Parliamentary Joint Committee
on Corporations and Financial Services

CLERP (Audit Reform and Corporate Disclosure) Bill 2003

PART 1

Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters.

June 2004

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DUTIES OF THE COMMITTEE

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the duties of the Committee as follows:

The Parliamentary Committee's duties are:

(a) to inquire into, and report to both Houses on:

  (i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

  (ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

TERMS OF REFERENCE

On 8 October 2003, the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into and report on the exposure draft bill, CLERP (Audit Reform and Corporate Disclosure) Bill, and relevant related matters.

The Committee was aware that legislation based on the exposure draft might be introduced into Parliament before it could complete its inquiry. In calling for submissions, the Committee explained that should the draft bill be superseded by the introduction of legislation into Parliament, the Committee would welcome additional comments on the differences between the exposure draft bill and the legislation.

As anticipated, on 4 December 2003, the CLERP (Audit Reform & Corporate Disclosure) Bill 2003 was introduced into Parliament. On 11 March 2004, the Committee resolved that it would broaden its terms of reference to examine this Bill.

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REVISION OF PENALTIES INCLUDING PENALTIES FOR INDIVIDUALS BREACHING THE CONTINUOUS DISCLOSURE PROVISIONS

ACRONYMS AND ABBREVIATIONS

AASB	Australian Accounting Standards Board
ACCC	Australian Competition and Consumer Commission
ACSI	Australian Council of Super Investors Inc
AGM	Annual General Meeting
AICD	Australian Institute of Company Directors
AIRA	Australasian Investor Relations Association
ALRC	Australian Law Reform Commission
APS	Australian Public Service
ASA	Australian Shareholders' Association Ltd
ASC	Australian Securities Commission
ASFA	Association of Superannuation Funds of Australia Limited
ASIC	Australian Securities and Investments Commission
ASX	Australian Stock Exchange
AWU	Australian Workers' Union
BCA	Business Council of Australia
CAB	Corporations Amendment Bill 2002
CASAC	Companies and Securities Advisory Committee
CAMAC	Corporations and Markets Advisory Committee
CEO	Chief Executive Officer
CGI	Corporate Governance International Pty Ltd
CLERP	Corporate Law Economic Reform Program
CPA	Chartered Professional Accountants
CSA	Chartered Secretaries Australia
CUSCAL	Credit Union Services Corporation (Australia) Limited

FSU	Finance Sector Union of Australia
ICAA	Institute of Chartered Accountants in Australia
IFSA	Investment and Financial Services Association Limited
NIA	National Institute of Accountants
OECD	Organisation for Economic Cooperation and Development
SDIA	Securities & Derivatives Industry Association
SIA	Securities Institute of Australia
TI Australia	Transparency International Australia

PART 1

This report forms Part 1 of a two part report and covers a range of topics including:

- the proposed protection scheme for employees reporting breaches;
- the remuneration of directors and executives—disclosure in the remuneration report, options and equity schemes, termination payments and shareholders non-binding votes;
- the proposed infringement notices for alleged contraventions of the continuous disclosure provisions;
- individuals liable for contraventions of the continuous disclosure provisions;
- shareholder participation including notices of meeting, proxy voting, institutional investors and voting practices, and the 100-member rule;
- management of conflict of interests; and
- political donations and beneficial ownership.

Part 2 of the report covers auditing and financial reporting and will be tabled separately from Part 1.

The Committee received additional information after the report had been finalised. In particular, it received answers to a number of questions taken on notice by Treasury and ASIC. They will be tabled with the report but are also included in appendix 5 and 6.

EXECUTIVE SUMMARY

This report forms Part 1 of a two part report on the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003.

The release in September 2002 of a policy proposal paper heralded the beginning of the next round of the Government's Corporate Law Economic Reform Program. This phase (CLERP 9) was intended to build on previous reforms. In October 2003, as a further step toward completing the CLERP 9 process, the Government released an exposure draft of the CLERP (Audit Reform & Corporate Disclosure) Bill. Finally, on 4 December 2003, a bill was introduced into Parliament which according to the Treasurer 'generally implements the reforms proposed in the CLERP 9 policy proposal paper released in September 2002 and also refects the outcome of consultations since that time.'[1]

The Parliamentary Joint Committee on Corporations and Financial Services, which has had a long and active involvement in the development and implementation of the Government's comprehensive economic reform program, resolved to inquire into the CLERP 9 bill.

Overall, submissions to the inquiry supported the thrust of the reforms put forward in CLERP 9.[2] The Australian Shareholders' Association was one of a number of submissions that welcomed the changes in the proposed legislation.[3] Chartered Secretaries Australia and its members believed that in general the provisions in CLERP 9 would 'make a significant contribution to restoring investor confidence in Australia'. In its view the proposals reinforce 'existing good practice', rather than impose 'a straitjacket on corporate behaviour'.[4] The ANZ maintained that the reforms arrived at 'a sensible balance between corporate disclosure, raising audit standards, and enhancing opportunities for shareholder engagement'.[5]

Taking a similar view, the Securities Institute stated that the CLERP 9 legislation represents:

> a reasonable, balanced and considered initiative by the Government to improve transparency and disclosure in the financial reporting process, ensure quality and consistency in auditing services, foster accountability and

1 Peter Costello, *House Hansard*, 4 December 2003, p. 23761.

2 See for example Australian Council of Super Investors, *Submission* 5, p. 1, which recognised and supported 'the general thrust of the proposals to improve shareowner participation'. See also *Submission* 18, p. 1; *Submission* 19, p. 2; *Submission* 25, Executive Summary; *Submission* 30, p. 1.

3 *Submission* 22, p. 1.

4 *Submission* 8, p. 4.

5 *Submission* 14, p. 3.

> corporate governance awareness, promote an informed market and build investor confidence in our capital markets and in investing in Australian securities. [6]

The Finance Sector Union also generally supported the majority of the proposed reforms but as with many of the participants in this inquiry called for some improvements.[7] Indeed, some aspects of CLERP 9 provoked strong criticism. The following summary highlights the main areas of concern raised during the inquiry.

Whistleblowing

CLERP 9 contains provisions that would allow protected disclosures to be made to ASIC and within a company. The Committee accepts that the proposed whistleblower protection scheme is sketchy in detail but that the intention is quite clear. In its view, this area is one that will require further refinement. A number of questions remains unanswered particularly as to whether the scope of the scheme should be expanded to cover legislation outside corporations law. There is also scant information in either the legislation or the Explanatory Memorandum on the obligations of companies to ensure that they have in place a whistleblower scheme both to encourage the reporting of wrongdoing and to protect whistleblowers from unlawful reprisal. The Committee made a number of recommendations intended to offer greater encouragement for whistleblowers to come forward with information about suspected wrongdoing and for companies to investigate such reports.

Once the proposed whistleblower provisions come into operation, answers to the questions that it poses may become clearer. Indeed the longer term solution may be found in the development of a more comprehensive body of whistleblower protection law that would constitute a distinct and separate piece of legislation standing outside the Corporations Act and consistent with the public interest disclosure legislation enacted in the various states.

Executive remuneration

CLERP 9 proposes to amend provisions governing the disclosure of directors' and executives' remuneration. They are designed to strengthen the current provisions of the Corporations Act and address concerns about the lack of disclosure of payments made to directors and executives.

The Committee is firmly of the view that the Remuneration report should be a self-contained document providing all relevant information required under the executive remuneration disclosure provisions. It supports the proposed legislation in this regard. It draws attention, however, to the number of witnesses who expressed the importance

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6 *Submission* 11, p. [1].

7 *Submission* 38, p. [1]. The Finance Sector Union called 'for greater accountability to stakeholders, rather than just greater disclosure to shareholders.'

of having the legislation and the accounting standards complementary, of avoiding any potential for confusion between the two and of minimising duplication.

The Committee notes that a heavy reliance is to be placed on regulations to ensure that the intention of the legislation translates into corporate practice. Evidence to the Committee has revealed that a significant number of companies lack diligence in satisfying the current disclosure requirements especially in establishing the connection between executive rewards and performance. ASIC will have a key role in ensuring compliance with the current and proposed disclosure obligations.

The Committee sees a clear need for ASIC to take a strong and early stand in making known, as stated in the Explanatory Memorandum, that disclosure 'should explain the basis on which remuneration packages are structured and how this relates to corporate performance'. The generality of this provision should not be an excuse for companies, when making this disclosure, to avoid their obligation to present the information in a way that can be understood by shareholders.

Clearly the disclosure of options continues to be a contentious matter. The Committee has no doubts that the statements and guides issued by bodies such as the ASX and ASIC support the current legislation in trying to effect full disclosure of director and executive remuneration particularly in areas susceptible to non-compliance. Accounting standards will further assist the legislation in achieving full disclosure of director and executive remuneration especially in the areas where compliance needs to improve such as the issue and valuing of options. Their success in achieving full and meaningful disclosure will need to be monitored and assessed.

The Committee accepts that the nature of termination or retirement payments raises a number of important disclosure issues. Again it believes that the legislation should close off loopholes that would allow any retirement or termination rewards or benefits to escape the disclosure net. Furthermore, the Committee believes that disclosure requirements should ensure that shareholders are provided with information in a timely and easily comprehensible document that would enable them to obtain a sound understanding of all payments made to directors and senior executives including a full account of accrued benefits.

Non-binding vote on the remuneration report

CLERP 9 proposes to allow shareholders a non-binding vote on the remuneration report.

In light of the recent publicity given to executive remuneration and the public perception that boards have failed in their duty to restrain the size of executive payments, the Committee accepts that it is important for shareholders to have a more effective voice in the setting of executive remuneration and the determination of performance benchmarks. The Committee understands that allowing shareholders to have a non-binding vote on the remuneration report is an innovation that has given rise to fears about possible confusion even conflict between the traditional roles of the board as stewards of the company and the shareholders as owners of the company.

The Committee, however, is not convinced that the proposal may necessarily complicate or muddle these roles. It believes that a board in tune with the views and expectations of its shareholders, fully aware of the skills and experience needed in the company and capable of conveying such information to shareholders would not create discord by placing an unacceptable proposition before the shareholders.

The Committee also appreciates the argument that a non-binding vote has no real force except as an avenue for shareholders to express their views on the remuneration policy of their company. Again taking account of the apparent surprise and outrage with which the announcements of some executive remuneration packages have been received in recent times suggest that boards need to be made aware of shareholders opinions. A non-binding vote presents shareholders with an opportunity to place on the record their views to guide directors and inform them of their expectations.

At this stage the Committee does not support the view that the remuneration report should be subject to a binding vote of shareholders. It notes that the non-binding vote is new and suggests that a sensible approach is to allow the non-binding vote ample time to be tested for its effectiveness before any further reforms are considered.

While not persuaded of the merits of allowing shareholders to have a binding vote on the remuneration report, the Committee appreciates the value in requiring shareholder approval for equity based schemes. It therefore recommends that CLERP 9 be amended to include a provision that equity based schemes be subject to shareholder approval.

The Committee is concerned that the provision establishing the formula that would exempt a retirement benefit from requiring shareholder approval sets a relatively high benchmark that appears to sanction or even encourage termination payments that would fall just below that level.

The safeguard is the disclosure requirements which allow shareholders if dissatisfied with the remuneration package to express their disapproval and if sufficiently provoked to remove the board. Thus the Committee commends measures designed to strengthen disclosure particularly to ensure that shareholders have timely knowledge of a remuneration package in its entirety with all its assorted components presented clearly and concisely.

The Committee notes the anomaly in requiring shareholder approval for directors' remuneration but allowing an exemption for termination payments that fall below a specified threshold. This is particularly so when considering the distinct role of a director who is elected by shareholders to represent their interests. It seems inconsistent with this principle that directors should be able to set their own retirement benefits should they fall below a certain level without having shareholder approval. The Committee would prefer that shareholders approve the total package of directors' remuneration including benefits such as retirement or termination benefits.

The Committee believes that executive directors have no place in the determination of executive remuneration and should have no opportunity to influence the boards' decision about their remuneration. It notes that the ASX's Principles of Good Corporate Governance recommends the establishment of a remuneration committee and adds that no individual should be directly involved in deciding his/her remuneration. The Committee believes that this principle should be stated in more definite language and given greater prominence in the ASX's principles. It has recommended that the Government include in the Corporations Act a general principle that executive directors are not to be involved in determining their own remuneration unless there are reasonable grounds for that not to occur.

Infringement notices

CLERP 9 proposes to allow ASIC to issue infringement notices for breaches of the continuous disclosure provisions.

The Committee appreciates the advantages to be gained by allowing ASIC to issue an infringement notice for breaches of the continuous disclosure regime. It cannot, however, ignore the weight of opposition to the proposal particularly the concern about the perceived lack of safeguards to protect the rights of those deemed to have breached the continuous disclosure provisions and the conflicting functions of ASIC as investigator, prosecutor and judge. The number of adjustments made to the original proposal to make it accord with the separation of powers doctrine central to the Constitution have placed limits on the authority of ASIC. Whether these refinements are sufficient to satisfy constitutional requirements is unclear.

The Committee has made a number of recommendations designed to remedy what appears to be shortcomings in the provisions but accepts that uncertainty about the appropriateness of the proposal still lingers. It underlines the need for this proposal to be monitored closely and reviewed after two years.

Individuals liable for breaches of the continuous disclosure provisions

The Bill would make a person involved in a contravention of continuous disclosure provisions liable to a civil penalty.

The Committee understands the concerns expressed by witnesses about the possibility that the proposal may affect persons who do not have a significant role in the management of the corporation. It refers, however, to the wording in the Explanatory Memorandum which states that involvement in a contravention 'requires some form of intentional participation and actual knowledge of the essential elements of the contravention'. Furthermore, an individual involved in a contravention only faces a pecuniary penalty if the contravention is serious.

The Committee accepts that this explanation particularly the emphasis on 'intentional participation' and the requirement to have 'actual knowledge of the essential elements of the contravention' offers adequate assurance that people unwittingly involved in a contravention will not be prosecuted.

Promoting shareholder participation—notices of meetings and use of electronic technology

The Bill seeks to apply the 'clear, concise and effective' standard to notices of meetings and to facilitate the use of electronic communication to enhance shareholder participation in meetings.

The Committee supports the legislation but understands that there is tension between the object to be 'concise' and the need to ensure that all material information is contained in a document. The Committee notes the suggestions made about including a requirement in the legislation that a notice of meeting must state 'the nature of the business to be transacted at the meeting in sufficient detail to enable a shareholder to form a reasoned judgment'.

The Committee fully supports the use of modern technology to enhance shareholder participation. The Committee, however, would not like to see retail investors miss out on opportunities to exercise their rights because technology is leaving them behind. The Committee notes that at the moment the proposals stipulate that a member nominates to have notices of meeting transmitted electronically to him or her. The Committee endorses this requirement and fully supports the use of modern technology to enhance shareholder participation particularly through proxy voting.

Promoting shareholder participation—Proxy voting

Although CLERP 9 did not cover the proxy voting system, a number of witnesses expressed the view that certain measures should be taken to address what they believed are flaws in the current legislation.

The evidence considered by this Committee clearly indicates that the law needs to be revised to ensure that the voting intentions of shareholders through their proxyholder are carried out according to their instructions. The Committee was unable to conduct a thorough examination of the proxy voting system but the evidence suggests that such an examination with a view to amending the current provisions governing proxy voting is long overdue.

Institutional shareholders and voting

A number of witnesses raised the matter of institutional shareholders voting at meetings.

The Committee believes that there is merit in requiring institutional investors to disclosure how they voted at meetings including abstentions. It notes that the OECD advocates this approach. The Committee does not, however, endorse compulsory voting by institutional shareholders. Too many practical issues remain unresolved such as whether the requirement applies to all resolutions put before the meeting or selected matters and if so what particular matters require voting. There is also the difficulty for institutional investors in ascertaining the voting intentions of their members. A number of witnesses also mentioned the costs involved in complying with voting requirement though estimates of such costs were vague. Of most concern, however, was the concern over the quality of a mandatory vote with one witness referring to 'conscripting proxies'.

Managing conflicts of interest

The proposed legislation is intended to supplement the existing general duty to provide financial services 'efficiently, honestly and fairly' by imposing a new obligation regarding the management of conflicts of interest on financial services licensees.

The Committee was impressed with the forthright stance taken at first by ASIC in its response to the CLERP 9 policy proposal paper in 2002. It notes the certainty with which ASIC expressed its opinion that the existing disclosure regime applying to general advisers does not provide 'a sufficient framework for conflict disclosure, as it applies to analysts' reports'. It also notes:

- ASIC's view that 'the Act needs to prohibit certain activities of analysts where conflicts cannot be effectively managed, and disclosure of such conflicts is not sufficient to mitigate consumer or market integrity risk;' and
- ASIC's suggestion about imposing a disclosure obligation.

The Committee can see advantages in having the legislation stipulate certain disclosure requirements and particular circumstances that should or must be avoided. Clearly a ban sends an unmistakable message that certain conduct or situations will not be tolerated. As it stands, the legislation does not deliver that strong message. ASIC's policy statement is left with this task.

Political donations

During the course of the inquiry a number of matters were raised that are not contained in CLERP 9 though they relate to some of the fundamental principles that underpin the legislation—accountability, transparency and shareholder participation.

The Committee notes the support given to the concept that companies should disclose their policy on political donations. The Committee agrees that shareholders are entitled to know about their companies' conduct in regard to making donations. It also understands the opposition to the suggestion that the policy and the donations should be subject to shareholder approval.

Beneficial ownership

The Committee appreciates the arguments put forward to increase the transparency of company ownership by making available to shareholders the names of beneficial owners of their companies. The suggestion that companies if they have the information make it available to their shareholders appears reasonable, sensible and in the public interest.

Disclosure document—clear, concise and effective

The Committee understands that the requirement to present disclosure documents in a clear, concise and effective manner is open to subjective assessments. Even so, the Committee believes that the requirement provides a necessary reminder to financial services providers of their obligations to ensure that consumers are provided with information necessary for them to make an informed decision about financial products and to make the most appropriate choice for their needs.

Increasing the disqualification period for directors

It is the Committee's view that an increase in the period of disqualification for directors is appropriate but that further investigation is needed to establish whether the enforcement side of the disqualification provisions is working or could work more effectively.

The following section lists the recommendations contained in the report.

RECOMMENDATIONS

RECOMMENDATION 1

2.35 The Committee recommends that a provision be inserted in the Bill that would require corporations to establish a whistleblower protection scheme that would both facilitate the reporting of serious wrongdoing and protect those making or contemplating making a disclosure from unlawful retaliation on account of their disclosure. The Committee refers to Australian Standard AS8004—2003 as a starting point for corporations.

RECOMMENDATION 2

2.36 The Committee further recommends that ASIC publish a guidance note designed for all companies, using AS8004—2003 as a model, to help further promote whistleblowing protection schemes as an important feature of good corporate governance.

RECOMMENDATION 3

2.50 The Committee recommends that paragraphs 1317AA(1)(a)(iv) be amended to read 'an employee of a person who has contracted for services with, or the supply of goods to, a company'.

RECOMMENDATION 4

2.64 The Committee recommends that the threshold test of 'in good faith' be removed and replaced by 'an honest and reasonable belief'.

RECOMMENDATION 5

2.72 The Committee recommends that the provision stipulate that the report relate to 'a serious offence'.

RECOMMENDATION 6

2.78 The Committee recommends that the Government give serious consideration to providing for anonymous reports. It believes that by having the requirements that a person must have an honest and reasonable belief that an offence has or will be committed and that the offence is a serious offence is sufficient safeguard against frivolous or vexatious reporting.

RECOMMENDATION 7

2.82 The Committee recommends that a provision be inserted in the proposed whistleblowing scheme that expressly provides confidentiality protection to persons making protected disclosures to ASIC or making such disclosures to the designated authorities within a company. Similar provisions should be inserted to protect the rights of persons who are the subject of a disclosure.

RECOMMENDATION 8

2.90 The Committee believes that the Government should review the proposed penalty to be set down in Schedule 3 as item 338 to ensure that it is comparable with other jurisdictions and offences of a similar nature.

RECOMMENDATION 9

2.91 The Committee further recommends that a provision be inserted in the Bill that would allow ASIC to represent the interests of a person alleging to have suffered from an unlawful reprisal.

RECOMMENDATION 10

3.73 The Committee recommends that ASIC release as soon as possible a guide that leaves no doubt that the remuneration report is to contain a discussion on the board policy for determining the remuneration of its most senior executives which is to be presented in such a way that links the remuneration with corporate performance.

RECOMMENDATION 11

3.74 The Committee also recommends that the regulations to be promulgated under this section adopt the direct and specific language used in the Explanatory Memorandum and not the vagueness of the wording in the Bill. The Committee recommends that regulations make clear that what must be included in the remuneration report is information 'such as performance hurdles to which the payment of options or long term incentives of directors and executives are subject; why such performance hurdles are appropriate and the methods used to determine whether performance hurdles are met'.

RECOMMENDATION 12

4.36 The Committee recommends that the Government review the penalty provisions for contraventions of section 300A with a view to allowing a greater degree of flexibility in applying penalties especially for offences unlikely to satisfy the test that the contravention 'materially prejudices the interests of the corporation or materially prejudices the corporation's ability to pay its creditors or is serious or is dishonest'.

RECOMMENDATION 13

4.55 The Committee recommends that a new sub section 300(10)(d) be inserted in the Bill which would require the directors' report to include details of the qualifications and experience of each person who has held the position of company secretary during the reporting period.

RECOMMENDATION 14

5.10 The Committee recommends that the Government include in the Corporations Act a general principle that executive directors are not to be involved in determining their own remuneration unless there are reasonable grounds for that not to occur.

RECOMMENDATION 15

5.60 The Committee recommends that CLERP 9 be amended to include a provision that requires equity based schemes as a form of executive remuneration to be subject to shareholder approval.

RECOMMENDATION 16

5.82 The Committee recommends that all payments made to directors be subject to shareholder resolution including payments such as the maximum annual cash payment and any retirement benefit or termination payout.

RECOMMENDATION 17

6.112 The Committee notes the many concerns expressed about the proposed infringement notice regime. In particular, the Committee refers to the blurring of ASIC's functions of investigator and adjudicator. In light of these concerns, the Committee recommends that ASIC's guide on issuing infringement notices more fully explain and document the procedures it will adopt to ensure that there is a clear and definite separation of its responsibilities to investigate and to adjudicate.

RECOMMENDATION 18

6.134 The Committee recommends that CAMAC review the operation of the infringement notice provisions two years after they come into force. It recommends further that in light of comments suggesting that ASIC is not fully or effectively using its current powers to enforce the continuous disclosure provisions that the review take a broader approach and examine the effectiveness of the enforcement regime for continuous disclosure as a whole including the criminal and civil provisions.

RECOMMENDATION 19

6.135 The Committee recommends that a three-year sunset clause relating to the infringement notice provisions be inserted in the Bill.

RECOMMENDATION 20

7.53 The Committee recommends that Treasury make the submissions it receives on the draft due diligence defence publicly available.

RECOMMENDATION 21

8.56 The Committee recommends that the law be amended to ensure that the voting intentions of shareholders through their proxyholder are carried out according to their instructions.

RECOMMENDATION 22

8.57 The Committee recommends further that the provisions governing voting at meetings be reviewed by CAMAC with a focus on the matters that have been raised during the inquiry but which the Committee has not examined in depth. Including the disclosure of voting—numbers for, against and abstentions on each resolution before the meeting.

RECOMMENDATION 23

8.87 The Committee recommends that as best practice, institutional investors:

- include a discussion of their voting policies in their annual report which includes how they manage conflicts of interest in regard to their investments; and
- disclose their voting record in the annual report.

RECOMMENDATION 24

8.103 The Committee recommends that the 100 member rule for the requisitioning of a general meeting be removed from section 249D of the Corporations Act.

RECOMMENDATION 25

9.27 The Committee recommends that the Government examine carefully ASIC's submission to Treasury and its surveillance report on research analyst independence with a view to amending the provisions on managing conflicts of interests to provide clearer direction on circumstances that must be avoided and activities that must not be undertaken because of conflicts of interest.

RECOMMENDATION 26

10.10 The Committee recommends that provisions be inserted in the Corporations Act that would require the annual report of listed companies to include a discussion of the board's policy on making political donations.

RECOMMENDATION 27

10.20 The Committee recommends that the Government reinstate in the Act the requirement for listed companies to keep a public register of notices of beneficial ownership.

CHAPTER 1

INTRODUCTION

Establishment of the inquiry

1.1 The release in September 2002 of a policy proposal paper, *Corporate disclosure: Strengthening the financial reporting framework,* heralded the beginning of the next round of the Government's Corporate Law Economic Reform Program. This phase (CLERP 9) builds on a substantial body of previous reforms and is intended to 'ensure that Australia's corporate regulatory framework remains effective and helps define world's best practice'.[1]

1.2 The recent instances of unacceptable or irresponsible corporate conduct that have marred the reputations of some highly respected companies and corporate executives have trained the focus of this package of reforms on improving corporate governance.[2] The proposal paper, a high-level policy discussion document, covered a range of matters including accounting standards and practices, the audit function in Australia, the continuous disclosure regime, conflicts of interest in relation to the provision of financial product advice, the disclosure requirements for shares and debentures and ways to encourage investors to become more active in the companies in which they invest. In many cases, the paper did not go into specific details about the form that the reforms would take.

1.3 The Government sought comments from interested parties on the contents of the paper as a means to refine the proposals. In October 2003, as a further step toward completing the CLERP 9 process, the Government released an exposure draft of the CLERP (Audit Reform & Corporate Disclosure) Bill. Again the Government invited comment on the proposals contained in this document.

1.4 The Parliamentary Joint Committee on Corporations and Financial Services, which has had a long and active involvement in the development and implementation of the CLERP reform program, consequently announced on 14 October that it would conduct an inquiry into the draft bill and relevant related matters and called for submissions.

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1 Foreword to *Corporate disclosure: Strengthening the financial reporting framework,* September 2002.

2 See for example, Foreword to *Corporate disclosure: Strengthening the financial reporting framework,* September 2002. There are numerous references to, and examples of, corporate collapse and wrongdoing; J Segal, '*Corporate Governance: Substance Over Form', UNSW Law Journal*, vol. 25, no. 2, 2002, pp. 320–2; M. Fogarity and A. Lansley, 'Sleepers Awake! Future Directions for Auditing in Australia', *UNSW Law Journal,* vol. 25, no. 2, p. 408. Also Chapter 2, footnote 3.

1.5 The Committee was aware that legislation based on the exposure draft might be introduced into Parliament before it could complete its inquiry. In calling for submissions, the Committee explained that should the draft bill be superseded by the introduction of legislation into Parliament, the Committee would welcome additional comments on the differences between the exposure draft bill and the legislation.

1.6 As anticipated, on 4 December 2003 a bill was introduced into Parliament which, according to the Treasurer, 'generally implements the reforms proposed in the CLERP 9 policy proposal paper released in September 2002 and also refects the outcome of consultations since that time.' On 11 March 2004, the Committee resolved that it would broaden its inquiry to examine this Bill.

1.7 The Committee is mainly concerned with exploring areas of the proposed legislation that attracted significant comment. Thus, this report refers only briefly to matters which drew little attention or received general approval. Overall, this report:

- identifies the key issues of concern raised by people who presented both written and oral evidence to the inquiry on the proposed legislation;
- ascertains, where necessary, whether these concerns are addressed satisfactorily in the Bill—a number of issues raised dealt with matters considered by some witnesses as notable omissions from the proposed legislation; and
- recommends changes to the legislation to remedy what it found to be short comings in the legislation.

Conduct of the inquiry

1.8 The Committee advertised the inquiry in the *Australian Financial Review* and the *Australian* calling for written submissions to be lodged by 17 November 2003. The Committee also wrote to relevant Commonwealth Government ministers, State premiers and Territory chief ministers drawing attention to the inquiry and inviting submissions. In addition, the Committee contacted over 200 individuals and organisations, including business and professional associations, academics, trade unions and consumer groups alerting them to the Committee's inquiry.

1.9 The terms of reference and other information about the inquiry were also advertised on the Committee's internet homepage at http://www.aph.gov.au/senate/committee/.

1.10 A total of 65 submissions was received together with a substantial number of supplementary ones. A list of submissions is contained in Appendix 1.

1.11 Apart from the information contained in written submissions and in oral evidence presented to it, the Committee drew on a range of material contained in reports and reviews from various committees of inquiries and from comments and articles by people directly involved with various aspects of the Bill. A selected bibliography is presented at the end of this report.

1.12 After initial consideration of the submissions, the Committee commenced its program of public hearings in Canberra on 9 and 11 March 2004. They were followed by further hearings in Sydney and Melbourne. Details of the hearings and the witnesses who appeared at them are contained in Appendix 2. The Hansard transcript of evidence taken at the hearings was made available on the internet.

Structure of the report

1.13 The Bill ranges widely over many aspects of corporations law but the focus is heavily on corporate governance. The form of the Bill largely determined the structure of the report which comprises the following chapters:

Chapter 2: Protection for employees reporting breaches—whistleblowing

Chapter 3: Executive remuneration—the remuneration report

Chapter 4: Executive remuneration—full disclosure including options and termination payments

Chapter 5: Shareholder vote on executive remuneration

Chapter 6: Infringement notices for breaches of the continuous disclosure provisions

Chapter 7: Individuals liable for breaches of the continuous disclosure provisions

Chapter 8: Shareholder participation including 'clear, concise and effective notices, enhanced use of technology and proxy voting

Chapter 9: Conflicts of interests

Chapter 10: Related matters: disclosure of political donations and beneficial ownership

Chapter 11: Conclusion

Acknowledgments

1.14 The Committee wishes to express its appreciation to everyone who contributed to the inquiry by making submissions, providing additional information or appearing before the Committee at public hearings.

CHAPTER 2

WHISTLEBLOWING

Background to whistleblower protection

2.1 Over the past fifteen years there has been growing recognition in Australia of the role that an effective whistleblowing scheme can have in promoting good corporate conduct and in helping organisations identify and correct unsound work practices. A number of commissions and committees of inquiry held since the late 1980s have built up a solid body of evidence that employees, although well-placed to expose fraud, waste or mismanagement, feel highly vulnerable and are hesitant to come forward with damaging information because of fear of reprisal.[1]

2.2 Although concerned primarily with the public sector, the findings of these various inquiries into whistleblowing in Australia apply with equal force to the private sector and the Committee has taken note of the recommendations of these inquiries to draw its own conclusions.[2]

2.3 In effect, the inquiries found that people well-placed to sound an early warning signal to prevent or minimise wrongdoing in an organisation needed encouragement and reassurance to speak out. Advocates of whistleblowing protection schemes say legislation to protect whistleblowers will encourage those who can identify corporate wrongdoing to report it.

2.4 With this growing acceptance that employees could be a valuable tool in combating corruption, detecting wrongdoing and in bringing offenders to account came a push for a new approach to whistleblowing. Since the middle of the 1990s, the issue of whistleblowing has gathered widespread attention with the result that various states in Australia have introduced public interest disclosure legislation. Invariably that has been directed at the public sector, and this Bill might be considered to be ground-breaking in its attention to whistleblowing in the private sector.

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1 For a brief summary of these numerous inquiries see Appendix 5 to Finance and Public Administration Legislation Committee, *Public Interest Disclosure Bill 2001 [2002]*, September 2002, p. 95.

2 See Appendix 5 to the Senate Finance and Public Administration Committee's report, *Public Interest Disclosure Bill 2001 [2002],* September 2002, pp. 95–100. This provides a background to the development of Whistleblowing legislation in Australia.

Recent corporate failures

2.5 The latest spate of corporate failures has once again highlighted the problems created by a culture of corporate silence which allows wrongdoing to go undetected.[3] It has raised public awareness of the crucial role that personnel can have in uncovering corporate wrongdoing. Most recent studies into whistleblowing agree that change is needed on two main fronts—a cultural shift in attitudes toward whistleblowers and legislative reforms to both encourage and maintain this change:

> Unless culture, practice and the law indicate that it is safe and accepted for them to raise a genuine concern about corruption or illegality, workers will assume that they risk victimisation, losing their job or damaging their career.[4]

2.6 Mr Sitesh Bhojani, Commissioner, Australian Competition and Consumer Commission (ACCC), recently endorsed the views of the National Association of Retail Grocers of Australia which had commented on the key role that whistleblowers can play in the enforcement of laws. It had stated:

> If whistleblowers are to be protected against the considerable risks to them personally and their career, then further specific statutory protection must be afforded to them. Employee whistleblowers often have very credible, first hand experience of the entity's wrongdoing and such evidence may be crucial in bring successful proceedings against the entity…[5]

2.7 The USA, with the introduction of the Sarbanes-Oxley Act in 2002, acknowledged that a new approach was needed to combat corporate crime and turned attention to whistleblowing as a means to pull back the veil of secrecy hiding corruption.[6] This Act creates federal protection for employees of public companies when they act lawfully to disclosure information about fraudulent activities within their company or assist criminal investigators in detecting and stopping fraud. The Act requires that the employee need only 'reasonably believe' that the action would constitute a violation of the law. No company, officer, employee or contractor,

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3 There are numerous articles on this subject of recent corporate collapses. See for example, Professor Jean J du Pleissis, 'Reverberations after the HIH and other recent Australian corporate collapses: The role of ASIC', *Australian Journal of Corporate Law,* vol 15, 2003, pp. 225–45. The Hon Justice Neville Owen, *Corporate Governance—Level upon Layer, 13th Commonwealth Law Conference,* Melbourne, 2003. See also chapter 1, footnote 2.

4 OECD Labour/management Programme, *Whistleblowing to Combat Corruption,* http://www.pcaw.co.uk_policy/oecdreport.html 14 September 2001.

5 Sitesh Bhojani, 'Should Whisleblowing be encouraged and protected and is it?', Transparency International Australia Presents: 'Whistleblowing: Betrayal or Public Duty', Sydney, 6 August 2002.

6 The USA took a leading role in developing legislation to deal with public interest disclosure. The first measures to deal with public interest disclosure were mainly concerned with environmental protection or health and safety matters.

subcontractor or agent of the company may discriminate against an employee in the terms and conditions of employment because of any lawful act by the employee.[7]

2.8 Some saw this move as 'a significant advance for employees in the private sector, many of whom have had little protection if they protest or expose an employer's illegal financial practices'.[8]

2.9 Australia has also witnessed a number of corporate collapses which have shaken public confidence in the integrity of the market. One advocate of whistleblower legislation argued that although the Corporations Act imposes many statutory obligations on members of the corporate world to step forward to inform the Australian Securities and Investments Commission (ASIC) of possible breaches of the law, it 'falls far short of a comprehensive whistleblowing code for the financial sector'.[9]

Policy proposal paper—first consultation period

2.10 Prompted by the same concerns about promoting good corporate governance and enhancing investor confidence in the markets, the Australian Government has moved to introduce a whistleblowing scheme. The broad framework for the scheme was outlined in the policy proposal paper released by Treasury in September 2002.

2.11 This paper made plain that the Government proposed to amend the law to provide qualified privilege and protection against retaliation in employment for any company employee reporting a suspected breach of the law to ASIC in good faith and on reasonable grounds.[10] Clearly, at this early stage in formulating an employee protection scheme, the intention was quite specific—to assist ASIC with enforcing the Corporations Act. The term whistleblower was not used in the policy paper.

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7 According to the discussion paper 'In the United States, the Sarbanes-Oxley Act contains penalties of fines or imprisonment for up to ten years for employers who knowingly, with the intent to retaliate, take action against an informant, including interference with his or her employment, or livelihood, for providing truthful information to a law enforcement officer about matters relating to the commission or possible commission or a federal offence'. There is also a provision that allows civil action for compensation to be taken by employees if they have been victimised by their employer due to their lawful activities in assisting investigators with corporate fraud. *Corporate disclosure: Strengthening the financial reporting framework,* Commonwealth of Australia, 2002.

8 See for example J. Ben-Asher et al "Whistleblower Protections under Sarbanes-Oxley', American Bar Association, Section of Labor and Employment Law, Committee on Employment Rights and Responsibilities, Mid-Winter Meeting, March 2003.

9 Paul Latimer, 'Whistleblowing in the Financial Services Sector', *Law School, University of Tasmania,* vol. 21, no. 1, 2002, p. 48.

10 Proposal 35, *Corporate disclosure: Strengthening the financial reporting framework,* Commonwealth of Australia, 2002, p. 179.

2.12 During the first consultation phase following the release of the policy proposal paper, the suggested employee protection scheme drew some commentary. Submissions to Treasury generally approved of the broad principle to provide protection for employees who report suspected breaches of the law.[11] Clearly, however, some interpreted the proposal in terms of a broader whistleblowing scheme and went into far greater detail about the complexities of implementing what they believed should be a more comprehensive employee protection scheme.

2.13 KPMG raised what it believed to be a number of practical issues regarding what would constitute 'in good faith on reasonable grounds' and which breaches of the law would be covered by the whistleblowing protection scheme.[12] The Australian Institute of Company Directors (AICD) was of the view that protection should be broadened beyond the scope of the company's employees to all whistleblowers.[13] Transparency International Australia (TI Australia) in particular highlighted the broad and complex range of issues that confront those designing a whistleblowing protection scheme. It maintained that limiting disclosure to ASIC was inadequate and stated:

> Although ASIC may be the appropriate reporting body with respect to alleged breaches of the Corporations Act 2001, the introduction by the Commonwealth of a corporate whistleblowing scheme ought to recognise that there are a range of bodies to which it might be appropriate for an individual to make a disclosure about the conduct of a corporation. [14]

2.14 It identified other regulators (Federal, State and Territory), law enforcement agencies and auditors as appropriate bodies to receive reports of unlawful behaviour.[15] TI Australia placed particular importance on having in place an internal reporting regime to encourage the reporting of wrongdoing within the organisation. It argued that there are sound policy reasons to encourage corporations to take responsibility for eradicating corporate wrongdoing and to establish their own internal processes to deal with disclosures of malpractice and wrongdoing.[16]

2.15 ASIC also commented on it being the sole recipient of protected disclosures. It noted that the current proposal extends to reporting to ASIC and not to raising matters at a higher level within the corporation (ie with directors) or with the auditor. It stated: ‘In addition to protection when raising matters with ASIC, employees need to have the confidence to raise matters with the directors of the company or the

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11 See for example submissions to Treasury, AICD, *Submission* 13, p. 13; KPMG, *Submission* 36, p. 22; Transparency International Australia, *Submission* 58, p. [4].

12 *Submission* 36 to Treasury, p. 22.

13 *Submission* 13 to Treasury, p. 13.

14 *Submission* 58 to Treasury, p. [6].

15 *Submission* 58 to Treasury, p. [6].

16 Submission 58 to Treasury, pp. [6–7].

auditor, without threat of retaliation'.[17] Therefore, it suggested that the protection also be extended to employees/officers who report suspected contraventions of the Act to the directors or the auditor. These protections might include 'penalties for those who discriminate against such officers, compensation for damage, and immunity from civil actions for defamation and breach of confidentiality'.[18]

2.16 The Securities Institute while supporting the proposal was concerned that:

> …the CLERP 9 proposal stops short of setting up a broad-based robust whistleblower protection framework addressing all issues.[19]

Exposure draft bill—second consultation period

2.17 After consultation and a review process, the Government released an exposure draft of the legislation containing the whilstleblower provisions. In announcing the release of the exposure draft for comment, the Treasurer stated:

> The proposed legislation if passed will afford privilege and protection from victimisation to company officers and others in relation to disclosures made to ASIC in good faith and on reasonable grounds regarding breaches or suspected breaches of the corporations legislation.[20]

2.18 In keeping with the framework outlined in the policy proposal paper, the exposure draft limited disclosures to ASIC and made no allowance for internal reporting, that is, reporting wrongdoing within the company. Its heading—'Reporting of Breaches to ASIC' placed this matter beyond doubt. There was no indication that the Government had any intention to broaden the scheme.

2.19 The exposure draft did, however, take a broader approach than that initially outlined in the policy proposal paper by extending protection to people other than company employees who disclose information to ASIC. The provisions established a scheme designed to encourage not only employees, but also officers and subcontractors engaged by a company to report suspected breaches of the corporations law to ASIC. The heading to this part of the draft Bill clearly indicated that the provisions were for the 'protection of whistleblowers'.[21]

2.20 Submissions based on the exposure draft, while in the main supporting the concept of protecting employees from reprisals for disclosing information about contraventions of the law, still perceived shortcomings in the proposal. They

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17 *Submission* 15 to Treasury, November 2002, p. 45.

18 *Submission* 15 to Treasury, November 2002, p. 45.

19 *Submission* 53 to Treasury, 22 November 2002, p. [6].

20 Media Release, the Hon Peter Costello, Treasurer of the Commonwealth of Australia, 'Government Releases Exposure Draft Legislation on Audit Reform & Corporate Disclosure', 8 October 2003.

21 CLERP (Audit Reform & Corporate Disclosure) Bill, Draft Provisions, pp. 155–6.

particularly noted its limited scope in restricting protected disclosures to reports to ASIC and making no allowance for internal reporting. In the view of the Corporations Committee, Law Council of Australia, the provisions:

> are inappropriate in some respects and do not go far enough in others. In particular the Corporations Committee is concerned that the provisions may be too draconian in their current form and therefore may create problems within organisations far beyond the benefits that the process may produce.[22]

The whistleblowing provisions in the Bill

2.21 The Bill introduced into Parliament in December 2003, however, contained a few significant changes from the draft exposure bill. Although initially designed to encourage the reporting of breaches of the Corporations Act to ASIC, the most recent proposal is broader in scope. It has expanded the category of person deemed to be a proper authority to receive a disclosure by allowing for internal reporting. As it now stands, the proposed legislation provides protection for an officer or employee of a company or a person who has contracted for services with a company or an employee of that person who discloses information to ASIC or:

- the company's auditor or a member of an audit team conducting an audit of the company; or
- a director, secretary or senior manager of the company; or
- a person authorised by the company to receive disclosures of that kind.[23]

2.22 The Committee considers that the incorporation of an internal reporting process into the employee protection scheme is a necessary step that has addressed one of the main concerns raised during both the first and second phases of consultation. The legislation, nonetheless, poses a number of important questions especially for those advocating a more comprehensive scheme.

2.23 The Committee notes here that the role of an effective whistleblower scheme has been a matter of lively public debate on and off since the late 1980s.[24] The policy proposal paper and now this legislation have once again enlivened the debate. Indeed, the Bill opens up discussion on the wider and more complex aspects about whistleblowing schemes.

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22 *Submission* 24, p. 9.

23 Part 9.4AAA—Protection for whistleblowers, the Bill, p. 180.

24 In 1989 the USA enacted the whistleblower Protection Act to strengthen and improve the level of protection for whistleblowers. It prohibits reprisals against any federal employee or job applicant who discloses information about illegal activities or certain wasteful activities. Whistleblower Protection Act of 1989, section 2, Public Law 101-12.

2.24 With this in mind, the following section starts with a discussion on the new proposal to allow protected disclosures to be made within the company and then examines the following matters:

- the definition of reportable offences and whether they should be broadened;
- persons who qualify for protection;
- conditions under which a person making a disclosure qualifies for protection including;
    - the requirement for a report to be made in good faith;
    - the status of anonymous reports;
    - the gravity of the offence;
    - making a false report;
- penalties for unlawful reprisal.

Procedures for investigating a disclosure

2.25 The proposed legislation is silent on a number of matters regarding procedures to be adopted when receiving and investigating a disclosure. It simply confers protection on persons who disclose information on contraventions of the Corporations legislation to designated authorities and creates an offence for a person causing or threatening to cause detriment to a person because that person has made a disclosure.

2.26 The AICD noted that the exposure draft did not deal with any processes ASIC must follow in investigating a claim to confirm whether it has substance. Nor did it contain any certifying process that may entitle, or disentitle, an informant to Clause 1317AB protection. It argued that there ought to be detail in the legislation which defines the processes of an investigation. It cited in particular the lack of any requirement for ASIC to take steps once a disclosure is made.[25]

2.27 Furthermore, the Bill, which now allows for an internal reporting process, does not place any obligation on corporations to put in place procedures for dealing with a report. Although the Bill recognised an internal reporting process as part of the employee protection scheme, its lack of detail on the proposed scheme leads to uncertainty about the responsibility of the entity. The proposed legislation is silent on the obligations on companies to put in place a reporting system. It leaves open the question about whether companies should be required to establish a reporting regime that sets in place procedures to facilitate the disclosure of information and to deal with the disclosure as soon as practicable. There is no mention of how a company or indeed

25 *Submission* 35, p. 22 of 51.

whether a company is required to assist and provide information to a person contemplating making a report.

2.28 Under the Sarbanes-Oxley Act every public company is required to establish mechanisms to allow employees to provide information anonymously to the corporation's board of directors. The audit committee in the company is vested with the authority for deciding how it is to satisfy this requirement of putting in place adequate procedures for reporting their concerns about questionable accounting or auditing matters. Reports made through this internal reporting mechanism constitute protected activity.[26]

2.29 The ASX Corporate Governance Council identified the promotion of ethical and responsible decision-making as a core principle underpinning good corporate governance. In offering guidance on how best to achieve this objective, the ASX recommends the establishment of a code of conduct to guide directors and senior executives as to, inter alia, the responsibility and accountability of individuals for reporting and investigating reports of unethical practices. It suggests that the code may usefully address a number of issues including 'encouraging the reporting of unlawful/unethical behaviour—active promotion of ethical behaviour and protection for those who report violations in good faith'.[27] According to the ASX, a code of conduct should:

> …enable employees to alert management and the board in good faith to potential misconduct without fear of retribution, and should require recording and investigating of such alerts.
>
> The company should have a system for ensuring compliance with its code of conduct and for dealing with complaints. In devising and implementing that system, the laws concerning defamation and privacy need to be considered.[28]

2.30 The Committee notes the release of Australian Standard 8004—2003 on 23 June 2003. It is designed as a practical guide for corporations, government agencies

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26 See section 301 of the Sarbanes-Oxley Act. Attached to the UK Combined Code of Corporate Governance is a guide on internal control. This guide includes a list of questions that boards may wish to consider including 'are there established channels of communication for individuals to report suspected breaches of laws or regulations or other improprieties?'[26] It also attaches Guidance on audit committees (The Smith Guidance) which recommends that 'the audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action. *The Combined Code of Corporate Governance,* July 2003, p. 52.

27 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations,* March 2003, pp. 25–6.

28 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations,* March 2003, p. 60.

and not-for-profit corporations[29] and puts forward a whistleblower protection program which it considers contains the essential elements of an effective scheme for establishing, implementing and managing an effective whistleblower protection program. It rests on the premise that an effective whistleblower scheme can result in:

- more effective compliance with relevant laws;
- more efficient fiscal management of the entity through, for example, the reporting of waste and improper tendering processes;
- a healthier and safer work environment through the reporting of unsafe practices;
- more effective management;
- improved morale within the entity; and
- an enhanced perception and the reality that the entity is taking its governance obligations seriously.[30]

2.31 The Standard argued strongly that there should be a presumption that the employee would try to have the matter resolved internally first.[31] Although the Bill is based on the same presumption, the Committee notes that the legislation does not refer to the sensible protocols developed by Standards Australia which call for an internal process being utilised by employees before the employee takes the matter to a regulator.

2.32 The Committee also draws attention to the regulations promulgated under section 16 the *Public Service Act 1999,* which require Agency heads to establish procedures for dealing with a report made by an APS employee. Regulation 2.4—Procedures for dealing with whistleblowers reports—outlines the procedures agencies must have in place to deal with whistleblowing reports. Among other things they require that the procedures must:

- have due regard to procedural fairness and comply with the *Privacy Act 1988*;
- provide that an APS employee in the Agency may report breaches (or alleged breaches) of the Code of Conduct to the Agency Head, or a person authorised by the Agency Head;

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29 Standards Australia, Australian Standard, *Whistleblower Protection Programs for Entities,* June 2003.

30 Standards Australia, *Whistleblower Protection Programs for Entities,* 23 June 2003, p. 4.

31 See also *Submission* 24, p. 10.

- ensure that if a report is made to the Agency Head, the Agency Head will, unless he or she considers the report to be frivolous or vexatious:
  - (i) investigate it; or
  - (ii) authorise another person to investigate it; and

  …

- provide information about the protection available under section 16 of the Act to persons making reports;
- enable an APS employee who has made a report, and who is not satisfied with the outcome of the investigation of the report, to refer the report to nominated independent bodies; and
- ensure that the findings of an investigation are dealt with as soon as practicable.

2.33 No submissions commented on whether companies should be obliged under legislation to establish an employee protection regime. Dr Simon Longstaff thought that it would be a prudent form of best practice for companies to have an internal disclosure regime. He told the Committee:

> Providing that the legislation does provide an alternative to go to an external party, such as ASIC, then the public is being served. Why a board or management would not avail themselves of the opportunity to create an internal mechanism under those terms I do not know, because it would certainly be in their best interests to do so.[32]

Committee view

2.34 The Committee recommends that the Bill take a more positive step by requiring corporations to put in place procedures to receive and investigate reports of wrongdoing in a corporation and to assist people making or contemplating making a report with objective advice and counselling. In particular, the Committee is strongly of the view that corporations have a responsibility to put in place procedures that would prevent reprisals from occurring and stopping them if they do occur. The Committee believes that corporations should already be doing so.

Recommendation 1

2.35 The Committee recommends that a provision be inserted in the Bill that would require corporations to establish a whistleblower protection scheme that would both facilitate the reporting of serious wrongdoing and protect those making or contemplating making a disclosure from unlawful retaliation on

32 *Committee Hansard*, 6 April 2004, p. 5.

account of their disclosure. The Committee refers to Australian Standard AS8004—2003 as a starting point for corporations.

Recommendation 2

2.36 The Committee further recommends that ASIC publish a guidance note designed for all companies, using AS8004—2003 as a model, to help further promote whistleblowing protection schemes as an important feature of good corporate governance.

2.37 The Committee believes that such procedures should already be in place and be recognised and appreciated as best practice. Recommending that listed companies be required to establish a whistleblower protection scheme does not impose an onerous obligation, particularly since models for this process are already available and can be readily adopted. However the Committee recognises that achieving cultural change will be far harder than setting up systems. The Committee also recognises that there is positive potential for systems such as AS8004—2003 to be used by non-listed companies and the not-for-profit sector.

Reportable offences

2.38 In accordance with the policy proposal paper, the exposure draft specified that disclosures would deal with suspected breaches of the current and previous provisions of the Corporations Act, ASIC Act and regulations made pursuant to these acts.[33] It did, however, call for comments on 'whether the Bill should provide protection in relation to disclosures made regarding contraventions of other legislation'.

2.39 TI Australia expressed the concern that, in proposing that ASIC be the body to which disclosures be made, the proposal might be read as being limited to disclosures relating to the Corporations Act. It believed that 'as a minimum, protection should extend beyond breaches or suspected breaches of the Corporations Act and extend to breaches or suspected [breaches] of any legislation (Federal, State or Territory) and any principles of common law that apply to the organisation'. Consideration should also be given to according protection to disclosures relating to breaches of internal codes of practice.[34]

2.40 The AICD did not support the legislation including breaches other than contraventions of the corporation legislation. It argued that to do so would create issues of jurisdiction and practicability which would place an otherwise 'unreasonable and unnecessary administrative burden on ASIC'. The Committee notes that this argument about placing a heavy burden on ASIC, however, has been weakened by allowing the internal reporting of corporate wrongdoing.

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33 Commentary, paragraph 390, p. 97.

34 *Submission* 58 to Treasury on its inquiry into CLERP 9, November 2002, p. [7].

2.41 A number of submissions to the inquiry, had no qualms advocating the extension of protection to disclosures of other or all legislation.[35] The Chartered Secretaries Australia (CSA) could see in principle 'no reason to make a distinction between various legislative regimes in providing protection for whistleblowers'. [36]

2.42 The Finance Sector Union (FSU) also believed that protected disclosures should be extended to other legislation. It stated:

> Our members work in an industry regulated by a wide range of legislation and many of the members we have assisted in the past have been sacked or otherwise unfairly treated for disclosures relating to legislation other than the Corporations Act. If a culture of compliance is to be encouraged, it is important that all relevant legislation is covered by the protection.[37]

2.43 ASIC was clear in its opinion that it should not be the agency to consider disclosures regarding contraventions of legislation not under its purview.[38] The Committee concurs. If the legislation were to cover activities outside the corporations law, the question arises about the appropriate agencies to receive reports. The CSA nominated the Commonwealth Ombudsman as a suitable authority to receive reports.[39]

Committee view

2.44 The Committee believes that ASIC is the appropriate agency to receive and investigate reports of breaches or suspected breaches of the Corporations legislation but not offences outside its jurisdiction. On the other hand, it makes little sense to restrict protected disclosures to contraventions of the Corporations legislation when made to designated authorities within the company. Jurisdiction is not at issue as a company's legal responsibilities extend far beyond corporations law. Good corporate governance principles would dictate that a company should have a reporting process in place in their organisation to deal with contraventions of matters such as health and safety legislation, industrial relations, tax and trade practices.

2.45 A major redrafting of the provisions would be required should the legislation be extended beyond breaches of the ASIC and Corporations Act—decisions would have to be made about designating the appropriate authorities to receive and investigate the reports. If the legislation is to remain as it now stands, it would appear that a two tier system would operate for the reporting systems within corporations, that is protected disclosures for reports about breaches of the ASIC and corporations act but not for reports about other offences outside these laws.

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35 *Submission* 8, *Submission* 22, *Submission* 25, *Submission* 29, *Submission* 38, *Submission* 43.

36 *Submission* 8, pp. 6–7.

37 *Submission* 38, p. [8].

38 *Submission* 8, p. 7.

39 *Submission* 8, p. 7.

2.46 The Committee believes that while the intention to introduce a whistleblowing scheme is admirable and this legislation sets down a basic framework for such a scheme, considerable thought still needs to be given to the many practical problems in implementing the scheme especially as it relates to reporting breaches within the company.

Persons who qualify for protection

2.47 As noted earlier, the exposure draft and the Bill took a broader approach than that initially contemplated in the discussion paper. The Bill extends protection to people other than company employees who disclose information to ASIC or to a designated authority in the company. The provisions established a framework designed to encourage not only employees, but also officers and subcontractors engaged by a company to report suspected breaches of the corporations law to ASIC. Further, the provisions would confer on the relevant employee, officer or subcontractor qualified privilege in relation to a protected disclosure of information provided to ASIC regarding a suspected breach of the law.[40]

2.48 The Corporations Committee of the Law Council of Australia and the AICD noted that provisions should apply to persons who are involved in the supply of goods as well as services to a company.[41] The Law Council placed this provision in the context of trading while insolvent. It noted that if whistleblower provisions were to be retained they should ensure that insolvent trading and other potential breaches of the legislation could be identified earlier in the process. It suggested that creditors may be well-placed to report their suspicions.[42] More generally, the CSA argued that the proposal did not go far enough to protect subcontractors and their employees. It believed that 'anyone in the chain should receive protection'.[43]

Committee view

2.49 The Committee notes the suggestion that if the proposed legislation is to take account of persons who have a contract for services, it should also include persons who are involved in the <u>supply of goods</u>. It believes that this is both a reasonable and sensible proposal.

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40 Australian Government, *CLERP (Audit Reform & Corporate Disclosure) Bill, Commentary on the Draft Provisions,* Corporate Law Economic Reform Program No. 9, October 2003, p. 96, Schedule 4—Enforcement and Explanatory Memorandum, p. 159.

41 *Submission* 24, p. 10; *Submission* 35, p. 19. It should be noted, however, that AICD would prefer the provisions to be limited to simply officers and employees.

42 *Submission* 24, p. 10.

43 *Submission* 8, p. 7.

Recommendation 3

2.50 The Committee recommends that paragraphs 1317AA(1)(a)(iv) be amended to read 'an employee of a person who has contracted for services with, or the supply of goods to, a company'.

Conditions under which a person making a disclosure would qualify for protection

2.51 The gravity of the offence and the motivations of the person making the disclosure have generated vigorous debate about the very fundamentals of whistleblowing protection legislation. A familiar message coming out of the numerous inquiries into whistleblowing is that people who work in or with an organisation and have been aware of a problem have been either too intimidated to sound the alarm or have raised their concerns in the wrong way or to an inappropriate person.[44] There is tension, however, between the points of view of those who fear that a low threshold requiring an agency to receive disclosures will encourage nuisance or malicious complaints and those who argue that the motives of the informant are irrelevant—that the substance of the disclosure should be the only material concern. The following section explores these views further.

Requirement for report to be made in good faith

2.52 The policy proposal paper took the view that a scheme to protect company employees from retaliation created a risk that could lead to some false reports about financial misconduct being made which would tie up valuable resources of the regulator and the company. To minimise the chances for malicious or nuisance reporting, the provisions to establish an employee protection scheme incorporate certain conditions necessary for a disclosure to attract protection under the law. The policy paper maintained that company employees reporting suspected breaches of the corporations law to ASIC must do so in good faith and on reasonable grounds.[45]

2.53 During the first consultation period, KPMG suggested to Treasury that the issue of what constitutes ‘in good faith on reasonable grounds’ is open to interpretation and may be problematic to establish in law. It noted the tricky problem of striking an appropriate balance between encouraging the reporting of a suspected breach of the law and deterring malicious use of this reporting mechanism.[46] TI Australia argued that the primary focus of any whistleblower scheme ought to be on the disclosure itself rather than the whistleblower. Thus, it preferred a scheme that

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44 See for example, OECD Labour/management Programme, *Whistleblowing to Combat Corruption,* http://www.pcaw.co.uk_policy/oecdreport.html 14 September 2001.

45 *CLERP Corporate disclosure: Strengthening the financial reporting framework,* Commonwealth of Australia, 2002, p.178.

46 *Submission* 36 to Treasury, 22 November 2002, p. 22.

would treat the person's reasons for making the disclosure as irrelevant, provided the disclosure is not known by the person to be false.[47] It asserted:

> A reasonable and honestly held suspicion or belief in the veracity of the reported information ought to be sufficient to attract protection under the scheme.[48]

2.54 ASIC suggested that instead of protection operating for breaches reported in good faith and on reasonable grounds, that the provision be worded so that the protection applies unless the reporting is frivolous or vexatious. According to ASIC this measure would afford additional protection to the reporting employee, 'as it shifts the onus of proof for the application of the protection from the employee to the person challenging the protection'.[49]

2.55 Despite doubts about the 'good faith' test, the exposure draft and the Bill did not depart from the proposal put forward in the policy proposal paper. To qualify for protection the person making a disclosure must have reasonable grounds for doing so and must make the report in good faith.[50]

2.56 According to the commentary on the exposure draft the use of 'good faith' is intended to raise the threshold for obtaining qualified privilege. It explained that:

> This is considered appropriate given the need to discourage malicious or unfounded disclosures being made to ASIC. Where a person has a malicious or secondary purpose in making a disclosure, it is considered that the good faith requirement would not be met.[51]

2.57 While some submissions were happy with the 'good faith' requirement, particularly as a deterrent for malicious or vexatious complaints,[52] others were concerned that the 'good faith' standard created a number of difficulties with interpretation and application. For example, the Finance Sector Union (FSU) noted that it would be important for the meaning of concepts such as 'good faith' and 'reasonable grounds' to be defined and explained in information issued to employees.[53]

2.58 Some witnesses also identified problems with the burden of proof when acting in good faith.[54] They insisted that consideration must be given to the scheme as an

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47 *Submission* 58 to Treasury on its inquiry into CLERP 9, November 2002, p. [1].

48 *Submission* 58 to Treasury on its inquiry into CLERP 9, November 2002, p. [7].

49 *Submission* 15 to Treasury, November 2002, p. 45.

50 Section 1317AA(1)(d) and (e).

51 Commentary, p, 97.

52 *Submission*s 14, 19 and 22.

53 *Submission* 38, p. [8].

54 *Submissions* 21 and 35.

effective whistlebower mechanism which places emphasis on the disclosure itself not the whistleblower thus making the person's reasons for making a disclosure irrelevant.[55] Mr Douglas Gration, CSA, told the Committee:

> I would have thought the good faith test should be not whether they have a malicious or secondary purpose but whether they genuinely and in good faith believe that there had in fact been a breach of the law.[56]

2.59 The St. James Ethics Centre also submitted that 'good faith' should not be a condition determining whether the whistleblower is afforded protection. Instead the honesty of the claim should be the sole condition needed for satisfying this requirement to attract protection. It maintained that the important consideration is ensuring that the maximum number of relevant disclosures are made.[57]

2.60 Similarly, the Centre for Corporate Governance could see no sense in considering motives provided that the complaint made was genuine in that it revealed unlawful conduct. It emphasised that the legislation should concentrate on encouraging the making of complaints that show a genuine and legitimate breach of the law, rather than deterring the making of complaints by those who may have less altruistic motives. It explained further:

> The Centre would agree that the legislation should not operate to encourage *unfounded* disclosures being made to ASIC; however, if a disclosure is meritorious yet made by a person who happens to harbour a strong dislike for the alleged offender, then the legislation should not operate to deny protection to such complainants.[58]

2.61 It went on to argue that if the aim is to encourage the reporting of alleged breaches of the law, raising the threshold to mandate good faith services would work against this objective.[59] Dr Simon Longstaff, St James Ethics Centre, told the Committee the test should be on the question of truth:

> …there are facts about things that occur, which can be checked and validated and, therefore, determined as being true, and that their truth does not depend on what the intentions of the person who spoke the truth

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55 *Submission* 23.

56 *Committee Hansard*, 18 March 2004, p. 49.

57 *Submission* 40, p. 4.

58 *Submission* 21, pp. 14–15. This contention that whistleblowers protection schemes must rest on the fundamental premise that 'if the disclosure is true, there is no need for any further objective test; has been well argued in the various committees of inquiries that have examined whistleblowing, See for example M. R. Goode, 'Policy Considerations in the Formulation of Whistleblowers Protection Legislation: The South Australian *Whistleblowers Protection Act 1993,* p. 42.

59 *Submission* 21, p. 15.

> happened to be. In that sense, it is reasonable to make that sensible distinction between the two.[60]

2.62 He believed that an 'honest and reasonable' belief would be acceptable.[61] Ms Kathleen Farrell, Law Council of Australia, also supported the honest and reasonable belief as the appropriate threshold test.[62]

Summary

2.63 This matter of the motivation behind the disclosure has generated lively debate about the very fundamentals of whistleblowing protection legislation. There is tension between the views of those who fear that a low threshold requiring an agency to receive disclosures will encourage nuisance or malicious complaints and those who argue that the motives of the person disclosing information is irrelevant—the focus should be on the substance of the allegations. The Committee believes that the legislation must be founded on the premise that the veracity of the disclosure is the overriding consideration and the motives of the informant should not cloud the matter. The public interest lies in the disclosure of the truth. Accordingly, the Committee makes the following recommendation.

Recommendation 4

2.64 The Committee recommends that the threshold test of 'in good faith' be removed and replaced by 'an honest and reasonable belief'.

False or vexatious reports

2.65 As a safeguard against the abuse of the system, some submissions suggested that malicious or vexatious reporting be made an offence.

2.66 The AICD referred to the suggestion that an informant who makes a disclosure to ASIC without reasonable grounds and not in good faith may be guilty of an offence under the general offence provisions of the Act.[63] It asked whether such action should be made a specific offence in order to discourage malicious or unfounded disclosures.[64] Although the policy proposal paper, the exposure draft and the Bill did not mention this issue, TI Australia recommended that to preserve confidence in the integrity of the scheme the making of a false report, in the knowledge that the information is false, should be an offence.[65]

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60 *Committee Hansard*, 6 April 2004, p. 2.

61 *Committee Hansard*, 6 April 2004, p. 3.

62 *Committee Hansard*, 16 March 2004, p. 57.

63 See sections 1308–1310.

64 *Submission* 35, p. 20 of 51.

65 *Submission* 58 to Treasury on its inquiry into CLERP 9, November 2002, p. [7]. See also *Submission* 23, p. 8.

2.67 The Corporations Act may address this concern in part through section 1308 which makes the providing of a false or misleading statement to ASIC an offence. This provision, however, does not address the problem for corporations and their internal reporting system except that the legislation does make clear the conditions necessary for a disclosure to attract protection.

2.68 Some submissions looked to dissuade the reporting of frivolous or trivial matters by imposing a degree of gravity on the offence to be disclosed. CUSCAL noted that due to the vastly expanded scope of the Corporations Act flowing from the *FRS Act 2001*, the range of potential breaches of this legislation is now extremely wide and variable in the gravity of the breach. It suggested that many potential breaches will be trivial.[66] The AICD shared the concern that the whistleblower provision appears to allow the reporting of any contravention to ASIC. It was also of the view that this proposal could be an invitation to provide information to ASIC about minor contraventions and suggested that to discourage inappropriate reporting, the protection should be limited to breaches for serious offences specifically under the Corporations Act.[67]

2.69 Taking a similar approach, the Law Council of Australia noted that the utility of the provisions needs to be balanced against the likelihood of abuse and the creation of a workload for ASIC which would require additional resources. It argued that protection should only relate to matters which might reasonably be considered serious breaches of law. It explained further:

> While whistleblowers should not have to go to the trouble of **ensuring** that there has been a breach of legislation, the Committee is concerned that the language used will be an invitation to them to go running to ASIC almost 'at the drop of a hat' and for that reason should only apply to reasonably apprehended serious breaches. Otherwise it is likely that complaints which arise in this way will constitute an unreasonable drain on ASIC resources in circumstances where ASIC already cannot address all complaints currently made to it in any year or those complaints will also not be acted on for the resource reason.[68]

2.70 As noted earlier, the Law Council supported the requirement for the 'honest and reasonable belief' test but added the requirement that the disclosure relate to a serious contravention. Ms Farrell elaborated:

> So what the whistleblowing provision should be asking people to do as a threshold is to consider honestly and reasonably whether what they are going to complain about is something important or something that is not

66 *Submission* 43, p. 2.

67 *Submission* 35, p. 19 of 51.

68 *Submission* 24, p. 10.

> important but is just a niggle and a nuisance—and, frankly, a nuisance to everyone, not only to ASIC but ultimately to the company as well.[69]

2.71 The Committee accepts that questions about the meaning of the term serious are likely to result. Despite the lack of clarity in the meaning of serious, the Committee believes that the requirement that a report must be about a serious breach sends a clear message to anyone contemplating making a disclosure that frivolous or vexatious reports will not entitle that person to protection.

Recommendation 5

2.72 The Committee recommends that the provision stipulate that the report relate to 'a serious offence'.

Anonymous reports

2.73 The Bill makes no allowance for a person to make an anonymous report. Whether such reports should attract protection has been a contentious matter for many years mainly because the arguments for and against have substance. Some whistleblowing schemes allow for anonymous reports such as the US Sarbanes Oxley legislation, and the Queensland and Victorian Public Interest Disclose Acts. There are others, however, that do not.

2.74 Views presented during the inquiry reflected this divided approach. The Stop Line was of the view that the majority of whistleblowers desire to be anonymous and rejected the suggestion that anonymity brings about 'a flood of vexatious or malicious allegations'. In the experience of members of the STOPline 'deliberate mischief and ill will from whistleblowers is minimal.' They maintained:

> Having said that some whistleblowers are misinformed or inaccurate while essentially well intended. It is the role of those charged with investigating the disclosure to ascertain the validity of the allegations as well as the motivation of the whistleblower.[70]

2.75 Mr Sitesh Bhojani, drew on his experiences as a Commissioner in enforcement in ACCC to underline the difficulties that may emerge when the Commission receives anonymous allegations of breaches. He cited the problems in testing the bona fides and the accuracy of the information, and the possibility that ACCC, in attempting to substantiate the information, may inadvertently reveal the identity. He also noted that ACCC cannot keep the whistleblower informed on the progress of the inquiry.[71]

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69 *Committee Hansard*, 16 March 2004, p. 58.

70 *Submission* 29, p. 3.

