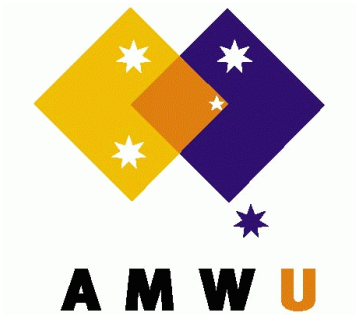
AUSTRALIAN MANUFACTURING WORKERS' UNION



Submission to Inquiry into the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009

Senate Standing Committee on Economics

July 2009

SUBMISSIONS OF THE AUSTRALIAN MANUFACTURING WORKERS' UNION

1. The Australian Manufacturing Workers' Union (the AMWU) welcomes the opportunity to make a submission to the Senate Standing Committee on Economics concerning the *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009* (the Bill).

2. The full name of the AMWU is the Automotive, Food, Metals, Engineering, Printing and Kindred Industries Union. The AMWU represents approximately 120,000 members working across major sectors of the Australian economy. AMWU members are throughout Australia's manufacturing industry, including metal manufacturing, printing and graphic arts, food and vehicle building, repair and service. They also comprise a significant proportion of workers in Australian mining, building and construction, aircraft and airline operations, laboratory, technical, supervisory and public sector employment. AMWU members are unskilled, semi skilled, tradespersons and professionals, and the vast majority of them are employed by private corporations.

3. The AMWU and its members have long rejected the *lassiez-faire* attitude to corporate regulation which has caused a disjunction between executive and non-executive remuneration to grow exponentially in recent years. We therefore strongly welcome the attempt made by this Bill to impose some accountability on corporations for the retirement remuneration paid to directors and executives. We remain concerned, however, at the limitations of this Bill – it is only one strand of a web of regulation which is necessary to constrain the tendency of the corporation to act without concern or acknowledgment of its responsibilities to the community in which it exists and the workforce which generates its wealth. In particular need of constraint is the tendency of those with power in a corporation to reward themselves disproportionately. Notwithstanding our support for this Bill, there are weaknesses in the Bill's attempt to bind the free hand of corporations, and there are further strands of regulation that are needed to redress the imbalance between the interests of the management of a corporation and that corporation's wider responsibilities in society.

Limitations in the scope of the Bill

4. We welcome that this Bill is directed at constraining the free hand of directors and executives to remunerate themselves excessively on the termination of their engagement. The need to regulate the otherwise unrestrained tendencies of those directors is evidenced in the spiralling remuneration of recent years, and the decreasing relativity between this remuneration and any measure of corporate profitability or good management. The absence of rationality in this

relationship is presented in many of the submissions to the current Productivity Commission Public Inquiry into Executive Remuneration.[1] There is evidence, in the least, that that there is market distortion which has become exponentially worse over the last two decades. Whether or not this distortion is a result of simple opportunism or a more sinister abuse of market power, there is a need to correct the imbalance between directors and executives' rewards and the value they add to their corporation. For example, it is becoming increasingly apparent that highly leveraged short term incentives for executives and directors inappropriately promote: a short-term focus, excessive risk-taking and highly individualistic behaviour.[2] Also in need of correction are the imbalances between those rewards and the rewards given to other employees of the same corporations, and the rewards for work given to workers in society generally. These imbalances must be corrected if social equity and a reduction in inequality are to remain goals of Australian society, and goals of the Government of that society. It must be corrected so as not to divert the interests of the directors of a corporation from the well-being of that corporation and its employees, and the position of that corporation as a good corporate citizen in society. It must simply be corrected to prevent – or at least stem – society's loss of faith in the social entity of the corporation.

5. When directors and executives have so much power in a corporate structure that they can effectively determine their own level of reward, it may be inferred that growing distortions and excess in executive remuneration are at least partly a result of a failure to restrain directors' and executives' inherent tendencies to excessively self-reward, or at least use their market power to influence this level of reward. This inference is sufficient, we submit, to warrant constraints being placed on that ability to self-reward, or influence reward.

6. The problem of the "golden parachute" is simply one manifestation of this excessive self-reward and it is towards the correction of this that this Bill is directed. However, the retirement or termination payouts are merely one symptom of a larger problem of boards of directors and executives disproportionately rewarding their own. This Bill does not address, for example:

   6.1. pay or reward other than termination payments – including non-monetary rewards. The potential for manipulation of non-termination remuneration will therefore manifest in corporate behaviour to the same extent that directors and executives currently use their power in a corporation to provide themselves with golden parachutes.

[1] See, at http://www.pc.gov.au/projects/inquiry/executive-remuneration, for example, Australian Council of Trade Unions: www.pc.gov.au/__data/assets/pdf_file/0009/89811/sub082.pdf ; RiskMetrics Group: www.pc.gov.au/__data/assets/pdf_file/0010/89524/sub058-part1.pdf ; Australian Manufacturing Workers' Union www.pc.gov.au/__data/assets/pdf_file/0011/89471/sub044.pdf ; Professor David Peetz, Griffith University www.pc.gov.au/__data/assets/pdf_file/0004/89482/sub050.pdf .

