



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

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Law and Bills Digest Section

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

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House: House of Representatives

Portfolio: Treasury

Commencement: 1 July 2011

Links: The links to [the Bill, its Explanatory Memorandum and second reading speech](#) can be found on the Bill's home page, or through <http://www.aph.gov.au/bills/>. When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the ComLaw website at <http://www.comlaw.gov.au/>.

Purpose

The Bill amends the *Corporations Act 2001* (the Corporations Act) to implement the Rudd/Gillard Government's response to a number of recommendations made by the Productivity Commission following its inquiry into executive remuneration in Australia in 2009. Particularly, the Bill:

- contains accountability mechanisms for executive remuneration (including introducing a 'two strikes and re-election' process for shareholder voting on remuneration reports)
- inserts provisions about setting limits on the number of directors a public company may have, and
- revises the law on voting by proxies.

Background

In March 2009, the Rudd Government tasked the Productivity Commission with inquiring into executive remuneration in Australia. More specifically, the Government wanted the Commission to consider:

- trends in remuneration in Australia and internationally
- the effectiveness of the existing framework for the oversight, accountability and transparency of remuneration practices in Australia, and

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

- the role of ‘large local institutional shareholders’ in the development, setting, reporting and consideration of remuneration practices.¹

The Commission received a large number of submissions, including from corporations, shareholder groups, financial planning/superannuation groups, accounting and law firms, academics and private citizens.² Among other things, it found that remuneration structures are ‘company and context-specific’ and that it was therefore not appropriate to prescribe standard amounts or conditions for executive remuneration. However, it made 17 recommendations about a diverse range of issues related to executive remuneration, including the election of directors, remuneration reports and committees, and voting rights. Some of the recommendations are directed to the Australian Securities Exchange (ASX) and do not require a response from Government.³ As the following table shows, most of the other recommendations are addressed in the Bill (usually in accordance with, but in much greater detail than provided in, the relevant recommendation):

| Productivity Commission Recommendation Number | Summary of recommendation | Location/treatment in the Bill |
|---|--|---|
| Recommendation 1 | Where, in an election of directors at an annual general meeting (AGM), the board seeks to declare no vacancies and the number of directors is less than the maximum provided in the company’s constitution, approval should be sought from shareholders by way of ordinary resolution at that AGM. (This requirement is referred to as the ‘no vacancy’ rule.) | Mainly proposed Subdivision B (‘Limits on numbers of directors of public companies’) of Division 1 of Part 2D.3 of the Corporations Act. (Part 2D.3 deals with the appointment, remuneration and cessation of appointment of directors; Division 1 deals with the appointment of directors.) See Part 2 of Schedule 1 to the Bill (items 27–32), particularly proposed sections 201N–201U . |

1. Productivity Commission, *Executive Remuneration in Australia*, Inquiry report, no. 49, December 2009, p. v, viewed 7 March 2011, <http://www.pc.gov.au/projects/inquiry/executive-remuneration/report>

2. Ibid., Appendix A (which is available as a separate pdf document at: http://www.pc.gov.au/data/assets/pdf_file/0005/93605/15-appendixa.pdf)

3. Recommendations 2, 3, 10 and 11. (Recommendation 6 is directed to both the Government and the ASX; and Recommendation 16 suggests that the Government should legislate for the relevant measures if the ASX does not give effect to Recommendations 2 and 10.) Note also that Recommendations 8, 12 and 14 are not directed primarily to the Government; they are directed to the Australian Securities and Investments Commission (ASIC) in the first instance. Further, Recommendation 13 deals with taxation rather than corporations law.

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| Recommendation 4 | Key management personnel and all directors should be prohibited from voting on remuneration reports and related resolutions. | Proposed Part 2D.8 of the Corporations Act ('Remuneration recommendations in relation to key management personnel for disclosing entities'); see item 8 of Schedule 1 to the Bill. |
| Recommendation 5 | Company executives should be prohibited from hedging unvested equity remuneration (such as shares and options) or vested equity that is subject to holding locks. | Proposed Part 2D.7 ('Ban on hedging remuneration of key management personnel') of the Corporations Act; see item 8 of Schedule 1 to the Bill. (particularly proposed section 206J). |
| Recommendation 6 | Key management personnel and all directors should be prohibited from voting undirected proxies on remuneration reports and related resolutions. | Proposed section 250BD ('Proxy voting by key management personnel or closely related parties'); see item 10 of Schedule 1 to the Bill. |
| Recommendation 7 | Except in exceptional circumstances, proxy holders must cast all of their directed proxies on remuneration reports and related resolutions. | Proposed sections 250BB and 250BC of the Corporations Act (see item 34 of Schedule 1 to the Bill). |
| Recommendation 9 | Section 300A of the Corporations Act (which sets out the specific information that is to be provided by listed companies in their annual directors' reports) should be amended so that individual remuneration disclosures are confined to key management personnel (that is, the requirement for the disclosure of the details of the remuneration of the company's top five executives should be removed). | Item 16 of Schedule 1 to the Bill repeals subparagraphs 300A(1)(c)(iii) and (iv) of the Corporations Act. |

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| Recommendation 15 | A 'two strikes and re-election' process should be introduced where resolutions to approve a company's remuneration reports have received two consecutive 'no' votes of at least 25 per cent. The 'second strike' vote on the remuneration report should be clearly decoupled from the 'spill resolution' vote. | Proposed Division 9 ('Meetings arising from concerns about remuneration reports') of Part 2G.2 of the Corporations Act. (Part 2G.2 deals with meetings of members of companies.); see item 13 of Schedule 1 to the Bill, which inserts proposed sections 250U–250Y . |
| Recommendation 17 | There should be a review of any corporate governance arrangements that the Government puts into place in response to the Productivity Commission's report. The review should occur not later than five years from the introduction of the new arrangements. | Not mentioned in the Bill. |

