The Senate

Economics Legislation Committee

Provisions of the Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002

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Chapter 1

Introduction

Background

1.1 The Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002 was introduced into the House of Representatives by the Treasurer, Mr Peter Costello MP, on 16 October 2002 and passed in the House on 11 February 2003.

Purpose of the Bill

1.2 The Bill proposes 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.[1] The main object of the Bill as stated in the Explanatory Memorandum is 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.

1.3 Unreasonable director-related transactions are defined as transactions made to a recipient in circumstances where a reasonable person in the company's circumstances would not have entered into the transaction.[2] In determining the reasonableness of a transaction factors such as the benefits and detriments to the company and the benefits to the recipient arising as a result of entering the transaction and any other relevant matters are considered.[3]

Reference of the Bill

1.4 As a result of a report by the Selection of Bills Committee, the Senate referred the provisions of the Bill to the Economics Legislation Committee on 11 December 2002 for inquiry and report by 3 March 2003. The Senate later extended the reporting date to 19 March 2003.

Submissions

1.5 The Committee advertised the inquiry in the *Australian* on Wednesday, 18 December 2002 and on the Parliament website. It also contacted a number of government agencies, organizations and individuals interested in the area of corporate and insolvency law alerting them to the inquiry and inviting them to make a submission. The Committee received nine submissions which are listed in Appendix 1.

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1 Explanatory Memorandum, p. 1.

2 Explanatory Memorandum, p. 4.

3 Explanatory Memorandum, p. 4.

Hearing and Evidence

1.6 The Committee held one public hearing on this inquiry in Parliament House, Canberra on Thursday, 6 March 2003. The hearing took the form of a roundtable discussion. Witnesses who presented evidence before the Committee are listed in Appendix 2.

1.7 Copies of the Hansard transcript are tabled for the information of the Senate. They are also available through the internet at http://www.aph.gov.au

Acknowledgement

1.8 The Committee thanks all those who assisted with its inquiry.

Chapter 2

The Bill in the context of current insolvency law

Background

2.1 The origin of this Bill lies in the collapse of the telecommunications carrier One.Tel in May 2001. Shortly after One.Tel was placed into administration it was reported that the company's co-managing directors, Mr Keeling and Mr Rich, had each received approximately $7 million in bonuses from the company in a year in which it had incurred substantial losses. In response to public concerns about the circumstances surrounding the collapse of One.Tel and the payment of bonuses to its directors, the Prime Minister announced on 4 June 2001 that:

> The Commonwealth intends to amend the law so that in future, where bonuses are paid in the circumstances where those bonuses were paid to the bosses of One.Tel, that money will be refundable and can be used to meet the lawful and legitimate entitlements of workers and also the other creditors of the company. [1]

2.2 Other inquiries have brought to light inappropriate transactions between companies and their directors.[2]

2.3 The Bill permits liquidators to reclaim unreasonable payments made to directors of companies that are subsequently put into liquidation.

Voidable transactions

2.4 Insolvency law has long adopted a policy of setting aside transactions in which an insolvent company disposes of property or makes payments to particular creditors within a relevant period of time prior to the commencement of formal insolvency. A debtor may be placed into external administration months or sometimes years after recognizing that this outcome is inevitable. In anticipation of the formal commencement of insolvency proceedings debtors may attempt to hide assets from their creditors, favour certain creditors over others, incur artificial liabilities or make gifts to relatives or friends. Outside an insolvency context some of these transactions may be perfectly permissible. In an insolvency context they may be unfair to the general body of unsecured creditors. The purpose of these laws is to prevent the depletion of the assets of the company through certain transactions entered into within a specified period prior to the winding up.

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1 The Hon John Howard MP, House of Representatives, *House Hansard*, 4 June 2001, p 27 127.

2 See, for example, transcripts of hearings of the HIH Royal Commission into the collapse of the HIH Insurance Group, http://www.hihroyalcom.gov.au/Hearings/Transcript.asp

2.5 Under the Corporations Act liquidators may recover certain payments made, or reverse certain transactions entered into, by companies in the period preceding the company's liquidation. Division 2 of Part 5.7B deals with those company transactions and payments which may be challenged by a liquidator during the period preceding formal insolvency.

2.6 The provisions, known as the 'clawback' or voidable transaction provisions, permit liquidators to seek court orders reversing certain transactions entered into by an insolvent company in the lead-up to liquidation or, in limited circumstances, in the period prior to the company becoming insolvent. There are essentially four types of transactions which are able to be challenged under the avoidance provisions: unfair preferences, uncommercial transactions, unfair loans and fraudulent transactions.

2.7 The key operative provision is section 588FE which provides that certain pre-liquidation transactions are to be regarded as voidable transactions. Under section 588FE two types of transactions are voidable: insolvent transactions (defined in section 588FC) and unfair loans (defined in section 588FD).

Insolvent transactions

2.8 An insolvent transaction must be either an unfair preference (defined in section 588FA) or an uncommercial transaction (defined in section 588FB). To constitute an insolvent transaction, the company which is in liquidation must either have been insolvent when the transaction was entered into or become insolvent as a result of entering into the transaction. A transaction is not voidable solely because it is an 'insolvent transaction'. Under section 588FE(2)–(5) an insolvent transaction is voidable where, in addition, it is:

- entered into during the six months immediately before the relation-back day (in most cases the day when the application to wind up the company was filed with the Court);
- an uncommercial transaction entered into during the two years immediately before the relation-back day;
- an unfair preference and an uncommercial transaction involving a related entity of the company and occurring during the four years immediately before the relation-back day;
- an unfair preference and an uncommercial transaction entered into during the four years immediately before the relation-back day where the company was a party to the transaction in order to defeat, delay or interfere with the rights of any or all of its creditors (section 588FE(5)).

Unfair loans

2.9 Most payments made by a company prior to a winding up are not generally recoverable by a liquidator unless the company was insolvent at the time it made the payment (or became insolvent as a result of making the payment). However, unfair loans are voidable irrespective of whether the company was insolvent at the time it made the loan. An 'unfair loan' is defined in section 588FD as one where the interest

was 'extortionate' at the time when the loan was made or has since become extortionate because of a variation. The explanatory memorandum to the 1992 Corporate Law Reform Act (para 1048) noted in relation to this provision:

> The section is not directed to loans which in hindsight may be judged as bad bargains but at transactions which are grossly unfair, so that in normal circumstances no reasonable company is likely to have entered into such a contract unless there were some further rationale such as where the agreement is a sham agreement intended to operate in circumstances of insolvency to confer an undue benefit on the lender.

2.10 The following table summarises the transactions that are voidable under the current law and the time frame in which they are voidable.

Type of transaction	**Length of time prior to relation-back day**	**Section**
Insolvent transaction (with a non-related entity)	6 months (or after the relation-back day but on or before the day when the winding up began)	588FE(2)
Insolvent and uncommercial transaction (with non-related entity)	2 years	588FE(3)
Insolvent transaction to which a related entity of the company is a party	4 years	588FE(4)
Insolvent transaction entered into for the purpose of defeating, delaying or interfering with the rights of any or all of the creditors	10 years	588FE(5)
Unfair loan	No time limit	588FE(6)

Unreasonable director-related transactions

2.11 The Bill adds the category 'unreasonable director-related transaction' to the list of voidable transactions in section 588FE. The main focus of the bill is on

transactions entered into by the company with its directors but extends to transactions made to, on behalf of, or for the benefit of a director or a close associate of a director.

2.12 Under proposed section 588FDA(1) an 'unreasonable director-related transaction' includes payments made by the company, conveyances, transfers and other dispositions of property and issues of securities including options. Incurring an obligation to enter into these kinds of transfers would also be a 'transaction' for the purposes of the Bill.