[2] PriceWaterhouseCoopers, *Executive Remuneration: Fit for the Future?*, 2009, at p.16.

6.2. wider social concerns, as discussed above, about the imbalance of executive rewards and the rewards of ordinary workers – whether in terms of termination payments or remuneration in general;

6.3. the impact that unbalanced corporate rewards have had on recent devastating global economic events, by promoting excessive risk taking and corporate greed, producing unsustainable corporate structures.

One obvious example is the proposed takeover by Airline Partners Australia (APA), a private equity consortium, of Qantas. It is now notorious that the Qantas Board recommended the acceptance of the takeover bid, which would have coincidentally rewarded Director Geoff Dixon and up to three dozen senior executives with a lucrative equity interest in APA, the corporation which was proposing the takeover. Whether by accident or design the takeover failed, and the passage of time reveals just how contrary to the long term interests of Qantas and Australia that takeover would have been. In this "deal", two thirds of Qantas' equity was to be replaced by debt, with a debt-to-equity ratio of 25:75 becoming a ratio of 75:25! The impact of the "success" of such a deal would have devastated Qantas as a corporation and a national carrier in current times of financial turmoil. This is highlighted by the fact that one of the larger members of the APA consortium, the Allco Finance Group, was recommended to be wound up by its administrator, with debts of over $1.1 billion. Too much risk would have rewarded board members – not the interests of the corporation, or its workers, or the society in which it operates.

7. Methods to curtail disproportionate self-reward by directors and executives include the empowerment of shareholders, and this is the mechanism adopted by this Bill. There is a general need to question, however, whether this method is sufficient to address the mischief of executive excess. First, when there are wider social concerns about excessive corporate remuneration, it is inappropriate to leave control of this excess to shareholders alone. It is unlikely, whilst a company is rewarding its shareholders with higher profits, that shareholders will be overly concerned about corporate social responsibility, or about executive salaries, wages or termination payments which are disproportionate to those received by other employees of a corporation or other workers in the economy at large. If such social equity is a concern, then some further regulation or constraint must be placed on the ability of the directors or executives to influence their own remuneration.

8. Secondly, it is often impractical to give more than advisory power to the body of shareholders in a corporation. If shareholders are given a veto over executive salaries, it is difficult to

conceive of an effective mechanism to negotiate salaries which are capable of approval by a group of shareholders with diffuse interests. The result of disapproval by a shareholder meeting of executive and director's remuneration would often be a stalemate. There would most likely need to be a parallel remuneration board of some sort, to represent shareholders' views where they conflict with the views of the a company's board. Again, whilst such a parallel corporate body could constrain the ability of a board to set its own remuneration, it would be unlikely to be motivated by considerations beyond the narrow profit-based interests of the corporation itself. Wider social interests would again be irrelevant to any assessment of executive pay. The wider interests of non-executive employees of the company would also be unlikely to influence profit-driven shareholders.

9. To incorporate social concerns, some way of measuring executive pay must be rationalised and generalised to reflect community concern over disproportionate pay. This can then be reflected in coercive and enforcement mechanisms. As suggested in the AMWU's submission to the current Productivity Commission inquiry, such mechanisms could include:

9.1. Making executive pay restraint a condition of doing business with the government or receiving government subsidies. Conditions on entities who engage in the sphere government procurement are not uncommon. Indeed, there has been a very recent reissue of the "*Australian Government Implementation Guidelines for the National Code of Practice for the Construction Industry*", to take effect from 1 August 2009. Such Guidelines in this and previous editions, have not been reluctant to regulate instruments of remuneration and negotiations for that remuneration, to a greater extent than would otherwise apply under legislation. Regulation of executive remuneration could similarly reflect Government policy, and restrain behaviour contrary to that policy;

9.2. Using the taxation system to curb excessive executive pay. This could apply generally, or in conjunction with the government procurement regulation noted above, as the 90% taxation of bonuses applied in the United States to banking firms who were recipients of US Federal Government bailout monies.[3] Similarly, tax deductibility could be removed where remuneration is excessive, as is already the case where tax deductibility is constrained when relatives are involved.

9.3. Setting a ratio. Whether used in accompaniment with punitive taxation, as part of government procurement conditions, or as a simple cap, the AMWU's suggested method of determining what amount is "excessive" pay, is to use a ratio of 25 times a company's

[3] C Hulse and DM Herszenhorn, "House Approves 90% Tax on Bonuses After Bailouts", *The New York Times*, 19 March 2009, at www.nytimes.com/2009/03/20/business/20bailout.html

lowest paid full-time adult wage. The advantage of this is to provide revenue where executive rewards are excessive, but allow strict pay capping to be avoidable through a simple method of raising the level of the lowest wages paid by the relevant company.