Source: Parliamentary Library

On 16 April 2010, the Rudd Government formally responded to the Productivity Commission's report.⁴ On 20 December 2010, the Treasury released an exposure draft of the Bill for public consultation. It received in excess of 40 submissions, many of which made detailed suggestions for improvement of the legislation that have now been taken up (either in whole or in part) in the current Bill.⁵

Committee consideration

On 24 February 2011, the Selection Committee (House of Representatives) resolved to not refer the Bill to a committee.⁶

On 3 March 2011, the Selection of Bills Committee (Senate) deferred consideration of the Bill to a later date.⁷

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4. C Bowen MP (then Minister for Financial Services, Superannuation and Corporate Law and Minister for Human Services), W Swan MP (Treasurer) and Senator N Sherry (then Assistant Treasurer), *Government responds to the Productivity Commission report on executive remuneration*, media release, 16 April 2010, viewed 16 March 2011, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2FZKGW6%22>
 5. For a copy of the exposure draft and the submissions, see the Treasury, *Exposure Draft - Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011*, departmental website, 20 December 2010, viewed 9 March 2011, <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1925>
 6. Selection Committee, Report no. 15, 23 February 2011, viewed 10 March 2011, http://www.aph.gov.au/house/committee/selc/reports/43rd_parliament/report_15.pdf

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Position of major interest groups

Some major interest groups remain dissatisfied with certain aspects of the Bill, despite having made comprehensive submissions to the Productivity Commission (and later the Treasury on the draft exposure legislation) which have now been addressed in part in the current Bill.

For example, John Colvin, Chief Executive Officer of the Australian Institute of Company Directors (AICD), acknowledged that while the Government had responded to some of its concerns (especially in relation to remuneration consultants and proxy voting), the legislation ‘remained excessive and fundamentally flawed, particularly in relation to the “two-strikes” and “no-vacancy” rules’.⁸

Mr Colvin argued these two measures are ‘too wide ranging and restrict the capacity of boards to add value for their shareholders’.⁹ Particularly, Mr Colvin believed the strict liability offences are inappropriate, ‘given the possible differing interpretations of the requirements’.¹⁰

Chief Executive of Chartered Secretaries Australia, Tim Sheehy, raised concerns about the way proxy voting is treated in the Bill, saying that prohibiting the chairman from voting undirected proxies ‘disenfranchises’ shareholders who gave undirected proxies and is ‘an unprecedented curtailment of shareholder rights’.¹¹ Mr Sheehy explained that shareholders often leave undirected proxies to the chair, but because the legislation prevents key management personnel (including executives and non-executive directors) from voting as proxies on remuneration-related issues, the votes would

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7. Selection of Bills Committee, Report no. 2 of 2011, 3 March 2011, viewed 10 March 2011, http://www.aph.gov.au/Senate/committee/selectionbills_ctte/reports/2011/rep0211.pdf
 8. AICD, *Pay laws excessive and fail to add value for shareholders*, media release, 23 February 2011, viewed 9 March 2011, <http://www.companydirectors.com.au/General/Header/Media/Media-Releases/2011/Pay-laws-excessive-and-fail-to-add-value-for-shareholders>. The issue of remuneration consultants is addressed in **proposed Part 2D.8** of the Corporations Act (which deals generally with remuneration recommendations in relation to key management personnel for disclosing entities). For example, **proposed section 206K** provides that a company’s directors (as a group, or as a sub-committee known as the ‘remuneration committee’) must approve any proposed remuneration consultant before the company enters into a remuneration consultancy contract. Failure to do so is a strict liability offence that carries a maximum penalty for an individual of 60 penalty units (see **item 22** of **Schedule 1** to the Bill). **Proposed section 206L** then states that if the remuneration consultant makes a remuneration recommendation in relation to one or more members of the company’s key management personnel, the consultant must provide the recommendation to the directors of the company and/or the members of the remuneration committee. However, the consultant commits an offence if he or she provides the recommendation to (a) a person who is an executive director of the company unless all the directors of the company are executive directors of the company or (b) a person who is neither a director of the company nor a member of the remuneration committee. The offence attracts a maximum penalty for an individual of 60 penalty units (see **item 22** of **Schedule 1** to the Bill). The term ‘*penalty unit*’ is defined in section 4AA of the *Crimes Act 1914* (Cth) as \$110 (if the offender is a body corporate, a court may impose a penalty up to five times this amount: section 4B of the *Crimes Act 1914*). Thus the maximum fine that could be imposed on an individual for committing an offence under **proposed subsections 206K(4), 206L(3) or 206L(4)** is \$6600 per offence.
 9. *Ibid.*
 10. *Ibid.*
 11. F Stewart, ‘Proxy concerns’, *Sunday Canberra Times*, 30 January 2011, p. 36, viewed 17 March 2011, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2F518463%22>

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remain uncounted.¹² Mr Sheehy argued that the solution would be for voting forms to specify that shareholders must either vote against the remuneration report or give their undirected proxies to the chair, who will vote in favour of the report.¹³

Financial implications

The Explanatory Memorandum makes no mention of the financial impact of the Bill. However, there should be little (if any) cost to public revenue, given that the measures contained in the Bill are directed at public companies and do not require oversight by government agencies.

Main issues and their treatment in the Bill

Voting rights of key management personnel and company directors in relation to remuneration reports

All company members ('shareholders') are currently able to vote on a listed company's remuneration report at the company's annual general meeting (AGM).¹⁴ However, this right creates a conflict of interest where shareholders, who are also the directors or executives of that company, vote on their own remuneration.