2.13 The Bill targets 'transactions' that a reasonable person in the company's circumstances would not have entered into. Under proposed section 588FDA(2) a transaction will be caught if it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction having regard to the benefits and detriments to the company of entering into the transaction, the benefits to other parties to the transaction and any other relevant matter.

2.14 The reasonableness of the transaction is determined at the time the payment, transfer or disposition of property, etc occurs and not at the time the company incurred the obligation. A liquidator will be able to recover payments where the unreasonableness of the transaction becomes apparent when the company actually makes the payment even if it appeared reasonable at the time the company incurred the obligation. Where a payment is made to a director or a close associate of a director a court will generally not be required to determine the reasonableness or fairness or otherwise of the obligation incurred by the company when the bargain was struck.

2.15 Under proposed section 588FE(6A) an unreasonable director-related transaction will be voidable where it is entered into or given effect to within four years of the relation-back day.

2.16 Unreasonable director-related transactions will be voidable irrespective of whether the company was insolvent at the time of the payment, transfer or disposition of property occurs or at the time the company incurred the obligation.

2.17 Proposed subsection 588FF(4) restricts the range of orders that a court may make in relation to voidable transactions. The court may make orders only in relation to the unreasonable portion of the total transaction taking into account the reasonable value (if any) that is attributable to it.

Chapter 3

Provisions of the Bill

Aims of the Bill

3.1 The aims of the Bill have been somewhat variously expressed. The legislative policy initiative announced by the Government in June 2001 referred to 'the recovery of bonuses paid to the directors of companies that later collapse'. The legislation does not deal *per se* with 'bonuses'. Its scope is broader in that it includes payments made by the company as well as conveyances, transfers, other dispositions of property, issues of securities including options and the incurring of an obligation to make such a payment, disposition or issue.

3.2 The explanatory memorandum to the Bill states that the purposes of the Bill are :

> To permit liquidators to reclaim unreasonable payments made to directors by companies prior to a liquidation
>
> and
>
> To assist in the recovery of funds, assets and other property to companies in liquidation where payments or transfers of property to directors are unreasonable.[1]

Background

3.3 Most submissions were generally supportive of the Bill though many took issue with particular provisions offering suggestions for amendments and improvements to the key definitions and operative provisions.[2] Some submissions argued that the scope of the Bill was too broad while others argued that it was too narrow and limited. A number of submissions raised issues concerning the interaction of the provisions of the Bill with other regulatory objectives of the Corporations Act such as corporate governance and shareholder rights. Other issues of concern raised in submissions included the interpretation of the operative provisions, the adequacy of the current law (and hence the need for government intervention), the potential impact

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1 Explanatory memorandum, 1.

2 The Australian Chamber of Commerce and Industry submitted that taken as a whole, it considers the Bill 'to be a focused and proportional approach to dealing with a fairly infrequent issue in corporate governance in Australia'. *Submission* 2, p. 1. The Association of Superannuation Funds of Australia also expressed support for the aims of the Bill. *Submission* 4 p. [2]. Similarly the CPA Australia and the Institute of Chartered Accountants in Australia gave qualified support for the Bill. *Submission* 5, p. 1.

of the Bill and the length of the period—four years—during which transactions may be clawed back.

Outline of the report

3.4 The following section of the report looks at the main concerns that were raised in submissions and during the public hearing. It examines the following issues:

- the need for new legislation;
- the types of remuneration that should be covered by the Bill;
- matters that could be included in the Bill particularly in regard to provisions to cover senior executives, retrospectivity and the importance of preventive measures;
- the interpretation of the term 'unreasonable';
- the four year time-frame.

Adequacy of the current law

3.5 Submissions opposed to the Bill argued that the adequacy of the current law in recovering unreasonable payments to directors has not been explored or shown to be deficient.

3.6 While it strongly opposed the Bill, the Australian Institute of Company Directors (AICD) noted 'the intense public focus on a number of high profile public collapses' and a need to 'respond to such public concern in a timely and constructive manner'. Nevertheless, it argued that in addressing such concerns in a precipitous fashion the Government has missed the opportunity of 'promoting the full enforcement of the existing law in this area'. It would prefer to see extra resources provided to ASIC to test the current law and only if such existing law is found to be lacking should there be legislative reform.

3.7 The Australian Shareholders' Association (ASA) noted that the Bill applies only in the case of a liquidation and not to other forms of administration. In its view there are other measures in the Corporations Act which allow a liquidator access to monies paid out by a company.

3.8 Others, however, although critical of some aspects of the Bill, believed it had merits. The Insolvency Practitioners Association Australia (IPAA) supported the Bill which it believed would 'supplement and strengthen the existing provisions and provide liquidators with the powers to reclaim unreasonable payments made to the directors of insolvent companies or "their close associates"'.[3]

3.9 The Department of the Treasury agreed. It told the Committee that:

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3 *Submission* 8, p. 1.

> At present, most payments made by a company prior to winding up are not recoverable by a liquidator unless the company was insolvent at the time it made the payments. As a result, large payments or transfers of property made to a director of a company that is later wound up may not be caught if the company was technically solvent at the time of the payment or transfer.[4]

3.10 The Australian Council of Trade Unions rather than dismiss the Bill argued that while it is heading in the right direction it does not go far enough.[5] It wanted the Bill to be strengthened.[6]

3.11 Some witnesses also saw the proposed legislation as a measure that would encourage a more thoughtful and responsible approach to the remuneration of directors. The Australian Stock Exchange (ASX) commented that permitting recovery of payments in circumstances in which the company is solvent may act as a significant disincentive for executive directors (particularly entrepreneurial executive directors) accepting bonus payments as part of a more modest fixed salary package and constrain some companies from designing appropriate remuneration packages. In stating its support for the proposed legislation it acknowledged 'the importance in the current climate of demonstrating that directors will not be able to profit in circumstances where their performance has not benefited the company'.[7]

3.12 The IPAA also believed that the Bill would alert company directors to the dangers of excessive remuneration. It asserted that:

> The insertion by the Bill of a new section 588FDA will give a clear and unambiguous message to officers and management of companies and provide liquidators with the necessary legal framework within which to pursue unreasonable director related transactions.[8]

3.13 Similarly, the Association of Superannuation Funds of Australia saw the advantage in using legislation to send a message to corporate Australia. It hoped that the provisions of the Bill would have a 'broader impact so far as they will encourage all directors to give greater consideration to broader corporate governance issues when entering into transactions'.[9]

3.14 The Treasurer stated that:

> The Bill gives a strong statutory expression of the Government's intention that directors should not receive unreasonable remuneration, particularly when creditors, employees and shareholders are at risk. Directors are in a

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4 *Submission* 3, p. 1.

5 *Committee Hansard*, p. E5.

6 *Committee Hansard*, p. E5.

7 *Submission* 6, p. 1.

8 *Submission* 8, p. 1. See also *Committee Hansard*, pp. E8 and E18.

9 *Submission* 4, p. [2].

> better position than most to know the true state of affairs of the company in the short to medium term, and should not profit from this knowledge at the expense of employee and ordinary creditors.[10]

3.15 It should be noted that the Bill was introduced into Parliament with the approval of the Ministerial Council for Corporations, which comprises the Commonwealth, States and Territories.[11]

Committee view

3.16 The Committee considers that the Bill would add to the current mechanisms for recovering unreasonable director-related payments as it would permit recovery of such payments within a longer time frame notwithstanding that the company was not technically insolvent at the time of the payment or transfer. Under the current law most payments made by a company prior to winding up are not recoverable by a liquidator unless the company was insolvent at the time it made the payments. Other avenues for recovery under the voidable transaction provisions are subject to more limited time frames.

3.17 It also believes that it sends a strong message to the corporate world that directors must act in accordance with their responsibilities to their shareholders, to those employed by their companies and other creditors.

