Senate Economics Legislation Committee

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

Submission No. 6

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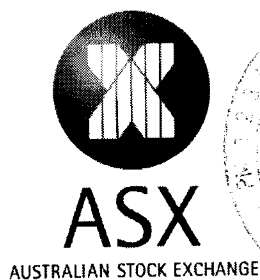
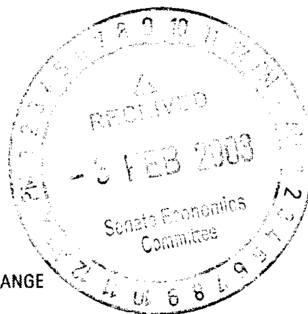
Attachments? No Attachments





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ASX Submission on Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002

Please find enclosed a submission by the Australian Stock Exchange in relation to the Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002.

If you require anything further, please call Susan Bray on (02) 9227 0876.

Yours sincerely,

Susan Bray
National Co-ordinator, Market Integrity

Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002

ASX Submission

General Comments

1. ASX supports the government's efforts to restore and promote investor confidence in the aftermath of collapses of companies such as OneTel. ASX sees the proposed legislation as part of a wider review of legislation and self-regulation impacting the governance of companies, aimed at encouraging companies and their officers to enhance the quality and transparency of their governance arrangements and the integrity of their financial systems.

2. In line with the position that ASX has adopted in relation to corporate governance and its support for the CLERP 9 proposals, ASX is generally supportive of this proposal and sees 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.

3. The proposed criteria to be used in the assessment of the 'reasonableness' of the director-related transactions require an assessment of the benefits accruing to the company by virtue of the transaction. ie that there is value to the company to be derived from the payment. We believe that this is the appropriate approach (subject to our comments below in relation to application) and that companies should ensure that there is an alignment between company performance or value added to the company and payments (or other benefits) made to directors.

   This approach accords with that likely to be taken by the ASX Corporate Governance Council in providing guidance (to be released in March) as to the appropriate remuneration structure for both executives and directors. Best practice will require companies to establish a nexus between payments to its officers and employees and the value to the company of these; in the same way bonus payments to directors should be capable of justification on this basis.

Areas of Concern

4. Whereas the approach appears appropriate, ASX is concerned as to effect of the application of certain of the provisions; this approach may specifically meet some of the issues surrounding the collapse of OneTel, but in doing so it may create unintended difficulties for companies in structuring appropriate remuneration schemes for their directors:

   a. The circumstances in which the proposed legislation may be triggered are widely drawn, including circumstances where the company is solvent at the time the benefit is paid. Whereas this will capture payments made at a time when they were economically unviable, although the company was solvent, it will need to be carefully applied to ensure that recovery is not sought of

legitimate payments rewarding legitimate effort prior to a subsequent and unrelated downturn in the performance of the company. Enabling recovery in these circumstances may act as a significant disincentive for executive directors (particularly entrepreneurial executive directors) from accepting bonus payments as part of a more modest fixed salary package and therefore prevent some companies from accessing appropriate directors, as there can be no absolute certainty for the recipient that this part of their remuneration is really theirs until 4 years after the bonus is received.

b. The proposed legislation contemplates a 4 year period during which the transaction may be voidable. Since the proposed provision could be invoked even where the company was solvent, we believe that a four year time period may be excessive, particularly in light of our comments above as to the disincentive factor of the proposal.

c. 'Reasonableness' is to be assessed at the time that the transaction was entered into (ie at the time the payment was made) rather than at the time that the obligation was incurred. We believe that this provision potentially compounds the danger of recovery actions against legitimate bonus payments. If the terms of a bonus structure established in advance (on reasonable terms) are open to review at the time agreed for payment and may, in any event, be clawed back up to 4 years later, this type of remuneration structure may not be available to those companies that need to rely upon it.

d. Provided that securities issued to a director have not been transferred, there appears to be no reason why the court should not have the power to cancel the securities if the transaction is voided. However, section 588FF(1) is not being amended to confer this power on the court.

Specific issues relating to interaction with other provisions of Corporations Act and Listing Rules

5. The Bill may not have fully taken account of the related party transaction provisions in Part 2E of the Corporations Act, the takeover provisions in Chapter 6 of the Corporations Act, and the operation of Listing Rule 10.1. This has the potential to cause considerable uncertainty, particularly the issue of the weight to be given to shareholder approval of a transaction:

   a. the definition of "unreasonable director-related transaction" overlaps with the transactions covered by listing rule 10.1. Listing rule 10.1 requires security holder approval based on an expert's report as to the fairness and reasonableness of the transaction. It would therefore seem difficult for a liquidator to show that "a reasonable person in the company's circumstances would not have entered into the transaction".

   b. the definition of "unreasonable director-related transaction" also overlaps with the transactions covered by Part 2E. While Part 2E does not require an expert's report, it does require shareholder approval unless an exception

applies and section 219 requires an "explanatory statement" which must include the potential costs and detriments to the company of the transaction. Where shareholder approval has been obtained under Part 2E it would therefore also seem difficult for a liquidator to show that "a reasonable person in the company's circumstances would not have entered into the transaction".

c. the definition of "unreasonable director-related transaction" – which includes an issue of securities - may also overlap with item 7 of section 611, which permits a takeover through an issue of securities with security holder approval. An independent expert's report is customarily provided when seeking such approval. Where shareholder approval has been obtained under section 611 it would therefore also seem difficult for a liquidator to show that "a reasonable person in the company's circumstances would not have entered into the transaction".

It is possible that the Bill is intended to apply primarily to transactions for which shareholder approval was not obtained under Part 2E, in reliance on the exception in section 211 for "reasonable remuneration", or other exceptions e.g the commercial arms' length exception. However, this is not discussed in the Explanatory Memorandum.

6. Given that there are existing provisions dealing with related party transactions and issues of securities, the Bill should be consistent with those provisions. 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's report that the transaction is fair and reasonable unless it can be shown that the report was inadequate.

7. Alternatively, the Bill creates an opportunity to review the related party transaction provisions of the Corporations Act. If Part 2E were to be extended to include transactions with "significant shareholders" and to require an independent expert's report – at least for transactions above a specified threshold – and the exception for "arms' length" transactions deleted, ASX could delete listing rule 10.1.