A number of submissions to the Productivity Commission's inquiry raised this issue—although they were not necessarily agreed about the impact on the outcome of any vote even if directors and executives were allowed to vote on their own remuneration. For example:

- *Chartered Secretaries Australia (CSA)* believes that there is a conflict of interest in allowing directors and executives to vote on their own remuneration, saying that it 'disempowers shareholders'
- *RiskMetrics* argued that the 'primary role of the non-binding report is to allow shareholders to convey their view of the company's remuneration practices to the board ... and [it is] counterproductive to allow members of key management personnel to be able to vote on this resolution'
- *Macquarie Group* argued that excluding executives would have little impact on the vote because the resolution is not binding and the number of votes held by executives 'would be small and unlikely to influence the outcome'

12. Ibid.

13. Ibid.

14. Section 250R of the *Corporations Act 2001* (Cth) deals with the business of an AGM. Specifically in relation to a company's remuneration report, subsection 250R(2) states that at a listed company's AGM, a resolution that the remuneration report be adopted must be put to the vote. Subsection 250R(3) states that the vote on the resolution is advisory only and does not bind the directors or the company. For the full text of section 250R, see http://www.austlii.edu.au/cgi-bin/sinodisp/au/legis/cth/consol_act/ca2001172/s250r.html (viewed 8 March 2011).

- *BHP Billiton* agreed that in the majority of companies where shares are widely held by investors, there would not be a material impact in restricting the ability of directors to vote
- the *Australian Institute of Company Directors (AICD)* said that prohibiting those named in a remuneration report from voting on it would produce ‘little marginal benefit’
- *Origin* argued that because non-executive directors ‘have their aggregate remuneration or fees approved directly by shareholders’, there is no logical basis for preventing non-executive directors from voting on the remuneration report
- *Guerdon Associates* suggested several reasons why directors should not be excluded from voting, including the fact they owe a fiduciary duty to shareholders [which presumably is higher than their own self-interests], and because the *Corporations Act 2001* (the Corporations Act) already prevents directors and related parties from voting on issues in which they have a pecuniary conflict of interest¹⁵, and
- the *Australian Securities Exchange (ASX)* supported the prohibition on key management personnel voting ‘where there is a direct conflict of interest’ but did not support a general prohibition on key management voting on matters ‘where they did not directly obtain a benefit from the outcome of the resolution’. The ASX also noted that where there is a direct conflict, its Listing Rules¹⁶ prevent directors from voting their shares.¹⁷

Obviously the impact of voting by directors and executives will depend on their level of shareholding in the company. The Productivity Commission noted that while the impact is ‘likely to be negligible in most cases’, in some cases the shareholdings of directors and/or executives ‘are significant and potentially influential’.¹⁸ In this regard, it referred to the shareholdings of Frank Lowy (170 million shares, or 10 per cent of Westfield) and Paul Little (10 per cent of Toll Holdings).¹⁹ Further, the influence of any particular shareholder may be affected by the number of proxy votes he or she holds.

The Productivity Commission also referred to submissions that argued that instead of precluding directors and company executives from voting on remuneration reports, the prohibition should really only apply to key management personnel and not non-executive directors.²⁰ This is because ‘the director fee pool is already set by shareholders and directors are under a fiduciary duty to act in the best interests of the company’.²¹

15. See, for example, section 224 of the Corporations Act (‘Voting by or on behalf of related party interested in proposed resolution’) at http://www.austlii.edu.au/cgi-bin/sinodisp/au/legis/cth/consol_act/ca2001172/s224 and section 253E of the Corporations Act (‘Responsible entity and associates cannot vote if interested in resolution’) at http://www.austlii.edu.au/cgi-bin/sinodisp/au/legis/cth/consol_act/ca2001172/s253e

16. See Chapter 14 of the ASX Listing Rules at <http://www.asxgroup.com.au/media/PDFs/Chapter14.pdf> (viewed 8 March 2011).

17. Productivity Commission, *Executive Remuneration in Australia*, op. cit., pp. 316–317.

18. *Ibid.*, p. 316.

19. *Ibid.*

20. *Ibid.*

21. *Ibid.*

The Productivity Commission concluded that extending the prohibition on directors and shareholders voting on remuneration matters where a conflict of interest can arise to include the special case of the non-binding vote would be appropriate ‘to ensure the “purity” of the shareholder signal’.²² It said: ‘The purpose of the non-binding vote is to give non-involved shareholders a say and it is incongruous for directors and executives to be able to influence this outcome’.²³

Ultimately, the Productivity Commission recommended (Recommendation 4) that: ‘The *Corporations Act 2001* should specify that company executives identified as key management personnel and all directors be prohibited from voting their shares on remuneration reports and any resolutions related to those reports.’ In its view, extending the prohibition to include ‘*associates*’ of directors and key management personnel ‘appears infeasible in practice’, adding:

As many participants indicated, the term ‘*associates*’ could inadvertently preclude from voting some major company shareholders by virtue of them being defined as associates to the primary company. Even a tighter definition such as ‘*close associate*’—defined in s.9 of the Corporations Act—could inappropriately exclude relatives of directors or key management personnel who independently purchased shares in the company.²⁴

Item 12 of Schedule 1 to the Bill deals with the issue of voting on advisory resolutions by key management personnel or closely related parties. It inserts **proposed subsections 250R(4)–(10)** into the Corporations Act.²⁵ These provisions contain much greater detail than the Productivity Commission’s recommendation but essentially provide:

- a vote on a remuneration report cannot be cast (in any capacity) by or on behalf of key management personnel whose remuneration details are included in the remuneration report and any ‘closely related party’ of such a member (**proposed subsection 250R(4)**)²⁶
- a person described in proposed subsection 250R(4) may cast a vote on the resolution if the person does so by proxy appointed in writing that specifies how the proxy is to vote on the proposed resolution and the vote is not cast on behalf of a person in proposed subsection 250R(4) (**proposed subsection 250R(5)**)

22. Ibid., p. 371.

23. Ibid.

24. Ibid. The term ‘*close associate*’ [of a director] is defined in section 9 of the Corporations Act to mean a relative of the director or a relative of a spouse of the director. The term ‘*associate*’ is defined more generally in sections 10–17 of that Act.

25. See footnote 14 for a description of section 250R in relation to remuneration reports, including a link to an electronic version of the current consolidation of section 250R.