71 Sitesh Bhojani, 'Should Whistleblowing be encouraged and protected and is it?', Sydney, August 2002, pp. 11–12.

2.76 The St James Ethics Centre argued that if whistleblowers are not given the opportunity to report an incident anonymously and still be protected it may restrict the number of disclosures made. It accepted that it may be difficult to offer effective protection to a person who chooses to remain anonymous, nonetheless it was of the view that the option of making anonymous disclosures would be a desirable inclusion in the Bill.[72] Dr Longstaff stated:

> …we believe that anonymity ought to be an option available to people making disclosures. The only real objection to it that we can see might be a practical one of how you might identify a person who has made a disclosure subsequently if you do not have the means to identify them. With that in mind, we think it is quite possible that those people wanting to avail themselves of this protection ought to be given a unique identifier at the time the disclosure is made—it could be in the form of a number or an alphanumeric code—so that if, at a later date, other people seek to claim protection without being able to identify themselves, the person who did make the disclosure can be correctly identified and therefore continue to enjoy the protections afforded by the proposed legislation. With that in mind, we think that, on balance, public interest is better served by having people able to make an anonymous disclosure because, although the protections are afforded under the proposed legislation, many people looking at the history of what has happened to whistleblowers might have a reasonable apprehension that, should they become known as the person making the disclosure, some detriment will be suffered by them.[73]

2.77 In explaining further the practicalities for those who may want to seek protection after having made an anonymous disclosure, Dr Longstaff said:

> You allow a person to be identified if they seek to take advantage of the protection. The protection, as it would work, would be afforded to them from the moment they made the disclosure in an appropriate form. It is then a fact that it exists as a legal protection. It is up to them, though, to invoke it, and they can do so at any time. That might risk their anonymity, but if they wish to sit by and see what happens…then they may never invoke the formal privilege.[74]

Recommendation 6

2.78 The Committee recommends that the Government give serious consideration to providing for anonymous reports. It believes that by having the requirements that a person must have an honest and reasonable belief that an offence has or will be committed and that the offence is a serious offence is sufficient safeguard against frivolous or vexatious reporting.

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72 *Submission* 40, p. 4.

73 *Committee Hansard*, 6 April 2004, pp. 1–2.

74 *Committee Hansard*, 6 April 2004, pp. 3–4.

Confidentiality and protection of identity

2.79 The AICD noted that paragraph 387 of the Commentary refers to section 127 of the ASIC Act as providing confidentiality protection. It points out that this section deals with the information itself, not necessarily the identity of the person who discloses the information to ASIC. It maintained that if their reading of s 127 is correct and there is a gap in protection then s 127 ought to be amended to make clear that the identity of an informant is confidential information.[75]

2.80 Standards Australia in its AS8004–2003 states that a whistleblower who reports or seeks to report a suspected offence 'should be given a guarantee of anonymity (if anonymity is desired by the whistleblower) bearing in mind, that in certain circumstances, the law may require disclosure of the identity of the whistleblower in legal proceedings'. The Standard requires information received from a whistleblower to be held in the strictest confidence and only in specified circumstances to be disclosed to a person not connected with the investigation.[76] Such measures also protect the rights of those named in a disclosure.

Committee view

2.81 The Committee believes that the confidentiality provisions in any whistleblower scheme are central to building public trust in the system and to preserving its integrity. Any doubts about the protection of the identity of a whistleblower should be clarified in the legislation which should provide a guarantee of anonymity. Again while the Explanatory Memorandum offers some advice on this matter in regard to privacy concerns with disclosures to ASIC, there is no mention of such safeguards with disclosures made within an entity. The Committee would like assurances from the Government that there are adequate safeguards in the proposed legislation for the protection of confidentiality and that they are expressly stated.

Recommendation 7

2.82 The Committee recommends that a provision be inserted in the proposed whistleblowing scheme that expressly provides confidentiality protection to persons making protected disclosures to ASIC or making such disclosures to the designated authorities within a company. Similar provisions should be inserted to protect the rights of persons who are the subject of a disclosure.

Definition of detriment

2.83 The Bill prohibits any actual or threatened detriment being levelled against a person whose disclosure qualifies for protection (proposed subsections 1317AC(1) and (2). The type of detriment contemplated in the Explanatory Memorandum would

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75 *Submission* 35, p. 19 of 51. See paragraph 5.384 in Explanatory Memorandum which repeats paragraph 387 in the Commentary.

76 Standards Australia, AS8004–2003, *Whistleblower Protection Programs for Entities*, p. 10.

include the termination of employment, a reduction in a person's terms and conditions of employment, demotion, or unfair or unequal treatment in the workplace. Where a person contravenes either proposed subsection 1317AC (1) or (2), they will commit an offence and where loss or damage is suffered by the victim as a result of the contravention, compensation may be available under proposed s1317AD.[77] The objective of this provision is to capture the range of harm, loss or damage that a whistleblower may suffer as a result of reprisals on account of making a disclosure. TI Australia, however, argued that:

> Because retaliatory action against whistleblowers can take many forms, the scope of protections must be carefully considered. Whistleblowers must be protected from harassing and intimidating conduct as well as from the obvious actions causing injury, loss or damage. Such actions and conduct against a person who has made, or is intending to make, a protected disclosure must be an offence under the scheme.[78]

2.84 This observation builds on the evidence presented to the various inquiries into whistleblowing schemes which highlights the many different and often subtle forms that a reprisal can take.[79]

2.85 The various States that offer protection to whistleblowers from unlawful reprisal have incorporated into their respective legislation a definition of detriment that contains common elements.[80] For example, in addition to action causing injury,

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77 *CLERP (Audit Reform & Corporate Disclosure) Bill, Commentary on the Draft Provisions,* Corporate Law Economic Reform Program No. 9, October 2003, p. 97.

78 *Submission* 23, p. 8.

79 Finance and Public Administration Legislation Committee, *Public Interest Disclosure Bill 2001 [2001],* p. 72–3.

80 In New South Wales detrimental action means action causing, comprising or involving any of the following:

(a) injury, damage or loss,
(b) intimidation or harassment,
(c) discrimination, disadvantage or adverse treatment in relation to employment,
(d) dismissal from, or prejudice in, employment,
(e) disciplinary proceeding. (section 20 *Protected Disclosures Act 1994)*

In Queensland detriment includes—

(a) personal injury or prejudice to safety; and
(b) property damage or loss;
(c) intimidation or harassment; and
(d) adverse discrimination, disadvantage or adverse treatment about career, profession, employment, trade or business; and
(e) treats of detriment; and
(f) financial loss from detriment. (Schedule 6—Dictionary, *Whistleblowers Protection Act 1994)*

See also section 9(4)(a), *Whistleblower Protection Act 199,* (South Australia) loss or damage, the Victorian *Whistleblowers Protection Act 2001* includes 'intimidation or harassment and discrimination, disadvantage or adverse treatment in relation to a person's employment, career, profession, trade or business, including the taking of disciplinary action'.[81]

Committee view

2.86 The Committee believes the definition of detriment should provide ample protection for an informant against the many and varied forms that a reprisal can take. It suggests that the Explanatory Memorandum recognise that retaliation can take various and subtle forms and make clear that the examples it provides are a guide only. For even greater certainty, the Government should give consideration to inserting in the whistleblowing provisions a definition of detriment.

2.87 The Committee also notes some inconsistencies in the terms used in the provisions of the Bill and the language used in the Explanatory Memorandum. According to the Explanatory Memorandum, the provisions, as outlined in the Bill, would prohibit employers from victimising employees, officers or subcontractors when they report a suspected breach to ASIC in good faith and on reasonable grounds. The Bill stipulates, however, that 'a person', not necessarily an employer, may contravene these provisions.[82] Also, the Heading in the Explanatory Memorandum for Part 2: Protection for employees reporting breaches to ASIC should be changed to reflect changes made to the draft Bill which now allow reporting within a company.

Enforcement and penalties

2.88 Section 1317AC which prohibits victimisation leaves a number of questions unanswered. The proposed legislation does not make it clear who is to enforce protection. While it makes actually causing, or threatening to cause, detriment a contravention, it does not specify whether ASIC or the company have a role in preventing reprisals from taking place and if they do what action they should take. In other words, it is unclear whether the onus rests solely on the whistleblower who has been subject to unlawful reprisal to defend his/her interests or whether the agency receiving the report should assume some responsibility for protecting the whistleblower.

2.89 In turning to the penalty, TI Australia argued that the offence ought to carry with it meaningful penalties as a deterrent. The Bill sets down a penalty of 25 penalty units or imprisonment for 6 months or both. The penalty is relatively light in comparison to that set by a number of state public interest disclosure laws and to

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81 Section 3—Definitions, *Whistleblowers Protection Act 2001,* (Victoria).

82 Proposed section 1317AC(2).

offences in the Corporations Act such as the penalty for an officer who negligently provides false or misleading information.[83]

Recommendation 8

2.90 The Committee believes that the Government should review the proposed penalty to be set down in Schedule 3 as item 338 to ensure that it is comparable with other jurisdictions and offences of a similar nature.

Recommendation 9

2.91 The Committee further recommends that a provision be inserted in the Bill that would allow ASIC to represent the interests of a person alleging to have suffered from an unlawful reprisal.

ASIC's resources

2.92 During the Committee's inquiry into Australia's insolvency laws, a number of witnesses expressed the view that ASIC does not have the resources to follow through on administrators/ liquidators reports that contained allegations of suspected breaches of the Corporations Act. Building on these findings, similar doubts were presented in submissions to this inquiry. The Centre for Corporate Governance made the point that transforming disclosures into action is futile unless ASIC is in a position to follow them up. AICD stated that 'ASIC is already on record as stating that it does not have the resources to deal with all the complaints it receives'.[84]

2.93 Likewise, Professor Adams questioned whether ASIC has the resources to handle what he termed 'a flood of complaints'. He said:

> The ASIC annual report for the financial year 2002-03 shows that of the 8,708 cases they handled only five per cent were investigated, 66 per cent were resolved in terms of information—we do not really know what that means, and it is never explained—and a further 29 per cent were not resolved at all; they were just looked at. In other words, ASIC is already very busy dealing with these issues, and that excludes the 5,251 referrals that ASIC receives through its external administration process—liquidators

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83 See Finance and Public Administration Legislation Committee, *Public Interest Disclosure Bill 2001 [2002],* September 2002, p. 71. See para 10.2. The *Protected Disclosures Act 1994* (New South Wales) sets the maximum penalty for a person who takes detrimental against another person as a reprisal at 50 penalty units or imprisonment for 12 months, or both, the Queensland *Whistleblowers Protection Act 1994* sets the penalty at 167 penalty units or 2 years imprisonment and the Victorian *Whistleblowers Protection Act 2001* provides for a maximum penalty of 240 penalty units or 2 years imprisonment or both.

84 *Submission* 21, pp. 12–13; *Submission* 35, p. 22. The same point about ASIC's limited resources to handle all the complaints it receives, especially allegations of wrongdoing made in administrators/ liquidators reports, was made to the Committee's inquiry into Australia's insolvency laws.

> et cetera. They already carry a heavy burden and, in our opinion, are not yet resourced to deal with those things.[85]

2.94 This same issue about ASIC's ability to enforce the Corporations Act is discussed in greater detail in a later chapter dealing with the issue of infringement notices.

Conclusion

2.95 Without doubt there was strong support for the introduction of a whistleblower protection scheme but also many suggestions on how the proposed scheme could be made more effective. The Committee is aware of the importance of implementing a scheme that will achieve the goal of encouraging the reporting of wrongdoing in the workplace by protecting those making disclosures from reprisals.

2.96 In particular, the Committee is concerned about the lack of detail surrounding the internal reporting proposal. It refers to Australian Standards AS 8004–2003, *Whistleblower Protection Programs for Entities*, as a guide for companies. Without any detailed consultation or examination of the guide, it is reluctant to recommend that such a guide be incorporated into the Corporations Act. The standard nonetheless provides an example of what the legislation should expect of companies.

2.97 The Committee believes that the proposed whistleblowing provisions are a step in the right direction, but only a first step. The Committee's recommendations are not ambitious. They are intended to send a message firstly to companies that they should have in place an effective whistleblower scheme to assist them in monitoring, exposing and hopefully preventing wrongdoing in their own organisation and secondly that they have a responsibility to protect people making a disclosure from retaliation. Boards should not be able to turn a blind eye to unlawful reprisals. The recommendations are also intended to achieve a balance between the desire to encourage the reporting of serious contraventions but at the same time discourage frivolous or vexatious reports.

2.98 The Committee accepts that the scheme contained in the CLERP 9 proposal is sketchy in detail but that the intention is quite clear. In its view, this area is one that will require further refinement. As noted earlier a number of questions remains unanswered particularly as to whether the scope of the scheme should be expanded to cover legislation outside corporations law. There is also scant information in either the legislation or the Explanatory Memorandum on the obligations of companies to ensure that they have in place a whistleblower scheme both to encourage the reporting of wrongdoing and to protect whistleblowers from unlawful reprisal. Once the proposed whistleblower provisions come into operation, answers to these questions may become clearer. Indeed the longer term solution may be found in the development of more comprehensive body of whistleblower law that would constitute a distinct and

85 *Committee Hansard*, 16 March 2004, p. 14.

separate piece of legislation standing outside the Corporations Act and consistent with the public interest disclosure legislation enacted in the various states.

CHAPTER 3

EXECUTIVE REMUNERATION—REMUNERATION REPORT

Overview

3.1 Recent reports in Australia have turned the spotlight on executive remuneration.[1] In some cases they show substantial increases in remuneration but without a corresponding improvement in performance. This trend has drawn much media attention with calls for measures to be taken to arrest the apparent escalation in executives' pay.

The ASX Best Practice Recommendations

3.2 The ASX in its best practice recommendations enunciates two core principles in relation to executive remuneration—remunerate fairly and responsibly and encourage enhanced performance. It explains that companies need to adopt remuneration policies that attract and maintain talented and motivated directors and employees so as to promote enhanced performance of the company. The ASX underlines the importance for companies to make clear the relationship between performance and remuneration and for investors to have an understanding of the policy underlying executive remuneration. It stated:

> Disclosing the remuneration policy is a fundamental requirement for remuneration reporting. The interests of shareholders and the market are best served through a transparent and readily understandable framework for executive compensation and its costs and benefits.
>
> Transparency as to the remuneration policy should be complemented by full and effective disclosure, in keeping with the spirit and intent of the

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1 John Shields. Michael O'Donnell and John O'Brien, *The Bucks Stop Here: Private Sector Executive Remuneration in Australia*, A Report Prepared for the Labor Council of New South Wales, [2003]. Research commissioned by the combined Public Sector and Commonwealth Super Schemes, Catholic Super Fund and Northern Territory Government Public Authorities Superannuation, *Position paper Executive remuneration*.

> Corporations Act and ASX Listing Rules, of the remuneration paid to directors and senior management.[2]

3.3 These fine aspirations, however, do not register with a public that has witnessed the recent parade of executives accepting high remuneration while their companies' performance slipped. Terms commonly used in the media such as 'breath-taking chief executive payouts', 'outlandish pay claims', 'soaring executive remuneration' and 'salary scandals' document the public's growing disillusionment with Australia's top executives.[3] The following extract captures the tone of public reporting on executive remuneration:

> The succession of impossible to justify payments to failed CEOs like Southcorp's Keith Lambert and Lend Lease's David Higgins; the extraordinary $32 million payment to former Colonial executive Chris Cuffe; the furore over the remuneration of former Brambles CEO Sir C. K. Chow; and the controversy over retirement benefits for AMP directors that prompted Stan Wallis reluctantly to forgo a $1.6 million payment created a shareholder and community backlash that shocked boards across the country.[4]

3.4 Evidence presented to the Committee reinforced these perceptions which were given credence by data indicating that some executives have received substantial increases in their remuneration packages which have grown out of all proportion to the earnings of less senior employees. Mr Rodney Masson, FSU, told the Committee:

> …at least for the big four banks, we can inform the committee that a combined total of $20 million was paid to the four CEOs in the past

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2 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations,* March 2003, p. 51. These principles reflect those espoused in the UK Code of Corporate Governance. On the level of remuneration the UK code maintains that ‘levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors’ remuneration should be structured so as to link rewards to corporate and individual performance'. *The Combined Code of Corporate Governance,* July 2003, p. 12.

3 The examples of press articles criticising executive remuneration are far too numerous to cite here but see for example *Business Review Weekly,* 5–11 June 2003, Feature Salaries, the *Australian,* 9 October 2003, p. 19; 14 October 2003, p. 24; the *Australian Financial Review,* 14 October 2003, p. 62; Jennifer Hill and Charles M Yablon, 'Corporate Governance and Executive Remuneration: Rediscovering Managerial Positional Conflict', *UNSW Law Journal,* vol. 25 no. 2, p. 294. In their article, Hill and Yablon state that 'the "outrage factor" has been alive and well in the Australian community in recent years. It has been growing since 2000 when there was a public outcry about the payment of A$13.2 million—one of the largest severance payments in Australian commercial history—to George Trumbull former CEO of AMP Ltd, and the engineer of its disastrous takeover of GIO Insurance Ltd'. It goes on to chronicle the recent history of large payments to executives.

4 Stephen Bartholomeusz, The *Age*, 14 October 2003, p. 3. See also the *Australian*, 8 October 2003, p. 7.

> reporting season. This does not include the retirement benefits paid to Frank Cicutto, rumoured to be a further $14 million. As we point out in our submission, it is possible for CEOs in our industry to make as much as 74 times the average weekly earnings in the sector; and as much as 188 times the weekly earnings of front-line staff, who earn considerably less than the average. Recent analysis in the Financial Review shows that over the past 20 years CEO salaries have risen by as much as 1,500 per cent from an already relatively high base in our industry.[5]

3.5 This chapter looks at the provisions on remuneration of directors and executives and uses the ASX principles to remunerate fairly and responsibly and to encourage enhanced performance as the yardstick against which to assess their appropriateness and likely effectiveness.

3.6 One of the main prongs in this legislation concentrates on disclosure as the means toward greater transparency and accountability and as a way to encourage fair and sensible remuneration for senior executives and to improve performance. This chapter traces the recent history of disclosure requirements for executive remuneration as set down in legislation. It then identifies and examines central concerns with the current and proposed disclosure requirements including:

- the expectation that disclosure of executives pay will fuel further increases;
- their application to smaller entities;
- the relationship between remuneration and performance;
- achieving meaningful disclosure;
- the alignment of accounting standards and disclosure requirements;
- valuing options; and
- termination payments.

Finally, the chapter considers the disclosure of directorships and discusses the merits of disclosing information on company secretaries.

History of legislation requiring disclosure of executive remuneration

3.7 The debate about executive remuneration is not new. In the mid 1990s, the Government embarked on a program to improve the provisions of the Corporations Law which dealt with company formation, company meetings, share capital, financial statements and annual returns. Part of this review took account of the function of the directors' report in disseminating information to members about a range of matters. They included the overall financial position of the company including its operational

5 *Committee Hansard*, 14 April 2004, p. 62.

results, key strategic initiatives, major commitments and sources of funding for those commitments, and likely future developments or trends that have had or are likely to have a significant effect on the business.

Draft Second Corporate Law Simplification Bill 1996

3.8 The Committee considered the provisions governing the contents of the Directors' Report when it examined the exposure draft of the Second Corporate Law Simplification Bill 1996. During its inquiry, the Committee was told that better disclosure of remuneration was in accord with international best practice in corporate governance and 'should enable shareholders to better evaluate the "cost" of their managers'.[6] It found the proposed legislation deficient and recommended that proposed section 300 be amended to require listed companies to disclose additional matters including the policies of the Board for determining the remuneration (including incentives) of the board and senior executives, and the relationship of these policies to the performance of the company/group. It also wanted the quantum and components of the remuneration of each director of the company and each of its 5 highest paid executives, including the existence and length of any service contract for the Chief Executive Officer, to be disclosed.[7]

Company Law Review Bill 1997

3.9 In 1998, the Committee when examining the Company Law Review Bill 1997, again gave detailed consideration to the disclosure of directors' remuneration and whether specific information on remuneration matters should be included in the annual directors' report.[8] It agreed with the approach taken in the Bill to have full disclosure of directors' and executives' remuneration as a means of ensuring accountability to shareholders and of building public confidence in capital markets. Even so, it recommended that:

> The government consider whether more detailed disclosures are required and whether they should be disclosed in the directors' report…[9]

Section 300A

3.10 At this time there was growing public disquiet about the salary package increases of senior executives which appeared to be out of kilter with the value of

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6 Parliamentary Joint Committee on Corporations and Securities, *Report on the Draft Second Corporate Law Simplification Bill 1996,* November 1996, p. xix.

7 Parliamentary Joint Committee on Corporations and Securities, *Report on the Draft Second Corporate Law Simplification Bill 1996,* November 1996, p. 36.

8 Parliamentary Joint Committee on Corporations and Securities, *Report on the Company Law Review Bill 1997,* March 1998, p. 14.

9 Parliamentary Joint Committee on Corporations and Securities, *Report on the Company Law Review Bill 1997,* March 1998, p. 17.

shares and the performance of some companies.[10] During debate in the Senate on the Bill, section 300A was inserted in the Corporations Act by amendment of Schedule 1 of the Company Law Review Bill. Arguing in favour of this provision, Senator the Hon Peter Cook, said:

> I think shareholders who are the owners of a company are not told what the executives that run that company on behalf of the shareholders receive for doing the job that shareholders delegate them to do. It should be a basic entitlement, I think, that shareholders should have that information.[11]

3.11 This section, now incorporated in the Corporations Act, requires the disclosure of information about the remuneration of directors and executive officers in the annual directors' report of listed companies. The report is to contain:

- discussion of broad policy for determining the nature and amount of emoluments of board members and senior executives of the company; and
- discussion of the relationship between such policy and the company's performance; and
- details of the nature and amount of each element of the emolument of each director and each of the 5 named officers of the company receiving the highest emolument.[12]

3.12 Section 300A, however, came under criticism. Ernst and Young noted that the requirements for executives and directors' remuneration under this section were introduced by late amendment and were not subject to a reasonable period of public exposure and discussion prior to inclusion in the law. It found:

> …many ambiguities and apparently unintended consequences in the drafting of the section which have led to uncertainty and inconsistency in its application.[13]

3.13 In 1999, the Committee had the opportunity to examine this provision and to explore further the question it had posed 12 months earlier about whether annual reports should include more detailed particulars on the remuneration of directors and executive officers. It did so when inquiring into the *Company Law Review Act 1998.*

3.14 During that inquiry, the Committee took evidence that identified a number of deficiencies including definitional problems,[14] and the inadequate link between

10 See for example, Senator Peter Cook, *Senate Hansard*, 25 June 1998, p. 4059.

11 Senator Peter Cook, *Senate Hansard*, 25 June 1998, p. 4059.

12 Section 300A, *Company Law Review Act 1998,* No. 61, 1998.

13 Ernst & Young, *Best Practice in the Disclosure of Directors' and Executive,* Corporate Governance Series, April 1999, p. 1.

14 Mr Easterbrook*, Committee Hansard*, 17 August 1999, p. 232.

remuneration policy and a company's performance.[15] Some witnesses were also concerned about unintended consequences arising from applying the requirement in section 300A to smaller companies where the consequences of having to disclose the remuneration of each of the 5 highest paid senior executives created difficulties.[16] The Committee made a number of recommendations including:

- the words senior executive be amended to 'executive';
- the definition of the term 'executive' be inserted as being 'a person who is involved in the management of the company or entity';
- the words 'emolument' be amended to 'remuneration';
- the new accounting standard on directors' and executives' remuneration require a statement by the board which discusses its remuneration policy and the relationship between that policy and the company's performance and how individual performance is measured, in addition to the responsibilities of directors to encourage higher corporate performance, the risks assumed by directors and how rewards are related to that policy;
- the provisions relating to disclosure of directors' and executives' remuneration apply to all listed companies;
- replace s 300(1)(d)(ii) with 'granted to the directors and to the 5 most highly remunerated executives of the company'; and
- insert in section 300A a provision which requires disclosure of the value of options granted, exercised and lapsed unexercised during the year and their aggregation in the total remuneration.[17]

3.15 In its response to the Committee's report on the Company Law Review Act, the Government stated its commitment to the principle of enhanced transparency in the corporate sector, particularly in the area of executive remuneration, which, it

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15 Senator Grant Chapman, Senate *Hansard*, 21 October 1999, p. 10131.

16 See Mr Bostock, *Committee Hansard*, 16 June 1999, p. 97. Other problems included ambiguity or inconsistency in the interpretation of section 300A; possible duplication with disclosure requirements caused by reconciling accounting standards and disclosure reporting requirements; uncertainty over the valuing of options granted to directors and executives; confusion between section 300A and paragraph 300(1)(d) on options as to whose options need to be disclosed; and termination payments. See Mr Meade, *Committee Hansard*, 16 June 1999, p. 25; Mrs Picker, *Committee Hansard*, 16 June 1999, p. 82; Mr Becher, *Committee Hansard*, 17 August, p. 261; Mr Easterbrook, *Committee Hansard*, 17 August 1999, p. 242.

17 Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on Matters Arising from the Company Law Review Act 1998,* October 1999, pp. 154–6.

acknowledged had in recent times become the focus of intense public interest.[18] It recognised the appropriateness of executive remuneration being set through the operation of the market mechanism, but held that transparent and relevant information on remuneration and its relationship to the performance and policy of the board is an essential tool for accountability to shareholders.[19] The Government agreed with the majority of the Committee's findings (see appendix 3).

Forerunner to provisions in CLERP 9—Corporations Amendment Bill 2002

3.16 In keeping with these basic principles and to address concerns about weaknesses in the disclosure regime of payments made to executives, the Government released an exposure draft Bill containing proposed amendments to sections 300 and 300A of the Corporations Act. They were contained in the exposure draft of the Corporations Amendment Bill 2002 (CAB) which was released for public consultation in December 2002. The CAB sought to clarify the current disclosure requirements in sections 300 and 300A of the Corporations Act. The Government on its release of this draft legislation recorded its commitment to the principle of enhanced transparency in the corporate sector, particularly in the area of executive remuneration.[20]

3.17 These amendments, intended to strengthen and clarify disclosure requirements relating to executive remuneration in subsection 300(1) and section 300A, were based on the recommendations made in the Committee's earlier report. They stipulated that remuneration details must be disclosed for each of the five most highly remunerated executive officers other than directors, in addition to disclosure relating to each director.

3.18 Under the proposed amendments, the value of options would be disclosed in the directors' report for the financial year. There would be a power to specify in regulations the method for determining the value of options. It was envisaged that the valuation methodology prescribed by regulation would be determined in accordance with a new accounting standard, which was expected to be introduced in the future.[21]

3.19 The issue of executive remuneration again came to the fore, during debate on the Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002 in the Senate. The Labor Party and the Australian Democrats expressed concern that the proposed legislation did not address the core problem of excessive executive

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18 Government Response to the Report of the Parliamentary Joint Statutory Committee on Corporations and Securities, Matters Arising From the Company Law Review Act 1998, December 2000, p. 27 of 32.

19 Government Response to the Report of the Parliamentary Joint Statutory Committee on Corporations and Securities, Matters Arising From the Company Law Review Act 1998, December 2000, p. 27 of 32.

20 Exposure Draft, Corporations Amendment Bill 2002, Explanatory Memorandum, 2002, p. 5.

21 Exposure Draft, Corporations Amendment Bill 2002, Explanatory Memorandum, 2002, p. 6.

remuneration.[22] They moved a number of amendments which according to Senator Stephen Conroy would 'stamp down on corporate excess'.[23] They included amendments intended to enhance the disclosure requirements on executive remuneration and to encourage shareholder participation in the setting of executive remuneration (Appendix 4 provides a complete list of amendments).

3.20 Although the Government recognised the amendments as well-intentioned, Senator Campbell told the Senate that the Government would not be supporting the remuneration changes because it already contemplated changes to the law which would be public 'within a period of weeks'.[24] He said:

> The government has been committed, as I have said, to a process of improving corporate disclosure through CLERP 9. I have developed a series of proposals which we are consulting on and which will go to cabinet in the very near future. They will be the subject of an announcement, obviously after the cabinet meeting, and will be the subject of CLERP 9 legislation which will be tabled in the parliament or given public exposure very shortly after it is drafted.[25]

The Committee now looks at the CLERP 9 proposals governing executive remuneration.

CLERP 9

3.21 The provisions on executive remuneration contained in the CAB, some in modified form, have been incorporated into the CLERP 9 Bill and are being advanced as part of the broader changes proposed by the Government to the disclosure requirements.[26] The amendments in CLERP 9 seek to enhance the existing regulatory framework by:

- extending the application of the disclosure requirements beyond the listed company to include the corporate group;
- enhancing the specific disclosures that must be made;

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22 The Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002 proposed to amend the Corporations Act 2001 to permit liquidators to reclaim unreasonable director-related payments and transfers of property made to directors by their companies up to four years prior to liquidation. The main object of the Bill as stated in the Explanatory Memorandum was to assist in the recovery of funds, assets and other property to companies in liquidation where payments or transfers of property to directors is unreasonable.

23 Senator Stephen Conroy, *Senate Hansard*, 27 March 2003, p. 10356.

24 Senator Ian Campbell, *Senate Hansard*, 26 March 2003, p. 10286.

25 Senator Ian Campbell, *Senate Hansard*, 26 March 2003, p. 10280.

26 See items 8 and 10, *CLERP (Audit Reform & Corporate Disclosure) Bill, Commentary on the Draft Provisions,* Corporate Law Economic Reform Program No. 9, October 2003, p. 101.

- giving shareholders greater capacity to hold directors accountable for their decisions regarding remuneration; and
- providing shareholders with greater say in relation to the quantum of termination payments.[27]

3.22 The current disclosure regime for executive remuneration has been in place since 1998 and adequate time has elapsed to allow an informed assessment of its effectiveness and the need, if any, for change.

3.23 As noted earlier, people who came before the Committee in 1999 listed a range of perceived flaws in section 300A (see paragraphs 3.13–3.14). More recently, a report commissioned by the combined Public Sector and Commonwealth Super Schemes, Catholic Super Fund and Northern Territory Government Public Authorities Superannuation Scheme revealed shortcomings in the disclosure regime for executive remuneration. It also gave substance to the public perception that executive remuneration is out of step with community expectations and has reached unacceptably high levels. It found, based on research of 172 S&P/ASX 200 Index companies, that:

> …s300 and s300A of the Corporations Act 2001 are not having their intended effect. Remuneration disclosures, generally, do not discuss alignment with company performance. Options valuations in company disclosures are a strong candidate for improvement and have already attracted the attention of ASIC.
>
> The research findings help explain why community focus (including political) is on headline remuneration, not on alignment of reward. The information to enable an intelligent evaluation is difficult to obtain and in a significant number of cases, absent. Improving the nature of disclosure (remuneration quantum and the relationship to entity performance) will enable investors to better assess the reward practices of the companies in which they are owners. Improved alignment of reward is a desirable outcome for shareowners.[28]

3.24 In considering the CLERP 9 provisions relating to the remuneration of directors and executives, the Committee examines the requirements as currently set down in section 300A and the proposed amendments. It keeps in mind the criticism that has surrounded this section since its introduction in 1998 especially as presented to this Committee in 1999 (see paragraphs 3.13–3.15).

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27 *CLERP (Audit Reform & Corporate Disclosure) Bill, Commentary on the Draft Provisions,* Corporate Law Economic Reform Program No. 9, October 2003, p. 102.

28 *Position Paper—executive remuneration,* research commissioned by Public Sector and Commonwealth Super Schemes, Catholic Super Fund and Northern Territory Government Public Authorities Superannuation Scheme, p. 7.

Schedule 5—Remuneration of directors and executives

3.25 The proposed amendments are contained in Schedule 5 of the Bill. They are designed to strengthen the current provisions of the Corporations Act and address concerns about the lack of disclosure of payments made to directors and executives.

3.26 New paragraph 300A(1)(a) is to replace the current paragraph and specifies that the directors' report for a financial year for a company must include in a separate and clearly identified section of the report:

> discussion of:
>
> (i) board policy for determining, or in relation to, the nature and amount (or value, as appropriate) of remuneration of directors, secretaries and senior managers of the company; and
>
> (ii) if consolidated financial statements are required—board policy in relation to the nature and amount (or value, as appropriate) of remuneration of other group executives for the consolidated entity;

3.27 This provision addresses a number of definitional problems that were raised during the Committee's earlier inquiry into the *Company Law Review Act 1998.* The intention of the legislation is clarified by using the word 'board' and not 'broad' and the term remuneration replaces the word 'emolument'. It also adds the term 'or value as appropriate' in determining the remuneration.

3.28 The proposed legislation also substitutes paragraph 300A(1)(c) with the following provision which requires the directors' report to include:

> (c) the prescribed details in relation to the remuneration of:
>
> (i) each director of the company; and
>
> (ii) each of the 5 named company executives who receive the highest remuneration for that year; and
>
> (iii) if consolidated financial statements are required—each of the 5 named relevant group executives who receive the highest remuneration for that year.
>
> If a person is covered by both subparagraph (c) (ii) and subparagraph (c)(iii) and details of the person's remuneration are included in the directors' report under subparagraph (c)(ii) details of the person's remuneration do not need to be included in the report under subparagraph (c)(iii).

3.29 The proposed amendments would retain the current requirement for the disclosure of the remuneration of the 5 most highly paid company executives and all directors of the listed company. The key change is the inclusion of the top 5 group executives of the consolidated entity in the disclosure requirements.

3.30 The term 'officers of the company' has been changed to 'company executives' which has a more specific meaning giving emphasis to the decision-making responsibility of the officer. The proposed legislation explains that a person is a company executive of the company if he or she is a secretary or senior manager of the company. Senior manager is defined as a person, other than a director or secretary of the corporation, who makes, or participates in making, decisions that have a substantial effect on the business of the corporation or has the capacity to affect significantly the corporation's financial standing.[29]

3.31 The Bill defines group executives for a consolidated entity as:

(a) the directors of the companies or bodies within the consolidated entity; and

(b) the secretaries of the companies or bodies within the consolidated entity; and

(c) the senior managers of any corporation within the consolidated entity; and

(d) the partners, and senior managers, of any partnership within the consolidated entity; and

(e) the trustees, and senior managers, of any trusts within the consolidated entity; and

(f) the senior managers of any joint venture within the consolidated entity.

Response to proposed provisions on executive remuneration

3.32 Overall, witnesses accepted the broad principle that 'investors in a publicly held company have a right to expect full transparency with regard to the remuneration received by the board and by the most senior executives'.[30] Many agreed that there is 'a need for increased transparency' and generally supported the intention of the Bill to strengthen the disclosure requirements of executive remuneration.[31] A number referred to recent high profile cases where inadequately designed remuneration schemes meant that shareholders were poorly informed.[32] Professor Ian Ramsay was of the view that there has been 'some tardy behaviour in the market place' and

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29 See Schedule 1, item 86—proposed definition of senior manager to be inserted in Section 9.

30 *Submission* 35, p. 23.

31 See *Submission* 19, p. [8]; *Submission* 25, p. 42; *Submission* 30, p. 5; *Submission* 38, p. [9]; *Submission* 44, p. 4; *Submission* 47, p. [3].

32 See *Submission* 44, p. 5.

although efforts had been made to improve transparency 'we still see evidence that some companies struggle to appropriately disclose their remuneration arrangements'.[33]

3.33 Critical comment was not confined to poor disclosure practices but extended to the apparent inability of the board to moderate the increases in executive remuneration. For example, based on comments made by retail shareholders, the ASA suggested that shareholders believe that boards for many years had failed to contain executive remuneration costs.[34] It asserted:

> …boards, as a whole, have not only been poor at restraining the size of executive packages, but have also been found wanting in their ability to properly maintain control of the structure of executive remuneration packages.[35]

3.34 Professor Robert Walker, Australian Council of Super Investors (ACSI), captured the prevailing attitude toward the disclosure of executive remuneration when he said:

> We are talking here about accountability, and I do not think you compromise requirements for accountability. To be able to form a company with limited liability, to be listed and to attract public investment is a privilege, and I think the 19th century ideals, that with that go some responsibilities to be fully accountable to the community, have some merit.[36]

3.35 Many noted that the proposals are consistent with international best practice.

3.36 Although submissions generally agreed with the current disclosure requirements and some welcomed the proposal to extend the requirements to group executives others wanted the legislation to go further. In contrast, some witnesses saw no advantage in broadening the requirement and expressed strong opposition to the reforms. The Committee now turns to examine the criticism about specific aspects of the provisions including:

- the effect on remuneration and whether it would result in further increases in executive remuneration;
- the consequences of the requirement to disclosure details of remuneration of the 5 highest paid company executives for smaller companies;
- establishing a link between remuneration and performance;

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33 *Committee Hansard*, 18 March 2004, p. 11. See also *Submission* 44, p. 4.

34 *Submission* 22, p. 3.

35 *Submission* 22, p. 4.

36 *Committee Hansard*, 16 March 204, p. 83.

- achieving meaningful disclosure;
- the disclosure and valuing of options; and
- the disclosure of termination payments.

'Ratcheting up' executive pay

3.37 Some business people responded immediately to the release of the exposure draft of CLERP 9 with the argument that the disclosure requirements would not achieve the desired result and rather than contain rising remuneration would lead to an increase in incomes for executives. David Gonski, Coca-Cola Amatil chairman, did not object to the disclosure requirements about the remuneration of executives. He anticipated, however, that disclosure of the top-10 paid executives was 'going to increase the amount…each is being paid.[37] Helen Lynch, Qantas chairwoman, shared the view that an unintended consequence would be 'a bigger group of people who are going to have higher salaries, because those comparisons will be done again'.[38]

3.38 These same predictions were presented as evidence during the inquiry. The Business Council of Australia (BCA) did not support the proposal arguing that:

> Increasing the number of executives covered by the disclosure requirements will only exacerbate unintended consequences from the disclosure requirement, particularly the 'ratcheting up' of executive salaries in a competitive market where demand for experienced and proven executives is strong. It is also inconsistent with general privacy principles and the movement towards greater protection for personal information.[39]

3.39 It suggested that the current requirement to disclose the remuneration of named individual executives be replaced with a requirement to disclose the combined remuneration of a set number of executives.[40]

3.40 The AICD also felt that an unfortunate by-product of the increased disclosure in relation to senior executive remuneration was 'the inevitable "benchmarking"' which in its view has 'contributed to a significant increase in remuneration levels'.[41]

3.41 Those in favour of improved disclosure held firmly to the view that shareholders as owners of the company have 'every right' to know particular

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37 *Australian Financial Review*, 'Company leaders take chair to talk governance', 27 October 2003.

38 *Australian Financial Review*, 'Company leaders take chair to talk governance', 27 October 2003. See also quotes from Michael Evans, AMP Henderson Global Investors, *Sydney Morning Herald*, 10 October 2003, p. 29.

39 *Submission* 20, p. 4.

40 *Submission* 20, p. 4.

41 *Submission* 35, p. 23.

remuneration packages.[42] They countered the assertion about the 'ratcheting up' of executives' pay with arguments that remuneration experts have a sound understanding of executives incomes. Mr Richard Gilbert, Investment and Financial Services Association (IFSA), told the Committee that:

> There is already a market for information out there for executive salaries. It does not take much to go to a headhunting company and find out what people are being paid, and the media can do that. So we do not see that as a critical barrier.[43]

3.42 Mr Bill Shorten, Australian Workers Union (AWU), dismissed the argument that disclosure would lead to a 'race to inflated executive returns'. He believed that:

> We think that companies having more information about what is happening will not lead to a ratcheting up; what it will lead to is a linking of performance to executive remuneration, which is appropriate. The Australian Workers Union are not against successful companies paying senior executives lots of money, but we do believe that, unlike the workers, who tend to get paid much less and have to bear the risk of job losses when companies underperform, there is very little upwards accountability of directors. We think transparency will in fact add to accountability.[44]

The top 5 most highly remunerated executives—application to smaller companies

3.43 Several submissions, including the Business Council of Australia (BCA), argued that increasing the number of executives to be disclosed would exacerbate problems with the current disclosure. For example, the BCA contended that disclosure has required reporting on junior, non-managerial executives.[45] Tap Oil Limited provided an example of how the application of this provision goes beyond the intention of the legislation. It informed the Committee that it is a small company with twenty five direct employees, three of whom are 'officers'. It explained:

> …and the Bill requires the disclosure of remuneration details of a further five employees, taking the disclosure to eight out of a total of twenty five employees. Practically, this means that Tap must disclose remuneration in detail down to the level of middle management. We do not think Tap is unique in these circumstances as many companies will find the disclosure reaching down to middle management levels.[46]

42 See *Submission* 3, p. [1]; *Submission* 14, p. 12.

43 *Committee Hansard*, 16 March 2004, p. 6.

44 *Committee Hansard*, 14 April 2004, p. 90.

45 *Submission* 20, p. 11.

46 *Submission* 56, pp. 1–2.

3.44 In its view, remuneration of employees is a private and sensitive issue and 'all companies strive to keep respective employee's salary packages and bonuses confidential in order to avoid internal conflicts'. It suggested that:

> For small companies, an arbitrarily determined, across the board level of disclosure goes far beyond this and rather than assist shareholders, I believe it places their company at a considerable disadvantage to larger companies in respect of managing and keeping staff.[47]

3.45 Ms Farrell, Law Council of Australia, also regarded this provision as unwarranted. She told the Committee:

> The amendments that have been made to section 300A require disclosure for a number of the highest-paid people, both at the group level, which we absolutely support because we think it makes sense that you cannot structure it around the disclosure, and at the listed company level. We think a requirement for disclosure at the listed company level where there is a group is not very sensible. It just leads to serendipitous reporting, potentially of a janitor—he is the only person employed there, so he hits the top five. If this provision were limited to group reporting, it would catch everyone, including highly paid people who are in the listed company, but it will not lead to some silly reporting which can derive just from where someone happens to be employed. We ask that reconsideration be given to that drafting.[48]

3.46 The AICD also believed that the proposal does not allow for particular business structures and suggested that it would be 'clearer, simpler and more logical to rely solely on the new 'top five consolidated group executives'. It explained that the proposed extension encompassing the top 5 highest paid would be of 'limited value' and 'discriminates against those groups whose "head office function" executives are employed by the listed company while the more highly remunerated "operational" executives are employed by operating subsidiaries'.[49]

3.47 On the other hand, other submissions saw the changes as one way to ensure disclosure in the report on all the appropriate executives.[50]

3.48 A number viewed the exact number of executives to be disclosed as less important than the information to be conveyed. For them it was important that the method chosen would ensure that the most appropriate executives' remuneration was disclosed. In other words 'limit the scope for corporate structures to be used to avoid

47 *Submission* 56, p. 2.

48 *Committee Hansard*, 16 March 2004, p. 52.

49 *Submission* 35, p. 24.

50 *Submission* 5, p.12; *Submission* 14, p.12; *Submission* 19; *Submission* 21, p. 20; *Submission* 25; *Submission* 30.

existing reporting requirements.'[51] While the proposed changes intend to overcome this by adding five executives from the group entity, there was some support in submissions to require remuneration disclosure for the ten (or five) most senior managers (or most highly remunerated) in the group entity (or economic entity). For example, the FSU wanted the disclosure requirements to extend to the top ten most highly remunerated executives in the listed companies.[52]

Committee view

3.49 The Committee appreciates the view that the requirement to disclose the remuneration of the top 5 highest paid company executives and the top 5 highest paid group executives appears unnecessary in some cases. The new disclosure provisions, however, apply to 'company executives' which means a person who is a secretary or senior manager and to 'group executives' which means the directors or secretaries of the companies within the consolidated entity or senior managers. As noted earlier a senior manager is defined as a person, other than a director or secretary of the corporation, who makes, or participates in making, decisions that have a substantial effect on the business of the corporation or has the capacity to affect significantly the corporation's financial standing.[53] This definition should allay the concerns of those who fear that the remuneration package of middle management officers or junior officers may be subject to the disclosure requirements.

Remuneration and performance

3.50 The ASX clearly identified the importance of companies making a connection between remuneration and performance. To encourage enhanced performance, it recommended companies disclose the process for performance evaluation of the board, its committees and individual directors and key executives.[54] This approach accords with international best practice evident in the draft revised text of the OECD Principles of Corporate Governance. The OECD principles state that:

> In particular, it is important for shareholders to know the specific link between remuneration and company performance when they assess the capability of the board and the qualities they should seek in nominees for the board.[55]

3.51 The UK Combined Code of Corporate Governance sets down the broad principle that the board should undertake a formal and rigorous annual evaluation of

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51 Australian Council of Superannuation Investors, *Submission* 5, p. 12.

52 *Submission* 38, p. [10].

53 See Schedule 1, item 86—proposed definition of senior manager to be inserted in Section 9.

54 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations,* March 2003, p. 47.

55 OECD, *OECD Principles of Corporate Governance*, Draft Revised Text, January 2004, p. 16.

its own performance and that of its committee and individual directors.[56] It elaborates further that the 'board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted. The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.[57]

3.52 In turning to performance, the Code states that 'the performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give these directors keen incentives to perform at the highest levels'.[58]

3.53 Under the current legislation in Australia the annual directors' report must include a discussion of the relationship between the board's policy for determining the nature and amount of emoluments of board members and senior executives and the company's performance.[59] Despite this requirement, there has been a push from sectors within the industry to improve the link between pay and performance. For example, IFSA has formulated guidelines to assist its members pursue an active role in monitoring the Corporate Governance responsibilities of the companies in which they invest. One guideline in particular offers advice on performance evaluation:

> The board should develop a formal performance evaluation process. The board should review its performance and the performance of individual directors, the company and management regularly.[60]

3.54 In 2003, Deloitte prepared advice, based on best practice from the US, Australia, Canada and the UK, for the Business Council of Australia (BCA) as a 'set of global best practice guidelines on executive remuneration'. The guide states that a company's executive remuneration policy should record the principles, objectives and design features of the policy and remuneration program.' It maintained that:

> A clear relationship between corporate performance and individual reward needs to be drawn.[61]

3.55 In its example of a Company Remuneration Policy Statement, the guide suggests the inclusion of a statement that the company's remuneration programs:

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56 *The Combined Code of Corporate Governance,* July 2003, p. 10.

57 *The Combined Code of Corporate Governance,* July 2003, paragraph A6.1, p. 11.

58 *The Combined Code nf Corporate Governance,* July 2003, paragraph B1.1, p. 12.

59 Sub section 300A(1)(b).

60 Investment and Financial Services Association Limited, *Corporate Governance*: A guide for Fund Managers and corporations, March 2003, p. 26.

61 Deloitte, *Executive Remuneration: Best Practice Principles and Guide,* November 2003, p. 11.

> Reward performance, not failure so that the company's best performers receive highly competitive remuneration and poorer performers receive less.
>
> Encourage executives to manage from the perspective of the shareholders by ensuring performance indicators are tied to achieving alignment of company and shareholder interests.[62]

3.56 Without doubt the business community in Australia is now aware of the importance of achieving a linkage between remuneration and performance and of the public's perception that at the moment this nexus is weak. Indeed, for a number of years there has been growing concern about the number of prominent cases indicating a disconnection in Australia between executive remuneration and performance.

3.57 This concern was evident in submissions. Although they generally endorsed the requirement to disclose the quantum of remuneration, many stressed that aligning executive remuneration with performance was important.[63] There was, however, a strong sense that companies had fallen short in matching executive remuneration with the rewards of investment performance.[64]

3.58 Mr Phillip Spathis, Australian Council of Super Investors (ACSI), cited a number of studies that found 'a negligible link between the size of fixed and variable outcomes and company performance'.[65] One such study by the Public Sector and Commonwealth Superannuation Schemes cited research that was unable to establish a link between remuneration for executive and performance for shareholders (paragraph 3.23). It found that remuneration 'is strongly correlated with the size and complexity of the company, but the link to company performance in terms of return on equity and return on assets is largely absent'.[66] The research was based on 172 S&P/ASX 200 Index companies listed in both 2001 and 2002. Among its major findings were:

- 43 companies (25%) did not disclose a detailed remuneration policy (2001; 52 companies); and
- only 45 companies (26%) disclosed information on individual performance hurdles and how hurdles link to shareholder value (2002; 41 companies).

3.59 In noting that 74% of the listed companies failed to disclose information on individual performance hurdles and their connection to shareholder value, the report suggested:

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62 Deloitte, *Executive Remuneration: Best Practice Principles and Guide,* November 2003, p. 11.

63 *Submission* 10, p. [3].

64 *Submission* 10, p. [3]; *Submission* 44, p. 5.

65 *Committee Hansard*, 16 March 2004, p. 72.

66 *Position Paper—executive remuneration,* research commissioned by Public Sector and Commonwealth Super Schemes, Catholic Super Fund and Northern Territory Government Public Authorities Superannuation Scheme, pp. 4–5. See also *Submission* 10, p. [1].

> despite having governance structures in place there is a lack of disclosure, signalling that the governance policies are not working and potentially leaving companies exposed to risk.[67]

3.60 The ACSI welcomed the measures in CLERP 9 to improve the disclosure requirements on remuneration. It advanced the principle that 'in making disclosures about director and executive remuneration, companies should approach their obligation from the starting point of providing shareholders with comprehensive disclosure'.[68] It maintained that the information made available needs 'to ensure that the nature of remuneration including any performance hurdles on which the payment is based is clearly spelt out and accessible to shareholders'.[69]

3.61 It argued that disclosure of remuneration should be accompanied by an explanation of its connection to performance. It stated:

> Future performance benchmarks for remuneration should also build upon succinct reports, that include appropriate graphs and diagrams, that outline how existing remuneration outcomes have tracked against company performance as measured against both relative and absolute measures of community performance as well as other relevant measures such as growth in market share, innovation, new product development etc.[70]

3.62 Mr Spathis wanted pressure applied to corporations that would ensure that they make the link between pay and performance. He stated:

> …it is integral that the remuneration reports clearly outline and explain the relationship between remuneration policy and company performance. We are concerned about this lack of linkage. There are a number of studies that were undertaken by Westpac governance service, the New South Wales trades and labour council and us that have found a negligible link between the size of fixed and variable remuneration outcomes and company performance.[71]

3.63 To the same effect, Professor Ramsay argued the importance of having appropriate incentives for executives which means that proper transparent hurdles must be established. He said:

> I am convinced that many companies are getting better at this, but getting companies to set the right hurdles on things like options has been a slow

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67 *Position Paper—executive remuneration,* research commissioned by Public Sector and Commonwealth Super Schemes, Catholic Super Fund and Northern Territory Government Public Authorities Superannuation Scheme, pp. 4–5.

68 *Submission* 5. p. 13.

69 *Submission* 5, p. 13.

70 *Submission* 5, p. 15.

71 *Committee Hansard*, 16 March 2004, p. 72.

> process. At the tail end, if someone needs to have their employment terminated because of poor performance, then shareholders are genuinely concerned if they see payments of many millions of dollars for poor performance and sometimes employment contracts that appear to go for under a year. In some instances we see companies getting it wrong at both ends, yet both ends are important in providing the right environment for senior executives.[72]

3.64 IFSA submitted that:

> Performance hurdles should be clearly disclosed and should be based on specific benchmarks that assess actual company performance, eg peer assessment in terms of long-term growths of the company and resulting shareholder value. Moreover, what is important in director and employee remuneration is that there be a strong alignment between shareholder and board/executive interests.[73]

3.65 The ANZ joined the call for a connection to be made between remuneration packages and corporate performance. It stated that there is no justification for large compensation packages that reward failure.[74] It explained further:

> Just as importantly, clearly defining what constitutes success is important if the corporate community is serious about its credibility amongst shareholders and the wider community. Requiring that the Annual report details the performance hurdles to which payment of options or long term incentives are subject, why such hurdles are appropriate and the methods used to determine whether performance hurdles are met are appropriately captured in the Bill.[75]

3.66 The FSU wanted broader measures of performance to apply to take account not only of shareholder return but of the interests of all stakeholders in the company. It cited the balanced scorecard approach introduced in 1992 by Kaplan and Norton. It submitted that:

> A balanced scorecard approach recognises that financial measures alone are insufficient for modern organisations and generally include measures in the areas of financial, customer satisfaction, internal business processes and learning and growth.[76]

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72 *Committee Hansard*, 18 March 2004, p. 12.

73 *Submission* 44, p. 5.

74 *Submission* 14, p. 12. See also Mr Easterbrook, *Committee Hansard*, 9 March 2004, p. 9.

75 *Submission* 14, p. 12.

76 *Submission* 38, p. [12].

3.67 Building on this approach, the FSU suggested that measures include customer satisfaction, employee satisfaction and motivation, process improvement, corporate reputation and strategic development.[77] It recommended that:

> The Corporations Law must be amended to require that the responsibilities of the directors of publicly listed companies include a responsibility to stakeholders such as employees and customers. There needs to be a fairly broad discretion for companies to develop their own processes to meet this responsibility, however any performance measures set for non-executive directors and executives should reflect this responsibility.[78]

3.68 Despite having stated that there needs to be fairly broad discretion for companies to develop their own processes to meet this obligation, it did stipulate that information such as the ratio between the highest and the lowest paid employee in the company, the growth or decline in employment in the company and the measures by which the company's performance in relation to stakeholders is judged is to be included in the report.

3.69 The Committee notes the guides on best practice produced by organisations such as the ASX and Deloitte encouraging companies to establish and explain the link between remuneration and performance (see paragraphs 3.50–3.55). Avowing a principle is one thing, putting that principle into practice is another. It requires not only commitment by the company but the willingness to devise and implement a model that will establish a clear connection between remuneration and rewards and put in place means to track and measure performance against stated objectives. The proposed legislation clearly requires the remuneration report to contain a discussion of the board's policy for determining the nature and amount of remuneration of directors and senior managers. There is a requirement under the current legislation for the directors' report to include a discussion of the relationship between the board's policy on remuneration and the company's performance.[79] Although implied, the provision does not stipulate that this discussion is to link income and other benefits with performance. This requirement, however, is made clear in the Explanatory Memorandum to CLERP 9 which states that disclosures:

> …should explain the basis on which remuneration packages are structured and how this relates to corporate performance. To assist in meeting this obligation, the regulations will require disclosure of information such as performance hurdles to which the payment of options or long term incentives of directors and executives are subject; why such performance hurdles are appropriate and the methods used to determine whether performance hurdles are met.[80]

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77 *Submission* 38, p. [12].

78 *Submission* 38, p. [12].

79 Section 300A(1)(b).

80 Explanatory Memorandum, p. 168.

Committee view

3.70 The Committee attaches the highest importance to boards, when determining remuneration, to establish a direct connection between the remuneration to be received by directors and executives and performance. It believes that the intention of the proposed legislation as it now stands is clear—that the annual directors' report is to include a discussion on the board's remuneration policy for determining the nature, amount or value of the remuneration of directors, secretaries and senior managers. This provision essentially replicates the current one except for definitional changes. And further, under current legislation which will remain in force, there must be a discussion of the relationship between such policy and the company's performance. The problem appears to lie in putting this requirement into practice and the lack of willingness by some corporations to comply with this intention. The difficulty with enforcing this obligation also undermines its effectiveness.

3.71 The Committee notes that a heavy reliance is to be placed on regulations to ensure that the intention of the legislation translates into corporate practice. Evidence to the Committee has revealed that a significant number of companies lack diligence in satisfying the current disclosure requirements especially in establishing the connection between executive rewards and performance. ASIC will have a key role in ensuring compliance with the current and proposed disclosure obligations.

3.72 The Committee sees a clear need for ASIC to take a strong and early stand in making known, as stated in the Explanatory Memorandum, that under section 300A(1)(a) disclosure 'should explain the basis on which remuneration packages are structured and how this relates to corporate performance'. The generality of this provision should not be an excuse for companies, when making this disclosure, to avoid their obligation to present the information in a way that can be understood by shareholders. Furthermore, any contract linking remuneration to performance should add value in the longer term. A high share price in a bull market is not always a measure of executive performance.

Recommendation 10

3.73 The Committee recommends that ASIC release as soon as possible a guide that leaves no doubt that the remuneration report is to contain a discussion on the board policy for determining the remuneration of its most senior executives which is to be presented in such a way that links the remuneration with corporate performance.

Recommendation 11

3.74 The Committee also recommends that the regulations to be promulgated under this section adopt the direct and specific language used in the Explanatory Memorandum and not the vagueness of the wording in the Bill. The Committee recommends that regulations make clear that what must be included in the remuneration report is information 'such as performance hurdles to which the payment of options or long term incentives of directors and executives are

subject; why such performance hurdles are appropriate and the methods used to determine whether performance hurdles are met'.

Meaningful Disclosure

3.75 The ASX in its Principles of Good Corporate Governance and Best Practice Recommendations advises that:

> Transparency as to the remuneration policy should be complemented by full and effective disclosure, in keeping with the spirit and intent of the Corporations Act and the ASX Listing Rules, of the remuneration paid to directors and senior management.[81]

3.76 As already noted, not all companies appear to comply fully with either the letter or intent of the law. Mr Rodney Masson, Finance Sector Union, was of the view that 'disclosure needs to be far more specific and clear so that those who are not necessarily financially literate have no difficulty in understanding them and then comparing them back over time to see what growth has occurred'.[82]

3.77 The ACSI also raised this issue, which relates to one of the central objectives of the legislation—the intelligibility of the disclosure contents. It was particularly concerned to ensure that the information made available was instructive, thorough and presented in such a way that it could be understood. It stated:

> It is an imperative that listed entities properly comply with the requirements of section 300A to disclose the 'broad policy' for determining the nature and amount of emoluments of board members and senior executives—including an explanation of the relationship between remuneration policy and company performance.[83]

3.78 It made the point that some companies that comply with section 300A provide such extensive disclosures that it is difficult for investors to interpret the material.[84] Furthermore it noted from experience that many listed entities fail to disclose arrangements to pay retirement benefits to directors or executives—only accruing entitlements in the accounts, while elsewhere disclosing sums paid or payable for the past year.

3.79 To assist companies observe the spirit of the legislation, the ACSI referred to the Securities and Exchange Commission which amended its disclosure requirements to replace lengthy and legalistic 'boilerplate' disclosures with a series of tables designed to inform shareholders 'of exactly what is being done at their expense'. The

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81 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations,* March 2003, p. 51.

82 *Committee Hansard*, 14 April 2004, p. 68.

83 *Submission*, 5, p. 13.

84 *Submission* 5, p. 13.

Commission required the presentation in registration statements of a Summary Compensation Table covering the benefits granted to CEOs and other senior executives. This format, as presented below, was designed to provide an easily understood summary of all forms of executive compensation in a single location.

3.80 The ACSI maintained that similar tables could be used to present information on compensation and benefits paid or payable to directors.[85]

Summary Compensation Table

		Annual Compensation			Long term compensation Awards		Payouts	All other compensation
(a)	(b)	(c)	(d)	(e)	(f)	(h)	(i)	(j)
Name and principal position	**Year**	**Salary ($)**	**Bonus ($)**	**Other annual compn. ($)**	**Restricted stock awards ($)**	**Options/ SARs ($)**	**LTIP payouts ($)**	**($)**
CEO	1992							
	1991							
	1990							
A	1992							
	1991							
	1990							
B	1992							
	1991							
	1990							
C	1992							
	1991							
	1990							
D	1992							
	1991							
	1990							

Note: SARs refers to the value of stock options; LTIP refers to 'Long Term Incentive Plans'. Acrued retirement benefits would be listed under 'other' compensation.

3.81 The National Institute of Accountants suggested that companies should be encouraged to report to shareholders a *pro forma* mechanism for the payment of retiring directors and senior executives and then to report to shareholders where a particular payment falls outside the ambit of the agreed format.[86] ASIC also agreed

85 *Submission* 5, p. 14.

86 *Submission* 25, p. 42.

that disclosure is often 'enhanced by easy to understand tables' which is 'supported by generally good thinking about effective consumer communication'.[87]

3.82 Under new section 300A(1C), regulations may be issued to provide how elements of the disclosure are to be determined. In the commentary on the Bill, the Government advised that it intends to require disclosures to conform to the new accounting standard now issued as *AASB 1046 Director and Executive Disclosures by Disclosing Entities*.[88]

3.83 The Committee is pleased to note that this standard has included a preferred model to assist companies present information in a clear and concise table (see following table). This approach to the adoption of the one model would certainly lead to greater transparency and make the information readily understood by shareholders.

3.84 Although the Committee endorses the concept of having a standard model to be used in the remuneration report, it did not inquire into the strengths and weaknesses of the model recommended in AASB 1046 and how thoroughly it had been tested especially by shareholder groups. If promulgated as a regulation under CLERP 9, it may be subject to Parliamentary scrutiny. In any case the market should be informed by an ASIC Guidance note.

Accounting standards and disclosure requirements

3.85 It appears that certain elements of AASB 1046 may vary from the requirements specified in the proposed legislation. This standard is therefore a critical consideration in implementing CLERP 9.

3.86 A number of witnesses were concerned about the actual setting out of the disclosure and the compatibility between the accounting standards and the disclosure requirements in CLERP 9. The proposed legislation as it now stands specifies that certain details in relation to remuneration are to be recorded in the directors' report.

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87 Mr Rodgers, *Committee Hansard*, 29 April 2004, p. 52.

88 *CLERP (Audit Reform & Corporate Disclosure) Bill, Commentary on the Draft Provisions,* Corporate Law Economic Reform Program No. 9, October 2003, p. 104. The Preface to AASB 1046 explains that the majority of the disclosures in this standard were initially proposed in Exposure Draft ED 106, the standards cited in the Explanatory Memorandum.

Appendix 3 in AABS 1046—Table 3 Remuneration Disclosures

Company Ltd	year ended 31-Dec 20X5							
$'000	**Primary** Salary & Fees	Cash Bonus	Non-Monet.	**Post Employment** Super-annuation	Retirement Benefits	**Equity** Options	**Other Benefits**	**TOTAL** $'000
Specified Directors								
Andrew, A.	Chairman (non executive)							
	104	-	-					
20x5	96	-	-	8	42			154
20x4				8	32			136
	Director and Chief Executive							
Black, B	officer							
	780	117	88					
20x5	710	107	78	94		137	8	1.223
20x4				85		274	10	1,265
	Director (non-executive)							
Cathie, C.	52	-	2					
20x5	48	-	1	4	22	-	-	80
20x4				4	16	-	-	69
	Director (non executive)							
David, D.	13	-	-					
20x5	48	-	-	1	11	-	-	25
20x4				4	16	-	-	68
	Director (non-executive)							
Edgar, E	39	-	-					
20x5				3	13	-	-	55
Total Remuneration: Specified Directors								
20x5	988	117	89	110	88	137	8	1,537
20x4	938	107	79	103	76	274	10	1,588
Specified Executives								
Gail, G.								
20x5	550	83	59	66	-	274	15	1,019
20x4	510	77	33	61	-	-	13	694
Honner, H	GeneralCounsel/ Company. Sec							
20x5	370	67	38	44	-	216	4	739
20x4	350	63	29	42	-	216	12	712
Innis, I	Chief Financial Officer							
20X5	430	90	37	52	-	124	3	735
20X4	410	86	32	49	-	124	3	704
James, J	General Manager, Marketing: resigned 8 January 2006							
	330	43	45					
20x5	320	42	39	40	-	69	-	526
20x4				38	-	137	-	576
Kelly, K	340	65	23					
20x5				41	-	197	-	665
Total Remuneration: Specified Executives								
20x5	2,020	347	201	242	-	852	21	3,683
20x4	2,040	312	171	245	-	592	40	3,400
Group totals in respect of 20x4 do not necessarily equal the sums of amounts disclosed for 20x4 for individuals specified in 20x5 as different individuals were specified in 20x4								

3.87 Without limiting this requirement, regulations may provide that the value of an element of remuneration is to be determined in a particular way or by reference to a particular standard.[89] Mr Michael Coleman, KPMG, stated:

> In my opinion you just have only one requirement: the requirement that is included in the accounting standard. If you do have a requirement in an accounting standard and in a regulation, you will always have issues to do with interpretation, and the things that you might disclose in one place might be different. I do think that financial statements are lengthy enough and potentially confusing enough to the uninformed as it is, without having the same sorts of words being used to describe slightly different, or even significantly different, numbers…On my understanding of the philosophy behind these disclosures, it has been agreed that it is appropriate that the accounting standard should deal with all those types of disclosures. If for some reason there is a view that the accounting standard is not giving the appropriate disclosures then submissions can be made to the Accounting Standards Board…It really is very important that financial statements are as clear as possible.[90]

3.88 Mr Harley McHutchison, Deloitte Touche Tohmatsu, also asked for the regulations and accounting standards to be consistent.[91] The ANZ preferred that the details of the remuneration be set out through accounting standards which 'will have the force of law…rather than through regulations'.[92] Similarly, Telstra stated that 'guidance on matters of measurement and financial disclosure in relation to directors' and executives' remuneration should be dealt with in an appropriate accounting standard and administered by the accounting standard setting body.[93] It concluded:

> It is confusing where there are differences between the scope and detail of disclosures and the basis of measurement required in the directors' report and those made in compliance with accounting standards.[94]

3.89 The Group of 100 Inc was among the many witnesses who were worried about the possible inconsistency between the requirement and the accounting standards. It submitted:

> The G100 believes that the proposals should harmonise with those required in Accounting Standards. It is inefficient and potentially misleading and confusing to users where there are differences between the scope and detail

89 Proposed section 300A(1C).

90 *Committee Hansard*, 16 March 2004, p. 27.

91 *Committee Hansard*, 11 March 2004, p. 24.

92 *Submission* 14, p. 12.

93 *Submission* 41, p. [3].

94 *Submission* 41, p. [3].

> of the disclosures and the basis of measurement required in the directors' report and those made in compliance with Accounting Standards.[95]

3.90 The Institute of Chartered Accountants and CPA Australia stated bluntly that:

> …it would be preferable for all disclosure requirements to be made in a manner either required by or consistent with the applicable accounting standards.
>
> Accounting standards AASB 1017, 1028 and 1034 contain requirements for disclosure of directors' and executives' remuneration. It is confusing for users and preparers of financial statements to have different disclosures in different locations report.[96]

3.91 This statement was endorsed by PriceWaterhouseCoopers and KPMG.[97]

Committee view

3.92 The Committee notes the concerns expressed, particularly by the accounting bodies, about the need to have the regulations governing disclosure on executive remuneration consistent with accounting standards. Their testimony highlighted the important function that Parliament will take in scrutinising the regulations promulgated under these provisions to ensure that the requirements of the legislation and the accounting standards are compatible and avoid unnecessary duplication.

3.93 The presentation of information also includes the performance measurement. According to ACSI, shareholders should have

> …a reasonable expectation that Company remuneration committees and boards will make genuine efforts to explain, comprehensively and in a user friendly manner, the various benchmarks for performance that will impact on remuneration particularly, equity based remuneration. This will ensure that shareholders make informed and rational decisions with regard to proposals submitted by the company.[98]

3.94 It noted that such a reform would overcome a current deficiency that exists in some countries where shareholders need 'to scour across disparate pieces of information in an annual report and explanatory memorandum, in order to understand the remuneration framework and then to make any connection to company performance'. It maintained that the provision of a remuneration report will provide a

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95 *Submission* 46, p. 2.

96 *Submission* 36, p. 113.

97 *Submission* 27, p. 113; *Submission* 33, p. 114.

98 *Submission* 5, p. 18.

practical opportunity for shareholders to have a 'one stop shop' of information on these issues.[99] The following section looks more closely at this matter.

Location and auditing of the remuneration report

3.95 The proposed legislation requires the information on executive remuneration to be included in a separate and clearly identified section of the directors' report under the heading 'Remuneration report'.[100] A number of submissions endorsed this proposal.[101] Mr Harley McHutchison, Deloitte Touche Tohmatsu, wanted the information on executive remuneration to be in the one place. In his view this would be 'more efficient if there was only one place to look at to determine what the necessary disclosure is or should be'.[102]

3.96 There was, however, a difference of opinion on the actual location. The proposed legislation requires the disclosure and discussion of remuneration packages and policies for directors and executives to be in the director's report. AASB 1046, however, requires a similar disclosure within the financial reports. This may result in a duplication of a significant volume of information within the same annual report.

3.97 Citing practices in other countries, Mr Keith Alfredson appears to suggest that corporate governance issues, such as remuneration disclosures, might not belong within financial statements. Specifically, remuneration disclosures are only required to appear in an audited corporate governance report (UK) or in the director's report (USA), not in the financial reports. AASB 1046 requires that remuneration disclosures appear in the financial reports.[103]

3.98 Another concern was raised regarding independent auditing of the disclosures. Independent auditing of financial reports provides assurance of the reliability and comparability of the information being disclosed. Disclosures in the financial reports are scrutinised by audit whereas the directors' report is not. Mr Alfredson suggested that any disclosure should 'clearly differentiate between vested remuneration and accrued, but unvested, remuneration and further that 'such disclosures should be required to be audited, even though they are part of the Governance report and not the accounts'. [104]

3.99 Mr Malcolm Rodgers, ASIC, saw a connection between the audited financial statements and the remuneration report. He explained:

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99 *Submission* 5, p. 18.

100 Proposed subsection 300A(1A)., items 10 and 13.

101 *Submission* 14, p. 12.

