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General Manager
Corporations and Financial Services Division
The Treasury
Langton Crescent
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Dear Sir / Madam,

PMP Limited submits its views on the exposure draft of the *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011* (the **Exposure Draft**). This submission primarily addresses the proposed provisions designed to strengthen the non-binding vote on remuneration reports, and to improve accountability on the use of remuneration consultants.

1. THE "TWO STRIKES RULE"

The Exposure Draft proposes that where at least 25 per cent of a company's shareholders vote against the company's remuneration report at an AGM, the remuneration report for the subsequent year must explain the extent to which shareholder concerns about the previous remuneration report have been addressed by the company.

Where a company's remuneration report receives a "no" vote of at least 25 per cent of shareholders voting at an AGM in two consecutive years, a "spill" resolution must be put to shareholders at the second AGM.

If the spill is passed by an ordinary resolution of shareholders, an extraordinary general meeting of shareholders must be convened within 90 days. At that meeting, the directors who held office when the second remuneration report was approved by the company's directors must vacate their office and stand for re-election.

PMP Limited strongly opposes the introduction of this "two strikes rule", as currently drafted, for the reasons set out below.

1.1 The proposed rule is open to abuse

PMP Limited submits that the "two strikes rule" may be open to abuse by shareholders, and that the introduction of the "two strikes rule" as currently drafted would undermine the protections shareholders are provided in relation to changes of corporate control under Chapter 6 of the *Corporations Act 2001* (Cth) (**Corporations Act**).

As drafted, the "two strikes rule" could be used by a shareholder with a large, but still minority, stake in a company to destabilise the board or the company for reasons unrelated to executive remuneration. For example, a shareholder may attempt to use the “two strikes rule” as a mechanism to replace a company’s board of directors with new directors who represent their own interests under the cloak of opposing the company's executive remuneration policies. This may facilitate a shareholder obtaining control of a company without paying a control premium, as minority shareholders may be unaware of the true intentions of a substantial shareholder who opposes successive remuneration reports in order to trigger a spill resolution. Low shareholder turn out at an AGM may mean that even shareholders with relatively small holdings may have the power to trigger a spill resolution.

In practice, abuse of the "two strikes rule" would be a particular concern for companies that have a concentrated share registry. For example, PMP Limited's nine largest shareholders hold approximately [86] per cent of the shares in the company. In such circumstances, it is conceivable that one or two of PMP Limited's major shareholders alone could, under the cloak of opposing the remuneration report, trigger a spill resolution by voting against successive remuneration reports, and thereby seize control of the company.
In this context, PMP Limited submits that the 25 per cent voting threshold is too low given that shareholders, unlike directors and executives, have no duty to act in the best interests of the company or other shareholders but have the legitimate right to act in their own best interests.

Additionally, any alleged abuse of or disputes arising out the "two strikes rule" would be costly and time consuming to resolve, given that disputes would need to be considered by a court in most circumstances. The Takeovers Panel has consistently determined that it will decline to hear matters solely related to a change of directors or control of the board of directors where the change of control is not accompanied by an acquisition of voting power, unless that change of control occurs in the context of a takeover bid or proposed takeover bid.

It is also conceivable that a minority shareholder could threaten to vote against a remuneration report in order to exert improper influence on the board on any number of matters that are unrelated to executive remuneration, such as strategy of the company or dividend policy.

1.2 The 25 per cent threshold is too low

PMP Limited strongly opposes the introduction of the "two strikes rule". However, if such a rule is introduced, it suggests a spill resolution should only be triggered in circumstances where no less than 50 per cent of shareholders vote against the second remuneration report. Under the present drafting, it would be possible to trigger a spill resolution even where a majority of shareholders have voted in favour of a company's remuneration report in two successive years. Raising the trigger threshold would mean that a spill resolution would only be triggered where a majority of shareholders are not in favour of a remuneration report.

1.3 The "two strikes rule" is unnecessary

As acknowledged in the Productivity Commission's 2009 discussion paper on executive remuneration, and the explanatory memorandum for the Exposure Draft, the evidence suggests that boards do generally respond to the threat of a vote against a non-binding vote against a remuneration report.

However, even if this were not the case, shareholders are already able to remove the directors of a company where they wish to indicate their disapproval of a remuneration report. The Corporations Act already provides that shareholders that hold at least five per cent of the votes that may be cast at a general meeting have the ability to request that a general meeting be convened[1] (or convene a meeting themselves[2]) to consider resolutions proposed by a shareholder, which could include a motion that one or more of the directors stand for re-election. Such resolutions can be passed by way of an ordinary resolution.[3]

Additionally, one-third of the directors of a listed company must submit themselves for re-election at each AGM. If shareholders wish to indicate their disapproval of the remuneration report by voting directors out of office, they have an existing ability to do that. Moreover, two-thirds of a company's board could be removed within two years under these existing provisions.