10. So, this Bill only goes to one element of executive remuneration (the golden parachute), and only facilitates shareholder input on executive pay – not a wider community input, or even the input of the wider body of employees who generate the income of the enterprise. The question must then be, does it do this limited job well?

Limitations of the Bill in achieving its stated aims

11. Without resiling from our comments above, that wider legislative reform is required, the AMWU remains of the view that this Bill is welcome and should be enacted. That said, there are some limitations in the construction of the Bill which may undermine its effectiveness in achieving its stated aims such as ensuring that regulation of executive pay keeps pace with community expectations, and addressing growing community concern on termination benefits.[4]

The use of proxy votes

12. For a number of reasons, the use and misuse of proxy votes by directors is approaching notoriety. It is difficult to deny that uninterested shareholders placing vast swathes of votes in the hands of interested (or even self-interested) chairpersons often presents an insurmountable hurdle to an effective debate over a particular issue at a shareholder meeting. The implications of *Campbell v Jervois*[5] – that a chairman was not bound to vote proxies in a manner consistent with the intention he had advertised in material accompanying the proxy form – is another brick in the wall protecting the interests of the board from the interests of the wider body of shareholders.

13. The general misuse of the proxy is an issue clearly beyond the scope of this Bill, but we would submit that this is because this legislative change is of limited scope. We note that this Bill does curtail the use of undirected proxies in respect of votes concerning a director's or associate's termination remuneration. The general misuse of proxies is not addressed by this Bill of course, because there remains a wider need, than with respect to termination payments alone, to address the lacuna between interests of the directors and upper management of a company from the wider community, from their workforce and, and even from their shareholders in general. As we have noted above, pay injustice reflected in immoral executive

[4] *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009, Explanatory Memorandum* at paragraphs 2.2-2.4.
[5] *Jervois Mining Ltd, in the matter of; Campbell v Jervois Mining Ltd* [2009] FCA 40

and directors' pay is a result of the self-interest of those who have too much power over the affairs of the corporation in society. That self-interest does not permit consideration of wider social and pay equity concerns. This is why that self-interest must be limited by effective regulation.

Manipulation of "base salary".

14. We understand the attempt made in the Bill to delegate the definition of "base salary" to new Regulations made for the purposes of this new Act. We appreciate this is an attempt to remain flexible and fleet of foot in response to rapidly rearranged executive pay packages which will attempt to circumvent the strictures of this Bill. We simply reiterate that unless the control of retirement income is accompanied by increased control over other income of directors and executives, it will not be enough. To make Regulations to tighten the screws at one end of that equation without have some ability to regulate the remaining remuneration of those directors and executives, will distort the mix of remuneration of directors and executive, but not control its overall excess. The use of the Regulation making power further to the definition of "base salary" admits that there is a natural tendency of the self-interested to manipulate the form of remuneration for their own benefit. This realisation must be reflected in wider regulation of those same corporate players across the entire scope of their remuneration, or any attempted control of retirement remuneration will be ultimately meaningless.

Penalties

15. In the context of executives and directors who will manipulate, and have manipulated, executive remuneration, it is necessary to consider whether the coercive provisions of this Bill are appropriately directed. We appreciate that penalties have significantly increased, but are concerned that manipulation by the recipients of termination payments may not be adequately controlled by these penalties. An amount which is not approved must be repaid (s.200J) and there are increased penalties where non-approved termination benefits are given. However, there is no additional sanction against arranging affairs to avoid the effect of this new Bill. Given the expected manipulation of pay arrangements, sanctions against avoiding or conspiring to avoid the shareholder approval required by this Bill, would strengthen the Bill's effectiveness.

Conclusions

16. The fundamental question over whether this Bill is effective will be answered if the Bill overcomes the power relationship which allows the senior officers of a corporation to set their own remuneration. The power imbalance between those directors and executives on the one

hand and shareholders, other employees and the wider community on the other is demonstrated in the unequal and irrational outcomes we have seen for executive remuneration in recent years. If that power relationship is left undisturbed, then executives and directors of a company will be smart enough, or well advised enough, to act around legislation which simply tries to trap them when they engage in certain remuneration practices. If a board is powerful enough, it will manipulate pay and remuneration to reward itself if given the opportunity.

17. This legislation must then take the power to self-reward away from boards. Shareholder control is one element of this. To more fully empower shareholders, steps can be taken, such as properly tracking proxies, holding directors accountable to the declared use of proxies ensuring directors and executives have *no* role in any vote on their own remuneration.

18. Secondly, however, a reflection of the will of a firm's employees, and the wider community's concern must also be strong enough to avoid the power that directors and executives have over internal company decision-makers to manipulate their own rewards. It is the view of the AMWU that this is best achieved through a capping of total executive and directors rewards to a maximum of 25 times the pay of a corporation's lowest employee wage. If a company does well, executives can be rewarded, but only in the same ratio that employees generally are rewarded.

19. We welcome this Bill. We commend the Government. It is not enough. We submit that the Government must go further.