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SUBMISSION ON CORPORATIONS LEGISLATION AMENDMENT (DEREGULATORY AND OTHER MEASURES) BILL 2014 BY AUSTRALIAN SHAREHOLDERS' ASSOCIATION

We submit the following comments on the Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014 (draft Bill). The Australian Shareholders' Association (ASA) has around 5,500 members, being retail investors in public listed entities. ASA is the only body representing this sector of the Australian financial community that has an active position in seeking to achieve improvement in management of listed entities. In our monitoring program, volunteer monitors are generally prominent at annual company meetings questioning directors on performance and governance issues.

We respond to the draft Bill by reference to the summary of the proposed amendments as listed on the first page of the explanatory document (EM). Our comments appear in normal type, with the summarised proposals in italics as follows.

1. Removing the obligation to hold a general meeting on the request of 100 shareholders

The proposed amendment is to s 249D of the Corporations Act, which currently enables either at least 100 voting members, or those holding in aggregate at least 5% of the eligible votes of a company, to requisition a general meeting with a stated agenda. ASA is pleased that the draft Bill does not propose to amend s 249N which permits similar numbers of members to have a proposed resolution included in the agenda of a forthcoming general meeting. ASA also notes with approval that the draft Bill does not propose to amend s 249P (regarding members' statements).

In Australia, only a handful of EGMs have been called by shareholders over the past 20 years, whereas the inclusion of a resolution at an AGM under s 249N or a statement under s 249P has been more frequent. ASA has not sought to gather the necessary 100 signatures for almost a decade. Over the 20-year period, there have been 30 instances (of which we are aware) of Australian listed company shareholder meetings where these sections have been used following the successful gathering of over 100 signatures from shareholders; only four of those were to call EGMs, 11 to add resolutions to an existing AGM agenda, and 15 were for s 249P statements. Unions, green groups, ASA and Get-up are the only bodies which have done this on more than one occasion.

Leaving aside the top 20 companies by market capitalisation, the average market capitalisation of other ASX 200 companies is currently about \$2.6 billion, so the minimum 5% level of support needed to require one of these companies to call an EGM (under the proposed amended s 249D) would be shares to the value of about \$130 million. The minimum level of support needed to call an EGM for a company in the top 10 list by market capitalisation would be between \$1.5 and \$6.5 billion in value of shareholdings. Typically, about half of the shares in a listed company are held by institutional shareholders on behalf of their managed funds, which we believe have not called, and rarely support, such requisitions. At some companies, a further significant block of shares is held by directors and executives of the entity and their associates; this group would similarly be unsympathetic to retail shareholder concerns that lay behind a s 249D requisition.

It would be a significant and costly task for a concerned minority to find sufficient support in the remaining population of shareholders for a requisition under the 5% rule.

Share registries refuse to provide searches of email addresses, so it is likely to be necessary to send out invitations to join a s 249D requisition by ordinary mail. As an example, Telstra has 1.4 million shareholders, so a mail-out to them would cost \$1 million in postage alone and would be well beyond the resources of most non-profit bodies including ASA to do. That cost would then be more than duplicated by the company in calling an EGM in response to the s 249D requisition. One possibility — albeit radical — would be for the requisitioning shareholders to be permitted to require an email message about the proposed requisition to be sent by the share registry to all that company's shareholders who have provided their email addresses, providing it had been cleared by an independent party such as ASIC to ensure that the message and content were for a proper purpose. That would eliminate any privacy objections.

Even for small companies, seeking a 5% support level for a meeting requisition is a daunting task. Two recent meetings were requisitioned under s 249D by shareholders of a small company (Empire Oil & Gas NL), the second of which resulted in the effective replacement of the board and management. This company had 11,000 shareholders and the process of seeking 100 signatures to the requisition resulted in the discovery that the proponents had the support of more than 5% of the issued shares, and ultimately a majority of the shareholders who voted, but this was unknown at the start of the process. Had the proposed amendment to s 249D been in place, the use of the section to requisition a meeting would have been unlikely, although the use of internet and chat sites does make discovering 5% support more feasible today than would have been the case even five or 10 years ago.

ASA can see the issue from the perspectives of both parties — most shareholders do not want their company put to unnecessary expense to accommodate the concerns of a tiny minority who, as Treasury indicates, would have little prospect of success at the requisitioned meeting. However, occasionally an issue of importance arises on which there is a divergence of opinion between management and a shareholder group, and the only way of getting public focus on the issue may be by way of a s 249D requisition, given that small numbers of shareholders attend general meetings to hear the debate on requisitioned resolutions.

