CHAPTER 9

CORPORATE GOVERNANCE BOARD

Listed companies should be required by law to establish a corporate governance board

9.1 During debate in the Senate on the Company Law Review Bill 1997, amendments were moved to the Bill relating to the requirement that listed companies must establish a corporate governance board.[1]

9.2 Under the amendments a corporate governance board would be required as follows:

(i) It would be required for all companies which become listed after the commencement of the section;

(ii) All other listed companies must propose a resolution that a corporate governance board be required, and if the resolution is passed, it cannot be changed.

9.3 A corporate governance board would be a body that is:

(i) separate and distinct from its company's board of directors, and

(ii) elected by shareholders on the basis of one vote per member.

9.4 The functions of the corporate governance board, to the exclusion of the main board, would be as follows:

(i) To determine the remuneration of company directors;

(ii) To appoint auditors and determine the remuneration of auditors;

(iii) To review the appointment, remuneration and functioning of independent agents, such as valuers, who provide material information to shareholders;

(iv) To appoint persons to fill casual vacancies of directors;

(v) To determine whether amendments should be made to the company's constitution, whether on the request of the company's directors or on the board's own initiative;

(vi) To decide issues of conflict of interest on the part of the company's directors and determine how those conflicts will be managed;

---

1 Hansard, *Senate*, 24 June 1998, P3486.

(vii) To control the conduct of general meetings and determine voting procedures.[2]

9.5 Few submissions to the PJSC supported a requirement for listed companies to establish a corporate governance board and generally the support for the amendments was qualified. The majority of submissions opposed the amendments and favoured retaining the ASX Listing Rule which requires listed companies to set out their main corporate governance practices in their annual report.

ASX Listing Rule 4.10.3

9.6 In the UK, Canada, Hong Kong and Australia, securities exchanges have introduced listing rules which require companies to make annual disclosures about their corporate governance practices. In the US, listing rules prescribe certain particular governance practices such as the appointment of audit committees but do not require the disclosure of governance practices.

9.7 ASX Listing Rule 3C(3)(j), now Listing Rule 4.10.3, was introduced on 1 July 1995. It requires each listed company to disclose its main corporate governance practices. More specifically, the Rule states that a listed company must include in its annual report "a statement of the main corporate governance practices that the company has had in place during the reporting period. When the statement identifies a corporate governance practice that has been in place for only part of the reporting period, the part of the period for which it has been in place must be disclosed. *Note: to assist companies, an indicative list of corporate governance matters is set out at Appendix 4A*."

9.8 Appendix 4A is meant as a guide for listed companies in preparing a statement of corp orate governance practices. The matters listed include the following items:

- The main procedures for establishing and reviewing the remuneration arrangements for directors and senior executives; and
- The main procedures for the nomination of external auditors and for reviewing the adequacy of existing external audit arrangements.

2 The proposed amendments are set out in full in Appendix 3 of this Report

Arguments in favour of a statutory requirement that a listed company establish a corporate governance board

Good corporate governance increases shareholder value

9.9 The Australian Investors Association Ltd (AIA) commended the requirement in so far as it was not inconsistent with the stated policies of the AIA and the Australian Shareholders' Association Ltd (ASA). The policy position of the AIA and the ASA in relation to corporate governance issues is that listed companies have failed to respond adequately to the corporate governance Listing Rule 4.10.3 of the ASX.[3] Companies with no corporate governance practices were not obliged to make a statement for the purposes of the Rule.

9.10 According to the ASA and AIA, research conducted in the US demonstrated "a clear correlation between sound corporate governance practices and good financial performance."[4] Implementing good corporate practices was, therefore, in the interests of shareholders. While the AIA and ASA acknowledged that the Rule is "a step in the right direction", there was no requirement for companies to implement such practices.[5] The ASA and AIA contended that an appropriate government authority should be tasked to:

- Review company reports to ensure compliance with the ASX Listing Rule;
- Require listed companies to implement corporate governance practices;
- Advise companies that compliance with the Listing Rule is a 'minimum position'; and
- Ensure that companies are aware of the correlation between sound corporate practice and good financial performance.[6]

9.11 At its hearing on 18 August 1999, the Australian Shareholders' Association Ltd (ASA) took an alternative position to the AIA/ASA joint policy statement regarding the ASX Listing Rule, preferring the present corporate governance model:

> In regard to the corporate governance board and audit committee, again it is an alternative model. But I think the concept of a majority of independent directors and an independent chairman, the ASX requirement for an audit committee, really provides an at least

3 Australian Investors Association Ltd, Submission 25, see attached ASA/AIA Policy, p 6.

4 Australian Investors Association Ltd, Submission 25, see attached ASA/AIA Policy, p 6.

5 Australian Investors Association Ltd, Submission 25, see attached ASA/AIA Policy, p 6.

6 Australian Investors Association Ltd, Submission 25, see attached ASA/AIA Policy, p 6.

> effective corporate governance model. I am concerned that the introduction of a separate board is likely to lead to more complication and confusion than benefit. The present model is efficient.[7]

Corporate Senate

9.12 M.A.I. Services Pty Ltd which initiated the proposed amendments argued for the establishment of a corporate governance board or Corporate Senate for all public companies.[8] The functions of a Corporate Senate would encompass the roles of an audit committee, remuneration committee and nomination committee. Specifically, the supervisory Senate board would have responsibility for the appointment and control of auditors, the remuneration of management and its disclosure to shareholders, and the extent of disclosure of all other information. A system of voting for electing the Corporate Senate on the basis of one vote per member, as opposed to one vote per share, would ensure the protection of minority interests. M.A.I. Services Pty Ltd contended that the establishment of a supervisory board with defined powers will avoid the need for detailed prescriptive laws and regulations and restrain the excessive power of a unitary board and its inherent conflicts of interest.[9] Mr Shann Turnbull, Principal of M.A.I. Pty Ltd Services told the PJSC that the impetus for a Corporate Senate was simplification of the Law:

> The whole purpose is to simplify your corporate law. You could reduce many parts of your corporate law and listing requirements because you could delegate decisions, which might otherwise go to shareholders, to your corporate governance board, and some of the listing requirements. If you are looking at costs and benefits, it is back in the context of how to get less prescriptive law and that is to set up processes in place for shareholders to look after themselves. The reason a lot of shareholders do not vote is that they feel they do not have any power.[10]

Qualified support

9.13 Arnold Bloch Leibler supported the concept of a corporate governance board but not for every listed company:

> The matter of a corporate governance committee should be left to the directors of the listed company and, ultimately, to its shareholders.[11]

---

7 Mr Ted Rofe, Committee Hansard, 18 August 1999, p 308.

8 M.A.I. Services Pty Ltd, Submission 80, pp 2-3.

9 M.A.I. Services Pty Ltd, Submission 80, p 3.

10 Mr Shann Turnbull, Committee Hansard, 18 August 1999, p 358.

11 Arnold Bloch Leibler, Submission 23, pp 8-9.

9.14 Similarly, it was suggested that such a requirement was appropriate only for large listed companies and that smaller companies could hire consultants and make their own decisions.[12]

Arguments against a statutory requirement that a listed company establish a corporate governance board

Company board is responsible for corporate governance

9.15 The Australian Law Reform Commission (ALRC) advised that responsibility for maintaining and monitoring corporate governance is the responsibility of the board. It noted that this responsibility should not be delegated or dissipated to any significant degree through the establishment of a separate corporate governance board. The ALRC stated:

> It is concerned that this particular proposal could lead, in practice, to the undesirable bifurcation of board responsibilities.[13]

9.16 Where appropriate, the ALRC suggested that an audit committee could provide guidance in ensuring that corporate governance obligations are being met. Similarly, the Henry Walker Group Ltd argued that corporate governance is the responsibility of the board and the requirement is in part satisfied by current audit committee structures.[14]

9.17 The Australian Institute of Company Directors (AICD) submitted that directors as a group are responsible for corporate governance matters and beyond mandating the bare structures, it was not the function of the Law to prescribe particular governance structures for companies.[15]

9.18 Arnold Bloch Leibler considered that it was unnecessary for every listed company to have a corporate governance board. The requirement would add to the administrative costs of running the company while not necessarily providing any real benefits to shareholders. The establishment of such a board was a matter for the directors to determine:

> After all, responsibility for all of the day to day management issues affecting a company rests with its directors. The directors should be free to determine how they will deal with these issues and not be obliged to delegate responsibility for corporate governance to a sub-

12 Mr JA Sutton, Submission 57, p 1.

13 Australian Law Reform Commission, Submission 10, pp 4-5. See also Mr John Wilkin, Submission 21, p 7 and Mr Peter Jooste QC, Committee Hansard, 16 August 1999, p 162.