102 *Committee Hansard,* 11 March 2004, p. 24.

103 *Submission* 52.

104 Mr Keith Alfredson, *Submission* 52.

> There is an audit process to the extent that the remuneration reflected in the remuneration report forms part of the financial report. It is subject to the audit process. I have not put my mind to this question, including whether that creates additional difficulties for the auditor and the audit process in asking them to review effectively a part of the directors' report which is not—[105]

Committee view

3.100 The Committee is firmly of the view that the Remuneration report should be a self-contained section of the directors' report providing all relevant information required under the executive remuneration disclosure provisions. It supports the proposed legislation in this regard. It draws attention, however, to the number of witnesses who expressed the importance of having the legislation and the accounting standards complementary, of avoiding any potential for confusion between the two and of minimising duplication.

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105 *Committee Hansard*, 29 April 2004, p. 53.

CHAPTER 4

EXECUTIVE REMUNERATION—FULL DISCLOSURE

4.1 There was an undertone of scepticism in the evidence before this Committee about achieving full disclosure especially with regard to the value of options and termination payments. This chapter examines whether the provisions governing the disclosure of the remuneration of directors and executives will achieve full disclosure.

4.2 Mr Stephen Mayne, Publisher, Crikey.Com.Au, presented a commonly held view that everything should be disclosed. He told the Committee:

> Relocation packages often run to hundreds of thousands of dollars, but there is no disclosure of that. A company like David Jones has a provision whereby directors get shopping discounts of up to 35 per cent. That is of value—some of them spend many tens of thousands—and the value of the goods they get is not disclosed in the annual report. So I would say every benefit they get, where it extends into large costs for the company, should be disclosed. Often it is a case of a company meeting costs which are providing a benefit for the company—if you agree to relocate six children and put them all in private schools, the shareholders are often spending hundreds of thousands of dollars providing a benefit to the executives—but it is not disclosed.[1]

4.3 The CLERP 9 proposal clearly states that the prescribed details in relation to remuneration are to be disclosed. And further that the regulations may provide that the value of an element of remuneration is to be determined in a particular way or by reference to a particular standard.[2] As noted in the previous chapter, the Government intends that the information to be disclosed in relation to remuneration will be the same as that proposed to be disclosed under AASB 1046.[3] The Explanatory Memorandum states that in the absence of an accounting standard the following information will need to be disclosed:

- primary benefits including cash and other incentive and base remuneration;
- post-employment benefits, including retirement benefits and contributions by, or changes in the liability of, the entity to pension or superannuation plans and other arrangements to benefit employees following cessation of employment;

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1 *Committee Hansard*, 14 April 2004, p. 39.

2 Proposed subsection 300A(1C).

3 Explanatory Memorandum, p. 168. The Memorandum states further that 'the regulations may build on these requirements in relation to the basis on which remuneration is determined'.

- equity compensation; and
- other compensation benefits not disclosed under the above categories.[4]

Shares and options

4.4 In its report into the Company Law Review Act in 1999, the Committee cited two surveys that showed a number of cases where companies were failing to comply with the disclosure requirements for directors' and officers' emoluments especially in relation to the value of options. The Committee noted this non-compliance stemmed not from an unwillingness to comply but because of the drafting of section 300A which made the law on the disclosure of the value of options unclear.[5]

4.5 More recently, the report on executive remuneration commissioned by a combination of superannuation funds found that of the 107 companies reported issuing options, 50 (47%) did not report the value of those options (2001; 125 and 82% companies respectively).[6] Clearly, this aspect of disclosure is still a matter of concern.

4.6 IFSA held the view that the value of shares and share option schemes should be fully disclosed to shareholders. It stated its belief that:

> …shareholder consideration and approval of employee and executive share schemes is a fundamental shareholder right. The design of executive and employee share and option schemes is an important issue for all shareholders. These schemes involve considerable expense to the company and may dilute the existing shareholder base.[7]

4.7 The Finance Sector Union reinforced the call for all options and other share incentive arrangements to be fully costed.[8] It believed that more could be done to improve the disclosure of total emoluments of executives 'where previous option allocations are made clear in the course of shareholders being asked to grant additional allocations'. [9]

4.8 The ASX makes clear in its best practice guide that the disclosure requirements for the amount of remuneration would include 'the value of shares issued

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4 Explanatory Memorandum, p. 168.

5 Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on Matters Arising from the Company Law Review Act 1998,* October 1999, p. 156.

6 *Position Paper—executive remuneration,* research commissioned by Public Sector and Commonwealth Super Schemes, Catholic Super Fund and Northern Territory Government Public Authorities Superannuation Scheme, p. 4.

7 *Submission* 44, p. 5.

8 *Submission* 38, p. [11].

9 *Submission* 38, p. [11].

and options granted, according to an established and recognised method of valuation'.[10] ASIC's Guidelines to valuing options in directors' reports unequivocally states that:

> All listed companies are required to comply with their obligations under 300A(1)(c) by disclosing the value of emoluments relating to options in their directors' reports. Companies are not relieved of their statutory obligation merely because they regard the calculation or disclosure as being too difficult or onerous.[11]

4.9 ACSI gave particular attention to share and option schemes and listed a number of concerns that in its view need specific consideration when drafting regulations.[12] It included annual reports where there are no adequate performance hurdles for exercising a share option or receiving shares under an executive incentive scheme. It also, among numerous other matters, noted annual reports that do not disclose the value of shares (or deferred shares or performance rights etc) granted to directors and the 5 highest-paid executives and the price of share options (or the method of determining it).[13]

4.10 The Australian Shareholders' Association (ASA) also recognised failings in the disclosure of options. It told the Committee:

> In Australia, shareholder groups (including both the ASA and its institutional equivalent IFSA) have effectively forced directors to improve their efforts in relation to equity-based payments. It is important to note that it was these shareholder groups which have led the debate, rather than directors. Indeed there are still companies that do not meet even the most basic guidelines in relation to option pricing and performance hurdles.[14]

4.11 The legislation places a heavy reliance on regulations to ensure that the intention of the legislation is realised. The Committee notes that AASB 1046 sets down details to be disclosed with regard to options and rights provided as remuneration to specified directors and executives. The Committee further notes the explanation given by the AASB 1046 that the standard 'applies to both options and rights granted as remuneration to specified persons during the reporting period, unlike the Corporations Act which includes grants made since the end of the reporting period and does not refer to rights'.[15]

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10 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations,* March 2003, p. 52.

11 ASIC, *Guidelines to valuing options in annual directors' reports*, June 2003, p. 1.

12 *Submission* 5, pp. 16–17.

13 *Submission* 5, pp. 15–16.

14 *Submission* 22, p. 4.

15 Australian Accounting Standards Board, Accounting Standard AASB 1046, Director and Executive Disclosures by Disclosing Entities, paragraph 8.2.1.

4.12 The Committee repeats its concern that the proposed legislation and accounting standards be consistent (see paragraph 3.92).

4.13 The Australian Accounting Standards Board (AASB), in regard to equity in the form of equity not in the disclosing entity or its subsidiaries (for example in an overseas listed parent company), informed the Committee that although equity in this guise would not be considered equity compensation it would nonetheless be covered under non-equity remuneration. Ms Stoddart explained further:

> It would certainly be caught under the definition of remuneration in section 5.1 of AASB 1046, which includes things that are made available for the management of the company by the entity and by any related party. An overseas parent would undoubtedly be a related party. So it would be caught but not as equity because it is not equity in that company.[16]

4.14 Again fulfilling the requirement to disclose information only partially meets the obligation to shareholders. The information must be set out in such a way that shareholders can understand and fully appreciate the value of the benefit as a single element and its place in the overall package. According to IFSA:

> Shareholders may then assess whether boards have designed schemes that meet the particular needs of the company in terms of driving improved company performance.[17]

4.15 The question, for ISFA, was not that executive and employee share and option schemes should be abandoned but that boards develop incentive schemes that 'are appropriate for the circumstances of the company and which are aimed at driving superior executive performance'.[18]

Committee view

4.16 Clearly the disclosure of options continues to be a contentious matter. The Committee has no doubts that the statements and guides issued by bodies such as the ASX and ASIC support the current legislation in trying to effect full disclosure of director and executive remuneration particularly in areas susceptible to non-compliance. Accounting standards will further assist the legislation in achieving full disclosure of director and executive remuneration especially in the areas where compliance needs to improve such as the issue and valuing of options. Their success in achieving full and meaningful disclosure will need to be monitored and assessed.

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16 *Committee Hansard*, 29 April 2004, p. 73.

17 *Submission* 44, p. 5.

18 *Submission* 44, p. 5.

Non-recourse loans

4.17 Another area of remuneration that needs further clarification is non-recourse loans. On this matter, Treasury informed the Committee that they were still examining this issue. It stated that one of the points to be considered was that with non-recourse loans, the full value of the loan 'may not necessarily be attributable to remuneration'. The question then arises whether it should be disclosed as an element of remuneration or placed alongside the remuneration disclosures. Mr Simon Winckler, policy analyst, Treasury, explained that 'it may be more appropriate to require disclosure of loans alongside remuneration so that shareholders have an idea of the value of those loans without actually including them in attributive remuneration disclosures'.[19]

Termination payments

4.18 An area of remuneration that has also been a source of contention is termination payments. A number of organisations have outlined in their corporate governance guidelines the need to ensure transparency in the payment of termination or retirement payments to directors and executives. IFSA for example stated that it is important for such payments to be reasonable in the circumstances of the departure and to be fully disclosed to shareholders.[20] This guidance appears to the Committee self-evident and serves to highlight the need not only for improved disclosure but for a shift in cultural attitudes toward the determination of executive remuneration.

4.19 The high values of some recent termination payouts to directors and executives have taken many shareholders by surprise, particularly where the termination occurred at a time when the company was underperforming. A report prepared for the Labor Council of New South Wales identified large termination payments to departing senior executives as one of the most controversial aspects of executive remuneration. It stated:

> The Australian corporate landscape is littered with examples of failed executives being paid multi-million dollar payouts to ease the pain of separation following poor performance…in many cases, these so-called 'golden handshakes' dwarf the levels of annual cash remuneration paid to such executives.
>
> …
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> Various justifications are offered for such stratospheric and frequently hidden payments. Defenders of the practice argue that they represent special recognition for good/long service and provide an incentive for the departing executive to do so 'quietly' and not disclose corporate information to competitors. To critics, however, such payments amount to rewards for

19 *Committee Hansard*, 29 April 2004, p. 58.

20 IFSA, *Corporate Governance: A Guide for Fund Managers and Corporations,* p. 28.

> executive failure, an exercise in boardroom featherbedding, and an abrogation of corporate responsibility.[21]

4.20 Professor Ramsay told the Committee:

> I think it is true to say that there is significant shareholder concern about what we have seen in inappropriate termination payments by some very notable companies—a payment of many millions of dollars for seven months work et cetera.[22]

4.21 In some cases the market does not become aware of the payment until well after it has been received. Mr Mayne noted that a number of directors leave on 1 July but disclosure may not occur until 15 months later. [23]

4.22 The ASX best practice guidelines recognise that shareholder concern about executive payments is 'often exacerbated by a lack of information concerning core entitlements when they are agreed'. It suggested such worries could be alleviated by disclosing to the market the nature of the CEO's (or equivalent) termination entitlements at the time it is agreed to as well as at the time the actual payment is settled.[24] As a guide, it advised that termination payments for CEOs should 'be agreed in advance, including detailed provisions in case of early termination, except for removal for misconduct'. It stated further:

> Agreements should include a clear articulation of performance expectations. Consideration must be given to the consequences of an appointment not working out, and to the costs and other impacts of early termination'.[25]

4.23 The Association of Chartered Certified Accountants Australia and New Zealand maintained that concerns about excessive executive remuneration will not be resolved solely by 'ex-post disclosures of the sort proposed in the Bill'. It was of the view that the market would prefer 'to have prompt disclosure of remuneration (and pension) packages at the time they are entered into, supported by disclosures which index executive pay to normalised measures such as average employee earnings or A$ value/added A$ economic value added'.[26]

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21 John Shields, Michael O'Donnell and John O'Brien, *The Bucks top Here: Private Sector Executive Remuneration in Australia,* A report prepared for the Labor Council of New South Wales, p. 7.

22 *Committee Hansard* 18 March 2004, p. 12.

23 *Committee Hansard*, 14 April 2004, p. 38.

24 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, p. 53.

25 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, p. 56.

26 *Submission* 42, p. [4].

4.24 The ACSI argued that shareholders should not have to bear more ‘surprises’ and suffer 'the consequences of poor performing companies where executives are perceived to have been rewarded not only for poor performance' but 'in some instances failure'.[27]

4.25 As well as prompt disclosure of pay packages, Mr Mayne referred to the disclosure of accrued benefits the sum of which may be obscured by the method of reporting. He submitted:

> The retirement scheme and accrued benefits should be explained in full in every annual report. Just disclosing the annual accrued retirement benefit for that year is not enough as shareholders should be told each year what the trigger points (ie 10 years, 15 years) for increased payouts are when assessing whether to re-elect a director.[28]

4.26 The New Standard AASB 1046 notes the following:

> Some benefits provided on termination of services to the entity are receivable by the *employee* regardless of reasons for the departure. Although the timing and amount may be uncertain, it is certain in such cases the entitlement exists and payment of the benefit will occur. Such benefits are *retirement benefits* and must be included in *post-employment benefits*, despite any description such as 'termination gratuities'. In some cases, a contract may provide for different levels of *retirement benefit* to be paid depending on the cause of departure. Any additional benefits generated because the termination is involuntary or at the request of the entity are *termination benefits* as defined in this Standard. By definition, the nature of *termination benefits* is such that they arise in one reporting period and, unlike most *retirement benefits*, are not accrued over several reporting periods.[29]

4.27 The above statement only further underlines the importance of having a reporting regime in place that will capture all forms of remuneration and present the information in such a way that shareholders are able to fully appreciate the total remuneration package including accrued benefits and payments such as termination benefits.

4.28 The Committee presented a detailed discussion of similar problems encountered in achieving meaningful disclosure of fees and charges in its report on regulations promulgated under the FSRA with regard to dollar disclosure. It outlined a model that included requirements such as the use of common or standardised

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27 *Submission* 5, p. 19. Mr Gilbert, Chief Executive Officer, Investment and Financial Services Association, also favoured disclosure. *Committee Hansard*, 16 March 2004, p. 8.

28 Supplementary *Submission* 63A, p.[4].

29 AASB 1046, para 5.2.19.

terminology and the presentation of information that would allow comparisons with past records and with forecasts over long periods of time.[30]

Committee view

4.29 The Committee understands that some termination payments over recent years have created public concern particularly the sudden and late disclosure of the amount of a termination benefit. The requirement to disclose is central to maintaining shareholder confidence in the market.

4.30 It accepts that the nature of termination or retirement payments raises a number of important disclosure issues. Again it believes that the legislation should close off any loopholes that would allow any retirement or termination rewards or benefits to escape the disclosure net. Further the disclosure requirements should ensure that shareholders have a full appreciation of the type and value of payments including a full account of accrued benefits.

4.31 The Committee appreciates the value in disclosing to shareholders the most significant aspects of a contract at the time it is agreed especially if the component is likely to result in a substantial termination payment. It endorses the ASX best practice guidelines that 'the nature of the termination entitlements of the chief executive officer (or equivalent) be disclosed to the market at the time they are agreed as well as at the time the actual payment is made' (paragraph 4.22).

4.32 Termination payments in particular highlight the importance of tying remuneration to performance so that any discussion on remuneration would include the board's approach to managing the risk of executives being rewarded for failure.

Penalties for failing to meet requirements under section 300A

4.33 Directors of a company contravene section 300A if they fail to take all reasonable steps to comply with, or to secure compliance with the requirement to disclose the information specified under this section. It is a civil penalty provision under section 1317E. A court may order a person to pay the Commonwealth a pecuniary penalty of up to $200,000 if the contravention materially prejudices the interests of the corporation or materially prejudices the corporation's ability to pay its creditors or is serious. Considering that section 300A is about information that must be included in the remuneration report, these conditions appear to set an unrealistically high test for a court to consider.

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30 Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment Regulations 2003 (Batch 6); Corporations Amendment Regulations 2003/4 (Batch 7); and Draft Regulations—Corporations Amendment Regulations 2004 (Batch 8),* March 2004, p. 51.

4.34 On application from ASIC, the Court may disqualify a person from managing corporations for a period that the Court considers appropriate if the Court is satisfied that the disqualification is justified.

Under section 344 a person commits an offence if they contravene Section 300A and the contravention is dishonest.

4.35 In reviewing the penalties applying to breaches of section 300A, the Committee is not convinced that they allow ASIC the flexibility to deal with the range of contraventions likely to occur. Minor contraventions should not involve the courts and may simply require a warning notice from ASIC or a small fine with an order to remedy the deficiencies. The more serious offences would warrant a substantial penalty while disqualification may be appropriate for serious and serial offenders.

Recommendation 12

4.36 The Committee recommends that the Government review the penalty provisions for contraventions of section 300A with a view to allowing a greater degree of flexibility in applying penalties especially for offences unlikely to satisfy the test that the contravention 'materially prejudices the interests of the corporation or materially prejudices the corporation's ability to pay its creditors or is serious or is dishonest'.

4.37 Aside from changes to enhance the disclosure of executives' remuneration, the Bill proposes to give shareholders greater capacity to hold directors accountable for their decisions regarding remuneration and to provide opportunities for shareholders to voice their views in regard to executives' remuneration. This matter is discussed in the following chapter.

Disclosure of information—directorships

4.38 The proposed legislation also adds a number of provisions requiring greater disclosure on directorships. It adds paragraph (e) to the end of subsection 300(11). It requires the report for a listed company to include the details for each director on all directorships of other listed companies held by the director at any time in the 3 years immediately before the end of the financial year and the period for which each directorship has been held. [31]

4.39 Few submissions commented on this proposal. ASFA supported the proposal. Professor Geoffrey George, however, went further in stating that a requirement of corporate legislation that multiple directorships be prohibited is long over due.[32] He was concerned about the network of influence through association on the boards of Australian public companies. He recently reviewed the Annual Report of Boral

31 Item 15, Schedule 8.

32 *Submission* 16, p. [2–3].

Limited which in his assessment confirmed 'the continuing significance of multiple directorships'. He maintained that:

> The existence of multiple directorship decreases the independence of 'independent' directors, and further, concentrates corporate control in fewer hands in a way that is far from transparent![33]

4.40 The AWU expressed the same concerns. Mr Bill Shorten told the Committee of the union's belief that 'directors in public listed companies should not assume too much responsibility by accepting a number of multiple directorship'. He elaborated:

> The Australian Workers Union believes that the maximum number of directorships a person is allowed to hold in public companies should be three. We note that the Australian Shareholders Association said that the chairmanship of a listed company is the equivalent of three directorships and that the maximum number should not exceed five. We think that the stewardship of three publicly listed companies is a very important responsibility and we are seriously sceptical of the ability of the professional director class to focus upon a number of different directorships.[34]

4.41 He explained further:

> …we think that being a chairperson of a major company, such as Qantas, Blue Scope Steel, Pasminco or a bank requires all of your attention. We are seriously sceptical that they could do much more than one other directorship with that function. We certainly do not support people being chair of two publicly listed companies at the same time. We think that the attention to detail and the leadership required from that position precludes the effective execution of those tasks, acknowledging your caveat about related entities.[35]

4.42 Mr Shorten supported his conclusions by citing instances where he thought directors or chairs might be overstretched:

> We have looked at the directorships of a number of prominent people who have been involved with Ansett, NAB or Pasminco. Margaret Jackson is currently the Chairperson of Qantas and a director of the ANZ Banking Group, Billabong International and John Fairfax Holdings—she is very busy. We regard that as an excessive number of positions.
>
> Graham Kraehe is Chairman of BlueScope Steel, is currently involved with the National Australia Bank, and is a director of Brambles, News Corporation and other organisations. We think it is impossible to be able to pay the necessary attention to all those tasks, especially in the case of these individuals as chairpersons. We know Catherine Walter is a director of the

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33 *Submission* 16, pp. [2–3].

34 *Committee Hansard*, 14 April 2004, p. 86.

35 *Committee Hansard*, 14 April 2004, p. 88.

> Australian Stock Exchange Ltd, Orica and a range of other non-publicly listed companies. We seriously question whether or not this director is able to focus on all of the directorial responsibilities required across a wide range of companies. Charles Goode is the Chairman of the ANZ Banking Group, Woodside Petroleum, Singapore Airlines and other companies—just a very busy portfolio.[36]

4.43 Mr Stephen Mayne, Publisher, Crikey.Com.Au, also identified the tendency for directors and chairs to hold multiple positions and called into question their ability to perform their duties conscientiously and effectively. He said he found the directors club 'very tight; and where 'you come across directors who are overcommitted and who have relationships with each other'.[37] As with many witnesses he had no trouble in naming individuals:

> I notice that the ASX corporate governance guidelines suggest that individuals only chair one top 100 company each. There are currently seven

36 *Committee Hansard*, 14 April 2004, p. 86. He produced further examples, pp. 86–7:

'To look at some of the companies that have been at least controversial and, in the opinion of the Australian Workers Union, have underperformed on their shareholders' expectations: Charles Allen, before he resigned, was a director of Amcor, AGL and Air Liquide. Brian Clark was Chairman of Vodafone Holdings in Japan, a non-executive director of China Mobile Ltd, and chairman and board member of a number of Vodafone Group companies. Peter Duncan is a director of Orica, GasNet and CSIRO and chairman of Scania Australia. Kenneth Moss is a director of Adsteam Ltd and GPT Management Ltd and Chairman of Boral Ltd and Centennial Gold. Geoffrey Tomlinson is a director of Reckon Ltd, Funtastic Ltd and Program Maintenance Services, Deputy Chairman of Hansen Technologies Ltd and a director of Amcor. Edward Tweddell is Chairman of Ansell and a director of the Australian Postal Corporation and CSIRO. These are very busy NAB directors before we even get to their NAB responsibilities.

AMP Ltd were of course involved with the not so successful GIO venture. Peter Willcox is the Chairman of AMP and of Mayne Group at the same time. Richard Grellman of Atlas Group Holdings is Chairman of Cryosite Ltd and the New South Wales Motor Accidents Authority. Meredith Hellicar is a director of James Hardie Industries in the Netherlands, the New South Wales Treasury Corporation—that will be interesting—the Southern Cross Airports group, Amalgamated Holdings and other companies. Peter Mason is Chairman of JP Morgan Chase and a director of the Mayne Group and Pasminco, who employed many of our members, and Chairman of NAB. Mark Rayner was the Chairman of NAB and Mayne Nickless and a director of Boral. The list goes on, and I will table the list of some of the companies that we have noted, but these people clearly are struggling with the number of directorships they have if you judge the performance of some of the companies they have been in. The gene pool from which the directors is drawn is too small and too limited, and with the cynical gender appointment of an even smaller group of women directors who are the names to have on these company boards it is very difficult to argue wage restraint or to argue the benefits of restructuring to the people on the shop floor when there is such a small group of people whose names constantly reappear time and time again in corporations. Certainly when you look at the performance of some of these corporations it is a wonder how they keep getting reappointed.'

37 *Committee Hansard*, 14 April 2004, p. 28. Dr Geof Stapledon and John Fickling found that 'it is feasible that some directors may be spreading their resources too thinly'. See Dr Geof Stapledon and John Fickling, Institutional Analysis, *Board Composition and Pay in the Top 100 Companies,* Paper presented to the CMSF Conference, March 2001, p. 26.

> chairmen who are chairing two, and that is a fairly good example of how tight the system is. If you look at the boards of the big four banks, those directors are on a majority of the top 50 companies. I would say that the apex of the directors club is the big four banks, who dominate now the majority of the funds management industry. Those same directors cover the majority of the top 50, and that is where I think it is too tight.[38]

4.44 Mr Richard Jones, CSA, however, was of the view that the requirement to disclose the directorships in the past three years is unnecessary and that the past year would be sufficient. He argued that 'If someone wishes to look beyond that, they can get a copy of the earlier annual reports that would be available on the web site'.[39] The Australian Shareholders' Association welcomed the proposal but had a query about the wording and whether ‘an individual must disclose a directorship of a company that was formerly listed in the prior three years'.[40]

Committee view

4.45 The Committee shares the concerns expressed by some witnesses about directors and chairmen holding multiple positions which could undermine their ability to contribute to the stewardship of a company as fully as they would otherwise. Hopefully, disclosure of such information will place shareholders in a better position to assess the quality of the contribution directors would make to the company when it comes to the appointment of directors. Even so, the Committee believes that, if the situation continues where some directors hold a number of directorships and chairs inconsistent with sound corporate governance, regulatory measures may be necessary to curb this practice.

Composition of boards

4.46 This discussion on people holding multiple directorships also touched on a far more serious matter dealing with the performance of board members. Evidence presented in this and the previous chapters shows the public's disappointment with boards that seem incapable or unwilling to restrain excessive executive remuneration and furthermore unable to link executive remuneration with company performance. CLERP 9, however, apart from enhancing disclosure provisions does not look into the boardroom to seek remedies to improve corporate governance. It turned its focus on auditors and improved financial reporting to answer some of the concerns raised by recent corporate failings and to increased shareholder participation to improve the board's performance.

4.47 Disquiet about the composition of boards, the independence of directors and the relationship between shareholders, the board and company executives, however, is

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38 *Committee Hansard*, 14 April 2004, p. 28.

39 *Committee Hansard*, 18 March 2004, p. 51.

40 *Submission* 22, p. 8.

not new. During debate in the Senate in 1998 on the Company Law Review Bill 1997, a raft of amendments were brought forward including an amendment proposed by Senator Andrew Murray on corporate governance. He wanted measures introduced such as the requirement for listed companies to establish a corporate governance board.

4.48 The Labor Party while not supporting the amendments told the Senate that 'we do put the government on notice about the need to thoroughly examine the proposal.'[41] Senator Conroy was certain that the Labor Party would go 'shoulder-to-shoulder' with the Australian Democrats in looking at corporate governance. The Government agreed that the matter should be examined further.

4.49 Senator Murray also wanted the election of directors to be more democratic and representative.[42] He said:

> The current system of electing directors facilitates the dominance of control groups and lessens the possibility of support being expressed for particular directors. The result of this is that, for minority interests to be held, minorities must often rely on expensive and problematic remedies such as recourse to the legal system, the ASX rules and ASIC which reduces the attractiveness of investing, reduces genuine shareholder participation and facilitates fairly domineering managerial or board control.[43]

4.50 Again both the Government and the Labor Party did not support the amendment but indicated that the matter was worthy of consideration and agreed it should be considered by the Parliamentary Joint Committee on Corporations and Securities.

4.51 The Committee agrees that a thorough examination of the composition of boards in Australia including the appointment of directors is long over due and the Committee will consider this matter when determining its future program.

Disclosure of information—company secretaries

4.52 The Corporations Amendment Bill 2002 proposed to add new sub section 300(10) which would require the directors' report for a financial year to include details of the qualifications and experience of each person who is a company secretary as at the end of the year.[44] The CPA and ICAA had no objection to the addition of the company secretary disclosure requirement.[45] The CSA welcomed this addition as recognition of the role of the Company Secretary in developing and ensuring

41 Senator Nick Sherry, *Senate Hansard*, 24 June 1998, p. 3924.

42 Senator Andrew Murray, *Senate Hansard*, 24 June 1998, p. 3919, 4011.

43 Senator Andrew Murray, *Senate Hansard*, 24 June 1998, p. 4012.

44 Item 12, Exposure draft of the Corporations Amendment Bill 2002, p. 4.

45 Submission to Treasury, (CAB) 25 March 2003, p. 3.

implementation of appropriate corporate governance standards within companies.[46] It informed Treasury:

> In addition, and in light of current failures and the need for good corporate governance, CSA would like to reiterate its recommendation made in March 2000 that the Company Secretary of a public company be required to have formal qualifications prescribed by the Act, such as membership of one of the major accounting bodies, state law bodies or Chartered Secretaries Australia…Adoption of this proposal would bring Australian practice into line with the long-standing practice in the UK.[47]

4.53 This provision requiring the qualifications and experience of the company secretary to be disclosed in the annual report is not contained in CLERP 9 and the CSA saw that this proposed legislation provided an opportunity to advance the proposal. It noted that in both the UK Higgs Review and the ASX Corporate Governance Council's guidelines, the role of the Company Secretary is mentioned in ensuring 'implementation of good corporate governance'.[48] CSA informed the Committee that the amendment would not result in any increased compliance costs and would disclose to the market relevant information about the governance of a listed entity. In its view, it would 'assist investors make informed decisions on how seriously their company takes good corporate governance'. Mr Timothy Sheehy, CSA, told the Committee:

> It is in the interest of shareholders, we believe, that the individual who is usually charged with the governance of an organisation be properly qualified. That is what we believe, but we believe that shareholders should be informed as to what the qualifications of that person are. It is a pivotal role in an organisation, its importance is increasing and it is as important as the qualifications of a director.[49]

Committee view

4.54 The Committee notes the advice of the CSA and is persuaded that an amendment as suggested by the CSA would be consistent with the objective of the CLERP Bill which is '…to improve the operation of the market by promoting transparency…'

Recommendation 13

4.55 The Committee recommends that a new sub section 300(10)(d) be inserted in the Bill which would require the directors' report to include details of

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46 CSA submission to Treasury (CAB), March 2003, p. 4.

47 CSA submission to Treasury (CAB), March 2003, p. 4.

48 *Submission* 8, p. 14.

49 *Committee Hansard*, 18 March 2004, p. 51.

the qualifications and experience of each person who has held the position of company secretary during the reporting period.

Conclusion

4.56 In this chapter, the Committee has limited its discussion to the disclosure requirements as set down in sections 300 and 300A. In the following chapter, the Committee shifts its consideration to the role of shareholders in determining executive remuneration and the influence they exert and should exert over such determinations.

CHAPTER 5

EXECUTIVE REMUNERATION—NON-BINDING VOTE

5.1 Aside from changes to enhance the disclosure of executives' remuneration, the Bill proposes to give shareholders greater capacity to hold directors accountable for their decisions regarding remuneration and to provide opportunities for shareholders to voice their views with regard to executives' remuneration.

5.2 This chapter considers the four measures contained in CLERP 9 designed to encourage shareholders to exercise some influence over the remuneration packages of the executives that manage their company. It includes:

- the opportunity to discuss the remuneration report;
- the notice of meeting alerting shareholders to the opportunity to vote on the remuneration package;
- the non-binding vote by shareholders on the remuneration package (discussion on this point includes an examination of the traditional role of the board and the shareholders); and
- shareholders approval of termination payments.

Shareholders to discuss remuneration report

5.3 Currently, the legislation requires the chair at a listed company's AGM to allow reasonable opportunity for the members as a whole to ask questions about, or make comments on, the management of the company.[1] While retaining this obligation, the Bill will also require the chair to allow reasonable opportunity for members as a whole to ask questions about, and to comment on, the remuneration report.[2]

5.4 Participants in the inquiry generally agreed to the introduction of this measure which would provide an opportunity for shareholders to express their views on remuneration. They understood that the annual general meeting is an important feature of corporate governance which allows shareholders as owners of the company to gain a better understanding of the corporation and its management. By questioning the board and debating matters in an open forum, they are able to participate actively in and influence decision-making.[3] Such participation encourages transparency and

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1 Section 250S(1). It is an offence of strict liability.

2 Proposed section 250SA.

3 See for example *Submission* 21, p. 17; *Submission* 41, [2].

enables the shareholders to hold the board accountable for their stewardship of the company and in particular on the crucial issue of executive remuneration.

5.5 The ASX supported the concept of facilitating discussion on executive remuneration policy at the AGM. In its view:

> It is perfectly valid for shareholders to engage with the Board (as primary delegate of corporate authority) on the detail of the Board's remuneration and the overarching policy framework for remuneration and the link to corporate performance.[4]

5.6 Support was not always enthusiastic. Professor Michael Adams, while having no objection to the proposal, was not convinced that 'such a provision is absolutely necessary, as a competent chair of a listed company would already provide members with such an opportunity…'[5]

5.7 Of those fully satisfied with the requirement, some saw no need to contemplate further measures to allow shareholders a greater say in setting executive remuneration. The Law Council of Australia was of the view that a specific obligation to allow members to ask questions and make comments about the remuneration report 'should suffice to gauge the attitude of shareholders to the level of remuneration of executives'.[6] The Bill, however, goes further by allowing shareholders to have a non-binding vote on the remuneration report. This proposal received a mixed response from witnesses.

Shareholder approval for payments to directors

5.8 Under the ASX Listing rules, an entity must not increase the total amount of directors' fees payable by it or any of its subsidiaries without the approval of shareholders. The notice of meeting to approve the increase of directors' fees must include the amount of the increase, the maximum amount that may be paid to the directors as a whole, and a voting exclusion statement.[7]

5.9 The rule does not apply to the salary of executives whose remuneration is determined by the board. At this point, the Committee emphasises the importance of this rule and the need to ensure that in the case of executive directors it is strictly observed. From the outset, the Committee states its belief that executive directors have no place in the determination of executive remuneration and should have no opportunity to influence the boards' decision about their remuneration.[8] The

4 *Submission* 48, p. 6. See also *Submission* 41, p. [2].

5 *Submission* 21, p. 20.

6 *Submission* 24, p. 13.

7 ASX Listing Rule 10.17.

8 See also discussion about the respective roles and definitions of executive and non executive directors in paragraphs 5.19–5.20 and 5.27–5.29 and accompanying footnotes.

Committee notes that the ASX's Principles of Good Corporate Governance recommends the establishment of a remuneration committee and adds that no individual should be directly involved in deciding his/her remuneration. The Committee believes that this principle should be stated in more definite language and given greater prominence in the ASX's principles.

Recommendation 14

5.10 The Committee recommends that the Government include in the Corporations Act a general principle that executive directors are not to be involved in determining their own remuneration unless there are reasonable grounds for that not to occur.

5.11 The following section looks at the proposal in CLERP 9 to require a non-binding vote of the remuneration package which includes the remuneration of the 5 highest paid company executives and the 5 highest paid group executives.

Non-binding vote

5.12 Proposed sections 249L(2) and 250R(2) require that a resolution to adopt the remuneration report must be put to the vote at the company's AGM and the notice of the AGM must inform members of the resolution.

5.13 A number of matters that were raised during the consultation period following the release of the exposure draft have since been addressed in the Bill and by assurances offered by the Treasurer.

Legal consequences for directors and the company flowing from the non-binding vote

5.14 One of the major worries centred on possible legal consequences for the company or its directors that could flow from the non-binding resolution, for example legal issues for Boards that do not abide by the shareholders' vote even though the vote is meant to be non-binding.[9] The main concern was to have certainty that directors and companies, where they chose to act in a way contrary to the non-binding resolution, would not be subject to legal action because of that decision.[10] For example, the BCA wanted an additional provision inserted in the Bill to state that if the directors do not accept or otherwise act in accordance with such a resolution, such actions of the directors may not be used in any legal proceedings against either the directors or the company.[11] To the same effect, the Law Council of Australia suggested that a new provision should be included in CLERP 9 to ensure that the outcome of the resolution could not be taken into account 'in determining whether the

9 *Submissions* no. 14, p. 13; *Submission* 18, p. 2; *Submission* 20, p. 14.

10 *Submission* 20, p. 14. See also *Submission* 24, pp. 12–13.

11 *Submission* 20, p. 14. See also *Submission* 24, pp. 12–13.

directors have breached their duties in entering into any arrangement to which the resolution relates.'[12]

5.15 The draft Bill stated that the vote on the resolution to adopt the remuneration report 'does not bind the directors'. This provision has been amended and states expressly that:

> The vote on the resolution is advisory only and does not bind the directors or the company. [13]

5.16 The rewording of this provision was designed to make clear that directors or the company would not be legally answerable if they acted contrary to the shareholders decision on the remuneration vote. Furthermore, the Treasurer, the Hon Peter Costello MP, offered the following assurance to the House of Representatives:

> The concept of a non-binding shareholder vote is new in the Corporations Act; as such, there are no legal precedents for the consequences where directors do not act in accordance with a non-binding resolution. Prior to proceeding with this proposal, the government sought legal advice from the Australian Government Solicitor. The Australian Government Solicitor advised that the failure of directors to abide by a non-binding resolution of shareholders could not, of itself, constitute a breach of directors' duties. This is consistent with the government's intention that a non-binding vote be advisory only. A provision to make it clear that the vote is not binding on the directors or the company has also been included in the legislation.[14]

The Explanatory Memorandum while emphasising that the vote is advisory notes that the Bill is 'not intended to detract from the responsibility of directors to determine executive remuneration'.[15]

Committee view

5.17 The Committee accepts that the amendments to the exposure draft bill and the Treasurer's assurances leave no doubt that there would be no legal consequences for directors or the company because of decisions they take following the non-binding vote. The Committee believes that the amendment was necessary to ensure that the result of the resolution cannot be taken into account in determining whether the directors have breached their duties in entering agreements to which the resolution relates.

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12 *Submission* 24, p. 13.

13 The Bill, Schedule 5, item 7, p. 191.

14 Peter Costello, House *Hansard*, 16 February 2004, p. 24841.

15 *Explanatory Memorandum*, para 5.436, p. 169.

Opposition to the non-binding vote

5.18 The report now turns to specific criticism levelled against the proposal to allow shareholders a non-binding vote.

Non-binding vote and traditional roles of the board and the shareholder

5.19 This provision raised the fundamental question about the respective roles of the board and shareholders. The United Kingdom's recently revised 'Combined Code on Corporate Governance' sets down the broad principle that 'every company should be headed by an effective board, which is collectively responsible for the success of the company.' It outlines what it holds to be the board's role which is:

> to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. It should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

5.20 It goes on to state that non-executive directors are 'responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing, and where necessary removing, executive directors, and in succession planning'.[16] Dr Geof Stapledon and Mr John Fickling offered the following definition of directors:

> A non-executive director is a person sitting on a company's board who is not engaged in the day-to-day running of the company and does not hold a

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16 *The Combined Code of Corporate Governance,* July 2003, p. 4. Numerous people have commented on the different and distinct roles of shareholders, non executive directors and executives. For example Henry Bosch formerly chairman of the National Companies and Securities Commission, explained that 'Shareholders form companies by pooling part of their savings in a common endeavour. They elect a board of directors, and delegate most of the powers or ownership to them, to direct and be responsible for the management of the company. However, since these powers are delegated to the board as a whole, it can act only when it meets, and is physically impossible for it to manage the company in an operational sense. Thus the board must hire management, and delegate a large part of its powers to it. It follows that management is accountable to the board and the board is accountable to the shareholders. It is because these accountabilities are not well-understood, and even less-observed, that failures in governance occur. Henry Bosch, 'The Changing Face of Corporate Governance", *UNSW Law Journal,* vol. 25, no. 2, 2002, p. 270. The Australian Chamber of Commerce and Industry in its statement on *Corporate Governance and Responsibility, 2003,* maintains that 'the main functions of the board are to provide a broader strategic direction for the enterprise and monitor the conduct and performance of management…other particular responsibilities of boards include reviewing corporate strategy and planning, overseeing management (including remuneration and succession planning), dealing with potential conflicts of interest, and ensuring the integrity of accounting and reporting systems'.

position of executive management. On the other hand, an executive director is a person who is not only a board member but also a senior executive.[17]

5.21 The proposal put forward in the exposure draft for a non-binding vote elicited an immediate response from the business world and raised the central question about the respective roles of the board and shareholders. Some saw it as an attack on the fundamental principles underpinning the concept of a limited liability company.

5.22 Mr John Schubert, BCA, questioned the proposal to give shareholders a non-binding vote on executives because such a move challenged the 'whole concept of a publicly listed company'. To his mind, the very nature of a publicly listed company rested on the premise that shareholders pass over the right to be involved in the day-to-day operation of the corporation to the board'.[18] He argued that such a move would 'take away from the board the responsibility for the direction of the company…' He wondered where it would stop.[19]

5.23 Ms Margaret Jackson agreed that CLERP 9 almost ignored the 'reality of what's happened in the market or happening at AGMs and is introducing something which is the beginning of a fundamental change in the free-enterprise system, and the operation and the legal base on which companies operate'.[20]

5.24 Submissions to this inquiry continued this theme that the non-binding vote offends the basic principle that shareholders approve the remuneration of directors and directors determine the remuneration of executives—that it is an unwarranted and unwelcomed encroachment on the authority and duties of the board.[21]

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17 G. Stapledon and J Fickling, *Board Composition and Pay in the Top 100 Companies,* Paper presented to the CMSF Conference, March 2001, p. 13. In their survey using a sample of 72 companies in 2001, they found that 'the average board composition among sample companies was 78.24% non-executive and 21.76% executive…for most sample companies, non-executive directors make up 80–90% of the board. These companies generally had only one or two executive directors: the Chief Executive Officer and possibly also a Finance Director (or CFO). p. 18.

18 Transcript, 'PM', 'Business gives mixed response to CLERP 9 proposals for shareholders to vote on executive pay', Wednesday, 8 October 2003.

19 Transcript, '7.30', 'Treasurer, Shadow Minister, BCA and shareholder activist comment on CLERP 9 proposals for shareholders to vote on dollar executive pay packets', 8 October 2003. *Australian Financial Review*, 'Company leaders take chair to talk governance', 27 October 2003.

20 *Australian Financial Review*, 'Company leaders take chair to talk governance', 27 October 2003.

21 See for example, *Submission* 20, p. 4.

5.25 Opposition to the non-binding vote was based on a conviction embedded in the long history of corporate law which dictates that certain matters are the domain of the board while others are the province of shareholders.[22]

5.26 For some, the proposal would generate confusion over the traditional roles and powers of shareholders and directors which could complicate the legal environment. At worst it could create unresolvable conflict between the board and shareholders.[23] A number of witnesses suggested that the proposal represents the beginning of an unhealthy trend of shareholder intrusion in management issues. They advised against introducing such new proposals as they further blur the proper roles of management and shareholders and should be treated warily.[24]

5.27 The AICD argued that ‘Good corporate governance requires that boards take sole responsibility for their remuneration decisions. If shareholders are dissatisfied with the board’s performance, they have a right to make their views known at the AGM and vote against the re-election of the directors'.[25] The ASX stated that:

> …to extend shareholder entitlements to a retrospective non-binding resolution on decisions regarding specific executive remuneration traverses the traditional line of accountability in respect of a company and its shareholders, in that individual managers, unlike directors, are not directly accountable to shareholders and do not effectively set their own remuneration.[26]

5.28 Mr Steven Munchenberg, BCA, agreed that shareholders own the entity in which their capital is invested which gives them certain rights and expectations. He also accepted that shareholders should approve the remuneration of board members. He told the Committee:

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22 See for example the views of Mr Keeves and Mr Golding, *Committee Hansard*, 16 March 2004, p. 59. Paula Darvas, See 'Section 249D and the 'Activist' Shareholder: Court Jester or Conscience of the Corporation?', in *Company and Securities Law Journal,* vol 20. p, 392. She wrote, 'The "traditional legal model" of the corporation delineates responsibility for corporate decision-making between the board of directors and the shareholders. Managerial powers are clearly defined, and can be exercised in "a domain…constitutionally off-limits to shareholders". The role of the board of directors is ongoing direction and supervision of the management of the affairs of the company. Day-to-day affairs are the responsibility of the company's management who are guided and monitored by the board of directors. Shareholders can only make decisions by resolution in a general meeting on a limited range of issues, such as: appointment or removal of directors; amendment to the company's organic documents; and mandatory shareholder approval of certain management decisions that affect the company.'

23 *Submission* 19, p. [8].

24 *Submission* 18, p. 2; *Submission* 20, p. 13; *Submission* 24, p. 13; *Submission* 35, pp. 23–4; *Submission* 46, p. 3.

25 *Submission* 35, p. 23.

26 *Submission* 48, p. 6. See also *Submission* 20, p. 13; *Submission* 35, p. 24.

> The directors on the board are there as the elected representatives of shareholders. Therefore, shareholders should have a direct say in the remuneration of those directors and whether they continue on the board or not.[27]

5.29 In his opinion, the same reasoning did not apply to executives—'shareholders delegate to their elected board the decisions on the next layer of executives who are not on the board'. He told the Committee that section 250R(2):

> …undercuts the very basis of limited liability companies, where shareholders delegate day-to-day decision making to their elected boards. As a matter of principle, it is difficult to see why shareholders should ratify a board's decision on executive remuneration but not ratify a range of other decisions that have as much or more impact on their shareholdings' value.[28]

5.30 He argued that if shareholders vote down the remuneration 'it is a vote of no confidence in the board and the board has to respond to that'.[29]

5.31 Continuing with this theme, Baker and McKenzie thought the non-binding vote 'a strange idea with uncertain ramifications'. It submitted:

> The board of a company has the power to manage the company's business, and has responsibility for the company's remuneration policies. The appropriate remedy is one that shareholders already have—if they are dissatisfied with the way in which the directors are managing the company, they should replace the directors.[30]

5.32 Professor Adams also saw problems with the non-binding vote which in his view would cause greater frustration:

> I feel that the problem with the draft provision 250R(2) is that it does not really address the issue. If anything, it could create an environment of expectation when clearly the board has the power, in fact, to completely reject that outcome. Time, money and effort could be spent to address this particular area, but my feeling would be that the overall impact would not be a change from the position we have at the moment—and the overall benefit would not be there at all.[31]

The non-binding vote—a chocolate teapot?

5.33 Moreover, a number of witnesses could see little merit in the proposal and questioned its usefulness. For some, the proposal was of negligible value or would

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27 *Committee Hansard*, 11 March 2004, p. 6.

28 *Committee Hansard*, 11 March 2004, p. 2.

29 *Committee Hansard*, 11 March 2004, p. 11.

30 *Submission* 37, p. 4.

31 *Committee Hansard*, 16 March 2004, p. 18.

have no meaningful or lasting effect. To them it was of little utility—that there does not appear to be any compelling policy justification for a non-binding resolution to adopt the remuneration report. In Telstra's view the proposal ‘seems to be a hybrid that is unlikely to achieve a practical benefit for either the company or shareholders. A majority vote against the report will not bind the directors and cannot override legally binding contracts entered into with directors and executives.’ The Centre for Corporate Governance suggested that it would do little other than provide shareholders with 'a false hope and add length and expense to the AGM'.[32] It stated:

> If the objective of the proposed changes is to provide shareholders with an opportunity to express their views on remuneration, then a provision requiring the chair to invite debate on this topic is far more appropriate than a 'chocolate teapot' provision, such as s 250R(2), which simply permits the board to pay lip-service to the members while incurring substantial and unnecessary costs for the company.[33]

5.34 The Commercial Law Association of Australia held that this proposal is not a matter previously known in company law and regarded it as an unwelcome development. It stated:

> Rather than a measure that is designed to protect shareholders, the Task Force is of the view that in time the members' position will be weakened. They become a collective toothless tiger.[34]

Support for the non-binding vote

5.35 Those in favour of the non-binding vote countered with the argument that the proposal did not challenge or confuse the respective roles of the board and the shareholders. They agreed that the board occupied a position of trust and stewardship and that directors had a fiduciary duty to steer the company in the best interests of the shareholders.[35]

5.36 They saw the non-binding vote as an effective means for shareholders to have a voice in deciding the remuneration of those who are managing their company and a means whereby they can ensure that a useful remuneration report is produced. It allows shareholders, if they disagreed with the way the directors have rewarded senior management, 'a collective mechanism to voice their feelings without the need to vote directors out of office'.[36] Mr Easterbrook stated that the non-binding vote is:

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32 *Submission* 21, pp. 20–1. See also *Submission* 18, p. 2; *Submission* 24, p. 13; *Submission* 35, p. 23.

33 *Submission* 21, p. 21.

34 *Submission* 49, p. [3].

35 See for example, *Submission* 5, p. 3.

36 ASA, *Submission* 22, p. 5.

> …simply an incentive for boards and remuneration committees to do a better job. The only sanction of a non-binding vote is, frankly, embarrassment. If a board does such a bad job on remuneration that the shareholders throw out its remuneration report, that is a public condemnation of the directors and, because people do not like being publicly condemned, it is likely to encourage them to do a better job.[37]

5.37 Mr Richard Gilbert, IFSA, saw the non-binding vote as moral suasion and an effective means not only of signalling shareholders' wishes to the board but of the board canvassing their opinion.[38] Mr Mayne agreed and used the UK experience to support his view. According to Mr Mayne 'where you have had remuneration policies rejected, the media which flows from that and the whole focus on it is a very powerful tool'.[39] The AWU argued that the non-binding vote would offer guidance to the board on the levels of remuneration they consider to be appropriate.

5.38 It also cited the experience in the UK where the availability of this mechanism to vote on directors' remuneration has not caused 'an avalanche of shareholder opposition to the Board'.[40]

5.39 The ACSI supported the introduction of a non-binding vote to shareholders in relation to a company's remuneration report.[41] It rejected outright the notion that the non-binding vote would 'ratchet up' executive salaries, undermine the legitimate role of the board and 'turn shareholders into "defacto boards"' especially considering that the vote is non-binding.[42] Rather it argued that the proposal correctly 'ensures that Boards will be aware that their approach to remuneration policy as it applies to the Board and Executives will be more closely monitored by shareholders to ensure that it is sufficiently linked to high performance outcomes'.[43]

5.40 The Committee in concluding its consideration of the non-binding vote, takes note of the recently released draft revised OECD principles of corporate governance. It said:

> Several countries have introduced an advisory vote which conveys the strength and tone of shareholder sentiment to the board without endangering employment contracts.[44]

37 *Committee Hansard*, 9 March 2004, p. 3.

38 *Committee Hansard*, 16 March 2004, p. 6. See also *Submission* 44, p. 4.

39 *Committee Hansard*, 14 April 2004, p. 44.

40 *Submission* 5, p. 2.

41 *Submission* 5, p. 17.

42 *Submission* 5, pp. 2 and 18.

43 *Submission* 5, p. 18.

44 OECD, *OECD Principles of Corporate Governance,* Draft Revised Text, January 2004, p. 16.

Committee view

5.41 The Committee accepts that allowing shareholders to have a non-binding vote on the remuneration report is an innovation that has given rise to fears about possible confusion even conflict between the traditional roles of the board as stewards of the company and the shareholders as owners of the company. The Committee is not convinced that the proposal may necessarily complicate or muddle these roles.

5.42 In light of the recent publicity given to executive remuneration and the public perception that boards have failed in their duty to restrain the size of executive payments, the Committee accepts that it is important for shareholders to have a louder and more effective voice in the setting of executive remuneration and the determination of performance benchmarks. It believes that a board in tune with the views and expectations of its shareholders, fully aware of the skills and experience needed in the company and capable of conveying such information to shareholders would not create discord by placing an unacceptable proposition before the shareholders.

5.43 The Committee also appreciates the argument that a non-binding vote has no real force except as an avenue for shareholders to express their views on the remuneration policy of their company. Again taking account of the apparent surprise and outrage with which the announcements of some executive remuneration packages have been received in recent times suggest that boards need to be made aware of shareholders opinions. A non-binding vote presents shareholders with an opportunity to place on the record their views to guide directors and inform them of their expectations.

5.44 The Committee endorses the proposal for a non-binding vote on the remuneration report.

A binding vote

5.45 A binding vote of shareholders is required for the issuing of shares and on cash payments to non-executive directors.[45] Indeed, the ASA informed the Committee that a binding vote over the equity component of directors' salaries had been in place for a number of years. It explained:

> Not only has this vote not blurred the responsibilities of shareholders and directors, it has been an implicit and progressive part of shareholder activism…
>
> It is important to emphasise that shareholder activitism has been successful in bringing directors into line in relation to share-based pay. Examples include: the News Corporation Limited (where a resolution to grant executive options without hurdles was approved by directors but opposed by

45 *Committee Hansard*, 14 April 2004, p. 44.

> shareholders), Harvey Norman Limited (where directors had approved a resolution to effectively re-price options that were out-of-money), and Coles Myer Limited (where the plan approved by directors contained inadequate hurdles). These are recent examples; over the past few years there have been many cases where boards have considered one package to be appropriate, only to have to make substantial changes as a result of an opposing vote (or threat of an opposing vote). We can see no reason why this will not be the case in the event that shareholders are given a non-binding vote over complete salary packages.[46]

5.46 The FSU wanted the proposal in CLERP 9 to go further and require a binding vote on the remuneration package. It argued that such a measure was necessary if shareholders were to have the capacity to hold directors accountable for remuneration decisions.[47] Mr Mayne had no problems accepting the introduction of a binding vote but conceded that any step forward is positive.[48] Those who objected to the non-binding vote had even stronger reasons for opposing the binding vote which would confer greater power on shareholders. As noted earlier, Mr Munchenberg, BCA, acknowledged that shareholders own the entity in which their capital is invested which gives them certain rights but in his view this entitlement did not extend to executive remuneration.

5.47 Mr Dean Paatsch, Institutional Analysis Research, said he would not support a situation with binding votes.

> I think you would really get into a bizarre situation whereby, throughout the course of the year, if shareholders had the opportunity to overturn salary packages negotiated with the executives…
>
> I really think that the whole system of making executive appointments would break down where executives were subject to a binding vote by shareholders. It would be a crazy situation where, if you were the incoming CEO, you would have to wait six months to work out whether your salary package had been approved.[49]

5.48 Mr Wilson, ASA, accepted that boards are better placed to set remuneration. In his words they 'have a better feel for the executive’s prior performance, not only in the financial sense but also in the other business skills as well'. In considering a binding vote, he argued that would mean:

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46 *Submission* 22, p. 4.

47 *Submission* 38, p.[13].

48 *Committee Hansard*, 14 April 2004, p. 44. See also Mr Masson who stated that full remuneration issues should be subject to shareholder approval *Committee Hansard*, 14 April 2004, p. 68.

49 *Committee Hansard*, 14 April 2004, p. 26.

> …taking away that responsibility from the board and putting it in the hands of shareholders who (a) might be quite removed from the company, (b) do not have that statutory requirement to act in the shareholders' best interests, and (c) perhaps may not even be particularly sophisticated…I think it would be much safer to have a non-binding vote on such a thing rather than a binding vote. [50]

5.49 Mr Mayne, who favoured a binding vote, responded to Mr Paatsch's statement that it would create a crazy situation by noting that CEOs are already 'signing up and not knowing whether they have got an options package or not, because it has not been approved by shareholders'.[51]

Committee view

5.50 At this stage the Committee does not support the view that the remuneration report be subject to a binding vote of shareholders. It notes that the non-binding vote is an innovation and suggests that a sensible approach is to allow the non-binding vote ample time to be tested for its effectiveness before any further reforms are considered.

Equity based schemes

5.51 The OECD principles, while accepting that shareholders should have a means to express their views on executive remuneration, held that board and executive contracts are not appropriate subjects for approval by the general meeting of shareholders.[52] It nonetheless made an exception in the case of equity based schemes which it suggested:

> …have the potential to dilute shareholders capital and to powerfully determine managerial incentives, many countries now call for them to be approved by shareholders. In an increasing number of cases, any changes to existing schemes must also be approved.[53]

5.52 This approach was taken by a number of witnesses who, although they did not agree with a binding vote on remuneration, identified equity based remuneration as a special case. Mr Wilson, ASA, submitted:

> Wherever there is a potential increase in the amount of equity and therefore the potential dilution of shareholders' funds, there should be some sort of shareholder approval to have that enacted. It is a fundamental right for

50 *Committee Hansard*, 9 March 2004, p. 19.

51 *Committee Hansard*, 14 April 2004, p. 44.

52 OECD, *OECD Principles of Corporate Governance,* Draft Revised Text, January 2004, p. 16.

53 OECD, *OECD Principles of Corporate Governance,* Draft Revised Text, January 2004, p. 16.

> shareholders, and to get around that by devious means is plainly just not right.[54]

5.53 Mr Munchenberg also agreed that the matter over equity payments is distinct in that the provision of equity is something that directly affects the relative equity of shareholders. To his mind, 'It is a direct dilution of the shareholders' interests in the company. Every time you issue further equity, it dilutes the shareholders' interests'. He told the Committee:

> …as a matter of principle, the shareholders should have a vote on those things where there is a direct interest that directly affects the structure of the corporate entity where shareholders delegate the authority to run their investments to a board and management of the company.[55]

5.54 ASX Listing Rules require the approval of shareholders before a director or associate of the director can acquire securities under an employee incentive scheme.[56] This rule does not apply to executive share options.

5.55 Mr Easterbrook, CGI, cited the ASX Listing Rules that were in existence until July 2000 regarding shareholder votes on changes to equity schemes and the requirement for a three-quarter shareholder approval. He was strongly of the view that they should be reinstated and also included in CLERP 9.[57]

5.56 ACSI also referred to the Listing Rules pointing out that voting on remuneration issues once applied in respect of executives. It noted that up until July 2000, the ASX Listing Rules required Boards to submit to shareholders any proposal to approve the introduction and amendment of employee or executive share and option plans. It asserted that 'Boards now have the discretion to introduce such arrangements that apply to employee and executive and option plans, without seeking the approval of shareholders despite the dilutive impact such arrangements could have on shareholders' equity'. It recommended that ASX Listing Rules or the Corporations Act should be amended to give shareholders a binding vote on all equity based remuneration proposals.[58]

5.57 Mr Spathis, ACSI, supported the submissions made by the ASA and CGI 'that all equity based remuneration schemes could be approved by shareholders prior to implementation'. He stated:

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54 *Committee Hansard*, 9 March 2004, p. 24. See also evidence of Mr Masson, *Committee Hansard*, 14 April 2004, p. 65.

55 *Committee Hansard*, 11 March 2004, p. 17.

56 ASX Listing Rules 10.14. See also Listing Rules 10.11.1–10.15A.9.

57 *Committee Hansard*, 9 March 2004, p. 10.

58 *Submission* 5, p. 18.

> Voting on remuneration issues is not such a novel idea. Shareholders currently have the opportunity to vote on resolutions by simple majority in relation to equity grants for board members. We believe that in the context of reforms being proposed in the CLERP 9 package the shareholder approvals should be by special resolution that is 75 per cent majority…Such requirements for shareholder approval were required under the ASX listing rules up until mid-2002. In the absence of their reinstatement in the listing rules we would seek that they be included in the CLERP 9 package of reforms on remuneration disclosure and reporting.[59]

5.58 When asked about the removal of the requirement for shareholder approval for equity based schemes, Ms Karen Hamilton, ASX, replied:

> We did not consider that was an appropriate matter to be trapped in the listing rules of a particular market operator. If it were considered sufficiently important then it should be in the law. We wanted to be consistent also with the legal provisions of the law in that regard. That is why it was removed. It was subject to public consultation at the time…I certainly am a firm believer that we do need shareholder approval of those plans and that is certainly a recommendation of the council. Whether we need to go further and enshrine special resolution requirements in the law, I am not so sure.[60]

Committee view

5.59 While not persuaded of the merits in allowing shareholders to have a binding vote on the remuneration report, the Committee appreciates the value in requiring shareholder approval for equity based schemes. It therefore recommends that CLERP 9 be amended to include a provision that equity based schemes be subject to shareholder approval.

Recommendation 15

5.60 The Committee recommends that CLERP 9 be amended to include a provision that requires equity based schemes as a form of executive remuneration to be subject to shareholder approval.

Prohibition on certain payments

5.61 A further suggestion involved the prohibition of certain payments to executives such as non-recourse loans. While not necessarily favouring this form of remuneration, organisations such as the AICD preferred to rely on disclosure as a means of monitoring and managing this type of benefit rather than banning them altogether. Mr Munchenberg explained:

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59 *Committee Hansard*, 16 March 2004, p. 73.

60 *Committee Hansard*, 16 March 2004, p. 91.

> The reason is that we can see circumstances where, to take that example and a number of others, such as the payment of options to directors, there may be justification for doing it. But, if you are going to do it, it must be disclosed. Non-recourse loans may be a very effective instrument for a company in trouble that wants to bring in a successful executive to try to trade that company out of its troubles. A non-recourse loan would be offered as part of the incentive for that chief executive…
>
> …as part of an incentive to get an executive into that company that is struggling, you may say to the executive, 'If you are able to get us out of this, you get the options, and the non-recourse element does not come into play. But if, despite your best efforts, your expertise and skills and everything that you do, the company still fails—which they do sometimes—you should not be penalised for that.' So it is a way of managing the risk in those circumstances. The payment of options to directors is another one. The vast majority of major corporations do not pay options to their directors. Many, many small companies, especially start-up ones, would not be able to survive unless they could pay options to their directors because they cannot pay cash to them at the start-up stage. So we are just saying that an absolute prohibition on these things has adverse implications. We would rather see full and frank disclosure of these things and then people can make their individual judgments.[61]

Mr Mayne also disagreed with the proposal to ban non-recourse loans but insisted that they must be disclosed.[62]

Termination Payments

5.62 Chapter 2D, Division 2 of the Corporations Act deals with termination payments and also covers exempt benefits and benefits in certain circumstances. Under section 200E, benefits in connection with retirement from board or managerial office generally need membership approval by a resolution passed at a general meeting. Section 200F exempts certain benefits from this requirement. The proposed amendment in CLERP 9 adds sub section 200F(2) to section 200F. It states that the requirement to seek membership approval in connection with a person's retirement from office in relation to a company is not required if:

(a) the benefit is:

  (i) a genuine payment by way of damages for breach of contract; or

  (ii) given to the person under an agreement made between the company and the person before the person became the holder of the office as the consideration, or part of the consideration, for the person agreeing to hold the office; and

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61 *Committee Hansard*, 11 March 2004, p. 19.

62 *Committee Hansard*, 14 April 2004, p. 40.

(b) the value of the benefit, when added to the value of all other payments (if any) already made or payable in connection with the person's retirement from board or managerial offices in the company and related bodies corporate, does not exceed the greater of:

(i) the amount worked out under subsection (3); and

(ii) the amount worked out under subsection (4)

(3) The amount worked out under subsection (3) is the amount worked out using the formula:

$$\frac{\textbf{Total remuneration} \times \textbf{Relevant period}}{\textbf{3}}$$

where:

relevant period is the number of years in the relevant period or 7, whichever is the lesser number.

total remuneration is the amount of the total remuneration of the person from the company and related bodies corporate during the last 3 years of the relevant period.

The amount worked out under subsection (4) is:

(a) if the relevant period for the person is less than 12 months—a reasonable estimate of the total remuneration that the person would have received from the company and related bodies corporate during the relevant period if the relevant period had been 12 months; or

(b) if the relevant period for the person is 12 months—the total remuneration that the person received from the company and related bodies in the relevant period; or

(c) if the relevant period for the person is more than 12 months—the total remuneration that the person received from the company and related bodies corporate in the last 12 months of the relevant period.

5.63 The Explanatory Memorandum advises that these provisions apply to a benefit that may be given to a person in connection with their retirement from 'board or managerial office' which according to the Memorandum 'applies the provisions to company directors in all capacities in which they act within the company'.[63] It explained further that the provisions are intended 'to ensure that payments made to directors upon their retirement from office are subject to shareholder scrutiny where they may be large relative to the length of time in office or overall remuneration

63 Explanatory Memorandum, p. 169.

practices of the company.' Before discussing the application of this provision to directors, the Committee first examines its application to those in 'managerial office'.

5.64 As noted in the previous chapter, termination benefits have over the past few years come under severe public criticism for both the size of the payout and the late disclosure of the payment. The FSU cited a number of examples which it regarded as excessive termination payments. They included the $32.75 million paid to former CBA executive (and Colonial First State) executive Chris Cuffe; the $13 million for former AMP CEO, George Trumbull, the $2.1 million for Paul Batchelor. It also cited the case of the CEO of Suncorp Metway, Steve Jones, who received nearly $30 million in his last year at the company, which included a $2.45 million termination payment with two years of his contract still to run.[64]

5.65 There are two main aspects to the debate on this proposal to exempt the disclosure requirements for termination payments that fall below the threshold outlined above—the legal implications that flow from requiring shareholder approval and the distinction between termination payments for directors and for executives.

Legal implications of shareholder approval for termination payments

5.66 The AICD stated bluntly that this proposed amendment 'lacks logic and may operate to impose unreasonable and unintended restrictions, particularly, during the first year of the relevant officer's employment by the company'. It explained:

> …in practice, senior executives which a company wishes to recruit are particularly concerned to ensure that they have an initial security of tenure, or will otherwise be appropriately compensated…because the Section 200G(3) formula operates by reference to aggregate past remuneration received, it will result in a very low threshold in the first years of operation which is the very period of greatest concern to the executive being recruited.[65]

5.67 It was also concerned about the provision dealing with genuine payments of damages for breach of contract and the imposition of an arbitrary cap. It did not understand how, in practice 'shareholder approval could be obtained in such circumstances, failing which a potentially costly law suit would be inevitable…'[66]

5.68 IFSA also had concerns about the possible retrospective impact of the proposal dealing with retirement benefits. It pointed out that the provision has the potential of 'enabling shareholders to refuse agreed termination payments to directors

64 *Submission* 38, p. [13].

65 *Submission* 35, p. 25.

66 *Submission* 35, p. 25.

and executives'. It also questioned the legality of the proposal to the extent that it applies to existing contractual arrangements.[67]

5.69 ASFA shared this concern about the legal implications and the breach of contract. It stated:

> If, for whatever reason, shareholder approval is not secured, then the directors could be found in contempt of court or in breach of certain statutory requirements (for instance, under unfair contract/dismissal provisions in workplace relations legislation) for failing to make payments to a departed executive as required by a court or tribunal.[68]

5.70 The Committee accepts that there may be legal consequences if shareholder approval is denied for a contract already settled. The Committee believes that there is a need for clarification on the legal implications that could flow from these provisions and for Treasury and the ASX to issue guidance on the legal implications stemming from these provisions and best practice to avoid difficulties.

5.71 In essence, this provision would certainly require the board to give careful consideration to the retirement and termination clauses when negotiating a contract to ensure that they would be acceptable to shareholders. This obligation on the board would alert directors to their duty to remunerate sensibly, fairly and to link pay with performance. Boards may also prefer to leave agreement on the retirement or termination clauses of a contact until after shareholders have approved the contract.

5.72 Keeping in mind that the threshold set by the legislation is generous, the Committee believes that most retirement or termination arrangements would not need shareholder approval and any such arrangements above this threshold should certainly require shareholder blessing.

5.73 The difficulty for the Committee is in endorsing the threshold set by the proposed legislation. It is concerned that the provision sets down a formula that establishes a relatively high benchmark—a payment above this point requires shareholder approval, a payment below it is exempt from approval. The benchmark appears to be set at quite a high level and in effect appears to sanction or even encourage termination payments that would fall just below this level.

5.74 The safeguard is the disclosure requirements which allow shareholders if dissatisfied with the remuneration package to express their disapproval and if sufficiently provoked to remove the board. Thus the Committee commends measures designed to strengthen disclosure particularly to ensure that shareholders have timely knowledge of a remuneration package in its entirety with all its assorted components presented clearly and concisely.

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67 *Submission* 44, p. 4.

68 *Submission* 19, p. [8].

Termination payments to directors

5.75 The discussion to this stage has been confined to the retirement benefits of company executives. In considering remuneration, directors are in a different category. They are elected by the shareholders and the company by resolution determines the remuneration to be paid to them.[69]

5.76 ACSI agreed with measures that limit the scope of current operations that apply to payment made to directors or former directors and supported the proposal to limit payments that can be made without shareholder approval as outlined in subsection 200G(3). It recognised that the use of this formula will ensure that payments to directors upon their retirement from office are subject to shareholder scrutiny.[70]

5.77 Mr Mayne, however, asked why there are two different types of non-executive director pay and two different types of resolutions—cash up-front and retirement benefits. He argued:

> It should be the one resolution, which is: director pay—maximum for the year $1.5 million spread amongst the directors—and retirement formula—this. It is all the one resolution so you can deal with it. Because often you do not know—it is like a defined benefit super scheme—how the liabilities are spiralling out. When a board member gets an increase in their annual fee from $100,000 to $150,000, if they are getting a five times multiple of their final fee—which is often the formula—you do not realise that the resolution passed back in 1987 on directors' retirement payments, which has not been mentioned in an annual report for 15 years, means that this director is going to retire with an extra $250,000 lump sum in his packet just because he has been able to ratchet up the final fee.[71]

5.78 Further he asked why have a resolution if it can be contracted away. He provided the following example:

> That is what has happened at Aristocrat. The shareholders passed a particular retirement scheme for the directors and then a new director joined the board with a contract—a service agreement—that specifically bypassed the shareholder approval which had been given. If you are going to have shareholder approval for something, make it binding; do not let the directors contract their way around it.[72]

69 Section 202A.

70 *Submission* 5, p.19.

