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Friday 2 August 2019

Speech by APA Group Executive Governance, Risk & Legal Nevenka Codevelle to ACCC/AER Regulatory Conference in Brisbane

Thanks Cristina for the introduction.

Today, I really wanted to pick up some of the key corporate governance themes that were reinforced by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Banking Royal Commission), and talk about how those themes informed the development of the Energy Charter and what that may mean for the role of regulation going forward.

2017 Corporate Governance Trends

First, let me take you back to mid-2017, which is when the Energy Charter idea first came into being. It was clear that pressure had been building for companies to lift their game when it came to behaviour and social licence. That pressure came from all quarters, ranging from community outrage over the size of executive remuneration through to climate change activists, regulators and also investors wanting comfort around long term investment sustainability.

That year, 2017, saw public consultation on the draft of the 4th edition of the ASX Corporate Governance Principles & Recommendations. Reflecting market sentiment, the ASX pushed the envelope by including a principle that would have required entities to "instil a culture of acting ethically and in a socially responsible manner", noting that "social licence to operate" is something boards and management need to preserve.

Furthermore, in 2017, the Australian Prudential Regulatory Authority (APRA) commenced its inquiry into CBA's governance, culture and accountability, following a number of incidents of misconduct by the bank. APRA's outstanding report released in 2018 generated a lot of interest well beyond financial services.

Then, finally, in December 2017, the Banking Royal Commission was called. The report that came out in February 2019 grabbed headlines, and reinforced the direction and themes of corporate governance issues.

Energy Charter birth

Now the headlines during this period were pretty much equally shared between the financial services sector and the energy sector, as rising prices and reliability issues became political concerns.

The Edelman Trust index had energy as the least trusted industry in Australia, behind the banks but at least ahead of tobacco and gaming!

In response to community concerns, wave after wave of new regulation was being introduced at lightning speed of questionable effectiveness and dubious process. Calls for a Royal Commission into energy were also being made. What was clear was that community expectations were not being met, and trust and confidence in the industry was at an all-time low, and that was a problem.

Something had to shift. Consumer outcomes had to improve and the energy industry needed to play its part. A new approach and a new conversation were needed.

Energy Charter approach

The first thing was to recognise that the energy system as a whole had to respond in some sort of a coordinated way. No individual business or single part of the supply chain would be able to fix the problem alone.

That meant two things. First, the industry had to be brought together. The second was asking businesses, irrespective of where they sit in the supply chain, to think about their part in delivering better consumer outcomes and being held accountable.

I cannot overemphasise the massive shift in mindset that these two views of the world represented, particularly after 20 years of structural separation, where markets and competition were meant to do all the hard work, with businesses only needing to focus on their own commercial prosperity and their own silo.

So what happened then? Lots and lots of conversations. An Industry Working Group was established, as was an absolutely essential End User Consultative Group. To that end, I would like to call out the critical role Energy Consumers Australia played in bringing stakeholders to the table.

I would also like to call out the role of the signatory CEOs. At the outset, we knew that to maintain the highest integrity of process and outcome, personal commitments from CEOs would be required. Each of the signatory CEOs sit on a CEO Council that provides strategic direction and oversight for the Charter. This was essential in creating a sense of collective accountability and also in driving change by setting tone from the top and by investing personal reputation to the cause.

How it works

The Energy Charter was launched in January 2019. There are currently 18 signatories across the electricity and gas supply chains.

The Charter comprises a number of Principles and Principles in Action common to all signatories. Signatories are required to publicly report their performance against these principles annually, with the first reports due on 30 September 2019. An independent Accountability Panel will assess the disclosures and make findings and recommendations for continuous improvement at both the individual business and the whole of industry levels. Signatories will also have to measure themselves against a maturity model and disclose their improvement plans against which they will be assessed in future reporting periods.

Structure and link with corporate governance

The structure and design of the Energy Charter was very much informed by what was going on at the time in the corporate governance space.

The driver behind the Energy Charter initiative was to rebuild trust and confidence in the industry. The Charter's stated purpose is to progress the *culture* and *solutions* required to deliver a more affordable, sustainable and reliable energy system for all Australians, in line with *community expectations*.