14 Henry Walker Group Ltd, Submission 12, p 3.

15 Australian Institute of Company Directors, Submission 47, p 5.

> committee in circumstances, where it might otherwise be inappropriate or unnecessary for them to do so.[16]

9.19 Several submissions referred to the responsibility of company boards to be independent. For example, Mr John Wilkin stated:

> The Board is responsible for the management and control of the company. There is no demonstrated need for the Board to adopt any particular system for compliance with any particular philosophy or any particular law. [17]

Concern for small listed companies

9.20 The West Australia Joint Legislative Review Committee of the Australian Society of Certified Practising Accountants, The Institute of Chartered Accountants and the Chartered Institute of Company Secretaries expressed concern that the requirement would pose difficulties for smaller listed companies. The Review Committee noted that in Western Australia there are a large number of junior exploration companies with only a minimum number of directors. According to the Review Committee, these small companies would have difficulty in dealing with "wider governance issues".[18]

9.21 The Association of Mining and Exploration Companies Inc submitted that most companies are not large enough to have a separate corporate governance board and audit committee. In small companies corporate governance and audit issues are addressed by the board due to resource constraints.[19] Roebuck Resources NL told the PJSC that the requirement is not "appropriate for the smaller listed companies which may only have a small number of executive and non-executive directors, thus making the requirement to set up separate committees or boards inappropriate."[20]

9.22 The PJSC was told how in practical terms smaller listed companies dealt with corporate governance matters:

> **Mr Crabb**-In the case of smaller listed companies, it is really not practical. I sit on a few company boards where we only have four

16 Arnold Bloch Leibler, Submission 23, pp 8-9. See also Law Institute of Victoria, Submission 55, p 3 and Australian Listed Companies Association Inc, Submission 66, p3.

17 Mr John Wilkin, Submission 21, p 7.

18 West Australia Joint Legislative Review Committee of the Australian Society of CPAs, The Institute of Chartered Accountants and the Chartered Institute of Company Secretaries, Submission 18, p 4.

19 Association of Mining and Exploration Companies Inc, Submission 45, p 3.

20 Roebuck Resources NL, Submission 69, p 2. See also Amity Oil NL, Submission 70, p 2; Lynas Gold NL, Submission 72, p 2; KPMG, Submission 71, pp 3-4, Blakiston & Crabb, Submission 64, p 2; Preuss Feinauer and Associates, Submission 27, p 2 and Mr Laurie Factor, Committee Hansard, 16 August 1999, p 128.

> directors. We meet once or twice monthly, if not more than that informally. It is basically run by the board. You know what is going on at all times. The thought of having a separate corporate governance board or audit committee is superfluous because two directors-the independent directors-would sit separately and, as an independent director, you have the obligation to consider those factors anyway.[21]

9.23 The Australian Stock Exchange (ASX) was strongly opposed to the introduction of a requirement for listed companies to have a corporate governance board on several grounds including that:

> For small to medium sized listed entities, it could impose a substantial cost burden (we note that each board must have at least 3 members with a majority of them "external members").[22]

Costs of compliance

9.24 The PJSC was told that the introduction of a statutory requirement would add to costs and efficiencies.[23] The Law Institute of Victoria submitted that the requirement should not be introduced without a proper analysis of the need for such a requirement and its implications for small companies.[24]

9.25 Coles Myer Ltd submitted that the estimated total annual cost of compliance with the proposed amendments was $1.2 million.[25] To establish a separate corporate governance board with the same level of service and entitlements as the main board, Coles Myer Ltd would incur the following annual costs:

Fee to chair the corporate governance board ($120,000)

Fees of the three independent directors ($240,000)

Standard retiring allowances for those directors ($360,000)

Board papers, meeting costs, video conferencing, electronic presentations, reports, accommodation, airfares etc ($100,000)

Remuneration experts fees to determine the fees of directors and senior management independently from management and the main board ($250,000)

Management costs to prepare reports, present that to the board and to provide secretarial services ($100,000)

---

21 Mr Rick Crabb, Committee Hansard, 16 August 1999, p 180.

22 Australian Stock Exchange, Submission 44, p 9.

23 Mr Peter Jooste QC, Submission 48, p 2. See also Lynas Gold NL, Submission 72, p 2, Amity Oil NL, Submission 70, p 2 and Roebuck Resources NL, Submission 69, p 2.