71 *Committee Hansard*, 14 April 2004, p. 39.

72 *Committee Hansard*, 14 April 2004, p. 39.

5.79 Mr Easterbrook noted that retirement benefits for directors are now frowned upon. He told the Committee that until quite recently, non-executive directors had been paid in two ways—annual fee and a pension. He went on to say:

> Best practice does not like retirement benefits because it potentially impacts on a director's independence because, the longer he stays there, the more he will collect and therefore it could be an incentive for him just to toe the line even if he was not happy with what was going on. So there has been a worldwide movement towards trying to get rid of these retirement benefits and pay directors what they ought to be paid each year.[73]

5.80 In his view the 'die is cast' and retirement benefits will not be there for the future, 'instead the director will get paid a whole fee during the year.' Mr Shorten supported a prohibition on granting options and the payment of bonuses and retirement benefits 'other than statutory superannuation' to non-executive directors.

Committee view

5.81 The Committee notes the anomaly in requiring shareholder approval for directors' remuneration but allowing an exemption for termination payments that fall below a specified threshold. This is particularly so when considering the distinct role of a director who is elected by shareholders to represent their interests. It seems inconsistent with this principle that directors should be able to set their own retirement benefits should it fall below a certain level without having shareholder approval. The Committee would prefer that shareholders approve the total package of directors' remuneration including benefits such as retirement or termination benefits.

Recommendation 16

5.82 The Committee recommends that all payments made to directors be subject to shareholder resolution including payments such as the maximum annual cash payment and any retirement benefit or termination payout.

Conclusion

The Committee has examined various aspects of executive remuneration in this and the previous two chapters. In summary the Committee recommended that:

- section 300A should ensure that—
  - all forms of remuneration are captured;
  - the total remuneration package includes accrued benefits and payments;

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73 *Committee Hansard*, 9 March 2004, p. 12.

    - information is presented in such a way that shareholders are able to fully appreciate the total remuneration package including accrued benefits and payments such as termination benefits;
    - a clear link is established between remuneration and performance;
- executive contracts containing the remuneration package be disclosed at the time they are agreed;
- equity based schemes as a form of executive remuneration be subject to shareholder approval;
- all forms of director remuneration be subject to shareholder approval including termination benefits; and
- penalties for breaches of section 300A should be reviewed to ensure that ASIC is able to take action against less serious breaches without having recourse to the courts.

CHAPTER 6

CONTINUOUS DISCLOSURE AND INFRINGEMENT NOTICES

6.1 There is international acceptance that reliable, timely and readily accessible information on company activity and performance is fundamental for investors.[1] The International Organization of Securities Commissions recognised that most retail investors participate in the securities markets through the secondary trading that occurs in the markets, rather than through initial offerings of securities. It found that ‘Material information should also be updated and provided on an ongoing basis to the public, so that retail investors who participate through secondary trading, and who are most in need of regulatory protection, can benefit from this same type of disclosure on an ongoing basis. In other words, the body of information available to an investor should contain both information disclosed at the IPO [initial public offering] stage…as well as information disclosed on an ongoing basis. The fundamental principle of full and fair disclosure is that the listed entity should provide all information that would be material to an investor’s investment decision.’[2]

6.2 It acknowledged that each market has developed different regulatory approaches due to its unique legal and institutional history. Despite the differences, it maintains that ‘most jurisdictions agree that listed entities should have an ongoing obligation to disclose information that would be material to an investor’s investment decision and that is necessary for full and fair disclosure'.[3]

6.3 The Australian market certainly adheres to such principles. Indeed, for many years Australian governments have advocated and sought to put in place a regulatory regime that would ensure that all information relevant to an investor was disclosed to the market in a timely, fair and efficient manner. This chapter examines the most recent attempt to further improve the disclosure regime.

6.4 Major corporate collapses have been a significant stimulant to regulatory change in Australia. Reform of the regulatory framework seems to come in surges generated by spectacular company failures which trigger a crisis of confidence in the markets accompanied by calls for an overhaul of the system. Continuous disclosure is

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1 The Technical Committee of the International Organization of Securities Commissions, *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities,* October 2002, p. 2.

2 The Technical Committee of the International Organization of Securities Commissions, *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities,* October 2002, p. 2

3 The Technical Committee of the International Organization of Securities Commissions, *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities,* October 2002, p. 3.

one area that is looked upon as a means to promote public confidence in the markets and comes under close scrutiny for its effectiveness.

6.5 The corporate breakdowns of the 1980s exposed perceived inadequacies in the Australian regulatory system and raised concerns about the timeliness and adequacy of the disclosure of relevant information to investors. They placed increasing pressure on the authorities to improve the disclosure regime. For example, the Australian Securities Commission (ASC) found that the events of the 1980s had 'highlighted the importance of prompt disclosure in order to prevent "surprises", and perhaps even misconduct, at an early stage'.[4] Mr Alan Cameron, ASC, stated further:

> Had relevant information concerning transactions been disclosed, both shareholders and the ASC's predecessors could have been in a better position to detect misconduct and to take timely enforcement action.
>
> Investors would have been in a better position to make an investment decision to enter or exit the companies. Some windows of opportunity for trading on inside information may have closed.[5]

6.6 At that time, the situation had created a strong political imperative for the Government to respond to the collapses. It set in train a reform process that focused on enhanced disclosure as a means of grappling with the problem. Much of the debate that took place in the early 1990s resonates today as once again a series of company failures have ushered in a period of review and placed the disclosure regime again under the spotlight.

6.7 Aside from increasing financial penalties and applying penalties to persons not previously subject to them for breaches of the continuous disclosure regime as discussed in chapter 7, the proposed legislation is also concerned with the method of pursuing offenders. One problem facing ASIC, however, is successfully prosecuting suspected breaches of the Act. This chapter looks at the proposal in CLERP 9 to allow ASIC to issue infringement notices for breaches of the continuous disclosure obligations.

6.8 In announcing this measure, the Government stated:

> The continuous disclosure provisions should strike an appropriate balance between encouraging the timely disclosure to investors of materially price sensitive information; preventing the emergence of a false market as a result

4 Alan Cameron, 'Corporate Law Reform Bill (no. 2) 1992, *Companies and Securities Bulletin,* No. 118, February 1993, p. 2.

5 Alan Cameron, 'Corporate Law Reform Bill (no. 2) 1992, *Companies and Securities Bulletin,* No. 118, February 1993, p. 2.

of the premature disclosure of information in relation to uncertain matters; and safeguarding the commercial interests of disclosing entities.[6]

6.9 This chapter examines the proposal to introduce the infringement notice taking account of the importance for a disclosure regime to ensure that: the market is kept well informed; investments are protected; consumer confidence is maintained; and the opportunities for business to be able to operate in a competitive environment are not stifled. The proposal to allow ASIC to issue an infringement notice builds on a legacy of reforms. The following section begins by providing a brief background to the development of the current disclosure regime before turning to the provisions contained in CLERP 9.

Recent developments in Australia's disclosure regime

6.10 Following the corporate failures in the 1980s, the Government embarked on a legislative reform program to rectify what it saw as deficiencies in the current regulatory framework. At that time, the Government was of the view that the failure was not one of 'the substantive law but rather a failure to adequately enforce that law and to have in place a system capable of enforcing it'.[7] Disclosure was identified as a key area of weakness.

6.11 Indeed, a report by the Companies and Securities Advisory Committee (CASAC) found in 1991 that the 'Corporate Law does not contain a comprehensive scheme for the full and accurate disclosure of material matters on a timely basis'. In particular it noted that there was 'no general continuous disclosure requirement for the benefit of those engaged in the secondary trading of securities'.[8] CASAC recognised that to be effective, a continuous disclosure regime must impose reporting obligations, together with consequential liability for breaches, on those persons in the disclosing entity best placed to ensure compliance.[9]

6.12 Reforms implemented under the Corporate Law Reform Act 1994 rested on the core premise that for investors to have confidence in the integrity of the marketplace and to make informed investment decisions they need the timely disclosure of relevant information. [10]

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6 *Corporate disclosure: Strengthening the financial reporting framework,* Commonwealth of Australia, 2002, p. 138.

7 See for example statement by The Hon Michael Lavarch, Attorney-General, House *Hansard*, 1 February 1994, p. 62.

8 Companies and Securities Advisory Committee, *Report on an Enhanced Statutory Disclosure System*, 1991, p. 1.

9 Companies and Securities Advisory Committee, *Report on an Enhanced Statutory Disclosure System*, 1991, p. 13.

10 Michael Lavarch, Attorney-General, House *Hansard*, 15 December 1993, p. 4083.

6.13 Although the Act introduced a statutory based system of continuous disclosure, it built on the existing continuous disclosure requirements in place for companies listed on the Australian Stock Exchange.[11] Under this legislation, which took a more self-regulatory approach, the Australian Stock Exchange had the task of primary monitoring of continuous disclosure by listed companies. During passage of the legislation, the Government maintained:

> While the bill retains and reinforces the role of the Stock Exchange, it also strengthens the position of the ASC to take action to ensure compliance with continuous disclosure obligations. Most importantly, it retains the principle that civil remedies should be available in respect of breaches of disclosure obligations. As now formulated, the bill provides investors with a right to recover damages where loss is suffered as a result of the market being misled through an intentional, reckless or negligent failure to fulfil these obligations.[12]

6.14 In 1996, CASAC conducted a review of the continuous disclosure regime introduced in 1994 and found overall that the enhanced disclosure regime for listed entities, based on adherence to the ASX Listing Rules, was operating effectively.[13] In particular, it noted that there was 'overwhelming support for the supervisory and enforcement role and powers of the ASX and the ASC in regard to continuous disclosure'.[14] In essence it found that:

> …continuous disclosure had helped to keep the market, and investors in listed disclosing entities, more informed. Continuous disclosure also reinforced the obligations on directors and management to disclose material information to the market. Respondents considered that investors gained a better and more timely understanding of the issues facing the company and how these might affect the value of their shares. Continuous disclosure also encouraged listed entities to formalise their lines of internal communication to ensure that the directors and senior management were fully informed of all events affecting the price or value of the entity's securities. Overall, the respondents considered that continuous disclosure encouraged greater investor confidence in the price discovery mechanism of the securities market.[15]

6.15 Although it noted that the ASC and ASX each assist in maintaining the integrity of the security market through their respective roles in enforcing continuous

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11 See for example, Mr B.T. Cunningham, House *Hansard*, 1 February 1994, p. 46.

12 Michael Lavarch, Attorney-General, House Hansard, 15 December 1993, p. 4083.

13 Companies and Securities Advisory Committee, *Report on continuous disclosure,* November 1996, p. 2.

14 Companies and Securities Advisory Committee, *Report on continuous disclosure,* November 1996, p. 4.

15 Companies and Securities Advisory Committee, *Report on continuous disclosure,* November 1996, p. 4.

disclosure and that the system was working satisfactorily, it believed that the arrangements could be improved. In particular it suggested that the ASC should have a greater range of sanctions to enforce the continuous disclosure requirements, namely, small administrative penalties and enforceable undertaking arrangements in connection with the statutory continuous disclosure requirements.[16] CASAC's findings have direct relevance to the provisions now under consideration.

6.16 The recent failures of HIH, One Tel, Ansett and Harris Scarfe have sparked another wave of concern about the adequacy of the regulatory framework in protecting consumers and inspiring confidence in the market. Again remedies are being sought by strengthening the continuous disclosure regime.

6.17 From the policy proposal stages of CLERP 9, the Government has maintained that disclosure is fundamental to market integrity and investor protection—that it is an important component of the current Australian disclosure framework.

6.18 Although the Government argues that Australia's current disclosure regime is fundamentally sound it proposes measures to further enhance its effectiveness.[17] As noted earlier, the cornerstone of a fair and effective disclosure regime is that investors have access to materially price sensitive information on an equal basis, so that particular market participants are not disadvantaged in relation to others.

6.19 Under the current regulatory framework, listed disclosing entities are also required under the listing rules of their respective listing markets to make ongoing disclosures in relation to certain specified matters.

Current continuous disclosure provisions

6.20 As the legislation now stands, a Court may order a person to pay the Commonwealth a pecuniary penalty of up to $200,000 if the Court has made a declaration of contravention of a range of provisions governing conduct such as breaches of the continuous disclosure provisions, market manipulation, false trading and market rigging and insider trading.[18] The proposed legislation wants to build on this civil penalty regime by allowing ASIC to issue an infringement notice to a disclosing entity for an alleged contravention of the continuous disclosure provisions as an alternative to proceedings for civil penalties.

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16 Companies and Securities Advisory Committee, *Report on continuous disclosure,* November 1996, pp. 6 and 31.

17 *Corporate disclosure: Strengthening the financial reporting framework,* Commonwealth of Australia, 2002, p. 129.

18 Section 1317G. Financial services civil penalty include among other sections s 1041A (market manipulation; subsection 1041B(1) (false trading and market rigging—artificially maintaining etc. ml price;) subsection 1043A(1) insider trading New ss 674(2A), 675(2) and 675(2A) are to be part of this regime.

6.21 As noted above, only courts may impose financial penalties for contraventions of the continuous disclosure provisions. Section 674 ties the listing rules of a listing market directly with the continuous disclosure requirements of the Corporations Act. ASX Listing Rule 3.1 requires listed entities to disclose immediately materially price sensitive information to the ASX so that it can be disseminated to investors. ASX Listing Rules state that once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information. Under section 677 of the Corporations Act the meaning of 'material effect' applies if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether or not to subscribe for, or buy or sell, the first mentioned securities. The Listing Rules provide guidance on information deemed to be material and would require the disclosure of matters such as:

- a change in the entity's financial forecast or expectation;
- a transaction for which the consideration payable or receivable is a significant proportion of the written value of the entity's consolidated assets—normally, an amount of 5% or more would be significant, but a smaller amount may be significant in a particular case;
- a proposed change in the general character or nature of a trust;
- a recommendation or declaration of a dividend or distribution;
- under subscriptions or over subscriptions to an issue.[19]

6.22 Section 674 of the Corporations Act recognises the Listing Rule by creating criminal and civil liability under the Act for non-compliance.

6.23 In effect sub section 674(2) requires a listed disclosing entity to notify the market operator of information about specified events or matters as they arise. This is to enable the operator to make that information available to participants in the market if that information is not generally available and is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED securities (enhanced disclosure securities)[20] of the entity.[21] Except for specified entities, unlisted disclosing entities are also bound by similar provisions contained in section 675.

6.24 If a Court is satisfied that a person has contravened section 674(2) or 675(2), it must make a declaration of contravention. Once a declaration has been made, ASIC can then seek a pecuniary penalty order or a disqualification order (s 1317E (ja)).

19 ASX, Listing Rules, Chapter 3, General Rule 3.1.

20 See section 111AD.

21 Section 674(2).

Under section 1317G(1A), the Court may order a person to pay the Commonwealth a pecuniary penalty of up to $200,000 if the contravention is serious or materially prejudices the interests of acquirers or disposers of the financial product or materially prejudices the issuer of the financial product or, if the issuer is a corporation or scheme, their members.

The proposed infringement notice

6.25 The proposed legislation is intended to supplement existing criminal and civil court procedures by allowing ASIC to issue an infringement notice for minor contraventions of the continuous disclosure regime.

6.26 The Attorney-General's Department notes that infringement notices 'involve a departure from the traditional separation of powers doctrine that only a court may impose a penalty'. It maintains, however, that they 'are justified by the efficiency and cost savings they provide for enforcement agencies and as a low key means for a potential defendant to atone for wrong doing'.[22]

Policy proposal paper—first consultation period

6.27 According to the policy proposal paper issued in September 2002, the proposed infringement notice arrangements would be in accord with the Attorney-General's understanding of the function of such a device. It stated that the proposed legislation would:

> remedy a significant gap in the current enforcement framework by facilitating the imposition of a financial penalty in relation to relatively minor contraventions of the regime that would not otherwise be pursued through the courts and in relation to which ASIC considers a relatively small financial penalty would be justified. The capacity to issue an infringement notice would also allow ASIC to signal its views concerning appropriate disclosure practices to listed entities more effectively than through court action alone.[23]

6.28 ASIC supported the proposal that it be given the power to impose financial penalties and issue infringement notices in relation to contraventions of the continuous disclosure regime. In its view such a power:

> …will improve the flexibility, cost effectiveness and timeliness of remedies, and underpin the integrity of the law by providing a proportionate remedy for conduct that may not otherwise be addressed. A power to fine is an

22 Minister for Justice and Customs, *A Guide to Framing Commonwealth Offences, Civil Penalties and Enforcement Powers*, February 2004, p. 45.

23 *Corporate disclosure: Strengthening the financial reporting framework,* Commonwealth of Australia, 2002, p. 149.

important tool particularly for late or inadequate disclosure, where existing remedies are ineffective or overly complex.[24]

6.29 The central thrust of ASIC's argument rested on the difficulties it experiences in prosecuting offences or taking effective civil action for breaches of disclosure after the event. It maintained that ASIC intervention can speed up and, in some cases, cause proper disclosure. On the other hand, it noted that having to institute formal proceedings, even of a civil nature, is 'not necessarily the best means of regulating and improving disclosure conduct'.[25]

6.30 Clearly, ASIC saw the proposed administrative penalty regime as a means to deter breaches of the continuous disclosure provisions. It argued, however, that the fine needs to be proportionate to the gravity of the breach and 'to reflect the need to deter the conduct in question'. It noted that the requirement to seek a court order to enforce an administrative penalty would be a significant safeguard against ASIC abusing its power or making erroneous decisions.[26] It cited overseas cases where regulators use administrative penalty regimes as an effective enforcement tool.[27]

6.31 Others were not so certain about expanding ASIC's power to allow it to impose penalties for breaches of the continuous disclosure regime. When initially presented in the policy proposal paper released in September 2002, the scheme attracted fierce opposition. Indeed, AICD labelled the infringement notice as a 'backward step'.[28] Those critical of the measures cited problems such as the apparent conflicting functions of investigator and judge assumed by ASIC, the constitutionality of the proposal; the overlap and potential confusion in the roles of ASIC and the ASX, the inappropriateness of the infringement notice procedure because of the degree of subjectivity required to establish the facts of the offence and the onus of proof resting

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24 ASIC *submission* to Treasury, November 2002, p. 35.

25 ASIC *submission* to Treasury, November 2002, p. 35. Mr David Knott, former chairman, ASIC, told an audience in August 2001 that he had earlier in the year raised the question of the regulator being given power to issue fines for market offences. He explained: 'the need to institute formal proceedings, even of a civil nature, is not necessarily the best means of regulating and improving disclosure conduct. Moreover, there are issues connected with the burden of proof and with the Courts' approach to evidentiary and procedural requirements in civil penalty matters that may tend to limit their practical use to ASIC. For example, while intervention by ASIC often confirms inadequate disclosure and leads to additional information being released to the market, there is seldom sufficient evidence to support a prosecution once the corrective information has been released'. Launch of the Australasian Investor Relations Association, 13 August 2001, p. 4.

26 ASIC submission to Treasury, November 2002, p. 35.

27 ASIC submission to Treasury, November 2002, p. 35.

28 AICD submission to Treasury, 22 November 2002, p. 9 of 20.

with the accused.[29] The release of the exposure draft in October 2003 did little to quell opposition.

Exposure draft—second consultation period

6.32 The response to the draft exposure to allow ASIC to issue an infringement notice drew immediate and strong criticism in the media from some business people. To their way of thinking, the complex and subjective nature of continuous disclosure requirements did not lend itself to on-the-spot fines which was further complicated by ASIC assuming the role of the regulator, the judge and the jury.[30] Margaret Jackson, Qantas chairwoman, described the on-the-spot fines as 'illogical' claiming that they ignored how corporations 'really work'.[31] Professor Ramsay raised the idea of an independent panel. He stated:

> many people would have liked the idea of an independent panel that sits aside or apart from ASIC to determine whether or not there's been a breach of the continuous disclosure rules, and then perhaps for ASIC to take that recommendation and make a decision about say the appropriateness of the fine.[32]

The Bill and the provisions governing the issue of an infringement notice

6.33 The proposed scheme outlined in the policy proposal paper of September 2002 and detailed in the exposure draft has undergone various changes to accommodate some of the criticism levelled at the proposal during the consultation periods. The introduction of the Bill into Parliament in December 2003 provided a clearer understanding of the procedures to be adopted when issuing an infringement notice.

6.34 One significant change dealt with the ASX's role in the continuous disclosure regime. The AICD was one of a number who suggested that the legislation include a formal requirement that ASIC work with the ASX in exercising its authority in relation to entities and the ASX regulations. It cited the need for such a formal

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29 See in particular KPMG *submission* to Treasury, no. 36, p. 18 and also Securities Institute, AICD and Chartered Secretaries of Australia *submission* to Treasury, November 2002.

30 Transcript, '7.30', 'Treasurer, Shadow Minister, BCA and shareholder activist comment on CLERP 9 proposals for shareholders to vote on dollar executive pay packets', 8 October 2003 and *Australian Financial Review*, 'Company leaders take chair to talk governance', 27 October 2003.

31 *Australian Financial Review*, 'Company leaders take chair to talk governance', 27 October 2003.

32 Transcript, 'PM', 'business gives mixed response to CLERP9 proposals for shareholders to vote on executive pay', Wednesday, 8 October 2003.

requirement perhaps even to 'the signing off by ASIC that it has consulted the ASX in relation to the alleged "minor breach"'.[33]

6.35 The Bill has taken account of this particular matter. It now includes a provision that requires ASIC to consult with the relevant market operator for a listed disclosing entity before giving that entity the statement of reasons for believing that the disclosing entity has contravened the continuous disclosure requirements.[34]

6.36 Even so, the proposal came under attack from many quarters. For example the Securities Institute maintained that although the Bill makes a more practical attempt to encapsulate the proposal by additional procedural restrictions, it continued to 'question whether it is appropriate to extend these powers to ASIC'.[35] Before examining the concerns raised in submissions, the Committee outlines the main features of the proposed infringement notice regime.

6.37 The Bill clearly enunciates the steps ASIC must take when issuing an infringement notice. It must among other things:

- have reasonable grounds to believe that a disclosing entity has contravened the continuous disclosure provisions;
- issue the infringement notice to the disclosing entity by serving it on the entity;
- have regard to any guidelines issued by the relevant market operator;
- before issuing the infringement notice give the disclosing entity a written statement that sets out ASIC's reasons for believing that the disclosing entity has contravened subsection 674(2) or 675(2);
- give a representative of the disclosing entity an opportunity to—
  - (i) appear at a private hearing before ASIC; and
  - (ii) give evidence to ASIC; and
  - (iii) make submissions to ASIC

in relation to the contravention.[36]

6.38 There are numerous requirements governing the contents of the infringement notice such as it:

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33 *Submission* 35, p. 32. See also *Submission*s no.6A, p. 7 and *Submission* 8, p. 10.

34 Subsection 1317DAD (2).

35 *Submission* 11, p. [5].

36 1317DAD.

- must give details of the alleged contravention by the disclosing entity;
- must state the maximum pecuniary penalty that a Court could impose in relation to the alleged contravention;
- must specify the penalty that is payable in relation to the alleged contravention;
- if it is alleged that the disclosing entity contravened subsection 674(2)—may specify information that the disclosing entity must notify to the relevant market operator in accordance with the provisions of the listing rules referred to in subsection 674(1);
- if it is alleged that the disclosing entity contravened subsection 675(2)—may require the disclosing entity to lodge a document with ASIC that contains specified information; and
- must state that the disclosing entity may make written representations to ASIC seeking the withdrawal of the infringement notice.[37]

6.39 The proposed legislation stipulates the conditions that would apply to the issue of an infringement notice. For example, ASIC must not issue more than one infringement notice to the disclosing entity for the same alleged contravention and the infringement notice would have no effect if it were issued more than 12 months after the day on which the alleged contravention was to have occurred.[38]

6.40 The legislation also specifies fixed penalties to be imposed for an alleged contravention of subsection 674(2) which are:

- $100,000 if the disclosing entity is a Tier 1 entity ; or
- $66,000 if the disclosing entity is a Tier 2 entity; or
- $33,000 if the disclosing entity is a Tier 3 entity.

Under certain circumstances the penalty for Tier 3 can be set at $66,000.[39]

6.41 For alleged contravention of subsection 675(2) the penalty is $33,000 which can under certain circumstances be set at $66,000, for example, if the disclosing entity has at any time been convicted of an offence of the continuous disclosure provisions.

6.42 The legislation defines what constitutes a failure to comply with an infringement notice and also covers provisions should a disclosing entity not satisfy the requirements of the notice.

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37 Section 1317DAE(2).

38 Section 1317DAC.

39 Section 1317DAE(2).

6.43 If a disclosing entity fails to pay the penalty, it is liable to proceedings under Part 9.4B for a declaration of contravention and a pecuniary penalty order in relation to the alleged offence. Should a disclosing entity not notify the relevant market operator of any information specified in the infringement notice or in the case of an unlisted disclosing entity fail to lodge with ASIC any required document specified in the infringement notice, it is liable to proceedings for an order under section 1324B in relation to the alleged contravention.

6.44 The compliance period for an infringement notice is 28 days beginning on the day after the day on which the infringement notice was issued. ASIC may extend the compliance period for a further 28 days.[40]

6.45 A disclosing entity may provide written representations to ASIC seeking a withdrawal of the notice. The proposed legislation states that evidence or information that a representative of the disclosing entity gives ASIC in the course of making representations is:

- not admissible in evidence against the disclosing entity in any proceedings;
- not admissible in evidence against a representative of the disclosing entity in any proceedings (other than proceedings for an offence based on the evidence or information given being false or misleading).[41]

ASIC may withdraw the notice.

Submissions to the inquiry

6.46 Witnesses agreed emphatically that the market has to be fully informed and that the continuous disclosure provisions are important to the fair and efficient operation of the market.[42] They regarded timely disclosure and proper enforcement as central to an effective disclosure regime.[43] The submissions to the inquiry, however, were divided in their opinions on the proposal to allow ASIC to issue an infringement notice for a breach of the continuous disclosure provisions. Many submissions echoed the concerns raised immediately after the release of the exposure draft. They were highly critical of the infringement notice process and identified what they perceived as serious flaws in the proposed legislation. The key issues of contention involved: the lack of justification for the changes; doubts about ASIC's ability to enforce the provisions; uncertainty about whether the legislation applied to serious or minor breaches; questions about the constitutionality of the proposal; the subjectivity required to determine a breach; the possible erosion of basic rights; the conflicting

40 Section 1317DAH.

41 Section 1317DAI.

42 See for example, Professor Adams, *Committee Hansard*, 16 March 2004, p. 20; Mr Gration, *Committee Hansard*, 18 March 2004, p. 46.

43 See for example, Ms Farrell, *Committee Hansard*, 16 March 2004, p. 50.

roles conferred on ASIC and the absence of any proposal to review the legislation. The following section examines each issue in turn.

Lack of justification for the introduction of the infringement notice

6.47 A number of witnesses could see no point in introducing the measure to allow ASIC to issue infringement notices. To them it appeared to lack justification—a case for such a reform had not been established. Indeed, it was suggested that ASIC had not fully tested its current powers such as the ability to seek an injunction against a party which it suspected of breaching the continuous disclosure provisions.[44] Professor Bob Baxt submitted:

> ASIC has made no case for the vesting in it of the power to issue infringement notices. Mere assertions that it has had difficulty in establishing a breach of the law in this area, and assertions that the courts are too slow in providing the appropriate remedy in a case of a breach of continuous disclosure regime, have not been backed by any statistics showing which cases have been run and lost.[45]

He went on to say:

> I suggest that the mere allegation that something is difficult is not nearly good enough for such a very important change to be introduced into the law especially when an expert committee [ALRC] has indicated that it is opposed to such a change. Whilst it may be appropriate to vest in the regulator the ability to impose fines where one is dealing with very minor breaches of the legislation (failure to file annual accounts), to extend it to an area as difficult and complex as continuous disclosure is very unwise. This is an area of similar difficulty to the misuse of market power provisions of the TPA and the decision to give such power to a regulator is an example of government pleasing a regulator that has not pursued its obligation to enforce a particular area of the law because of perceived difficulties.[46]

6.48 The New South Wales Young Lawyers Business Law Committee stated that it was not aware of any particular circumstances in which the court system has been deficient or too slow for ASIC to enforce the law.[47] IFSA was similarly unaware of a problem regarding systematic breaches of the continuous disclosure provisions that would warrant the imposition of a fining power.[48] Others suggested that if there were

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44 The Business Council asserted that 'further powers should not be given to ASIC until the effect of the current powers, particularly the recent additional power to seek civil penalties, has been properly tested'. *Submission* 20, p.p. 18–19; *Submission* 8, p. 9.

45 *Submission* 6A, p. 2.

46 *Submission* 6A, p. 3.

47 *Submission* 18, p. 2.

48 It stated that 'While aware of a few high profile cases, we consider that the action undertaken by ASIC had significant impact on the companies and senior executives'. *Submission* 44, p. 7.

defects in the current court system they should be remedied.[49] Mr Munchenberg told the Committee:

> We are seeing a trend in a number of different areas of the law for arguments to be mounted that it is too time-consuming and too costly to go to court to prove that someone has breached the law. We need something faster. We are seeing this tendency towards giving regulators interventionist instruments to be able to do that. There may be justification in the argument that it does take a long time to go to courts, but we would argue that the solution to those things is not to give regulators effectively executive discretion to determine that there have been breaches of the law.[50]

6.49 Professor Adams shared the view that there has not been a fundamental breakdown in the provisions nor a fundamental breakdown in the law. He could not see 'the benefit of putting this additional burden' in the legislation.[51] Indeed, the AICD asserted that the current system was operating effectively stating that the average number of announcements made per company grew 65% since the enhanced continuous disclosure regime came into effect in 1994. It also noted the number of per company disclosures had increased from approximately 26 to 50 in the period since 1994.[52]

6.50 Professor Adams, who opposed the introduction of infringement notices, referred to the use of enforceable undertakings—a mechanism whereby an individual does not admit liability but agrees that they will remedy their practices and, if necessary, make adjustments on compliance matters. In his view this has been an effective tool.[53]

6.51 The Law Council argued that ‘greater resources should be directed to civil prosecution of more serious breaches, an alternative that has not yet been actively pursued and which remains untested’.[54] It also suggested that ASIC should use court enforceable undertakings from parties more effectively. One commentator cited section 1324 injunctions and suggested that the section provides 'sufficiently wide application to be used in a variety of contexts and is available to ASIC, shareholders and creditors alike to stop any kind of contravention of the Corporations Act including

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49 *Submission* 20, pp. 18–19; *Submission* 24, p. 17, *Submission* 44, p. 7.

50 *Committee Hansard*, 11 March 2004, p. 5.

51 *Committee Hansard*, 16 March 2004, p. 21.

52 *Submission* 35, p. 29.

53 *Committee Hansard*, 16 March 2004, p. 21. See also p. 22.

54 *Submission* 24, p. 18. See also *Submission*. 6A, p. 2; *Submission* 35, p. 33, *Submission* 44, p. 7.

minor breaches of the continuous disclosure provisions'. He maintained that history shows that this section is rarely used by ASIC.[55]

6.52 Some suggested that the use of infringement notices would not produce the 'quick regulatory response' it was intended to achieve.[56] Ms Farrell observed that:

> If anyone thinks that these fines are going to happen immediately then they have misconceived the process.[57]

6.53 A number observed that the proposal ignored the Australian Law Reform Commission's (ALRC) report which found that 'the granting of infringement notice powers to ASIC in relation to continuous disclosure was neither justified in the evidence nor was of a sensible law reform development'.[58] For some the proposal represented the thin edge of the wedge which could set a precedent for other areas of corporation law enforcement.[59]

6.54 Apart from the lack of evidence indicating that the current system was failing, a number of people questioned the wisdom in allowing ASIC to issue infringement notices. They feared that the proposal would undermine or confuse the role of the ASX. A number even argued that the ASX is better positioned to enforce continuous disclosure because of its understanding of the market and its role as the front-line

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55 J. McConvill, 'Australian Securities and Investments Commission's proposed power to issue infringement notices: Another slap in the face to s 1324 of the Corporations Act or an undermining of corporate civil liberties?', *ABLR,* vol. 36, 2003, pp. 43–4.

Section 1324 reads:

Where a person has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes or would constitute:

(a) a contravention of this Act; or

(b) attempting to contravene this Act; or

(c) aiding, abetting, counselling or procuring a person to contravene this Act; or

(d) inducing or attempting to induce, whether by threats, promises or otherwise, a person to contravene this Act; or

(e) being in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by a person of this Act; or

(f) conspiring with others to contravene this Act;

the Court may, on the application of ASIC, or of a person whose interests have been, are or would be affected by the conduct, grant an injunction, on such terms as the Court thinks appropriate, restraining the first-mentioned person from engaging in the conduct and, if in the opinion of the Court it is desirable to do so, requiring that person to do any act or thing.

56 Chartered Secretaries Australia, *Submission* 8, p. 2.

57 *Committee Hansard*, 16 March 2004, p. 54.

58 *Submissions* 6A, p. 2; *Submission* 20, p. 17; *Submission* 24; p. 14; *Submission* 35, p. 28.

59 *Submission* 11, p. [5]; *Submission* 17, p. 5; *Submission* 24, p. 15, *Submission* 35, pp. 29 and 32.

regulator responsible for monitoring the market.[60] For example, the Securities Institute had doubts about whether ASIC was the best placed to address such breaches. It asserted:

> We believe that the ASX's understanding of the market and its role as the front-line regulator responsible for monitoring of the market means that it is better positioned to assess the price-sensitivity of a particular matter and pursue actions accordingly to ensure market integrity.[61]

6.55 This debate then leads to the question about ASIC's ability to enforce the continuous disclosure regime and whether it is equipped to carry out this function effectively.

ASIC's ability to enforce the provision

6.56 A number of witnesses expressed concerns about ASIC's ability to handle the increased workload that could flow from the introduction of the infringement notice proposal.[62] In the view of the Commercial Law Association of Australia Limited, ASIC is not well placed nor well skilled to undertake this function. In its view, ASIC is not 'seized of jurisdiction to consider matters of State and common law that will invariably also apply—eg *Fair Trading Act* breaches and negligent misstatement'.[63]

6.57 Of even greater concern to the Committee is the suggestion that ASIC is not taking full advantage of the law as it stands to enforce the continuous disclosure regime. AICD maintained that ASIC 'has not always been as aggressive and as willing to pursue company collapses as the facts of the situation may warrant'.[64] Professor Baxt told the Committee:

> ASIC has certain powers. If it enforced those powers regularly and consistently and showed some leadership in this context, maybe we would not have needed the ASX guidelines.
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> …the ASX privately have said to me that they are very unhappy with the infringement notice regime. They believe it is a sop to ASIC. What ASIC

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60 *Submission* 6A, p. 5; *Submission* 8; p. 9; *Submission* 11, p. [5], *Submission* 24, p. 19; *Submission* 35, p. 32. ASX was concerned that 'in the absence of full and effective co-operation between ASIC and ASX, where the different but complementary roles of each are delineated and respected, the infringement notice regime will not achieve the intended enhanced outcomes but instead may result in fragmentation of administration and reduced effectiveness of the overall disclosure framework'. *Submission* 48, p. 7.

61 *Submission* 11, p. [5].

62 See for example, Mr Sheehy, *Committee Hansard*, 18 March 2004, p. 48.

63 *Submission* 49, p. 2.

64 Supplementary *Submission*, 35A, p. 2.

> has said consistently—I come back to this because this is part of the theme—is, ‘It is too hard for us to run these cases. These cases are too difficult. These cases take too long.’ The evidence, when it is there, is to the contrary. Southcorp…

6.58 He went on to argue that if the courts are not equipped to deal with these matters then 'let us fix up the courts. Let us not start imposing additional burdens on companies, and eventually on consumers'.[65]

6.59 The matter of ASIC having adequate resources to enforce the infringement notices was also raised by Professor Adams and is tied to the overall issue about ASIC's resources.[66] This concern with ASIC's ability to enforce the legislation was also discussed in the chapter on whistleblowing (paragraphs 2.93–2.95) and in the Committee's report on Australia's insolvency laws.[67]

6.60 Evidence presented to the Committee's inquiry into Australia's insolvency laws by a range of witnesses including liquidators, administrators, the ATO, CPA and the AMWU indicated that ASIC fails to follow-up adequately on reports of suspected breaches of the Corporations Act.[68] A number believed that a lack of resources was behind ASIC's inability to investigate properly suspected contraventions. Testimony taken during this inquiry confirms the Committee's view that confidence in the regulatory system is crucial to the efficient and effective operation of the markets which in large measure depends on the adequate funding of ASIC. The Committee believes that funding must take account of the demands and complexities of overseeing and enforcing Australia's corporation's law.

Enforcement of serious or minor breaches

6.61 A number of submissions questioned the preference given by CLERP 9 to minor offences. They were concerned that the legislation does not address the problem of effective enforcement of serious breaches which, in the opinion of a number of witnesses, should be the priority. ASX stated that it would be concerned if the focus of the enforcement effort were ‘unduly skewed to the punishment of “less serious” contraventions'.[69] The Law Council asserted that 'Greater resources should be directed to civil prosecution of more serious breaches, an alternative that has not yet been

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65 *Committee Hansard*, 18 March 2004, p. 99.

66 See for example Professor Adams, *Committee Hansard*, 16 March 2004, p. 22.

67 See also Michael J Duffy, 'Shareholder Democracy or Shareholder Plutocracy? Corporate Governance and the Plight of Small Shareholders', *UNSW Law Journal,* vol 25, no. 2, 2002, p. 455.

68 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake,* May 2004, pp. 156–8.

69 *Submission* 48, p. 8.

actively pursued and which remains untested'.[70] The interpretation of 'less serious' varies.

6.62 The Explanatory Memorandum is at pains to stress that the legislation intends that the proposed infringement notice mechanism is to be used only in relation to less serious contraventions of the continuous disclosure regime. It maintains that the proposal strikes 'an appropriate balance between enhancing ASIC's capacity to deal with relatively minor contraventions of the continuous disclosure provisions and ensuring that there are adequate procedural safeguards'.[71]

6.63 This statement contradicts ASIC's advice to the Australian Law Reform Commission where it commented that it was 'seeking the power to issue infringement notices for failure to comply with the continuous disclosure provisions in the Corporations Act, and that such contraventions were not of a 'less serious nature'.[72] In its submission to Treasury, however, ASIC stated that a power to impose fines 'will provide an important enforcement tool that will give a relatively fast, flexible and proportionate outcome for a lower level failure to disclose…'[73]

6.64 Ms Farrell, however, noted what appeared to be an anomaly in the provisions. According to her understanding the obligation to continuously disclose something applies only if that piece of information is material to the market. In her words 'so it beats me how you can ever have a minor contravention in this area. The threshold issue is: was the information material?'[74]

6.65 The emphasis given in the Explanatory Memorandum and by ASIC that the infringement notice would only be issued for 'relatively minor' breaches, may well reflect constitutional considerations.

Constitutionality of the infringement notice procedures

6.66 The proposal to allow ASIC to issue an infringement notice for breaches of the continuous disclosure regime rekindled the longstanding question on the separation of powers. Section 71 of the Australian Constitution vests the judicial power of the Commonwealth in a Federal Supreme Court, known as the High Court, and in such other federal courts as the Parliament creates and in such other courts as it invests with federal jurisdiction. According to Quick and Garran:

> The judicial power is the power appropriate to the third great department of government, and is distinct from both the legislative and the executive

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70 *Submission* 24. p. 17.

71 Explanatory Memorandum, p. 174.

72 Australian Law Reform Commission, *Principled Regulation: Civil and Administrative Penalties in Australian Federal Regulation,* Report no. 95, 2002, Chapter 12, paragraph 12.58.

73 ASIC *Submission* to Treasury, November 2002.

74 *Committee Hansard*, 16 March 2004, p. 53.

> powers. The judicial function is that of hearing and determining questions which arise as to the interpretation of the law, and its application to particular cases. 'the distinction between the departments undoubtedly is, that the legislature makes, the executive executes, and the judiciary construes the law'.[75]

6.67 The authors go on to state that 'though no specific definition of these powers is attempted, it is conceived that the distinction is peremptory, and that any clear invasion of judicial functions by the executive or by the legislature, or any allotment to the judiciary of executive or legislative functions, would be equally unconstitutional.' They conceded that it is not always easy to draw the distinction between judicial and executive functions.[76]

6.68 One hundred years on, uncertainty still clouds the issues of judicial and executive power. Following the release of the policy proposal paper, a number of people expressed concerns about the constitutional validity of the proposal to allow ASIC to issue infringement notices. Mr James McConvill commented on the lack of clarity surrounding the constitution. He wrote:

> Given that the High Court, despite ample opportunity, has not clearly articulated what is meant by 'judicial' power, and when an administrative body is taken to be exercising federal judicial power, the constitutional validity issue would definitely be uncertain rather than capable of simple decision one way or the other.[77]

6.69 As mentioned earlier, a number of changes were made to the proposal between its first appearance in the policy proposal paper and as a Bill introduced in Parliament in December 2004. For example, one particular aspect that may have given rise to a challenge on constitutional grounds concerned the limitations that the proposed legislation would have placed on the ability of the courts to determine a penalty. The proposal provided that if ASIC issued an infringement notice that was not paid and ASIC commenced court proceedings, and if a court determined that a contravention had occurred, it would be permitted to impose a financial penalty not less than the penalty set out in the ASIC infringement notice. This provision is no longer found in the proposal in the Bill to allow ASIC to issue an infringement notice and some saw this change as a means to keep clear of the constitutional question.

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75 John Quick and Robert Garran, *The Annotated Constitution of the Australian Commonwealth,* Sydney, 1901, p. 719.

76 John Quick and Robert Garran, *The Annotated Constitution of the Australian Commonwealth,* Sydney, 1901, p. 720.

77 James McConvill, 'Australian Securities and Investments Commission's proposed power to issue infringement notices: Another slap in the face to s 1324 of the Corporations Act or an undermining of corporate civil liberties?', *ABLR,* vol. 36, 2003, p. 40.

6.70 Despite the changes made to the initial proposal, a number of witnesses still held strong reservations about the constitutional legitimacy of the proposal.[78] The Australian Investor Relations Association (AIRA) acknowledged that the proposals may be structured with the intention of avoiding unconstitutional limits on those who exercise Commonwealth judicial powers to inflict penalties. It, however, maintained that 'those are a fundamental part of the constitutional rights of Australians.'[79]

6.71 The AICD also raised concerns about constitutional issues. In its submission to Treasury, it stated that while it is likely that power will be drafted in such a way as to reduce the possibility of a constitutional challenge, larger corporations will not be shy in using a challenge to the courts as a basis for testing ASIC's power. It warned that:

> The chance that a court may set aside these provisions and other aspects of the legislation could result in another administrative nightmare for Australian governments as occurred after *RE Wakin.*[80]

6.72 The Centre for Corporate Governance was among the many participants in the inquiry that held strong doubts about the constitutionality of the proposal. It insisted that the question of whether an entity had breached the continuous disclosure provisions is 'a question of law, questions that are reserved for judicial bodies, not the executive arm of government'.[81] It explained further:

> Whilst the Centre acknowledges that Australia's system of responsible government does not adopt Baron de Montesquieu's strict formulation of the separation of powers, the accepted blurring of the lines has hitherto been confined to that between the executive and the legislative arms. At no stage has s 71 of the Constitution been interpreted by the High Court as allowing non-judicial bodies to exercise judicial powers: see, for example, *R v Kirby; Ex parte Boilermakers' Society of Australia* (1956) 94 CLR 254 and *Brandy v Human Rights and Equal Opportunity Commission* (1995) 1893 CLR 245. Yet this is precisely what the proposed infringement notice seeks to establish.[82]

6.73 Likewise, Professor Adams thought the proposal challenged the concept of responsible government and the separation of powers. He told the Committee:

> It possibly goes against the interpretation in the High Court on section 71 of the Australian Constitution and I honestly believe that it will not benefit

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78 AICD, 2002, *Submission* 17, p. 5; *Submission* 21, p. 23.

79 *Submission* 17, p. 5.

80 *Submission* 13 to Treasury, 22 November 2002, p. 11.

81 *Submission* 21, p. 23.

82 *Submission* 21, p. 23.

> corporate Australia and the integrity of the markets to have this particular provision.[83]

6.74 In its consideration of infringement notices, the ALRC took account of the constitutional limitations that prevent non-judicial officers from considering, deciding on and imposing penalties. It explained:

> In this context non-judicial officers can only perform purely administrative tasks; they simply put into effect a process of issuing penalty notices that is triggered automatically by a particular set of facts. For this reason, it is critical to determine whether the amount payable under an infringement notice is truly to be regarded as a penalty, as under the Constitution only a court may exercise judicial power. Given the restriction placed on the imposition of administrative penalties by the Constitution, a breach is dealt with administratively where the regulator imposes, without discretion, a penalty that arises automatically wherever the regulator identifies the set of facts or circumstances that give rise to a breach. The penalty is predetermined by law; all the regulator does is to document the breach and the penalty. For this reason, federal schemes do not have a ‘fallback’ penalty that will be imposed if the person fails to pay the amount specified in the infringement notice (such as licence suspension or cancellation commonly used in State and Territory schemes).[84]

6.75 One of the strongest criticisms levelled at the proposal which also touches on defining 'judicial power' is the heavy reliance on subjectivity in determining whether and when certain information should have been disclosed.

Subjective interpretation of breaches

6.76 The Guidelines issued by the Attorney General's Department states the following principle:

> An infringement notice scheme may be employed for relatively minor offences, where a high volume of contraventions is expected, and where a penalty must be imposed immediately to be effective. An infringement notice scheme should only apply to strict or absolute liability offences. These offences should carry physical elements on which an enforcement officer can make reliable assessment of guilt or innocence.[85]

6.77 Many witnesses asserted that the proposal fails to meet requirements on a number of fronts. Of most importance, however, is that the proposed infringement notice arrangement does not take account of the difficulties in establishing a breach which requires subjective considerations. They maintain that contraventions of the

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83 *Committee Hansard*, 16 March 2004, p. 16.

84 ALRC, *Principled Regulation,* para. 12.19.

85 Minister for Justice and Customs, *A Guide to Framing Commonwealth Offences, Civil Penalties and Enforcement Powers,* February 2004, p. 45.

continuous disclosure provisions do not equate with offences such as a traffic infringement—thus while appropriate for matters such as failure to provide annual reports and other minor breaches, the infringement notice is not suitable for contraventions of the continuous disclosure regime.[86] Witnesses referred to the ambiguities and to the uncertainties in deciding whether and/or when to disclose information. They argued that these involved decisions about which reasonable minds might differ in their judgement.[87] Mr Douglas Gration, CSA, told the Committee that the decisions:

> …involve genuinely difficult exercises of judgment. You have to work out what sort of share price impact particular information or proposals might have and what the expectations of investors are in relation to disclosure of that information. You will have things that are reasonably financially trivial that cause quite a significant share price impact and, conversely, quite large transactions that seem to have no share price impact. There is also that ever difficult question in relation to disclosure—when something is sufficiently well developed that you can announce it to the market.[88]

6.78 Telstra was of the view that an on-the-spot fine or infringement notice is more appropriate for relatively minor breaches of the Corporations Act that relate to 'factual issues which do not need to be adjudicated on the merits through the courts'. It maintained that decisions as to whether to make a disclosure involve assessing a range of complex factors and making complicated judgements, 'in many cases within a short timeframe and pressured commercial environment'. Telstra drew attention to the complex considerations needed under Listing Rule 3.1A in determining whether the exception to disclose applies:

(a) whether a 'reasonable person would not expect the information to be disclosed';

(b) the information 'concerns an incomplete proposal or negotiation';

(c) the information is 'sufficiently definite to warrant disclosure'.

It understood that under the proposal, ASIC can issue an infringement notice if it has reasonable grounds to believe that a contravention of the relevant provisions have occurred. It noted, however:

> …reasonable people may differ in good faith as to whether or not a breach has occurred.[89]

86 *Submission* 6A, p. 3; *Submission* 8, p. 8; *Submission* 18, p. 2; *Submission* 20, p. 17; *Submission* 21, p. 24; *Submission* 35, p. 33, *Submission* 37, p. 3; *Submission* 41, p. [1].

87 See for example, Baker & McKenzie, *Submission* 37, p. 3.

88 *Committee Hansard*, 18 March 2004, p. 46.

89 *Submission* 41, p. [1].

6.79 The ASX provides as an example of information that would require immediate notice if material under its listing rule:

> a transaction for which the consideration payable or receivable is a significant proportion of the written value of the entity's consolidated assets. Normally, an amount of 5% or more would be significant, but a smaller amount may be significant in a particular case.[90]

6.80 Clearly, this example, which uses the term 'normally', twice uses the word 'significant' and adds a qualification that would apply to a particular case, highlights the latitude that exists in coming to a decision about whether information should be disclosed. Put simply, some decisions are not black and white matters. In Mr Gration's view, they are judgements on which different people acting in good faith may reach different conclusions.[91] Mr Andrew Guy, AICD, agreed with this view and posed the following questions:

> At what stage when a company is negotiating to buy or sell something should they make an announcement to the market? Should they announce it when they have entered into discussions with someone? Should they announce it only when it is finally determined and conditional contracts have been entered into or when the conditional contract becomes unconditional? If you announce it too early it has the effect of pushing the price up, and then if it becomes unconditional and the price goes down, what of those who have in the meantime bought shares on the basis of the first announcement, even though it might have been announced as conditional? The problem that arises here is that it is very difficult in practical circumstances to come out and determine for a board when it is, and to prescribe in a few words when announcements should [be] made is difficult.[92]

6.81 Many thought that a punishment that can flow from a decision assessed in hindsight as wrong was 'virtually inequitable and unfair'.[93] The BCA advised that, as the decisions rely on subjective assessment, 'any enforcement regime should be light handed, with adequate checks and balances and minimal potential for misguided or inappropriate use of regulatory power.'[94] Ms Farrell from the Law Council added:

> It is also an area where only strict or absolute liability offences are involved. This is absolutely an area where a mental element is involved. You have to have intended to do it, you have to have applied your mind to whether or not

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90 ASX Listing Rule 3.1, third dot point.

91 *Committee Hansard*, 18 March 2004, p. 47.

92 *Committee Hansard*, 18 March 2994, p. 85.

93 See for example, Professor Adams, *Committee Hansard,* 16 March 2004, p. 21.

94 *Submission* 20, p. 18.

> the information was material or you have to have been completely reckless as to whether or not it was material.[95]

6.82 A number of submissions drew on research by the ALRC to underscore what they believed to be a mistake in introducing the infringement notice regime. The Commission was unconvinced that the alleged breaches of the continuous disclosure provisions were appropriate contraventions to be dealt with under an infringement regime. In its view they 'involve subjective judgments as to the materiality of information and are, therefore, contraventions involving a "state of mind" element'.[96] It explained:

> …because of the coercive potential of an infringement notice and the absence of any requirement that the regulator have evidence sufficient to support a finding of guilt or liability before a notice may be issued, it is appropriate that infringement notice schemes only be used for offences and contraventions which do not require proof of a fault element and accordingly the ALRC recommends that in criminal schemes, an infringement notice scheme should be an option for offences of strict or absolute liability only, and in civil penalty schemes, an infringement notice scheme should not apply to a contravention in which the proof of a fault element or state of mind is required.[97]

It referred to the guidelines issued by the Attorney-General's Department which advised that infringement notices are acceptable for:

- relatively minor offences;
- offences with a high volume of contraventions;
- where a penalty must be imposed immediately to be effective;
- where only strict or absolute liability offences are involved;
- where the physical elements of an offence are clear cut.

6.83 The proposed infringement notice regime does not measure up to the Attorney-General's criteria. Indeed, the Attorney-General's Department stated that:

> The efficacy of an infringement notice scheme depends on the reliability of the assessments made by enforcement officers as to whether an offence has occurred. These assessments will be consistently accurate if the assessment turns on straightforward and objective criteria rather than on complex legal distinctions. The offences should not require proof of fault and the physical

95 *Committee Hansard*, 16 March 2004, p. 54.

96 ALRC, *Principled Regulations*, para 12.35.

97 ALRC, *Principled Regulation*, para 12.60.

> elements giving rise to a notice should be readily capable of assessment by the enforcement officer. [98]

6.84 This quote from the Attorney-General's guidelines, which clearly states that the offences should not require proof of fault and the physical elements giving rise to a notice should be readily capable of assessment by the enforcement officer, leads to the following discussion on the reverse onus of proof.

Reverse onus of proof

6.85 The infringement notice procedures rely on a reverse onus of proof which turns upside down the long-held presumption that one is innocent until proven guilty.[99] According to Professor Baxt:

> What worries us as an organisation and what must worry the average Australian citizen is that we are moving more and more to a principle that we operate on the basis that, when things are tough to prove on the part of whoever it might be, whether it is a regulator or not, the onus is switched and the person who is charged is made to answer the charge that he or she is guilty and has to prove their innocence. That is what worries me and the institute about the infringement notice regime.[100]

6.86 He was further concerned about the precedent it would set and said:

> We are worried that the proposal in this bill to introduce a new system of infringement notices in relation to the operation of the continuous disclosure regime is but another chink in the already very heavily pierced armour of limited liability and another very significant erosion of the principle that people are innocent until they are proven guilty.[101]

6.87 The New South Wales Young Lawyers voiced the same concern. While recognising the importance of having the ability to respond efficiently to breaches, it considered 'an equally important feature of our legal system is the fundamental presumption that one is innocent until proven, in a court of law, to be guilty'.[102]

6.88 The Senate Standing Committee for the Scrutiny of Bills usually draws attention to a clause in a Bill that 'places the onus of proof on an accused person to disprove one or more elements of the offence with which he or she is charged.'[103] In

98 Minister for Justice and Customs, *A Guide to Framing Commonwealth Offences, Civil Penalties and Enforcement Powers,* February 2004, p. 46.

99 *Submission* 6A, p. 8.

100 *Committee Hansard*, 18 March 2004, pp. 82–3.

101 *Committee Hansard*, 18 March 2004, pp. 82–3.

102 *Submission* 18, p. 2.

103 See comments, Senate Standing Committee for the Scrutiny of Bills, *First Report of 2004,* 11 February 2004, p. 17.

response to that Committee's queries on two recent cases—the Building and Construction Industry Improvement Bill 2003 and the Criminal Code Amendment (Espionage and Related Offences) Bill 2002—the Attorney-General explained that the rationale for having a reverse onus of proof clause is that 'the reason or intention for a person's conduct will often be a matter solely within the knowledge of that person'. It explained that, 'without the reversal of onus, it would often be extremely difficult for an applicant to establish that the conduct complained of was undertaken for a particular reason or intent'.[104] It stated further:

> Commonwealth criminal law policy on reversing the onus of proof is that it should only be allowed in cases where the matters to be proved are peculiarly within the knowledge of the defendant and are difficult for the prosecution to disprove beyond a reasonable doubt. It must be peculiarly within the defendant's knowledge and therefore within his or her ability to prove or disprove.[105]

6.89 The Senate Standing Committee on the Scrutiny of Bills had no comment to make on the CLERP 9 Bill.

6.90 Applying the reverse onus of proof to breaches of the continuous disclosure provisions places a greater emphasis on the importance of having safeguards in place to protect basic rights. Yet this particular aspect of the provisions has also created much controversy.

Due diligence/business judgement defence

6.91 Many submissions were of the view that the proposal to allow ASIC to issue infringement notices circumvents the normal processes of the law in that it lacks safeguards such as due diligence defences.[106] They also raised questions about the hearing process—such as the right to be legally represented—which need to be clarified.[107]

6.92 The main concern in this area was that the proposed infringement notice regime would weaken the protections afforded by the law to corporations and individuals—for example, the law of evidence, even of civil evidence, does not apply. Mr Munchenberg told the Committee that:

> …if a regulator is to be given such a powerful instrument, we need to be very careful that things such as due process, natural justice and other fundamental principles like that are protected. What we are concerned about

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104 Senate Standing Committee for the Scrutiny of Bills, *First Report of 2004,* 11 February 2004, p. 18.

105 Senate Standing Committee for the Scrutiny of Bills, *Ninth Report of 2002,* 28 August 2002, p. 367.

106 *Submission* 8, p. 8; *Submission* 17, p. 4; *Submission* 41, p. [2].

107 *Submission* 7, p. 2.

> at the moment is that, in the argument that ASIC needs to be able to respond quickly to these things, those things are being sacrificed. While we do not want to see this proposal put in, we believe some of its risk could be moderated if there was third party involvement. Just involving the ASX is not sufficient, but it is better than not.[108]

6.93 The Australian Investors Relations Association was also concerned about what it perceived to be an increasing erosion of protections afforded by the law to corporations and individuals. It was of the view that:

> The availability of the civil penalty provisions and actions may be easier for ASIC to bring and for it to gain a verdict in its favour, but they are questionable circumvention of the protection which the criminal laws affords the reputation and livelihood of the defendant.[109]

6.94 It found that although at least they do involve the judicial system, the proposals to introduce infringement notices 'are a much more questionable circumvention of the normal processes of the law'.[110]

6.95 Again the issue of due process and natural justice appear to be further compromised by the lack of independence of the arbiter. This matter of independence as a bulwark against conflicts of interest emerged as a crucial element in the protections that should be available to alleged offenders. Many saw the conflicting functions assumed by ASIC under the new proposal as a threat to the integrity of the regime. They wanted measures in the legislation that would ensure natural justice for persons named in the contravention such as a due diligence defence and defence if appropriate compliance procedures were in place.[111]

Conflicting functions of investigator, prosecutor and judge

6.96 Many witnesses referred to what they believed were discordant functions conferred on ASIC—prosecutor, judge, and jury—in direct contradiction to the doctrine of the separation of powers. A number of submissions argued that this blurring of functions introduced conflict of interest issues.[112] Many shared the concerns of the BCA which outlined the contradictions that would flow from the proposal:

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108 *Committee Hansard*, 11 March 2004, p. 20.

109 *Submission* 17, p. 4.

110 *Submission* 17, p. 4.

111 See for example, *Submission* 8, p. 8.

112 See for example, the Securities Institute, *Submission* 11, p. [5]; NSW Young Lawyers, *Submission* 18, p. 2; *Submission* 6A; p. 4; *Submission* 20, p. 19; *Submission* 21, p. 22; *Submission* 24, p. 14; *Submission* 25, p. 43; *Submission* 37, p. 3; *Submission* 41, p. [2]; *Submission* 46, p. 2.

> ASIC would undertake an investigation and, having concluded that a contravention has or is likely to have, occurred, initiate the process for issuing an infringement notice. ASIC would then conduct a hearing to determine whether, in its judgement, a contravention has occurred. The relevant company would have the opportunity at the hearing to make submissions to ASIC.[113]

6.97 To the same effect, the NIA argued:

> The idea that ASIC can make an initial determination and independently review that decision once hearing from the company has many problems. It fails fundamentally any test of independence. Furthermore, ASIC has a pecuniary benefit in upholding its own earlier decision. It therefore cannot review its own decisions.'[114]

Some argued that third parties should be involved in the decision on whether an infringement notice is warranted.

6.98 Telstra maintained that 'natural justice would dictate that the final decision makers be separate from the investigatory team'.[115] Although not commenting on the overall infringement notice process, the ALRC did note the possible conflict involving the consideration of an application to withdraw the notice. It recommended that:

> The officer within the regulator who considers an application for withdrawal of an infringement notice should be different from the officer who made the decision to issue the infringement notice.[116]

6.99 The ALRC asked whether a company can expect natural justice through an independent and impartial hearing from ASIC when ASIC has already satisfied itself of the likelihood that a contravention has occurred. It added that in its opinion there is a need for 'some level of independence in any system of internal review, even in the limited circumstances of the right to seek withdrawal of an infringement notice where only the factual basis on which the notice was issued may be challenged'.[117]

6.100 According to Professor Baxt, the New Zealand Commerce Commission, recently vested with the power to issue cease and desist orders, has made clear that it will establish different divisions within the organisation to ensure that there is a separation between the investigators and the final decision makers. He also cited the United Kingdom where the Financial Services Authority (FSA) has similar powers and is required to ensure that there is a division or responsibility between those conducting the investigation and those issuing the relevant order. The Law Council of

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113 *Submission* 20, p. 19.

114 *Submission* 25, p. 43.

115 *Submission* 41, p. [2].

116 ALRC, *Principled Regulation,* para 12.109 and recommendation 12–10.

117 ALRC, *Principled Regulation,* para 12.109.

Australia made similar observations about the procedures in New Zealand and the UK.[118] The AICD understood that the FSA does not perform the functions in the same way as proposed for ASIC in the Bill.[119]

Guidelines

6.101 A number of witnesses who recognised the need to have a separation of functions between those investigating alleged contraventions and those hearing the matter of whether an infringement notice should be issued suggested that ASIC develop a set of guidelines indicating how the division of roles is to be managed.[120] The Law Council put forward two proposals. Firstly, it suggested the legislation be amended to provide for a division of responsibility between those investigating alleged breaches of the continuous disclosure provisions and those hearing the matter of whether an infringement notice be issued. As an alternative, it proposed that ASIC be required to issue a set of guidelines indicating how the separation of power and responsibility would be undertaken.[121]

6.102 The ALRC also recommended that guidelines should be developed and published by regulators on how they would exercise their discretion to issue, withdraw and correct infringement notices.[122]

6.103 Other witnesses suggested the introduction of a dispute resolution mechanism through a corporations panel; or the involvement of a third party in the decision as to

118 *Submission* 24, p. 18.

119 *Submission* 35, p. 28. The AICD in enlarging on its understanding provided the following information in a footnote. 'The AICD has been advised that FSA staff make a recommendation in relation to the taking of disciplinary action and that this is then considered by the Regulatory Decisions Committee (RDC), a body which is outside the management structure of the FSA but which cannot be described as being independent from the FSA. If the RDC considers that action is appropriate then a process of issuing statutory notices is followed. The first notice is the warning notice setting out the proposed action and the reasons for this. The recipient may make representations to the RDC and it will consider the position in light of any submissions and whether action remains appropriate. If it is appropriate the RDC will issue a decision notice confirming what it proposes to do and why. The recipient may challenge this and refer the matter to a Financial Services and Markets Tribunal which is independent of the FSA or it may accept it, in which case a final notice is issued. Ultimately, therefore, the matter can be referred to an independent tribunal. The decision in relation to whether sanction/discipline is appropriate is taken by the FSA, but there is scrutiny of this by a body that it separate from the management structure and not involved in the investigation.'

120 The Law Council of Australia, *Submission* 24, p. 18; *Submission* 6A, p. 4; *Submission* 35, p. 30.

121 *Submission* 24, p. 18.

122 ALRC, *Principled Regulation*, p. 27.

whether an infringement notice is warranted.[123] A similar approach was to establish a separate panel removed from the functions of ASIC to investigate and issue notices.[124]

6.104 Mr Timothy Sheehy, CSA, was one of a number of people who advanced the view that a peer review panel would be more appropriate 'to adjudicate on disputes over whether or not an organisation has followed continuous disclosure obligations'.[125] He stated:

> I note that in the regulatory impact statement there were issues raised about cost and continuity of interpretation. The point that we make is that a peer review type panel does not need to involve excessive cost. It can react fairly quickly, but, most important, it would be made up of experts from the industry who would interpret obligations on what a reasonable person would be expected to receive in terms of information. That is one of the underpinnings of the listing rule in determining whether or not disclosure should be made.[126]

ASIC's guide on issuing infringement notices

6.105 On 5 February 2004, ASIC indicated that it would release a policy proposal and final policy statement in a guide on ASIC's process regarding the proposed power to issue infringement notices for breaches of the continuous disclosure regime.[127] In keeping with this undertaking, ASIC, on 20 May 2004, released a guide on its use of infringement notices. The guide indicates clearly that the arrangements that ASIC intends to put in place are intended to keep separate the investigation and adjudication functions. It states that the delegate appointed to adjudicate on the alleged breach will not have been involved in the investigation of the matter and 'will look at the matter for the first time when receiving the brief'.

6.106 It also makes clear that the entity has a right to legal representation and that other people, such as a corporate officer, may also appear as a representative. The guide, however, states that the delegate has discretion to allow people other than the representative of the entity to appear at the hearing.

Committee view

6.107 The Committee welcomes this guide which provides a measure of assurance that ASIC is aware of the importance of keeping its investigation and adjudicating functions separate and has put in place procedures to ensure that this is maintained.

123 *Submission* 8, p. 8; *Submission* 20, p. 21.

124 *Submission* 8, p. 8.

125 *Committee Hansard*, 18 March 2004, p. 47.

126 *Committee Hansard*, 18 March 2004, p. 47.

127 ASIC, Media and information releases 04–029, 'Proposed ASIC CLERP 9 policy papers timetable, 5 February 2004.

Although the Committee has not had the opportunity to consider the guide in depth, there are a number of questions that need clarification.

6.108 With regard to the division of the conflicting roles, the Committee would like to see a stronger statement that the delegate will maintain his/her independence from the investigation team after being briefed on the suspected breach and that the investigation team and the delegate maintain a strict division of responsibility. Further that this arrangement would extend to any assistant that may be appointed to assist the delegate conduct the hearing.

6.109 The Committee notes that the delegate appointed to determine whether there has been a breach of the continuous disclosure provisions would be made by one of ASIC's members 'to whom has been delegated the power to hold hearings'.[128] The Committee would like assurances that given the subjectivity required in determining whether there has been a breach of the continuous disclosure provisions that the delegate have the expertise and experience necessary to assess the merits of the case effectively.

6.110 Finally Section 1317DAC of the proposed legislation states that if ASIC has reasonable grounds to believe that a disclosing entity has contravened the continuous disclosure provisions it may issue an infringement notice. The guide states at paragraphs 4 and 14 that if the delegate believes that the disclosing entity has breached the relevant provisions. The Committee believes that the wording in the legislation 'has reasonable grounds to believe' should be reflected in the guide.

Summary

6.111 The Committee acknowledges the conflicts inherent in ASIC prosecuting and reviewing its own investigation and determining whether to issue an infringement notice. In effect ASIC's independence is severely compromised by assuming the dual role of prosecutor and judge. The Committee believes that there needs to be a clear separation between those investigating and prosecuting the case and those judging the merits of the case. It notes that ASIC has prepared guidelines on the processes it would follow regarding the proposed power to issue infringement notices for breaches of the continuous disclosure regime.

The Committee is of the view that this matter of the conflicting roles to be assumed by ASIC warrants close attention and urges ASIC in reviewing its policy statement to heed the concerns of the many witnesses who expressed doubts about the appropriateness of the proposed regime. The Committee believes that the guidelines must include procedural and other safeguards that are contained in the criminal justice system.

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128 ASIC, *Hearings practice manual, The principles of, and how we conduct, administrative hearings,* 14 May 1999, p. 5.

Recommendation 17

6.112 The Committee notes the many concerns expressed about the proposed infringement notice regime. In particular, the Committee refers to the blurring of ASIC's functions of investigator and adjudicator. In light of these concerns, the Committee recommends that ASIC's guide on issuing infringement notices more fully explain and document the procedures it will adopt to ensure that there is a clear and definite separation of its responsibilities to investigate and to adjudicate.

Lack of review process

6.113 A few submissions referred to the absence of a review process from the infringement notice provisions which they held to be an erosion of fundamental legal rights. They suggested that the legislation allow appeals to the Administrative Appeals Tribunal.[129]

6.114 Professor Baxt and the AICD referred to ASIC's statement that the mechanism used in issuing an infringement notice is similar to their function in granting of licences under the Act. Both were of the opinion, however, that ASIC's decisions 'in that very new, and as yet largely untested, role are arguably subject to review by the Administrative Appeals Tribunal'.[130]

6.115 The ALRC acknowledged that the proposed infringement notice regime had been criticised for failing to provide an appeal mechanism. It took account of the claims that this 'absence of review of the decision to issue an infringement notice leaves too much to the discretion of the decision maker and removes one area of jurisdictional challenge for people involved in the industry'. But it was not persuaded to their view. In answer to these concerns, the Commission discussed the options presented to a person served with a notice. It understood that a person could pay the amount specified in the notice, argue its case to ASIC and try to have the notice withdrawn or refuse to pay the fine and defend the matter in court. It reasoned that the decision to issue an infringement notice is not a decision to impose a penalty, 'as it is not a final or operative determination of substantive rights'. The Commission concluded therefore that 'the exclusion of external merits review of the decision to issue an infringement notice is acceptable'.[131]

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129 *Submission* 6A, p. 3; *Submission* 17, p. 5; *Submission* 21, pp. 24–5; *Submission* 35, p. 29; Professor Adams, *Committee Hansard*, 16 March 2004, p. 16.

