



13 September 2013

Mr David Swift
Executive General Manager, Corporate Development
Australian Energy Market Operator
PO Box 7326
Baulkham Hills BC NSW 2153

Submitted via www.aemo.com.au

Dear Mr Swift,

AEMO Governance Review

Alinta Energy notes the Australian Energy Market Operator's (AEMO) *Governance Review Discussion Paper* and welcomes the opportunity to provide feedback on AEMO's governance structure.

Alinta Energy endorses the view that governance arrangements should provide appropriate representation, flexibility and support for efficient market operations. To date Alinta Energy has worked with AEMO as it develops these objectives and is largely satisfied with AEMO's performance; notably AEMO's technical expertise and improved commitment to efficiency.

Nonetheless it is an appropriate time to critically and independently appraise AEMO's governance structure and how changes may improve AEMO's ability to discharge its functions and increase industry satisfaction with AEMO overall by drawing feedback from members, consumers and government stakeholders.

Review Remains Incomplete

As the operator of East Coast energy markets, AEMO plays a vital role in managing an essential service which is also of significant economic value. An organisation of the size and scope of AEMO warrants a comprehensive and independent analysis. As such, Alinta Energy considers that AEMO electing to undertake an in-house self-assessment process is inappropriate.

Further, the current review paper provides little indication how the corporate governance principles developed by the ASX, will be practically applied by AEMO or linked to a benchmark from which progress can be measured. As such, a suitable strategy determining practical outcomes from which AEMO's board can be held accountable is lacking at present.

Alinta Energy has conveyed to AEMO its disappointment with the current approach and is awaiting confirmation of an alternate independent method of assessment. Nonetheless there are a number of specific observations which are worth stating in the context of the existing paper.

- The existing membership structure of AEMO, comprising a 60-40 government to industry ownership split, may no longer be fit for purpose. Whilst AEMO entirely draws on industry funds to manage its operations, it is debateable if it is at all accountable to industry.
- The benefit of full industry ownership of AEMO has been partly debated in past forums, and remains a valid option.
- AEMO canvassing options to fund additional activities requires significant scrutiny and is of concern to industry.
- Greater industry ownership would increase in-depth scrutiny of AEMO's performance and hold Board members to greater account as well as pave the way for an extension of terms only where appropriate. Current arrangements contain little membership oversight into the selection process.
- The skills requirement selection matrix should preference recent industry experience; however, selection should not be dictated to by government based on some form of quotas.
- There is merit in facilitating a greater alignment within AEMO's constitution to the principles adopted in other Australian corporate boards such as the ASX.

These issues outlined above should not be assessed in isolation by AEMO and as such, the existing review remains incomplete. Nonetheless, the existing discussion paper provides an opportunity to debate issues which are of priority to participants. Alinta Energy's specific comments which should be examined as part of a future review process are outlined below.

Membership – Ownership Structure

AEMO membership

AEMO operates under a unique membership structure whereby AEMO's members are in fact also its owners. The existing membership configuration of AEMO is split between 60% government and 40% industry. Alinta Energy notes the discussion paper's conclusion that it is unnecessary to make any amendments to the existing ownership split at this time.

Given the concerns of industry and absence of consultation, it is unclear how the discussion paper reached this decision. Alinta Energy suggests further work is needed in this area, with the goal of adjusting the framework of AEMO to a 50-50 membership split a minimum objective.

The emerging view from market participants is that an adjusted balance between industry and government representatives in the market may positively contribute to developing market opportunities and may be more fit-for-purpose than existing arrangements.

The rationale for full industry ownership of AEMO has been partially debated in past forums and revolves around arguments that full industry ownership will lead to enhanced responsiveness, transparency and independence from secondary objectives which are not market imperatives. The option for full industry ownership should be revisited.

At times AEMO appears to act as a government agency and not as an independent market operator. Unless governance arrangements are reformed this view will continue.

The rights of company owners need to be clearly recognised and upheld

AEMO currently has a broad scope of core objectives including the overarching National Energy Objective, the National Gas Objective and a special focus on the long term interest of consumers in relation to reliability, security, quality and price. These objectives, in addition to AEMO's other specified legislated functions are set out in AEMO's constitution.

Alinta Energy is fully supportive of AEMO's current functions as they pertain to market operations. However, Alinta Energy considers the discussion paper's conclusion that there may be merit in widening AEMO's parameters to allow funding of additional activities is inappropriate.

AEMO canvassing options to fund additional activities are misplaced. Under the current membership split of 60-40, seeking to achieve additional broadly defined activities runs the risk of being dictated to by a government driven agenda, to the disregard of industry input.

Alinta Energy understands several market participants are forming the view, that the privileges of industry members are not being clearly recognised and consulted under the current ownership split. Given this, it seems paradoxical that AEMO draws on industry funds to manage its operations, yet could be considered not accountable to industry.

Alinta Energy strongly considers that adjusting the weighting of AEMO's ownership structure will lead to more efficient outcomes and will better engage industry. It is clear that the existing ownership structure of AEMO remains less than satisfactory and further work is needed in this area.