24 Law Institute of Victoria, Submission 55, p 3.

25 Correspondence to PJSC, 1 September 1999, pp 3-4.

Total costs estimated to be $1,170,000

Present arrangements are adequate

9.26 The PJSC was told that the ASX Listing Rule provides for details of corporate governance practices for listed companies.[26] It was submitted that the requirement is unnecessary because the present arrangements of corporate governance are adequate:

> A majority of companies already have an Ethics or Conduct Committee, which covers much broader issues than simply corporate governance. The Institute is not aware of any shortcomings in the present reporting of Corporate Governance as required by the ASX Listing Rules, and believes this is a more appropriate regulatory approach.[27]

Two tier model not appropriate to Australian companies

9.27 GIO Australia Holdings Ltd (GIO) opposed the introduction of a two tier model for corporate governance on the grounds that it would add a separate layer of responsibility for corporate governance to that of the main board. Such a model would be similar to that in Germany which is unlike any other model of corporate governance. GIO described it thus:

> If it is intended to promote the addition of a separate supervisory or governance board along the lines of the German model then there is no justification for this imposition on Australian Boards at all. The German model is peculiar to the German economy, German share ownership structure and German culture and has not been adopted anywhere else in the world for listed public companies.[28]

9.28 GIO advanced four arguments against a two tier model. The proposed model would create confusion as to which board was responsible for a particular policy, give rise to conflicts between the two boards, establish two sets of decision making processes and inhibit clear and decisive direction for companies.[29] The Accounting Bodies also expressed concern that a two tier model would create an unwieldy and divisive structure:

---

26 National Can Industries Ltd, Submission 49, p 1.

27 Chartered Institute of Company Secretaries, Victoria Branch, Submission 24, p 3. See also Mr Peter Jooste QC, Submission 48, p 2; Belmont Holdings Ltd, Submission 20, p 2; Joint Submission by the Australian Society of CPA and the Institute of Chartered Accountants in Australia, Submission 73, p 4 and the Securities Institute, Submission 75, p 1.

28 GIO, Submission 29, p 3.

29 GIO, Submission 29, p 3. See also Mr Tim Hammon, Committee Hansard, 17 August 1999, p 270 who advised that a two tier model would give rise to legal difficulties such as determining which board took precedence and confuse shareholders.

> **Mr Parker-**The problem with separately elected body means that there is the potential for dispute, for gridlock, between the corporate governance board and the board of directors. You have mentioned corporate governance boards being set up in some parts of the state. I must admit I am not familiar with how successful those boards have been, but I just have this voice inside of me that says that, if you have two boards with different responsibilities, you have the chance of heightening tensions rather than trying to work smoothly.[30]

9.29 Similarly, the Law Institute of Victoria was not convinced that a separate corporate governance board was necessary. The Law Institute referred to the 1998 UK Hampel Report which found little enthusiasm for the two tier framework. The preferred model in the Hampel Report was the unitary board which offered flexibility and retained the power of the board to delegate functions to board committees.[31]

9.30 The ASX noted that if Australia were to adopt a requirement for listed companies to have corporate governance boards, it would be viewed as a regressive step by the major international capital markets:

> It is important that we remain compatible with major capital markets (in particular the UK and the USA) – it is believed that such a change would not be viewed favourably in this context. In an age where we are trying to "globalise" our standards, this change would arguably represent a step backwards.[32]

9.31 The AICD submitted that legislating the requirement would result in the European two tier structure. Applied to Australian companies the two tier model is "misconceived" and "probably unworkable".[33]

'Outsider' and 'insider' models of corporate governance

9.32 A paper authored by Mr Trevor Robertson, an executive and doctoral student in the area of corporate governance was submitted for the PJSC's consideration. The paper explored models of corporate governance. It described the model of corporate governance in Australia, USA and Britain as an 'outsider' model where managers are relatively unfettered by board control but where control instead arises from the discipline of the capital markets. The model presumes that information flows are good and the regulatory system requires ample disclosure and listing rules are enforced. The model is also based on liquid stock markets and diversification of investment portfolios.