130 *Submission* 6A, p. 4; *Submission* 35, p. 30.

131 ALRC, *Principled Regulation,* paras 12.29 and 12.31.

Committee view

6.116 The Committee takes note of the ALRC findings that the decision not to allow for a review process is acceptable given that the decision to issue an infringement notice is not a decision to impose a penalty.

Implications flowing from publicity

6.117 Under the proposed infringement notice provisions, ASIC may publish details of the disclosing entity's compliance with the infringement notice. the announcement must, however, be accompanied with a statement to the effect that compliance with the notice is not an admission of guilt or liability and the entity is not regarded as having contravened the provision specified in the notice.[132] A few submissions noted concerns about damaging repercussions that could result from adverse publicity stemming from the issue of an infringement notice.[133] In particular, they cited the possibility of ‘trial by media’ or follow-on suits.[134] The AICD wanted the provision that allows ASIC to publicise the infringement notice to be limited to the number of notices issued and complied with while the Securities Institute and the CSA wanted it removed from the legislation.[135]

6.118 The ALRC opposed publishing details of the infringement notice. It again stressed that unlike enforceable undertakings or notices about penalties imposed by courts, the infringement notice only alleges a contravention—'it is not an authoritative statement as to liability'. It concluded:

> Whilst it might be argued that publicity of the issue of an infringement notice provides an opportunity to achieve both specific and general deterrence, the ALRC does not consider that this is a legitimate aim for an infringement notice scheme as an infringement notice is not a ‘penalty’ and therefore the purposes for which a penalty might be imposed, and publicised, are not relevant. The ALRC considers that no public announcement should be made by a regulator about the issue of an infringement notice to, or the payment or non-payment of the amount specified in an infringement notice by, an identified or identifiable person, as the issue of an infringement notice amounts to an allegation only and is not conclusive proof that the offence or contravention has been committed.[136]

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132 Proposed section 1317DAJ—publication in relation to infringement notices.

133 *Submission* 6A, p. 6; *Submission* 8, p. 11; *Submission* 11, p. [5]; *Submission* 17, p. 5; *Submission* 20, p. 21; *Submission* 24, p. 14; *Submission* 35, p. 31; *Submission* 44, p. 6.

134 See for example, *Submission* 6A, p. 6.

135 *Submission* 35, p. 31; *Submission* 8, p. 11, *Submission* 11, p. [5].

136 ALRC, *Principled Regulation*, para 12.102.

6.119 It was of the view that any public reporting of infringement notice activities should be only done on an aggregate or anonymous basis.

6.120 Others, however, supported even greater publicity and Mr Wilson suggested that investors should have access to a public register which he called 'the shame file.'[137] He argued that shareholders should 'be entitled to go to a register to see the repeat offenders' names when they are making an investment decision'. Mr Bill Shorten, AWU, agreed with this view:

> One aspect of the infringement notices which has attracted criticism from business is that, if the entity decided to comply with an infringement notice, ASIC could be allowed to publish in the Gazette a copy of the notice or an accurate summary of the notice for the purposes of media reporting. We believe that the positive reporting of companies accepting infringement notices will in many ways—even more than monetary penalties—be a way of promoting better corporate behaviour. It is our experience in a range of other legislative regimes that alternative penalties, such as notices, have a way of focusing companies as much as monetary fines.[138]

6.121 ASIC referred to the limitations placed on administrative arrangements for imposing fines and acknowledged that to interpret the payment of the fine as an admission of liability would 'change the architecture of the infringement notice quite substantially'. As discussed in paragraphs 6.65–6.74, the constitution places strict limits on the ability of the administrative arm of government to impose penalties. As ASIC explained 'if you are going to assign liabilities to people then they should be subject to the same rigors of evidence…that you would deliver in a court'.[139]

6.122 Even so, according to former chairman, Dr David Knott, ASIC originally hoped that publicity arising from the issuing of an infringement notice would deter breaches. He believed that the power to impose 'fines of substance would add discipline to the market's processes—not just because of their financial impact but more importantly perhaps through their public nature'.[140]

6.123 The AICD was not only concerned about the publicity surrounding the infringement notice but ASIC's accountability should it fail to observe the requirements under the legislation. It stated that:

> Whilst it is made clear that ASIC is not permitted to publish details of an infringement notice or of a disclosing entity's compliance with an infringement notice…there is no offence committed by ASIC (or its officers) in relation to its failure to follow these rules. So, the fact that ASIC makes a mistake and publicises additional material to that set out by the

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137 *Committee Hansard*, 9 March 2004, pp. 26–7

138 *Committee Hansard*, 14 April 2004, p. 85.

139 *Committee Hansard*, 29 April 2004, p. 66.

140 David Knott, *'Launch of the Australasian Relations Association*, p. 5.

> provision, or indeed publishes the fact that an infringement notice may have been issued and withdrawn, may result in no real consequences to ASIC…But such an error can be very serious indeed for the relevant company.[141]

It recommended that the rules in the legislation should be quite specific as to the type of publicity that might be used and provide appropriate remedies if those rules are not followed.[142]

Committee view

6.124 The Committee understands that adverse publicity surrounding a breach of the continuous disclosure provisions would serve as a potent deterrent. It, however, is conscious of the uncompromising stand that the legislation must take in insisting that the payment of the fine is not an admission of guilty or liability and the fine is not to be seen as a penalty but simply as a means to forestall court action. This stand is essential to avoid constitutional issues and as a result publicity should not be used as a form of exemplary punishment since no offence has been proven.

6.125 The Committee regards the proposed provisions governing publication in relation to infringement notices as appropriate.

Support for the infringement notice proposal

6.126 Only a few submissions approved the infringement notice process. The ACSI believed that the proposals for enhanced enforcement through the issue of infringement notices was long overdue and supported them.[143] The AWU believed that there were clear benefits to be gained from the introduction of the infringement notice regime in that it was simpler to use and had the potential to reduce costs associated with enforcing the continuous disclosure provisions.

6.127 The ASA believed that assertions about the role of ASIC as judge, jury and executioner overstated the new powers. It stated that:

> Various regulations now include the power to issue on the spot fines where behaviour needs to be modified quickly eg NSW Water Restrictions. Typically, the size of the fine is not ruinous (up to $110,000 for violating continuous disclosure regime) and there is the opportunity to argue the issue. While there is the risk of negative share price reaction to the issuance of an infringement notice, investor confidence is at risk from continued trading of an uninformed market for even a short period of time.[144]

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141 *Submission* 35, p. 30. See also *Submission* 6A, p. 5.

142 *Submission* 6A, p. 5.

143 *Submission* 5, p. 19.

144 *Submission* 22, p. 6.

6.128 It preferred to focus on the benefits to be derived from the reforms including reduced time burden to the Court.[145] It also suggested that the proposal would:

- introduce an immediacy that is critical to investor confidence;
- introduce a remedy for minor breaches of disclosure regime;
- provide for a company to present evidence to ASIC to defend itself;
- allow a company to choose to have the matter dealt with by the court; and
- impose a penalty on companies that consistently breach the disclosure regime.[146]

6.129 The ASX sent a somewhat mixed message. Ms Hamilton told the Committee that the ASX support the introduction of an infringement notice regime 'to facilitate effective enforcement of the continuous disclosure contraventions'.[147] It believed that the right balance has been struck.[148] It did, however, continue to refer to people's fears about the lack of safeguards in regard to due process. Ms Hamilton told the Committee:

> I think we are between a rock and hard place. There is obviously a lot of concern about the due process inherent in all of this and a lot of nervousness about that. I think naming and shaming is a very powerful incentive, a very powerful tool. But with that comes the concern that, unless we address those concerns about due process, no lawyer in the country is ever going to advise their client to participate in the infringement notice regime—they would rather take their chances in the courts. So we are trying to find a balance here in addressing those concerns about due process and still having some form of quicker redress in respect of a contravention.[149]

6.130 Although concerned about the importance of co-operation between ASX and ASIC and complementarity in their dual responsibility as well as the focus on less serious breaches, the ASX was strongly committed to the proposal. It believed that the additional power would complement and strengthen the system of continuous disclosure.[150]

6.131 Overall, the majority of witnesses were uneasy about this proposal. Their concerns ranged over many aspects particularly about the lack of adequate safety mechanisms to protect basic rights. Apprehensive about this proposal and uncertain of

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145 *Submission* 22, p. 6.

146 *Submission* 22, p. 6.

147 *Committee Hansard*, 16 March 2004, p. 87.

148 *Committee Hansard*, 16 March 2004, p. 87.

149 *Committee Hansard*, 16 March 2004, p. 90.

150 *Submission* 48, p. 7.

its consequences, a number of witnesses suggested that the Bill be amended to require a review by the Corporations and Markets Advisory Committee (CAMAC) of the operation of the provisions 18 months or 3 years after enactment.[151]

6.132 Ms Farrell acknowledged that the Treasurer has indicated that there would be a review after two years but asserted with regard to the infringement notice provisions that 'the parliament should have to reaffirm that they really want to do something as anomalous as this'.[152] In light of the numerous concerns about the proposal, a number of submissions suggested that the provisions include a sunset clause.[153]

Committee view

6.133 The Committee notes the number of people who have strong reservations about the soundness of introducing the infringement notice provisions. It recommends that a review of the operation of infringement notice regime be undertaken after two years and a sunset clause relating to the infringement notice provisions be inserted in the Bill.

Recommendation 18

6.134 The Committee recommends that CAMAC review the operation of the infringement notice provisions two years after they come into force. It recommends further that in light of comments suggesting that ASIC is not fully or effectively using its current powers to enforce the continuous disclosure provisions that the review take a broader approach and examine the effectiveness of the enforcement regime for continuous disclosure as a whole including the criminal and civil provisions.

Recommendation 19

6.135 The Committee recommends that a three-year sunset clause relating to the infringement notice provisions be inserted in the Bill.

Conclusion

6.136 The Committee appreciates the advantages to be gained by allowing ASIC to issue an infringement notice for breaches of the continuous disclosure regime. It cannot, however, ignore the weight of opposition to the proposal particularly the concern about the perceived lack of safeguards to protect the rights of those deemed to

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151 *Submission* 8, p. 10 and *Submission* 24, p. 17. The CSA noted that an 'advantage of the referral to CAMAC of the infringement notice regime is that this would involve a review by the same body that previously reported on continuous disclosure'. The Companies and Securities Advisory Committee (CASAC) was CAMAC's predecessor.

152 *Committee Hansard*, 16 March 2004, p. 55.

153 The Law Council of Australia, *Submission* 24, p. 17. See also *Submissions* 6A, p. 7; *Submission* 8, p. 9; *Submission* no. 20, p. 21; *Submission* 35, p. 32.

have breached the continuous disclosure provisions and the conflicting functions of ASIC as investigator, prosecutor and judge. The number of adjustments made to the original proposal to make it accord with the separation of powers doctrine central to the Constitution have placed limits on the authority of ASIC. Whether these refinements are sufficient to satisfy constitutional requirements is unclear.

6.137 The Committee has made a number of recommendations designed to address what appears to be deficiencies in the provisions but accepts that uncertainty about the appropriateness of the proposal still lingers. It underlines the need for this proposal to be monitored closely and reviewed after two years.

CHAPTER 7

REVISION OF PENALTIES INCLUDING PENALTIES FOR INDIVIDUALS BREACHING THE CONTINUOUS DISCLOSURE PROVISIONS

7.1 The policy proposal paper released in September 2002 recognised the importance of tailoring penalties to meet the different circumstances of particular contraventions.[1] The proposed legislation contains a number of measures with regard to increasing some penalties before looking at the proposal to extend liability for breaches of the continuous disclosure provisions to individuals.

Increased criminal penalties for specific offences—false or misleading statements, false information (ss 1308 (2), 1309 (1) and (2))

7.2 The Bill proposes to increase criminal penalties for a person knowingly providing false or misleading information to ASIC from 100 penalty units or imprisonment for two years or both to 200 penalty units or imprisonment for 5 years or both. The penalty for an officer of a corporation who intentionally provides false or misleading information to key corporate officers and financial market operators would likewise rise to 200 penalty units or 5 years imprisonment or both. The penalty for an officer who negligently provides false or misleading information would be increased from 50 penalty units or imprisonment for 1 year or both to 100 penalty units or imprisonment for 2 years or both.[2]

7.3 The explanatory memorandum stated that the increase in the penalties was designed to reflect 'the importance of the obligations that they contain.' The changes are also intended to align the penalties with those for similar contraventions such as providing false information affecting the decision of others to acquire or dispose of financial products and engaging in dishonest conduct relating to a financial service or product.[3] Similar penalties also apply to offences relating to market manipulation, false trading and market rigging, and offering securities without a current disclosure document.[4]

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1 *Corporate disclosure: Strengthening the financial reporting framework*, Commonwealth of Australia, 2002, p. 143.

2 Schedule 4—Enforcement, Part 1—revision of criminal penalties, *Corporations Act 2001*, Schedule 3, table items 335, 336, 337, p. 179.

3 *Explanatory Memorandum*, p. 158.

4 Sections 727 1041A, to F.

Committee view

7.4 The Committee supports the increase in the penalties proposed in CLERP 9.

Increase civil penalties

7.5 Currently, section 1317G of the Act sets down the maximum pecuniary penalty payable in relation to a contravention of a financial services civil penalty provision at $200,000 for both individuals and bodies corporate.[5] Under the proposed changes, the maximum for an individual will remain at $200,000 but the maximum penalty for a body corporate will be altered to $1 million.[6]

7.6 Generally, submissions expressed no concerns with increasing the penalties for entities to $1 million.[7] They appreciated that a contravention of the continuous disclosure regime is a significant matter and the relevant penalties should reflect its importance and significance to the Australian market.[8] The Centre for Corporate Governance, University of Technology, Sydney, took the view, however, that if ASIC is 'to enjoy the convenience of being required to meet only the civil standard of proof, there must be an appropriate *quid pro quo'* in the form of 'lower civil penalties than those under the offence provisions'.[9]

Committee view

7.7 The Committee supports the increase in maximum penalty for a body corporate to $1 million for a contravention of the financial services civil penalty provision.

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5 Civil penalties are statutory penalties paid to the Commonwealth for breaches of certain provisions in the Corporations Act. A financial services civil penalty provision means a provision referred to in paragraphs subsection 1317E (1)(ja) to (jg). They include—subsection 674(2), [proposed 674(2A), 675(2) and 675(2A)] (continuous disclosure); section 1041A (market manipulation); subsection 1041B(1) false trading and market rigging—creating a false or misleading appearance of active trading etc.); subsection 1041C(1) (false trading and market rigging—artificially maintaining etc. market price); section 1041D (dissemination of information about illegal transaction); subsection 1043A (1) (insider trading); subsection 1043A(2) (insider trading).

6 *CLERP (Audit Reform & Corporate Disclosure) Bill, Commentary on the Draft Provisions,* Corporate Law Economic Reform Program No. 9, October 2003, p. 99. Amend s 1317G(1A) and insert new subsection 1317G(1B).

7 *Submission*s 14, p. 12; *Submission* 19, p. [8]; *Submission* 20, p. 5; *Submission* 22, p. 3; *Submission* 24, p. 11; *Submission* 25, p. 41; *Submission* 37, p. 2.

8 See for example, Law Council of Australia, *Submission* 37 to the Treasury, November 2002, p. 12.

9 *Submission* 21, p. 18.

Penalties imposed on individuals for breaches of the continuous disclosure provisions

7.8 Despite general support for the increase in penalties for corporate entities, a number of submissions had strong reservations about the application of the civil penalty to individuals involved in an entity's contravention of the continuous disclosure provisions.

7.9 According to the policy proposal paper of September 2002, it is not currently possible for ASIC to seek a civil penalty order against an individual involved in a contravention of the continuous disclosure provisions. Such a penalty may only be sought against the relevant entity.[10] The Bill would make a person involved in a contravention of continuous disclosure provisions liable to a civil penalty. In other words, liability for a contravention of the continuous disclosure provisions would extend to the individual so that a person may be liable separately from the company for the same contravention.

7.10 Proposed subsection 674(2A) stipulates that a person who is involved in a listed disclosing entity's contravention of the provisions governing continuous disclosure also contravenes the subsection. A similar provision under 675(2A) applies to a person in an unlisted disclosing entity. The penalty attached to this contravention is a civil penalty as set down in subsection 1317E, that is a maximum $200,000. Under this new provision if a Court is satisfied that a person has contravened subsection 674(2) or 675(2) it must make a declaration of contravention and may order a person to pay the Commonwealth a pecuniary penalty of up to $200,000. The policy proposal paper argued that:

> While it is appropriate to impose financial penalties on entities in relation to contraventions of the continuous disclosure provisions, this practice may shield from responsibility individuals who should arguably themselves be held accountable for contravening conduct by the relevant disclosing entity. It can also be argued that the burden of financial penalties imposed on an entity is likely to fall disproportionately on persons such as shareholders …rather than on the individuals whose conduct led to the contravention.[11]

7.11 It stated further that 'the prospect of financial penalties being imposed on individuals may operate as a more credible and effective deterrent than the prospect of financial penalties being imposed on a body corporate'.

7.12 In its inquiry into civil penalties, the ALRC found that commentators generally supported individual liability with many noting that it 'may encourage greater transparency in management processes, and improve accountability and

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10 *Corporate disclosure: Strengthening the financial reporting framework*, Commonwealth of Australia, 2002, p. 144.

11 *Corporate disclosure: Strengthening the financial reporting framework,* Commonwealth of Australia, 2002, p. 145.

performance standards.' Some commentators to its inquiry agreed that the corporate structure should not shield those who should be personally liable for socially damaging activities.[12]

7.13 Even so, during the first consultation period for CLERP 9, some concerns were expressed to Treasury about this proposal to apply penalties to individuals. The definition of 'involved in' raised queries as did the question of whether discretionary relief from liability was available on grounds such as the person acted honestly and ought to be excused for the contravention.[13] Corrs Chambers Westgarth suggested that before further drafting on the proposal is considered 'significant consultation with shareholders' should take place.[14]

7.14 In response to the criticism, the commentary to the exposure draft sought to clarify the extent and nature of involvement in a contravention that would warrant prosecution. It stated:

> The amendments are intended to apply to individuals with real involvement in a contravention of the continuous disclosure provisions, including individuals who: aided, abetted, counselled or procured the contravention; were knowingly concerned in, or party to, the contravention; and conspired to effect the contravention. The amendments are not intended to apply, for example, to individuals who passed on information produced elsewhere in the disclosing entity, including those responsible for communication with the ASX in relation to listing rule matters.[15]

7.15 Despite this explanation, the proposal to allow civil penalty orders to be sought against persons involved in a contravention by a disclosing entity continued to draw wide criticism. The major concern was that an individual involved in a breach could be unfairly held liable for the contravention. Even some of those who agreed with the extension of liability to individuals sought additional safeguards to protect individual rights.[16] The main criticisms were that:

- people not occupying senior positions in the company, although involved in the contravention of the continuous disclosure provision, could be caught up in a prosecution for decisions for which they were not responsible—the provision says 'a person' not 'an officer' of the company; and

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12 ALRC, *Principled Regulations,* para 8.6 and 8.8.

13 *Submissions* 13, p. 11, *Submission* 15, p. 36, *Submission 2*5, p. 12 and *Submission* 37, p. 18 to Treasury. ASIC supported the proposal but for it to be effectively implemented, the definition of 'involved in' should be that in s 79 of the Act. *Submission* 15 to the Treasury, p. 36.

14 *Submission* 25 to the Treasury, p. [12].

15 *CLERP (Audit Reform Corporate Disclosure) Bill,* Commentary on the Draft Provisions, para. 437, p. 108.

16 See *Submission* 25, p. 43; *Submission* 24, p. 14; *Submission* 27, p. 115.

- the lack of a due diligence or business judgement defence.

Use of the term 'involved in'

7.16 The ANZ agreed with the proposal to extend civil liability for breaches of the continuous disclosure provisions to individuals. It maintained that it would be a 'more credible deterrent than just imposing penalties on a body corporate'. Notwithstanding the assurances offered in the commentary as quoted above, ANZ, however, stressed the importance of making a distinction between those who aided, abetted, counselled or procured the contravention as opposed to those who simply pass on information produced elsewhere in the disclosing entity.[17]

7.17 A number of witnesses held similar views and shared the uncertainty of how the term 'involved in' would apply.[18] The Centre for Corporate Governance argued that if that distinction is not made clear in the legislation such people will 'be caught within the definition of s 79'.[19] Indeed, the application of section 79 definition of 'involved in a contravention' which includes a person who 'has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention' caused concern.

Potential broad application of the provision below senior managers

7.18 Although the AICD accepted that it may be appropriate to make persons liable for participating in or aiding and abetting the contravention, it urged that care be taken. It advised that 'in the context of the very difficult area of continuous disclosure, such a proposal should be adopted with a great deal of caution'. In the previous chapter the report underlined the subjective nature of decisions that must be made with regard to continuous disclosure often under time constraints. The AICD surmised that not only would directors be caught up by this extension of liability but many others would be exposed to prosecution including legal advisers and other professionals.[20]

7.19 The potential broad application below senior managers prompted the suggestion that the provision should apply only to directors or very senior

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17 *Submission* 14, p. 13.

18 *Submission* 35, pp. 26 and 27 and footnote below.

19 *Submission* 21, p. 22. Section 79 reads:

A person is involved in a contravention if, and only if, the person:

(a) has aided, abetted, counselled or procured the contravention;

or

(b) has induced, whether by threats or promises or otherwise, the contravention; or

(c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or

(d) has conspired with others to effect the contravention.

20 *Submission* 35, p. 27.

executives.[21] The Law Council maintained that the reach of the provisions should extend to the listed entity, directors and senior management but not to others who have definitional liability under similar provisions, such as section 729 of the Corporations Act.[22] It cited the case of those providing professional advice:

> Such 'outsiders' are not in a position to obtain or evaluate all relevant information, and they are not in a position to effect disclosure if they form a different view to the corporate officers. Without this protection, professionals will be less willing to provide advice, and that will be detrimental to securing compliance with the disclosure obligations.[23]

7.20 It recommended that a specific carve out be introduced in terms similar to section 16(1)(a). This would exempt a person 'who gives advice to another, or acts on the other's behalf, in the proper performance of the functions attaching to a professional capacity or a business relationship'.

7.21 To the same effect, ICAA, CPA, PriceWaterhouseCoopers and KPMG suggested that the drafting should confine the possibility of a penalty to a person with 'a real involvement' in the contravention.[24] They took the same approach as the Law Council. Although they supported the extension of liability to persons who are in a position to make the listed disclosing entity's disclosure decision and then to effect disclosure they did not support the extension of liability to persons 'who might be involved in the decision making process but who cannot effect disclosure'.[25]

7.22 They provided an example of an accountant who is consulted on a financial matter that is disclosable to the market who could be a person involved in the contravention if disclosure does not occur. Their submission explained further:

> The accountant can recommend disclosure but cannot compel disclosure. Knowledge of the information and non-disclosure could be enough for such an adviser to have contravened the subsection.[26]

7.23 The AIRA also shared concerns about the possible effect of the proposed extension on officers who are not directors or senior officers who 'have the authority to make a decision on whether or not to disclose information'. It noted:

> An investor relations officer, or another officer of a listed corporation who is not at a truly senior level in the corporation may nevertheless be involved in working on and possibly advising a director or senior officer on the

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21 *Submission* 27, p. 115; *Submission* 31, p. 115; *Submission* 33, p. 116; *Submission* 36 p. 115.

22 *Submission* 24, p. 15. This section describes the persons liable on disclosure documents.

23 *Submission* 24, p. 14.

24 *Submissions* 27, p. 115; *Submission* 31, p. 115; *Submission* 33, p. 116; *Submission* 36 p. 115.

25 ibid.

26 ibid.

> information and its disclosure. Not infrequently, an investor relations officer will have quite a substantial involvement, but is subject to the wishes and decision of a director or senior officer who make decisions for reasons quite different from those with which the officer is not concerned and may involve the taking of a risk which the more junior would not shoulder.[27]

7.24 In its view, the penalty provisions are 'intimidatory or threaten such officers'. It pointed out that these officers may not have the salary or status in the corporation of a more senior officer and even if a civil penalty proceeding is unsuccessful against them it could ruin their career and cost them their position.[28] It suggested that the proposed civil penalty should only be available against those who are directors or have a very senior executive position in the corporation.[29]

7.25 The ALRC also considered the test to determine when an individual will be deemed to be liable for the conduct of the corporation. It recommended that any provision that deems an individual to be personally liable for the contravening conduct of a corporation 'should do so by including a definition which encompasses a substantive approach to involvement in management'.[30]

7.26 Although no changes were made to the draft provisions, the Explanatory Memorandum to the Bill included additional notes that offered more detailed commentary on the application of this provision with regard to the interpretation of ‘involved in’. It stated:

> Involvement in a contravention therefore requires some form of intentional participation and actual knowledge of the essential elements of the contravention. Furthermore, an individual involved in a contravention only faces a pecuniary penalty if the contravention is serious.
>
> Although participants in the decision making process or those who have the capacity to effect disclosure (such as director, executives and senior managers, for example) are most likely to possess such intention and knowledge, the amendments are not necessarily limited to this class of individuals. For instance, involvement in a contravention may extend to staff or advisers that knowingly withhold from their superiors or clients, respectively, relevant information that leads to a contravention of the continuous disclosure provisions. [31]

7.27 The Memorandum repeated the assertion made in the commentary to the exposure draft bill that ‘the amendments are not intended to apply to individuals with less than real involvement in a contravention'. It added, however, that relief is

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27 *Submission* 17, p. 2.

28 *Submission* 17, p. 3.

29 *Submission* 17, p. 3.

30 ALRC, *Principled Regulation,* para 8.55.

31 Explanatory Memorandum, p. 171.

available through section 1317S'. This section allows the Court to grant relief from liability for contravention of a civil penalty provision (which has the meaning given in subsection 1317E which under the proposed legislation would include new subsections 674(2A) and 675(2A) and existing 675(2)), on the grounds that the person had acted honestly and the person ought fairly to be excused for the contravention.

7.28 The Law Council did not think that the court's authority to forgive a breach under section 1317S provides a sufficient balance. In its view it is 'very difficult to obtain court forgiveness'. It believed that more was needed and referred to its recommendation that a due diligence defence apply to decisions made in good faith and based on appropriate systems and processes.

Subjectivity of determination

7.29 The ASX had a more specific concern about the liability of individual officers. It submitted:

> Approximately two years ago ASX introduced a requirement for nomination of a responsible person for communication with ASX in relation to listing rule matters. This is to ensure there is always a ready contact point at a senior level particularly for continuous disclosure matters…
>
> The proposed extension of civil liability to individuals is likely to impact on the willingness of key individuals to take on this role…In any event we consider that personal liability should only be attracted in circumstances of gross negligence, recklessness and dishonesty, which is provided in section 1309 of the Act.[32]

7.30 The Committee notes that both the commentary to the exposure draft and the Explanatory Memorandum point out that the amendments are not intended to apply to those responsible for communication with the ASX in relation to listing rules.[33]

Committee view

7.31 The Committee shares the concerns expressed by witnesses about the possibility that the proposal may affect persons who do not have a significant role in the management of the corporation. It understands the concerns expressed by witnesses regarding people being caught up in proceedings following a breach of the continuous disclosure provisions who were not central to the disclosure decision. It refers, however, to the wording in the Explanatory Memorandum which states that involvement in a contravention 'requires some form of intentional participation and

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32 *Submission* 48, p. 8.

33 *CLERP (Audit Reform Corporate Disclosure) Bill,* commentary on the Draft Provisions, para. 437, p. 108. The Explanatory Memorandum states '…individuals who pass on information produced elsewhere in the disclosing entity, such as those responsible for communication with the market operator in relation to listing rule matters, would not be taken to be involved in a contravention of the continuous disclosure provisions'.

actual knowledge of the essential elements of the contravention'. Furthermore, an individual involved in a contravention only faces a pecuniary penalty if the contravention is serious.

7.32 The Committee accepts that this explanation, particularly the emphasis on 'intentional participation' and the requirement to have 'actual knowledge of the essential elements of the contravention', is helpful in ensuring that people inadvertently or unintentionally participating in a contravention will not get caught up.

Trespass on individual rights

7.33 A number of submissions expressed concern at possible violation of individual rights. The AICD maintained that the civil penalty provisions are ‘intimidatory or threaten such officers’ and indeed, ‘raise concerns in terms of civil liberties and the rights of individuals’.[34] Professor Baxt expressed concern about the legislation which targets individual directors in situations where they are left without appropriate protection.[35]

7.34 Witnesses were also conscious of the complications caused by the subjectivity required in determining whether information should have been disclosed. The BCA noted that disclosure decisions are rarely the responsibility of any one individual. In its experience, they are typically corporate decisions taken collectively. For example by a Board or senior management team, often acting on the advice of a range of internal and external advisers. It concluded:

> Ascribing individual responsibility to one or more individuals within that team or group will be difficult and may place an unfair onus on particular executives, such as the company secretary.[36]

7.35 Given this difficulty and combined with the subjective nature of the decisions, the BCA believed that individuals should not be liable for breaches of the continuous disclosure provisions. This matter of subjective judgment was discussed more fully in the previous chapter. In brief the decision about what and when to disclose rests on subjective assessments based on the information available at the time and frequently under time pressures. A number of submissions argued that the legislation must recognise that the potential exposure to liability is based on the judgement of issues which arise day-to-day and may differ according to varying perceptions of the facts.[37] In other words, directors and other corporate officers would be placed at a greater risk of liability for taking decisions about whether to release information that is open to varying interpretations as to their correctness.

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34 *Submission* 17, pp. 2–3. See also Submission 20, p. 16.

35 *Committee Hansard*, 18 March 2004, p. 84.

36 *Submission* 20, p. 16.

37 *Submission* 35, p. 26; *Submission* 20, the Business Council of Australia, p. 16.

7.36 Furthermore, the BCA contrasted breaches of the continuous disclosure regime with insider trading where 'the action and behaviour of an individual lies at the heart of the offence'. It submitted that if the continuous disclosure regime is to expand personal liability to individuals then the legislation 'must be tempered by a due legislated diligence/business judgment defence'.[38]

7.37 Baker & McKenzie also referred to the difficulty in deciding whether a piece of information needs to be released to the market and concluded:

> It is unfair to make these individuals personally liable if their decision, with the benefit of hindsight, proves to be incorrect. Such a provision should be subject to an exception for actions in good faith. Alternatively, the safe harbour of the 'business judgement rule' could be extended to encompass decisions not to disclose information.[39]

Due diligence defence

7.38 The Law Council of Australia advocated the inclusion of a due diligence defence but it emphasised the importance of companies having in place procedures that would facilitate compliance with the continuous disclosure regime. It argued that a balanced sanctions regime in the continuous disclosure area 'should encourage and reward the making of decisions based on proper systems, the receipt of appropriate advice and the making of decisions in good faith'. It recommended:

> There should be a due diligence defence applying to decisions made in good faith based on appropriate systems and processes, thus encouraging a culture of compliance and knowledge of continuous disclosure obligations.[40]

7.39 The AICD endorsed this recommendation word for word.[41]

7.40 The ALRC also examined ways to better define the circumstances in which an individual would be deemed liable for a contravention. It made a number of recommendations that have relevance. It recommended that the Regulatory Contraventions Statute should provide that, in the absence of any clear, express statutory statement to the contrary:

- any legislation that deems an individual to be personally liable for the contravening conduct of a corporation should include a fault element that the individual knew that, or was reckless or negligent as to whether, the contravening conduct would occur; and

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38 *Submission* 20, p. 17.

39 *Submission* 37, p. 2.

40 *Submission* 24, p. 15.

41 *Submission* 35, p. 26.

- any provision in legislation that deems an individual to be personally liable for the contravening conduct of a corporation should include as a threshold test for liability that:

  (i) the individual failed to take all reasonable steps to prevent the contravening conduct; and

  (ii) the individual was in a position to influence the conduct of the body corporate in relation to the contravening conduct.[42]

7.41 These findings together with the evidence presented to the Committee suggest that caution and serious consideration should be given to legislation that contemplates holding an individual liable for the contravention of a corporation.

7.42 It should be noted that the Treasurer gave the following undertaking during the second reading speech:

> It is not the government's intention that a person who has taken all reasonable steps to comply with their individual responsibility should be liable for contravening the act. It is the government's intention that the showing of due diligence by persons in relation to this responsibility should be a defence. I indicate to the House that the government will ensure—if necessary, by amendment in the Senate—that that is the outcome of these provisions. The defence would operate so that an individual would not be personally liable where a breach of the continuous disclosure obligation occurs where the person took all reasonable steps to ensure that the disclosing entity complied with its continuous disclosure obligations and, after doing so, believed on reasonable grounds that the disclosing entity had complied with its obligations. The approach is modelled on a similar defence applying in relation to the prospectus provisions of the act.[43]

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42 ALRC, *Principled Regulation,* Recommendation 8–2 and 8–3. See also recommendation 8–1.

43 Peter Costello, House *Hansard*, 16 February 2004, p. 24843. The Treasurer is referring to section 731—Due diligence defence for prospectuses

Reasonable inquiries and reasonable belief—statements

(1) A person does not commit an offence against subsection 728(3), and is not liable under section 729 for a contravention of subsection 728(1), because of a misleading or deceptive statement in a prospectus if the person proves that they:

(a) made all inquiries (if any) that were reasonable in the circumstances; and

(b) after doing so, believed on reasonable grounds that the statement was not misleading or deceptive.

Reasonable inquiries and reasonable belief—omissions

(2) A person does not commit an offence against subsection 728(3), and is not liable under section 729 for a contravention of subsection 728(1), because of an omission from a prospectus in relation to a particular matter if the person proves that they:

(a) made all inquiries (if any) that were reasonable in the circumstances; and

7.43 ASIC explained that the defence would be 'something that sits alongside the elements that you need to prove' which provide for 'where a person acts honestly and in circumstances ought fairly to be excused from a contravention.' According to Ms Louise Macaulay:

> …where someone makes all due inquiries, acts to the best of their capacity and, for example, gets all the necessary advice in the circumstance then they should not be exposed to a civil penalty contravention. That is reflected in the definition of the term 'involved in' in a sense. That is defined in section 79 of the Corporations Act. As you said, it requires some kind of intent and actual knowledge.[44]

7.44 The Treasurer's announcement was greeted with support from a number of witnesses. Ms Farrell told the Committee:

> We consider it critical for two reasons. Firstly, it will actually promote compliance because it will encourage people to put processes in place—and sometimes you need carrots as well as sticks to get people to comply. Secondly, it is fair. It is fair because the damage that can be done to an individual officer by a failure to disclose in a timely way for which they are liable can be completely devastating. So investors can lose too, but investors generally will not lose to anything like the same extent.—we would also seek a carve out for the provision of professional advice…it is along the lines of section 16(1)(a), which is the carve-out from the associate's provision.[45]

7.45 Although a number of witnesses acknowledged the Treasurer's undertaking, they still felt it necessary to emphasise the importance of having in place due diligence defences for individuals in relation to contraventions of the continuous disclosure regime.[46] Mr Douglas Gration, CSA, told the Committee:

> We think—and we certainly encourage all our member companies to do this—that what you really need is a good process and system in place; in determining whether an individual should be penalised for a failure, the courts and ASIC ought to have regard to whether there is a good process and system in place and whether it has been followed. We very much support that amendment.[47]

(b) after doing so, believed on reasonable grounds that there was no omission from the prospectus in relation to that matter.

44 *Committee Hansard*, 29 April 2004, p. 51.

45 *Committee Hansard*, 16 March 2004, pp. 49–50. In simple terms section 16 (1)(a) means that a person is not an associate of another person…merely because…one gives advice to the other, or acts on the other's behalf, in the proper performance of the functions attaching to a professional capacity or a business relationship.

46 *Committee Hansard*, 18 March 2004, p. 47.

47 *Committee Hansard*, 18 March 2004, p. 47.

7.46 Professor Baxt echoed these sentiments:

> …we think extending the continuous disclosure regime to apply to directors without adequate defences is a problem.…The promise by the Treasurer that there will perhaps be amendments introduced into the Senate if necessary to deal with this matter is comforting, but we are concerned that this should be achieved by appropriate defensive regimes put in place that protect the innocent director in the appropriate circumstances.[48]

7.47 Mr Andrew Guy, AICD, made the point that: 'This is simply nondisclosure; someone got something wrong. Yet their whole personal estate net worth is on the line because it might be a large company and someone might buy a large amount of shares and finally allege that they lost.' He wanted the provision removed altogether.[49]

Committee view

7.48 The Committee understands the concerns raised by witnesses about the need for the legislation to provide statutory protection to ensure that individuals held liable for a contravention of the continuous disclosure provisions are treated appropriately and fairly. Although the explanatory memorandum has offered assurances that only those who have participated intentionally and with knowledge of the essential elements of the breach are covered by the meaning of involved in a contravention, the Committee accepts that added protections are required in the form of a due diligence defence.

7.49 A due diligence defence would require that, given the facts and evidence, on the balance of probabilities, all reasonable care was taken to avoid the contravention. As noted by a number of witnesses by incorporating a due diligence defence, the onus is placed on the board to ensure that they have in place a proper and effective system intended to prevent a contravention of the continuous disclosure provisions.

Draft due diligence defence for consultation

7.50 During the drafting phase of this report, the Committee recommended that the legislation include a due diligence defence to apply to decisions where all reasonable precautions were taken and care exercised to prevent the contravention. Implicit in this statement was that the corporation would have in place a proper and effective system intended to prevent contraventions of the continuous disclosure provisions.

7.51 On 18 May 2004, and in keeping with the Treasurer's undertaking, the Government released a draft amendment that would include a due diligence defence to subsections 674(2A) and 675(2A). It reads:

<u>Due diligence defence – draft provisions</u>

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48 *Committee Hansard*, 18 March 2004, p. 84.

49 *Committee Hansard*, 18 March 2004, p. 103.

Insert after subsection 674(2A):

(2B) A person does not contravene subsection (2A) if the person proves that they:

(a) took all steps (if any) that were reasonable in the circumstances to ensure that the disclosing entity complied with its obligations under subsection (2); and

(b) after doing so, believed on reasonable grounds that the disclosing entity was complying with its obligations under that subsection.

Insert after subsection 675(2A):

(2B) A person does not contravene subsection (2A) if the person proves that they:

(a) took all steps (if any) that were reasonable in the circumstances to ensure that the disclosing entity complied with its obligations under subsection (2); and

(b) after doing so, believed on reasonable grounds that the disclosing entity was complying with its obligations under that subsection.

7.52 The Committee accepts that the first threshold test in the draft due diligence defence is appropriate and in accord with the ALRC's recommendations with regard to contraventions of a corporation for which an individual may be held liable. The Committee, however, is not convinced that the second test will satisfy the concerns raised by participants in this inquiry. It notes that Treasury has called for submissions on the draft due diligence defence provision which will allow those who were seeking the inclusion of such a provision in the legislation to put their views.

Recommendation 20

7.53 The Committee recommends that Treasury make the submissions it receives on the draft due diligence defence publicly available.

CHAPTER 8

ENHANCING SHAREHOLDER PARTICIPATION

8.1 The revised OECD Principles of Corporate Governance are drawn from the experiences not only in the OECD area but also in non-OECD countries and are based on comprehensive consultations. They build on the OECD Principles of Corporate Governance that were agreed to in 1999 and are intended to assist governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries.

8.2 The first principle recognises that the corporate governance framework should protect and facilitate the exercise of shareholders' rights. These include the right:

- to obtain relevant and sufficient information on the corporation on a timely and regular basis;
- to participate and vote in general shareholder meetings;
- to elect and remove members of the board; and
- to share in the profits of the corporation.[1]

8.3 Consistent with international trends, the ASX in its Best Practice Recommendations outlines the core principle underpinning the rights of shareholders which is to respect the rights of shareholders and to facilitate the effective exercise of those rights. It explains further that this means that a company should empower its shareholders by:

- communicating effectively with them;
- giving them ready access to balanced and understandable information about company and corporate proposals; and
- making it easy for them to participate in general meetings.[2]

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1 *OECD Principles of Corporate Governance*, Draft Revised Text, January 2004, p. 6. See also UK combined code of corporate governance which states as a broad principle that 'the board should use the AGM to communicate with investors and to encourage their participation'. It refers to the recording of proxy votes, the separation of resolutions at the AGM, the presence of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend, and for the notice of meeting and related papers to be sent to shareholders at least 20 days before the meeting. *The Combined Code of Corporate Governance,* July 2003, p. 19.

2 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations,* March 2003, p. 39.

8.4 CLERP 9 adopts the same approach and recognises that shareholders have fundamental rights that should be protected. This chapter looks at the initiatives contained in the Bill that are designed to improve communication with shareholders and to encourage their active involvement in meetings. It looks at the measures proposed to ensure that documents and notices provided to shareholders are intelligible and that advances in technology are being used to assist shareholders to participate in meetings.

Notices of meeting

8.5 The Bill is based on the premise that information should be intelligible to shareholders who are not well-versed in business matters.[3] It seeks to apply the 'clear, concise and effective' standard to notices of meetings.[4] The intention is to streamline the contents of notices without sacrificing the comprehensiveness of the information.

8.6 Overall, the submissions that commented on the proposals to facilitate and encourage shareholder participation supported the measures.[5] The National Institute of Accountants strongly endorsed the measures aimed at improving the notice of meeting provisions. It was of the view that the requirement for notices to be worded and presented in a clear, concise and effective manner would make notices of meetings shorter, easier to comply with and more usable.[6]

8.7 There was, however, some unease about the need to balance the obligation for corporations to disclose all relevant and material information with the desire for such documents to be concise.[7] The Law Council of Australia was of the view that there is greater likelihood of such a provision being used tactically. It explained 'if the notice complies with the information requirement, the fact that it might not have been done concisely (for instance) should not prejudice the validity of the notice'.[8] It explained further that the problem is that this requirement is highly impressionistic and 'likely, where sectional interests are enlivened, to lead to litigation, and may provide a means of unwarranted interference with proper corporate governance processes, on the basis of arguments about how information is presented, rather than the substance of what is presented'.[9]

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3 Companies & Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 15.

4 Subsection 249L(3)

5 Submissions 5, p. 20; *Submission* 8, p. 12; *Submission* 48, p. 10.

6 ibid., *Submission* 25, p. 46.

7 *Submission* 14, p. 13; *Submission* 25, p. 46.

8 *Submission* 24, p. 27.

9 *Submission* 24, p. 27.

8.8 Despite its reservations about the use of the term concise, it suggested that the various new provisions dealing with notices of meeting apply to information accompanying a notice of meeting.[10]

8.9 A number of submissions to the Companies & Securities Advisory Committee in 2000 favoured the requirement in the New Zealand *Companies Act 1993* that the notice of meeting must state 'the nature of the business to be transacted at the meeting in sufficient detail to enable a shareholder to form a reasoned judgment in relation to it'.[11]

Committee view

8.10 The Committee supports the legislation but understands the concerns that there is tension between the object to be 'concise' and the need to ensure that all material information is contained in a document. The Committee notes the suggestions made about including a requirement in the legislation that a notice of meeting must state 'the nature of the business to be transacted at the meeting in sufficient detail to enable a shareholder to form a reasoned judgment'.

The use of modern technology for notices of meeting

8.11 With advances in technology proceeding apace, the Committee recognises that the use of electronic communications should be facilitated and encouraged. Most submissions supported the proposed legislative measures that would allow the electronic distribution of annual reports and notices. It particularly appreciates that such measures could promote greater participation by shareholders in meetings through proxy voting which is significant for shareholder decision-making.

8.12 From its first announcement, the general proposal as outlined in the policy proposal paper to permit members to elect to receive annual reports and notices electronically received warm approval.[12] The Securities Institute endorsed the proposal and the development of the Corporate Governance Council's best practice guidelines on electronic shareholder participation.[13]

8.13 The Law Council of Australia particularly welcomed the introduction of provisions that permit more effective dissemination of corporate information by electronic means.[14] While generally supporting the proposals, some participants in the inquiry, however, voiced caution. ASFA strongly supported the provisions but

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10 *Submission* 24, p. 28.

11 Companies & Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 16.

12 See Submissions from Securities Institute, *Submission* 53 to Treasury, p. [6]; ASIC, *Submission* 15, p. 50; and Corrs Chambers, *Submission* 25, p. [19].

13 *Submission* 53 to Treasury, p. [6].

14 *Submission* 24, p. 28.

suggested that the implementation required close monitoring to ensure that they 'are not being used to undermine shareholder participation'.[15]

Committee view

8.14 The Committee fully supports the use of modern technology to enhance shareholder participation. The Committee, however, would not like to see retail investors miss out on opportunities to exercise their rights because technology is leaving them behind. The Committee notes that at the moment the proposals stipulate that a member nominates to have notices of meeting transmitted electronically to him or her.

8.15 In its recent inquiry into the level of banking and financial services in rural, regional and remote Australia, the Committee was presented with strong evidence that particular groups of consumers were not benefiting from advances in technology and some people, particularly older Australians, were reluctant to use e-commerce. The Committee found that despite the potential to open up a range of financial services to customers, the banking sector had not done enough to facilitate access to new technology and most importantly had failed to ensure that their customers had the opportunities and were encouraged to use new technology.[16]

8.16 The Committee cites these findings to alert the business community to the potential for certain people to be excluded from the advantages being offered by developments in technology. It emphasises that the companies have a responsibility to assist in the education and training necessary for investors to make effective use of any innovations that may be introduced due to advances in technology. Further, the Committee believes that companies should ensure that those unable to use the new technology do not suffer any detriment and are able to continue to have adequate access to information and services.

Proxy votes and modern technology

8.17 In 2000, CASAC recognised that technology is moving quickly to transform the traditional form of meeting. It said:

> The concept of shareholder participation only through physical meetings is now being overtaken by technology. The means may become available in the near future for some shareholders to participate in physical meetings through purely electronic means. For instance, shareholders may be able to use electronic means to receive information from the company and communicate with their fellow shareholders prior to the meeting, as well as participate in the meeting and vote on resolutions during the course of the

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15 *Submission* 19, p. [9].

16 Parliamentary Joint Committee on Corporations and Financial Services, *Money Matters in the Bush,* January 2003.

> meeting. In this way, some shareholders could be involved in decision-making solely through this 'virtual meetings' technology.[17]

8.18 The OECD Principles of Corporate Governance in acknowledging the objective of facilitating shareholder participation suggested that companies consider favourably the 'enlarged use of information technology in voting, including secure electronic voting in absentia'.[18] It noted especially that as a matter of transparency, meeting procedures should ensure that votes are 'properly counted and recorded, and that a timely announcement of the outcome be made.'[19]

8.19 As part of its objective to encourage shareholder participation at meetings, CLERP 9 looked at the better use of modern technology.

8.20 Under ASX Listing rule 14.2 all public companies listed in Australia must include a proxy form in any notice of meeting. In general a proxy confers on a person nominated on the proxy form the same rights as a shareholder to speak and vote at a meeting. The ASX guidelines for notices of meetings suggests that companies should consider 'allowing shareholders to lodge proxies electronically, subject to the adoption of satisfactory authentication procedures'.[20]

8.21 Section 250BA of the Corporations Act is concerned with proxy documents of listed companies. It provides that a company receives an appointment authority when it is received at the company's registered office; a fax number at the company's registered office or a place, fax number or specified electronic address. It also provides that in a notice of meeting for a meeting of the members of a company, the company:

- must specify a place and a fax number; and
- may specify an electronic address.

8.22 This provision was inserted into the Company Law Review Bill 1997, following a motion by the Opposition during the course of debate. In October 1999, this Committee examined closely the receipt of proxy appointments and concluded that it was 'a matter of prudence and good corporate governance for companies to facilitate the receipt of proxy appointments'. It noted, however, that certain practical issues were drawn to its attention which included 'the authentication of proxies and security of electronic communications'. It further endorsed its earlier findings that legislation does not and should not impose 'an obligation to use electronic forms of

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17 Companies & Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 6.

18 *OECD Principles of Corporate Governance,* Draft Revised Text, January 2004, p. 17.

19 *OECD Principles of Corporate Governance,* Draft Revised Text, January 2004, p. 17.

20 Attachment A, ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations.*

communication but rather facilitates its greater use to improve the flow of information in the market'.[21]

8.23 The Government agreed with the view that the section be retained but rejected the need to impose prescriptive requirements concerning the receipt and validation of proxy appointments on companies by the Corporations Law.

8.24 The proposed amendments in CLERP 9 represent a further refinement of the law governing the electronic submission and receipt of proxy forms. Proposed subsection 250A(1A) will allow regulations to prescribe means to authenticate proxy appointments other than signature. In addition, changes to section 250B are intended to permit companies to offer a facility for electronic submission of proxy appointment forms.

8.25 The proposals attracted little interest in submissions. The ACSI, ASFA, ASA and the NIA approved the measures which they believed would enhance shareholder participation. ASA maintained that the reforms show forethought—that they are 'neither onerous nor costly for companies', and 'will drastically increase the level of participation from retail shareholders'.[22] The NIA stated that 'we are now in the electronic age and the proposals will help companies to adopt more flexible means to deal with proxy issues'.[23]

8.26 Professor Geoffrey George was of the view that the existence of a proxy voting system remains a significant barrier to enhanced shareholder control and could well be dispensed with in future corporate law reform'. He thought the proposed changes were 'generally trivial and unlikely to make any significant contribution to shareholder participation or enhance shareholder control'.[24]

Committee view

8.27 The Committee fully supports the use of modern technology to enhance shareholder participation particularly through proxy voting.

Body corporate as proxy

8.28 In 1998, this Committee recommended that section 249X(1) provide for a body corporate as well as a natural person to be appointed as a proxy.[25] The

21 Parliamentary Joint Committee on Corporations and Securities, *Report on Matters Arising from the Company Law Review Act 1998,* October 1999, p. 133.

22 *Submission* 22, p. 6.

23 *Submission* 25, p. 47; *Submission* 5, p. 21; *Submission* 19, p. [9]; *Submission* 22, p. 6.

24 *Submission* 16, p. [2]. He noted that the origins of proxy voting systems are presently subject to a research project at Victoria University.

25 Parliamentary Joint Committee on Corporations and Securities, *Report on Matters Arising from the Company Law Review Act 1998,* October 1999, p. 133.

Government supported the Committee's recommendation.[26] CASAC also considered the issue of whether a shareholder should have the option of appointing a body corporate as its proxy and recommended that 'there should be legislative provision for shareholders to appoint a body corporate as a proxy'.[27]

8.29 In accord with the Committee and CASAC's recommendations, the Bill inserts new sub section 249X(1) in the Corporations Act which would permit an individual or a body corporate to be appointed by a person as his/her proxy. Proposed paragraph 250D(1)(d) will enable a body corporate appointed as a proxy for a member to nominate an individual to exercise its powers at meetings.

8.30 The CSA and ASA raised the only significant concerns about the provision. CSA cited the case where the appointed company proxy could not attend the meeting and explained that:

> In such circumstances a number of the companies which CSA's members represent have accepted as valid a nomination of the 'appointed representative of the ASA (or other named organisation) at the meeting' where the company has received written advice from the organisation ahead of the meeting as to who its representative will be. We believe this negates the need to amend the law to permit the appointment of a body corporate to act as proxy, as we believe this could be fraught with difficulty.[28]

8.31 Although ASA approved the general concept in the Bill, it suggested that there was a lack of clarity as to what 'is required by a corporate proxy representative in order to nominate a representative to vote proxies given to the body corporate'. It wanted guidelines.[29] Mr Wilson in querying the mechanics of the provision said:

> …we just need to come to some sort of agreement whereby if someone appoints, for instance, ASA, or the shareholders association, that can be identified.[30]

Committee view

8.32 The Committee suggests that ASIC prepare guidelines to clarify the concerns about the procedures for a body corporate to appoint a representative who is to vote as a member's proxy.

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26 Government Response, p. 24 of 32.

27 Recommendation 12, p. 48.

28 *Submission* 8, Attachment 2.

29 See Mr Wilson, *Committee Hansard*, 9 March 2004, p. 27.

30 *Committee Hansard*, 9 March 2004, p. 27.

The integrity of the proxy voting system

8.33 Although the provision dealing with proxy votes and the use of technology in CLERP 9 drew little comment in submissions, matters related to proxy voting not addressed in the Bill generated interest in submissions and during public hearings. The major concerns were:

- the integrity of the voting system including
  - the requirement to vote as directed;
- institutional voting including
  - level of voting;
  - disclosure of voting; and
  - compulsory voting.

8.34 All public companies listed in Australia must include a proxy form in any notice of meeting. Under ASX Listing Rule 14.2, the proxy form must provide for the shareholder to vote for and against each resolution.[31] It must also provide for the shareholder 'to appoint proxies of the holder's choice, but may specify who is to be appointed as proxy if the holder does not choose a person to act as the holder's proxy'.[32]

8.35 In 2000, CASAC acknowledged that proxy voting has been a long standing key element in share-holder decision-making especially given that many shareholders do not attend general meetings. It stated:

> It has been commonplace for directors of companies, or other interested individuals, to seek support from shareholders by requesting them to appoint a particular person as their proxy, either generally or in relation to particular proposals.[33]

It noted that the process of proxy solicitation has not been closely regulated, except in the North American jurisdiction and asked 'whether more controls are needed in Australia'.[34]

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31 Listing Rule 14.2.1

32 See Listing rule 14.2.2. There are a number of sub sections under Rule 14.2 which specifies the requirements for proxy forms.

33 Companies & Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 39.

34 Companies & Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 39.

8.36 According to Mr Stephen Mayne, Crikey.Com.Au, there was no doubt that reform was called for. He maintained that the system 'needs some sort of Corporations Law guidance as to how elections are conducted on proxies and even on things like proxy information flow'. He gave the following example of what he believed to be a flawed system:

> The system that the boards use is that they send out the documentation with reply paid envelopes, and if you merely sign the form and send it back the default mechanism is that that goes to the chairman as an open proxy. Typically they gather about 10 per cent of all votes as open proxies, so that is 10 per cent in their back pocket…[35]

Proxy voting and the obligation to vote as directed

8.37 The provisions in the Bill do not consider this matter of the integrity of the proxy voting system in Australia. Yet one of the main and most persistent areas of concerns deals with the obligation on a proxy to vote as instructed.

8.38 The OECD revised principles noted that voting by proxy is generally accepted. It said:

> Indeed, it is important to the promotion and protection of shareholder rights that investors can place reliance upon directed proxy voting. The corporate governance framework should ensure that proxies are voted in accordance with the direction of the proxy holder and that disclosure is provided in relation to how undirected proxies will be voted.[36]

At the moment, Section 250A(4) provides:

> (4) An appointment may specify the way the proxy is to vote on a particular resolution. If it does:
>
> (a) the proxy need not vote on a show of hands, but if the proxy does so, the proxy must vote that way; and
>
> (b) if the proxy has 2 or more appointments that specify different ways to vote on the resolution—the proxy must not vote on a show of hands; and
>
> (c) if the proxy is the chair—the proxy must vote on a poll, and must vote that way; and
>
> (d) if the proxy is not the chair—the proxy need not vote on a poll, but if the proxy does so, the proxy must vote that way.

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35 *Committee Hansard*, 14 April 2004, p. 28.

36 *OECD Principles of Corporate Governance,* Draft Revised Text, January 2004, p. 16. The term 'proxy holder' in this quote may be intended to read 'shareholder'.

> If a proxy is also a member, this subsection does not affect the way that the person can cast any votes they hold as a member.
>
> Note: A company's constitution may provide that a proxy is not entitled to vote on a show of hands (see subsection 249Y(2)).

8.39 This subsection clearly places the chair under a duty to exercise all proxies which he or she has as chair in accordance with the issued instructions but does not extend this obligation to all proxies. This provision has been the subject of debate for a number of years.

8.40 Evidence presented to this Committee and views expressed more widely in public commentary suggests that reform is needed in this area. In 2000, CASAC considered whether the statutory obligation on the chair to vote proxies as directed on any poll should apply to other persons put forward by the board as a proxy. It came to the view that:

> The Corporations Law should stipulate that any person put forward by the company board as a proxy must vote the proxies on a poll at the meeting. This would overcome the possibility of shareholders being disenfranchised by a person, other than the chair, who is put forward by the board as a proxy deliberately failing to vote that proxy in accordance with the shareholder's instructions.[37]

It explained further:

> The obligation of the chair to vote on a poll overcomes the possibility of that person intentionally abstaining from voting the proxies given to him or her where a majority of those proxies direct a vote which is contrary to the result preferred by the chair. However, this problem may still arise if the proxy form circulated by the board stipulates a person other than the chair as the proxy. The Corporations Law does not oblige that proxy to vote the shares on a poll, and it is uncertain whether a proxy put forward by the board, other than possibly a director, would be under any fiduciary duty to do so.[38]

8.41 It recommended that 'there should be a legislative requirement for any person put forward by the company board as a proxy to vote the proxies on any poll according to their terms'.[39]

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37 Companies and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 49.

38 Companies and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 49.

39 Companies and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 50.

8.42 Addressing this same matter, Mr James McConvill wrote of the complexities of the issue particularly when placed side by side with the duties of directors. He noted that in a case involving a particular factual matrix:

> …it is possible that a director's failure to vote as directed when appointed as proxy could constitute a breach of the duty to act with due care and diligence under s 180(1) of the Corporations Act (by falling below a standard of conduct that the shareholder reasonably expects that the director would exercise), and possibly a breach of the oppressive conduct provisions under Pt 2F.1 of the Corporations Act (as disenfranchising certain shareholders by failing to vote as directed may mean that these shareholders are unfairly prejudiced or unfairly discriminated against).[40]

8.43 He then looked at other obligations placed on a director such as the duty to act in good faith which in his view means to act honestly in the best interests of the company. He surmised:

> Interestingly, when a director is appointed proxy, there will often be a conflict between the duty of the director to act in the best interests of the company and the duty to represent the appointers' interests. For example, an appointer may instruct the director to vote in favour of a resolution increasing share dividends by 20% at a time when such an increase would have a detrimental impact on the ability of the company to pay its outstanding debts. As a fiduciary of the company, the director's main duty will be to act in the company's best interests and vote against the resolution—even though this is not what the appointer instructed. Accordingly, while there may be some situations where failing to exercise proxy votes as directed may contravene the duty to act in good faith in the best interests of the company, this will certainly not always be the case. There may, indeed, be quite a number of situations where exercising proxy votes as directed would actually *contravene* the director's duty to act in the best interests of the company.[41]

8.44 His suggestion would be to amend the Corporations Act in a way that removes any qualifications so that the obligations to vote as directed applies to all proxies in all circumstances. He proposed that s 250A(4) and (5) be repealed and

40 James McConvill, 'The Obligation of proxies to vote as directed: The present state of play and the need for a resolution', *Company and Securities Law Journal*, vol. 21 no. 4., pp. 268–270.

41 James McConvill, 'The Obligation of proxies to vote as directed: The present state of play and the need for a resolution', *Company and Securities Law Journal*, vol. 21 no. 4., pp. 268–270.

replaced by a new s 250A(4) which would specify that 'if upon appointment it is specified that a proxy is to vote a particular way, then the proxy must vote that way'.[42]

8.45 Mr McConvill also proposed that in light of this broad change to the obligation of proxies to vote, that an express provision be included in the Corporations Act requiring a person's consent before they can be appointed as a proxy and 'thus have a duty to vote as directed by the appointer'. He explained:

> It would also be stated that a chair or director of the relevant company included on a company's proxy appointment form will be taken to have consented to being appointed as a proxy for the purposes of the provision. While this amendment could potentially carry the burden of adding to the administration involved in organising and conducting company meetings, it is submitted that this would be outweighed by the benefit of avoiding the potential problem of a person appointed as proxy being held liable for failing to vote when they have no relationship with the appointer and no intention of attending the meeting to vote.[43]

8.46 This issue was taken up during the course of this inquiry. A number of witnesses adopted the same approach to section 250. They were of one view that a proxy must vote all proxies in accordance with the directions given and not just the ones the proxy agrees with.[44] For them, CLERP 9 provided an opportunity to remedy what they see as an anomaly in the Corporations Act. Mr Richard Jones, CSA, told the Committee:

> There are two areas of concern with his legislation—in fact, they are more omissions than inclusions. Late last year the institute suggested changes to section 250 regarding the use and abuse of proxies. To remind the committee, that section requires chairmen of meetings to vote proxies as directed. In other words, if they get a proxy for or against, they should vote it for or against. It does not extend to directors and company secretaries. There are significant examples of some directors of quite large companies cherry picking the proxies that have been given to them. An example might be that he has been given proxies for and against and he chooses to only use those that are for because that promotes his particular cause.

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42 James McConvill, 'The Obligation of proxies to vote as directed: The present state of play and the need for a resolution', *Company and Securities Law Journal*, vol. 21 no. 4, p. 271. He suggested further 'so that the new duty applies to all proxies in all circumstances, the author proposes that both the clarification note to the existing s 250A(4) (which states that a company's constitution may provide that a proxy is not entitled to vote on a show of hands), as well as section 250A(5) (which states that s 250A(4) is only applicable if the proxy is appointed as a result of the company sending out a list of nominees or proxy appointment forms to members) also be repealed.

43 James McConvill, 'The Obligation of proxies to vote as directed: The present state of play and the need for a resolution', *Company and Securities Law Journal*, vol. 21 no. 4., p. 271.

44 See Mr Gration, *Committee Hansard*, 18 March 2004, p. 54.

> Unfortunately, it is clear that that has extended to persons other than chairmen, directors or company secretaries. There are ordinary shareholders who have been given proxies who are cherry picking those proxies. As a matter of good corporate governance we believe that all shareholders, whether they attend meetings or whether they vote through a proxy, are entitled to expect their views to be counted and not cast aside at the whim of a particular proxy holder who chooses to promote his particular cause. The change to section 250 is very minor, and as an institute we are prepared to assist the drafters in making the change.[45]

8.47 CSA was under the impression that 'many shareholders assume that when they complete and lodge a proxy form that they are in fact lodging a "direct vote"'. Mr Gration explained further that most shareholders think of their proxy form more as 'a postal vote.'[46] The CSA emphasised that this assumption is false and sought an amendment to the Bill to ensure that the voting intentions of shareholders are carried out. Mr Gration said that the legislation should ensure that:

> If you are appointed as a proxy and you attend the meeting and vote, you must vote all the proxies that you hold and you must vote them in accordance with the directions given to you where they have given you those directions. If I appoint my aunt as a proxy and she does not show up to the meeting, that is fine and she does not have to vote. But if she shows up to the meeting she must vote and she must vote in accordance with my instructions. If she holds…multiple proxies, she needs to vote all of those, not just the ones that she agrees with.[47]

8.48 The CSA cited CASAC's recommendation (as given above) and noted that although it is limited to persons put forward by the company board, it supports the inclusion of all proxyholders who vote.[48] It explained:

> It should be noted that in CSA's 1999 submission to CASAC, CSA took the view supporting '…the position of CASAC that the obligation to vote on a poll should attach to any person put forward by the company board as a shareholder proxy. Despite this it is not felt that the Corporations Law need stipulate that any person put forward must vote. We are not aware of any cases where such a proxy has not voted on a poll but the situation may be different where the vote is taken on a show of hands and the proxy wishes to vote his or her own shares and cannot vote twice.'
>
> CSA's view in 1999 has now changed as recent court cases and practices have indicated that the practice of 'cherry-picking' is more common that previously anticipated.[49]

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45 *Committee Hansard*, 18 March 2004, p. 48.

46 *Committee Hansard* 18 March 2004, p. 54.

47 *Committee Hansard*, 18 March 2004, p. 54.

48 *Supplementary submission*, 8A, p. 2.

8.49 It proposed the following amendment to sub section 250A(4):

> [How a proxy is to vote] An appointment may specify the way the proxy is to vote on a particular resolution. If it does:
>
> the proxy need not vote on a show of hands, but if the proxy does so, the proxy must vote that way; and
>
> if the proxy has 2 or more appointments that specify different ways to vote on the resolution—the proxy must not vote on a show of hands;
>
> if the proxy is the chair—the proxy must vote on a poll, and must vote as directed in respect of each appointment; and
>
> if the proxy votes on a poll and if the proxy has 2 or more appointments that specify different ways to vote on the resolution—the proxy must vote on a poll as directed in respect of each appointment.
>
> If a proxy is also a member, this subsection does not affect the way that the person can cast any votes they hold as a member.
>
> 250A(5) [Offence] A person who contravenes subsection (4) is guilty of an offence.[50]

8.50 Mr Les Callan, Compliance Logistics, also highlighted the prevalence of cherry picking. He defined this activity as:

> An action, taken by a person with the assumed power to do so, to circumvent a directed vote of a member (given by the use of a proxy form) from being included in the tally used to determine the outcome of a resolution at a Meeting of Members.[51]

8.51 He argued that section 250A(4)(d) 'when read without reference to the Common Law principles governing the agency duties attached to a proxyholder, could be construed so as to legitimise this practice.' He explained further:

> I contend that Cherry Picking is already illegal and while some change is desirable for transparency purposes, there is no forensic need to change the Law to stop such practices occurring. Several Supreme Court judgements have confirmed the Common Law principle that a proxyholder, as agent, must vote and must vote as directed. Section 250A(4)(d) of the Law is simply dealing with the proxy form itself. A proxy, solely by virtue of being named on an instrument appointing a proxy, has not entered into any real or implied agency agreement with the member.

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49 *Supplementary submission* 8A, p. 2.

50 *Supplementary Submission* 8A, attachment 1.

51 *Submission* 64, p. 4.

> Logically the agency agreement between the person named as proxy and the member arises when that person accepts the documents enabling him or her to vote at the Meeting. The proxy (the person offered the agency) becomes a proxyholder (an agent acting for the member at the meeting) when the Meeting polling paper is accepted. That acceptance ensures that no other person, including the Chairman of the Meeting, named on the proxy form as an alternate proxy can deal in any way with that member's vote (either directed or undirected) while the proxyholder remains at the Meeting. A proxyholder under Common Law must vote and must vote as directed. Consequently the cherry picking action is in breach of the Common Law duty overtly accepted by the proxyholder by the acceptance of the polling paper.[52]

8.52 Mr Callan put before the Committee three solutions as follows:

> Add a Note after 250(A)(4)(d) to the following effect:
>
> A proxy, who attends the Meeting and is prepared to act on behalf of the member as indicated on the instrument, becomes a proxyholder for the member and must vote as directed. Evidence of a preparedness to act as proxyholder is the acceptance of a voting instrument issued to the proxy at the Meeting
>
> or
>
> Change the wording of Section 250(A)(4)(c) and (d) to the effect:
>
> if the proxy is the chair—the Chairman must accept the proxyholding and vote on a poll, and must vote that way; and
>
> if the proxy is not the chair—the proxy need not accept the proxyholding but if the proxy does, the proxyholder must vote on a poll and must vote that way.[53]

8.53 His third solution was more involved in that he suggested the formulation of a new and more transparent proxy appointment regime. Under this scheme, 'Where a member directs the manner in which a vote is to be cast at a Meeting of Members, the Chairman of the Meeting will act as facilitator for the member for the purpose of casting the directed vote—irrespective of who the member nominates as proxy'.[54]

8.54 Witnesses identified a number of other concerns surrounding the voting procedures at meetings. Mr Mayne suggested that companies should reveal the number of shareholders who vote for and against resolutions as well as the total

52 *Submission* 64, pp. 4–5.

53 *Submission* 64, p. 5.

54 *Submission* 64, p. 5.

amount of shares voted.[55] In his view 'this would make public the substantial number of resolutions each year which are passed by compliant institutional investors when a majority of voting shareholders have actually opposed it'.[56]

Committee view

8.55 The evidence considered by this Committee clearly indicates that the law needs to be revised to ensure that shareholders voting intentions are respected. The Committee was unable to conduct a thorough examination of the proxy voting system but the evidence suggests that such an examination with a view to amending the current provisions governing proxy voting is long overdue.

Recommendation 21

8.56 The Committee recommends that the law be amended to ensure that the voting intentions of shareholders through their proxyholder are carried out according to their instructions.

Recommendation 22

8.57 The Committee recommends further that the provisions governing voting at meetings be reviewed by CAMAC with a focus on the matters that have been raised during the inquiry but which the Committee has not examined in depth. Including the disclosure of voting—numbers for, against and abstentions on each resolution before the meeting.