Examples of other operator arrangements

In assessing AEMO's corporate governance arrangements, it is appropriate to consider comparable operator arrangement in other jurisdictions. Alinta Energy notes that AEMO's existing arrangements represent a unique structure when compared to international jurisdictions.

Whilst there is no need for corporate governance arrangements to be identical across different organisations, a level of familiarity is considered a positive attribute.

Therefore, whilst minor differences will always exist between international energy markets, it is worth noting different arrangements overseas and what (if any) different arrangements, could contribute to AEMO operating more effectively.

Alinta Energy notes the discussion papers observation that almost all United States markets operate under 100% industry owned models. The efficiency of overseas industry owned operators raises the question whether the existing arrangements in Australia are effective and if AEMO is efficient.

Alinta Energy considers it important that any review process should seek to justify how the existing 60-40 membership split delivers better outcomes than 50-50 arrangements, or a 100% industry ownership model.

Board Arrangements

AEMO Board appointments

The confidence the market puts in AEMO as an independent market operator can be significantly weakened in the absence of a skilled and experienced Board comprising both government and industry representatives. It is therefore imperative that any Board selection process is managed correctly.

Alinta Energy understands AEMO's board currently comprises of 9-non-executive directors whom are appointed by the SCER appointment selection panel, while the managing director is appointed by the Board.

In Alinta Energy's view, the skills requirement matrix, used to assess the technical expertise of candidates is appropriate; given many of the required board appointments are technical and highly

specific in nature. However, given the continuously changing nature of energy markets, there is a view that sitting Board members should be in possession of recent industry experience and the existing skills requirement matrix should be amended to accurately preference this recent experience.

Further, there is a convincing case that some level of detailed knowledge in complex information technology systems should also be incorporated into the skills requirement matrix given the significant usage of such systems throughout modern day energy markets.

Ensuring fresh perspectives and representation at the Board level is important, as significant experience developed decades ago, may no longer be relevant. This view follows that existing arrangements and appointments by SCER may not be aligned to that of best business practise in a way which is open and accountable to the marketplace and shareholders.

In this regard, Alinta Energy considers that Board members should be elected and dismissed based on members votes, rather than the current process via SCER.

Board members length of term

Alinta Energy notes the discussion paper's conclusion that there may be merit in allowing directors to extend their Board appointments periods longer than two three year appointment terms, given the amount of technical expertise and knowledge built up over this time.

In Alinta Energy's view, an option of increasing Board members length of terms could only be progressed if Board members were reappointed based on a vote of AEMO members operating under a 50-50 ownership structure, as is common corporate practise. In general Industry participants have no reservations about supporting the reappointment of board members whom have a proven record of positive contributions to the market place.

However, current arrangements contain little membership oversight in the selection of Board directors or the ongoing review process which assesses the contribution that directors are making to AEMO and the market place. As such, Alinta Energy does not support directors having further tenure under the existing governance structure¹.

Alinta Energy notes that in other markets such as the ASX, independent consultants are commissioned to develop orderly board renewal plans in assessing membership structures. The ASX also reviews their charter annually to keep their objectives and responsibilities relevant.

Given a conclusive case has not been presented in the discussion paper; Alinta Energy does not support the proposed extension or modification of sitting terms for Directors, prior to a 50-50 membership structure being established.

Other Board considerations

Alinta Energy notes the discussion paper's finding that there is merit in reviewing the definition of an independent director within the AEMO constitution. Alinta Energy supports this recommendation.

Further, Alinta Energy agrees that it seems appropriate to facilitate a greater alignment with the corporate governance structure used by the ASX, in order to bring AEMO in line with the principles broadly adopted in Australian common corporate practise standards. Such a change may incorporate a larger pool of potential Board directors being considered for Board appointments.

¹ Such a recommendation is consistent with the findings of the Uhrig Review as outlined in "Governance Arrangements for the Proposed Australian Energy Market Operator", (2007), pg 18, Market Operator Working Group.

Other concerns aside, Alinta Energy is satisfied with the Board's focus on streamlining identified processes in a number of corporate structure areas, including the key focus on targeting synergies in aiming to increase cost savings to stakeholders where possible. Alinta Energy is supportive of such efforts being progressed.

Conclusion

As outlined above, in Alinta Energy's perspective AEMO electing to undertake an in-house review is inappropriate, and consequently the review remains incomplete.

Nonetheless Alinta Energy welcomes AEMO's *Governance, Discussion Paper* as a starting point of debate, from which a comprehensive and frequent independent review process can be established going forward to ensure AEMO is perceived (both internally and externally) as operating efficiently.

Alinta Energy has raised a number of further matters that AEMO and any independent consultant involved in the review process are encouraged to consider.

Should you have any queries in relation to these matters please do not hesitate to contact me on, telephone, (02) 9372 2633, or Mr Anders Sangkuhl, telephone, (02) 9375 0962.

Yours sincerely



Jamie Lowe
Manager, Market Regulation