CHAPTER 2

PROPORTIONAL VOTING FOR DIRECTORS

Introduction

2.1 On 24 June 1998 during the committee stage of debate on the Company Law Review Bill 1997 Senator Murray moved that the following provisions be added:

Division 9 – Election of directors

250U Application of this Division

(1) This Division applies to companies which become listed corporations after the commencement of this section.

(2) All other listed corporations must:

(a) at least 2 weeks but no more than 4 weeks before the next annual general meeting held after the commencement of this section, or at the second annual general meeting after commencement if there is insufficient time between commencement and the next annual general meeting, circulate a summary of the method of electing directors which is described in this Division, together with the opinion of its directors on matters relevant to the application of this method to the company; and

(b) propose a resolution at the next or second annual general meeting held after the commencement of this section (as the case may be), that the company elects that this Division apply to it.

(3) Any resolution of a listed corporation which would result in this Division no longer applying to the company is invalid.

(4) Nothing in this Division requires a company which was a listed corporation at the commencement of this section to propose a resolution at any annual general meeting held after the commencement of this section, that this Division apply to the company, if the resolution under paragraph (2)(b) is defeated.

250V Directors to be elected annually

(1) All directorships of a company become vacant at the annual general meeting of that company.

(2) The time at which directorships become vacant is immediately before the meeting proceeds to elect directors.

(3) Unless precluded by the company's constitution, a person who has previously held a directorship of the company may nominate for re-election.

250W Process of election

(1) The election of directors must be conducted by a poll.

(2) Each member of the company is entitled to the number of votes calculated using the following formula:

V x S

where:

V is the number of directorship vacancies.

S is the number of shares held by the member.

(3) Members may cast their votes as they think fit in favour of any number of the nominees for directorships and members need not cast all of their votes.

2.2 The Senate did not agree to the amendment. The Government subsequently confirmed that it opposed the amendment and referred the matter to the PJSC for inquiry.

Submissions

2.3 The PJSC received 38 submissions which addressed this topic, of which 8 were in favour and 30 opposed.

Arguments against proportional representation for directors

The need for a united board

2.4 Many submissions advised that a system of proportional representation would prejudice essential board unity. Porter Western Limited submitted that a minority interest on the board could exercise a disproportionate interest, with small factions not operating in the interest of the company. Companies require decisive governance which the present system has delivered. Arnold Bloch Leibler submitted that a company needed a cohesive and in many cases a strong board. There should be vigorous debate at the board level about the primary object of the company, making money for its shareholders, not power plays between groups of directors. These power plays should be fought and lost on the floor of the general meeting and not perpetuated, which is a problem with proportional representation. A relatively small lobby group could appoint a nominee to the board, which could lead to division. The Corporations Law should not perpetuate minority positions within the company.

2.5 The Australian Stock Exchange Ltd (ASX) and the Association of Mining and Exploration Companies separately submitted that directors have a duty to act in good

faith for the benefit of the company as a whole, not particular interest groups. The Australian Institute of Company Directors (AICD) submitted that one or more groups or factions may promote disharmony or disagreement on a board, where collective decision making and cohesion are so important. A fractious board is detrimental to the company. A board should be united in policy and outlook. The Investment and Financial Services Association Ltd (IFSA) submitted that directors are there to represent the interests of all shareholders. The risk is that the board will not be truly unified. Factions would prevent the board from providing a clear strategic environment for management. The Australian Shareholders Association (ASA) submitted that a board should be a group of people with diverse skills who can work together as a team in the interests of all shareholders, not represent different interest groups. Mr L Factor submitted that minority representation could be disruptive and destructive of the team spirit. There could be a conflict situation with dissident directors perhaps publicly challenging in the press actions of the company.

The nature of elections for directors

2.6 Mr R I Barrett submitted that it was entirely ill conceived to compare elections for directors to elections for the Senate. For instance, there is no presumption that every position on a board of directors should be filled. Members may decide how many directors there should be (if necessary, by amending the constitution), may remove directors, elect new ones and increase or reduce the number of available seats. They may choose to leave available seats vacant. The question is always whether A should be elected, not who out of A, B and C should fill a particular vacancy. The AICD submitted that the objective was to appoint the best-qualified directors, not representatives of an interest group. The ASA submitted that elections for directors should not be confused with elections for members of parliament.