The three key words or phrases to draw out from this purpose statement are: culture, solutions and community expectations.

Culture

First, culture. Culture is critical. The most important principle in the Energy Charter, that of "putting customers at the centre of what each business does and the energy system as a whole", is essentially about culture.

Justice Hayne in the banking Royal Commission called out the need to ensure a "culture of compliance". While that is important, it is simply too low a bar when looking to rebuild trust and confidence. Regulatory compliance is a ticket to play only. Reflecting this, the Energy Charter principles require businesses to make progress in instilling a culture of doing the right thing, of openness and collaboration, of fairness and customer-centricity. And it requires boards to actively oversee the alignment of the corporate culture with these principles.

Solutions

Second, the word solutions. The Charter's focus needed to be on outcomes rather than processes. Picking up the link made in corporate governance discussions between remuneration and outcomes, the Charter principles require that workforce incentives be aligned to drive positive customer outcomes. That means recognition and reward, incentive structures and KPIs.

The only way to really move the dial on trust and confidence is to deliver positive solutions and customer outcomes that are measurable. For 2019, signatories will report using measures and metrics that are available and appropriate for their businesses. What we're finding in the lead up to this first reporting period is that insightful measures and metrics are not adequately available and more work needs to be done. The disclosure reports this year will provide a baseline, with more insightful common measures and metrics to be developed going forward.

The Energy Charter is ultimately about cultural change and that is a long game. Outcomes will improve over time. However, in the near term, signatories with input from the End User Consultative Group, are working on a number of initiatives we've called Better Together initiatives; to improve outcomes in areas such as connection, customer complaints management and outages that require coordination across the supply chain.

Community expectation

Finally, community expectation. Interestingly, in the Banking Royal Commission, Justice Hayne opened proceedings by asking financial institutions to provide a statement of where they had failed to meet community expectations, rather than regulatory non-compliance.

It was a given during development of the Energy Charter that community expectations was the standard we needed to meet in order to rebuild trust and confidence.

But what did this mean in a real sense? In developing the principles which are all about better customer outcomes, a threshold question was, who is the 'customer'? Particularly for non-retail businesses, is it only the party that pays the invoice or should it be broader than that to include consumers, landholders and the community?

Increasingly, right up the supply chain, we're seeing conversation and mindset shift towards the view of customer as also including consumers and possibly other stakeholders. This is consistent with broader social licence concerns.

The other aspect to call out was the Energy Charter development itself. The End User Consultative Group was critical in providing guidance and insight on community expectations and priorities. The process of engagement, collaboration and co-design with the Group was a hallmark of the Energy Charter development process and the Charter Principles reflect the outworkings of that process.

Broader application

The Energy Charter is unique in the world and has attracted interest internationally. Its core structure as a Collective Accountability Model could have application more generally; particularly to other sectors where end-user outcomes are dependent on coordination across complex supply chains or networks where, for whatever reason, those outcomes need improving. This could include health, telecommunications, transport and even financial services.

A Collective Accountability Model is a different approach to that of regulation. It is about accountability for continuous improvement rather than compliance; it is about spirit and intent and principles, rather than prescriptive rules; and it is about hearts and minds and changing culture, which is most effectively done when the behaviours and values are driven and demonstrated as virtues in their own right, rather than by threat of a regulatory stick.

For certain, new and even existing areas of regulation, a Collective Accountability Model may well be a more effective mechanism to deliver desired outcomes than through regulation. The Australian Energy Markets Commission, in its recent Demand Response Rule Change Draft Decision, was open to this approach in recommending that the Energy Charter include a commitment by retailers to facilitate more wholesale demand response.

The Energy Charter is very much at the start of its beginning. This is the first year of its operation with business disclosures due on 30 September 2019 and the Accountability Panel report due by 30 November 2019.

As with all innovations, it will be interesting to see how the Energy Charter itself evolves over time, whether a form of Collective Accountability Model is taken up by other industries and the breadth of its role compared with that of regulation.

Thank you.

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About APA Group (APA)
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