---

30 Mr Colin Parker, Committee Hansard, 16 June 1999, pp 36-37.

31 Law Institute of Victoria, Submission 55, p 3.

32 Australian Stock Exchange, Submission 44, p 9.

33 Australian Institute of Company Directors, Submission 47, p 4.

Most OECD countries have the 'insider' model where board representation of specific interests play a strong monitoring and disciplinary role vis-à-vis management.

9.33 Mr Robertson referred to the regulatory developments in Australia in the area of corporate governance. The paper noted the development of a single, national Corporations Law framework in 1991 and the Listing Rules of the ASX which were based on the UK Cadbury Code, a code of Best Practice set out in the Cadbury Report. The legislative evolution of corporate governance was an evolving and continual process with interested parties debating whether the current legislative arrangements are appropriate or whether they are too prescriptive.

9.34 Mr Robertson cited the *OECD Economic Surveys 1998 Australia* where it was reported that over the last decade attention has focussed on instances of corporate misconduct. The OECD's view was that these should not result in the governance of all enterprises being unduly burdened:

> It would be unfortunate if the legacy of distrust that they have left resulted in excessive burdens being imposed on the governance of enterprises. … By and large, the balance in Australian corporate regulation appears to have shifted too far towards a prescriptive and intrusive approach.[34]

More disclosure of corporate governance practices

9.35 The Investment & Financial Services Association Ltd (IFSA) opposed the amendments, preferring that listed companies explain to investors through annual reports and other publications what corporate governance practices they have adopted and the reasons for their adoption. In its July 1999 Corporate Governance, A Guide for Investors and Corporations, IFSA recommended that:

> The board of directors of a listed company should prominently and clearly disclose, in a separate section of its annual report, its approach to Corporate Governance. This should include an analysis of the Corporate Governance issues specific to the company so that public Investors understand how the company deals with those issues.[35]

34 Mr Trevor Robertson, Submission 28, p 11 quoting from the *OECD Economic Surveys 1998 Australia* (1998, p 115).

35 *Corporate Governance: A Guide for Investment Managers and Corporations*, July 1999, 9.2.1, Guideline 1 – Annual Disclosure.

9.36 The Guide also recommends that company boards should appoint an audit committee, a remuneration committee and a nomination committee for proposing new nominees to the board.[36] IFSA, however, stated that:

> IFSA members acknowledge that companies may develop other governance practices appropriate to their circumstances that are also sound. The central aim for IFSA members and other institutional investors is that listed companies explain their corporate governance practices and the reasons for them and that these practices are transparent.[37]

9.37 The AICD submitted that companies should make their own choices as to whether it is appropriate, given their individual circumstances, for the company to appoint a corporate governance committee. It argued that flexibility in corporate governance was essential and should not be prescribed through legislation. There is already a range of guidelines for companies to follow in this area and current references include *Strictly Boardroom*, by Professor FG Hilmer, the IFSA Guidelines for Investment Managers, the *Corporate Practices and Conduct Booklet* published by the AICD and the ASX Listing Rules.[38]

Conclusions

9.38 In its March 1998 *Report on the Company Law Review Bill 1997*, the PJSC indicated that it did not favour a prescriptive approach to corporate governance and opposed detailed legislative prescriptions of the kind recommended by shareholder groups. The PJSC noted that the Bill improved corporate governance practices and provided adequate protection to minority interests.[39] As a consequence, the PJSC listened extremely carefully to comments on the proposed amendments which would require listed companies to establish a corporate governance board or Corporate Senate.

9.39 A strong argument that was made to support the establishment of a corporate governance board was that research in the US suggested a correlation between good corporate governance practices and increasing shareholder value. By implication, a similar outcome could be achieved in Australia if governance measures such as a corporate governance board were introduced in Australia. However, the PJSC was told that "there is no evidence that the market [in

---

36 *Corporate Governance: A Guide for Investment Managers and Corporations*, July 1999, 12.6.1 - The Audit Committee, 12.6.2 - The Remuneration Committee and 12.6.3 - The Nomination Committee.