ASA is concerned about any reduction in shareholder rights. Whilst we will accept the Government's proposal to abolish the 100 shareholder trigger for the calling of EGMs, because of the cost involved, ASA continues to support the right for any single (or group of) shareholder(s) representing more than 5% of voting shares to be able to call EGMs. The table within the story "Boards, unions and activist groups clash over EGM rules" (AFR, March 19, 2014) created the false impression that small groups of activist retail investors have called numerous EGMs in Australia over the years. It is in fact a very rare event. Three of the six examples (CBA, Santos and Rio Tinto) cited as "meetings called under the 100 shareholder rule" were simply resolutions proposed by investors at the AGMs under s 249N. These meetings were happening anyway, so there was no "frivolous waste of shareholders' money".

Accordingly, whilst repealing the 100 signature rule, the Government should also make an off-setting amendment to reduce the real "red tape" burden for retail shareholders — as opposed to companies — by making it easier for them to propose resolutions at AGMs, the cost of which shareholders are already funding. The administrative burden of investors having to obtain 100 signatories to propose a resolution at the AGM is a significant and potentially costly task. By all means abolish the 100-signature rule in s 249D to eliminate a problem that doesn't really exist, but, whilst looking at shareholder rights, the Government should empower Australia's seven million retail investors by requiring only 10 signatures for AGM shareholder resolutions under s 249N. This is the best way to energise lifeless AGMs and — given with adequate notice — it would incur little extra cost for listed companies.

The US requirements for shareholder-proposed resolutions are informative. A single shareholder who has held more than \$US2000 worth of shares continuously for more than 12 months may propose a resolution

at the AGM of any US listed company. That is arguably too easy, so ASA believes a revision to s 249N to permit just 10 signatures for AGM resolutions would be an appropriate compromise, provided each holding is a marketable parcel worth more than \$500. Companies might object that an activist group could satisfy the provision by purchasing only \$5,000 worth of shares between themselves and then selling them soon after the AGM. It would be reasonable to combine our proposed 10 shareholders qualification with the US requirement of a continuous holding for at least a year to avoid the risk of such short term manipulation.

2. *Requiring companies to include a general description of their remuneration governance framework, to the extent that it is not included elsewhere in the annual report*

ASA supports the requirement to disclose this information. However, we note that the definition of the “framework” refers only to the key management personnel, which would rarely be more than eight executives and the non executive directors — even in groups that employ tens of thousands of people. Best practice would be to extend this “framework” disclosure to describe the remuneration practices and principles, especially regarding incentives, that apply throughout the organisation.

3. *Removing the requirement to disclose the value of options granted to key management personnel, replacing it with a requirement to disclose the number of lapsed options and the year in which they were granted*

ASA supports the clarification of the disclosure of options and the removal of duplicated requirements between the Corporations Act and Regulations. However, does the reference in the new para (e)(iv) to the “year in which granted” mean financial year or calendar year?

4. *Relieving certain disclosing entities from the obligation to prepare a remuneration report*

Section 300A is captioned as applying to listed entities, but subs 300A(2) extends its obligations to all disclosing entities. The proposed amendment to that subsection to make the section applicable only to “listed disclosing entities” goes too far, in ASA’s opinion.

There are a number of unlisted disclosing entities which are also public companies with shares held by retail investors. These include companies with over 100 members which have been delisted by the ASX, incorporated co-operatives, real estate development companies, and companies formed by groups with a common interest, which are currently required to prepare a remuneration report, but will not need to do so if the proposed amendments are legislated. Some of these entities may be very substantial and of great interest to several classes of stakeholders. The drafting of Pt 1.2A is complex, but it seems possible that the proposed change would also exempt unlisted companies that have issued debentures. Whilst ASA’s primary focus is on listed entities, we do not believe it appropriate to excuse disclosing entities from reporting obligations only because they are unlisted. The lack of the shareholder vote, noted in paras 23 and 24, is not a sufficient reason to exempt the disclosure. We would prefer s 300A(2) to remain unchanged, and instead that the heading of s 300A be changed to clarify that it applies to all disclosing entities rather than only to listed disclosing entities.

5. *Amendments to the test for payment of dividends (the dividends test)*

The draft Bill proposes that the test for directors to satisfy, in determining if a dividend may be declared or paid, be changed to holding a reasonable belief that the company will be solvent immediately after the dividend is declared or paid respectively. The current requirement is a determination of sufficient net assets as defined by accounting standards, together with a need to ensure that the payment is fair and reasonable and without prejudice to the ability to pay creditors. Solvency is defined in s 95A of the Corporations Act in the following terms “A person is solvent if and only if, the person is able to pay all the person’s debts, as and when they become due and payable.” The EM explains that the current legislation is seen to place on directors a very specific requirement to measure net assets as at the date dividends are to be paid. In practical terms, this is difficult and we agree that a simple solvency test (without specifying the need for net assets to be measured at a particular date) would simplify the evidentiary burden. We support

the changes proposed, although we also recognise that it may be more difficult to hold directors to account if a company becomes insolvent soon after paying a dividend, under the new regime. However, our observation is that listed companies rarely if ever fail *only* because of dividend payments.