Accordingly, PMP Limited submits that the proposed "two strikes rule" is unnecessary given shareholders are already provided with adequate protection to remove directors by the existing provisions of the Corporations Act.

1.4 A successful board spill resolution may adversely affect the share price of the company

PMP Limited submits that the market uncertainty that would likely be created where a spill resolution is passed would almost certainly exert downward pressure on the company's share price. This uncertainty may last for several months.

Contrary to the presumed intention of the drafters of the Exposure Draft, the possibility of share price pressures may make institutional investors reluctant to vote to trigger the spill resolution even where they are dissatisfied with the remuneration report.

1.5 The "two strikes rule" places undue emphasis on executive remuneration

Making a non-binding vote against a remuneration report a possible trigger for a board spill inappropriately elevates executive remuneration beyond other company matters. Indeed, PMP Limited considers that there are several matters that would form a more relevant basis for a board spill trigger than executive remuneration. For instance, where a company suffers several years of losses, or where a change of corporate control transaction proposed by the board fails.

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[1] *Corporations Act 2001* (Cth), section 249D.

[2] *Corporations Act 2001* (Cth), section 249F.

[3] *Corporations Act 2001* (Cth), section 203D.

However, even in these circumstances, an automatically triggered spill resolution would be an unwarranted intrusion into the management of the company as provided for in the company's constitution.

1.6 Shareholders not present at the AGM will be disadvantaged

Additionally, shareholders who do not vote in person at the meeting (i.e. those shareholders voting by proxy, attorney or corporate representative) will be unfairly disadvantaged by the operation of the "two strike rule".

Where a company's remuneration report receives a 'no' vote of 25 per cent or more at an AGM, the meeting papers for the subsequent AGM must contain notice of the possible spill resolution. However, because shareholders who cast their vote prior to the AGM will not know the outcome of the second non-binding vote on the remuneration report when they fill out their proxy form, or otherwise instruct their representative, they will not be in an informed position as to whether to vote for or against that spill resolution.

1.7 The disclosure requirements regarding shareholder comments are unclear

Under the proposed reforms, where more that 25 per cent of shareholders vote against a remuneration report, the company would be required to set out any concerns raised by shareholders at the company's AGM in the subsequent year's remuneration report, and state the extent to which those concerns had been addressed by the company.

It is not clear from the drafting of the proposed provision whether a company would be required to include a discussion of each comment raised at the AGM, regardless of relevance, or only the major comments. In many circumstances it would be impractical to include a complete discussion of each discreet comment raised at the AGM and how the company has addressed that comment. Such excessive disclosure would likely be irrelevant to shareholders in any event. However, under the current drafting, it would appear that anything less would risk non-compliance.

An additional practical difficulty with this requirement is that, in many cases, the reasons for a shareholder vote against a remuneration report are not clearly communicated to the company. In such circumstances, companies may need to rely on the advice published by analysts and other governance advisers if they wish to demonstrate their compliance with the disclosure requirement, even though such comments may not have been raised "at the company's most recent AGM". This may lead companies to place undue weight on such views.

PMP Limited opposes the introduction of this disclosure requirement. However, if it is to be retained in the final Bill, PMP Limited considers that the drafting of proposed provision must be revised to clarify the substance of the requirement.

2. REMUNERATION CONSULTANTS

The Exposure Draft also proposes the introduction of a new regime for the use of remuneration consultants by companies. These reforms show a fundamental lack of understanding about how companies operate. The proposals will interfere with the legitimate functions of management in relation to remuneration policy, and in some circumstances, will require a company to disclose the advice it has received from external advisers that does not relate to executive remuneration.

Under the proposed reforms, a new definition of "remuneration consultant" is to be included in the Corporations Act. This definition will include anyone other than an officer or employee of the company who provides advice "relating to the nature and amount or value of remuneration for one or more members of the key management personnel for the company". As lawyers and accountants typically offer advice on the structuring of executive remuneration, it is likely that such advisers will be caught by this definition.

The Exposure Draft contemplates the introduction of the following rules for listed companies and companies defined as "disclosing entities":

(a) Contracts with remuneration consultants relating to advice concerning key management personnel can only be executed by non-executive directors.