3.18 Having accepted that the proposed legislation is an important measure to improve corporate governance in Australia, the report now turns to perceived deficiencies in the Bill.

Title of the Bill

3.19 The joint submission from CPA Australia and the Institute of Chartered Accountants in Australia observed that the title of the Bill implies that it 'relates only to bonus payments to directors whereas the unreasonable director-related transaction provisions are not restricted to just bonus payments.' It supported the broader reach of the proposed legislation stating:

> Director related payments, not just bonuses, should be subject to scrutiny to ensure they are reasonable and have received appropriate approval.[12]

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10 The Hon Peter Costello MP, Treasurer of the Commonwealth of Australia, Media Release, 'Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002, 16 October 2002. See also second reading speech, Mr Peter Costello MP, *House Hansard*, 16 October 2002, p. 7677.

11 The Hon. Peter Costello, MP, Treasurer of the Commonwealth of Australia, Media Release, 'Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002, 16 October 2002. See also Second Reading Speech, Mr Peter Costello MP, *House Hansard*, 16 October 2002, p. 7677.

12 *Submission* 5, p. 2.

Committee view

3.20 The Committee accepts that the title of the Bill does not adequately reflect the scope of the Bill's operation. The Committee suggests that the title be reworded to convey the message that it is concerned with director related payments, not simply bonuses.

Ambit of the Bill

3.21 A number of submissions argued that the Bill is too tame and does not go far enough in addressing the question of excessive executive remuneration. They wanted to broaden the ambit of the Bill to include:

- solvent companies
- remuneration of senior executives
- retrospective provisions
- measures to enhance transparency and accountability.

The following section looks at the proposals for broadening the coverage of the Bill.

Solvent companies

3.22 The Bill is limited to transactions of companies in liquidation. Some submissions argued that the Bill should not be limited to companies in liquidation but should apply to all companies irrespective of insolvency. The ACTU submission argued that one of the serious limitations of this Bill is that:

> The Bill does not apply to unreasonable or excessive remuneration of directors or executives in circumstances where the company does not become insolvent, even though its performance may not have justified these payments or transactions, and the cost is borne by shareholders.[13]

3.23 The joint submission from the CPA of Australia and the Institute of Chartered Accountants took a similar position in arguing that unless there is a compelling case the voiding of payments provisions should apply to all companies, including those operating normally and those under administration, and not just insolvent companies under external administration.[14]

Committee view

3.24 The Committee considers that broadening the provision so as to encompass all companies irrespective of insolvency would amount to a significantly different and wider legislative proposal that is beyond the scope of the Committee's inquiry.

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13 *Submission* 7, p. 2.

14 *Submission 5*, p. 2.

Remuneration of senior executives

3.25 The Bill applies only to directors and is not generally intended to cover employees of companies. The definition of 'director' in section 9 extends the concept of director in some cases to include persons acting in the position of director although not validly appointed to that position (de facto director) and persons in accordance with whose instructions or wishes the directors of the company are accustomed to act (shadow director).

3.26 The ACTU submission suggested that the legislation should extend its application to senior executives who were not directors.[15] The Australian Institute of Company Directors also referred to the focus of this Bill on payments to directors even though the current public controversy is concentrated on executive remuneration.[16] The joint submission from CPA Australia and the Institute of Chartered Accountants in Australia expressed the view that the amendments should first address the granting of bonuses and other benefits to directors and senior executives and consider the interests of creditors and shareholders.[17] Mr Alfred Rofe, from ASA, submitted to the Committee that:

> It is necessary to distinguish between remuneration and termination payments payable to
>
> a) Non-executive directors of a company
>
> b) Senior executives who are in a position to directly influence the strategies and the results of the operations of the company (who may or may not be directors); and
>
> c) Other employees (including executives who are not in a position to directly influence the strategies and the results of the operations of the company).

3.27 In his view 'most of the current debate involves payments to senior executives who, in most cases, are also directors, but there is also an increasing concern with respect to retirement payments to non-executive directors'.[18]

Recommendation

The Committee considers that limiting the Bill to directors (whether formal, de facto or shadow) is unduly narrow and recommends that it apply also to senior executives who are not directors.

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15 *Submission* 7, p. 2; *Committee Hansard*, p. E14.

16 *Submission* 1, p. 1.

17 *Submission 5*, p. 1.

18 *Supplementary Submission*, p. 1.

Retrospectivity

3.28 The Opposition moved an amendment in the House of Representatives to provide that the commencement date of the legislation be 4 June 2001, the day the Prime Minister announced that the Government would legislate to remedy deficiencies in the current law. The ASA was not alone in observing that the Bill did nothing to facilitate the recovery of payments in the case of One-Tel.[19]

3.29 The retrospective application of the legislation was not discussed during the public hearing. The Treasurer, however, in presenting the proposed legislation stated that to avoid constitutional doubt, the legislation would apply with prospective effect, from the commencement of the Bill.

Committee view

3.30 The Committee accepts that the provisions of the Bill should not be retrospective.

Measures to enhance transparency and accountability

3.31 A number of witnesses argued that the proposed legislation was a case of 'closing the door after the horse has bolted'.[20] The Australian Shareholders Association argued strongly that:

> It is more appropriate to prevent, or at least discourage, the payment of unreasonable remuneration, including bonuses and severance payments and the entering into arrangements to make such payments, rather than to seek to recover them after they have been made.[21]

3.32 Taking a similar view, the ACTU wanted the Bill to deal with the way in which remuneration is determined. It argued that the proposed legislation needed to specify in greater detail the criteria for its application. It proposed that the Government legislate to require boards of public companies to establish independent remuneration committees and require option packages to be subject to performance benchmarks.

3.33 Mr Arthur Dixon, CPA Australia, agreed with the view that increased transparency is a critical issue. The joint submission from CPA Australia and the Institute of Chartered Accountants in Australia suggested that bonuses and other benefits to directors and senior management should be subject to disclosure. In their view disclosure would go beyond that required by Part 2M.5 of the Act and Accounting Standard AASB 1017 'Related Party Disclosures' to include:

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19 See, for example, the comments of Mr Dwyer, National President, Insolvency Practitioners Association of Australia, Committee Hansard, p. E8.

20 See comments by Professor Bob Baxt, *Committee Hansard,* p. E6.

21 *Supplementary Submission* 9, p. 1.

> the likely cost at the time the transactions are incurred [approved] with at least annual updates of the likely eventual cost and approved by shareholders. This would avoid the surprises to the market that have been occurring when the previously unknown magnitude of the payments have eventually been disclosed to the market.[22]

Committee view

3.34 The Committee notes that proposals relating to the matters raised in the ACTU submission are being considered in other contexts (for example CLERP 9 and the exposure Draft Corporations Amendment Bill[23]) and go beyond the scope of the Bill in question.

3.35 The Committee also notes that the recovery of unreasonable director-related payments is to be treated in a similar manner to, and within the current legislative framework, for the recovery of other voidable transactions. It agrees that it is a desirable goal of corporate law to seek to prevent or discourage the payment of unreasonable director-related remuneration. Measures to achieve such a goal are beyond the scope of this Bill. The prevention or discouragement of unreasonable director-related remuneration is also not the only goal. The Committee considers that the Bill should be assessed in terms of the desirability of protecting creditors of companies in liquidation.

The types of remuneration covered by the Bill

3.36 The following section considers suggestions put forward in submissions that certain payments to directors should be exempt under the provisions of the Bill.

Basic remuneration

3.37 Some submissions considered that the Bill should be limited to payments in the nature of bonuses and/or severance payments and exclude basic remuneration. The CPA/ICA submission noted that the title of the Bill implied that it was referable only to bonus payments to directors and indicated that the Bill should be restricted to bonus and severance payments beyond a specified threshold which would relate to varying factors based on the features of companies and their industries.