Institutional shareholders and proxy voting

8.58 The obligations of institutional shareholders to their members in particular managing the potential conflict of interest in relation to the casting of proxy votes was another matter of concern. The following section looks at the level of voting by institutional shareholders, the disclosure of voting by institutional shareholders and whether they should be obliged to vote.

Level of proxy voting

8.59 Testimony before the Committee recognised that institutional investors represent an increasing proportion of share registers. Witnesses acknowledged the potential for these institutions to influence corporate governance. Mr Alexander Easterbrook, Corporate Governance International, told the Committee that 'roughly two-thirds of the market is in the hands of institutions'.[57] For him it was important to improve not only their level of voting but also the quality of the voting. He noted:

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55 *Supplementary Submission* 63A, p. 5.

56 *Supplementary Submission* 63A, p. 5.

57 *Committee Hansard*, 9 March 2004, p. 2.

> If the voting level is very low, it means that small groups of shareholders are much more influential, and that should not be the case. This 44 per cent is an average. It ranges from about 19 per cent up to about 60 per cent. In some companies the level of voting is very low. If only 19 per cent are voting in a widely held company and you have a group of shareholders who have five per cent, in reality they have 25 per cent of the vote. That is one of the reasons why we want to get this vote up: so that small interest groups cannot have the degree of leverage that they currently have.[58]

8.60 A number of institutional investors responded to the observations that institutional investors occupy a position that enables them to exert significant influence on the behaviour of the companies in which they invest. They suggest that such institutions over recent years have begun to take seriously their responsibilities to vote at meetings. Mr Spathis, ACSI, told the Committee:

> …super funds have considered super funds voting to be either too costly or too complex and therefore trustees have not been adequately monitoring the companies in which they invest. In addition to that, trustees have not been adequately monitoring those parties who have a responsibility in the area, such as fund managers, and whether or not these fund managers have voted on their behalf. But things are changing and we are working with a number of superannuation funds to develop a policy framework to ensure that they do behave like shareholders and get involved in voting and constructive dialogue with the corporations in which they invest…investors rely on good corporate governance and regulations to raise their confidence about the company.[59]

8.61 Dr Bradley Pragnell, ASFA, conceded that trustee directors may have for a period of time 'been asleep at the wheel' but they are now alert to the importance of taking an active part in voting. He told the Committee:

> From my discussions with our members, particularly around controversial issues, around executive remuneration and around share option issues to executives and directors, there is a lot of time and energy being spent on trustee boards and on the investment committees of trustee boards looking at these issues. They are now viewing these issues as part of their fiduciary responsibility. They are looking very seriously at these issues.[60]

8.62 Mr Gilbert, IFSA, told the Committee that their recent survey indicated that '90-plus per cent voting activism on the part of managers'. He offered the following assurance:

> I would also like to say that IFSA and its fund manager members believe that in the context of all these changes it is important that there be

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58 *Committee Hansard*, 9 March 2004, p. 4.

59 *Committee Hansard*, 16 March 004, p. 69.

60 *Committee Hansard*, 7 May 2004, p. 15.

> shareholder activism. That is absolutely critical, and we maintain and uphold those principles. I think that going forward you will see more than [that] has happened, although we say that there have been dramatic improvements in activism and involvement. So to that end we do not see any value in mandating proxy voting. We would also advise the committee that the Association of Superannuation Funds also opposes mandating of proxy voting and, in relation to that, it made a submission to the OECD on 5 December 2004 expressing a similar position to IFSA's.[61]

8.63 In Australia there are growing expectations that institutional investors will take an active part in monitoring and influencing the companies in which they invest especially through exercising their vote at meetings. For example, the Australian Chamber of Commerce and Industry urges institutional investors to be mindful of their fiduciary duty to their clients and to 'take a greater degree of active interest and engagement in the affairs of those companies where, they, on behalf of their clients, have substantial economic interests'.[62]

8.64 Professor Ramsay, who maintained that more could be expected from Australia's institutions, recognised the need not only for them to vote but to do so intelligently—to ensure that their votes are informed. He noted that institutions 'have the economic influence to be a very positive force for ensuring good governance in our companies'.[63]

Disclosure of voting by institutional shareholders

8.65 The OECD noted the trend for shares to be held by institutional investors and the importance of voting as a means to promote good corporate governance. It found:

> The effectiveness and credibility of the entire corporate governance system and company oversight will, therefore, to a large extent depend on institutional investors that can make informed use of their shareholder rights and effectively exercise their ownership functions in companies in which they invest. While the principle does not require institutional investors to vote their shares, it calls for disclosure of how they exercise their ownership functions with due consideration to cost effectiveness.[64]

8.66 The disclosure of voting is one of the central features of the OECD Principles of Corporate Governance which state:

> The exercise of ownership rights by all shareholders, including institutional investors should be facilitated.

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61 *Committee Hansard*. 16 March 2004, p. 2. The date given in the quote of December 2004 is a misprint from the original transcript.

62 Australian Chamber of Commerce and Industry, *Corporate Governance and Responsibilities.*

63 *Committee Hansard*, 18 March 2004, p. 18.

64 *OECD Principles of Corporate Governance* Draft Revised Text, January 2004, p. 18.

> Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights. The voting record of such investors should also be disclosed to the market on an annual basis.
>
> Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interests that may affect the exercise of key ownership rights regarding their investments.[65]

8.67 A similar approach is taking form in Australia. Mr Paatsch suggested that greater disclosure on the way institutions and fund managers exercise their proxy votes would reassure the market of the voting integrity of the system. He cited legislation in the US whereby 'all mutual funds that cast their proxy votes make it available to their members on the web site or public record'. He argued further that:

> The rise of institutional investment in Australia has been phenomenal since the superannuation guarantee charge, so the requirement to compel the disclosure of proxy votes falls in relation to those areas. You will, I think, clean up the vast majority of the problem, and proxy voting levels will rise, where you compel those entities which are already within your jurisdiction to legislate on.[66]

8.68 The Finance Sector Union of Australia also turned its attention to the disclosure of how proxies are exercised. It called for stronger measures in relation to voting by trustees of super funds and fund managers. It wanted to place a requirement on:

- the company to disclose to company members how undirected proxies will be exercised;
- trustees of super funds to direct their proxies in relation to resolutions in the listed companies that they invest in;
- fund managers to disclose on a public website how they voted and, where possible, disclose the reasons for their vote. [67]

8.69 Mr Masson agreed that where fund managers are voting they should make known how they voted. He suggested:

> Indeed, where super fund trustees are voting, they should make it known how they will be exercising their vote, and perhaps that is a lead-in step that then goes to the next point of super fund members actually being able to

65 *OECD Principles of Corporate Governance* Draft Revised Text, January 2004, p. 7.

66 *Committee Hansard*, 14 April 2004 , p. 24.

67 *Submission* 38, pp. [3–4].

> engage and direct trustees with respect to how they may exercise that vote. But that would be a further step down the track somewhere.[68]

8.70 Mr Mayne referred to 'faceless institutions' and conflicts of interest. He cited the case of the chairman of the Commonwealth bank who was also on the board of BHP and the resolution for a merger of BHP with Billiton:

> …the Commonwealth Bank, the largest Australian shareholder in BHP; BHP putting full page ads in the Financial Review from the directors saying, 'We recommend this deal and we urge shareholders to vote for this deal'; and John Ralph [chairman of the Commonwealth Bank] on the board of BHP. Colonial are not going to embarrass its own chairman and vote against the BHP-Billiton merger. We do not know how they voted…there is no public disclosure of it.[69]

8.71 He urged that Australian institutional shareholders move to full public disclosure of their voting.[70] He suggested that this disclosure is particularly important because 'invisible institutions keep returning dud directors with 99% yes votes and we need to know who is doing this for better institutional accountability'.[71]

8.72 Professor Geoffrey George expressed the same disappointment at the conduct of institutional investors. He submitted:

> The existing Board usually gathers sufficient proxy votes to ensure that whatever the Board wishes to happen, happens. The AGM could hardly be regarded a model forum for participative democratic control! Most shareholdings are never voted, and the voting behaviour of institutional investors, usually important and often significant, generally remains a mystery.[72]

8.73 Mr Paatsch also noted the dominance of large institutions and the potential for conflicts of interest:

> In the bank's situation, virtually 30 per cent of every retail funds management dollar ends up in the hands of a 'bank' controlled wealth management organisation, and there is a perception that the fund managers are reluctant to cast their votes in a way that would not carry favour with their clients. [73]

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68 *Committee Hansard*, 14 April 2004, p. 66.

69 *Committee Hansard*, 14 April 2004, p. 37.

70 Supplementary *Submission* 63A, p. 3.

71 Supplementary *Submission* 63A, p. 3.

72 *Submission* 16, p. [2].

73 *Committee Hansard* 14 April 2004, p. 14.

8.74 He believed that this situation could 'very easily be remedied in the consumer's mind to relieve this perception of conflict of interest by having greater disclosure over the way that institutions and fund managers cast their proxy votes'. As referred to earlier, he noted that:

> There is legislation in the US which goes to that effect, so all mutual funds there that cast their proxy votes make it available to their members. It is frequently on a web site or the public record, and that is something that I would commend to the committee's attention.[74]

Compulsory voting by institutions

8.75 Some participants in the inquiry wanted legislation to go beyond disclosure of voting to require mandatory voting for institutional investors. Mr Mayne supported compulsory voting but stressed the primary importance of the requirement to disclose how the organisation voted. He told the Committee:

> I think that the most important area where this should be introduced is in director elections. The reason I say that is that we do not have a problem with executive pay in terms of institutions voting. You are getting 'no' votes regularly on options packages of 30 and 40 per cent. News Corp got rolled last year. So now, institutions in Australia, culturally, are voting down and voting against options packages and director benefits. Southern Cross Broadcasting—
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> …
>
> They have been passed, but what I am talking about here is the size of the 'no' vote. You are getting regular 'no' votes of 30 or 40 per cent. Rupert Murdoch should have seen it coming, because for the previous four years he was averaging 'no' votes around the 35 per cent mark for his executive options. But when it comes to director elections there is no culture of 'no' voting; it is 99 per cent for the worst directors. So, that is the area where there is a severe problem—where 'the club', the oligarchy, is self-supporting, and no matter how poorly a director performs they get re-elected.[75]

8.76 Mr Bill Shorten, AWU, believed that his union would support compulsory voting, he supposed that the attitude of the senior officials would be that 'it is appropriate to try to exercise compulsory voting'.[76] He said:

> We think that a corporation will function more efficiently if there is a forced, active interest from all of the shareholders, rather than simply

74 *Committee Hansard,* 14 April 2004, p. 14.

75 *Committee Hansard*, 14 April 2004, p. 43.

76 *Committee Hansard*, 14 April 2004, p. 89.

> leaving it to a few institutions and the board of the company to make all the decisions without the scrutiny of voting.[77]

8.77 CASAC in 2000 cited recent empirical research indicating a lower level of proxy voting in Australia compared with some overseas jurisdictions. It saw no reason, however, for any statutory requirement for scheme managers or institutional shareholders to attend company meetings or vote their shares. It concluded that 'Any such obligation would be difficult to apply (for instance, in distinguishing between institutional and non-institutional shareholders) and could be largely ineffective'.[78] It suggested that a better approach would be 'to continually develop and monitor best practice guidelines regarding participation in company meetings by scheme managers or institutional shareholders, supported by existing statutory and common law principles.'[79]

8.78 The CSA took a similar approach to encourage the disclosure of voting so that investors are better informed but rejected the concept of mandatory voting by institutions. It argued:

> While more contentious matters will always attract the attention of the media, the vast majority of matters put before shareholders are non-contentious and carried with a substantial majority. To require institutions, trusts and funds to vote on all matters in all companies that they have an investment may create substantial additional costs to be incurred by institutions with no real corresponding benefit realized by the ultimate investor.[80]

8.79 The IFSA Corporate Governance Guide for fund managers and corporations issued the following advice on proxy voting policy and procedures:

> Fund managers should have a written Corporate Governance policy, including policies regarding the exercising of proxy votes. The policy should be approved by the board of the fund manager and should include formal internal procedures to ensure that that policy is applied consistently.
>
> Wherever a client delegates responsibility for exercising proxy votes, the Fund manager should report in a manner required by the client. Reporting on voting should be a part of the regular reporting process to each client. The report should include a positive statement that the fund manager has complied with its obligation to exercise voting rights in the client's interest

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77 *Committee Hansard*, 14 April 2004, p. 89.

78 Companies and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 65.

79 Companies and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 65.

80 Supplementary *Submission* 8A, p. 4.

> only. If a fund manager is unable to make the statement without qualification, the report should include an explanation.[81]

8.80 Mr Gilbert, however, could see no value in mandating proxy voting and told the Committee:

> Intelligent voting is much better than unintelligent voting, and intelligent voting has got to be a matter between the funds manager and the institution—the super fund—via proper disclosure and a proper relationship in terms of the flow of information. So there is a real danger that if you have a black-letter system you will diminish voting intelligence quite substantially.[82]

8.81 Dr Pragnell shared these concerns about compulsory voting. He cited the increased expenses associated in particular with putting in place compliance systems but could not quantify the costs.[83] Mr Ross Clare noted that while many were already taking their voting rights seriously, 'there most likely is a difference between a high incidence of voting on a voluntary basis and putting in place systems to ensure that it happens in every case'.[84] He said that he was referring to an expansion of existing systems and processes:

> It comes down to the level of assurance of your systems. Different levels of assurance are needed when it is done on a voluntary basis as opposed to one where there are legal requirements and possible sanctions. I would see that as being a difference. If you had a legal obligation you would have to have a compliance program in place to ensure that it happened on top of the mechanics of voting—[85]

8.82 While conceding that being active share owners would enable funds to recoup costs incurred in voting 'by better performance of those companies in the long run', he concluded that 'there are strong arguments for large funds to do it but for small funds it is a balance of time and return'.[86]

8.83 Taking up the theme of the quality of the vote when obliged to do so, he was worried that while 100 per cent voting could be achieved, the question was 'whether we are going to end up with conscripts in terms of voting of proxies as opposed to willing and engaged share owners.'[87] He enlarged on this prediction:

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81 Investment and Financial Services Association Limited, *Corporate Governance: A Guide for Fund Managers and Corporations,* reprint March 2003, p. 5.

82 *Committee Hansard*, 16 March 2004, p. 3.

83 *Committee Hansard*, 7 May 2004, p. 12.

84 *Committee Hansard*, 7 May 2004, p. 13.

85 *Committee Hansard*, 7 May 2004, p. 13.

86 *Committee Hansard*, 7 May 2004, p. 17.

87 *Committee Hansard*, 7 May 2004, p. 15.

> If we end up conscripting proxies, then we are going to end up with, yes, a majority of funds…I do not want them to think of proxy voting as a compliance requirement. I want them to think of proxy voting as part of their duties as a trustee in terms of managing their investments.[88]

8.84 Mr Easterbrook concurred with the view about improving the quality of the voting. He was worried that compulsory voting would increase the level of voting but the quality would fall.[89] Professor Frank Clarke also saw problems and asked 'How do we ensure that the institution votes in such a way that it really is achieving this sort of representation of all individuals who have their money invested in those funds?'[90]

Committee view

8.85 The Committee does not endorse compulsory voting by institutional shareholders. Too many practical issues remain unresolved such as whether the requirement applies to all resolutions put before the meeting or selected matters and if so what particular matters require voting. There is also the difficulty for institutional investors in ascertaining the voting intentions of their members. A number of witnesses also mentioned the costs involved in complying with voting requirement though estimates of such costs were vague. Of most concern, however, was the concern over the quality of the vote with one witness referring to 'conscripting proxies'.

8.86 The Committee does believe, however, that there is merit in requiring institutional investors to disclosure how they voted at meetings including abstentions. It notes that the OECD endorses this approach.

Recommendation 23

8.87 The Committee recommends that as best practice, institutional investors:

- **include a discussion of their voting policies in their annual report which includes how they manage conflicts of interest in regard to their investments; and**
- **disclose their voting record in the annual report.**

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88 *Committee Hansard*, 7 May 2004, p. 15.

89 *Committee Hansard*, 9 March 2004, p. 5.

90 *Committee Hansard*, 11 March 2004, p. 58. Similar views have been expressed in public by a number of commentators. Henry Bosch noted the proposal to make it compulsory for institutional shareholders to vote their proxies. He observed, 'that requirement could easily be met by passing the form to the office boy and telling him to vote in favour of all management resolutions. Black letter law is often only a roadmap for the unscrupulous or the slothful—as the controllers of Enron showed when they parked the corporate debt in off balance sheet vehicles'. Henry Bosch, 'The Changing Face of Corporate Governance', *UNSW Law Journal,* vol. 25, no. 2, 2002, pp. 283–4.

Opportunity for shareholders to requisition a meeting

8.88 Section 249D of the Corporations Act provides for the calling of a general meeting by directors when requested by members. Under this section, directors of a company must call and arrange to hold a general meeting on the request of members with at least 5% of the votes that may be cast at the general meeting or at least 100 members who are entitled to vote at the general meeting.

8.89 The exposure draft of the Corporations Amendment Bill 2002 proposed among a number of measures to remove the 100 member rule from this section. Although a number of proposals contained in this exposure draft are now contained in CLERP 9, a provision to change the 100 member rule is not. Even so, a number of witnesses raised this matter. The following section briefly traces the development of this rule before examining the evidence presented to the Committee.

8.90 In 2000, CASAC came to the view that:

> The Corporations Law should differentiate between the threshold for shareholders to requisition a general meeting and the threshold for shareholders to propose a resolution at the next scheduled general meeting. The threshold should be much higher in the former than in the latter situation, given that the costs and administrative burdens for a company in holding extraordinary general meetings are much higher than those incurred by the company in adding items to the agenda and distributing additional draft resolutions and accompanying statements for meetings that have already been scheduled.[91]

8.91 In December 2002, the Parliamentary Secretary to the Treasurer, Senator the Hon Ian Campbell, announced the Government's intention to remove the rule allowing 100 shareholders of a company to call a special general meeting. Under the government's proposal a minimum of five per cent of total voting rights would be required before directors must call a meeting. Senator Campbell maintained that the current 100-member test:

- gives disproportionate influence to a minority that is out of all proportion to their economic interest;
- fails to recognise the substantial size difference between public companies; and
- in allowing a small minority of shareholders to call such a meeting may serve narrow interests which 'can be costly and penalise the majority of shareholders'.

91 Companies & Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company,* Final Report, June 2000, p. 28.

8.92 He cited the case of NRMA where '12 extraordinary meetings seeking the removal of directors had been called during the last two years' which he said 'demonstrated the need to change the law'. Senator Campbell explained further:

> In the NRMA's case, where there are about two million members, special meetings were able to be requisitioned by a mere .005 per cent of members. The cost of each of the meetings held was several million dollars.
>
> Commonsense says a law which allows that to happen needs to be changed.[92]

8.93 In response to the draft exposure, the CSA acknowledged that the 100 members/5 per cent 'rule' has been a long standing issue. It supported the removal of the 100-member rule stressing that it 'has the effect of placing substantial expense on companies and their memberships.'[93] In its submission to Treasury it stated:

> To emphasise the point, very recently the Wilderness Society forced the Tasmanian wood products groups—Gunns—to a shareholder meeting using this very provision of the Corporations Act. While the stated cost of the meeting to Gunns was in the order of '…tens of thousands of dollars…' the cost for a large listed public company such as Telstra would most likely exceed $1,000,000.[94]

8.94 The CSA held this situation to be 'unacceptable'. It explained that in its desire to resolve the matter it has 'supported alternative proposals such as the square-root as a means of providing shareholders with an opportunity to express their views'.[95]

8.95 The CPA and ICAA in their submission to Treasury opposed the removal of the 100 member rule for calling special general meetings and the removal of the requirement for companies to disclose information reported to overseas exchanges. It submitted that 'the 100 member rule is a shareholder right and the fact that the right doesn't exist overseas is not an adequate basis for removing a local right'. It noted that

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92 Senator The Hon Ian Campbell, Parliamentary Secretary to the Treasurer, Media Release, Canberra, 2 December 2002.

93 Supplementary *Submission* 8A, p. 13.

94 CSA's *Submission* to Treasury on the Exposure Draft Bill for consultation—Corporations Amendment Bill 2002, p. 2.

95 CSA's *Submission* to Treasury on the Exposure Draft Bill for consultation—Corporations Amendment Bill 2002, p. 2. Michael J Duffy provides the following background on the square root rule: '…on 18 December 2000, the Minister for Financial Services and Regulation, Joe Hockey, proposed a compromise position: a test based on the numerical square root of the total number of members of a public company (ie, a company with 250,000 shareholders would have a threshold of 500 members) in response to criticism from the Australian Labor Party and others that this rule might in some cases lead to an unfairly high threshold, Mr Hockey in August 2001 floated the possibility that the square root equation might be subject to a cap of 500 members and a floor of 100. 'Shareholder Democracy or Shareholder Plutocracy?', *UNSW Law Journal,* vol. 25, No. 2, 2002, p. 441.

if the concern relates to abuse of the rule, then consideration should be given to refining the rule by specifying a minimum economic interest by each of the 100 members in the company rather than replacing the right.

The 100 member rule—no proposed change in CLERP 9

8.96 As noted above this matter of the 100 member rule is not contained in CLERP 9 but has been raised in evidence. The AICD acknowledged the reforms pertaining to shareholders' meetings in CLERP 9, but was disappointed that the '100 member' rule was not addressed. In its view, the rule has been used at times by special interest groups, comprising a tiny minority of shareholders, to force companies to call meetings to consider issues that do not attract any widespread interest amongst the body of shareholders.

8.97 IFSA submitted that section 249D should be amended so that members must comprise at least 5% of the votes that may be cast at the general meeting to be able to call a meeting.[96] Mr Sheehy told the Committee that the standard around the world is 5% and that in his opinion the 100 members is undesirable—not practical—and that a compromise was in order.[97] He explained further:

> The principles we espoused a couple of years ago are still the same, and they are that we believe that the number of shareholders required should be on some form of sliding scale relative to the size of the register, that there should be a cap and a floor and that there should be a minimum economic interest. The number should move with the size of the register. Those basic principles need to be enshrined. There was a proposal called the square root proposal. We are prepared to look at other measures if it is a bit too difficult to figure out what the square root is. We are open. We recognise that there needs to be a cap, that in some organisations the register is just so large that it will be seen to be too large.
>
> Likewise, there should also be a floor. We do not think it is appropriate that a shareholder who owns as little as one share can be counted, so there needs to be some minimum economic interest. We had talked a couple of years ago about $500. It is not an insurmountable amount of money, but those principles remain unchanged.[98]

8.98 Professor Ramsay agreed citing that a mere 100 shareholders in Telstra can call an extraordinary general meeting. He also used the NRMA as an example to show that the provision is 'inappropriate'. He concluded 'I think we need to ensure that shareholders with an appropriate entitlement have the right to call an EGM; I am just not convinced about the figure of 100 members.'[99] To the same effect, Mr Mayne

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96 Supplementary *Submission* 44A, p.3.

97 *Committee Hansard*, 18 March 2004, p. 56.

98 *Committee Hansard*, 18 March 2004, p. 55.

99 *Committee Hansard*, 18 March 2004, p. 13.

maintained that 100 shareholders is 'too easy' for the calling of an extraordinary general meeting which he believed 'should only be a last resort option because of the additional cost it imposes on the company'.[100]

Opportunity to place items on agenda—100 member rule

8.99 Those arguing for a change in the 100-member rule to call a meeting were clear in expressing the opinion that this did not apply to placing resolutions on the agenda of meetings. There was undoubted support for shareholders being able to place items on agenda at general meetings. For example, Mr Mayne stated that he would support changes that required 5 per cent of the capital for an EGM provided it was made easier to get resolutions at AGMs.[101] The Law Council told the Committee that:

> The Corporations Committee has put to government before that it regards the annual general meeting as an important venue for shareholders to be able to speak, that it would support provisions that assist people in putting matters on an agenda which are there for a proper purpose—that is, for a purpose relating to how the company is being run and questions that are being asked about that. It does not support the resources of a company being misapplied in the course of a year by unnecessary meetings, in particular for purposes which are often not corporate purposes.[102]

8.100 Mr Sheehy while advocating a change to the 100-member test to requisition a meeting, did not want any modification with regard to putting a resolution to an ordinary meeting. He accepted that that should be left alone. IFSA took the same approach.[103]

8.101 Mr Mayne told the Committee that while he would have no hesitation in putting up resolutions he would not call a EGM which he regarded as disruptive. He did, however, outline the difficulties for shareholders to have an item placed on the agenda of general meetings:

> That is because of the practical difficulty a small shareholder faces in getting 100 signatures to sponsor a resolution to be put up at an annual meeting; the odd union group and the odd green group have been able to do it, but for genuine small independent shareholders logistically it is very difficult. So I would love to see some sort of change to the 100-shareholder rule which would make it easier for shareholders to put up resolutions. I cite the situation in the US; there you only have to own $US2,000 worth of shares to be able to place a resolution on the notice paper. Last year at the Exxon Mobil AGM in Dallas there were 12 shareholder resolutions. If you

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100 Supplementary *Submission* 63A, p. [1].

101 Supplementary *Submission* 63A, p. [1].

102 *Committee Hansard*, 16 March 2004, p. 66.

103 Supplementary *Submission* 44A, p. 3.

> exclude Boral, we have not had 12 shareholder resolutions in Australia since the Vietnam War.[104]

Committee view

8.102 The Committee notes the disappointment expressed by some witnesses that CLERP 9 did not deal with the 100 member rule for the requisition of a meeting. Most who commented on the 100 member provision favoured its removal to be replaced with a higher threshold—some suggested 5% of members. The Committee understands and appreciates the argument for the removal of the 100 member rule and suggests that an alternative test may be required.

Recommendation 24

8.103 The Committee recommends that the 100 member rule for the requisitioning of a general meeting be removed from section 249D of the Corporations Act.

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104 *Committee Hansard*, 14 April 2004, pp. 27–28.

CHAPTER 9

MANAGEMENT OF CONFLICTS OF INTEREST BY FINANCIAL SERVICES LICENSEES

Background

9.1 There is general acceptance in the corporate world that independence and objectivity should be the bedrock principles of all analytical research. Recent debate about the independence of analysts, however, indicates a growing public concern about the various forces in the market that work against the adherence to such fundamental principles. People are aware that certain interests may jeopardise the independence and impartiality of research which is reflected in the content of the report and its consequent recommendations.

9.2 In 2001, the Association for Investment Management and Research published a position paper, *Protecting the Integrity of Research*, which identified the pressures on analysts that may bias their research and recommendations. In July 2002, it put forward its proposed Research Objectivity Standards for public comment. In the same year the Sarbanes Oxley Act was passed which required the Securities and Exchange Commission to adopt or authorise rules to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances. In May 2002, the Commission approved rule changes by the NYSE and the NASD governing research analyst conflicts of interest which according to the Commission 'significantly enhanced the disclosure of actual and potential conflicts of interest to investors'.[1] More recently, the International Organization of Securities Commissions released a Statement of Principles to guide securities regulators in addressing the conflicts of interest securities analysts may face.

9.3 In Australia, a similar debate about research has also spurred a number of institutions to review practices. In November 2001, the SIA/SDIA issued *Best Practice Guidelines for Research Integrity,* which set down ten key principles to assist analysts and their companies manage conflicts of interest that may compromise the integrity of research and recommendations. In September 2002, the Government released it policy proposal paper on CLERP 9 which contained a discussion on analysts independence and the following month the ASX released a Guidance Note which outlined what the ASX regarded as minimum standards of practice relating to independence of research, disclosure of interests and dealing before release of research recommendations. ASIC, which had been maintaining a watching brief on domestic and international issues on analyst conduct, published a surveillance report

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1 U.S. Securities and Exchange Commission, 'NASD and NYSE Rulemaking: Securities and Exchange Commission (Release No. 34–48252; File No. SR–NASD–2002–154; SR–NYSE–2002—49, 29 July 2003.

on research analyst independence in August 2003 before the Government released its exposure draft on CLERP 9. Since the release of this draft, ASIC has published its policy proposal *Licensing: Managing conflicts of interest,* and invited comment on the contents of this paper.

9.4 The various proposals and suggested guidelines and standards are grounded in shared notions of the principles that should inform research analysts. They are also based on a general acceptance of the important role that analysts have in maintaining investor confidence and market integrity. The SIA/SDIA described the role of the analyst as one that:

> …is to promote the efficiency of the market by gathering and analysing information and providing valuable insights on companies and industry trends.
>
> However, where an analyst's form offers both research and other corporate and trading services, the symbiotic relationship that exists between these activities has the potential to give rise to conflicts of interests which, if not properly managed, could damage investor confidence in the integrity of the market.[2]

9.5 The reviews are in agreement in identifying the influences at work that threaten an analyst's independence and objectivity and there is much common ground in the remedies they put forward. For example, the SIA/SDIA Guidelines recommend a number of specific measures that should be adopted by companies to ensure the integrity of any research they conduct and publish. The Committee notes in particular the guidelines to establish separate and distinct reporting structures within an enterprise; to enhance disclosure of interests; and to place certain restrictions on trading and research activities and the relationship between remuneration and revenue received through corporate activities.[3]

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2 Securities & Derivatives Industry Association and the Securities Institute, *Best Practice Guidelines for Research Integrity,* 2001, Introduction.

3 Securities & Derivatives Industry Association and the Securities Institute, *Best Practice Guidelines for Research Integrity,* 2001, Guidelines 2, 5 and 6. For example guideline 2 states, 'Where an analyst's firm offers both research and other corporate or trading services, it should provide separate and distinct reporting structures to ensure that the integrity of research and investment recommendations is not compromised.

Analysts should report directly to the Head of Research and should not submit research reports or investment recommendations to the firm's other corporate or trading units for approval'.

Guideline 5 states, ' analysts should not trade a security while they are preparing research on it or for a reasonable period after issuing research on it.

Analysts should not be allowed to trade in a manner inconsistent with their recommendations'.

9.6 In canvassing ideas on managing conflicts of interest, the CLERP 9 policy proposal paper explored the different obligations relating to conflicts of interest and posed a number of options for reform.[4] They included proposals:

- to separate research activities from other areas—to remedy the problem of analysts being involved in , or aware of, other financial activities within the same firm which could create conflicts of interest;
- to require financial services licensees, as part of their general duties, to ensure conflicts of interest are disclosed adequately and managed effectively;
- to impose certain conditions on financial services licensees for managing and disclosing relevant conflicts of interest;
- to prohibit specified conduct in regard to research activities similar to the current prohibitions on misleading and deceptive, unconscionable or dishonest conduct;
- to bring the obligations for general advice in line with those for personal advice; and
- to extend the range of disclosure obligations to capture a wider class of persons in Financial Services Guides and Statements of Advice.

9.7 In response to the proposals, ASIC recognised the important role of the analyst and was certain that there were insufficient protections to ensure that conflicts of interest were being managed appropriately. It submitted:

> The work of analysts is sufficiently influential to warrant special safeguards to ensure that direct and indirect users of reports can be reasonably confident that integrity is not flawed by conflicts. Conflict can occur either at the level of the individual doing the work, or in the organisational setting and context in which the work takes place.
>
> In ASIC's regulatory experience, it is uncertain and difficult to rely on the licensee's obligations to act efficiently, honestly and fairly as the sole basis to:
>
> (a) issue specific guidelines on minimum standards of conduct for a licensee or representatives of a licensee (eg individual researchers of an analyst); or
>
> (b) enforce specific minimum standards of conduct for a licensee or its representatives.[5]

9.8 It was in no doubt that the existing disclosure regime applying to general advisers does 'not provide a sufficient framework for conflict disclosure, as it applies to analyst's reports'.[6] It concluded:

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4 Commentary, p. 125.

5 *Submission* 15 to Treasury, November 2002, p. 27.

> The current regulatory approach leaves clients who receive and may rely on research reports to make financial decisions without disclosure of specific conflicts and remuneration arrangements relating to that report.[7]

ASIC was of the view that, at a fundamental level:

> …the Act needs to prohibit certain activities of analysts where conflicts cannot be effectively managed, and disclosure of such conflicts is not sufficient to mitigate consumer or market integrity risk. The activities that cause the most concern are those where the analyst or individual researcher has a direct pecuniary interest in the likely outcomes if clients acted on the recommendations or opinions expressed in the research report.[8]

9.9 ASIC also believed that retail clients who receive research reports need to be informed of conflicts of interest and remuneration arrangements by providers of such reports in order to be able to weigh up the merits of the opinions and recommendations given in the report. It suggested imposing a disclosure obligation that details conflicts of interest and remuneration arrangements. This information to be provided in the report.[9]

9.10 These views were also reflected in a surveillance report conducted by ASIC in 2003. Although the report found no contraventions of the Act, it did identify areas of concern likely to give rise to conflicts of interest that may threaten the integrity of the research. The report found:

- analyst remuneration comprises salary and bonus, but the calculation of the bonus component is not always transparent and depending on how it is calculated, paid and allocated, the bonus that is offered as a reward for work performed may unduly influence an analyst;
- reporting lines were in some cases unclear or misunderstood by both staff and management—ASIC found in particular that the ability of the research arm to have either solid or dotted line reporting responsibilities to the trading or corporate finance contaminates the independence of the research arm;

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6 *Submission* 15 to Treasury, November 2002, p. 27.

7 *Submission* 15 to Treasury, November 2002, p. 28.

8 *Submission* 15 to Treasury, November 2002, para. 2.12, p. 28. ASIC recommended prohibitions on

- trading by an analyst or its individual researchers in products that are the subject of a current research report, within a set period either side of the issue of the report (eg 30 days prior and 5 days afterwards); and
- trading by an analyst or its individual researchers against a recommendation or opinion contained in a current research report. ASIC considered that the current market misconduct provisions in the Act (eg the insider trading prohibitions) do not address the instances of the conduct described above.

9 *Submission* 15 to Treasury, November 2002, p. 30.

- heavy or singular reliance on staff integrity, coupled with weak or unenforceable trading policies—in ASIC's opinion this carries an unacceptable risk that conflicts would occur and go undetected;
- disclosure in form rather than in substance—ASIC did not regard the extent of disclosure to be adequate; and
- possible weakness in structure could permit corporate finance to exert undue influence on the research area.[10]

9.11 It concluded that the guidelines developed by SDIA and SIA ‘have not been adopted as uniformly and closely as is appropriate’. It went further to state that ‘even if fully implemented, it did not believe that they adequately address the deficiencies identified in the report’.

Conflicts of interest provisions in CLERP 9 Bill

9.12 Originally, the CLERP 9 discussion on conflicts of interest focused on research analysts. This approach changed somewhat by the time the exposure draft bill was released and the Bill presented in Parliament. The Explanatory Memorandum noted that under the current regulatory regime, Financial Services Licensees are required ‘to do all things necessary to ensure that the financial services covered by the licensee are provided efficiently, honestly and fairly’.[11] It stated further:

> While industry has widely accepted that this would include managing conflicts of interest, the duty was not express in its application to conflicts of interest.
>
> It was considered that any new provision should not be limited in application to analysts, but should also provide for financial services licensees more generally, as the potential for conflicts of interest to arise are not limited in application.[12]

9.13 The proposed legislation is intended to supplement the existing general duty to provide financial services ‘efficiently, honestly and fairly’ by imposing a new obligation regarding the management of conflicts of interest on financial services licensees. Proposed subsection 912A(1)(aa) would require a financial services licensee to 'have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative'.

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10 *Research analyst independence, ASIC, surveillance report,* August 2003, pp. 24–29.

11 Section 912A of the Act.

12 Explanatory Memorandum, p. 204.

9.14 ASIC may suspend or cancel an Australian financial services licence if the licensee has not complied with their obligations under section 912A.[13] ASIC also has the power to make a banning order against a person who has not complied with their obligation under section 912A.

9.15 The Explanatory Memorandum advised that adequate arrangements for managing conflicts of interest would include:

> …ensuring that there is adequate disclosure of conflicts to investors, who can then consider their impact before making investment decisions. It will require internal policies and procedures for preventing and addressing potential conflicts of interest that are robust and effective.[14]

9.16 The provision received general support from submissions that commented on the proposal to place this additional licensing obligation on Financial Services Licensees.[15] The ANZ noted that this requirement will supplement the general duty to provide financial services 'efficiently, honestly and fairly' and would 'provide a stronger legislative basis for ASIC to develop guidance and take enforcement action'.[16] The NIA also recognised that the requirement goes beyond analysts to other financial services licensees who 'will face the same pressures in relation to conflicts of interest'.[17] It specifically mentioned remedies in relation to failures to address conflict of interest issues and suggested that 'Even in circumstances where a person has not suffered a loss as a result of a failure to disclose a conflict of interest, there should be some form of penalty for not disclosing such'.[18] A number of concerns were raised, however, including:

- confusion over what constitutes financial and non-financial services;[19]
- the specific remedies to address failures to address conflict of interest issues;[20]
- the issue of compliance costs—CUSCAL argued that the provision 'introduces a specific new obligation for AFS licensees'.[21]

9.17 As discussed earlier, the original rationale for this proposal was to ensure independence of analysts. It will now apply to a much wider spectrum of licensees.

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13 Section 915C of the Act.

14 Explanatory Memorandum, pp. 204–5.

15 *Submission* 5, p. 21; *Submission* 11, p. [4]; *Submission* 14, p. 14; *Submission* 19, p. [10]; *Submission* 24, p. 29.

16 *Submission* 14, p. 14.

17 *Submission* 25, p. 50.

18 *Submission* 25, p. 50.

19 *Submission* 11, p. [4].

20 *Submission* 25, p. 50.

21 *Submission* 43, p. 3.

ASIC says licensees will have to have in place measures, processes and procedures that are regularly monitored, reviewed and updated to meet the new AFSL obligation. According to CUSCAL, this will add to the considerable compliance burden already imposed on credit unions by the FSR legislation 'when the real target of the measure is conglomerate firms and responding to developments in the global financial services industry.'[22]

9.18 Before ending discussion on managing conflicts of interest, the Committee refers to the ASIC policy proposal paper, *Licensing: Managing conflicts of interest,* released in October 2003. The paper was based on the conflicts management obligations and explains how ASIC would expect licensees to comply with the proposed obligation under CLERP 9. It notes a number of proposals including:

- controlling conflicts—licensees should ensure that, regardless of the presence of conflicts, their services are provided in a way that clearly demonstrates fairness, honesty and professionalism;
- disclosing conflicts—licensees should ensure that they provide clients with sufficient disclosure about conflicts of interest; and
- avoiding conflicts—in some cases, the continuing presence of a conflict (even if disclosed) will be incompatible with the fair, honest and professional provision of the affected services. If so, licensees should either
  - decline to provide the affected financial service; or
  - ensure that the conflict is avoided entirely.[23]

9.19 The ADIA/SIA best practice guidelines use the same strong language to convey the understanding that certain matters should be disclosed and that certain practices should be avoided. For example analysts should not trade a security while they are preparing research on it; and analyst's remuneration should not be directly linked to revenue received through corporate activities in which the analyst has been involved.

9.20 Under the Sarbanes Oxley Act, rules must be adopted to address conflicts of interests that can arise when securities analysts recommend equity securities in research reports and public appearances. It also sets down the requirement for rules in relation to the disclose of conflicts of interest. As well as these overarching requirements, the Act specified in greater detail matters to be covered by the rules. For example, the Act requires that rules be adopted to establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure or oversight of those who might potentially bias their judgement or

22 *Submission* 43, p. 3.

23 ASIC, ASIC Policy Proposal, *Licensing: Managing conflicts of interest (with Specific guidance for providers of research reports),* October 2003, pp. 8–9, 13.

supervision. Rules are also to be adopted governing disclosure on specific matters such as the extent to which the securities analyst has debt or equity investments in the issuer that is the subject of the appearance or research report. Also, whether the securities analyst received compensation with respect to a research report, based upon the investment banking revenues.[24]

9.21 ASIC's position has departed from its initial response to the policy proposal paper of September 2002. Rather that adhere to the notion that there are some situations that must be avoided altogether, it now asserts that:

> The fundamental proposition in our own published policy proposal is that you cannot identify a particular piece of conduct that you would say in every case cannot be managed adequately by disclosure. It all depends on the particular circumstances of the licensee and the particular interaction that they have with their clients. You cannot say that a particular piece of conduct will always involve you in a conflict that you cannot manage by disclosure and you must refrain from it. I think we have not taken the view that we should go as far as prescribing some conduct as always necessarily involving a conflict that cannot be dealt with by disclosure. It is a slightly academic point. It is not possible—particularly in the context of Australian financial services licensees, with the vast spectrum of activities that they engage in and the vast spectrum of relationships they have with their clients, whose interests might be damaged by a conflict—for you to prescribe a rule saying, 'This conduct will always fit into that category, whereas that kind of conduct will always be able to be managed by disclosure.'[25]

9.22 Mr Malcolm Rodgers, ASIC, did not think that the legislation was weakened by the failure to prohibit certain activities. He believed that ASIC could deliver the results under a 'general obligation that will play out in the same way'. He explained that at the beginning of the process ASIC saw the practical enforcement of the management of conflict of interests being made easier by prescribing prohibitions in the law.[26] He went on to repeat the argument that having 'reasonably high levels of generality is that it is very difficult for the regime to anticipate in every case in advance where a particular problem might occur'. According to Mr Rodgers 'we can administer the provisions in the present bill in a way that will give robust effect to that legislation'.[27]

9.23 The Australian Consumers' Association, however, was concerned that attention needs to be given to the avoidance requirement for some conflicts that have arisen in financial services. Ms Catherine Wolthuizen elaborated further:

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24 Sarbanes-Oxley Act of 2002, section 501.

25 *Committee Hansard*, 29 April 2004, p. 35.

26 *Committee Hansard*, 29 April 2004, p. 42.

27 *Committee Hansard*, 29 April 2004, p. 42.

> Ultimately, this regime is more about disclosing to a consumer and ASIC assessing the quality of the disclosure. Another question that arises is that, even if we do get to a point where disclosure could be deemed effective and you disclose to someone, for example, that you were a participant in the luxury cruise around the South Pacific that was held by one of the major funds at the start of this year, and the consumer understood that, again, if most of your competitors are engaging in similar conduct, it does not necessarily cure that kind of behaviour or provide any kind of disincentive to that sort of behaviour.
>
> Moreover, it still leaves that corrosion of trust that an efficient financial services market should be fostering between consumers and intermediaries and that enables a consumer who may not otherwise be able to assess and evaluate the products on the market to choose the one most appropriate to their needs.[28]

In a more general context, the ACA submitted:

> Reform of regulation in this area must start from the recognition that disclosing and managing conflicts of interest are two different things. Merely admitting to conflicts does not reduce their capacity to undermine the integrity of advice, especially where it is being provided to a retail investor, a class of client which ASIC has identified as 'the primary consumers of sell-side research'. Some conflicts of interest are so damaging to the independence of investment advice, that they cannot be 'managed' and appropriate measures should be implemented to ensure such practices are avoided altogether.[29]

Committee view

9.24 The Committee was impressed with the forthright stance taken at first by ASIC in its response to the CLERP policy proposal paper in 2002. It notes the certainty with which ASIC expressed its opinion that the existing disclosure regime applying to general advisers did not provide 'a sufficient framework for conflict disclosure, as it applies to analysts' reports'. It also notes:

- ASIC's view that 'the Act needs to prohibit certain activities of analysts where conflicts cannot be effectively managed, and disclosure of such conflicts is not sufficient to mitigate consumer or market integrity risk;' and
- ASIC's suggestion about imposing a disclosure obligation.

9.25 ADIA/SIA assumed an equally firm position in its best practice guidelines to the disclosure of conflicts of interest and on the prohibition of specific activities maintaining that certain matters should be disclosed and certain practices should be avoided.

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28 *Committee Hansard*, 7 May 2004, p. 37.

29 Draft submission, Australian Consumers Association, p. 2.

9.26 The Committee can see advantages in having the legislation stipulate certain disclosure requirements and particular circumstances that should or must be avoided. There are numerous prohibitions contained in the Corporations Act for example section 448C disqualifies certain persons from acting as company administrators in certain circumstances. The prohibitions do not have to be exhaustive. Clearly a ban sends an unmistakable message that certain conduct or situations will not be tolerated. As it stands, the legislation does not deliver that strong message. ASIC's policy statement is left with this task.

Recommendation 25

9.27 The Committee recommends that the Government examine carefully ASIC's submission to Treasury and its surveillance report on research analyst independence with a view to amending the provisions on managing conflicts of interests to provide clearer direction on circumstances that must be avoided and activities that must not be undertaken because of conflicts of interest.

CHAPTER 10

RELATED MATTERS—POLITICAL DONATIONS, BENEFICIAL OWNERSHIP

10.1 During the course of the inquiry a number of matters were raised that are not contained in CLERP 9 though they relate to some of the fundamental principles that underpin the legislation—accountability, transparency and shareholder participation. This chapter looks at two such matters— corporate political donations and beneficial ownership.

Political donations

10.2 Senator Andrew Murray, Australian Democrats, made available to witnesses a proposal in the form of a draft amendment for their response. The amendment would make it unlawful for a company or an officer of a corporation to:

(a) make any political donation to a political organisation unless:

(i) the political donation is authorised by a resolution passed at an approved general meeting by a majority of shareholders of the corporation before the relevant time; or

(ii) the political donation is made on the authority of the corporation, board or management body in accordance with a donation policy which has been approved by a general meeting of the corporation before the relevant time.[1]

Political donations and the policy underlying the making of donations

10.3 Statistics gathered from a recent CSA's Rapid Response Survey showed that the majority of companies surveyed did not make political donations with only 29% of respondents making political donations at the local, state and federal level. The survey also indicated that currently 79% of respondents have a policy on political or charitable donations and 59% of these companies disclose these policies to shareholders.[2]

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1 This is consistent with a recommendation put forward in Supplementary Remarks by Senator Andrew Bartlett and Senator Andrew Murray in Parliamentary Joint Committee on Electoral Matters, *Report of the Inquiry into the conduct of the 2001 Federal Election and matters related thereto.*

2 Supplementary *Submission* 8A, p. 3.

Disclosure and shareholder approval for political donations

10.4 CSA endorsed the 'overarching principle of disclosure of information to the market so that investors can make informed decisions about their investments'. In keeping with this principle, it supported the disclosure of political donations in a company's annual report. Further, it suggested that listed companies should be encouraged to develop donation policies and to make such information readily available to the public notably through the company's website. According to CSA, 'Development and disclosure of a policy would provide investors with sufficient information on which to make their investment decisions'.[3] It rejected, however, the proposal that companies must seek shareholder approval for individual donations. In its opinion:

> Approval of specific donations, if they are made, is a matter for the board and management.[4]

10.5 Telstra was of the view that it is 'reasonable for shareholders to ask how political (and other) donations serve a company's interests'. It cited Justice Owen's opinion in the Report of the HIH Royal Commission:

> In discretionary areas of this kind there is a possibility of abuse. The principles in accordance with which donations are made call for consideration at board as well as management level together with appropriate disclosure.[5]

Telstra also quoted Sir Gerard Brennan who said:

> There are sound reasons of policy for imposing a limitation on directors' powers to donate corporate assets. Investors, whose charitable inclinations are diverse, do not authorise directors to dispose of corporate assets to charitable objects of the directors' choice. The choice should remain with the individual investor when he or she obtains his or her share of the distributed profits. From the moral viewpoint, there is no virtue in a directors' resolution to dispose of corporate assets to a charitable object. Virtue consists in the giving of what is one's own, not in the giving of assets that belong to another.
>
> However laudable the object of the donation, discretionary payments of this kind from the funds of shareholders should be undertaken in a transparent and justifiable way with full regard to the interests of the shareholders. Companies should develop their own guidelines for the disclosure of their arrangements for the stewardship of corporate donations. Guidelines should cover the disclosure to shareholders of donations made to charitable,

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3 Supplementary *Submission* 8A, p. 3.

4 Supplementary *Submission* 8A, p. 3.

5 Supplementary *Submission* 41A, p. 1.

> philanthropic, political or other discretionary objects together with a statement of the rationale for those payments.[6]

10.6 Consistent with these views, Telstra supported the requirement that listed companies disclose their policy regarding political donations and the details of donations made in the period under review in their annual report. It observed that this disclosure would rightly be the subject of discussion at the annual general meeting. It did not agree with the proposal that the company's policy on donations and the actual donations should be subject to shareholder approval at the annual general meeting. It submitted:

> …such a requirement would encroach on a matter that is properly left to the discretion of the board and management (subject to full disclosure to shareholders in the annual report) and could continue a trend where significant amounts of time at company general meetings are spent addressing matters largely unrelated to the overall operations and performance of the company.[7]

10.7 The AICD thought that in part political donations by companies were becoming less common because such donations are 'required to be disclosed under other legislation'. It also pointed out that there is increased opportunity for shareholders to ask questions about donations or the underlining policy at a company's general meeting. Thus, it could not support the proposal that shareholders approve the company's policy on donations or on the actual political donations.[8]

10.8 Mr Tom Ravlic endorsed the proposal that the existence and quantum of political donations be disclosed. He maintained that shareholders are entitled to 'be told in no uncertain terms what their companies are doing with their funds'.[9] He did not support the proposal for companies to obtain shareholder approval on matters dealing with political donations. He placed this matter in the context of the responsibilities residing with the members of the board in that they are 'charged with the task of making decisions they believe are appropriate and company management are charged with the task of making decisions they believe to be in the interests of the entity'. In his opinion there is no need:

> …to further clutter the law with disclosure and penalty provisions that may end up making the administration of corporations far more onerous than necessary. It is advisable to keep it simple and require disclosure of political donations. Non-disclosure of such donations should be penalised in a similar

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6 Supplementary *Submission* 41A, pp. 1–2.

7 Supplementary *Submission* 41A, p. 2.

8 Supplementary *Submission* 35A, p. 2.

9 Supplementary *Submission* 1E, p. [1].

> fashion to that which failures to follow continuous disclosure rules are dealt with.[10]

Committee view

10.9 The Committee notes the support given to the concept that companies should disclose their policy on political donations. The Committee agrees that shareholders are entitled to know about their companies conduct in regard to making donations. It also appreciates the opposition to the suggestion that the policy and the donations should be subject to shareholder approval.

Recommendation 26

10.10 The Committee recommends that provisions be inserted in the Corporations Act that would require the annual report of listed companies to include a discussion of the board's policy on making political donations.

Disclosure of beneficial ownership

Background

10.11 Before changes to the Corporations Law in 1995, companies were required to maintain a number of company registers. The public had access to them so that they could obtain information on the status of the company and those involved in the company. One such register contained notices of beneficial ownership in the listed company. Under the First Corporate Law Simplification Act, companies were no longer required to maintain that particular register. The measure was intended to remove unnecessary duplication. The Act recognised that much of the information in company registers must also be given to ASC. In practice the Government believed that it would be 'quite simple for members of the public to access this information through the ACS's electronic searching facilities and through the ASX in the case of listed companies rather than going to a company's offices and searching registers kept by it'.[11]

Proposal to require disclosure of beneficial owners

10.12 The Australasian Investor Relations Association (AIRA) informed the Committee that a listed entity can only access its own beneficial shareholders which makes it difficult for one investor to know the names of the other investors in the company. It explained further:

> …the top 20 shareholders listed in the annual report are the registered shareholders so, to some extent, it is meaningless because a large number of them are nominees, custodians. So we do not see why beneficial

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10 Supplementary *Submission* 1E, pp. [3–4].

11 The Hon M.H.Lavarch, Second Reading Speech, *House Hansard,* 8 February 1995, p. 705.

> shareholders should not be known. This inadvertent outcome of the corporate law simplification program has meant that in Australia we have less transparency than in other markets such as the UK and the US. It probably also helped retail shareholders to see which large institutions own that stock.[12]

10.13 AIRA noted that under section 672 ASIC can lodge notices at its own discretion or as requested by a shareholder of a company. It was concerned, however that ASIC charge $500 for every notice that they lodge on behalf of a shareholder. In its view:

> For the purposes of transparency, it is very expensive exercise for any shareholder…to request ASIC to obtain that information on their behalf; and, even then, that information is not required to be disclosed publicly. In a sense, ASIC are a guilty party in the process as well.[13]

10.14 Mr Dean Paatsch, Governance Information Products, stated his belief that all shareholders in the market ought to be able to obtain information on beneficial ownership of listed entities. To his mind, such information is 'market relevant information'—'it is price relevant and it is in the interests of the transparency of the market as a whole'. He asserted that this interpretation has been 'supported both by several court decisions and recently by a decision of the Takeovers Panel'. According to Mr Paatsch, the interests of good corporate governance would be served by having information about the true owners of Australian companies available to shareholders. Finally, making such information available would bring Australia into line with the practices in other jurisdictions. He explained:

> In the UK and the US beneficial ownership information, where it is in existence, is in the public domain, and we believe that Australia ought to be brought into line with those other jurisdictions. The final point that I would make in relation to the suggestion is that it is a very simple suggestion to put into action. The information would only need to be put in the public domain where it was in existence. It would not require a listing rule to support it. It would be kept in parallel with other record-keeping requirements for the register. The general shareholder register is available for inspection as well.[14]

10.15 Mr Mayne was another witness who agreed with the proposition that listed companies be required to keep a publicly accessible register of beneficial owners. He saw a clear benefit arguing that public companies should 'not be able to hide the fact that you are a shareholder in a public company and that if companies have that

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12 *Committee Hansard*, 29 April 2004, p. 6.

13 *Committee Hansard*, 29 April 2004, p. 9.

14 *Committee Hansard*, 14 April 2004, p. 17.

information 'it should be in the possession of the shareholders who actually own the company'.[15]

10.16 Mr Charles Berger, Australian Conservation Foundation, concurred with other witnesses who had spoken on this matter of disclosure of beneficial ownership. He maintained that there has been a 'total breakdown in accountability' and identified three reasons for people having access to information about beneficial ownership. According to Mr Berger, the right to access this information goes to the heart of democracy, accountability and the protection of investors because the information:

- is market relevant even if ownership falls below the 5 per cent threshold;
- is essential to ensuring compliance with the law—not only in regard to the 5 per cent disclosure but also rules about insider trading;
- allows people who are affected by Australian corporations to exercise their right to know who they can petition when that are affected by their activities.[16]

10.17 Mr Paatsch put forward what he regarded as a sensible and straightforward suggestion of 'reinstating an earlier provision which was deleted by the first corporate law simplification act in 1995. He argued that the simplicity of the proposal is that 'only where information has been delivered and collected would you be required to put it on the public register'. He stated further:

> We have come an awfully long way in information technology such that, whereas in the past there may have been some sympathy to the argument that it was difficult or costly to keep those records, really, the information is in existence. It has already been paid for by shareholders of the company. It is difficult to sustain that argument. It is really a question of disclosure. We are not suggesting that the disclosure be any more onerous than is currently the case with their register, so there would be no requirement for them to publish to the ASX. They would simply maintain a register available for inspection in the same way that they normally would.[17]

Committee view

10.18 As noted by the AIRA, a shareholder can request ASIC to lodge tracing notices on their behalf but for a cost of $500 for each notice they lodge. In the Committee's view, this imposition is not consistent with the objective of having relevant information readily available to the public and the original intention of the legislation has been lost.

15 *Committee Hansard*, 14 April 2004, p. 37.

16 *Committee Hansard*, 7 May 2004, p. 22.

17 *Committee Hansard*, 14 April 2004, p. 20.

10.19 The Committee appreciates the arguments put forward to increase the transparency of company ownership by making available to shareholders the names of beneficial owners of their companies. The suggestion that companies if they have the information make it available to their shareholders appears reasonable, sensible and in the public interest.

Recommendation 27

10.20 The Committee recommends that the Government reinstate in the Act the requirement for listed companies to keep a public register of notices of beneficial ownership.

CHAPTER 11

CONCLUSION

General support for CLERP 9

11.1 In this report, the Committee focused on areas of concern with CLERP 9. It must be stressed, however, that, overall, submissions to the inquiry supported the thrust of the reforms put forward in the proposed legislation.[1] The ASA was one of many submissions that welcomed the changes.[2] The CSA and its members believed in the main that the provisions in CLERP 9 would 'make a significant contribution to restoring investor confidence in Australia'. It saw the proposals 'as reinforcing existing good practices, rather than imposing a straitjacket on corporate behaviour'.[3] The ANZ maintained that the proposal arrived at 'a sensible balance between corporate disclosure, raising audit standards, and enhancing opportunities for shareholder engagement'.[4]

11.2 Taking a similar view, the Securities Institute stated that the CLERP 9 legislation represents:

> a reasonable, balanced and considered initiative by the Government to improve transparency and disclosure in the financial reporting process, ensure quality and consistency in auditing services, foster accountability and corporate governance awareness, promote an informed market and build investor confidence in our capital markets and in investing in Australian securities. [5]

11.3 The Finance Sector Union also generally supported the majority of the proposed reforms but as with many of the participants in this inquiry called for some improvements.[6]

11.4 This chapter briefly outlines a number of non-controversial issues in CLERP 9 including the improved presentation of disclosure documents, provisions regarding

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1 See for example Australian Council of Super Investors, *Submission* 5, p. 1, which recognised and supported 'the general thrust of the proposals to improve shareowner participation'. See also *Submission* 18, p. 1; *Submission* 19, p. 2; *Submission* 25, Executive Summary; *Submission* 30, p. 1.

2 *Submission* 22, p. 1.

3 *Submission* 8, p. 4.

4 *Submission* 14, p. 3.

5 *Submission* 11, p. [1].

6 *Submission* 38, p. [1]. The Finance Sector Union called 'for greater accountability to stakeholders, rather than just greater disclosure to shareholders.'

changes to the definition of senior manager, and the proposed increase in the period of disqualification for directors.

The Presentation of Documents—clear, concise and effective disclosure

11.5 Three key documents, known as disclosure documents, form the very core of information that investors need to make informed decisions—prospectuses, profile statements and offer information statements. The legislation sets down the information that must be contained in disclosing documents. Under the proposed legislation these requirements remain in force but to further enhance the value of the information, the Bill looks to improve how that information can be better presented.

11.6 The Bill requires that the information in a disclosure document be worded and presented in a clear, concise and effective manner. A contravention is not an offence but ASIC may make a stop order if a document does not meet the requirements. Should the person making the offer become aware that information in the disclosure document is not worded and presented in a clear, concise and effective manner, the proposed legislation would allow that person to lodge a supplementary or replacement document with ASIC.

11.7 Few submissions commented on this provision. The Australian Shareholders' Association and IFSA supported the requirement that disclosure documents such as prospectuses be presented in a clear, concise and effective way.[7] Some, such as the Securities Institute, questioned the need for such a general and potentially subjective requirement. It suggested that ASIC provide corporate issuers with 'appropriate guidance, thereby engendering confidence when preparing a prospectus'.[8] The ANZ, for example, had reservations about the term concise and its openness to interpretation and hoped that as this concept develops in practice that a clearer sense of what constitutes 'ambiguous, vague or unclear' information develops.[9] The National Institute of Accountants qualified its support for the requirement by adding that the disclosure not detract from the level of information that is provided.[10]

Committee view

11.8 The Committee understands that the requirement to present documents in a clear, concise and effective manner is open to subjective assessments. Even so, the Committee believes that the requirement provides a necessary reminder to financial services providers of their obligations to ensure that consumers are provided with information necessary for them to make an informed decision about financial products and to make the most appropriate choice for their needs.

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7 *Submission* 22, p. 6; *Submission* 44, p. 7.

8 *Submission* 11, p. [6].

9 *Submission* 14, p. 13.

10 *Submission* 25, p. 44.

Definitions—officer, senior manager and employee

11.9 In April 2003, the Hon Justice Owen handed down his report into the collapse of HIH Insurance. He noted some deficiencies in definitions used in the Corporations Act.

11.10 The Explanatory Memorandum acknowledged these findings and stated that the proposed amendments were designed to clarify the classes of personnel who have duties and obligations under the Act. The changes include having one definition of officer as contained in section 9 which generally covers persons who have a degree of influence or potential influence over the general conduct of the entity.

11.11 A definition of senior manager is also inserted in section 9. Again the definition reflects the important level of influence and decision-making that the position carries.

11.12 The measures to clarify and generally tidy up the definitions of the various classes of personnel drew little comment. The Australian Shareholders Association and the NIA welcomed the changes to establish the one meaning for officer.[11]

Committee view

11.13 The Committee regards the proposed changes as appropriate.

Disqualification of directors

11.14 Section 206B of the Act provides for an automatic five-year disqualification period from managing corporations for persons convicted of an offence specified in that provision. They include offences that have the capacity to affect significantly the corporation's financial standing that is punishable for a period greater than 12 months or an offence that involves dishonesty and is punishable by imprisonment for at least 3 months. The Bill inserts section 206BA which would allow Courts to disqualify persons for up to a further 15 years on application by ASIC. The application must be made within the first year of the automatic disqualification.

11.15 Section 206D of the Corporations Act currently gives the Court, on application by ASIC, power to disqualify persons from managing corporations for up to ten years if that person has within the last 7 years been an officer of 2 or more corporations that have failed. The Court, however, must be satisfied that management was responsible wholly or in part for the collapse and that the disqualification is justified. The Bill increases the maximum period of disqualification to 20 years.

11.16 The Bill also proposes to clarify the contents required in ASIC's register of disqualified company directors and other officers. The CSA noted that the relevant

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11 *Submission* 22, p. 8; *Submission* 25, p. 49.

section nominates all persons who are disqualified as a result of breaches of sections 206C, D, E and F but does not mention section 206B.[12]

11.17 Of the submissions that commented on this proposal the great majority supported the measures with some suggesting that stronger steps should be taken to ensure that people deemed unsuitable to manage a company are not permitted to do so. The suggestions included:

- the legislation to provide direction to the Courts to ensure that a disqualified director is not in a position to manage the company in a de facto senior manager's role;[13]
- a longer period of disqualification due to 'the long term influence of the board and board members on a corporation's culture and operations'—the Australian Shareholder's Association suggested a life-time ban for a director found to 'have a cavalier attitude to the law';[14]
- the provision to disqualify directors where they 'have failed to meet their liabilities (not just debts) including employee entitlements and superannuation contributions'.[15]

11.18 The Centre for Corporate Governance, however, objected to the increase in the maximum period of disqualification to 20 years on the grounds that the 10-year period has only been in operation since March 2000 and there is no evidence justifying the increase. The Centre 'was unable to uncover a case in which s 206D had been used to impose the maximum penalty of 10 years' and hence in 'the absence of evidence of the need for doubling the maximum penalty suggests…that there is no such need'. It also opposed raising the maximum period under automatic disqualification clauses from 5 to 20 years.[16]

11.19 The Committee during its inquiry into Australia's insolvency laws looked at unlawful phoenix company activity where director disqualification is one of the main avenues used to deter or prevent this type of conduct. A number of submissions urged the Government to introduce stronger measures to defeat the occurrence of this type of activity including harsher penalties for directors who promote the use of a phoenix company. Submissions to that inquiry also wanted better systems to identify and record directors who have been office bearers of insolvent companies. Comments were also made about the enforcement side of the legislation. In the view of CPA Australia:

12 *Submission* 8, p. 7.

13 *Submission* 8, p. 7.

14 *Submission* 22, p. 3.

15 *Submission* 38, p. [2].

16 *Submission* 21, p. 16.

> There is a perception that the preponderance of phoenix companies is due, in part, to lack of prosecution by the ASIC for offences committed and in part, to lack of sufficient investigation by liquidators.

11.20 The Committee also notes the following findings of the Cole Royal Commission in relation to unlawful phoenix company conduct which tie in with penalties for misconduct and the register of offenders:

- implement measures to check all new company officers against the National Personal Insolvency Index and to check that current directors have not been declared bankrupt (recommendation 106);
- an increase in the maximum penalties for offences associated with fraudulent phoenix company activity (recommendation 108);
- extending ASIC's power of disqualification to permit disqualification where a person on one occasion was an officer of a corporation which has been wound up and been the subject of a liquidator's report (recommendation 109).

Committee view

11.21 The Committee notes the general approval of the increase in the periods of disqualification for directors for specified breaches of the Corporations Act. The Committee understands, however, that the Cole Royal Commission took a much stronger stand against directors convicted of an offence. Furthermore, the Committee notes that a number of witnesses supported the introduction of such measures.

11.22 Although concerned with promoting good corporate governance, the focus of CLERP 9 was not primarily on directors. As noted above the Committee discussed some matters relating to the duties and accountability of directors in its report on Australia's insolvency laws. It also touched on such concerns in this inquiry particularly with regard to executive remuneration and multiple directorships. It is the Committee's view that an increase in the period of disqualification for directors is appropriate but that further investigation is needed to establish whether the enforcement side of the disqualification provisions is working or could work more effectively.

11.23 The Committee appreciates that the passage of the Bill has general support. It has made recommendations to address what it believes are important matters. In some cases, however, while the Committee has taken care to document areas of concern, it did not make specific amendments to address less significant perceived deficiencies. It draws the Government's attention to comments made in this report which suggests that the government:

- review the section on whistleblowing in the Explanatory Memorandum to rectify anomalies; (paragraph 2.88);

- consider the inclusion of a requirement that a notice of meeting must state the nature of the business to be transacted at the meeting in sufficient detail to enable a shareholder to form a reasoned judgment (paragraph 8.9);

- take account of the concerns of the ASA in regard to guidelines for the procedures for a body corporate to appoint a representative who is to vote as a member's proxy; (paragraph 8.32); and

- address the concerns of the CSA that the provisions governing the register of disqualified directors do not include those disqualified under section 206B (paragraph 11.16).

Conclusion

11.24 This report has examined aspects of CLERP 9 that deal with promoting the reporting and investigating of wrongdoing within companies, improving the disclosure provisions of executive remuneration, introducing infringement notices for breaches of the continuous disclosure regime, increasing penalties for certain offences, and facilitating shareholder participation through more effective and improved communication and the presentation of information.

11.25 The proposed legislation has placed a heavy reliance on disclosure and on the active involvement of shareholders and, in the case of the whistleblowing scheme, on persons working in or for companies to promote good corporate governance. The Committee believes that these measures are a vital first step toward building trust and confidence in Australian corporations. Clearly, while participants in the inquiry offered general and wide support for CLERP 9, many held reservations about particular features of the proposed legislation. The Committee has made recommendations to address some of these concerns but, as with the majority of witnesses, welcomes the reforms.

SENATOR GRANT CHAPMAN
CHAIRMAN

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CLERP 9 MINORITY REPORT

AUSTRALIAN DEMOCRATS

SENATOR ANDREW MURRAY

Executive summary

In this Minority Report we have briefly outlined our broader philosophical position, and the areas in which we will be seeking to amend the CLERP 9 legislation. To a limited extent we have also indicated our reaction to the recently circulated amendments proposed by the Australian Labor Party (ALP).

Our amendments will include:

- **Requiring disclosure of all executives' and employees' packages that are more than 20 times the full-time adult ordinary time earnings. Based on the December 2003 weekly figure of $937.70[1], this would require reporting of all remuneration packages of over $975,208.**
- **A binding vote being required to approve the remuneration and retirement packages of *all* directors whether executive directors or non executive directors.**
- **Amending section 249D to ensure that such members hold marketable parcels of shares, which could be defined as a minimum of 100 shares per shareholder at a value of not less than $500 per parcel.**
- **Extending the requirement to vote on material corporate governance resolutions to fund managers.**
- **Requiring shareholders of companies to approve a political donations policy at least once every three years.**

Introduction

The Australian Democrats are and have been strongly supportive of the process and intent of the Corporate Law Economic Reform Programme (CLERP). Over nearly a decade of reform, we have been engaged in the community, the Committee and in the Senate at every stage of the CLERP process, as well as Financial Services Reform (FSR) and all the previous manifestations.

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1 ABS, Average Weekly Earnings (6302.0)

I support the Report of the Committee. Nevertheless despite its quality, it is lacking in a number of respects. Hence this minority report.

The Democrats recognise that the majority of changes proposed by the CLERP 9 legislation will improve corporate governance. In some areas, the legislation makes considerable leaps forward in terms of accountability and good process.

CLERP 9's provisions will be supported by us and should be commended; however, we should recognise that the legislation is not really disturbing the fundamental relationship between shareholders, executives, directors and the auditor.

Many seem to believe that traditional Australian ways of dealing with such relationships should not be disturbed. We make the point that other countries have different and workable models, and Australia should keep an open mind on productive change. We also make the point that the traditional relationship between shareholders, executives, directors and the auditor in Australia has been exposed as having some real weaknesses.

