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Dear Mr Miller

Exposure Draft – Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011

We refer to the Exposure Draft of the Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011 released on 20 December 2010. Set out below are the submissions on the Exposure Draft prepared by the Corporations Committee of the Business Law Section of the Law Council of Australia ('the Committee'). This submission has been endorsed by the Business Law Section. Owing to time constraints, it has not been considered by the Directors of the Law Council of Australia Limited.

As you know, the Exposure Draft follows on from the Productivity Commission report on executive remuneration, and the Government's announcement on 16 April 2010 of its response to that report. In the course of the Productivity Commission investigations, the Committee made submissions (copy attached) in which it argued against a number of the changes proposed by the Commission that have now been included in the Exposure Draft of the Bill. In this submission, we have not sought to repeat all of the policy arguments why those changes should not be made. Instead, we have (largely) sought to focus on the drafting of the proposed legislation.

Our comments on the Exposure Draft are as follows:

1. Ban on hedging of remuneration of key management personnel

Section 206J prohibits an arrangement which has the effect of limiting the exposure of the member to risk relating to an element of the member's remuneration that depends on the satisfaction of a performance condition. The way we interpret this is that it prohibits arrangements that limit any type of risk relating to an element of remuneration (e.g. salary or options), provided that element depends on satisfaction of a performance condition.

In our view, it is only those arrangements which have the effect of limiting the exposure of the member to risk of non-satisfaction of the performance condition that should be prohibited. The way section 206J is currently drafted, if a member of key management personnel entered into an arrangement to limit foreign currency risk on a component of salary that was subject to a performance condition, they would commit an offence. We assume that that is not the intention.

As currently drafted, section 206J applies to key management personnel of any company in Australia, even private companies. We think that any issues in executives hedging performance related remuneration in private companies should be dealt with by agreement between the key management personnel of those companies and the shareholders in those companies. We would recommend limiting section 206J to companies that are disclosing entities and their subsidiaries.

Section 206J(2) states that regard is to be had to the regulations for the purposes of determining whether an arrangement has the relevant effect. We would appreciate an opportunity to review those regulations once drafted and before they are passed.

2. Advice on remunerating key management personnel/engaging remuneration consultants

While the Committee agrees that the remuneration consultant should give their final advice directly to the entire board or the remuneration committee (section 206L(2)), it objects to sections 206L(3) and (4). As pointed out in our original submissions, the external remuneration consultants will need to work with management to formulate their advice, and if they cannot do this freely it will have a material adverse effect on the quality of the advice that is ultimately given. As currently drafted, if in the course of discussions with management the remuneration consultants given any form of advice on the nature or amount of remuneration, they will likely be in breach of section 206L(3) and/or (4). This is clearly not practical as the development of that advice has to be an iterative process with management in the first instance. We strongly recommend the deletion of sections 206L (3) and (4).

As stated in our previous submissions, the Committee also opposes the proposal (in proposed new section 300A(1)(h)) to name remuneration consultants in the remuneration report and, in particular, the requirement to include a summary of the advice given by the remuneration consultant in that report. This information is confidential to the listed companies receiving it. There is also the issue that many international firms which currently provide remuneration advice to listed companies will cease to do so if their advice is to become public in their client's remuneration report, thereby commoditising their advice.

Other points on the provisions include:

- The definition of "remuneration consultant" and section 206K(1) should be amended to make it clear that the advice caught by the provisions is advice which actually recommends the nature and amount or value of remuneration. The provisions currently capture advice "relating to" the nature and amount or value of remuneration, which could include legal or accounting advice on the structuring of remuneration (without going to quantum), or even advice on the quantum which is payable by the company under its existing arrangements. To achieve this, we would recommend replacing "advice relating to the nature and amount or value of remuneration for" to "any recommendation as to the nature and amount or value of remuneration to be received by".

- We would also recommend an express exception in the definition of "remuneration consultant" and section 206K(1) for legal advice in relation to remuneration arrangements.

3. Prohibition on any member of key management personnel voting undirected proxies on resolutions connected with remuneration

The proposed section 250A(5B) will have the unintended effect of disenfranchising a significant proportion of the shareholders in listed companies when voting on the remuneration report and many other remuneration related resolutions. This is because a large proportion of proxies are undirected, and almost all undirected proxies given by shareholders in listed companies are given in favour of the Chairman. If the Chairman is unable to vote those proxies (which is the effect of section 250A(5B)), then those shareholders will be disenfranchised.