Committee view

3.38 The Committee considers that restricting the Bill to 'bonuses' would pose definitional problems, unduly limit the scope of the Bill and invite payment in other forms.

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22 *Submission* 5, p. 2.

23 Available from Treasury website, http://treasury.gov.au/, Bills, Acts & Legislation.

Provisions approved by shareholders

3.39 A critical provision determining the scope of the Bill is proposed section 588FDA which sets out the criteria to be used in assessing the 'reasonableness' of a director-related transaction.

3.40 A number of submissions proposed that in determining the reasonableness of a transaction the Court should take account of any resolution passed by members of the company at a general meeting and even exclude, from the definition of 'unreasonable director-related transaction', payments approved by shareholders at a general meeting.

3.41 The Corporations Act requires certain transactions between a director and a public company to be approved by members at a general meeting. The remuneration of directors of public companies is generally regulated by Chapter 2E. A public company is prohibited from giving a financial benefit to a related party of the public company unless the financial benefit falls within one of the exceptions to Chapter 2E or has been approved by a majority of disinterested members after being provided with information as to the costs and consequences of the provision of the benefit.

3.42 Exceptions include remuneration paid to a person in his/her capacity as an officer of the body corporate if it would be reasonable to give the remuneration given the circumstances of the company and the relevant officer's circumstances including the responsibilities involved in the office or employment.

3.43 Other kinds of payments to directors are also subject to similar requirements.

3.44 Division 2 of Part 2D.2 regulates termination payments. Section 200B prohibits a company from giving a person a benefit in connection with that person's retirement from a board or managerial office in a company without member approval under section 200E. Section 200C prohibits a person from giving a benefit to a person who holds or has at any previous time held a board or managerial office in a company or a related body corporate without member approval under section 200E. Section 200E specifies the requirements for member approval for the giving of such a benefit. The benefit must be approved by a resolution passed at a general meeting of the company. Details of the benefit must be set out in or accompany the notice of the meeting.

3.45 The ACCI proposed that in determining the reasonableness of a transaction the Court should be required to take into account any resolution by members of the company in general meeting regarding the transactions under review.

3.46 The ASX drew attention to Chapter 2E, and Listing Rule 10.1 which in certain circumstances requires the approval of holders of an entity's ordinary securities in the case of transactions between a company and its officers. It commented that it is unclear whether transactions which are required to be approved by shareholders at a general meeting under procedures set out in the Corporations Act and the Listing Rules are subject to the clawback arrangements and what weight will be given to shareholders' approval of a transaction.

3.47 In the ASX's view:

> The ability of the liquidator to seek to avoid transactions should not extend to transactions approved by shareholders on the basis of an independent expert report that the transaction is fair and reasonable unless it can be shown that the report was inadequate.[24]

3.48 The joint submission from CPA Australia and the Institute of Chartered Accountants of Australia reinforced the opinion that where shareholders have approved the bonus and severance payment agreements when the company is solvent, the payments should not be subject to voiding under the proposed legislation.[25] Similarly Professor Baxt argued that:

> If matters are disclosed to shareholders, the shareholders have the right to vote on those issues. If there is full disclosure and there is no conflict, it seems a bit odd to say four years later—because a company may, as a result of events beyond its control, have suffered losses et cetera—that we now have the ability to seek a repayment of sums that have been voted by the shareholders. If there is a failure of disclosure and if there is fraud in the minority et cetera, I would agree that that is the basis for challenging that.[26]

Committee view

3.49 The Committee notes that in determining whether a transaction is an 'unreasonable director-related transaction' a court may take account of the matters specified in section 588FDA(1)(c)(i)-(iii) including 'any other matter': section 588FDA(1)(c)(iv). It would appear that a court would be able to take into account the fact that a payment has been approved by shareholders of the company at a general meeting and the weight to be given to such a matter.

Remuneration and the company's constitution

3.50 The AICD would exclude from the operation of the Bill remuneration paid to a director in accordance with the company's constitution.

Committee view

3.51 In the Committee's view this would unduly restrict the application of the Bill.

Payments to trusts or payments made by solvent companies

3.52 Two submissions raised the possibility of transactions that may fall outside the strict terms of the definition of 'unreasonable director-related transaction'. ASFA noted the possibility of a payment made to a discretionary trust of which a director or

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24 *Submission* 6, p. 3.

25 *Submission* 5, p. 2.

26 *Committee Hansard*, p. E11.

close associate is a potential beneficiary.[27] The CPA/ICA submission noted the possibility of a parent company appointing one of its directors as a director of a subsidiary and making a payment to the director in his/her capacity as a director of another company. There is also the question of the divestiture of assets in the period after receipt of a payment or transfer of property and the relation-back day.

3.53 Mr Rogers, Department of the Treasury, informed the Committee that:

> The Bill is directed at payments made to directors or to their close associates or on behalf of those directors. If a payment is made to a related party by a company that becomes liquidated on behalf of the director, this Bill is going to catch that. If it is made to any other related party or any other creditor or any other person other than a director, or connected with them, to the extent that it is caught by the existing law, it will be caught on a wind-up then.[28]

3.54 When asked about the situation where the company was a subsidiary company and some directors may be one and the same, Mr Dwyer, IPAA, was of the opinion that:

> The law adequately provides liquidators with provisions to claw that back under the related sections under 588, which relate to uncommercial transactions. This legislation supplements that and provides the ability to claw back directors' bonuses from directors and related parties to directors, which has not been there for liquidators previously. So it is supplementing the existing law. [29]

Committee view

3.55 The question of possible avoidance of the application of the legislation is an appropriate issue to consider. The payment of a director's remuneration by an external party will not ordinarily have the effect of reducing the assets of the company available for distribution to creditors.

Recommendation

The Committee, however, recommends that the Government monitor the application of the legislation with a view to assessing whether appropriate anti-avoidance provisions should be included in the legislation.

Entitlement of shareholders

3.56 The CPA/ICA submission stated that proposed section 588FF(4) appeared to preclude shareholders benefiting from the clawback of a payment as it limited the

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27 *Submission* 4.

28 *Committee Hansard,* p. E19.

29 *Committee Hansard*, p. E19.

court to making orders '…only for the purpose of recovering for the benefit of creditors of the company…'.

Committee view

3.57 The Committee understands that in a liquidation of an insolvent company shareholders are ordinarily entitled to the residual value of assets of the company after payment of creditors. The Bill would not appear to affect the entitlement of shareholders in this regard. Regrettably it is rarely the case that in a liquidation there are assets remaining to be returned to shareholders.

Application to associates

3.58 ASFA noted that the definition of 'close associate' for the purpose of proposed section 588FDA does not extend to same sex couples and neither does the definition of 'relative' in section 9 of the Corporations Act.

Committee view

3.59 The Committee suggests that in bills proposing amendments to the Corporations Act and other legislation concerned with corporate governance the expressions 'close associate', 'relative', 'spouse' or like terms be defined to include same sex couples in light of community standards.