Community concern requires more than process changes

Like all politicians and political parties, we respond to voter concerns.

Community concern with corporate governance is alive and strong. Community concern is less concerned with law than with ethics and morality. It wants its expectations met.

Our judgement is that Australians are looking for more than process and technical changes in corporations law. They are looking for legislation to drive a change to corporate behaviour that is value-driven from a moral and responsible perspective, particularly with respect to wider society.

Legislative and regulatory change needs to catch this mood and reflect it. As a broad judgement, we believe that CLERP 9 does not reflect this mood.

It is self-evident that corporate law needs to be practical and effective and able to contribute to and facilitate the growth of Australia's national wealth.

The process of corporate law reform needs to take heed of the realities of domestic and international markets. It also has to ensure that society's values, needs and demands are properly reflected in corporations law. To do that requires attention to or at least a perspective from the behavioural sciences, ethics, and moral philosophy.

Better process and checks and balances in the corporations law are genuinely helpful in restraining the unscrupulous, greedy or delinquent. Far better would be a change to corporate culture and values to win back some of the community trust that business—particularly big business, has lost.

The PricewaterhouseCoopers report into the recent $360 million National Australia Bank foreign exchange trading scandal found that:

> The Board and CEO must accept responsibility for the 'tone at the top', and for the environment in which management did not report openly on issues in the business.[2]

The community has told politicians 'it wants something done'. That general message has been heard and will result in more prescription. CLERP 9 is one vehicle. It does not go far enough.

In a democracy, social principles are buttressed by law based on moral obligation, and work best when reinforced by a belief that you can trust the participants to work to the spirit of those principles and morals.

Put simply, in Australia and much of the Western World, society has passed judgement. Those who run corporations are often condemned as amoral at best and immoral at worst, and to be untrustworthy and unethical.

In making a speech to some academics recently, I had a look at the social contract. Some of my observations there are relevant to my theme.

John Ralston Saul is a scholar of the modern corporation. His studies focus on the fundamental questions of power, obligation and responsibility, and whether 'society' consents to actions taken by organisations on its behalf.

I agree that what underpins corporate legitimacy is the notion of consent, narrowly and specifically in the case of shareholders, and broadly by society.

Saul tells us that of the one hundred top economies in the world, fifty-one are corporations. Such great power needs restraint.

The most common method of successfully restraining power is through democratic means. In important respects, corporations are democracies. Social principles govern democracies, and the social contract is founded on moral obligation.

Political philosophy and moral philosophy should inform decisions taken on corporate governance. In my opinion, the thoughts of history's great thinkers are useful.

Adam Smith is often misused. His hidden hand is said to operate for the benefit of society through the beneficial aggregation of self-interest. But he never said that means it operates in a moral vacuum.

Locke thought consent could only be given by the majority, who delegate to authority the codification and enforcement of moral standards and laws.

2 PricewaterhouseCoopers, *Investigation into foreign exchange losses at the National Australia Bank*, 12 March 2004, p. 38. See http://www.nabgroup.com/vgnmedia/downld/pwcreport.pdf.

Rousseau—like Smith—thought that men could not consent to something contrary to their interest. The 'general will' of men, in giving consent imposed a moral obligation. The common good means that duty replaces appetite.

Whatever the philosophical difficulties of the consent concepts—and there are many—the common thread is that our society still rests on the base of the social contract, and consent.

Political obligation arises from the consent of the governed. The governed in Australia are telling the political establishment that the corporate bureaucrats who run big business have lost their sense of duty, obligation and responsibility and are instead acting greedily, selfishly and irresponsibly.

This may be profoundly unfair to the majority of business men and women, but broadly, that is the message we're getting. So, if we are to be true to the social contract, reform is needed.

In a post-HIH Australian corporate world, the Government understand, as we do, that good regulation and good governance contribute to wealth creation and economic stability.

HIH was symptomatic of a global disease. Enron did immense damage to the American economy and its international standing. So did Parmalat to Italy and the European Union's standing in corporate matters.

Unfortunately for some, the message does not seem to be fully understood. The President of the Business Council of Australia, Mr Hugh Morgan, was recently reported to have said:

> But I look at the Enron situation and yeah, Ok, in a multitrillion-dollar economy what's the outcome? The system works—these people were not only gross, they were conducting illegal activities and they've gone to jail, which is where they should be.[3]

The Democrats do not believe that the Enron situation shows 'the system works'. In our opinion, the greed and corruption that led to the debacles of HIH and Enron can be limited or restrained by much stronger corporate governance.

If you read the evidence, the underlying message is that the business world would prefer to keep the status quo. That should ring alarm bells. Many still don't get it.

To continue with the status quo would be a green light to more corporate disasters.

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3 *Australian Financial Review*, 'Morgan hungry for more reform', 17 May 2004, p. 69.

An interesting Treasury paper[4] by Gordon de Brouwer notes that countries with greater governance on a macroeconomic level have greater wealth, economic growth and development. This is not a coincidence.

Better macroeconomic and institutional structures means greater stability, more access to international finance, more developed equity and venture capital markets, more R&D, innovative activity and entrepreneurship.

Time for a new approach?

CLERP 9's provisions will be supported by us and should be commended; however, we should recognise that the legislation is not really disturbing the fundamental relationship between shareholders, executives, directors and the auditor.

The Democrats believe that, at its very core, existing company law is inadequate in terms of corporate governance. The board and directors, that central institution to the relationship between shareholders and the company, has not been addressed by the CLERP process.

Directors' duties are very wide on operational and management matters, but poor corporate governance and ethics can create situations where major conflicts of interest, mismanagement, impropriety and even corruption can go unchecked.

Fundamental to our philosophy is a belief that many of the political principles that apply to popular democracies can transfer across to the shareholder democracies.

Well-founded concepts such as the 'separation of powers', 'accountability' and 'democratic process' have as valuable a role to play in the corporate world as they do in political life.

Corporate democracy is the key to corporate governance. At the heart of democracy is the restraint of power—the notion of checks and balances and regular testing of popular support.

So in discussing corporate governance, our political and constitutional language is a helpful tool. Best practice regular elections; compulsory voting; representative bodies; independent institutions and people; appointments on merit; the separation of powers; transparency, accountability and full disclosure.

The Democrats believe that one solution is for the current responsibilities of a board to be split between a main board and a governance board.

The main board would continue to be elected by shareholding and concentrate on strategic, business and operational issues. It would contain executive and

4 'Macroeconomics and Governance', Gordon de Brouwer, Treasury Working Paper, December 2003.

non-executive directors and because of its election method would continue to have a bias towards the dominant or large shareholders.

A small Corporate Governance Board would be composed of non-executive independent directors (perhaps three).

It would have a limited remit and would call and chair shareholder meetings, propose changes to the company constitution, resolve conflicts of interest, determine the remuneration of directors and executive management, appoint auditors and other advisors such as valuers and manage the process of electing directors.

To protect the interests of *all* shareholders, not just the dominant shareholders, voting rights would be determined democratically by numbers rather than by power based on the number of shares held. In other words it would be determined by shareholder not shareholding.

Because of its election method, it would have a bias towards all shareholders rather than just the large shareholders.

This 'separation of powers' seems a difficult concept for the traditional business community to fully appreciate at present. It has worked well in our broader political democracy.

The Democrats do not seek to attempt amendments to create a governance board at this stage. The idea needs to be better understood first.[5]

Chapters 3 and 4: Executive remuneration—remuneration report; and Executive remuneration—full disclosure

Executive and director remuneration is a matter of great public and private interest. It lies at the heart of investor confidence and faith in the credibility of corporations and the share market.

It is a matter of great public interest because the extravagant greed of too many directors and executives has not only caused a justifiable public outcry but has also contributed to major company failures and market shocks.

It is a matter of great private interest because too many shareholders have been robbed by the syphoning off of their funds through board-approved salary and retirement package rackets.

At the heart of the matter is a series of connected failures. Neither board practice nor the law prohibit arrangements where there is a conflict of interest. Those who benefit from devising clever, concealed and costly salary, bonus or option packages—which

5 Dr Shann Turnbull is a well-known thinker on such matters, and his international and domestic essays are well worth reading.

benefit the executive and director mates on the board—are quite often the same people who approve those packages.

They are even sometimes ticked off at the shareholder level by the chairman holding proxies that he exercises at his absolute discretion, a travesty in law if there was ever one. If ever there was a single reason to require institutional investors to exercise a compulsory vote, the corrupt use of 'discretionary' proxies is it.

And the myth that executives do not influence these matters is just that, a myth. One in five directors is an executive.

I think this Chapter lacks some vital commentary, particularly since it is so germane to the parliamentary debate that will follow this Report. This has been a sharp area of disagreement between government and non-government, and catch-up is occurring.

For instance last year, the Democrats and Labor introduced amendments to:

- ensure remuneration packages have to be disclosed at the time of contract;
- require companies to disclose accruing retirement benefits to executives and directors'
- strengthen shareholders' power to veto directors' retirement payouts; and
- force companies to reveal, in graph form, increases in executive salaries compared to share prices.

The Government did not accept those amendments at that time.

Further, you cannot divorce board delinquency in authorising unjustified remuneration packages from some company constitutions and board behaviour that allows or fosters poor director-election processes and the patronage of mates. This cosy world delivers supporting structures of mutual self-interest and aggrandisement.

Therefore the accompaniment to good remuneration practice and good remuneration committees has to be best practice election processes, and maximum independence, and ethical systems to prevent the conflicts of interest and collegiate conspiracy where corporate insiders enrich themselves at the expense of shareholders.

The Democrats have long thought that:

- Disclosure must be full, including all options.
- Disclosure must include a calculation of estimated total cost if the executives were to leave in the next financial year.
- Executive packages should be expensed (see accounting standards debate).

- Executive contracts that require Board approval may not be voted on by executive directors (only non executive).
- Executive contracts must specify risk and performance criteria.

Last year, a report on executive salaries was conducted by Dr John Shields from the University of Sydney for the Labor Council of New South Wales. It stated that it had found evidence that the more a company pays its top executives, the worse it performs.

The report examined share prices, return on equity movements and earnings per share in Australia's largest 100 companies. In all criteria, taking into account the size of the company, there was a significant reduction in shareholder returns where executives were 'over-paid'.

It found that companies perform best when the executives are paid between 17 and 24 times average earnings. If they were paid more, performance began to deteriorate. Even if the executive was paid in share bonuses and share options, the company results suffered.

Over the past decade, executive remuneration has, on average, mushroomed from 22 times average earnings to 74 times average earnings.

Highlighting the importance of remuneration disclosure, the HIH Royal Commission Recommendation No.1 on Corporate Governance says:

> I recommend that the disclosure and other requirements of the Corporations Act 2001, the relevant accounting standards and the Australian Stock Exchange Listing Rules that relate to directors' remuneration be reviewed as a matter of priority, to ensure that together they achieve clear and comprehensive disclosure of all remuneration or other benefits paid to directors in whatever form.[6]

The Democrats support the proposal of a remuneration report outlining the remuneration of directors and the 5 most highly paid executives in the company and the consolidated entity, as a first step.

The cut-off at 5 is arbitrary. It may sometimes be the case that it does not pick up some of those whose pay is so high that shareholders may need to be alerted to the fact. For example, it is understood that despite its dreadful recent performance, there are 14 executives at AMP paid over $1 million a year.

In the interests of transparency and accountability, the Democrats propose to introduce an amendment requiring the annual disclosure of the remuneration of all executives

6 *The Failure of HIH Insurance*, The HIH Royal Commission, Vol 1, Canberra, April 2003, p. 116.

and employees that are paid more than 20 times the full-time adult ordinary time earnings. Based on the December 2003 weekly figure of $937.70,[7] this would require reporting of all remuneration packages of over $975,208.

Amendments to CLERP were released by the ALP at the end of May. Based on the limited information so far provided by the ALP on their executive remuneration amendments, the Democrats support much of their intent. To vote against them, we would need to be persuaded that they are not in the interests of shareholders.

Chapter 5: Executive remuneration—the non-binding vote

This chapter highlights a fundamental problem and is one reason I have proposed a governance board as one solution. Reading Chapter 5, I am struck by the clash between what should be clear principles and the awkward solutions being proposed by CLERP 9.

In our system we all accept that shareholders in listed companies should do two things—they should keep control over most things to do with the board, and they should delegate the rest to the board. This principle is spelt out clearly in paragraph 5.22 of the Committee's report.

Directors are supposed to think and act independently (and with less self-interest) than executives. Ideally, a separation of attitudes as well as powers.

The board is separate (or should be) from the executive—a basic and necessary separation of powers that is designed to protect the shareholders. However we have allowed executives to be members of boards and, partly because most directors are former executives, the executive culture dominates board thinking.

Remember that one in five directors is an executive.

The Committee's report (paragraph 5.27) said:

> The AICD argued that 'Good corporate governance requires that boards take sole responsibility for their remuneration decisions. If shareholders are dissatisfied with the board's performance, they have a right to make their views known at the AGM and vote against the re-election of the directors'.[8] The ASX stated that:
>
> …to extend shareholder entitlements to a retrospective non-binding resolution on decisions regarding specific executive remuneration traverses the traditional line of accountability in respect of a company and its shareholders, in that individual managers, unlike directors, are not directly

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7 ABS, Average Weekly Earnings (6302.0)

8 *Submission* 35, p. 23.

> accountable to shareholders and do not effectively set their own remuneration.[9]

This 'right' is a Clayton's right in those cases where the company constitution, election methodology, and board membership rigging and stacking (plus non-compulsory voting of shares) prevent full accountability of incumbent directors to shareholders.

With respect to many issues (especially remuneration), my opinion is that boards or their surrogates often argue in their submissions to this Committee from the perspective of the executive, not from the perspective of the board or all (as opposed to dominant) shareholders.

In theory it should be quite simple—if you are on the board, you are subject to the shareholders. If you do not want to be subject to the shareholders, get off the board and appear before the board as an executive when the board needs you to.

Board members' remuneration and retirement packages should be subject to the binding vote of shareholders. That has to be the consequence of the principle that the board is responsible to the shareholders.

We are just starting to see the power of shareholder activism. Earlier this year, News Corporation, the multi-media empire of the Murdoch family, historically voted to deny an option scheme for the non-executive directors, including two of Rupert Murdoch's sons.

Interestingly, the option scheme was not particularly unusual. At most AGMs, executives and directors give themselves a tidy generous option package and it is, almost routinely, approved. The institutions give their proxies to the Chairman and only the small minority shareholdings oppose.

However, recently, another options package at Harvey Norman was also defeated as a result of shareholder activism.

Before anyone congratulates themselves on the outcomes at Harvey Norman and News Corp, they should recognise that the only reason shareholders got to have a say was because it was *options* that were being issued. In corporations law, shareholders get to have a say on options because they directly dilute their shareholdings.

Shareholders at News Corp could vote against Mr Chernin getting his options, worth just over half a million dollars, but they could not vote against his US$16 million salary!

Possibly, the vote against the options, which are relatively minor in comparison to his salary, was simply a vote of frustration at this amazing salary package.

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9 *Submission* 48, p. 6. See also *Submission* 20, p. 13 and *Submission* 35, p. 24.

The Democrats believe that shareholders should get more than simply a non-binding vote on salaries. We believe that shareholders should get a legitimate veto.

If the Board of News Corp believes Mr Chernin is worth US$16 million, they should at least put forward an explanation and ask the shareholders to approve it.

While as an indicative vote the non-binding vote is not a waste of time, our proposal would give shareholders real power.

We have noted media comment saying that the shareholders at Southcorp probably want a vote on the $2 million salary going to Keith Lambert after the *negative* 27% return to shareholders last year; or that equally, the shareholders at Aristocrat probably want a say on Des Randall's $3.65 million package after a *negative* 21% return last year.

For those who say this shareholder power should be confined to directors, nearly every case of excess is by a director who is also an executive.

Our proposal would give the embattled shareholders of organisations like Southcorp, AMP and Aristocrat a real say in executive remuneration packages.

That is why I support a binding vote being required to approve the remuneration and retirement packages of *all* directors whether executive directors or non-executive directors.

If the executives and directors are worth what they are getting, the shareholders will approve the packages.

The *only* variation that should be permitted to that is if an absolute majority of all shareholders (not just those voting) agree that that should not be the case for executive directors, in which case at the same time as that vote, a board remuneration policy should be approved instead.

It should not be forgotten that one in five directors is also an executive. Despite the statements by bodies like the ASX and ASIC urging them not to, because of the clear conflict of interest, these people participate in the construction of their packages and often approve their own packages in a grotesque and breath-taking conflict of interest and mutual acts of aggrandisement.

There is regularly a roar of outrage at executive payouts and packages that has been directed at directors *who were also executives*. The rest of the outrage has been directed at a few directors, particularly chairmen.

Our proposal would give shareholders a binding vote with some practical power, rather than simply an outlet for their anger.

Chapters 6 & 7: Continuous disclosure, infringement notices and penalties

In the evidence before the Committee on infringement notices and penalties, I have observed that witnesses and commentators often fail to distinguish between two streams of law—that which applies to individuals in their private capacity, and that applying to entities and the individuals with authority within those entities.

Customs, the ATO, ASIC, the ACCC, APRA, Transport, Intelligence and other agencies all have powers that are specific to entities and the individuals with authority within those entities, such as the obligation to answer questions, the obligation to produce documents, limited privilege, and in some cases the reverse onus of proof.

All Governments and all parliaments have accepted the distinction between these two streams for decades, and that distinction has got stronger in the last decade, as the corporate veil has been attacked.

The reverse onus of proof in this environment is entirely consistent. Corporate individuals with authority have not and do not have the same protections as those same individuals do in their private capacity.

Having said that, executives and directors must not be deterred from reasonable and calculated risk. A defence of reasonable conduct is appropriate.

The Democrats have seen the amendments proposed by the ALP and support their broad intent. We would need to be convinced that these amendments would not be in the best interests of shareholders.

Chapter 8: Enhancing Shareholder Participation

Section 249D

The Democrats are particularly opposed to any attempt to remove the 100 member rule in section 249D for shareholder meetings. We have listened to the evidence outlining the perceived problem, and agree that limited reform is required.

At present, the threshold for requisitioning a special general meeting under section 249D of the *Corporations Act 2001* is that:

(1) The directors of a company must call and arrange to hold a general meeting on the request of:

- (a) members with at least 5% of the votes that may be cast at the general meeting; or
- (b) at least 100 members who are entitled to vote at the general meeting.

The Government tried to reform this provision by setting a minimum of a 5% economic interest before being able to requisition a special general meeting. This percentage of capital method is common elsewhere—in the United Kingdom 10%; in Canada and New Zealand 5%; in Europe between 5 and 20%—but it is obvious that in companies that have hundreds of millions of shares, this is an impossible threshold for average shareholders.

The Democrats' position is that requiring a 5% economic interest as a threshold for a company to concur in the request for a general meeting under section 249D is setting a requirement which is too onerous. It will deliver power back to the oligarchs.

Even the much touted 'square-root solution' can still create very high thresholds.

Having failed via regulation (disallowed in 2000), there is still a desire to drop section 249D(b). That will not get through the Senate. What will get through the Senate is a reasonable tightening up of section 249D(b).

The requirement for 100 shareholders may indeed be considered too low, but the fact is that it is only possible to point to a few examples where it is possible to say shareholder rights might have been abused. North Limited and the NMRA are two examples of companies that have complained. In NMRA's case they were hit with 12 requisitions over 18 months, which is undoubtedly excessive and expensive.

The Democrats are prepared to amend the Act to ensure that such members hold marketable parcels of shares, which could be defined as a minimum of 100 shares per shareholder at a value of not less than $500 per parcel.

Institutional voting

It is worth repeating paragraph 8.66 of the Committee's report which says:

> The disclosure of voting is one of the central features of the OECD Principles of Corporate Governance which state:
>
> The exercise of ownership rights by all shareholders, including institutional investors should be facilitated.
>
> Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights. The voting record of such investors should also be disclosed to the market on an annual basis.[10]

The Democrats believe that the trustees and managers of superannuation funds and managed investment schemes have a fiduciary duty to act in the best interests of their members and beneficiaries. We believe that a trustee can only satisfy their fiduciary obligations by taking an active interest in material corporate governance activities of their equity investments.

10 OECD Principles of Corporate Governance Draft Revised Text, January 2004, p. 7.

Material corporate governance activities would include voting on constitutional issues and decisions on the election and remuneration of directors.

Voting on these three matters should be mandatory.

In the absence of support for our view, the Democrats will support the broader amendments of the ALP to require fund managers, trustees of super funds and life companies to maintain and disclose voting policies and records.

We will amend the legislation to extend the requirement to vote on material corporate governance resolutions to fund managers.

Chapter 9: Management of Conflicts of Interest By Financial Services Licensees

The Democrats have seen the amendments proposed by the ALP and support their intention. To vote against them, we would need to be convinced that these amendments would not be in the best interests of shareholders.

Chapter 10: Political Donations

Sir Gerard Brennan was right in saying:

> There are sound reasons of policy for imposing a limitation on directors' powers to donate corporate assets.[11]

For obvious reasons, as a sub-set of corporate donations, political donations are even more sensitive than other types of donations, and ones in which the community has a particular interest.

I want to commence this section with these tables below. Now what is one to make of this largesse to political parties? And bear in mind that these figures are federal and do not include figures with respect to local government or state government records and entities.

11 This quote has been taken from paragraph 10.5 of Chapter 10 of the Committee's report.

Political donations above $100,000 in the Building & Construction Industry[12]

Property developers		Builders & constructors	
Company	**Amount $**	**Company**	**Amount $**
Croissy Pty Ltd	1,901,000	Multiplex Constructions Pty Ltd	1,710,350
Lend Lease Corporation	1,172,738	Leighton Group of Companies	1,277,817
Mirvac	812,976	Meriton Apartments Pty Ltd	1,018,067
Australand Property Group	695,698	Baulderstone Hornibrook Pty Ltd	747,767
Furama Pty Ltd	588,776	Paynter Dixon Constructions Pty Ltd	319,650
Gandel Group	571,230	Becton Group	302,945
McRoss Developments	535,500	Walter Construction Group	231,500
Terrace Tower Group	410,990	Grocon Pty Ltd	217,050
Westfield Group of Companies	295,636	Stockland Group of Companies	131,855
Randazzo Group of Companies	204,500	St Hilliers Pty Ltd	103,850
Stockland Group of Companies	201,706		
Toga Group of Companies	174,720		
Northgan (Gandel Group)	154,795		
Lewlac Pty Ltd	149,330		
MAB Corporation	110,290		
Total for property developers	$7,979,884	Total for builders & constructors	$6,060,851

Combined total donations: $14,040,735

12 Compiled from on-line AEC returns 1998/1999 to 2002/2003.

Political donations at board discretion reflect poor corporate governance. You would be hard put to find any corporations (or unions) whose donations policy and practice has the specific approval of the shareholders or members.

We would change the law to require such approval. We would also force disclosure of who lay behind donations by clubs, trusts, foundations and fundraisers. Although we would prefer to outlaw donations, at the least we would cap maximum donations

In particular, we would apply a similar provision to Part IVA of the Tax Act with a general anti-corruption provision in electoral law. The Electoral Act and Corporations Act should specifically prohibit political donations that have even any hint or implication of 'strings attached'.

The Australian Shareholders' Association (ASA) released a media statement on 20 May 2004 stating that they have adopted a policy statement opposing political donations by companies. The policy goes on to say that where such donations have been made, there should be discussion of them at the next AGM.

'Decisions about contributions to political entities are the prerogative of shareholders, not directors,' said ASA chairman, Mr John Curry.

Mr Curry said the ASA believed companies should be allowed to lobby political parties but ultimately it should be the shareholders, rather than the boards, who decided whether a gift should be made.

Below is an extract from our Supplementary Remarks to the Joint Standing Committee on Electoral Matters titled—*Report of the inquiry into the 2001 Federal Election and matters related thereto.*[13]

We will be introducing amendments into the Corporations Law as outlined in our minority report that will require shareholders of companies to approve a political donations policy at least once every three years.

EXTRACT:

> In most cases, donors appear to make donations to political parties for broadly altruistic purposes, in that the donor supports the party and its policies, and is willing to donate to ensure the party's candidates and policies are represented in parliament. Nevertheless, there is a perception (and probably a reality), that some donors specifically tie large donations to

13 This report can be obtained from the web site for the Joint Standing Committee on Electoral Matters at http://www.aph.gov.au/house/committee/em/elect01/report.htm. The extracts are on pp. 15-16 of the Supplementary Remarks chapter in the report. http://www.aph.gov.au/house/committee/em/elect01/report/Democrats.pdf.

the pursuit of specific policies they want achieved in their self-interest. This is corruption.[14]

RECOMMENDATION 4.6

The Act should specifically prohibit donations that have 'strings attached.'

The practice of companies making political donations without shareholder approval and without disclosing donations in annual reports must end. So must the practice of unions making political donations without member approval. It is neither democratic nor right.

Shareholders of companies and members of registered organisations (or any other organisational body such as mutuals) should be given the right either to approve a political donations policy, to be carried out by the board or management body, or the right to approve political donations proposals at the annual general meeting.

This will require amendments to the relevant acts rather than to the Electoral Act.[15]

RECOMMENDATION 4.7

The Corporations, Workplace and other laws be amended so that either:

(a) Shareholders of companies and members of registered organisations (or any other organisational body such as mutuals) must approve a political donations policy at least once every three years; or in the alternative

(b) Shareholders of companies and members of registered organisations (or any other organisational body such as mutuals) must approve political donations proposals at the annual general meeting.

Under the Registered Organisations schedule of the *Workplace Relations Act* elections are conducted under the auspices of the AEC.

It would seem self evident, in the public interest and for the same reasons - that the same provisions governing disclosure of donations for political organisations should apply to industrial or other organisations for whom the AEC conducts elections.

Controversy sometimes attends union elections. Trade Unions are an important institution in Australian society and union elections have become far more expensive to campaign in today than ever before.

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14 http://www.aph.gov.au/house/committee/em/elect01/report/Democrats.pdf at pp. 15-16.

15 http://www.aph.gov.au/house/committee/em/elect01/report/Democrats.pdf at pp. 15-16.

> Many people and organizations contribute to union election campaigns. As for political elections the public and members of those unions in particular should have the right to know the source of any campaign donations above a minimal amount.[16]

RECOMMENDATION 4.8

Where the AEC conducts elections for registered and other organisations, the same provisions governing disclosure of donations for political organisations should apply.

Final comment

Those businesses and business men and women who have sullied the reputation and standing of the rest of the business world need to get the message. They need to understand that their greed and extravagance has been unacceptable and has damaged Australia. It has gone on for too long and the Australian shareholders and the public deserve better.

The Democrats are determined to ensure these CLERP 9 amendments are as strong as possible, provide greater power to shareholders and a measure of reassurance to the Australian public that the greedy unscrupulous corporate delinquents are being reined in.

SENATOR ANDREW MURRAY

16 http://www.aph.gov.au/house/committee/em/elect01/report/Democrats.pdf at pp. 15-16.

LABOR MEMBERS MINORITY REPORT

CORPORATE LAW ECONOMIC REFORM PROGRAM (AUDIT REFORM AND CORPORATE DISCLOSURE) BILL 2003 ("CLERP 9")

Introduction

The inquiry conducted by the Joint Committee on Corporations and Financial Services into the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003* ("**CLERP 9**") ("**the Bill**") provided valuable insights into the prevailing mood of shareholders, union members, academics, company directors, accountants, regulators, activists, company secretaries, lawyers, auditors (internal and external) and others who will be impacted by the Bill.

The Joint Committee received sixty-five (65) submissions and heard from over different 40 groups. Hearings were conducted in Canberra, Melbourne and Sydney.

The Bill is supplemented by regulations, ASIC Policy Statements and other guidance.

The Explanatory Memorandum states that the underlying objective of the Bill is to:

> *"improve the operation of the market by promoting transparency, accountability and shareholder activism."*[1]

It's important that when boards are considering this Bill, the details of the legislation do not obscure the objectives underlying the Bill.

The Australian Council of Super Investors (ACSI) advised the Committee that:[2]

> *"…..we cannot simply rely on the law alone to improve corporate behaviour, although legal mechanisms are critical to ensuring that community expectations are clearly spelt out."*

It's important that the principles which this Bill proposes are considered at a board level.

The Labor members hope that the Bill will have an impact on the culture within companies. If the requirements in this Bill are delegated to the compliance divisions within companies to address, then the Bill will not have achieved its full potential.

To achieve meaningful reform, it is necessary for the boardrooms of corporate Australia to do a "stock-take' and consider whether their culture and their internal processes and procedures implement the principles enshrined in this Bill.

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1 Explanatory Memorandum, p. 1.
2 Committee Hansard, 16 March 2004, p. 69

Cultural change within Australian boardrooms is as important as the black letter laws which Parliament will pass.

The recent PricewaterhouseCoopers (PwC) report into the National Australia Bank highlighted the importance of cultural issues and made the point that an organisation's culture is a board responsibility.

The PwC report found that:

> *"The Board must accept responsibility for the "tone at the top" and for the environment in which management did not report openly on issues in the business."*
>
> *(Investigation into foreign exchange losses at the NAB, 12 March 2004)*

The majority of witnesses recognised the need for corporate reform and supported the principles of the Bill. However, concerns were raised by groups such as the Business Council of Australia (BCA) and Australian Institute of Company Directors (AICD) in relation to enhancing disclosure of executive remuneration, the non-binding vote on the remuneration report and ASIC's power to issue an infringement notice.

Other witnesses such as the Australian Shareholders Association (ASA), the Australian Council of Super Investors (ACSI), Corporate Governance International (CGI), the Australian Conservation Foundation (ACF), the Australian Workers Union (AWU) and the Financial Services Union (FSU) supported the new disclosure requirements, the non-binding vote and ASIC's infringement power.

The inquiry provided an opportunity to consider aspects of the Bill which require further “toughening up” such as the audit provisions, the provisions relating to disclosure of executive remuneration and the provisions relating to shareholder activism.

Beyond CLERP 9

Whilst the CLERP 9 Bill provides a vehicle for reform, the reforms proposed by the Bill should not be viewed as completing the task of corporate reform.

The inquiry provided an opportunity to contemplate issues which the Bill has not directly addressed such as the election of directors, beneficial ownership of shares, corporate social responsibility (CSR), the 100 member rule and the application of the *Corporations Act* beyond listed companies.

The application of certain provisions of the *Corporations Act 2001* beyond listed companies is an issue requiring further consideration.

The Australian Shareholders Association (ASA) advised the Committee that listed investment trusts operate under a different set of rules than ordinary listed companies for example, they are not required to hold annual general meetings.

Another issue that has been raised recently is whether companies which are overseas owned and operated and which are listed on the Australian Stock Exchange (ASX), should have similar disclosure obligations as their Australian counterparts under the *Corporations Act 2001*.[3]

It should be noted that all listed companies are subject to *ASX Listing Rule 4.1* which requires them to provide a statement in their annual report disclosing the extent to which they have followed the *ASX Corporate Governance Guidelines*. The Guidelines adopt a "comply or explain approach". This means that companies can choose not to follow the Guidelines, provided that they explain why they have not followed them.

This self-regulatory approach may not always be in shareholders best interests.

Another macro concern is that of enforcement. A strong regulatory framework is important but if the penalties are weak or the regulator does not have sufficient resources to enforce the law, the framework will do little more than pay lip service to the noble principles that it attempts to enshrine.

Penalties for many new offences in the CLERP 9 Bill are low.

For example the CLERP 9 Bill sets breaches of the auditor liability regime at between $1,100 and $2,750.[4] Also, a breach of the requirement to give shareholders a non-binding vote at the AGM amounts to a fine of $550.[5] The Labor members are of the view that these penalties should be increased.

It's also clear that penalties under the *Corporations Act 2001* need reform. The Labor member's believe that penalties for serious breaches of the *Corporations Act 2001* should be doubled.

Labor's Position

Good corporate governance practices ensure that the market is well-informed at all times and that shareholders base decisions on relevant information.

This is essential for the capital market to allocate capital to the most efficient uses and ensure that resources are productively employed.

For the capital market to fulfil this function it must be efficient, fair and transparent.

In Labor's view, Parliament needs to strengthen the corporate governance regulatory framework to ensure that Australia’s capital market remains efficient, fair and transparent.

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[3] Tony Harris, *Above and beyond the law,* Australian Financial Review, 1 June 2004.
[4] Criminal penalties may also apply with imprisonment for 6 months an option as well. See further - CLERP 9 Bill, Schedule 1, Part 3, p. 100.
[5] See further – CLERP 9 Bill, Schedule 5, p. 193-194.

The CLERP 9 Bill goes some way to strengthening the framework.

However, it does not go far enough.

The Labor members take the view that the CLERP 9 Bill:

- fails to sufficiently hold boards accountable; and
- fails to sufficiently empower shareholders.

Accordingly, amendments are needed to toughen up the Bill. On 30 May 2004, Senator Conroy[6] released a *Guide to Labor's proposed Amendments to the CLERP 9 Bill.* This Guide outlines the amendments which Labor plans to make to the Bill (see Appendix 3). The Guide notes that further amendments are anticipated following the release of this report.

In October 2003, Senator Conroy released a discussion paper in relation to CLERP 9. This paper was released prior to the release of the draft CLERP 9 Bill and outlined the areas of reform that Labor believed should be included in the CLERP 9 Bill.

The Labor members welcome the Government's decision to adopt a number of Labor's proposals including the following:

- Giving shareholders a non-binding vote on the remuneration report;
- Expanding the disclosure requirements for executives from the top 5 executives to the top 10 executives within the corporate group;
- Recognising the need to amend the disclosure obligations in section 300 A in relation to executive remuneration; and
- Requiring the auditor to attend and answer questions at the AGM.

This report covers the key areas of concern for the Labor Members in relation to the Bill. Those concerns relate to:

- Executive remuneration (Schedule 5);
- Management of conflicts of interest (Schedule 10); and
- Shareholder participation (Schedule 8).

Enforcement and penalties are also discussed.

It should be noted that the Labor members will comment on the CLERP 9 audit reforms (in Schedule 1 of the Bill) and the financial reporting reforms (in Schedule 2) in a separate report.

The Labor member's position on each of the Committee's recommendations is set out in Appendix 1.

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[6] Labor's Shadow Minister for Financial Services and Corporate Governance

Executive Remuneration (Schedule 5 of the Bill)

The payment of obscene salary packages and massive termination payments, (often in light of poor corporate performance) has resulted in an uproar from shareholders, employees and retirees.

The community is outraged that there appears to be one rule for corporate executives and another rule for the rest of the workforce.

Mr Bill Shorten from the Australian Workers Union (AWU) said that:[7]

> *"The Australian Workers Union are not against successful companies paying senior executives lots of money, but we do believe that, unlike the workers, who tend to get paid much less and have to bear the risk of job losses when companies underperform, there is very little upwards accountability of directors."*

The link between payment and performance appears to have been severed.

In addition, many people feel as though the payments to directors and executives do not correspond with community expectations.

In 1998, Labor with the Democrats inserted section 300A into the Act. This section required the disclosure of information about the remuneration of directors and executives in the annual report of all listed companies.

This was a major step towards increasing the transparency surrounding executive remuneration. Unfortunately, the spirit of this section has not been followed by some companies, particularly relating to the disclosure of options.

What type of remuneration has to be disclosed?

The CLERP 9 Bill amends sections 300 and 300A of the Act. The new provisions set out the broad principles in relation to disclosure of remuneration. The disclosures required under section 300A(1) are set out in the regulations.[8] Disclosures made in accordance with section 300A will form the basis of the "remuneration report" which will be located within the directors' report.

The Bill rationalises the definitions of "officer" and "executive officer". The term "senior manager" will also be inserted into the Act.

The accounting standard (*AASB 1046 Director and Executive Disclosures by Disclosing Entities)* requires disclosure of executive remuneration issues. However, only those disclosures required under the regulations will be included in the ‘remuneration report’ and therefore, voted on by shareholders.

[7] Committee Hansard, 14 April 2004, p. 90
[8] Exposure Draft Corporations Amendment Regulations 2004, Content Id 832, 25 May 2004.

The information to be included in the remuneration report includes:

- details prescribed by the accounting standards; and
- other disclosures.

The draft CLERP 9 regulations pick up some (but not all) of the disclosures required under the accounting standard.

For example, AASB 1046 requires the disclosure of holdings of equity in the company, loans outstanding and other transactions and balances (which include items such as assets sold or leased from directors or executives). These disclosures are not considered part of the directors or executives "remuneration" and therefore are not required to be disclosed under the regulations.[9]

The regulations require the disclosure of the following benefits:

- **Primary benefits** - which includes cash salaries, fees and commissions, cash profit sharing and other bonuses, and non-monetary benefits.

- **Post-employment benefits** - which includes pension and super benefits, post employment benefits approved by shareholders in accordance with the *Corporations Act* and other post-employment benefits.

- **Equity compensation** - which includes the value of shares and units, the value of options and rights; Alterations to the terms of options or rights during the reporting period; and the value of other equity compensation.

- **Other compensation** - which includes termination benefits, prescribed benefits and all other benefits. This also includes interest on a loan where there is a difference between actual interest payable and the commercial rate of interest.

In addition to these disclosures under the accounting standard, the regulations also require some *additional* disclosures. Those additional disclosures include:

- Payments made prior to the person holding office as part of the consideration for the person agreeing to hold office (sometimes referred to as "golden hellos"); and
- A discussion of the performance criterion (if any) which applies to the remuneration.

Unfortunately, the following do not need to be disclosed under the regulations (and therefore will not form part of the remuneration report):

- Company policy on the duration of contracts, notice periods and termination payments;

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[9] See advice from Treasury to the Joint Parliamentary Committee on Corporations and Financial Services, dated 26 May 2004.

- Whether the director or executive has entered into an ‘equity value protection scheme’ (that is a hedging instrument which ensures that the value of the equity remains fixed regardless of changing market values);
- Loans – (under the accounting standard AASB 1046, loans greater than $100,000 need to be disclosed but they are not required to be disclosed under the regulations); and
- Sufficient information showing the link between pay and performance.

The Labor members take the view that shareholders are entitled to this information.

The Labor member's note that interest on a loan is required to be disclosed under the regulations in accordance with the accounting standard AASB 1046.

AASB 1046 provides that the difference between actual interest payable on a loan to a director of executive and the commercial rate of interest (had the loan been agreed on an arm's length basis) is included in remuneration as a non-monetary benefit.[10]

A further point to note is that the international standard will provide that the issue of "options with value" is an expense to the company.[11]

The missing link – between pay and performance

The missing link in relation to the CLERP 9 Bill is its failure to require the disclosure of *sufficient* information about the link between an executive's salary package and their performance.

A number of witnesses stressed the importance of linking remuneration with performance.

The Australian Council of Super Investors (ACSI) advised the Committee that:[12]

> *"…it is integral that the remuneration reports clearly outline and explain the relationship between remuneration policy and company performance. We are concerned about this lack of linkage…..we do not object to executives and directors of well-run, efficient and acceptably profitable companies being well rewarded. As shareholders, we are therefore challenged to apply reasonable levels of scrutiny on these pay arrangements."*

The relationship between remuneration policy and company performance is a critical disclosure for shareholders. Yet in some cases this information is not being provided.

A report commissioned by the combined Public Sector and Commonwealth Super Schemes revealed that sections 300 and 300A:[13]

[10] Explanatory Memorandum, *Exposure Draft for Consultation,, Corporations Amendment Regulations 2004 (CLERP 9 Regs),* Content ID 832, 25 May 2004.
[11] Professor Boymal, Committee Hansard, 29 April 2004, p. 74
[12] Committee Hansard, 16 March 2004, p. 72.

> *"…are not having their intended effect. Remuneration disclosures, generally, do not discuss alignment with company performance. Options valuations in company disclosures are a strong candidate for improvement and have already attracted the attention of ASIC."*

The report was based on 172 companies on the ASX 200 list. The report found that found that:

- 25% did not disclose a detailed remuneration policy; and
- 26% did not disclose information on individual performance hurdles and how hurdles link to shareholder value.

Whilst some companies are not providing sufficient information about the performance hurdles it appears that other companies may choose not to link the remuneration with performance.

Draft CLERP 9 Regulations

Where part of a director's or executive's remuneration is subject to a performance condition, the draft CLERP 9 regulations require that the following is disclosed:

- An explanation of the performance criteria (or contingency) was and why it was used; and
- The method of determining whether the contingency has occurred or the criterion was met.

There is no requirement to advise shareholders if no performance conditions are required.

Also, the provisions discuss very broad principles in relation to aligning executive remuneration with performance.

In light of the failure of the previous provisions to elicit this type of information, the Labor members believe that the Bill should set out more detail of the types of disclosures expected in relation to performance conditions.

Enhancing Disclosure

To enhance the disclosures made in relation to performance conditions, the Labor members recommend that the following disclosures are made:

- Where the remuneration is not subject to performance hurdles, an explanation as to why;

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[13] Executive Remuneration – Research paper commissioned by the Public Sector and Commonwealth Super Schemes, Catholic Super Fund and Northern Territory Government Public Authorities Superannuation Scheme, p. 7.

- A discussion of the comparison with factors external to the company;
- A discussion of the relative importance of each of the elements considered; and
- Graphs showing shareholder return for the most recent 5 financial years.

In order to make an informed decision about an executive's salary package, shareholders are entitled to know the basis upon which the remuneration is based. This is even more important given that shareholders will be voting on the remuneration report.

The Labor member's take the view that more detailed disclosure is required in relation to the performance conditions which may apply to the remuneration package. We also believe that if no performance conditions are required, this should also be made clear.

Equity Compensation

The Australian Shareholders Association (ASA) believe that all equity based remuneration schemes should be approved by shareholders prior to implementation. In their view, if there is a potential to increase the amount of equity and thereby dilute shareholder's funds, shareholder approval should be required.[14]

Another issue is whether approval of equity under employee incentive schemes should occur by way of a special resolution. Changes to the ASX Listing Rules in 2000 means that only 50% of shareholders are required to approve this type of resolution.

The draft CLERP 9 regulations require the disclosure of equity compensation.
This includes:

- the value of shares and units,
- the value of options and rights;
- alterations to the terms of options or rights during the reporting period; and
- the value of other equity compensation.

The Labor members take the view that the original ASX listing rule should be reinstated such that approval by way of special resolution is required to equity granted under an employee incentive scheme.

It would also be useful for shareholders to be advised of the percentage of the person's remuneration which is made up of a grant of options. This was originally proposed by the *Corporations Amendment Bill 2002* but has not been included in the CLERP 9 Bill on the basis that this information is *"readily ascertainable from the disclosures required by the regulations."*[15]

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[14] Committee Hansard, 9 March 2004, p. 24

[15] See advice from Treasury to the Joint Parliamentary Committee on Corporations and Financial Services, dated 26 May 2004.

Termination payments

Shareholders, employees and retirees view the payment of massive termination payments to executives and directors where their companies are underperforming as unacceptable.

The draft CLERP 9 regulations require the disclosure of post employment benefits. Post employment benefits include:

- Pension and superannuation benefits;
- Post employment benefits which require approval by shareholders under the Corporations Act; and
- Other post-employment benefits.

Executives and Directors

Division 2, Part 2D.2 of the *Corporations Act 2001* governs the circumstances when shareholder approval is required before a benefit may be given to a person in connection with their retirement from "board or managerial office".[16]

Sections 200B, 200E and 200F (and related provisions) of the *Corporations Act 2001* require shareholder approval for termination benefits where they exceed a certain threshold. (This provision has been in the law for some time although the CLERP 9 Bill makes some modifications in relation to the exemptions.)

The threshold depends upon the number of years of service of the director or executive. However, it is possible for termination benefits to reach up to 7 times a person's annual salary before shareholder approval is required in some cases. (*See Appendix 2 for further information in relation to the application of the formula*).

The Labor member's take the view that termination payments for executives and directors exceeding 1 year's salary should be subject to shareholder approval. In determining the termination payment, statutory superannuation should be excluded.

The CLERP 9 Bill amends section 200F of the Act which provides exceptions to when shareholder approval is required. The Bill modifies the operation of some of the exemptions in section 200F. Where a payment is made pursuant to one of the exceptions, shareholder approval will be required where the payment exceeds an amount calculated in accordance with the formula specified or exceeds the value of one year's remuneration (which ever is the greatest).

It should also be noted that the proposed amendments to section 200F made by the CLERP 9 Bill only apply to agreements which are entered into after 1 July 2004. This means that agreements entered into prior this date will not require shareholder approval in accordance with the provisions.

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[16] Explanatory Memorandum, *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003,* p. 169.

Non-executive directors

Non-executive directors play a unique role on the board.

According to Corporate Governance International (CGI), the role of the non-executive director is to monitor the strategy and performance of the executive arm of the company and to safeguard the interests of shareholders generally.

Remuneration for non-executive directors should not provide any disincentive to independent action.

For this reason, the remuneration for non-executives should be distinguished from the remuneration for executives.

The *ASX Corporate Governance Guidelines* say that companies should not provide options, bonus payments or retirement benefits (other than statutory superannuation) to non-executives.[17]

The Labor members believe that this should be a requirement in the law for listed companies.

Non-binding vote

The information which is disclosed under section 300A and in the regulations will form the remuneration report – which will be subject to the non-binding vote.

The proposed non-binding vote on executive remuneration generated robust debate during the inquiry.

The BCA and the AICD do not support the non-binding vote and argue that it’s the board’s responsibility to determine executive remuneration.

On the other hand, investor and shareholder groups are overwhelming supportive of the non-binding vote.

Sandy Easterbrook from Corporate Governance International (CGI) advised the Committee that quote:[18]

> *"I must say that we are amazed that there is all this hysteria on the business side about this non-binding vote. It is actually terribly simple. The non-binding vote is simply an incentive for boards and remuneration committees to do a better job. The only sanction of a non-binding vote is, frankly, embarrassment. If a board does such a bad job on remuneration ….and the shareholders throw out its remuneration report, that is a public condemnation of the directors and, because people do not like being publicly condemned, it is likely to encourage*

[17] ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations,* March 2003, p. 56.
[18] Committee Hansard, 9 March 2004, p. 3

> *them to do a better job. That, frankly, is what has been the experience in the UK."*

The Australian Council of Super Investors (ACSI) advised the Committee that similar provisions in the United Kingdom were working well. They said that the average opposition recorded against remuneration reports in the United Kingdom was around 4%.[19]

In March 2003, Labor proposed an amendment which gave shareholders the ability to have a say on executive remuneration by putting up a non-binding vote at the AGM. This proposal was rejected by the Government at the time but has since been included in the CLERP 9 Bill.

The Labor members welcome the Government's decision to adopt Labor's policy.

Standardised disclosure

The accounting standard AASB 1046 recommends that disclosures are made in a table format (the format is set out in the standard). It is not mandatory for disclosures to be made in the table format.

A number of witnesses emphasised the importance of standardised disclosure to assist the users of financial reports.

ASIC said that discloses was enhanced by "easy to understand tables".

The Labor members recommend that consideration is given to requiring companies to disclose in accordance with the tables in AASB 1046.

Penalties

If a company fails to put the non-binding vote to the shareholders, the penalty is 5 penalty units ($550). If the company fails to allow reasonable discussion on the remuneration report, the penalty is $550. Also, if the company fails to refer to the non-binding vote in the notice of meeting the penalty is $550.[20]

Penalties for breaching the disclosure requirements in section 300 and section 300A amount to $220,000 or imprisonment for 5 years or both.[21]

The Labor members take the view that these penalties should be increased.

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[19] Committee Hansard, 16 March 2004, p. 72

[20] See further Schedule 5 of the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003*, p. 193-194.

[21] See subsection 344(2)

Other

The draft CLERP 9 regulations in relation to executive remuneration state that disclosure is not required *"if the details have not previously been disclosed in a remuneration report".*

It is understood that shareholders prefer the disclosure of "accrued benefits" in order to aid comprehension of the financial reports.

The Labor members recommend that consideration is given to requiring the disclosure of accrued benefits.

Management of Conflicts of Interest (Schedule 10)

Background

The CLERP 9 Bill inserts a new requirement on financial services licensees to manage their conflicts of interest.

New section 912A(1)(aa) requires licensees to:

> *"have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative."*

Failure to comply with this provision will mean that ASIC may suspend or cancel the licence. In addition, ASIC can make a banning order against a person who has not complied with this obligation (section 912A).

The intention of the provision is to require licensees to institute internal polices and procedures to address the issue of conflicts of interest.

The new requirement is intended to supplement the existing requirement for licensees to provide financial services "efficiently, honestly and fairly".

The requirements in the law will be complemented by an ASIC policy paper. A draft paper was released in October 2003. The paper is based around three steps:

1. controlling conflicts;
2. disclosing conflicts; and
3. avoiding conflicts.

The paper is divided into two sections with a dedicated section of the report relating to analysts.

Disclosing conflicts

A recent report raises concerns about the ability of disclosure obligations to overcome conflicts of interest.[22] It says that disclosure is often proposed as a potential solution to conflicts of interest. However, disclosure can have "perverse effects". For example:

1. People do not discount advice from biased advisors as much as they should, even when advisors' conflicts of interest are honestly disclosed.
2. Disclosure can increase the bias in advice as it leads advisors "to feel morally licensed and strategically encouraged to exaggerate their advice even further".

The authors say that the result is that disclosure may fail to solve the problems created by conflicts of interest and may make matters worse.

The report goes on to say that:[23]

> *"Disclosure offers a further benefit to both advisors and to policy-makers: It diminishes both parties' responsibility for adverse outcomes…..[with the disclosure approach], it could be argued that these …. investors should be held responsible for any negative consequences that result; caveat emptor."*

Putting the onus back on consumers to consider advice in light of disclosures made by their financial advisers is not an appropriate approach in relation to some conflicts.

Ms Wolthuizen, from the Australian Consumers Association (ACA) advised the Committee that simply disclosing conflicts of interest was not sufficient in some cases.

The ACA advised the Committee that:[24]

> *"In our view, the conflicts of interest that have emerged in financial services are extremely corrosive to consumer trust in the provision of advice and financial services from many intermediaries where these sorts of arrangements exist."*

The ACA identified the following conflicts as types which could not be remedied by disclosure:

- trail commissions on superannuation guarantee payments;
- soft-dollar commissions; and
- reports from research analysts in investment and broking firms.

[22] Cain, Loewenstein & Moore, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest,* Carnegie Mellon University, Pittsburgh, PA.

[23] Cain, Loewenstein & Moore, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest,* Carnegie Mellon University, Pittsburgh, PA.

[24] Committee Hansard, 7 May 2004, p. 36-37.

Conflicts of interest and Analysts

The Australian Securities and Investment Commission's (ASIC's) 2003 surveillance report on independence of research analysts found that significant improvement was needed in some areas.[25]

In relation to conflicts of interest, ASIC said:

> *"We did observe some systemic weaknesses in the ability of entities to adequately identify, manage and disclose conflicts of interest."*[26]

ASIC also found that investment banks had ignored industry guidelines:

> *"..the industry guidelines developed by the Securities and Derivatives Industry Association (SDIA) and the Securities Institute of Australia (SIA) have not been adopted as closely as intended and there is still significant room for conflicts of interest to occur and to remain unmanaged."*[27]

During the Committee hearing, one of the issues of raised was whether the requirements in the Bill and ASIC's policy paper were sufficient. Of particular importance is whether specific obligations should be imposed in relation to research analysts.

ASIC's view in November 2002 was that:[28]

> *"The work of analysts is sufficiently influential to warrant special safeguards to ensure that direct and indirect users of reports can be reasonably confident that integrity is not flawed by conflicts."*

ASIC's original submission to Treasury on CLERP 9 took a robust view in relation to the types of conflicts which needed to be disclosed and those which needed to be prohibited.

In this submission ASIC advised that effective regulation of analysts required "an integrated legislative approach".[29] ASIC suggested that such an approach comprised three elements:

1. restrictions or prohibitions on certain conduct which cannot otherwise be effectively regulated by an obligation to manage conflicts or disclose conflicts;
2. a general obligation on licensees to manage other conflicts when providing research reports; and

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[25] ASIC Surveillance Report, *Research Analyst Independence,* 22 August 2003
[26] ASIC Surveillance Report, *Research Analyst Independence,* 22 August 2003, p. 21.
[27] ASIC Surveillance Report, *Research Analyst Independence,* 22 August 2003, p. 5.
[28] ASIC, *Submission on CLERP 9 – Corporate disclosure: strengthening the financial reporting framework,* November 2002, p. 27.
[29] ASIC, *Submission on CLERP 9 – Corporate disclosure: strengthening the financial reporting framework,* November 2002, p. 26.

3. a specific obligation on licensees to disclose conflicts of interests when providing research reports.

Restrictions on conduct

ASIC's submission also raised concerns about whether disclosure was sufficient in relation to certain conflicts. It said:[30]

> *"In ASIC's view, at a fundament level, the Act needs to prohibit certain activities of analysts where conflicts cannot be effectively managed, and disclosure of such conflicts is not sufficient to mitigate consumer or make integrity risk."*

ASIC goes to recommend that the following activities are prohibited in the Act:

- trading by an analyst or researcher in products that are the subject of a current research report, within a set period; and
- trading by an analyst or its individual researchers against a recommendation or opinion contained in a current research report.

Disclosure of specific matters

ASIC's submission also says that there is a "disclosure gap" in relation to the requirements under the Act for providers of research reports. For example, the current conduct and disclosure provisions in Part 7.7 do not require specific conflicts and remuneration disclosure in a research report that contains a recommendation or opinion about a specific financial product to unidentified clients or a class of clients.

Accordingly there is no obligation for a Statement of Advice (SoA) to be provided in such circumstances. This means that clients may rely on research reports to make financial decision without disclosure of specific conflicts and remuneration arrangements relating to that report.

To remedy this "disclosure gap", the submission recommends amending the law to include a specific conflicts obligation to disclose information about remuneration and information about other interests and other relationships:

> *"that might reasonably be expected to be or have been capable of influencing the providing entity (or its representatives) in providing the report or recommendation."*[31]

[30] ASIC, *Submission on CLERP 9 – Corporate disclosure: strengthening the financial reporting framework,* November 2002, p. 28.

[31] ASIC, *Submission on CLERP 9 – Corporate disclosure: strengthening the financial reporting framework,* November 2002, p. 30.

Labor's proposals

The Labor members are concerned that guidance from ASIC alone will not be sufficient to address certain conflicts.

Accordingly, the Labor members endorse the following amendments:

- prohibiting trading by an analyst or researcher in products that are the subject of a current research report within a set time frame;

- prohibiting trading by an analyst or researcher against a recommendation or opinion contained in a current research report; and

- Publishing of any reports for a period after the analyst firm has acted in an IPO for the company that is the subject of the report ie. establish "quiet periods".

The Labor members also believe that the Government should:

- Mandate written disclosure in analyst reports of any interest of the analyst; and
- Require companies to disclose information provided during briefings to analysts.

The Australian Shareholders Association (ASA) advised the Committee that they endorsed Labor's proposal to require the disclosure of information provided during analyst briefings.[32]

Shareholder Activism (Schedule 8 of the Bill)

The Explanatory Memorandum notes that one of the Bill's objectives is to promote shareholder activism.[33]

The Labor members welcome the amendments in the CLERP 9 Bill relating to shareholder activism. They will assist in the process of voting by shareholders and enable groups such as the Australian Shareholders Association (ASA) to be appointed on individual shareholders behalf.

However, the CLERP 9 Bill fails to sufficiently empower shareholders.

Shareholder activism in Australia is at a much lower level than in the US and the UK.

With proxy voting levels in Australia at 44% and with proxy voting levels in the UK reaching 55% and around 80% in the USA - Australia has a long way to go to reach the levels of shareholder activism which exists in other jurisdictions.[34]

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[32] Committee Hansard, 9 March 2004, p. 17.
[33] Explanatory Memorandum, CLERP 9 Bill, p. 1.
[34] Corporate Governance International (CGI), *Proxy Voting Report*, March 2004.

Over half of the Australian adult population now invests in the share market either directly or indirectly.[35]

Considering that most Australian's having an exposure to the share market via their superannuation, shareholder activism and corporate governance are of immense importance.

Labor takes the view that the exercise of ownership rights by all shareholders, including institutional investors, should be facilitated by Government and supported by the regulatory framework.

Recently, 43% of shareholders in the Disney company in the US supported a "no confidence" vote in the Chairman, Mr Michael Eisner. As a result of this vote, Mr Eisner has stepped down as Chairman of Disney.

Shareholder activism is no longer confined to the US. It's a global movement that Australian companies are now grappling with.

Shareholder activism in Australia will continue to grow, and with it, the accountability of boards and management.

In his report into HIH, Justice Owen said:[36]

> *"There is an opportunity for institutions and especially managed funds to take a lead. Managed funds, through which the investments of numerous sometimes small investors are pooled, should be encouraged to undertake analysis of the performance and governance of the companies in which they invest. They should make their views known to those companies and exercise voting rights for the people on whose behalf they have invested."*

To make their views known, Justice Owen says:[37]

> *"A proactive stance, together with a report to their investors on whether and if so how they have exercised their votes would be consistent with their responsibilities."*

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35 ASX 2003 Australian Share Ownership Study

36 HIH Royal Commission, The Failure of HIH Insurance, Volume 1 – A Corporate Collapse and its lessons, p. 121.

37 HIH Royal Commission, The Failure of HIH Insurance, Volume 1 – A Corporate Collapse and its lessons, p. 121.

Recently some institutional shareholders in Australia have begun to take a more active approach in the companies in which they invest. The show down over Harvey Norman's options policy in July 2003 is one example. The withdrawal of resolutions on remuneration prior to the News Corporation AGM is another.

Some super funds are also taking an interest in the corporate governance practices of the companies they invest in. This is largely driven by the fact that 44% of super fund investments (amounting to around $518 billion) are invested in listed Australian companies.[38]

Voluntary Codes

In the UK, the Institutional Shareholders Committees' voluntary *Statement of Principles* has been criticised on the grounds that as they are not part of the law, it is impossible to overcome the web of conflicts of interest in the industry.

Similar considerations apply in Australia. Recent history shows that the self-regulatory approach in relation to proxy voting has failed to result in the level of activism seen in other jurisdictions. A good test of the level of activism is to consider the number of board resolutions which were defeated during the last AGM season. The Labor members are not aware of any resolutions which were defeated (although some were withdrawn prior to the AGM).

Whilst an open dialogue between a fund manger and a company prior to an AGM may produce outcomes and avoid the need for public disagreement, there are instances where Australian institutional investors have simply failed to act.

Accordingly, a legislative framework is required to overcome these conflicts.

Disconnect

Many Australian boards have acted in their own self-interest, not in the interests of their shareholders.

There is a disconnect between shareholders interests and the interests of the company.

This disconnect arises from the imbalance in the relationship between shareholders and the board of directors.

An article in the *Harvard Business Review*, accurately diagnosed the cause of the problem, saying that:[39]

> *"When shareholders fail to engage, either in setting direction or holding board members accountable for their behaviour, an important link in the*

[38] Phil Spathis, Australian Council of Super Investors (ACSI), Committee Hansard, 16 March 2004, p. 69.
[39] C. Montgomery and R. Kaufman, *The Board's Missing Link,* Harvard Business Review, March 2003, p. 90.

> *governance system is missing. In this context, a director's allegiance shifts from its proper base – the shareholders – to the nearby boardroom, where fellow directors and management fill the void."*

This re-direction of a director's allegiance from the shareholders to other directors and to management, has created an environment in which shareholders interests have taken second place to boardroom ego.

According to the Harvard Business Review, when shareholders are left out of the loop, the result is that:[40]

> *"..directors move closer to management, and (this) sets the stage for the cordial, consensus-driven environment for which boards are widely criticised."*

This issue is also prevalent in Australian boardrooms.

In his report into HIH, Justice Owen says that:[41]

> *"Shareholder apathy can play a part in undesirable corporate governance. If shareholders as owners are unwilling or unable to exercise their powers or make themselves heard, directors and management will lack guidance or constraint from those whose interests they are supposed to serve. Shareholders have an interest in seeing that a board is properly constituted and holding it to account for the company's performance."*

In order to hold directors accountable, shareholders need to be empowered.

Recently, the US has introduced new requirements in relation to their mutual funds. Under the rules mutual funds will be required to disclose their voting records.

The Labor members endorse the amendments foreshadowed by Senator Conroy. He has indicated that he will move amendments to:

- Require trustees of super funds to vote on material resolutions and to disclose their voting records and voting policies;
- Require fund managers to disclose their voting policy and voting records.

Additional ways to empower shareholders

There are a number of other steps which should also be taken to empower shareholders. Those steps include:

- Requiring shareholder approval (non-binding) where a director chairs more than 1 top 300 listed company;

[40] C. Montgomery and R. Kaufman, *The Board's Missing Link,* Harvard Business Review, March 2003, p. 90.

[41] HIH Royal Commission, The Failure of HIH Insurance, Volume 1 – A Corporate Collapse and its lessons, p. 121.

- Requiring disclosure of information about directors prior to being elected (such as their relationships with the company and other directors);
- Requiring disclosure of the qualifications of company secretaries;
- Amending section 250A(4) to ensure that the voting intentions of shareholders are carried out;
- Amending section 251AA to require disclosure of resolutions withdrawn prior to AGMs; and
- Requiring the disclosure of beneficial owners (discussed below).

Beneficial Ownership

Background

The issue of the who is behind the nominee companies which hold large stakes in Australian listed companies, was raised by a number of witnesses even though the issue is not addressed in the Bill.

The issue has recently gained media attention in light of the Off-set Alpine case and the (cancelled) Extraordinary General Meeting of NAB shareholders.

A recent letter in the *Australian Financial Review* asserted that whilst NAB directors knew who the real owners of the shares listed under the names of the nominee companies and they can lobby these invisible shareholders, other shareholders did not have this information.[42]

This issue was raised by the Australian Conservation Foundation (ACF) who said that disclosure of beneficial information gives shareholders the information they need in order to enter a dialogue with the relevant owners.

The issue has also been raised in the context of disclosures made in annual reports. Reviewing the annual reports of a number of listed companies reveals that these lists are frequently dominated by nominee companies.

Current Law

There are two ways to obtain information about beneficial owners.

- Firstly, a company can lodge a tracing notice against its own registered holders.

- Secondly, under section 672 ASIC can lodge notices on its own behalf or as requested by a shareholder. ASIC charge $500 for each notice lodged on behalf of a shareholder.

ASIC have advised the Committee that neither the substantial shareholding provisions in Part 6C.1 of the Corporations Act nor the annual reporting requirement

[42] 14 April 2004

in Part 2M.3 of the Corporations Act require disclosure by an entity, company or any other person about the beneficial ownership of shares in an entity.

Part 6C.2 of the Act permits a listed company or the responsible entity of a managed investment scheme to direct a member of the company or the holder of an interest in the scheme to disclose details of relevant interests in the shares or interests. This would include details about beneficial ownership. The company or registered scheme may choose to pass information they have obtained on to ordinary shareholders.

ASIC has a similar power. ASIC must exercise this tracing power if requested to do so by a member of the company or scheme unless it considers it would be unreasonable to do so in all the circumstances. If ASIC exercises the tracing power on the request of a member of the listed company or managed investment scheme, ASIC must pass on the information received on to the person who made the request unless it considers it would be unreasonable to do so in all the circumstances. Otherwise, information obtained under the tracing powers cannot generally be passed on to ordinary shareholders by ASIC.

ASX Listing Rule LR 4.10.09 requires the annual report of a listed entity to contain the names of the 20 largest holders in each class of security. This requirement is separate from any provisions dealing with disclosure of substantial holdings. The listing rule does not require beneficial ownership to be disclosed.

Why is the information needed?

A number of witnesses advised the committee that disclosing benefit ownership is market relevant information.

Mr Paatsch from IA Research said:[43]

> *"…it is market relevant information, it is price relevant and it is in the interest of the transparency of the market as a whole. Other jurisdictions have it, why ought not Australia?"*

In the US and UK, where beneficial ownership information is in existence it must be disclosed.

From the evidence provided to the Committee it appears that Australia is lagging behind international best practice in this area.

The concern raised was that many Australian companies are aware of the beneficial owners but this information is not provided to the public.

Mr Paatsch advised the Committee that most Australian listed corporations issue trading notices across their top 100 shareholders. He said that:

[43] Committee Hansard, p. 19

"…the majority of ASX 200 companies would do this at least quarterly or monthly, paying between $10,000 and $150,000 per year.."

In light of the fact that many large companies already have this information, Mr Paatsch said that it should be disclosed on a public register.

There is also an issue whether the company does not know who its beneficial owners are. One option which has been raised is to tie the payment of dividends to shareholders to the requirement to disclose the beneficial owner of the shares.

Jurisdictional Issues

In the Offset Alpine case, Justice Sackville ruled that Swiss banking law took precedence over Australian laws. In other words, the disclosure of beneficial owners was contrary to Swiss law and therefore not required.

The proposal to require companies to disclose beneficial owners onto a register where they have that information would not overcome the brick wall which Australian regulators face when dealing with jurisdictions such as Switzerland.

This is an issue which requires further consideration.

Conclusion

The Labor members are of the view that where a company has beneficial ownership information, it should be disclosed on a public register.

The Labor members acknowledge the problems faced by Australian regulators when dealing with jurisdictional issues and recommend further consideration of this issue.