26. The term ‘*closely related party*’ is not currently defined in the Corporations Act. It is to be inserted into section 9 (the Dictionary for the Corporations Act) by item 1 of Schedule 1 to the Bill. There, it is defined (in relation to a member of the key management personnel for an entity) to mean a spouse, child or dependant of the member or the member’s spouse; ‘anyone else who is one of the member’s family and may be expected to influence the member, or be influenced by the member, in the member’s dealings with the entity’; a company the member controls; or ‘a person prescribed by the regulations for the purposes of this paragraph’. It is therefore much wider in its application than the definition of ‘*close associate*’ in section 9 (noting that that term is only defined in the context of a director and not a member of an entity’s key management personnel): see footnote 24 above.

- the Australian Securities and Investments Commission (ASIC) may by writing declare that proposed subsection 250R(4) does not apply to a specified resolution or prevent the casting of a vote, on a specified resolution, by or on behalf of a specified entity. However, ASIC may only do so if it is satisfied that the declaration ‘will not cause unfair prejudice to the interests of any member of the listed company’. The declaration is not a legislative instrument (**proposed subsection 250R(6)**)
- if a person described in proposed subsection 250R(4) casts (or has a vote cast on his or her behalf) in relation to the resolution, he or she is guilty of an offence (**proposed subsection 250R(7)**). **Item 25 of Schedule 1** to the Bill inserts reference to this offence in Schedule 3 to the Corporations Act and provides that the (maximum) penalty is 200 penalty units, or imprisonment for 5 years, or both²⁷
- a vote cast in contravention of proposed subsection 250R(4) is taken not to have been cast (**proposed subsection 250R(8)**)
- a vote is cast on behalf of a person if (and only if) it is cast as proxy for the person, otherwise on behalf of the person, or in respect of a share in respect of which the person has power to vote or power to exercise or control the exercise of a right to vote (**proposed subsection 250R(9)**)
- subject to Part 1.1A of the Corporations Act (which deals with the interaction between corporations legislation and state and territory laws), proposed subsections 250R(4)–(9) have effect despite anything else in the Corporations Act, state or territory law (including general law) and anything in the company’s constitution (**proposed subsection 250R(10)**).

The ‘two strikes’ approach

Currently the Corporations Act contains no consequences that follow if a board chooses to ignore the shareholders’ (non-binding) vote on a remuneration report. The vote is simply ‘advisory’ only.

The Productivity Commission argued that the ‘two strikes’ approach would have greater potential ‘to target boards that are apparently consistently unresponsive while maintaining the integrity of the non-binding vote’.²⁸ Under the ‘two strikes’ approach, there would be an automatic requirement for directors to be re-elected if two consecutive remuneration reports (whereby the company’s directors) receive a ‘no’ vote from shareholders. The Productivity Commission suggested that the ‘two strikes’ approach would ‘complement a formal requirement for an explanation of the board’s response to the first “no vote”’, adding: ‘If shareholders judged the response or explanation unsatisfactory, they could then seek to remove the board or particular directors’.²⁹

The Productivity Commission pointed out that about five per cent of the ASX 200 received consecutive ‘no’ votes of 25 per cent or more of eligible votes cast against their remuneration

27. Schedule 3 to the Corporations Act sets out penalties for offences under that Act: see **item 25 of Schedule 1** to the Bill. The maximum fine that a court may impose under **proposed subsection 250R(7)** of the Corporations Act is \$22 000 (if the case of an individual) or \$110 000 (in the case of a body corporate).

28. Productivity Commission, *Executive Remuneration in Australia*, op. cit., p. 296.

29. *Ibid.*, p. 296.

reports in 2008 and 2009.³⁰ It also said that the average level of ‘no’ votes has been gradually increasing—with a ‘small but significant’ number of large companies receiving a ‘no’ vote in the 2009 reporting period.³¹ These companies include several large mining companies, Lend Lease and Qantas.³²

Some submissions to the Productivity Commission (such as those by the Business Council of Australia, Chartered Secretaries Australia and KPMG) argued that a ‘two strikes’ approach could ‘bring the potential for excessive shareholder influence on pay decisions, or board instability and with it the potential for a chilling effect on voting against the remuneration report’.³³ For example, the Business Council of Australia submitted:

The proposal elevates the issue of the remuneration report above other key strategic issues to be decided by the board. The recommendation puts inappropriate power in the hands of minority shareholders and could be used for ulterior motives. These concerns are particularly acute should a low threshold be adopted for the second ‘trigger’.³⁴

Similarly, KPMG said:

The requirement for a full re-election of the board could be a costly and de-stabilising process. If directors were being turned over at a high rate, a company might suffer significant strategic damage due to lack of continuity at board level ... The potential cost and strategic damage that can arise in respect of a full board re-election can also result in a real risk that shareholders may be less inclined to vote ‘no’ in respect of a remuneration report.³⁵

However, the Productivity Commission referred to evidence of shareholder voting patterns to demonstrate that shareholders are able to distinguish between remuneration and broader concerns about board performance.³⁶ Nonetheless, it also went on to suggest that in order not to inadvertently discourage shareholders from voting ‘no’ on the remuneration report, there might be an ‘opt out’ option from an otherwise automatic trigger to re-elect some or all directors. It noted that the ASX suggested that at the time shareholders voted on the ‘second’ remuneration report, ‘they could be given an opportunity to indicate whether, in the event the second strike were triggered, they also wished to vote to re-elect directors’.³⁷

In its submission to the Productivity Commission, the Business Council of Australia also suggested that requiring directors to stand for re-election over remuneration issues ‘may result in them not submitting for re-election—with detrimental implications for board capacity and experience,