Section 250A(5B) is, at least insofar as it relates to undirected proxies in favour of the chairman, unnecessary. Under the current law, if the Chair is precluded from voting their own shares on the resolution, ASX Listing Rule 14.2.3A requires the proxy form to contain a statement as to how the chair intends to vote undirected proxies and a notice stating that the chair may have a conflict of interest. Shareholders must then physically mark a box indicating that they have understood this statement. If the box is not marked, the undirected proxy must be disregarded. In our view, if a shareholder, after acknowledging that they understand the conflict, still wants the chair as an undirected proxy, they should be free to do so.

Section 250A(5B) should also expressly state that it is only when a member of key management personnel is prohibited from voting their own shares on the resolution that they (and their related parties) are prohibited from voting undirected proxies on the resolution.

4. 'Cherry picking' by non-chair proxy holders as to voting of directed proxies

Under the proposed amendment to section 250A(4), not only the chair but all appointees under directed proxies must vote those proxies. This will clearly not work in practice. The effect of this amendment is that an appointee under a directed proxy who is unaware that they have been appointed, or is unable to attend the meeting due to sickness or some other reason, is guilty of an offence. We assume that that is not the Government's intention.

As discussed in our original submissions to the Productivity Commission, to deal with cherry picking by non-chair proxy holders, the Committee supports the amendment to the Corporations Act which was proposed in the Corporations Amendment Bill (No.2) 2006. The effect of that amendment was that if the proxy is not the chair, the proxy need not vote on a poll, but if the proxy does vote on the poll in any capacity, the proxy must vote all proxies on the poll and must vote in the way specified in the appointment. This does not stop the non-chair proxy holder deciding not to vote any proxies at the meeting if a majority of the proxies they have received do not support their views on a resolution, but this would only be an issue where the non-chair proxy holder actually attends the meeting and does not vote. If they do not attend, the proxy would revert to the chair who must vote all directed proxies on a poll.

As discussed in our original submission, an alternative would be to require that if a non-chair proxy holder does attend the meeting, they must vote all of the directed proxies in their favour and must do so in accordance with those directions.

5. Prohibition on any member of key management personnel voting on the resolution to approve the remuneration report

As discussed in our original submission, the Committee supports the proposal to prohibit key executives from voting on the remuneration report, but believes that the proposed section 250R (4) to (10) should not apply to non-executive directors. The restriction is not necessary or appropriate for non-executive directors because their maximum aggregate remuneration is already subject to a binding shareholder vote under ASX Listing Rule 10.17, and those directors are excluded from voting on that resolution. There is also the fact that shareholders can remove non-executive directors at any time, or when they stand for re-election under the rotation provisions, without further liability to the company if the shareholders have an issue with their remuneration.

6. Strengthening of the non-binding vote – the two-strikes test

The Committee continues to be of the view that the proposal (the requirement that a spill resolution be automatically put at the second AGM if the second strike occurs at that AGM) is misguided. Under section 249D, shareholders holding 5% of the shares (or 100 members) can requisition a meeting at any time to remove all of the directors, so it is not clear why it is necessary to mandate that the spill resolution be put.

If, as seems to be the case, the Government is determined to press on with the change, the following issues should be addressed in the drafting of the provisions:

- section 250V(1)(b) needs to make it clear that it only applies to those directors referred to in (b)(i) who have not already ceased to hold office immediately before the spill meeting. This could be achieved by inserting the words "(if they have not otherwise already done so)" after "spill meeting" at the end of paragraph (b).

- section 250W(4)(b) should be deleted. If all of the directors who were on the board at the time the relevant remuneration report was approved have ceased to be directors, why is it necessary that all of them have been replaced by new directors? This provision could have the effect that the spill meeting would still need to go ahead if there were, say, 5 directors on the board at the time the remuneration report was approved; all 5 have ceased to be directors before the spill meeting is to be held; but only 3 or 4 new directors have been appointed to the board.

- section 250Y should be deleted. It is not apparent why a director who has been appointed by shareholders in general meeting at the spill meeting should have this disregarded when determining the directors to retire under the rotation provisions in the constitution. There is no reason why a new director appointed by shareholders at the spill meeting should have a three year term from the date of the meeting, while a director who stood for and was re-elected at the spill meeting does not.

- section 250U should be amended so that the Division does not apply where a majority of the directors who approved the remuneration report for the earlier AGM have ceased to hold office prior to the later AGM. It would be inappropriate for the board which approves the remuneration report for the later AGM to be exposed to a spill resolution because of the earlier remuneration report, if the board that approved that earlier remuneration report was effectively a different board.