Self-government for companies

2.7 A number of submissions advised that the method of electing directors should be decided by the company itself, not by the Corporations Law. Mr R I Barrett submitted that the choice among any particular methods of election is in the first instance a matter for the chairman and ultimately for the meeting itself. The Corporations Law should not make one voting method compulsory but should re-affirm the chairman's explicit duty to conduct any election in a manner which ascertains the true will of the members who vote. Mr I Cochrane submitted that there was no logic or reason why the decision to elect a director should be treated in any way differently from any other decision of a general meeting. Mr John Wilkin submitted that shareholders should choose the method of voting, so long as each ordinary share has a vote and the vote is for each director individually. Particular methods of voting should not be provided by law. Ernst and Young submitted that the members may amend the constitution if they prefer another method of election.

2.8 KPMG submitted that voting systems should be the subject of agreement between the company and its members. The AICD submitted that this matter was inappropriate for legislation; it was best left to the company itself. An individual company could trial proportional representation, but it was totally inappropriate and

contrary to the interests of the Australian economy for legislation to impose such a model. The ASA submitted that if any company wants proportional representation then it is free to adopt it, but that this should not be imposed. Coles Myer submitted that any matter relating to shareholders should be put to the shareholders to decide.

Proportional voting is impractical and counter-productive

2.9 A considerable number of submissions advised that proportional voting was impractical and counter-productive.

2.10 The Australian Society of Certified Practising Accountants, the Institute of Chartered Accountants in Australia and the Chartered Institute of Company Secretaries (W.A.) submitted that in most cases the number of directors to be elected would be few and the result would be no different from other methods. Even where there is a contested spill it would not be suitable. The ASA submitted that the quality of a board depends more on the selection process of a nomination committee by which vacancies are filled rather than an election process. Blakiston and Crabb submitted that instead of a rigid system of proportional representation that it would be better to have a requirement for independent directors. The IFSA submitted that the proposal would have the opposite effect to more democracy in a company.

2.11 Arnold Bloch Leibler submitted that the proposal applied only to new companies and there would be problems with two sets of laws operating. The AICD asked why should existing companies be able to avoid the proposed requirement while new companies are locked into it.

2.12 Bristile Ltd submitted that the proposal was unnecessarily complicated and would extend the time for voting. Ernst and Young also submitted that delays could occur.

2.13 The Law Society of W.A. submitted that the proposal would not achieve the desired result and may be counter-productive. Siddons Ramset opposed the proposal because of complexity and cost and because it was unlikely to change any outcomes. Coles Myer Ltd submitted that for a large company the costs of proportional representation would be great.

2.14 Boral submitted that the proposal was impractical; the Chartered Institute of Company Secretaries saw no reason for it; Ernst and Young submitted that there were no perceived benefits; and the Permanent Trustee Co Ltd opposed it because it added no value to the present position.

Adverse effect on the principle of election by absolute majority

2.15 A number of submissions advised that proportional representation would breach the principles of one vote, one value, and of an absolute majority for each successful candidate. Allen Allen and Hemsley submitted that the traditional system of electing directors by separate resolutions with respect to each candidate had certain limitations and may not operate fairly when the number of candidates exceeds the

number of vacancies. However, the traditional method ensures that each director receives an absolute majority of members voting at a general meeting. This principle of an absolute majority should be maintained, with the problem addressed by separate votes for each candidate with those receiving the highest absolute majorities elected. Arnold Bloch Leibler submitted that the proposal attacked the principle of majority decision making.

2.16 The ISFA strongly opposed the proposal because it conflicted with the principle of one vote, one value. Mr Peter Jooste QC submitted that the entire listing mechanisms on the ASX rely on one share, one vote. The ASA submitted that it supported one share, one vote.

Directors should be representative of those with the largest financial interest in the company

2.17 A number of submissions suggested that directors should reflect the choice of those shareholders who have the greatest financial interest in the company. Suncorp-Metway Ltd submitted that the present situation was satisfactory because it recognises those with the largest financial stake in the company. Bristiles Ltd submitted that a simple majority vote for each director individually better reflects the wishes of the shareholders who have most at stake in the company. The Australian Stock Exchange Ltd submitted that voting should reflect shareholders' economic interests.

2.18 Arnold Bloch Leibler submitted that while those with only a 35% interest may be able to control the company, that 35% may be a huge investment. The Australian Listed Companies Association Inc submitted that a member with 35% of the shares should be able to put a director on or off; this was better than a member with 5% being able to do that. Elections for directors are not political elections. He who pays the piper calls the tune and the largest shareholder must be allowed to call the tune.

More publicity and education could remedy any deficiencies

2.19 A number of submissions advised that any perceived problems could be solved by the ASX and ASIC encouraging companies to adopt best practice or to consider the options for a change in voting systems. Mr Peter Jooste QC submitted that the ASX Listing Rules could provide for companies to consider this when reviewing their constitutions. Mr Laurie Factor submitted that improvements could be made over time with education. There could be better information and design of the voting process in terms of existing constitutions.