Interpretation of operative provisions of the Bill

3.60 The key operative provision of the Bill is proposed section 588FE(6) which provides that a transaction is voidable if it is an 'unreasonable-director related transaction'. The latter term is defined in section 588FDA. The explanatory memorandum to the Bill describes the effect of the provision:

> It provides that a transaction of a company is an 'unreasonable director-related transaction' if it is made to a recipient in circumstances where a reasonable person in the company's circumstances would not have entered into the transaction. The reasonableness of the transaction is determined with regard to the respective costs and benefits to the company, and benefits to the recipient, of entering into the transaction.[30]

3.61 The AICD proposed that 'extortionate' be substituted for 'unreasonable' as the test for a voidable transaction in section 588FDA and that the transaction be shown to be so 'manifestly unreasonable' having regard to the factors in subsection 588FDA(1)(c) that 'no reasonable person in the company's circumstances would have entered into it'. It submitted:

> The difficulty of judging the 'unreasonableness' of a payment made up to four years earlier will probably lead to a proliferation of litigation. The Bill appears to require examination of the circumstances of the transaction

30 Explanatory memorandum, para 3.6.

> through the eyes of a reasonable person at the time of the transaction. Will it be possible to disregard the benefit of hindsight in making this judgement? Most likely, the application of such a test will lead to arbitrary outcomes influenced by the fact that at some time with up to four years after the relevant transaction, the company went into liquidation. On this count, the Bill looks more like a means of punishing directors for the failure of their companies (irrespective of fault on their part) than a means of restoring value to creditors.[31]

3.62 Mr Rogers, Department of the Treasury, offered the following explanation for the current definition of unreasonableness:

> Rather than introduce a new definition, it tries to pick up an existing one that is used for uncommercial transactions, which presumably already has a body of case law and common use by insolvency practitioners behind it, and apply that to directors' bonuses…they [AICD] suggested using the extortionate test, which suggests to me a higher benchmark. That has another problem, in the sense that it is currently applied to percentage rates to loans, so it is not something that is translatable to dollar amounts, whereas the current uncommercial transaction is.[32]

3.63 Section 588FB defines an uncommercial transaction as one where a reasonable person in the company's circumstances would not have entered into the transaction, having regard to:

- the benefits (if any) to the company of entering into the transaction;
- the detriment to the company of entering into the transaction;
- the respective benefits to other parties to the transaction of entering into it; and
- any other relevant matter.

Committee view

3.64 The Committee believes that the effect of amendments along the lines suggested by AICD would be to narrow considerably the range of transactions which

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31 *Submission* 1, p. 2. The AICD suggested that the 'reasonableness' test in s588FDA(1)(c) require that:

> (c) the transaction be so manifestly unreasonable having regard to:
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> (i) the benefits (if any) to the company of entering into the transaction;
>
> and
>
> (ii) the detriment to the company of entering into the transaction; and
>
> (iii) the respective benefits to other parties to the transaction of entering into it; and
>
> (iv) any other relevant matter;
>
> that no reasonable person in the company's circumstances could have entered into it.

32 *Committee Hansard*, p. E17.

may be caught. The term 'extortionate' may be appropriate to describe the terms of a loan but is not so readily transferable to the kind of director-related transactions that the Bill aims to cover.

Determining reasonableness of transaction

3.65 The Australian Chamber of Commerce and Industry (ACCI) considered that the definition of 'unreasonable', the circumstances of its application (the winding up of the company) and the nature of the remedy (the transaction being voidable to the extent that it is unreasonable) were appropriate. However, it considered it inappropriate for the reasonableness of the transaction to be determined at the time the company actually enters into the transaction regardless of its reasonableness at the time the company incurred the obligation. In its view this approach to the legislation gives undue weight to developments that may take place long after the obligation was incurred. The ACCI considered that proposed section 588FDA(2)(b) should look to the circumstances at the time the obligation was incurred rather than later developments outside the control of the parties to the agreement.[33]

3.66 ASFA also supported the reasonableness test applying at the time the company actually enters into the transaction rather than at the time the company incurred the obligation.

3.67 In relation to the time when the reasonableness of entering the transaction was determined under proposed subsection 588FDA(2) (ie at the time the company actually makes the payment, conveys, transfers or disposes of property, etc) the Treasury, quoting from the Treasurer's second reading speech, commented:

> This enables liquidators to recover payments where the true magnitude of the unreasonableness involved only becomes apparent when the company actually makes the payment, even if it appeared reasonable at the time the company agreed to make the payment.[34]

3.68 Elsewhere in its submission the Treasury noted:

> Directors have the primary responsibility under Australian corporate law for the viability of companies. Further, directors are in a better position than most to know the true state of affairs of the company in the short to medium term, and should not profit from this knowledge at the expense of employees and other ordinary creditors.
>
> Mr Rogers, Department of the Treasury, explained further:
>
> The Bill has a four-year net period where it can catch transactions. What that provision does in relation to obligations is to say, 'You don't look at the time the obligation was entered into'. For example, people have been talking

33 *Submission* 2, p. 2.

34 *Submission 3*. See also Mr Peter Costello MP, Second Reading Speech, *House Hansard*, 16 October 2002, p, 7677 and media release 16 October 2002.

> about reference to remuneration by market capitalisation. On the face of it, it may be an entirely reasonable and appropriate measure to use for executive remuneration. But down the track when the transaction is made—the case of One.tel is a prime example, I guess—it has gone bust and the payment of X million dollars is not reasonable where it has gone bust, even though the obligation was framed in a reasonable way.[35]

Committee view

3.69 The Committee considers it appropriate that the reasonableness test apply at the time the company actually enters into the transaction rather than at the time the company incurred the obligation. It is at the point of 'entering into the transaction' that a company is best placed to determine the benefits and detriments to the company, and the respective benefits to other parties, of entering into the transaction and ultimately the appropriateness of the payment.

General interpretation of the term 'unreasonableness'

3.70 Many witnesses were concerned about the lack of guidance being offered in the legislation to assist in the interpretation of the term 'unreasonableness'. They foresaw courts struggling with the interpretation of the term.

3.71 As noted in paragraph 3.61, the AICD commented that the difficulty of judging the 'unreasonableness of a payment made up to four years earlier will probably lead to a proliferation of litigation'. The requirement to examine the circumstances of the transaction through the eyes of a reasonable person at the time of the transaction may result in arbitrary outcomes influenced by the possibility of hindsight in making this judgment and the fact that the company was placed into liquidation. In the AICD's view the Bill had the potential to punish directors for the failure of their companies irrespective of fault.

3.72 The ACTU wanted to establish clear and tight guidelines as to what would constitute unreasonable. It wanted greater specificity with regard to performance which is to be reported through benchmarks to shareholders and a prima facie presumption of reasonableness.[36] Ms Sharan Burrow argued that:

> If we are talking about directors' fees with a $100,000 remuneration base, 40 per cent of that at $40,000 ought to be seen to be, prima facie, unreasonable. If we are going to set community standards, governments have to be brave enough to put something on the table.[37]

3.73 Mr Dwyer, IPAA, accepted that the court would be required to determine what is unreasonable. His concern was with the lack of resources where there are no assets to assist the liquidator rather than the wording of the law. He stated:

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35 *Committee Hansard*, p. E17.

36 Sharon Burrow, *Committee Hansard*, p. E14.

37 *Committee Hansard*, p. E14.

> We think that we are far better to get something into the law to trip the next payment, albeit we cannot make it retrospective, or at least start the ball rolling in terms of having legislation to target any future payments that are unreasonable or, indeed, are related party transactions.[38]

3.74 As noted in paragraph 3.62, the Department of the Treasury pointed out that the proposed legislation picks up an existing definition that is used for uncommercial transactions in the same part of the current law to reduce the kind of uncertainty surrounding the meaning of unreasonableness raised by witnesses.[39]

3.75 The Opposition in the House of Representatives moved amendments designed to provide some parameters to the court about what things it ought to consider in determining whether payments to a director were reasonable. It proposed that the following should be considered:

- the payments and benefits received by directors relative to payments and benefits received by employees in the company; and
- whether the payments or benefits were subject to appropriate performance conditions; and
- 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.[40]

3.76 Mr Peter Slipper in the second reading debate responded to this proposal as follows:

> Under the Bill the reasonableness or otherwise of a payment is determined along the lines of mechanisms already present in the Corporations Act under the uncommercial transaction provisions. Reasonableness is determined by having regard to the benefits and detriment to the company, the respective benefits to other parties to the transaction and any other relevant matter. The amendments moved by the opposition introduce additional elements which will add uncertainty to the operation of the Bill or simply limit its operation.[41]

Committee view

3.77 The Committee notes that the factors that a court is to have regard to in determining the reasonableness of a director related transaction replicate the factors to be taken into account in considering an 'uncommercial transaction' under section 588FB. The proposed criteria are consistent with those currently in force for another

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38 *Committee Hansard*, p. E14.