SENATOR PENNY WONG
DEPUTY CHAIR

MR ANTHONY BYRNE MP

SENATOR STEPHEN CONROY

MR ALAN GRIFFIN MP

APPENDIX 1
LABOR MEMBER'S POSITION ON THE COMMITTEE RECOMMENDATIONS

No.	Committee Recommendation	Labor Member's Position
1	The Committee recommends that a provision be inserted in the Bill that would require corporations to establish a whistleblower protection scheme that would both facilitate the reporting of serious wrongdoing and protect those making or contemplating making a disclosure from unlawful retaliation on account of their disclosure. The Committee refers to Australian Standard AS8004—2003 as a starting point for corporations.	The Labor members are considering the detail of the whistle blower recommendations but support many of them in principle.
2	The Committee further recommends that ASIC publish a guidance note designed for all companies, using AS8004—2003 as a model, to help further promote whistleblowing protection schemes as an important feature of good corporate governance.	The Labor member's are considering the detail of the whistle blower recommendations but support many of them in principle.
3	The Committee recommends that paragraphs 1317AA(1)(a)(iv) be amended to read 'an employee of a person who has contracted for services with, or the supply of goods to, a company'.	Support
4	The Committee recommends that the threshold test of 'in good faith' be removed and replaced by 'an honest and reasonable belief'.	Support
5	The Committee recommends that the provision stipulate that the report relate to 'a serious offence'.	The Labor members are considering the detail of the whistle blower recommendations but support many of them in principle.
6	The Committee recommends that the Government give serious consideration to providing for anonymous reports. It believes that by having the requirements that a person must have an honest and reasonable belief that an offence has or will be committed and that the offence is a serious offence is sufficient safeguard against frivolous or vexatious reporting.	The Labor members are considering the detail of the whistle blower recommendations but support many of them in principle.
7	The Committee recommends that a provision be inserted in the proposed whistleblowing scheme that expressly provides confidentiality protection to persons making protected disclosures to ASIC or making such disclosures to the designated authorities within a company. Similar provisions should be inserted to protect the rights of persons who are the subject of a disclosure.	The Labor members are considering the detail of the whistle blower recommendations but support many of them in principle.
8	The Committee believes that the Government should review the proposed penalty to be set down in Schedule 3 as item 338 to ensure that it is comparable with other jurisdictions and offences of a similar nature.	Support

No.	Committee Recommendation	Labor Member's Position
9	The Committee further recommends that a provision be inserted in the Bill that would allow ASIC to represent the interests of a person alleging to have suffered from an unlawful reprisal.	The Labor member's are considering the detail of the whistle blower recommendations but support many of them in principle.
10	The Committee recommends that ASIC release as soon as possible a guide that leaves no doubt that the remuneration report is to contain a discussion on the board policy for determining the remuneration of its most senior executives which is to be presented in such a way that links the remuneration with corporate performance.	The Labor members take the view that the legislation and regulations should provide more detail about the information to be disclosed.
11	The Committee also recommends that the regulations to be promulgated under this section adopt the direct and specific language used in the Explanatory Memorandum and not the vagueness of the wording in the Bill. The Committee recommends that regulations make clear that what must be included in the remuneration report is information 'such as performance hurdles to which the payment of options or long term incentives of directors and executives are subject; why such performance hurdles are appropriate and the methods used to determine whether performance hurdles are met'.	Support. The Labor members note that draft regulations have now been released. The Labor members take the view that the legislation and regulations should provide more detail about the information to be disclosed.
12	The Committee recommends that the Government review the penalty provisions for contraventions of section 300A with a view to allowing a greater degree of flexibility in applying penalties especially for offences unlikely to satisfy the test that the contravention 'materially prejudices the interests of the corporation or materially prejudices the corporation's ability to pay its creditors or is serious or is dishonest'.	Support in principle
13	The Committee recommends that a new sub section 300(10)(d) be inserted in the Bill which would require the directors' report to include details of the qualifications and experience of each person who has held the position of company secretary during the reporting period.	Support
14	The Committee recommends that the Government include in the Corporations Act a general principle that executive directors are not to be involved in determining their own remuneration unless there are reasonable grounds for that not to occur.	The Labor members take the view that the Corporations Act should prohibit the payment of options, bonus payments and other retirement benefits (other than statutory superannuation) to non-executive directors.
15	The Committee recommends that CLERP 9 be amended	Support

No.	Committee Recommendation	Labor Member's Position
	to include a provision that requires equity based schemes as a form of executive remuneration to be subject to shareholder approval.	
16	The Committee recommends that all payments made to directors be subject to shareholder resolution including payments such as the maximum annual cash payment and any retirement benefit or termination payout.	Support
17	The Committee notes the many concerns expressed about the proposed infringement notice regime. In particular, the Committee refers to the blurring of ASIC's functions of investigator and adjudicator. In light of these concerns, the Committee recommends that ASIC's guide on issuing infringement notices more fully explain and document the procedures it will adopt to ensure that there is a clear and definite separation of its responsibilities to investigate and to adjudicate.	The Labor members are concerned about the timeliness of the issuance of a notice of infringement.
18	The Committee recommends that CAMAC review the operation of the infringement notice provisions two years after they come into force. It recommends further that in light of comments suggesting that ASIC is not fully or effectively using its current powers to enforce the continuous disclosure provisions that the review take a broader approach and examine the effectiveness of the enforcement regime for continuous disclosure as a whole including the criminal and civil provisions.	As above.
19	The Committee recommends that a three-year sunset clause relating to the infringement notice provisions be inserted in the Bill.	Do not support
20	The Committee recommends that Treasury make the submissions it receives on the draft due diligence defence publicly available.	Support
21	The Committee recommends that the law be amended to ensure that the voting intentions of shareholders through their proxyholder are carried out according to their instructions.	Support
22	The Committee recommends further that the provisions governing voting at meetings be reviewed by CAMAC with a focus on the matters that have been raised during the inquiry but which the Committee has not examined in depth. Including the disclosure of voting—numbers for,	Support in principle. The Labor members are of the view that disclosure of voting

No.	Committee Recommendation	Labor Member's Position
	against and abstentions on each resolution before the meeting.	records should occur **after** the AGM.
23	The Committee recommends that as best practice, institutional investors: • include a discussion of their voting policies in their annual report which includes how they manage conflicts of interest in regard to their investments; and • disclose their voting record in the annual report.	We support the principle of disclosure of voting policies and voting records for fund managers, life companies and other institutional investors. However, the Labor members are of the view that this disclosure should occur on the entity's website to avoid increasing the length of annual reports. In addition, the Labor members are of the view that trustees of super funds should be required to vote on material resolutions.
24	The Committee recommends that the 100 member rule for the requisitioning of a general meeting be removed from section 249D of the Corporations Act.	Support. The Labor members support reform of this provision and note that the 'modified square root rule' received widespread support.
25	The Committee recommends that the Government examine carefully ASIC's submission to Treasury and its surveillance report on research analyst independence with a view to amending the provisions on managing conflicts of interests to provide clearer direction on circumstances that must be avoided and activities that must not be undertaken because of conflicts of interest.	Support in principle The Labor members are of the view that certain conflicts of interest should be prohibited.
26	The Committee recommends that provisions be inserted in the Corporations Act that would require the annual report of listed companies to include a discussion of the board's policy on making political donations.	This issue should be referred to the Joint Standing Committee on Electoral Matters.
27	The Committee recommends that the Government reinstate in the Act the requirement for listed companies to keep a public register of notices of beneficial ownership.	Support

Appendix 2
Termination Payments Graph

Division 2, Part 2D.2 of the *Corporations Act 2001* governs circumstances when shareholder approval is required before a benefit may be given to a person in connection with the retirement from "board or managerial office".

Retirement payments do not require shareholder approval if they are less than the total amount reached under the formula prescribed by legislation[44].

Annual remuneration per annum	Formula *Total remuneration x Relevant period* *3*	Total
3.5 years employment		
$1 million	($1million x 3 years) x 3.5 years 3	$3.5 million
$2 million	($2million x 3 years) x 3.5 years 3	$7 million
$3 million	($3 million x 3 years) x 3.5 years 3	$10.5 million
$4 million	($4 million x 3 years) x 3.5 years 3	$14 million
$5 million	($5 million x 3 years) x 3.5 years 3	$17.5 million
$6 million	($6 million x 3 years) x 3.5 years 3	$21 million
$7 million	($7 million x 3 years) x 3.5 years 3	$ 24.5 million
$8 million	($8 million x 3 years) x 3.5 years 3	$28 million
$9 million	($9 million x 3 years) x 3.5 years 3	$ 31.5 million
$10 million	($10 million x 3 years) x 3.5 years 3	$35 million
5 years employment		
$1 million	($1million x 3 years) x 5 years 3	$ 5 million
$2 million	($2million x 3 years) x 5 years 3	$10 million
$3 million	($3million x 3 years) x 5 years 3	$ 15 million
$4 million	($4million x 3 years) x 5 years 3	$20 million
$5 million	($5million x 3 years) x 5 years 3	$25 million
$6 million	($6million x 3 years) x 5 years	$30 million

[44] This formula applies to executive directors and executives of the company who are employed for more than 3 years (s. 200G).

Annual remuneration per annum	Formula *Total remuneration x Relevant period* *3*	Total
	3	
$7 million	($7million x 3 years) x 5 years 3	$35 million
$8 million	($8million x 3 years) x 5 years 3	$40 million
$9 million	($9million x 3 years) x 5 years 3	$45 million
$10 million	($10million x 3 years) x 5 years 3	$50 million
7 years		
$1 million	($1million x 3 years) x 7 years 3	$ 7 million
$2 million	($2million x 3 years) x 7 years 3	$14 million
$3 million	($3million x 3 years) x 7 years 3	$21 million
$4 million	($4million x 3 years) x 7 years 3	$28 million
$5 million	($5million x 3 years) x 7 years 3	$35 million
$6 million	($6million x 3 years) x 7 years 3	$42 million
$7 million	($7million x 3 years) x 7 years 3	$ 49 million
$8 million	($8million x 3 years) x 7 years 3	$56 million
$9 million	($9million x 3 years) x 7 years 3	$63 million
$10 million	($10 million x 3 years) x 7 years 3	$70 million

Appendix 3

A Guide to Labor's Proposed Amendments to the CLERP 9 Bill[45]

The CLERP 9 Bill	Labor's Proposed Amendments
SCHEDULE 1 - AUDIT REFORM	
Non-audit work Companies will be required to identify all non-audit services provided by the audit firm in the annual report and to disclose the fees relating to this work. Also, audit firms will have to explain why these non-audit functions do not compromise audit independence.	Labor proposes to move amendments which prohibit the company's auditor from providing certain non-audit services which compromise the independence of the auditor such as accounting and book keeping services, valuation services, resolution of legal disputes, actuarial services and internal audit services. <u>Note</u>: This proposal was supported by a number of groups during the JPC Inquiry including the Australian Shareholders Association, the Australian Council of Super Investors, the Institute of Internal Auditors and others.
Cooling off A two-year cooling off period is required before a partner or professional employee of an audit firm can join a client (where the person was a member of the audit team for the audit). Section 324CI, section 324 CJ	Labor proposes to move an amendment to require a 4-year cooling off period. <u>Note</u>: A 2 year period is contrary to Justice Owen's recommendation in the HIH report. Justice Owen recommended that 4 years was an appropriate cooling off period for those directly involved in the audit.[46]
Audit Committees *No recommendations in the CLERP 9 Bill*	Labor's amendments require that the top 300 listed companies:[47] - Have an appropriately composed audit committee (in accordance with the ASX

[45] Note: This Guide was released prior to the tabling of this report and further amendments are anticipated.
[46] Recommendation 11, HIH Royal Commission, *The Failure of HIH Insurance, Volume 1, A corporate collapse and its lessons*, April 2003, p. 177.
[47] <u>Note</u>: Originally, ASX Listing Rule 12.7 required companies within the ASX All Ordinaries Index (top 500) to have an audit committee. The ASX Implementation Review Group have recommended that the ASX LR is changed to apply to the top 300 listed companies.

The CLERP 9 Bill	Labor's Proposed Amendments
	Corporate Governance Principles); - Have a written charter for the audit committee; and - Have an audit committee which fulfils certain duties. Note: These amendments implement recommendations from Professor Ramsay's report.[48]
Auditor to attend AGM Auditor is required to attend the AGM and answer questions.	Support. In addition, Labor will move an amendment that requires the disclosure in audit reports of: - the impact of the position taken by the reporting entity where alternative accounting treatments are reasonably open from the reading of an accounting standard and the difference between those accounting standards is material; and - significant matters arising in the audit process. Note: These amendments implement recommendation 13 made by Justice Owen in relation to HIH.[49]
Penalties for breach A framework for auditor liability has been adopted in the Bill. Penalties range from $1,100 to $2,750 and/or imprisonment for 6 months. [See further: Schedule 1, Part 3, p. 100.]	Labor will increase these pecuniary penalties to start at $10,000.

[48] Professor Ian Ramsay, *Independence of Australian Company Auditors, Review of Current Australian Requirements and Proposals for Reform,* Report to the Minister for Financial Services and Regulation, October 2001.
[49] HIH Royal Commission, *The Failure of HIH Insurance, Volume 1, A corporate collapse and its lessons*, April 2003, p. 183.

The CLERP 9 Bill	Labor's Proposed Amendments
FRC – Oversight The role of the Financial Reporting Council (FRC) will be expanded to cover oversight of the audit standard setting process and the monitoring and advising on auditor independence.	Labor will move amendments to remove the power of the FRC to set the strategic direction of the AASB and AuASB. And also require that meetings are held in public.
SCHEDULE 2 – FINANCIAL REPORTING	
CEO / CFO to signoff to the board on financial accounts	Labor has proposed an amendment to this provision which extends the sign-off to include risk management and internal compliance procedures. <u>Note</u>: this amendment is based on the *ASX Corporate Governance Guidelines*.
SCHEDULE 4 - ENFORCMENT	
Part 4 amends the civil penalty provisions including increasing the maximum penalty applicable in relation to a contravention of a financial services civil penalty provision for a company to $1 million.	Labor proposes to move amendments to the Bill to strengthen enforcement provisions of the Corporations Act by: Doubling current penalties for serious breaches of the *Corporations Act 2001* from 5 years to 10 years and increasing to 5 years many offences that now only carry 2-year penalties. <u>Note</u>: Labor will also increase the penalties for breach of the new audit provisions. See above.
SCHEDULE 5 - Executive Remuneration	
Remuneration Report Listed companies will be required to disclose to shareholders details of directors and executives salaries and bonuses in a dedicated "Remuneration Report". The items to be disclosed will be in accordance with the accounting standard: *AASB 1046 Director and*	Labor proposes to move amendments to the Bill to strengthen the disclosure requirements. Labor will also require disclosure of: - duration of contracts; - equity value protection schemes;

The CLERP 9 Bill	Labor's Proposed Amendments
Executive Disclosures by Disclosing Entities.	- graphs plotting shareholder return for the previous five years etc. In addition Labor will prohibit: - the payment of options, bonus payments and retirement benefits (other than statutory superannuation) to non-executive directors; and - non-recourse loans to directors and senior executives. Note: Further amendments are anticipated.
Termination payments Existing provisions in the *Corporations Act 2001* relating to shareholder approval of termination payments are amended.	Labor will require shareholder approval of termination payments which exceed 1 year's salary (excluding statutory super). Note: Currently executives can obtain termination payments up to around 7 times their salary before needing shareholder approval.
Non-binding vote The remuneration report will be submitted to shareholders for advisory approval at the AGM. Approval will take the form of a non-binding resolution to adopt or reject the report.	Note: A similar policy was proposed by Labor in March 2003 and rejected by the Government. Labor welcomes the Government's decision to adopt Labor's policy.
Expanding disclosure obligations to top 10 The disclosure of executive remuneration will be expanded (from the directors and the five most highly paid executives) to the top five executives in the *entire corporate group*. This means that the remuneration of up to 10 senior managers must be disclosed.	Note: This policy is based on Labor's policy to expand to disclosure to the top 10 senior managers.
Acquisitions of equity under schemes *- not addressed in CLERP 9*	Labor will require that acquisitions by directors under an employee incentive scheme be approved by a special resolution.

The CLERP 9 Bill	Labor's Proposed Amendments
	Note: This amendment reinstates an ASX Listing Rule requirement which was amended in 2000 to require approval by 50% of shareholders rather than a special resolution.
Trading Windows *- not addressed in CLERP 9*	Labor will require trading windows and permit management to trade shares or exercise options only at specified times. Note: This amendment is currently being drafted.
SCHEDULE 6 – CONTINUOUS DISCLOSURE	
ASIC Infringement power ASIC will be given the power to issue infringement notices for breaches of the continuous disclosure regime.	Support in principle. Labor will move an amendment to ensure that the notice is disclosed in a timely fashion. Note: This amendment is currently being drafted.
SCHEDULE 8 - Shareholder Participation	
The CLERP 9 Bill makes some changes to increase shareholder participation. These amendments are welcome but do not go far enough.	Labor proposes to move amendments to the Bill to empower shareholders. Accordingly, Labor proposes the following reforms: • Require trustees of super funds to vote their proxies in relation to the listed companies that they invest in and disclose their voting policy and voting record; and • Require fund managers to disclose their voting policy and their voting record. Note: These amendments are included in Document 3.
Chair of more than one company - not addressed in CLERP 9	Labor will move an amendment such that where a director is appointed the Chair of a company and the director is already the

The CLERP 9 Bill	Labor's Proposed Amendments
	Chair of another company, the company will be required to put a non-binding resolution to shareholders at the AGM in relation to the appointment of the director as the Chair of the company. Note: This will only applies where the Chair is potentially the director of 2 companies within the top 300 companies on the ASX.
Directors to disclose their other directorships in the annual report *(new section 300(11))*	Support. *In addition*, Labor will move an amendment to ensure that shareholders are aware of the director's relationship with the company **BEFORE** being elected. When standing for election, directors should disclose: - all relationships between themselves and the company; - any relationship between the themselves and other directors of the company in addition to disclosure of their other directorships.
Disclosure of qualifications of company secretaries in the annual report - not addressed in CLERP 9	Labor will require the disclosure of the qualifications and experience of company secretaries in the annual report.
Proxy Voting *Members will be able to appoint an individual* *or a body corporate as a proxy.*	Support. *In addition*, Labor will move an amendment to section 250A(4) to clarify the provision and to ensure that the voting intentions of shareholders are carried out.
Disclosure of Withdrawn Resolutions - not addressed in CLERP 9	Labor will amend section 251AA to require disclosure of resolutions withdrawn prior to the AGM.
Beneficial Ownership	Labor will move an amendment to

<table>
<tr><th>The CLERP 9 Bill</th><th>Labor’s Proposed Amendments</th></tr>
<tr><td>- not addressed in CLERP 9</td><td>require disclosure of beneficial owners.

<u>Note</u>: This amendment is currently being drafted.</td></tr>
<tr><td colspan="2">SCHEDULE 10 - Conflicts of interest</td></tr>
<tr><td>The Bill inserts a requirement for financial services licensees to manage conflicts of interest. ASIC has produced draft guidelines on managing conflicts of interest.</td><td>Labor proposes to:

- prohibit trading by an analyst against a recommendation or opinion contained in a current research report;
- prohibit trading in securities which are the subject of a current research report within a prescribed period.
- enhance disclosure by mandating written disclosure in analyst reports of an interest of the analyst;

In addition Labor will:
- require companies to disclose information provided during briefings to analysts; and
- Require ‘quiet periods’ before publishing of any reports for a period after the analyst firm has acted in an IPO for the company that is the subject of a report.</td></tr>
<tr><td colspan="2">OTHER</td></tr>
<tr><td>Preventing companies from over-riding the Corporations Act 2001 & Preserving the 100 member rule in relation to proposing resolutions

- not addressed in CLERP 9</td><td>Labor will move amendments to:

- Ensure that the Corporations Act 2001 cannot be over-ridden by section 136.
- Ensure that section 249N specifically is not over-ridden by section 136 of the Corporations Act 2001.</td></tr>
</table>

APPENDIX 1

SUBMISSIONS AND TABLED DOCUMENTS

Number	*From*
1	Mr Tom Ravlic
1A	Mr Tom Ravlic
1B	Mr Tom Ravlic
1C	Mr Tom Ravlic
1D	Mr Tom Ravlic
1E	Mr Tom Ravlic
1F	Mr Tom Ravlic
2	Mr Geoff Dunsford
3	Professor Ronald Francis
3A	Professor Ronald Francis
4	Mr Rod Bennett
4A	Mr Rod Bennett
4B	Mr Rod Bennett
4C	Mr Rod Bennett
5	Australian Council of Super Investors Inc
6	Mr Bob Baxt
6A	Mr Bob Baxt
7	The Law Society of Western Australia
8	Chartered Secretaries Australia
8A	Chartered Secretaries Australia
9	Mr Martin Alciaturi
10	Public Sector & Commonwealth Superannuation Schemes
11	Securities Institute of Australia
12	Georgeson Shareholder Communications Australia Pty Ltd
13	Pitcher Partners Accountants Auditors & Advisors
14	ANZ Banking Group
15	Whistleblowers Australia
15A	Whistleblowers Australia
16	Professor Geoffrey George
17	Australasian Investor Relations Association
18	NSW Young Lawyers

Number	*From*
19	The Association of Superannuation Funds of Australia Limited
20	Business Council of Australia
20A	Business Council of Australia
21	Centre for Corporate Governance, University of Technology Sydney
22	Australian Shareholders' Association Ltd
23	Transparency International Australia
24	Law Council of Australia (Corporations Committee, Business Law Section)
24A	Law Council of Australia
24B	Law Council of Australia
24C	Law Council of Australia
25	National Institute of Accountants
25A	National Institute of Accountants
26	The Institute of Internal Auditors
27	PricewaterhouseCoopers
28	Maurice Blackburn Cashman Lawyers
29	STOPline Pty Ltd
30	Deloitte Touche Tohmatsu
31	CPA Australia
32	IA Research
33	KPMG
34	Ernst & Young
35	Australian Institute of Company Directors
35A	Australian Institute of Company Directors
36	The Institute of Chartered Accountants in Australia
37	Baker & McKenzie Solicitors and Attorneys
38	Finance Sector Union of Australia
39	Grant Thornton Association Inc
40	St James Ethics Centre
41	Telstra Corporation Limited
41A	Telstra Corporation Limited
42	The Association of Chartered Certified Accountants Australia & New Zealand
43	Credit Union Services Corporation (Australia) Limited
44	Investment and Financial Services Association Ltd
44A	Investment and Financial Services Association Ltd

Number	*From*
45	The Law Society of South Australia
46	Group of 100 Inc
46A	Group of 100 Inc
46B	Group of 100 Inc
47	Australian Workers' Union
48	Australian Stock Exchange Limited
49	The Commercial Law Association of Australia Limited
50	BDO Chartered Accountants and Advisers
50A	BDO Chartered Accountants and Advisers
51	Premier of New South Wales
52	Mr Keith Alfredson
53	Auditing & Assurance Standards Board
53A	Auditing & Assurance Standards Board
53B	Auditing & Assurance Standards Board
54	Mr Malcolm J Chambers
55	Australian Conservation Foundation
56	Tap Oil Limited
57	Securities and Derivatives Industry Association
57A	Securities and Derivatives Industry Association
58	Corporate Governance International Pty Ltd
59	Professor Graeme Dean and Professor Frank Clarke
59A	Professor Graeme Dean and Professor Frank Clarke
60	Australian Chamber of Commerce and Industry
61	Harding & Associates
62	P M Capital Ltd
63	Mr Stephen Mayne
63A	Mr Stephen Mayne
64	Compliance Logistics Pty Ltd
65	Mr John Fielding

ADDITIONAL INFORMATION/TABLED PAPERS

Date	*Details*
05/11/03	Letter from Mr Donald Magarey, Chairperson of the Companies Auditors and Liquidators Disciplinary Board, enclosing the CALDB's Annual Report for the year ended 30 June 2002

Date	*Details*
05/03/04	Letter enclosing article, Movie making can make money shrink, from Mr Rod Bennett
09/03/04	*Remuneration – Guidelines for Institutions and Listed Companies*, First Edition, March 2003—tabled at the Committee's public hearing on 9 March 2004 by Mr Sandy Easterbrook, Corporate Governance International Pty Limited
11/03/04	Copy of opening statement and attached article, *Auditor Independence Reforms—Recycled Ideas*, (Dean G, Clarke F and Wolnizer P; 2002, *Abacus*, Vol 38, No 2, pp. i-vi) tabled by Professors Graeme Dean and Frank Clarke at the Committee's public hearing on 11 March 2004
16/03/04	Copy of opening statement tabled by the Investment & Financial Services Association Ltd at the Committee's public hearing on 16 March 2004
13/04/04	Letter from Mr Ralph Evans, Australian Institute of Company Directors, responding to questions taken on notice during the Committee's public hearing on 18 March 2004
14/04/04	Copy of opening statement tabled by Mr Geoff Brayshaw, BDO Chartered Accountants and Advisers, at the Committee's public hearing on 14 April 2004
29/04/04	Copy of speech, The need for an accounting court, (made before the American Accounting Association 1957 convention, University of Wisconsin, Madison, Wisconsin, on 27 August 1957) tabled by Mr Tom Ravlic at the Committee's public hearing on 14 April 2004
07/05/04	Company Auditors and Liquidators Disciplinary Board Annual Report for the year ended 30 June 2003, tabled at the Committee's public hearing on 7 May 2004
07/05/04	Two letters dated 7 May 2004 from Mr Ross Clare, The Association of Superannuation Funds of Australia Limited, one responding to questions taken on notice during the Committee's public hearing on 7 May 2004 and the other providing additional information
07/05/04	Paper tabled by Ms Catherine Wolthuizen, Australian Consumers' Association, at the Committee's public hearing on 7 May 2004
13/05/04	Letter from The Institute of Chartered Accountants in Australia commenting on several issues raised at the Committee's public hearings

Date	*Details*
14/05/04	Letter from Mr Paul Coleman, Companies Auditors and Liquidators Disciplinary Board, responding to questions taken on notice at the Committee's public hearing on 7 May 2004
17/05/04	Letter with attachments from Mr Charles Macek, Financial Reporting Council, responding to questions taken on notice at the Committee's public hearing on 29 April 2004
20/05/04	Letter with attachments from the Department of the Treasury responding to questions taken on notice at the Committee's public hearing on 29 April 2004 and supplementary questions of 11 May 2004
20/05/04	Letter from the Australian Securities and Investments Commission responding to questions taken on notice at the Committee's public hearing on 29 April 2004
25/05/04	Letter from the Australian Securities and Investments Commission responding to questions taken on notice at the Committee's public hearing on 29 April 2004
26/05/04	Answer from the Department of the Treasury to written questions from the Committee regarding whistleblowing, executive remuneration, infringement notices and shareholder participation
28/05/04	Answer from the Department of the Treasury to written questions from the Committee regarding executive remuneration and quantum of termination payments to directors
31/05/04	Copy of letter to the Department of the Treasury from the Australian Institute of Company Directors regarding the suggested wording of a proposed due diligence defence to certain continuous disclosure obligations

APPENDIX 2

PUBLIC HEARINGS AND WITNESSES

TUESDAY, 9 MARCH 2004 - CANBERRA

CORPORATE GOVERNANCE INTERNATIONAL PTY LTD
EASTERBROOK, Mr Alexander (Sandy) Arthur Douglas, Principal/Director

AUSTRALIAN SHAREHOLDERS ASSOCIATION LTD
WILSON, Mr Stuart, Chief Executive Officer

THURSDAY, 11 MARCH 2004 - CANBERRA

NATIONAL INSTITUTE OF ACCOUNTANTS
ADAMS, Mr Dennis, Deputy Chief Executive Officer
AGLAND, Mr Reece, Technical Counsel, National Institute of Accountants

CLARKE, Professor Frank Lewis (Private capacity)

DEAN, Professor Graeme William (Private capacity)

INSTITUTE OF CHARTERED ACCOUNTANTS IN AUSTRALIA
HARRISON, Mr Stephen, Chief Executive Officer
PALMER, Mr William, General Manager, Standards and Public Affairs
REILLY, Mr Keith, Technical Adviser

DELOITTE TOUCHE TOHMATSU
McHUTCHISON, Mr Harley Beeman, Chairman

BUSINESS COUNCIL OF AUSTRALIA
MUNCHENBERG, Mr Steven, Director, Policy

TUESDAY, 16 MARCH 2004 - SYDNEY

UNIVERSITY OF TECHNOLOGY SYDNEY
ADAMS, Professor Michael Andrew, Assistant Director, Centre for Corporate Governance

KPMG
COLEMAN, Mr Michael John, National Managing Partner, Risk and Regulation,
FISK, Mr Adrian, Partner, Department of Professional Practice

DUNSFORD, Mr Geoffrey Alan, (Private capacity)

LAW COUNCIL OF AUSTRALIA
FARRELL, Ms Kathleen, Immediate Past Chairman, Corporations Committee, Business Law Section
GOLDING, Mr Greg Ray, Member
KEEVES, Mr John Storrie, Chairman, Corporations Committee, Business Law Section

INVESTMENT AND FINANCIAL SERVICES ASSOCIATION LTD
GILBERT, Mr Richard, Chief Executive Officer
O'REILLY, Mr David, Senior Policy Manager, Investment

AUSTRALIAN STOCK EXCHANGE LTD
HAMILTON, Ms Karen Leslie, Chief Integrity Officer, and Chair, Corporate Governance Council

AUSTRALIAN COUNCIL OF SUPERANNUATION INVESTORS INC
SPATHIS, Mr Phillip, Executive Officer
WALKER, Professor Robert, Adviser

THURSDAY, 18 MARCH 2004 - MELBOURNE

GRANT THORNTON ACCOUNTANTS
ADAM-SMITH, Mr Matthew Alexander, Partner
FENSOME, Mr Martin Edward, Partner

PITCHER PARTNERS
AZOOR HUGHES, Ms Sufiya Dianne, National Technical Director

AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS
BAXT, Professor Bob, Chair, Law Committee
EVANS, Mr Ralph, Chief Executive Officer
GUY, Mr Andrew, Board Representative, Law Committee
JOHNSON, Mr Mark, Deputy Chairman, Reporting Committee

AUDITING AND ASSURANCE STANDARDS BOARD
EDGE, Mr William Rodney, Chairman

CHARTERED SECRETARIES AUSTRALIA
GRATION, Mr Douglas, Member, National Legislation Review Committee
JONES, Mr Richard, Chairman, National Legislation Review Committee
SHEEHY, Mr Timothy Brian, Chief Executive

GROUP OF 100
HARRIS, Mr Geoff, National Executive Coordinator
STANHOPE, Mr John Victor , National President

CERTIFIED PRACTISING ACCOUNTANTS AUSTRALIA

LARSEN, Mr Gregory James, Chief Executive Officer
MULCARE, Mrs Catherine, Policy Adviser, Financial Reporting and Governance

AUSTRALIAN ACCOUNTING RESEARCH FOUNDATION
MIFSUD, Mr Richard, Executive Director

UNIVERSITY OF MELBOURNE
RAMSAY, Professor Ian Malcolm, Director, Centre for Corporate Law and Securities Regulation

TUESDAY, 6 APRIL 2004 - SYDNEY

SECURITIES INSTITUTE OF AUSTRALIA
BURKE, Ms Julie Catherine, National Policy Manager
MARSHALL, Mr Scott Edward, Member, Company Reporting Subcommittee
NEAL, Mr Ian Richard, President

SECURITIES AND DERIVATIVES INDUSTRY ASSOCIATION
CLARK, Mr Doug, Policy Executive
HORSFIELD, Mr David, Managing Director and Chief Executive Officer

PRICEWATERHOUSECOOPERS
HARRINGTON, Mr Anthony Patrick David, Chief Executive Officer
WARD, Mr Robert, National Managing Partner

ERNST AND YOUNG AUSTRALIA
LONG, Mr Brian James, Chairman of Board of Partners, Senior Audit Partner

ST JAMES ETHICS CENTRE
LONGSTAFF, Dr Simon, Executive Director

GEORGESON SHAREHOLDER COMMUNICATIONS AUSTRALIA PTY LTD
WILLIAMS, Mr Murray Evan, Executive Director

WEDNESDAY, 14 APRIL 2004 - MELBOURNE

ALFREDSON, Mr Francis Keith, (Private capacity)

BDO CHARTERED ACCOUNTANTS
BRAYSHAW, Mr Geoffrey Frank, Managing Partner
KNOTT, Mr Jeffrey Francis, Partner
REID, Mr Kevin Richard, Partner

AUSTRALIAN WORKERS UNION
GILLAM, Mr Trent, National Corporate Research Officer
SHORTEN, Mr Bill, National Secretary and Victorian Secretary

FINANCE SECTOR UNION OF AUSTRALIA
MASSON, Mr Rodney, National Communications Manager

CRIKEY.COM.AU
MAYNE, Mr Stephen David, Publisher

INSTITUTIONAL ANALYSIS RESEARCH
PAATSCH, Mr Dean, Manager, Governance Information Products

RAVLIC, Mr Tom, (Private capacity)

THURSDAY, 29 APRIL 2004 - MELBOURNE

AUSTRALIAN ACCOUNTING STANDARDS BOARD
BOYMAL, Professor David, Chairman
STODDART, Ms Ellen Kathrine, Senior Project Manager

DEPARTMENT OF THE TREASURY
DYLEWSKI, Mr Michael, Policy Analyst
HEALY, Ms Kate, Governance Insolvency Unit
HOLMBERG, Ms Kyla, Financial Reporting Unit
LEVY, Mr Peter, Policy Analyst
NIGRO, Mr Lenny, Policy Analyst
PASCOE, Mr Les, Financial Reporting Unit
RAWSTRON, Mr Mike, General Manager, Corporations and Financial Services Division
ROSSER, Mr Mike, Manager, Investor Protection Unit
SMITH, Ms Ruth, Manager, Market Integrity Unit
TAFT, Mr Peter, Policy Analyst
WIJEYEWARDENE, Ms Kerstin, Manager, Financial Reporting Unit
WINCKLER, Mr Simon, Policy Analyst
YOUNGBERG, Ms Naomi, Policy Analyst

AUSTRALASIAN INVESTOR RELATIONS ASSOCIATION LIMITED
LAWSON-KERR, Ms Carolyn, Chairman

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION
MACAULAY, Ms Louise, Director, Enforcement Policy and Practice
PRICE, Mr John, Assistant Director, Regulatory Policy
RODGERS, Mr Malcolm, Executive Director, Policy and Markets Regulation

FINANCIAL REPORTING COUNCIL
MACEK, Mr Charles, Chairman

AUSTRALASIAN INVESTOR RELATIONS ASSOCIATION LIMITED
MATHESON, Mr Ian, Director

FRIDAY, 7 MAY 2004 - SYDNEY

AUSTRALIAN CONSERVATION FOUNDATION
BERGER, Mr Charles, Law and Corporate Responsibility Coordinator

ASSOCIATION OF SUPERANNUATION FUNDS OF AUSTRALIA LTD
CLARE, Mr Ross William, Principal Researcher
PRAGNELL, Dr Bradley John, Principal Policy Adviser

COMPANIES AUDITORS AND LIQUIDATORS DISCIPLINARY BOARD
COLEMAN, Mr Paul John, Registrar
MAGAREY, Mr Donald Rees, Chairman

INSTITUTE OF INTERNAL AUDITORS
McDONALD, Mr Robert, Global Chairman

INSTITUTE OF INTERNAL AUDITORS
PARKINSON, Mr Michael, ex officio Member

FINANCIAL SERVICES, AUSTRALIAN CONSUMERS ASSOCIATION
WOLTHUIZEN, Ms Catherine Nicole, Senior Policy Officer

APPENDIX 3

GOVERNMENT RESPONSE TO THE REPORT OF THE PARLIAMENTARY JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES (EXTRACT)

(*Senate Hansard*, 6 February 2001, p. 21354)

Government response

The Government is committed to the principle of enhanced transparency in the corporate sector, particularly in the area of executive remuneration, which in recent times has become the focus of intense public interest. While it is appropriate for executive remuneration to be set through the operation of the market mechanism, transparent and relevant information on remuneration and its relationship to the performance and policy of the board is an essential tool for accountability to shareholders.

The Government supports the PJSC's view that sections 300A and 300(1)(d) should be retained. To a large degree, financial and accounting information should be set by an independent body, the AASB. However, transparency of executive remuneration is of such importance that it should continue to be imposed by the Corporations Law, and be retained in the annual director's report (rather than the financial or concise financial statements), to ensure the widest possible dissemination to shareholders.

The Government's response to the various amendments proposed by the PJSC is:

Paragraph 300A(1)(a) should be amended to replace the word “broad” with “board”;

The words “senior executives” in paragraph 300A(1)(a) should be substituted with “executive officers”. The term “executive officer' is defined in Section 9 of the Corporations Law as a person who is concerned in, or takes part in, the management of the body (regardless of the person's designation and whether or not the person is a director of the body);

The word “company” should be retained in section 300A;

The words “emolument” and “emoluments” should be substituted with “remuneration” wherever occurring in section 300A;

Subsection 300A(1) should be amended to make it clear that disclosure of the value of options granted to directors and the five most highly remunerated executive officers, together with the valuation of options they exercised and the value of options lapsed unexercised, and their aggregation in the total remuneration, is required.

While the Government supports the disclosure of information about remuneration policy and the relationship between that policy and the company's performance as already required by subsection 300A(1), the Government considers it would be inappropriate to use accounting standards as the vehicle for requiring the disclosure of this information and the additional information recommended by the Committee;

Accounting standards can only be used to specify the methodology to be used for accounting for different types of transaction and the disclosures that should be made in the financial report in respect of those transactions. In the case of information about remuneration, any disclosures required by an accounting standard would have to be included in a note to the financial statements;

The Government believes information about remuneration policies and the relationship between those policies and the company's performance is of considerable importance to shareholders and that the Corporations Law should continue to contain the requirement for the information to be disclosed in the annual directors' report;

However, the Government considers it unnecessary to make this general requirement any more specific and detailed as suggested by the Committee. In this regard, the general requirements in new section 300A are considered to be wide enough to encompass the matters outlined by the Committee. It is important that the requirements are flexible enough to enable companies to report those matters that most significantly impact on, and influence, remuneration and performance. An unnecessarily prescriptive approach in this area could risk stifling market developments and competition with regard to best practice;

The Government is concerned that the disclosure currently required by paragraph 300A(1)(c) may be effectively limited, because one or more of the five named officers may also be directors;

The Corporations Law should be amended so that the details of the remuneration of each director is listed, and the details of the remuneration of each of the five most highly remunerated executive officers, other than directors, is also disclosed;

There does not need to be a new definition of the term “executive” inserted in Section 9 - Dictionary, as there is already a definition of “executive officer”;

It is preferable for methods of valuation to be developed by the AASB, especially as accounting standards have the force of law. However, ASIC can provide guidance as to how a legal requirement may be met, and the Government recognises the assistance that ASIC renders the business community in this regard;

The Government does not support the application of section 300A to directors and senior executives of responsible entities of listed managed investment schemes. This position would also apply to unlisted managed investment schemes;

Section 300A requires listed companies to disclose the remuneration of directors and senior executives to shareholders who, as the owners of the company, have an equitable interest in the affairs of the company, including payments received by company officers and management;

The position of unit holders (or members) in a managed investment scheme is fundamentally different from that of shareholders in a company. Members of a managed investment scheme do not, as members, have any ownership interest in the responsible entity that manages the scheme's assets. As a consequence, it is not appropriate for managed investment schemes to provide members with information about remuneration of the directors and other company officers of the scheme's responsible entity;

Members do, however, receive information about fees and charges imposed by the responsible entity through the Corporations Law prospectus requirements. This provides unit holders with sufficient information to make decisions on the relative merits and costs of the different schemes in which they could invest.

APPENDIX 4

CORPORATIONS AMENDMENT (REPAYMENT OF DIRECTORS' BONUSES) BILL 2002

SCHEDULE OF AMENDMENTS MADE BY THE SENATE

Dem (1) [Sheet 2890]

Schedule 1, page 3 (after line 9), after item 1, insert:

1A Section 9 (definition of emoluments)

Repeal the definition, substitute:

> emoluments means the amount or value of any money, consideration or benefit given or accruing, directly or indirectly, vested or unvested, to a director of a body corporate in connection with the management of affairs of the body or of any holding company or subsidiary of the body, whether as a director or otherwise, but does not include amounts in payment or reimbursement of out-of-pocket expenses incurred for the benefit of the body.

Dem (2) [Sheet 2890]

Schedule 1, page 3 (after line 13), after item 2, insert:

2A Subparagraph 200F(1)(a)(iii)

Repeal the subparagraph, substitute:

> (iii) given to the person under an agreement made prior to 30 June 2003 and between the company and the person before the person became the holder of the office as the consideration, or part of the consideration, for the person agreeing to hold the office; or

Opp (3) [Sheet 2893 Revised]

Schedule 1, page 3 (after line 13), after item 2, insert:

2B After section 250R

Insert:

250RA Approval of director's report of listed company

1. The business of an AGM of a listed company must include a resolution approving the annual director's report prepared under section 300A, even if not referred to in the notice of meeting.
2. No entitlement of a person to remuneration or emolument is made conditional on the resolution being passed by reason only of the provision made by this section.
3. The chair of the AGM must allow a reasonable opportunity for the members as a whole at the meeting to discuss the resolution under subsection (1), and the resolution must be put to a vote at the AGM.
4. This section only applies to a company that is listed.
5. This section applies despite anything in the company's constitution.

Opp (4) [Sheet 2893 Revised]

Schedule 1, page 3 (after line 13), after item 2, insert:

2C Section 300A

Repeal the section, substitute:

300A Annual director's report—specific information to be provided by listed companies

(1) The director's report for a financial year for a company must also include:

(a) if a committee of the board has considered matters relating to the emoluments of the directors and executive officers:

(i) the name of each director who was a member of the committee at any time when the committee was considering any such matter; and

(ii) the name of any person who provided to the committee advice or services that materially assisted the committee in its consideration of any such matter; and

(iii) in the case of any person named under subparagraph (ii) who is not a director of the company, the nature of any other services that the person has provided to the company during the financial year and whether the person was appointed by the committee; and

(b) discussion of board policy for determining the nature and amount of emoluments of board members and executive officers of the company, including:

(i) discussion of the relationship between such policy and the company's performance; and

(ii) for each director and each of the 5 named officers (other than directors) of the company receiving the highest emolument, a detailed summary of any performance conditions to which any entitlement of that person to securities is subject; and

(iii) an explanation as to why such performance conditions were chosen; and

(iv) a summary of the methods to be used in assessing whether any such performance conditions are met and an explanation as to why those methods were chosen; and

(v) if any such performance condition involves any comparison with factors external to the company:

(A) a summary of the factors to be used in making each such comparison; and

(B) if any of the factors relates to the performance of another company, of two or more other companies, or of an index on which the securities of a company or companies are listed, the identity of that company, of each of those companies, or of the index; and

(vi) a description of, and an explanation for, any significant amendment to be made to the terms and conditions of any entitlement to securities of a director or of one of the 5 named officers (other than directors) of the company receiving the highest emolument; and

(vii) if any entitlement to securities of a director or of one of the 5 named officers (other than directors) of the company receiving the highest emolument is not subject to performance conditions, an explanation as to why that is the case; and

(viii) in respect of the terms and conditions relating to emoluments of each director and each of the 5 named officers (other than directors) of the company receiving the highest emolument, an explanation of the relative importance of those elements which are, and those elements which are not, related to performance; and

(ix) an explanation of the company's policy on the duration of contracts with directors and the 5 named officers (other than directors) of the company receiving the highest emolument, and notice periods, and termination payments, under such contracts; and

(c) details of the nature and amount of each element of the emolument of each director and each of the 5 named officers (other than directors) of the company receiving the highest emolument; and

(d) for each of the directors and the 5 named officers (other than directors) of the company receiving the highest emolument, details of the value of options granted, exercised and lapsed unexercised during the year and their aggregation in the total emolument; and

(e) for each of the directors and the 5 named officers (other than directors) of the company receiving the highest emolument, details of any equity value protection scheme entered into by them or on their behalf. For the purposes of this paragraph equity value protection scheme means any financial arrangement which results in the director or officer retaining legal ownership of equity in the company the value of which to the director or officer remains fixed regardless of changing market values; and

(f) details of the nature and amount of each element of the emolument of a person, however described, who carries out like responsibilities of a director or each of the 5 named officers (other than directors) of the company who but for this section would not be included as a director or one of the 5 named officers receiving the highest emolument; and

Note: Paragraph (f) includes consultants.

(g) a line graph which plots for each of the most recent 5 financial years the total shareholder return on:

(i) the holding of shares of that class of the company's equity share capital whose listing, or admission to dealing, has resulted in the company falling within the definition of listed company; and

(ii) a hypothetical holding of shares made up of shares of the same kind and number as those by reference to which a broad equity market index is calculated;

(iii) and state the name of the index selected for the purposes of the graph and set out the reasons for selecting that index; and

(h) any other matters prescribed in the regulations.

(2) This section only applies to a company that is listed.

(3) This section applies despite anything in the company's constitution.

(4) This section applies to directors and each of the 5 named officers (other than directors) of the company receiving the highest emolument irrespective of which company in a consolidated group of companies the directors and named officers hold office.

(5) For the purposes of this section and section 588FDA(1)(b), a director includes a director of a subsidiary company and includes a director of a partly-owned subsidiary company.

Opp (5) [Sheet 2893 Revised]

Schedule 1, item 3, page 3 (after line 23), after subparagraph (a)(iii), insert:

(iiia) a profit or benefit accrued to a person listed under subparagraph (b) as a result of the exercise of options over shares granted by the company; or

Opp (1) [Sheet 2896]

Schedule 1, item 3, page 3 (after line 27), after subparagraph (b)(i), insert:

(ia) one of the 5 named officers (other than directors) of the company receiving the highest emolument; or

Opp (6) [Sheet 2893 Revised]

Schedule 1, item 3, page 4 (after line 9), after subparagraph (iii), insert:

(iiia) the payments and benefits received by directors relative to payments and benefits received by employees in the company; and

(iiib) whether the payments or benefits were subject to appropriate performance conditions; and

(iiic) the time the payments or benefits were received, in particular, their proximity to the time at which the company was placed into administration or liquidation, and whether the company was insolvent at the time they were received; and

Opp (8) [Sheet 2893 Revised]

Schedule 1, item 4, page 5 (lines 3 and 4), omit "the commencement of the *Corporations Amendment (Repayment of Directors' Bonuses) Act 2002*", substitute "4 June 2001".

Dem (3) [Sheet 2890]

Schedule 1, page 5 (after line 29), at the end of the Schedule, add:

At the end of Division 6 of Part 5.7B

Insert:

588YA Liability of a company for the debts or liabilities of a related company

(1) When a company is being wound up in insolvency, the liquidator, a creditor of the company, a nominee of a creditor of the company or the ASIC may apply to the Court for an order that a company that is or has been a related body corporate pay to the liquidator the whole or part of the amount of a debt of the insolvent company. The Court may make such an order if it is satisfied that it is just to do so.

(2) In deciding whether it is just to make an order under subsection (1), the matters to which the Court shall have regard include:

(a) whether the company provided services for or on behalf of the related body corporate; and

(b) whether the company occupied premises which are owned by the related body corporate; and

(c) the extent to which the related body corporate took part in the management of the company; and

(d) the conduct of the related body corporate towards the creditors of the company generally and to the creditor to which the debt or liability relates; and

(e) the extent to which the circumstances that gave rise to the winding up of the company are attributable to the actions of the related body corporate or an officer or officers of the related body corporate; and

(f) any other relevant matters as the Court considers just and appropriate.

(3) An order under this section may be subject to conditions.

(4) An order shall not be made under this section if the only ground for making the order is that creditors of the company have relied on the fact that another company is or has been a related body corporate of the company.

Opp (R1) [Sheet 2872 Revised]

Page 5 (after line 29), at the end of the bill, add:

Schedule 2—Amendments relating to voting requirements

Corporations Act 2001

1 After section 250T

Insert:

Division 8A—Voting by trustees of supervised superannuation funds and prescribed fund managers at AGMs and other meetings

250TA Application

(1) Subject to subsection (2), this Division applies to all superannuation funds regulated under the Superannuation Industry (Supervision) Act 1993, including public offer superannuation funds, employer-sponsored funds, approved deposit funds, pooled superannuation trusts and public sector funds, which hold shares in a listed company at the date on which a meeting of shareholders in that company is held.

(2) This Part does not apply to:

(a) a small superannuation fund supervised by the Australian Prudential Regulation Authority; or

(b) a self-managed superannuation fund as defined in section 17A of the Superannuation Industry (Supervision) Act 1993; or

(c) other funds or investments as prescribed by regulation.

250TB Obligation of trustees

Where a meeting of shareholders in a listed company is held, the trustees of a superannuation fund to which this Division applies must comply with the requirements of sections 250TC and 250TD.

Penalty: 100 penalty units.

250TC Duties of trustees at meeting

For the purposes of section 250TB, the trustees of a superannuation fund to which this Division applies must:

(a) `cast votes at the meeting representing all the shares or interests held by the fund in that company; or

(b) appoint proxies to attend and vote on their behalf at that meeting.

250TD Duties of trustees following meeting

For the purposes of section 250TB, the trustees of a superannuation fund to which this Division applies must within 30 days of the conclusion of the meeting, disclose to the beneficiaries of the superannuation fund:

(a) all votes (including proxies) cast by the trustees pursuant to this Division and the matter in relation to which those votes were cast; and

(b) an explanation of the reason or reasons why the votes were cast in the manner chosen.

250TE Duties of prescribed fund managers

(1) This section applies to an entity which manages investments on behalf of other persons or entities as prescribed by regulation (a prescribed fund manager).

(2) This section does not apply to a prescribed fund manager who is acting on behalf of the trustees of a superannuation fund subject to this Division.

(3) A prescribed fund manager must publicly disclose the proxy voting policy and procedures followed by that fund manager.

(4) Where a meeting of shareholders in a listed company is held, a prescribed fund manager with an interest in that listed company must disclose:

   (a) details of the matters put to a vote;

   (b) whether the fund manager cast a vote on that matter (including by proxy) and how that vote was cast; and

   (c) whether that vote was cast in accordance with a Board recommendation or contrary to a Board recommendation.

HARRY EVANS
Clerk of the Senate
The Senate

27 March 2003

APPENDIX 5

ASIC ANSWERS TO QUESTIONS ON NOTICE

20 May 2004

Dr Kathleen Dermody
Secretary
Parliamentary Joint Committee on Corporations and
Financial Services
Parliament House
CANBERRA ACT 2600 Fax: 6277 5719

Dear Dr Dermody,

Parliamentary Joint Committee on Corporations and Financial Services Hearing on *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003*
Thursday 29 April 2004 Hearing

I refer to ASIC's appearance at the PJC's reference into the CLERP 9 Bill on Thursday 29 April 2004 in Melbourne. At that hearing two questions were asked on notice from Senator Wong. A summary of the questions and ASIC's response to them is set out below.

ASIC's submission to the ALRC's report on penalties stated it was "seeking the power to issue infringement notices for failure to comply with the continuous disclosure provisions, and that such contraventions were not of a "less serious nature". Does this contradict ASIC's submission to Treasury in relation to the imposition of fines in respect of continuous disclosure provisions.

This paragraph in ASIC's response to the ALRC's *Discussion Paper on Civil and Administrative Penalties in Australian Federal Regulation* refers to a model scheme for infringement notices which the ALRC's Discussion Paper proposed. The proposal was for a model scheme that would apply only to strict or absolute liability offences of a "less serious nature". ASIC's response was that some consideration or recognition should be given to a role for administrative penalties in respect of other contraventions, that is, contraventions of other than a less serious nature. This expression was intended to include contraventions of continuous disclosure obligations that are suitable for a fining regime.

It is, and has always been, ASIC's view that a contravention of the continuous disclosure obligations in sections 674(2) and 675(2) of the Corporations Act are of significance. The obligation to provide adequate disclosure is fundamental to the transparency of Australian financial markets. However, contraventions of the continuous disclosure obligations can be characterised in a number of ways. The most serious contraventions are those where there is criminal intent, and these have the most serious sanctions attached to them. Civil penalty remedies are also significant, carrying with them substantial fines, although not the reputational damage of a criminal conviction. In ASIC's experience, there are also other contraventions of a continuous disclosure obligations, which are of a less serious nature in the sense that either the delay in the disclosure is less significant, there is less significant trading in the period before there is disclosure, or the information not disclosure, although material, is of less real impact. These represent less serious contraventions of what is a significant offence. It is in respect of these less serious contraventions that ASIC proposed the fining power in relation to continuous disclosure.

There has been no change in ASIC's approach, and it is ASIC's intention that the infringement notice provisions are targeted to capturing less serious contraventions of the continuous disclosure obligations. I note that this is also the intention of the legislation as expressed in paragraph 5.460 of the Explanatory Memorandum to the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003.

It has been suggested by others appearing before the PJC that ASIC has not fully tested its current powers to enforce the continuous disclosure regime, for example that it has not fully tested its ability to seek an injunction against a party which it suspects of breaching the continuous disclosure provisions.

This question or questions raises a number of issues.

First, it is not presently intended that ASIC would routinely use an infringement notice power to obtain disclosure in circumstances where it had not occurred.
ASIC's concerns about current remedies for continuous disclosure contraventions do not relate to its ability to force a company to disclose information. When ASIC becomes aware of circumstances where there has not been disclosure, obtaining disclosure can be adequately dealt with by ASIC's or ASX's current powers. ASIC has not had cause to force disclosure through injunctive orders as in all cases, where ASIC has formed a view that the market was uniformed and disclosure is warranted, it has achieved the desired outcome through negotiation and the threat of litigation.

The bulk of the matters ASIC has referred to it by ASX are circumstances in which disclosure has already been made. Seeking an injunction to force disclosure in these cases is unnecessary. The purpose of the referrals is for ASIC to consider remedial action in respect of the period in which the company may have been in breach of its obligations in relation to disclosure, not for ASIC to seek a mandatory injunction to secure disclosure.

Secondly, it is correct that ASIC has not laid any charges against corporations in relation to a criminal breach of the continuous disclosure provisions. This does not reflect a lack of consideration of such charges, or a lack of will to enforce criminal misconduct. In ASIC's experience in these cases there is difficulty in obtaining sufficient admissible evidence to lay criminal charges. There have been numerous circumstances in the past where ASIC has sought the DPP's advice on this issue, however, to date there has been no circumstance where there has been sufficient admissible evidence to justify commencement of a criminal prosecution. There is considerable uncertainty as to the operation of this provision in the criminal jurisdiction. ASIC is not in a position to provide you with specific details of these circumstances which fall within this category due to privacy considerations. Should you wish to receive further information in confidence, please let us know.

The continuous disclosure obligation is an obligation of disclosing entities, not corporate officers. However, there are remedies available where corporate officers are knowingly concerned in a breach of the law by a corporation. In ASIC's experience, in situations where this conduct occurs, there are also more wide-ranging issues of breach of officers' duties. In these situations, ASIC usually takes criminal or, if this remedy is not available, civil penalty action in relation to these broader breaches. [Recent cases where ASIC has taken directors' duties proceedings where there has also been a failure by corporate officers to ensure adequate disclosure by a corporation include One-Tel and Clifford Corporation Ltd, both criminal and civil penalty.]

The other remedy currently available for breach of continuous disclosure obligations is a civil penalty action. The civil penalty regime in relation to continuous disclosure has been in force since 11 March 2002, and only applies to breaches on or after that date. ASIC has to date commenced one set of proceedings under these provisions, against Southcorp Limited in relation to a breach of section 674(2). These proceedings have also been, and are currently being, considered in a number of other matters that we are unable to detail for privacy reasons.

The Southcorp proceedings were commenced in January 2003, in relation to misconduct that occurred in April 2002. They were set down for a final hearing in December 2003, more than eighteen months after the misconduct occurred. After a number of Court appearances and applications the matter was resolved before final hearing with Southcorp prepared to agree to certain facts. After a hearing on penalty the court determined that a pecuniary penalty of $100,000 was payable.

The length of time taken to commence the Southcorp proceedings reflects the time that it takes to complete an investigation and prepare all the evidence to be filed in civil penalty cases. These matters are substantial commercial cases, and given their unusual civil/ criminal nature, and serious consequences, it is ASIC's experience that defendants always take a number of interlocutory points as part of their defence.

The final point is that although the length of time civil penalty matters are before the courts is not a deterrent to ASIC's ability and willingness to commence them in appropriately serious cases, their cost and consumption of other resources means that this type of proceeding is not an effective remedy where the continuous disclosure contravention is of a less serious nature. Currently there is very little alternative to dealing with a continuous disclosure contravention after the disclosure is made. ASIC may make an administrative order preventing the entity relying on certain exemptions from information disclosure in relation to corporate fundraising, however such an order only applies for 12 months and is irrelevant if a company is not intending to engage in public fundraising.

In the circumstances of these more minor contraventions of the continuous disclosure obligations (in a context were any contravention of continuous disclosure obligations is viewed as a serious matter), much regulatory benefit is gained from dealing with the contraventions in a way which means that the outcome is achieved close in time to the market conduct. That means that the circumstances of the disclosure are fresh in the market's mind and there is an affirmation that the consequences of a failure to disclose will occur in the short term rather than the long term. It also serves to provide an educative function to the markets by indicating to them the circumstances in which ASIC believes disclosure should have occurred.

ASIC endorses the NSW Young Lawyers Business Law Committee statement that there have been no particular circumstances in which the court system has been deficient or too slow for ASIC to enforce the law regarding the continuous disclosure regime. Any frustration which ASIC experiences while seeking civil penalty orders in relation to continuous disclosure contravention derives from the nature of civil penalties and the other factors set out above. While there are some serious issues that arise with the use of the civil penalty regime, this is not the forum in which it is relevant to develop those issues at this time. In the case of the infringement notice scheme, ASIC's view is that its central purpose is to a provide a faster and more effective remedy for less serious breaches of continuous disclosure obligations in the Corporations Act. It is not ASIC's intention to desist form commencing criminal prosecutions or civil penalty proceedings in this area in appropriate cases.

Yours faithfully

Jan Redfern
Executive Director Enforcement

APPENDIX 6

TREASURY'S RESPONSE TO WRITTEN QUESTIONS

Whistleblowing

To your knowledge are any measures planned that would clarify the obligations to be placed on corporations under the proposed whistleblower provisions? Is ASIC to have any role in supervising or assisting corporations in establishing an internal reporting and protection scheme for whistleblowers?

The Bill establishes a framework which is designed to encourage employees, officers and subcontractors engaged by a company to report suspected breaches of the corporate law to ASIC or internally within the company. While the Bill provides protections for employees who wish to report breaches of the law, it does not compel persons to report matters.

The whistleblowing provisions do not prescribe particular systems which companies must adopt to deal with complaints, as companies are best placed to determine what is appropriate for them according to their circumstances.

The proposed legislation... does not specify whether ASIC or the company have a role in ensuring that reprisals do not take place and if they do what action they should take. In other words it is unclear whether the onus rests solely with the whistleblower who has been subject to unlawful reprisal to defend his/her interests. Could you provide details on the protection and enforcement aspect of the proposed whistleblowing scheme?

While the Bill prohibits victimisation, it does not prescribe particular systems that companies must adopt to ensure that whistleblowers are not victimised. A whistleblower who has been victimised may report it to ASIC with a view to ASIC instituting enforcement action. Any company employee who victimises a whistleblower may be liable to a fine and/or imprisonment. A whistleblower who has suffered damage may recover compensation from the perpetrator(s).

The PJSC asked for comment on the Australian Institute of Company Director's observation that paragraph 387 of the Commentary refers to section 127 of the ASIC Act as providing confidentiality protection. It points out that this section deals with the information itself, not necessarily the identity of the person who discloses the information to ASIC. It maintained that if their reading of s 127 is correct and there is a gap in protection then s 127 ought to be amended to make clear that the identity of an informant is confidential information.

Pursuant to section 127 of the ASIC Act, ASIC must take all reasonable measures to protect from unauthorised use or disclosure information that is given to it in confidence in connection with the performance of its functions or powers under the corporations legislation. Where a whistleblower makes a disclosure to ASIC under proposed section 1317AA of the Corporations Act, it is considered that the disclosure of the whistleblower's name would be information given in confidence in connection with the performance of ASIC's functions as a regulator. Consequently, Treasury considers that the person's identity would be subject to the confidentiality requirements contained in section 127.

The PJSC asked for explanation of the reasons behind the setting of the penalty for unlawful reprisals against whistleblowers at 25 penalty points or 6 months imprisonment?

The penalty of up to 25 penalty units and/or 6 months imprisonment is based on the existing penalty provision attached to similar provisions in the *Inspector-General of Taxation Act 2003*.

Executive remuneration

Are you aware of any Inconsistencies between CLERP 9 legislation and AASB 1046?

The accounting standard AASB 1046 *Director and Executive Disclosures by Disclosing Entities* requires disclosure in the notes to the financial statements of information in respect of remuneration of 'specified directors' and 'specified executives'. The CLERP 9 Bill requires disclosure of the remuneration of directors and executives in the annual directors' report.

In terms of the coverage of both the accounting standard and the legislation, there may be instances where the remuneration of different executives will be disclosed. This arises as a result of the following:

- The Bill applies the disclosure requirements to the listed company and the consolidated entity. AASB 1046 requires disclosure of the remuneration of executives in the consolidated entity.
- The Bill has a monetary requirement, that is, the disclosure requirements apply to the 5 most highly remunerated executives in the listed company and the 5 most highly remunerated executives in the consolidated entity. The disclosure requirements in AASB 1046 do not rely on whether an executive is the most highly remunerated.

AASB 1046 requires disclosure of holdings of equity in the company, loans outstanding and other transactions and balances (which include such things as assets sold or leased from directors or executives). These additional disclosures, which are not part of the remuneration of directors and executives, are not required to be disclosed under the CLERP 9 regulations.

Is there inconsistency between the requirements of AASB 1046 and the regulations in respect of discussion of remuneration packages and policies for directors and executives in the directors' report and the financial statements?

There is no inconsistency between the accounting standards and the regulations.

Where is the remuneration report to be located in the directors' report?

The CLERP 9 Bill and regulations do not specify where the remuneration report is to be located, other than it must be included in the directors' report under the heading "Remuneration report" (Sch 5, item 13).

What has happened to the draft amendments to subsection 300A(1A) in the Corporations Amendment Bill 2002?

Item 14 of Schedule 1 of the Corporations Amendment Bill 2002 proposed that:

> For each of the persons covered by paragraph (1)(c), the directors' report for the financial year must disclose:
> (a) the value of options granted to the person in that year (whether over issued or unissued shares); and
> (b) the percentage of the person's remuneration for the financial year that is made up of options granted to the person in that year.

The CLERP 9 regulations will require disclosure of all equity remuneration granted to a director or executive in the current year, broken down to the level of at least the following categories:

- the value of shares and units;
- the value of options and rights;
- any increase in the value of options or rights granted as a result of changes in the terms of options or rights that have already vested.
- all other equity compensation.

The regulations therefore will require disclosure of the same information noted in paragraph (a) above. The information covered by paragraph (b) above is readily ascertainable from the disclosures required by the regulations.

Should ASX Listing Rules that were in existence until July 2000 regarding shareholder votes on changes to equity schemes be reinstated and included in CLERP 9?

The difference between the current listing rules and those that existed prior to July 2000 is that:

- Shareholder approval is no longer required for adoption of a new, or change to an existing, equity scheme for executives or employees; and
- Approval of grants of equity to board members only requires the approval of 50% of shareholders, rather than approval by a special resolution of shareholders.

The approach in the current listing rules is consistent with the policy reflected in the CLERP 9 Bill that the board of directors is responsible for determining the remuneration of executives.

Are there legal implications with the provision requiring shareholder approval of directors' termination payments over a certain limit and contracts that may have already been entered into?

Proposed subsection 1468(2) of the CLERP 9 Bill (Sch 12, item 2) provides that the amendments to section 200F (Sch 5, items 4 and 5) apply to an agreement only if the agreement is entered into on or after 1 July 2004. The transitional provisions will ensure that the approval requirements will not apply to agreements entered into prior to 1 July 2004.

Infringement notices

Does the definition of a breach of the continuous disclosure provisions in itself mean that the offence is serious?

One of the characteristics of information required to be disclosed under the continuous disclosure provisions is that it is:

> "information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of…securities" (paragraph 624(2)(c)(ii) of the Act).

Material effect is defined in section 677 of the Act:

> "…a reasonable person would be taken to expect information to have a material impact…if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the…securities."

The degree to which a person who commonly invests in securities can be influenced to acquire or dispose of securities can vary since such a person is likely to be capable of gauging the magnitude of the effect on a security's price or value resulting from certain information being disclosed to the market.

The infringement notice mechanism is designed to apply to relatively minor contraventions of the continuous disclosure regime that would not otherwise be pursued by ASIC through the courts and in relation which ASIC considers a relatively small financial penalty would be justified (because, for example, the contravention involved the non-disclosure of information that was considered relatively less material or the untimely disclosure of information).

Would you like to comment on the view that the infringement notice may well be subject to challenge on constitutional grounds?

We believe that the issue of an infringement notice will not involve the use of judicial power as infringement notices are not enforceable and the penalties specified are not at the discretion of ASIC, but determined by criteria built into the relevant provisions.

Based on advice received from the Australian Government Solicitor, we consider that the proposed infringement notice regime is constitutional.

Do you see the infringement notice being used as a form of exemplary punishment? Would you like to respond to the ALRC's findings and its relevance for the proposed infringement notice for continuous disclosure regime?

No, we do not see the infringement notice being used as a form of exemplary punishment.

Publicity is an important means of improving and promoting compliance with the continuous disclosure regime. The capacity to publicise compliance with an infringement notice allows ASIC to send a signal to the market concerning appropriate disclosure practices more effectively than through court action alone.

Under the draft provisions, ASIC may only publish details of an entity's compliance with an infringement notice – ASIC must not publish any other details in relation to the issue of, or failure to comply with, such a notice. Such publicity must also contain an express statement that compliance with a notice is not an admission of guilt or liability on the part of the company. This reflects the fact that an infringement notice is no more than an allegation that certain conduct has occurred and is not conclusive proof of wrongdoing.

This involves balancing the rights of the disclosing entity to due process and the value of naming an entity which has not complied with its continuous disclosure obligations. It is inappropriate to name an entity to which an infringement notice has been issued and which has not had a chance to respond, or which has not complied with an infringement notice. It may well result in trial by media.

In relation to the second question, it would be inappropriate for us to respond to the ALRC's findings. However, in relation to the relevance of the conclusion of the ALRC on publicity relating to infringement notices to the proposed infringement notice regime, we note:

- The proposed infringement notice mechanism is largely consistent with the recommendations of the Australian Law Reform Commission (ALRC) in its Report on 'Civil and Administrative Penalties in Australian Federal Legislation'.
- The mechanism departs from the ALRC's recommendations because it includes safeguards such as a private hearing at which the entity would be informed of the nature of the case against it and be permitted to give evidence and make submissions to ASIC.

- As stated in paragraph 5.507 of the Explanatory Memorandum to the Bill, the publicity provisions:

  > “[do] not prevent ASIC from publishing the use of infringement notices on an aggregate and anonymous basis including, for example, the number of notices issued and the number resulting in fines or civil penalty proceedings in a given period.”

How is ASIC held accountable for any possible breaches of the provisions governing the publication of infringement notices?

In the same ways as it is responsible for its performance of its other functions. ASIC is responsible to the relevant Minister and through that Minister to the Parliament. The Minister is empowered to give ASIC a written direction about policies it should pursue, or priorities it should follow, in performing or exercising any of its functions or powers under the corporations legislation (see section 12 of the *Australian Securities and Investments Commission Act 2001*). ASIC is required to produce an annual report by the *Commonwealth Authorities and Companies Act 1997*.

Could you comment on possible alternatives to the infringement notices such as enforceable undertakings and the advantages and disadvantages of those alternatives?

We do not see an enforceable undertaking as an alternative to an infringement notice in all circumstances. There will be occasions on which one is more appropriate than the other. The power to issue infringement notices will add to ASIC’s ‘toolkit’.

What are your views on having an independent panel rather than ASIC decide whether to impose a fine for a breach of the continuous disclosure provisions?

Various models of this proposal have been put forward over the last couple of years. Their disadvantages include that:

- It may detract from the responsibility of the market operator to maintain an informed market.

- It could lead to inconsistent interpretations of the continuous disclosure obligations of listed entities (which would not assist compliance). The market operator, ASIC, the review panel and the courts would be interpreting the relevant provisions.

- Depending on the model proposed, it may limit the market operator’s capacity to refer suspected contraventions to ASIC and ASIC’s capacity to respond.

- A panel could not simply be composed of ‘peers’ (ie representatives of disclosing entities), as some proponents seem to have envisaged; it would presumably need to include users of disclosed information.

- While proponents point to the Takeovers Panel, there are significant differences between the current role of the Takeovers Panel and the role that might be performed by a review body in relation to continuous disclosure. For example, the Takeovers Panel is remedial, not punitive, and the remedial role in relation to continuous disclosure is performed by the market operator.

On the basis of these considerations it has been decided that the introduction of some form of review panel of alleged contraventions of the continuous disclosure regime and determine whether a penalty should be imposed (either by the panel itself or by the courts on the application of ASIC) would not benefit investors, and would be likely to reduce the effectiveness of enforcement of the continuous disclosure framework.

Shareholder participation

What are your views on the proposal to require the annual directors' report to include details of the qualifications and experience of each person who is a company secretary at the end of the year?

The proposed amendment to subsection 300(10) of the *Corporations Act*, requiring public companies to disclose in their annual reports the qualifications and experience of their company secretaries, would be most effectively progressed through the Corporations Amendment Bill (No 2) 2002.

What are your views on submissions to CASAC in 2000 that a company notice of meeting must state 'the nature of the business to be transacted at the meeting in sufficient detail to enable a shareholder to form a reasoned judgement in relation to it'?

The proposed amendment to subsection 249L(3) of the *Corporations Act* provides that information in the notice of meeting must be worded and presented in a 'clear, concise and effective manner.'

The meaning of this requirement is clear. Further guidance is provided through the common law and the ASX Corporate Governance Council Guidelines for Notices of Meetings.

In its June 2000 report, '*Shareholder participation in the modern listed public company*,' CASAC noted that directors have a common law duty to properly inform shareholders about what is proposed for consideration at a meeting and to do so in a manner that is not misleading. Notices to shareholders should contain sufficient information for shareholders to be able to make reasonably informed judgements about attendance.

The ASX Guidelines for Notices of Meetings provide that notices must be honest, accurate and not misleading. Relevant information should not be withheld or presented in a manner designed to mislead shareholders or the market as a whole.

In light of the discussion above, it is not clear that the introduction of a new legislative requirement for company notices that 'the nature of the business to be transacted at the meeting in sufficient detail to enable a shareholder to form a reasoned judgment in relation to it' would improve the usefulness of company notices.

Are guidelines in relation to proxy voting necessary?

The draft *CLERP 9 Bill* contains an amendment to paragraph 250D(1)(d) of the *Corporations Act* to allow a body corporate appointed as a proxy to nominate an individual to exercise its powers as a proxy.

We consider that guidelines outlining how a body corporate may nominate such an individual are unnecessary and remove flexibility. Under section 250D of the *Corporations Act*, a body corporate may already appoint an individual as representatives in other contexts (for example, to exercise any powers the body corporate may exercise at a meeting of a company's members). Statutory guidelines have not been required in these contexts.

If considered appropriate, it would be for the ASX Corporate Governance Council and industry bodies to develop such guidelines.