37 Investment & Financial Services Association Ltd, Submission 34, pp 8-9.

38 Australian Institute of Company Directors, Submission 47, p 5.

39 Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Company Law Review Bill 1997*, March 1998, pp 7-17.

Australia] is rating down those companies that report little governance activity under the current disclosure regime".[40] The PJSC is also wary of comparisons with the US market without research having been undertaken in Australia and conclusions suggesting that Australian companies should replicate governance practices in the US. The PJSC believes that good corporate governance alone does not lead to increasing shareholder value. There is also the need to ensure that the regulatory framework and the Corporations Law work consistently to promote longer term wealth.

9.40 The PJSC was told that most listed companies are not large enough to have a corporate governance board which is separate from the main board. It was therefore suggested that the requirement should apply only to listed companies with a market capitalisation of $100 million. However, as one witness told the PJSC, the alternative "is very much a moving target. Depending on the flavour of the day, if you are a telco or something, suddenly you have got one and, who knows, next year we might find some other high-tech thing to get into and suddenly you are not. That is probably not by capitalisation."[41]

9.41 The PJSC has several concerns about the concept of a two tier governance model and the specific amendments which codify the method of election of members of the corporate governance board. As witnesses told the PJSC, the proposed amendments will lead in practice to the bifurcation of board responsibilities and the devolution of the board's additional role with respect to shareholder protection. The PJSC was told that the advantage of a governance board is that it "delegates decisions which might otherwise go to shareholders to the corporate governance board".[42] In the PJSC's view the delegation of shareholders' powers to a supervisory board will reduce the rights and entitlements of individual shareholders. The most potent of these is the shareholders' power to dismiss a director at a general meeting. Further, the amendments stipulate that the establishment of a corporate governance board is irreversible notwithstanding a resolution by members to the contrary. The amendments also deny property rights to individual shareholders because the system of voting for election to the corporate governance board is on the basis of one vote per shareholder and not on the basis of economic interests.

9.42 In the view of the PJSC a strong case has not been made to support the amendments and the evidence before the PJSC does not justify imposing on companies another layer of expense and the potentially divisive structure of a two tier model. The framework of company management in Australia is

---

40 West Australia Joint Legislative Review Committee of the Australian Society of CPAs, the Institute of Chartered Accountants and the Chartered Institute of Company Secretaries, Submission 18, p 4.

41 Mr Laurie Factor, Committee Hansard, 16 August 1999, p 128.

42 Mr Shann Turnbull, Committee Hansard, 18 August 1999, p 358.

constructed on the basis of a unitary board. The introduction of a two tier governance model would shift the emphasis of current corporate governance developments from an 'outsider' model to an 'insider' model with significantly reduced voting and property rights for individual shareholders. The PJSC agrees with the ASX that such a governance model would be a costly and regressive step in the context of the future progress of governance standards and Australia's compatibility with the major capital markets.

9.43 In the view of the PJSC responsibility for corporate governance must fall squarely on the main board. The PJSC believes that the responsibility of the board to shareholders should not be diminished to any degree by the establishment of a separately constituted corporate governance board. The majority of submissions endorsed the findings of the UK Hampel Committee on Corporate Governance which stated that "We have found overwhelming support for the unitary board of the type common in the UK. There was little enthusiasm for a two tier framework. The unitary board offers considerable flexibility. The board may delegate functions to board committees. Audit, remuneration and nomination committees play an important role in corporate governance. Some boards delegate operational decisions to an executive committee, and so adopt some features of the two tier board. In our view this is entirely a matter for the individual company."[43]

9.44 The PJSC recognises that there are important issues where independent judgements need to be exercised on remuneration practices, selection of board members and company accounts for example. The effectiveness of the board in maintaining and monitoring corporate governance is enhanced by the sub-committee structures of the main board. The PJSC accepts that committee structures will vary from board to board depending on the size of the company and for this reason the PJSC fully supports the initiatives by IFSA, the AICD and the ASX in promoting more disclosure of corporate governance practices. In the view of the PJSC the proposed amendments do not help to underpin future progress towards higher standards of corporate governance. The PJSC concludes therefore that the amendments should not proceed.

Recommendation

9.45 The PJSC recommends that the Corporations Law does not provide that listed companies must establish a corporate governance board.

43 Final Report of the Hampel Committee on Corporate Governance, 28 January 1998, para 3.12.