39 *Committee Hansard*, p. E17.

40 *House Hansard*, 11 February 2003, p. 11439.

41 *House Hansard*, 11 February 2003, p. 11442.

category of voidable transaction. It is important that this legislation is consistent with existing legislation that deals with voidable transactions. The Committee considers that the factors that the Bill proposes be taken into account in determining the reasonableness of a transaction are appropriate.

Interaction of the Bill with other corporate regulatory objectives

3.78 A number of submissions commented on the interaction between the Bill and other regulatory objectives and provisions of the Corporations Act.

3.79 The ASX saw the Bill as part of a wider review of legislation and self-regulation impacting the governance of companies and as being aimed at encouraging companies and their officers 'to ensure that there is an alignment between company performance or value added to the company and payments (or other benefits) made to directors'.

3.80 The Committee considers that the Bill may serve to complement other measures in the Corporations Act which seek to enhance the corporate governance of Australian companies. It concurs with ASFA's hope that:

> The presence of the amendments will have a broader impact in so far as they will encourage all directors to give greater consideration to broader corporate governance issues when entering into transactions.

A four year clawback period

3.81 Some submissions commented on the appropriateness of a four year claw back period.

3.82 ASFA pointed out that the four-year clawback period is shorter than the Corporations Act's mandatory record retention requirement. (Under the Corporations Act financial records must generally be retained for 7 years after the transactions covered by the records are completed: section 286(2)). In ASFA's view it was arguable that there should be no time limit for unreasonable transactions that should never be knowingly entered into by, or with, directors, officers or others.[42] It added that the longer the period involved, the less likely recovery might be. On the other hand the ASX argued that four years may be excessive and also limit the structuring of executive remuneration packages.[43]

3.83 Mr Rogers, Department of the Treasury, told the Committee that:

> A range of periods for clawbacks are allowed under part 5.7B of the Corporations Act, ranging from six months for any payment while the company is insolvent up to, I think, an unlimited period for certain payments done with a high degree of culpability. This fits somewhere in between. It is

42 *Submission* 4.

43 *Submission* 6.

most like the existing related party clawback allowance, which is also four years.[44]

Committee view

3.84 The Committee considers that a four year clawback period is justifiable.

Impact of the Bill

3.85 A range of concerns were expressed about the overall impact of the Bill.

3.86 The explanatory memorandum indicated that the Bill would have a low impact economy-wide given the narrow application of the amendments contained in the Bill to companies in liquidation. ASFA expressed the hope that it would encourage directors to give greater consideration to broader corporate governance issues when entering into transactions.

3.87 The IPAA supported the Bill commenting that it would strengthen existing provisions for recovering unreasonable payments made to the detriment of employees, secured and unsecured creditors. However, in the IPAA's view the practicalities of investigation and legal assistance in pursuing these claims are a concern given the extensive litigation that will be required of recover these payments. This is particularly so in the case of 'phoenix' companies which have inadequate assets available to a liquidator to ensure payment of reasonable costs and expenses.

Committee view

3.88 The Committee acknowledges that the Bill will be subject to elucidation by the courts over time. It notes that there is an extensive body of case law on the subject of voidable transactions.

Process

3.89 The AICD pointed out that since the commencement of the Corporate Law Simplification Project and the Corporate Law Economic Reform Program significant changes to corporate legislation have gone through an extensive consultation process before a change is introduced into the Parliament. According to some witnesses, this consultation process was lacking in regard to this Bill.[45]

3.90 It further considered that recent legislation dealing with the rights of employees in an insolvency context have not been given an opportunity to be tested in the courts. The AICD argued that until the courts have been given an opportunity to assess that legislation no further changes to the law (in relation to the rights of employees in an insolvency context) should be made.

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44 *Committee Hansard*, pp. E18–19.

45 *Submission* 1, p. 1, and comments by Professor Baxt, *Committee Hansard*, p. E2.

3.91 The Committee draws the Government's attention to clause 509(1) of the Corporations Agreement 2002 which envisages that in principle all Commonwealth Bills referred to in clause 506(1)—bills that would amend or repeal the Corporations Act and other Acts relating to the national companies scheme—will be exposed for public comment for at least 3 months before introduction. This in principle commitment appears to be honored more in the breach than in its observance.

Chapter 4

Conclusion

4.1 In considering this Bill and reviewing submissions lodged on this Bill the Committee has placed a high priority on the protection of creditors who suffer losses from the insolvency of companies.

4.2 The Committee is of the view that if the Bill operates as intended it will contribute to the overall scheme for the protection of creditors of companies in liquidation. It has the potential to add to the pool of monies available to unsecured creditors including employees and subcontractors. It complements other measures in the Corporations Act aimed at deterring the making of unreasonable payments to directors in the period leading up to a company's insolvency protecting creditors.

4.3 The concerns identified in submissions are not considered sufficient to prevent the Bill proceeding.

4.4 The Committee makes the following recommendations on the Corporations Amendments (Repayment of Directors' Bonuses) Bill 2002:

Recommendation 1

The Committee recommends that the Government monitor the application of the legislation with a view to assessing whether appropriate anti-avoidance provisions should be included in the legislation.

Recommendation 2

The Committee recommends that the Bill apply to senior executives who are not directors as well as directors.

Recommendation 3

The Committee reports to the Senate that it has considered the provisions of the Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002 and recommends that the Bill proceed.

SENATOR GEORGE BRANDIS
Chairman

Labor Members Minority Report on the

Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002

1. Introduction

For Labor, this bill provides an opportunity to put a legislative spotlight on excessive executive remuneration.

Labor supports the principle that unreasonable payments to directors should be clawed back once a company becomes insolvent. However, this bill does not go far enough – as it fails to address the issue of excessive executive remuneration when a company is solvent.

Also, there are a number of loopholes that exist in the bill that Labor has attempted to address by moving amendments in the House.

2. Loopholes

The bill provides that a liquidator can reclaim an 'unreasonable director-related transaction' made within four years of a company appointing a liquidator.

The definition of what constitutes an unreasonable director-related transaction creates a loophole for certain benefits which escape this definition. The definition does not capture all transactions between directors and companies. In particular, the bill only refers to payments made by the company and not to benefits received by the directors. The effect is that options issued to a director are clearly captured by the definition but any profit made on the exercise of those options is not captured.

The Labor members urge the Government to support Labor's amendments which amend the definition of 'unreasonable director-related transactions' to capture this benefit.

The second loophole in the definition is that it is up to the courts to determine when a payment is considered unreasonable.

To give this legislation some real teeth, the Labor members recommend that the Government support Labor's amendments to proposed section 588FDA which set out the circumstances which the court should have regard to in determining whether a transaction is unreasonable.

Under Labor's amendments, the court would be required to consider the following:

- The payments and benefits received by directors relative to payments and benefits received by employees in the company;
- Whether the payments or benefits were subject to appropriate performance criteria; and

- 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.

The Committee's view that the proposed criteria in the bill are consistent with existing legislation misses the point.

The purpose of Labor's amendments is to provide *greater* guidance to the Court as to the circumstances that the Court should consider in determining whether a transaction is unreasonable.

2. Scope of the Bill

Executive Remuneration

A large number of submissions, including submissions from the ASA, AICD, ACTU, CPA and ICAA, noted that the bill was too narrow as it failed to address executive remuneration.