Investor confidence and adverse economic effects

2.20 A number of submissions advised that the proposal would have an adverse effect on investors and on company performance. Arnold Bloch Leibler submitted that any requirement for directors to be elected annually could lead to a focus on short term profits rather than on long term growth. Also it does not accord with international best practice, which is to move away from different classes of voting stock. The IFSA suggested that any change to one vote, one value, would affect the

integrity of Australian capital markets. Freehill Hollingdale and Page submitted that the prime objective of a company is the creation of wealth for its shareholders by the profitable undertaking of business operations. This is done by efficient operation, which must extend to the board, which is responsible for setting the strategic direction of the company. The present practice is that it is unusual for a majority of directors to be up for election at once. Any change to this would lower the degree of control a majority shareholder would have over which directors are elected. It is essential for continuity of the underlying business that changes be progressive, to avoid the costs of loss of institutional knowledge and to ensure stability of duration for the company. A change would be a disincentive for potential directors. The business community perceives that directors' duties are onerous and in these circumstances qualified directors may decline to serve. If shareholders are dissatisfied with the strategic direction of the company they can leave through the marketplace. There are also statutory remedies for mismanagement. Ernst and Young submitted that there were no serious requests for change to the election of directors from the business community.

2.21 The ASX submitted that it was strongly opposed to annual election of all directors by proportional representation, with irrevocable shareholder approval for existing listed entities. This could result in business continuity problems, with boards concentrating on short term rather than long term performance. The Listing Rules provide for rotation of directors on a three-year basis, which is an appropriate balance. The AICD submitted that minorities have sufficient safeguards. The Corporations Law and the Listing Rules require companies to publish a variety of information. Minorities may requisition a general meeting and have a remedy in case of oppression. Also the proposal could debase the value of existing shares, particularly where investment decisions have been based on the one share, one vote principle. The proposal would make it difficult if not impossible to attract and retain good quality directors. It requires a reasonable length of tenure to make a worthwhile contribution. Mr Peter Jooste QC submitted that proportional voting may confuse international investors, inhibit the raising of capital and could distort the market for control, which historically has shown a premium for vendor shareholders.

2.22 The Law Society of Western Australia submitted that in all cases shareholders should approve any change and that it should not be irrevocable. The three-year rotation provided by the Listing Rules is adequate. The proposal could result in a short term focus and affect continuity. Coles Myer Ltd submitted that checks and balances were adequate, where in its own experience institutional shareholders combined to implement a change in the composition of the board. There is an economic and investment value attached to one share, one vote and proportional representation has the potential to raise that as an issue. Also, 100 shareholders now could take the question of voting to a company meeting, so there is no need for compulsion. Freehill Hollingdale and Page submitted that dissatisfied minorities should exit the company. The Corporations Law should not perpetuate minority positions inside the company. Lack of diversity will not be affected by proportional representation. The basic question is whether directors are doing a good job.

2.23 Blakiston and Crabb submitted that it was rare for there not to be independent directors on a board. It would not be possible to promote a company in the market place if it simply comprised nominees of one shareholder. Mr John Fast submitted that proportional representation would only work with annual elections and that would be wasteful and deliberating for a company. Companies do not work on a year to year basis; strategic plans are much longer than this.

Arguments in favour of proportional representation for directors

Unfair procedures when candidates exceed vacancies

2.24 A number of submissions suggested that common voting procedures operated unfairly where there were more candidates than vacancies. Mr Nick Renton submitted that a method of voting commonly used is particularly undemocratic in these circumstances. For instance, if there are, say, six vacancies and eight candidates the first six are elected one by one on a majority vote and the chairman of the meeting after the sixth resolution says that no more resolutions can be put. Mr Timothy Walshaw submitted that the result of this is that boards are hardly elected at all; they are self-appointed. The CPA/ICA/CICS (W.A.) submitted that the system is self-perpetuating, because the board recommends their successors or replacements. Mr R I Barrett submitted that such a system, without a further resolution in relation to the remaining candidates, would not withstand legal challenge.

