Chapter 3

Consideration of the bill

3.1 A number of issues were raised in connection with the bill. These included the timing of the measure prior to the report of the Productivity Commission (PC) inquiry into executive remuneration, and questions relating to the extent that shareholders should be able to deal with remuneration matters.

3.2 In relation to the bill itself, major areas of discussion included whether the 12 month threshold was appropriate, whether termination payments should be based on 'base salary' or 'total remuneration', and any possible adverse impact the bill might have on the ability of Australian companies to recruit.

3.3 A number of possible unintended consequences were raised, including the possibility of other aspects of remuneration being increased, and the possible burden imposed on subsidiaries and unlisted companies.

3.4 This chapter summarises some of these issues.

Timing of the bill

3.5 Several submissions proposed that it would not be appropriate to proceed with the bill before the outcomes of the PC inquiry and the APRA inquiry. Organisations which have called for delay until after completion of the PC report include ACCI, Guerdon, BHP Billiton, Hay Group, the AICD, the BCA, KPMG and Abacus.[1]

3.6 The AICD highlighted the risk that the PC might advise against the adoption of measures such as the bill:

> I put to the Productivity Commission at one stage whether, if they actually thought our idea—namely, not to have termination payment legislation of this sort—was a good one, they would say so. And they said that their job was independent and, if they came to that view, they might. So the issue was: if legislation went through and the Productivity Commission said it was a really bad idea, it would seem to be not the best result for anybody.[2]

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1 ACCI, *Submission 4*, p. 1; Guerdon Associates, *Submission 1*¸ p. 6; BHP Billiton, *Submission 5*, p. 2; Hay Group, *Submission 6*, p. 1., AICD, *Submission 12*, p. 3.; BCA, *Submission 9*, p. 1; KPMG, *Submission 16*, p. 3, Abacus, *Submission 21*, p. 1.

2 *Proof Committee Hansard*, 25 August 2009, p. 46.

3.7 Regnan, a governance consultancy, argued that issues surrounding executive remuneration should be looked at as a whole:

> Analysis of the proposed reform of termination payments that you are looking at today, we think, would be best viewed as part of an overall package. It is a bit like dealing with the muffler of a car and not considering at the same time, if you are talking about vehicle emissions, how other issues such as the efficiency of the engine, the quality of the fuel et cetera ought to be considered as a package.[3]

3.8 Treasury advised that it was a policy decision of government to proceed with the bill prior to the outcome of the Productivity Commission report. Without commenting on the decision either way, Mr Miller did make use of the 'muffler analogy' to observe:

> …if the car is very noisy at the time it might be best to put the muffler on first and work the rest out later.[4]

Giving shareholders a greater say

3.9 Mr Gary Banks recently summarised some of the varied views received by the PC during its inquiry into executive remuneration on the desirable level of shareholder involvement in setting pay:

> It seems generally accepted that the shareholder body en mass and over time 'owns' the company, in the sense that they have claim over the profit residual. By the same token, shareholders, whether individual or institutional, face 'limited liability' and can sell their interest in the company at any time.
>
> Shareholders are a heterogeneous group. They can hold different and often quite divergent views about company strategy and policy, reflecting their different risk preferences and time horizons. Indeed, it’s been put to us that investors often are more focused on the short term than executives and boards, who need to make investment decisions with long-term pay offs.
>
> The modern corporation emerged largely to circumvent problems created by divergent interests of asset owners and their competing claims for profits. Hence, the legal responsibility of executives and boards quite deliberately is to the company (which has a legal life of its own), not

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3 Mr Erik Mather, Managing Director, Regnan Governance Research and Engagement Ltd, *Proof Committee Hansard*, 25 August 2009, p. 29.

4 Mr Geoffrey Miller, General Manager, Corporations and Financial Services Division, Treasury, *Proof Committee Hansard*, 25 August 2009, p. 76.