30. Ibid., pp. 296—297 (including Table 9.2).

31. Ibid.

32. Ibid., p. 283 (Table 9.1).

33. Ibid., p. 296.

34. Ibid., p. 298.

35. Ibid.

36. Ibid., p. 297.

37. Ibid., p. 299.

succession planning and board performance’.³⁸ Nonetheless, the Productivity Commission expressed its own view that many directors ‘being in the latter years of their business careers’ are likely to hold directorships for non-pecuniary reasons. It also discussed submissions relating to the issue of whether increasing the consequences of a ‘no’ vote would lead to the homogenisation (‘vanillaisation’) of remuneration practices across companies, before concluding that it would be up to individual boards to convince their shareholders of the benefits of pay structures that differ from a form they prefer.³⁹

Ultimately the Productivity Commission recommended (Recommendation 15) that the ‘two strike’ approach should be adopted, but suggested that the vote on whether the board should be re-elected should be decoupled from the vote on the remuneration report.⁴⁰ It said: ‘This “two strikes and resolution” variant would reduce the potential for conflation effects impacting on the vote on the remuneration report, as well as avoiding the situation of an unnecessary extraordinary general meeting’.⁴¹ Having considered a number of submissions on the issue, it also recommended that the two remuneration report voting triggers should be set at 25 per cent (rather than the 50 per cent level suggested by some participants, including the ASX).

In full, the Productivity Commission recommended (Recommendation 15) that:

The *Corporations Act 2001* should be amended such that:

- where a company’s remuneration report receives a ‘no’ vote of 25 per cent or more of eligible votes cast at an annual general meeting (AGM), the board be required to explain in its subsequent report how shareholder concerns were addressed and, if they have not been, the reasons why
- where the subsequent remuneration report receives a ‘no’ vote of 25 per cent or more of eligible votes cast at the next AGM, a resolution be put that the elected directors who signed the directors’ report for that meeting stand for re-election at an extraordinary general meeting (the re-election resolution).

Notice of the re-election resolution would be contained in the meeting papers for that AGM. If it were carried by more than 50 per cent of eligible votes cast, the board would be required to give notice that such an extraordinary general meeting will be held within 90 days.

Item 13 of Schedule 1 to the Bill deals with the ‘two strikes and resolution’ process in essentially the same terms as Recommendation 15—although the Bill provides greater detail about the process than the Productivity Commission did in its recommendation. It inserts **proposed Division 9** into

38. Ibid.

39. Ibid., pp. 300–301.

40. Ibid., p. 389.

41. Ibid. The Productivity Commission suggested that a re-election resolution proposal could be included in the papers for the AGM. This has been taken up in the Bill: see proposed (revised) subsection 249L(2) in item 9 of Schedule 1 to the Bill.

Part 2G.2 of the Corporations Act to deal specifically with ‘meetings arising from concerns about remuneration reports’.⁴²

Proposed section 250U states that the Division will apply in relation to a listed company if at least 25 per cent of the votes cast on two consecutive resolutions that the remuneration report be adopted were against the company, and a resolution was not put to the vote at the earlier AGM under an earlier application of (proposed) section 250V.

Proposed subsection 250V(1) states that at the second/later AGM, a resolution (called the ‘spill resolution’) must be put to the vote. The spill resolution provides that:

- another meeting (‘the spill meeting’) of the company’s members will be held within 90 days
- all the company’s directors who were the company’s directors when the resolution to make the directors’ report considered at the later AGM was passed (and who are not a managing director of the company and who, under the relevant listing rules for the company, continue to hold office indefinitely without being re-elected to the office) cease to hold office immediately before the end of the spill meeting, and
- resolutions to appoint person to offices that will be vacated immediately before the end of the spill meeting will be put to the vote at the spill meeting.

Proposed subsection 250V(2) states that (proposed) subsections 250R(4)–(10) and other provisions of the Corporations Act that relate to those provisions apply in relation to the spill resolution in the same way as they apply in relation to a resolution that a remuneration report be adopted. In other words, key management personnel and their closely related parties are ineligible to vote on a spill resolution.

Proposed section 250W sets out the consequences of a spill resolution being passed. For example, the spill meeting must be held within 90 days of the passing of the spill resolution, but the requirements of section 249HA (amount of notice of meetings of listed companies) and other relevant provisions of the Corporations Act must be complied with. If the spill meeting is not held within the 90 day period, each person who is a director of the company at the end of the 90 day period commits an offence.⁴³ However, no offence is committed if before the end of the 90 day period, none of the company’s directors who were the company’s directors when the resolution to make the directors’ report considered at the later AGM was passed (and who are not a managing director of the company who under the relevant listing rules for the company continue to hold office indefinitely without being re-elected to the office) remain as directors of the company.⁴⁴

Proposed section 250X applies if there would otherwise be fewer than three directors immediately after the spill meeting.

42. Chapter 2 of the Corporations Act deals with meetings. Part 2G.2 deals specifically with meetings of members of companies.

43. **Proposed subsection 250W(5)** of the Corporations Act.

44. **Proposed subsections 250W(4) and (6)** of the Corporations Act.

Proposed section 250Y states that if a director who ceased to hold office immediately before the end of the spill meeting is appointed as a director by resolution passed at the spill meeting, his or her term of office runs as if the cessation and (re)appointment had not happened.⁴⁵

Ban on hedging remuneration of key management personnel

The Productivity Commission received a number of diverse opinions on the issue of whether directors should be banned from hedging incentive payments or unvested equity. For example:

- the Finance Sector Union and the Australian Council of Super Investors (ACSI) argued that the practice should be expressly prohibited—although the Australian Institute of Company Directors (AICD) said that the corporations and other black-letter law ‘might not prove effective given the complexities of hedging arrangements, and the difficulties in legislating for all possible vesting conditions and trading limitations’
- Chartered Secretaries Australia (CSA) and Macquarie Group argued that executives should be permitted to hedge vested remuneration—with CSA also suggesting that directors should disclose any hedging of shares, and
- CGI Glass Lewis and Guerdon Associates argued that hedging of vested equity without holding locks⁴⁶ should be permitted.⁴⁷

The Productivity Commission noted that it neither received, nor found, evidence that would enable it to assess the extent to which hedging of unvested entitlements occurs.⁴⁸ However, Woolworths and BlueScope Steel reported that they did not allow the practice to occur in their companies.⁴⁹

Ultimately, the Productivity Commission recommended (Recommendation 5) that companies should prohibit their executives from hedging unvested equity remuneration or vested equity subject to holding locks. In this regard, it said:

Performance-based pay structures are expressly designed to expose executives to company-specific risk in order to concentrate their efforts on driving performance. Hedging incentive payments can allow executives to effectively transform ‘at risk’ pay to fixed pay, undermining the intent of their contracts ... Shareholder confidence in remuneration practices

45. Note that under **proposed subsection 250X(5)**, the company must confirm the reappointment by resolution at the company’s next AGM.

