper notes that Schedule 2 sets more stringent requirements for determining independence than the ASX which considers that:

An independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their judgment.

The Paper suggests that the application of the ASX definition might increase the size of the pool of candidates for AEMO Directorships, which it states is a "relevant consideration in the relatively small domestic energy market". ElectraNet agrees that the intent of Schedule 2 to AEMO's Constitution and the ASX definition of an independent Director are identical, but is not convinced that this is a sufficient ground on which to remove Schedule 2 from the Constitution and replace it with the ASX definition of independent Director.

AEMO manages markets in which many of its Members compete and operates systems which other Members own. Technology and law mean there are no alternative markets or system operators available. Under these conditions, prudence suggests AEMO's governance would be better promoted through a more carefully defined independence test such as that in Schedule 2, provided the Constitution also enables the Selection Panel and Directors to find that a person who does not meet all the Schedule 2 requirements is independent. By comparison, the ASX definition is potentially too broad to obtain the same confidence that it will be applied consistently and with sufficient rigour in AEMO's circumstances. To be clear, as indicated on the previous page, ElectraNet supports the consideration of a wide range of candidates. However, given the small size of the energy market, it is also important to ensure that any candidates drawn from within that market are suitably independent.

AEMO funding of out of scope activities

This submission has noted earlier that AEMO exists to fulfil requirements which have been defined externally and expressed in law. ElectraNet notes with interest that AEMO has set itself a "Vision" and a "Mission Statement" which are sufficiently broad to encompass functions other than those to which it has been specifically directed by government and, with respect to which, it would be unable to recover its costs through Participant Fees. ElectraNet is concerned by the Paper's proposal that there might be "merit in exploring options to widen the existing parameters to thereby enable AEMO a narrow remit in which to fund additional, and potentially closely defined, activities".

The Paper doesn't identify what those activities might be, how they would be compatible with the existing functions prescribed by government or why there would be value to Members in AEMO's management devoting resources to such activities. ElectraNet strongly suggests that AEMO should transparently develop and obtain support for its case to undertake such, as yet unspecified, activities before it proposes that its governance arrangements be amended so that it can source revenue to fund them.

The Paper notes that NEMMCO had such funding arrangements but doesn't discuss what they were, what they were used to do, and why jurisdictions decided to not carry them over to AEMO upon its creation. ElectraNet suggests that a discussion of those aspects of NEMMCO's arrangements would sit usefully in any AEMO business case for undertaking these activities.

I understand a number of businesses have written to AEMO in similar terms. Please do not hesitate to contact me on (08) 8404 7141 or stirling.ian@electranet.com.au if you wish to discuss any matter raised in this submission.

Yours sincerely



Ian Stirling
Chief Executive Officer