7. Directors' report to address comments made on the remuneration report at the previous AGM

The proposed new section 300A(1)(f) requires that the directors' report include an explanation of whether comments made at the previous AGM on the remuneration report considered at that AGM have been taken into account, and either how they have been taken into account or why they haven't been taken into account. The following issues should be addressed in the drafting of this provision:

- the provision should only apply if there are actual complaints made at the previous AGM about the structure or quantum of remuneration. Comments on the remuneration report could be positive, or may not go to the structure or quantum of remuneration.

- the provision should make it clear that the explanation does not have to address each complaint individually, but to summarise what the complaints were generally and how they have been addressed. If each comment has to be addressed, the directors' report is likely to become much longer and more difficult for shareholders to comprehend.

8. No vacancy rule

The Committee supports the abolition of the 'no vacancy' rule but, as stated in our original submission, we contemplated that this would be effected by an amendment to the Act stating that, despite any provision in a company's constitution to the contrary, any determination by the directors as to the maximum number of directors is of no effect. What is now contemplated by the proposed section 201P is that, if a public company's constitution specifies a maximum number of directors, the Board can set a limit which is less than that maximum if the proposal that the Board set that limit has been approved by ordinary resolution of shareholders in general meeting. That approval by shareholders would only survive up until the next AGM of the company.

We agree that the Board should not set the maximum number of directors. However, it is not clear to us why shareholders by ordinary resolution should be able to approve the Board setting a limit below the maximum in the constitution, given that that limit has been set by a special resolution of shareholders. If the Board is proposing a lower limit, they can put a special resolution to shareholders to amend the constitution to reduce the maximum in the constitution. In other words, an ordinary majority vote should not be enough to authorise a reduction in the maximum that has been set by special resolution. If shareholders do want the ability of the general meeting to reduce the maximum by ordinary resolution, they can amend the constitution to provide that the maximum is X, but that the company may by ordinary resolution in general meeting specify a lesser number.

In our view, the provisions should simply state that any determination by the directors as to the maximum number of directors is of no effect. The process for annual renewals by shareholders in general meeting of the directors power to set a lower number is unwieldy and unnecessary.

If the provisions are to be adopted, there are a number of issues with the drafting:

- Section 201N states that the subdivision applies to all public companies. While we understand that the issues with the no vacancy rule can apply equally in more tightly held companies, we would suggest that the subdivision only apply to companies that are disclosing entities.
- Section 201N applies if the company's constitution allows its directors to set a limit "whose effect is to restrict the number of directors of the company to a number less than the maximum number of directors specified in the constitution". Issues with this include:
  - the constitution will often specify as the maximum "X directors or such lower number as the board may determine". Is the maximum here X or X as modified by the Board? If it is the later and the board then goes and sets a lower number as the maximum, this is not a "board limit" as defined in section 201N.
  - some listed public company constitutions do not specify a maximum, but provide that the maximum will be determined by the Board from time to time. Section 201N as currently drafted would not catch a maximum imposed by a Board under such a constitution.
- Under section 201P(1)(a), there must be a proposal which is approved by shareholders in general meeting. What is not clear is whether the proposal must specify the maximum number that the Board will impose, or simply the proposal that a maximum will be imposed. In other words, does the Board need to put an actual maximum number to shareholders, or can it leave this open (provided it is less than the maximum in the constitution)?
- Under section 201P(2), a board limit resolution only has effect until immediately before the start of the first AGM after the general meeting by which the authorisation resolution was passed. Does this mean that a person could nominate for appointment at that AGM even though that appointment would take the number of directors over the Board imposed maximum, because their appointment would take effect at the end of the AGM after the board limit has expired? If so, it would mean that the board limit would be of very limited utility (i.e. only at EGMs prior to the following AGM).
- Section 201R requires records of voting on a poll on a board limit resolution to be kept for 7 years. It is not clear why this is necessary, particularly when there are many shareholder approvals throughout the Corporations Act on equally important issues which do not require the company to keep voting records. We would recommend that section 201R be deleted.
- We would recommend that section 201U(3) be deleted, as it is not clear what is required to prove section 201U(3)(b) and the consequences of the section are that each appointment of a director at the meeting is invalid. For example, is it enough that a person says they would have nominated if not for the board limit, or must they have actually nominated and consented to become a director but been told by the company that their appointment would exceed the board limit.

- We would also recommend that section 201U(5) be deleted. What loss or damage is contemplated here?

If you have any questions in regard to the submission, please contact the Committee Chair, Guy Alexander, on (02) 9230 4874. The Committee would also be happy to meet with Treasury to discuss the legislation more broadly.

Yours sincerely

Margery Nicoll.

Margery Nicoll
Deputy Secretary-General

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Enc.