46. A ‘*holding lock*’ is a facility that prevents securities from being deducted from, or entered into, a holding (of units in a particular security) pursuant to a transfer or conversion. See Australian Securities Exchange (ASX), ‘Glossary’, website, 16 February 2011, viewed 16 March 2011, <http://www.asx.com.au/glossary/index.htm#H>

47. Productivity Commission, *Executive Remuneration in Australia*, op. cit., p. 229. Note that ACSI also suggested that the Corporations Act should be amended to require disclosure of any hedging of vested equity.

48. *Ibid.*, p. 228.

49. *Ibid.*

would be strengthened if the potential for a misalignment of interest between companies and executives were reduced.⁵⁰

Item 8 inserts **proposed Part 2D.7** into the Corporations Act to ban hedging of remuneration by key management personnel. Proposed Part 2D.7 currently only contains one provision: **proposed section 206J** (titled ‘No hedging of remuneration of key management personnel’).

Proposed subsection 206J(1) states that a member of the key management personnel for a company that is a disclosing entity⁵¹ (or a closely related party of such a member)⁵² must not enter into an arrangement with anyone if the arrangement would have the effect of limiting the exposure of the member to risk relating to an element of the member’s remuneration that has not yet vested in the member or has vested in the member but remains subject to a holding lock. For example, remuneration that is not payable to a member until a particular day is, until that day, remuneration that has not vested in the member.⁵³ The provision may also apply to shares or options that have not yet vested in the member.

Regard must be had to the regulations when determining if an arrangement has the effect mentioned in proposed subsection 206J(1).⁵⁴ A member of a company’s key management personnel who contravenes proposed subsection 206J(1) commits an offence.⁵⁵ The offence is one of strict liability, which means that the prosecution does not need to prove the member’s intent.⁵⁶ The offence carries a maximum penalty of 60 penalty units (or \$6600).⁵⁷

If a closely related party of a member of a company’s key management personnel contravenes proposed subsection 206J(1) and the member is reckless as to the contravention, then he or she also commits an offence.⁵⁸ A closely related party commits an offence if he or she intentionally contravenes proposed subsection 206J(1).⁵⁹

50. Ibid., p. 371.

51. Subsection 111AC of the Corporations Act states that if any securities of a body (except interests in a managed investment scheme) are enhanced disclosure securities, the body is a disclosing entity for the purposes of the Act: see http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s111ac.html

52. The term ‘closely related party’ is to be defined in section 9 of the Corporations Act. See item 1 of Schedule 1 to the Bill, as discussed in footnote 24 above.

53. **Proposed subsection 206J(2)** of the Corporations Act.

54. **Proposed subsection 206J(3)** of the Corporations Act.

55. **Proposed subsection 206J(4)** of the Corporations Act. See also **item 22 of Schedule 1** to the Bill which inserts a reference to this offence into the table in Schedule 3 to the Corporations Act.

56. See section 6.1 of the Criminal Code.

57. See **item 22 of Schedule 1** to the Bill which inserts a reference to this offence into the table in Schedule 3 to the Corporations Act.

58. **Proposed subsection 206J(6)** of the Corporations Act. See also **item 22 of Schedule 1** to the Bill which inserts a reference to this offence into the table in Schedule 3 to the Corporations Act.

59. **Proposed subsection 206J(7)** of the Corporations Act. See also **item 22 of Schedule 1** to the Bill which inserts a reference to this offence into the table in Schedule 3 to the Corporations Act.

However, ASIC may declare in writing that proposed subsection 206J(1) does not apply to a specified arrangement—but it may do so only if ASIC is satisfied that the operation of that provision would be unreasonable in the circumstances. The declaration is not a legislative instrument.⁶⁰ The note to this provision states that a defendant bears the evidential burden of proving that ASIC made the declaration.⁶¹

The ‘no-vacancy’ rule

ASX Listing Rule 14.4 states that a director (other than a managing director) must not (without re-election) hold office for more than three years.⁶² ASX Listing Rule 14.5 requires that an entity that has directors must hold an election every year.⁶³ However, some company boards arbitrarily set the number of directors at any given time at a number that is less than that permitted by the company’s constitution.⁶⁴ This practice is called the ‘no vacancy’ rule. Where it is invoked, an outside candidate may still nominate for a position on the board (in competition with other directors who are seeking re-election) but must receive at least 50 per cent of the vote.

Apart from the Productivity Commission’s inquiry in 2009, the ‘no vacancy’ rule was recently considered as part of an inquiry by the Parliamentary Joint Committee on Corporations and Financial Services (the Parliamentary Committee) in 2008 into shareholder engagement and participation in Australia. The Parliamentary Committee found that ‘board patronage and dominance by an entrenched few is unhealthy for the good corporate governance of any company and contrary to the interests of shareholders’.⁶⁵ It recommended (Recommendation 19) that ‘ASIC should develop a best practice guide to company constitutional recommendations and practice governing the nomination and election of directors’.⁶⁶

The Productivity Commission also received a number of submissions on this issue. It noted that the ‘average (board-endorsed) incumbent typically receives a 96 per cent “yes” vote’⁶⁷, and queried whether a change in the law would have much practical difference on board diversity.⁶⁸ Nonetheless, it found that in the interests of encouraging shareholder participation, it was important that ‘the mechanism that enables shareholders to vote for and against directors works effectively’.⁶⁹ It therefore recommended (Recommendation 1) that where, in an election of directors at an annual

60. **Proposed subsection 206J(8)** of the Corporations Act.