It appears that there will no longer be a need to show how the determination of solvency was made. Will the directors be required to make a formal board resolution to state that they have made adequate enquiries to ensure that they have a reasonable belief of the solvency, for example along the lines of s 295(4)? Would they need to support that with a written declaration from the CEO and CFO similar in purpose to that of s 295A?

The proposed s 254TA appears to be applicable only to the reduction of *ordinary* share capital. Is that deliberate? In s 254TA(c)(ii) must the amount paid up per share exceed the dividend per share—what happens if it does not, in the case of some of the shares? Does the word “year” in the new s 300(1)(a) and (b) mean the company’s financial year? The drafting suggests that dividends paid (or declared) *with respect to* that financial year, but paid after the year end, and before the Directors’ Report is signed, are *not* covered by this. What is the rationale for that exclusion?

We note that the heading of the new s 254T retains the old heading (with the addition of “declared or” —in particular the word “MAY” — even though the text describes the test in the negative, ie, “MUST NOT”). The adoption of this new Bill would be a good opportunity to make the heading consistent with the text. We assume, moreover, that any (additional) limitations or prohibitions contained in, for example, the company’s constitution, preference share terms of issue regarding dividend stops, or debt covenants, would *further* limit the dividend paying capacity, and would not be overridden by this section. Are ss 254T and 254TA to apply to capital reductions or dividends between a wholly owned subsidiary and its parent?

The interaction of subss (1) and (2) of s 254T is uncertain. What happens if the directors satisfy the solvency condition when they *declare* a dividend — but it is *paid* many months later? Subsection (3) suggests that (2) would not apply to the payment itself, so the directors would have to consider solvency only once—irrespective of the delay between declaration and payment.

Is the new s 254T applicable to all classes of shares, including preference shares, and to final and interim dividends irrespective of their timing and description? Paragraph 9 of the EM states that the disclosures are an important integrity measure. We agree, but wonder if the justification in the final sentence is appropriate. Is every company thus affected required to have an AGM?

We note that para 10 of the EM states “The proposed amendments are not designed to change existing taxation arrangements”. Has Treasury confirmed with the ATO that no changes of tax law or practice would arise?

6. *Transferring the remuneration setting responsibility for the offices of the Financial Reporting Council (FRC), Australian Accounting Standards Board (AASB), and the Auditing and Assurance Standards Board (AUASB) to the Remuneration Tribunal*

We offer no comment on the proposed amendments to the ASIC Act 2001.

7. *Improving the efficiency of the Takeovers Panel, by allowing the Panel to perform Panel functions while overseas*

We offer no comment on the proposed amendments to the ASIC Act 2001.

8. *Exempting certain companies limited by guarantee from the need to appoint or maintain an auditor*

We offer no comment on the proposed amendments as regards audit appointments for companies limited by guarantee.

9. *Minor technical amendment to clarify that directors may vary their financial year by up to 7 days, regardless of the length of previous years*

ASA agrees that it is appropriate that companies which prefer to align their annual financial year to a day of the week rather than a date on the calendar be allowed to vary their financial year by up to seven days to do so, and that they should not be impeded in making other decisions about financial years by so doing. We hope that the proposed amendment to s 323D has this effect. We would go further, however, and urge Treasury to take steps to amend taxation legislation to enable listed companies to select a financial year which best suits their operating cycle — without penalty in terms of having to make taxation payments in excess of those determined by applying legislated tax rates to their taxable income. The current requirement amounts to a penalty to do so if changing from a 30 June year-end. This has resulted in the current log-jam of a reporting system, with company executives, directors, auditors, analysts, printers and others under intense time-pressure to complete financial reports in a two-month period of the year, with little pressure at other times. This has the consequence of elevated professional fees, and a probable deterioration in the quality of work performed during the busy season. This pressure also affects retail and institutional shareholders — the owners of the company for whose benefit the AGMs are held. The “bunching” of AGMs, especially in October and November, places significant strain on the quality of engagement, when there can be up to 20 AGMs per day. ASA does not want to see a repeat of the Bond Corporation abuses where financial years were stretched to avoid accountability, but a more flexible approach to year-ends would be in the best interests of listed companies, their shareholders, and the financial community generally.

My colleagues John Campbell and Richard Wilkins have collaborated to prepare this submission for ASA.

Ian Curry

Chairman

Australian Shareholders' Association