The Committee's view that such issues are being considered in CLERP 9 and the exposure draft of the *Corporations Amendment Bill* is feeble. The CLERP 9 paper released by the Government fails to adequately address executive remuneration - in spite of its 205 pages. The only proposal in the CLERP 9 paper on executive remuneration is that the IASB standard requiring expensing of share options will have the force of law on adoption by the AASB, in the second half of 2003. The exposure draft of the *Corporations Amendment Bill*, is similarly bereft. It proposes minimal changes that mostly relate to the disclosure and valuation of options and non-cash benefits.

The Howard Government refuses to legislate in relation to executive remuneration, and instead has adopted a self-regulatory approach.

In contrast, Labor has tried to amend section 300A of the *Corporations Act* by moving amendments to this bill that require companies to publish details of board policy on executive remuneration including performance conditions, the methods used to assess whether the performance conditions have been met, discussion of the relationship between the company's performance and the board's policy and graphs showing shareholder return for the past five financial years.

Labor has also moved amendments that allow shareholders to vote on the board policy on executive remuneration - through an annual non-binding resolution on executive remuneration at annual general meetings.

The Labor members urge the Government to re-consider this opposition to Labor's amendments in relation to this bill, which enhance the disclosure requirements in relation to executive remuneration under section 300A of the *Corporations Act*.

Subsidiaries

Although not strictly relating to this bill, Professor Baxt from the AICD raised a number of issues in relation to the provisions in the *Corporations Act* relating to executive remuneration.

One of those issues relates to the directors' duties in the context of a consolidated group.

Professor Baxt said:

> *"One of the problems that we had with the first version of this legislation was that it did not seem to catch the situation where payments were made not to the directors of a particular company but to another company that was related. Whilst the definition of associate might arguably pick this up, arguably it does not. The government has already before it a report from CASAC or CAMAC, as it is now known, dealing with corporate groups and the way in which that particular area should be dealt with. It has not responded to that report and it has not deal with those issues in the broader sense, so we have these problems spreading out as we get more and more complexity in the way in which the law is developing."*[1]

In relation to this bill specifically, Professor Baxt said:

> *"The way this bill is drafted, I think that if a payment were made to a director of a partly owned subsidiary it might not be caught by this legislation…my initial reaction …is that those sorts of payments would not be caught. If we are talking about evil here – if I can be a bit colourful – then those sorts of payments would not be caught. It would be terrible if we found that someone got off. We see so many cases of people getting off because there is a technical flaw in the legislation and the court says, 'Sorry, there is no case to answer'. We saw that recently in a tax issue."*[2]

The Labor members are of the view that:

- The *Corporations Act* should be amended to ensure that the provisions relating to executive remuneration apply to directors (and key executives) regardless of which company in a corporate group they work for.
- Consideration should be given to whether amendments are also required to this bill to ensure that unreasonable payments made to a director of a partly owned subsidiary are caught by the bill.

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[1] Committee Hansard, 6 March 2003, page E2

[2] Committee Hansard, 6 March 2003, page E10

Officeholders

The Labor members support the Committee's recommendation that the bill also apply to senior executives who are not directors.

3. Date of Commencement

The bill will only apply to transactions entered into on or after the bill receives Royal Assent. Any payments made to directors before this date will not be captured.

The Committee has said that the provisions of the Bill should not be retrospective on the basis that the Treasurer has said that to avoid constitutional doubt, the legislation should apply prospectively.

However, advice from the Parliamentary Library is that whilst it is a principle of statutory interpretation that in the absence of a clear statement to the contrary, an Act will be assumed not to have retrospective application, there is nothing in the Australian constitution to prevent Parliament from enacting retrospective laws.

The Labor members are of the view that the legislation should commence from the date of the Prime Minister's announcement that the law would be amended, that is, from 4 June 2001.

4. Other matters

The Labor members are concerned about the lack of consultation that took place in relation to this bill and recommend that the Government comply with their obligations under the *Corporations Agreement 2002,* to expose bills relating to the *Corporations Act* for public comment for at least three months before introduction.

Senator Jacinta Collins
Labor Senator for Victoria

Senator Ruth Webber
Labor Senator for Western Australia

Supplementary Remarks

Senator Andrew Murray: Australian Democrats

Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002

Context

This *Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002* has a relatively narrow aim – to permit liquidators to reclaim unreasonable payments made to the directors of insolvent companies.

That is a desirable objective, although the Committee Inquiry has clearly indicated significant shortcomings in the Bill.

The Opposition in the House of Representatives outlined additional considerations in determining whether payments to directors and senior executives are reasonable. They proposed a number of amendments which addressed important issues. If they reproduce these in the Senate we will consider them with a sympathetic view.

The Bill was prompted by the collapse of One.Tel but it needs to be considered from a wider perspective than that.

This legislation has to be seen in context. 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 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 shareholders have been robbed by the syphoning off of their funds through board approved salary package rackets.

Market confidence has been badly affected in the long-term. The new and very large cohort of 'mum and dad' investors have been taught that they can not trust auditors and accounting standards, and that they can not trust directors to do their job and to do the right thing.

In the eighties and early nineties the opprobrium landed on entrepreneurs, who were by definition few in number. Now it is the corporate bureaucrats, the professionals, a whole class of business people and their advisers who have lost public trust.

At the heart of the matter are 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/option packages (the executive and director mates on the board) are also those who approve those packages;

- Full disclosure of executive and director packages to shareholders and the market has been poor and the bare minimum, despite legislation[1] which explicitly encouraged it;

- Boards do not have independent directors. Directors are subject to the patronage of dominant executives or owners. Good democratic processes for director election are rare. Far too often it is still a mates arrangement;

- Accounting and auditing standards and practices have been deficient;

- The regulators (ASIC, the ASX and the ASB) have been weak in their efforts.

The debates of 1997 and 1998 which led to the greater disclosure of pay packages was a result of the Democrats and Labor recognising that management and boards were conspiring to enrich themselves at shareholder expense. They rightly saw that the danger of creating acceleration in remuneration from disclosure was outweighed by the right of shareholders to judge pay and performance and to have a say in determining pay for performance.

Disclosure is an essential part of governance and is an essential market mechanism.

Unfortunately neither the law nor the regulators were up to the task of defeating the greedy. Hence the need for more changes to the law.

In commenting on new draft ASX guidelines for disclosure of executive pay packages, an Australian Financial Review editorial said: *"[the previous guidelines have been] notoriously porous and have allowed companies to hide details of incentive and retirement benefits until the lucky executives and directors have banked their cheques."*[2]

The problem with the ASX approach of course is that it is voluntary. Pathetically, the ASX says those who do not volunteer to disclose would have to explain why in due course. Talk about being hit with a wet lettuce!

Many company directors and executives have proven they are not to be trusted. Greed and self-interest govern their actions. The only antidote is black letter law to ensure transparency. Shareholders deserve full information on which to judge pay versus performance.

We welcome the fact that the Government, after 5 years, is finally accepting the need to enforce these remuneration provisions. They have also come a long way from their earlier positions with CLERP 9. Hopefully it will herald a new era. The Democrats will try and ensure it is as tough as it needs to be.

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[1] See Democrats and Labor amendments (s.300A), forcing the Government to accept disclosure of remuneration *Company Law Review Bill 1997*, Senate Hansard 24 and 25 June 1998.

[2] AFR 'Disclosure Pays Off' Page 70 Thursday 13 March 2003.

Further, the penalties for non-disclosure need to be high, and the Regulators put on notice to take an active interest. Companies have not had the morality that should motivate disclosure, the regulator was asleep, the accounting standard-setter snail-like, and the determination of boards to keep their greedy secrets meant they disregarded the present law's penalties, and anyway found ways round it.

Alan Kohler from the Australian Financial Review had this to say: *"Companies have been blatantly breaking the law by signing or maintaining contracts that include large termination benefits and performance incentives that are not disclosed each year."*

And *"Admittedly ASIC's PN98 was also deficient in not specifically requiring accrued termination benefits and long-term incentives to be disclosed each year, and the Accounting Standards Board took years to issue an exposure draft…"*[3]

Independence

The Joint Committee of Public Accounts and Audit Report 391[4] refers to independence throughout its Report. At 1.23-1.30 it has a succinct summary of independence.