(b) Remuneration consultants can only provide remuneration advice concerning key management personnel to non-executive directors.

(c) Where a remuneration consultant provides advice to a company, the remuneration report must disclose:

  (i) the name of the remuneration consultant;

  (ii) the name of each non-executive director who executed a relevant contract with a remuneration consultant;

  (iii) the name of each person to whom a remuneration consultant provided advice;

  (iv) a summary of the advice provided to the company by the consultant, and the fees paid to the consultant for that advice; and

  (v) a summary of the nature of any other work the consultant performed for the company in the relevant financial year, and the fees paid to the consultant for that work.

PMP Limited is most concerned that breaches of these rules are to be offences. PMP Limited submits that there is no other category of contract that companies enter into that is subject to such onerous restrictions. PMP Limited considers the consequences of breach to be disproportionate to the wrongdoing and inconsistent with existing company law.

2.1 The reforms show a lack of understanding of how companies operate

PMP Limited strongly disagrees with the proposed requirement that the non-executive directors of the company should have sole responsibility for setting the company's executive remuneration policy with advisers. PMP Limited considers that proposed reforms would effectively usurp the accepted role of the CEO in setting a company's remuneration policy. Under well accepted corporate governance arrangements, it is the responsibility of the CEO to administer and formulate remuneration policy for management with assistance from qualified specialists such as human resources executives and consultants. The role of the board and the remuneration committee in this process is to consider, and if thought proper, endorse the policy set by the CEO and set the remuneration of the CEO.

PMP Limited submits that it is untenable that a CEO be prohibited from obtaining advice about the remuneration of a key management personal that reports to that CEO.

Furthermore, it is not practical or desirable for external remuneration consultants to consult exclusively with non-executive directors. Non-executive directors will in most cases not be experts in many of the matters that they would be asked to consider, such as incentive plans, retirement benefits, superannuation, and tax. More importantly, if non-executive directors were given exclusive responsibility for these matters, it would require them to devote considerably more time to their expanded role, and would require them to assume greater risk and liability. Perversely, this would likely mean that remuneration paid to non-executive directors performing such functions would need to be increased.

2.2 Prescriptive execution requirements are unprecedented

PMP Limited opposes the introduction of execution requirements that will prohibit executive directors, and most likely company secretaries, from executing contracts with remuneration consultants on behalf of a company. Aside from the obvious practical problems that such requirements may create, the proposed requirements would be an unnecessary and onerous restraint on the exercise of proper corporate authority. It should be noted that in no other circumstances does the Corporations Act prescribe which directors may execute agreements with third parties, even in the context of related party transactions.

2.3 Advice provided by external advisers that is unrelated to executive remuneration may need to be disclosed

As noted above, it is likely that lawyers and accountants who provide advice relating to executive remuneration, even where that advice does not concern quantum, may be caught by the definition of “remuneration consultant”. Accordingly, it is likely that a remuneration report will need to include a summary of the nature of advice provided on matters totally unrelated to executive remuneration, even if such advice is confidential and market sensitive or subject to client legal privilege. The report will also need to disclose any amounts paid for such unrelated advice. In many circumstances, this information will be irrelevant in the context of a remuneration report and will impede the proper functioning of Chinese Wall arrangements of corporate advisers.

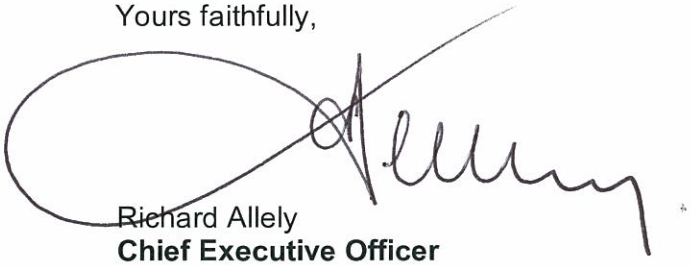
PMP Limited considers that there is no reasonable basis for requiring such wide ranging disclosure of information.

2.4 The proposed disclosure requirements are overly prescriptive

PMP Limited submits that boards should have the discretion to determine what information they disclose to shareholders about the use of remuneration consultants. In some circumstances, the proposed rules may lead to the disclosure of large amounts of information that is irrelevant to shareholders. This may be particularly so where a company seeks advice from many experts.

By mandating the inclusion of such information in the remuneration report, it may imply that the advice was followed by the board, or on the other hand, that the consultants named endorse the company's remuneration policy. In reality, it may be that neither of these implications is correct.

Yours faithfully,



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