61. See subsection 13(3) of the Criminal Code.

62. See footnote 16.

63. Ibid.

64. Productivity Commission, *Executive Remuneration in Australia*, op. cit., p. 367.

65. Parliamentary Joint Committee on Corporations and Financial Services, *Better shareholders – Better company: Shareholder engagement and participation in Australia*, report, June 2008, p. 59, viewed 16 March 2011, http://www.aph.gov.au/senate/committee/corporations_ctte/sharehold/report/report.pdf

66. Ibid., p. 60.

67. Productivity Commission, *Executive Remuneration in Australia*, op. cit., p. 163.

68. Ibid., p. 164.

69. Ibid. p. 165.

general meeting (AGM), the board seeks to declare no vacancies and the number of directors is less than the maximum permitted by the company's constitution, approval of the lower limit should be sought from shareholders by way of ordinary resolution at that AGM.

Item 30 of Schedule 1 to the Bill inserts **proposed Subdivision B** into Division 1 of Part 2D.3 of the Corporations Act to deal with the issue of limits on the numbers of directors of public companies.⁷⁰

Proposed Subdivision B will apply to a public company if its constitution allows its directors to set a limit (a 'board 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.⁷¹

Proposed section 201P states that directors must not set a board limit unless:

- a general meeting of the company has passed a resolution (a 'board limit resolution') approving the proposal to set the limit specified in the resolution
- the notice of the meeting set out an intention to propose the board limit resolution and stated the resolution, and
- the notice was accompanied by a statement explaining the resolution and meeting requirements in (proposed) section 201Q.⁷²

If the procedure in proposed section 201P is not followed, the board limit and anything done in reliance on it have no effect for the purposes of the company's constitution or the Corporations Act: **proposed section 201U**. It is not an offence to contravene the procedure⁷³, but if the company or a person who would otherwise have stood as a candidate for a board election suffers loss or damage because of the setting of the board limit in contravention of (proposed) section 201P(1), then the company or the person may institute proceedings in the Court.⁷⁴

70. Part 2D.3 of the Corporations Act deals with the appointment, remuneration and cessation of appointment of directors; Division 1 of Part 2D.3 deals specifically with the appointment of directors.

71. **Proposed section 201N** of the Corporations Act.

72. **Proposed section 201Q** sets out the requirements for an explanatory statement to members. It provides that the statement accompanying the notice of a general meeting stating an intention to propose the board limit resolution must be in writing and set out 'clearly, concisely and effectively' (a) the directors' reasons for proposing the board limit resolution and (b) all other information that is reasonably required by members 'in order to decide whether or not it is in the company's interests to pass the proposed board limit resolution' and is known to the company or to any of its directors. However, the requirement for the statement to set out 'all other information' that is known to any of the company's directors may be difficult to enforce, given that individual directors may have varying levels of knowledge of relevant information. Note that section 1309 of the Corporations Act contains offences where false and misleading information relating to a corporation's affairs is made available or furnished to members: see http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1309.html (viewed 14 March 2011).

73. **Proposed subsection 201U(7)** of the Corporations Act.

74. **Proposed subsections 201U(5) and (6)** of the Corporations Act. Section 1325 deals with the orders that the Court can make to compensate the suffering party (including the company) for the loss: see http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1325.html (viewed 14 March 2011).

If a poll is duly demanded on the question that the board limit resolution be passed, the company must keep written records, including the following details:

- for each member of the company who votes on the poll in person—the member’s name and how many votes he or she casts for and against the resolution
- for each member who votes on the poll by proxy (or by a representative authorised under section 250D)⁷⁵—the member’s name, and (for each proxy), the person’s name, how many votes he or she casts on the resolution as a proxy (or representative) for the member, and how many of those votes are for and against the resolution.⁷⁶

Failure to keep these written records is an offence that carries a maximum penalty of five penalty units.⁷⁷

The company must lodge a notice setting out the text of the board limit resolution within 14 days of the resolution being passed.⁷⁸

If an interested person applies to the Court, the Court may declare that a requirement set out in (proposed) sections 201Q, 201R or 201S has been satisfied if it finds that the requirement has been ‘substantially satisfied’.⁷⁹

Voting by proxies (where the appointment specifies how the proxy is to vote)

The Productivity Commission recommended (Recommendation 7) that proxy holders should, except in exceptional circumstances, be required to cast all their directed proxies on remuneration reports and related resolutions, adding that it ‘sees merit in this recommendation applying to other resolutions’. It explained the need for reform in this area as follows:

75. Section 250D of the Corporations Act provides that a body corporate may appoint an individual as a representative to exercise all or any of the powers the body corporate may exercise. See the full text of section 250D at http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s250d.html (viewed 14 March 2011).

76. **Proposed section 201R** of the Corporations Act.

77. See **item 32 of Schedule 1** to the Bill which inserts a reference to the offences in **proposed subsections 201R(2) and (3)** into the table in Schedule 3 to the Corporations Act. A court could impose a maximum fine of \$550 (where the offender is an individual) or \$2750 (where the offender is a body corporate). See also subsection 1311(1) of the Corporations Act which states that a person who does an act or thing that the person is forbidden to do by or under a provision of this Act, or does not do an act or thing that the person is required or directed to do by or under a provision of this Act, or otherwise contravenes a provision of this Act, is guilty of an offence by virtue of this subsection, unless that or another provision of this Act provides that the person is (or is not) guilty of an offence. See http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1311.html (viewed 14 March 2011).

78. **Proposed section 201S** of the Corporations Act.