Briefly, independence is determined by the method of appointment and termination, by the security of tenure, and by remuneration. It is enhanced by the best features of democracy – the separation of powers; full access to relevant information; high standards of process and performance; transparency, disclosure and accountability; and the full involvement of stakeholders, particularly through democratic elections.

As Report 391 says: *"Independence is important to ensure that a person or group of persons undertake their work professionally, with integrity and objectivity and free of bias and undue influence."*

It is notable (and a tribute to the past influence of board insiders on political insiders I suspect) that Corporations Law still lacks definitions or criteria for independence.

Hopefully public outrage has now created the right climate for reform.

Separation of Powers[5]

The issue of corporate governance is at the heart of managerial and board accountability. Existing company law is inadequate in terms of corporate governance.

Directors' duties are very wide on operational and management matters, and can create situations where major conflicts of interest, mismanagement and even corruption can go unchecked. As some of the recent corporate collapses show,

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[3] AFR Page 72 Saturday 15 March 2003.

[4] JCPAA Report 391 'Review of Independent Auditing by Registered Company Auditors'

[5] Dr Shann Turnbull is a notable Australian and international authority in this area of corporate governance. His writings have been an important contribution to the debate.

directors and senior management can evade their full responsibilities to the company's shareholders.

As a means of improving this situation, the Australian Democrats propose a separation of powers - that the law give shareholders of public companies the option of requiring a separation of the normal business and internal management functions of the board from the governance functions of ensuring openness, accountability and good process.

- The main board would continue to be oligarchic (representing the oligarchy of financially dominant bodies), elected by share-holding (financial power) and would concentrate on strategic, business and operational issues;

- A Corporate Governance Board, elected directly by shareholders, not shareholding, (i.e. numerical or democratic power) would comprise not more than three non-executive directors. It should call and chair shareholders meetings; propose changes to the company constitution; manage the process of electing directors; resolve conflicts of interest; *determine the remuneration and packages of directors and executive management;* and ensure independent advisers by taking the appointment of auditors and other advisers such as valuers away from the main board.

Corporate Democratisation

There is currently a great disparity between the principles of corporate democracy and the rules set out in the Corporations Act governing the internal operations of companies. For example, the existing method of electing company directors on a limited re-election basis allows dominance by control groups and inhibits the likelihood of support being expressed for particular directors or independent directors.

The law does not enable minority interests to be heard through more accessible internal procedures, forcing them to rely on expensive and time-consuming formal procedures like the legal system and the ASIC. Unacceptable discriminatory practices still apply, and women are still in a small minority as directors.

The Democrats believe that if the ASX and ASIC do not soon insist on best practice election processes, then election procedures for companies would need to be legislated.

Related Companies

Corporate restructuring is used by unscrupulous companies to deprive creditors (including employees) of access to assets, when a subsidiary collapses. There have been recent examples of this where employees, and creditors generally, have lost out where the company responsible for the failure has been a holding company that has washed its hands of the debts of the subsidiary company.

When companies were originally conceived, it was intended that they would provide a benefit of limited liability to their owners – the shareholders. It was not intended that they would be manipulated to allow the separation of assets in one company and

liabilities in another, resulting in those to whom money is owed having access to no significant assets to satisfy their entitlements.

In accordance with recommendations of the Law Reform Commission in 1988, the Democrats propose making related companies liable for the debts of insolvent companies in limited circumstances. It would be up to a court to consider matters like:

- The extent to which the related company took part in the management of the insolvent company; and
- The conduct of the related company to the creditors of the insolvent company; and
- The extent to which the circumstances that gave rise to the winding up are attributable to the actions of the related company.

Labor has supported these Democrat initiatives a number of times in the Senate, but the Coalition have refused this obvious reform. Their refusal has benefited the dishonest and immoral.

Corporate Disclosure Rules

In the Democrats view, any substantial salary or performance package should be disclosed *at the time it is negotiated*. This should also apply to any potential redundancy payout and should include the value of shares and options.

We look forward to the CLERP 9 amendments. With the benefit of hindsight we have seen boards cleverly avoid our remuneration amendments through retirement benefits that were not fully disclosed. We intend to try and ensure that these provisions are strong and enforceable, and that the clear legislative intent cannot be circumvented by clever remuneration arrangements.

The Democrats will seek to toughen disclosure requirements and to financially punish any public company that does not appropriately - and promptly - inform ASIC and the ASX of the employment terms of its highly paid executives.

The revelation of the Commonwealth Bank's $32.7m payout to Mr Cuffe once again highlighted the urgent need to improve corporate disclosure rules.

The announcement of this extravagant payment was another example of shareholders being kept in the dark and treated with contempt by company directors.

The Board of the Commonwealth Bank should have hung their heads in shame. The details of the redundancy payout should have been made publicly available at the time they were negotiated.

Timely disclosure may, in some small way, have mitigated shareholder outrage, the damage to the Company's, Mr Cuffe's and Mr Murray's reputation, and any negative impact on the share price.

Shareholder Approval of Retirement Payouts

The revelation of AMP's multimillion payouts to executives and directors highlighted the urgent need to give shareholders the right to veto massive payments.

The announcement of the extravagant bonus payments was another example of shareholders being treated with contempt by executives and company directors.

We need tougher rules to empower shareholders with the right to decide whether exorbitant payments are appropriate. Due to their self-interest and greed, many directors have shown themselves incapable of showing adequate discretion.

For years now, weak company directors have allowed themselves to be victims of executive greed. Section 200B of the Corporations Act outlines that a company must not give a person a retirement benefit without shareholder approval as outlined in Section 200E. However, it seems that major corporations, the AMP and Commonwealth Bank being the obvious recent examples, are circumventing the spirit of these amendments.

These rules should be strengthened to allow shareholders the opportunity to veto payouts, particularly where;

- there has been a significant reduction in the company value;
- performance criteria have not been met in a material sense; and/or
- the company has made a loss or there has been a significant profit reduction.

Senator Andrew Murray
Australian Democrats

Appendix 1

List of public submissions

Submission No 1:	Australian Institute of Company Directors
Submission No 2:	Australian Chamber of Commerce and Industry
Submission No 3:	Department of the Treasury
Submission No 4:	Association of Superannuation Funds of Australia
Submission No 5:	CPA Australia and the Institute of Chartered Accountants in Australia
Submission No 6:	Australian Stock Exchange
Submission No 7:	Australian Council of Trade Unions
Submission No 8:	Insolvency Practitioners Association of Australia
Submission No 9:	Australian Shareholders' Association Ltd
Submission No 9A:	Australian Shareholders' Association Ltd

Appendix 2

Public hearing and witnesses

Thursday, 6 March 2003 - Canberra

Australian Institute of Company Directors

Baxt, Professor Robert, Chairman, Law Committee

Upton, Ms Gabrielle, Senior Policy Officer

Australian Council of Trade Unions

Burrow, Ms Sharan, President

Certified Practising Accountants Australia

Dixon, Mr Arthur James, Director, Accounting and Audit

Insolvency Practitioners Association of Australia

Dwyer, Mr Michael, National President

Australian Accounting Research Foundation

Neild, Mr Stanley, Manager, Legislation Review

Department of the Treasury

Rawstron, Mr Michael, General Manager, Corporate Governance Division

Rogers, Mr Scott, Analyst, Governance and Insolvency Unit, Corporate Governance Division

Wijeyewardene, Ms Kerstin, Manager, Accounting Policy Unit, Corporate Governance Division

Australian Shareholders Association Limited

Rofe, Mr Alfred Edward Fulton, Chairman,