Proportional representation is fairer for minority interests

2.25 A number of submissions suggested that proportional representation would be fairer to the interests of minority shareholders. The Australian Law Reform Commission submitted that it was strongly in favour of mechanisms to enable minorities to be heard, but suitable safeguards against abuse would be crucial. Mr Nick Renton submitted that votes for directors should be based on the same system as Senate elections. This would ensure that small groups with common interests as well as large groups would be able as of right to obtain board seats on the basis of their holdings if they wished. These groups could be:

- shareholders with a common philosophy;
- shareholders with a common interest, such as age pensioners;
- clients of the broker who organised the float;
- investors in one geographic location;
- former shareholders in a company taken over who want some continuity;
- unconnected shareholders who just want to see new blood on the board.

There is the scope for misuse, because it could be used for purposes other than to advance the interests of the company. However, directors may not vote on a matter in which they have a conflict of interest. It would be essential to have reasonable size quotas. Ballot papers would be required and although this would take time it would be

fairer. Also voting could take place ahead of the general meeting with the result announced at the meeting. Proportional representation should be the default mechanism if the replaceable rule is used; if it is left to the board then in a practical sense the shareholders will never get to vote on it. It would still be possible to have three-year elections. The CPA/ICA supported proportional voting similar to Parliament, but as a replaceable rule.

2.26 Mr Timothy Walshaw submitted that proportional voting by postal ballot would provide direct representation of shareholders in proportion to their interests, but strictly on the basis of one share one vote. The Australian Employee Ownership Association (AEOA) submitted that proportional representation would not only reflect the proportional interests of shareholders, but also guarantee minority interests such as employee shareholders, who can't exit the company easily.

2.27 Mr Shann Turnbull submitted that proportional representation would replace the less efficient and less effective stock market for corporate control with a far less expensive, but much more discriminating, sensitive and equitable internal voting market. Cumulative voting is preferred, with one share getting one vote for each vacancy, with the ability to distribute the votes between candidates as the shareholder wished. For instance, all votes could be cast for one candidate. The present position is a dictatorship. Companies need a loyal opposition. The Corporate Directors Association and the AEOA supported Mr Turnbull. Mr Nick Renton submitted that cumulative voting is unrefined proportional voting, because preferences are not marked and votes are not transferable.

2.28 Mr Neil Fisher of the Grains Council of Australia advised the Committee that the constitution of the privatised AWB Ltd provides for proportional voting for directors according to commercial interests. New South Wales and Western Australia, the largest producers, can elect more directors than say Victoria or Tasmania. There is also proportional voting on a regional basis.

Conclusions

2.29 The PJSC concluded that the Corporations Law should not provide expressly for proportional representation of directors. In particular, it should not provide for election of directors by cumulative voting.

2.30 The weight of evidence was clearly in favour of the present situation, where companies themselves decide on the form of election. The members of a company may decide if they wish to adopt any form of proportional representation, including cumulative voting, but there should be no compulsion in the Corporations Law for members to vote on a particular system. It is also inappropriate to provide for members to make an irrevocable decision. There are relatively simple procedures for members themselves to require a company to decide on a particular voting system at a general meeting. These procedures should be used if a group of shareholders feels that a company should adopt a particular form of proportional representation.

2.31 The PJSC concluded that proportional representation had the potential to affect the essential unity and cohesion of a board, with the possibility of factions and dissidents. Directors must act in good faith for the benefit of the company as a whole and the existence of minority interests would inhibit this.

2.32 The PJSC also largely accepted the submissions which argued that elections for directors were not comparable to those for parliamentarians, that proportional voting could be impractical and counter-productive, that it would strike at the principle of election by absolute majority of members voting, that directors should be generally representative of those with the greatest financial interest in the company and that proportional representation may affect consumer confidence and have adverse economic effects.

2.33 The PJSC accepted that proportional representation would increase minority representation on boards, but as noted above, concluded that its mandatory or irrevocable introduction would have disadvantages which easily outweighed any benefits.

2.34 The PJSC accepted that there was a perception of unfairness when members voted one by one for directors in cases where there were more candidates than vacancies. However, this problem could of course be addressed by any suitable voting system, not necessarily proportional or cumulative.

2.35 The PJSC sees considerable merit in the ASX and ASIC encouraging education and publicity campaigns with the object of making companies aware of the different voting procedures which are available and which may be suitable for the individual circumstances of the company. This could be a matter for consideration when companies are revising their constitutions. Also companies should be encouraged to adopt best practice in relation to the voting design and process in relation to their existing constitutions.

Recommendation

2.36 The PJSC recommends that the Corporations Law makes no provision mandating the adoption of any form of proportional voting for directors or requiring a company to put any such proposal to its members.

2.37 The PJSC recommends that the ASX and ASIC broadly review company voting procedures with a view to encouraging best practice in relation to voting design and process. This review could take the form of advising on a number of options for voting procedures, with indications of the advantages and disadvantages of each.