79. **Proposed section 201T** of the Corporations Act. The term ‘Court’ (when it appears with a capital ‘C’) is defined in section 58AA of the Corporations Act to mean the Federal Court, the Supreme Court of a State or Territory, the Family Court of Australia, or a State Family Court. See http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s58aa.html (viewed 14 March 2011).

Non-chair proxies are not obliged to exercise all their directed proxies and can vote shares that support their view on a resolution, while ignoring other directed proxies. Such ‘cherry picking’ lacks transparency and reduces the effectiveness of shareholder voting.

This proposal was initially recommended in June 2005 by the Joint Parliamentary Committee on Corporations and Financial Services Committee in its *Report on the Inquiry into the Exposure Draft of the Corporations Amendment Bill (No.2) 2005*.⁸⁰ At that time, the proposal had bi-partisan support.⁸¹

Then, in 2008, the issue of cherry picking was again examined by the Parliamentary Joint Committee on Corporations and Financial Services as part of its inquiry into shareholder engagement and participation.⁸² Among other things, it recommended (Recommendation 14) that the Government should amend the Corporations Act to prevent non-chair proxy holders from cherry picking votes.⁸³

Item 34 of Schedule 1 to the Bill inserts two new provisions dealing with proxy votes where the appointment of the proxy specifies how the proxy is to vote.⁸⁴

Proposed subsection 250BB(1) states that if the appointment of a proxy specifies the way the proxy is to vote on a particular resolution, then:

- the proxy need not vote on a show of hands (but if the proxy does vote, he or she must vote according to the appointment)
- if the proxy has two or more appointments that specify different ways of voting on a resolution—the proxy must not vote on a show of hands
- if the proxy is the chair of the meeting at which the resolution is voted on—the proxy must vote on a poll according to the appointment), and
- if the proxy is not the chair—the proxy need not vote on the poll (but if the proxy does vote, he or she must vote according to the appointment).⁸⁵

80. Details of the inquiry by the Parliamentary Joint Committee on Corporations and Financial Services into the Exposure Draft of the Corporations Amendment Bill (No. 2) 2005 are available at http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/2004-07/amendment_bill_2/index.htm (viewed 16 March 2011).

81. *Ibid.*, including the Labor Members Minority Report at pp. 27–28. See also Senator G Chapman (then Liberal Senator for South Australia and Chairman of the Joint Parliamentary Committee on Corporations and Financial Services), *Corporate governance reforms welcome – Committee Chairman*, media release, 8 December 2005, viewed 16 March 2011, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2F5PAI6%22>

82. Parliamentary Joint Committee on Corporations and Financial Services, *Better shareholders – Better company: shareholder engagement and participation in Australia*, op. cit.

83. *Ibid.*, p. 48.

84. **Item 33 of Schedule 1** to the Bill repeals existing subsections 250A(4), (5) and (5A) of the Corporations Act as a precursor to the insertion of **proposed sections 250BB and 250BB** by **item 34 of Schedule 1** to the Bill.

85. Note that a company’s constitution may provide that a proxy is not entitled to vote on a show of hands: see subsection 249Y(2) of the Corporations Act at http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s249y.html (viewed 14 March 2011).

If the chair contravenes **proposed subsection 250BB(1)**, the chair commits an offence if the appointment of the proxy resulted from:

- the company sending to members a list of persons willing to act as proxies (or a proxy appointment form holding the chair out as being willing to act as a proxy) or
- the operation of (proposed) section 250B.⁸⁶

If a person other than the chair contravenes **proposed paragraphs 250BB(1)(a) or (d)**, he or she commits an offence if he or she agreed to the appointment or held himself/herself out (or caused another person to hold him or her out) as being willing to act as a proxy in relation to the appointment.⁸⁷

If a person other than the chair has two or more appointments that specify different ways of voting on a resolution and does not abstain from voting on a show of hands, then he or she commits an offence if, in relation to at least two of the different ways of voting specified by the appointments, the person:

- agreed to at least one of the appointments specifying that way of voting, or
- held himself or herself out (or caused another person to hold him or her out) as being willing to act as a proxy in relation to at least one of the appointments specifying that way of voting.⁸⁸

The offences in **proposed section 250BB** are strict liability offences, which means that the intention of the person accused of committing the offence does not need to be proved.⁸⁹ They carry a maximum penalty of five penalty units (or \$550 for an individual).⁹⁰

Proposed section 250BC provides for the transfer of proxy votes to the chair if:

- an appointment of a proxy specifies how the proxy is to vote on particular resolution
- the appointed proxy is not the chair of the meeting
- at the meeting, a poll is duly demanded on the question that the resolution be passed, and
- either the proxy is not recorded as attending, or does not vote on the resolution.

Conclusion

In 2009, the Productivity Commission conducted an inquiry into executive remuneration in Australia and made 17 recommendations. The Bill gives effect to the recommendations that were directed to

86. **Proposed subsection 250BB(2)** of the Corporations Act.

87. **Proposed subsection 250BB(3)** of the Corporations Act.

88. **Proposed subsection 250BB(4)** of the Corporations Act.

89. **Proposed subsection 250BB(5)** of the Corporations Act.

90. **Item 36 of Schedule 1** to the Bill inserts a reference to the offences in **proposed subsections 250BB(2), (3) and (4)** into the table in Schedule 3 to the Corporations Act in place of the current reference to subsection 250A(5), which is to be repealed by item 33 of Schedule 1 to the Bill.

the Government and deal with corporations law. It does not deal with those recommendations that were specifically directed to ASIC or third parties. The Bill contains much greater detail than the Productivity Commission's recommendations. In late 2009/early 2010, the public had an opportunity to make submissions to the Treasury on draft exposure legislation. However, some major interest groups (such as the Australian Institute of Company Directors (AICD)) remain dissatisfied with certain aspects of the Bill—even though some of their suggestions have been taken up in full or in part in the current Bill.

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