> shareholders explicitly. So how much should company remuneration policy be driven by shareholders?[5]

3.10 The Australian Council of Super Investors supported giving shareholders a greater say.[6] Similarly, Professor Peetz stated:

> The interests of shareholders presently feature well behind the urgings of remuneration consultants in shaping excessive executive pay. Generous termination packages transfer risk from CEOs to shareholders, and shareholders should have a say in containing those risks.[7]

3.11 A contrary view was put forward by the Australian Compliance Institute:

> Whilst shareholders have always, to extent, had some say over benefits for directors, they traditionally do not intrude into operational matters associated with the actual running of the company. Shareholders delegate these aspects to the board of directors. Giving a binding vote on termination payments to non-director executives seems to go beyond this oversight function into operational management matters. It is also questionable whether shareholders would have access or exposure to the necessary information or history of performance to be able to assess the appropriateness of payment of termination payments due.[8]

3.12 Other submissions arguing that boards are responsible for such decisions included Origin Energy, the ABA and IFSA.[9] Guerdon Associates argued in their submission:

> Interference by shareholders in operational matters traditionally delegated to the board of directors blurs the extent that directors can be held accountable on these matters.[10]

3.13 At the hearing, Mr Peter McAuley, Director, Guerdon Associates, further explained this point:

> …we think there is a line beyond which shareholders elect the directors to serve them and represent them on the board. Shareholders should clearly have a say in many issues but there are, what we would term, more

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5 Mr Gary Banks, Chairman, PC, 'the Productivity Commission's executive pay inquiry: an update on the issues,' paper presented at FINSIA forum, 4-5 June 2009, pp 10-11, http://www.pc.gov.au/__data/assets/pdf_file/0011/89579/cs20090603.pdf, viewed 26 June 2009.

6 ACSI, *Submission 13*, p. 1.

7 Professor David Peetz, *Submission No. 15*, p. 25.

8 Australian Compliance Institute, *Submission No. 3, Attachment*, p. 2.

9 Origin Energy, *Submission No. 2*, p. 1; ABA, *Submission 24*, p. 1; IFSA, *Submission 25*, pp 1-2.

10 Guerdon Associates, *Submission 1*, p. 5.

> operational issues that we think belong with the directors in conducting the duties that they are elected for.[11]

3.14 BHP Billiton argued the bill shifts the balance too far towards shareholder decision making:

> We are also supportive of the general policy behind provisions of this nature – that at a particular level, shareholders should have a say in order to provide reassurance that arrangements struck by a Board are reasonable from the shareholders' perspective.
>
> However, the threshold set out in the bill – 12 months' base salary – represents an extreme adjustment in the other direction. It entails a very substantial shift from Boards' exercise of business judgement to other shareholder decision making.[12]

3.15 The AMWU proposed that decision making should be expanded to include groups other than shareholders:

> There is a general need to question, however, whether this method is sufficient to address the mischief of executive excess. First, when there are wider social concerns about executive corporate remuneration, it is inappropriate to leave control of this excess to shareholders alone. It is unlikely, whilst a company is rewarding its shareholders with higher profits, that shareholders will be overly concerned about corporate social responsibility…Secondly, it is often impractical to give more than advisory power to the body of shareholders in a corporation. If shareholders are given a veto over executive salaries, it is difficult to conceive an effective mechanism to negotiate salaries which are capable of approval by a group of shareholders with diffuse interests.[13]

3.16 The committee heard discussion about whether a shift to shareholders' approval will be successful, given the role of institutional shareholders. The argument here appears to be that decision makers at institutional shareholders, who are themselves likely to be senior executives or board members, are likely to be sympathetic to remuneration claims made by their fellow executives at other companies. This has been likened to a 'club'.

3.17 ACSI noted that there is a high degree of overlap between boards in Australia:

> …there is in fact a smallish number of people who move between boards. ACSI does research each year about the movements of boards and, if I remember correctly…the people who moved onto ASX boards not last year but the year before, 75 per cent were already on another ASX 100 board.[14]

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11 *Proof Committee Hansard*, 25 August 2009, p. 59.

12 BHP Billiton, *Submission 5*, p. 2.

13 AMWU, *Submission 10*, pp 4-5.

14 Ms Ann Byrne, Chief Executive Officer, ACSI, *Proof Committee Hansard*, 25 August 2009, p. 23.

3.18 In spite of this, ACSI argued a strength of the bill was to provide greater transparency on the way in which these decisions are made:

> There is a wonderful quote that we have come across in governance: 'Boards are like subatomic particles. They behave differently when they know that they are being observed.'[15]

3.19 Regnan Governance Research and Engagement Pty Ltd agreed that greater transparency offered by the bill will be advantageous, but noted that shareholders will need to play their part:

> We think that the bill is helpful because it forces companies to engage with their share owners and to give these issues a greater level of transparency than in the past. Remember that the bill takes the threshold from being seven times total remuneration to one times base salary, which is probably more than a sevenfold decrease in terms of the proportionality before companies are forced to engage with their share owners. So we think that that will be an opportunity, because, in the past, there has not been the ability to engage with the share owners. What does the share owner do? In the absence of information they go out and terminate a director because they suspect that something is there. At least now they will have the information. As we said earlier, it is important that share owners play their part in ensuring that those directors who struggle with termination payments perhaps get invited to be terminated themselves.[16]

3.20 Chartered Secretaries Australia argued that a more practical approach to giving shareholders a say on termination benefits would be for shareholders to approve a 'termination policy' containing a 'formula,' rather than approving each individual payment. Shareholders would then only need to approve subsequent payments which fall outside the approved policy or formula.[17]

The 12 month threshold

3.21 Several organisations argued the new 12 month limit was too low.

3.22 The BCA questioned the basis of 12 months, suggesting that the government has provided 'no explanation as to why such a "significant" reduction is required or

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15 Mr Phillip Spathis, Manager, Strategy and Engagement, Australian Council of Superannuation Investors, *Proof Committee Hansard*, 25 August 2009, p. 23.

16 Mr Erik Mather, Managing Director, Regnan Governance Research and Engagement Pty Ltd, *Proof Committee Hansard*, 25 August 2009, p. 37.

17 Chartered Secretaries Australia, *Submission 13*, pp 4-5.

discussion of the market failure which warrants the threshold being set at that level'.[18] BHP Billiton also opposes the 12 month period as too low.[19]

3.23 Alternative time frames were suggested. The AICD called for the threshold to be set at 2 years, or failing that, for the two year threshold to be adopted during the first year of a contract.[20] The Australian Compliance Institute also proposed two years.[21] Guerdon Associates support three times base salary and short term incentives,[22] whilst Origin Energy calls for the period to be equivalent to that used in the US or Europe.[23] Other submissions supported the proposed timeframe of 12 months.[24]

3.24 Professor Peetz argued one year is too generous:

> The legal minimum for termination payments set out in the Fair Work Act 2009 is a useful benchmark. It is unclear why CEOs should receive extraordinarily generous payouts on terms vastly superior to those available to ordinary employees dismissed for similar reasons.[25]

3.25 The National Employment Standard (NES) provisions in the *Fair Work Act 2009* provide that in general, employees will be entitled to 1-4 weeks notice of termination (or payment in lieu) depending on their length of service. This consists of 1 week for those who have served less than one year, rising to 4 weeks for more than 5 years, with an additional week in the case of employees who are more than 45 years old and who have completed 2 years' continuous service. This is based on an employee's full rate of pay, which may be inclusive of loadings, penalties, overtime and allowances.[26] Some awards and industrial agreements provide for greater amounts, including more than one year's base salary.

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18 BCA, *Submission 9*, p. 3.

19 BHP Billiton, *Submission 5*, p. 2.

20 AICD, *Submission 12*, p. 3.

21 Australian Compliance Institute, *Submission 3, Attachment*, p. 1.

22 Guerdon Associates, *Submission 1*, p. 6

23 Origin Energy, *Submission 2*, p. 4.

24 ACSI, *Submission 13*, p. 2.

25 Professor David Peetz, *Submission 15*, pp 25-26.

26 Australian Human Resources Institute/Holding Redlich, fact sheet, 'Notice of Termination and Redundancy Pay', pp 1-2, http://www.fairworkaustralia.ahri.com.au/docs/fwrc_notice_of_termination_and_redundancy_pay_factsheet.pdf, viewed 5 August 2009; Fair Work Ombudsman, Fact Sheet, 'Termination of employment', http://www.fwo.gov.au/Fact-sheets/Documents/FWO-Factsheet-Termination-of-employment.pdf, p. 2., viewed 5 August 2009

Pro-rata limit for service less than 12 months

3.26 For executives who have served less than 12 months with a company, the threshold reduces according to a formula established by items 31 and 37 of Schedule 1 of the bill. This was raised in some submissions as being too low in the initial stages of a contract.

3.27 The Law Council of Australia argued against a pro-rata limit for executives who have served less than 12 months.[27] The AICD suggested that higher payments are justified:

> This risk, and the potential cost, to an incoming CEO is greatest at the start of a contract. It is therefore common practice, in order to entice a CEO to join a company, for there to be a relatively high potential termination payment in the early part of a contract (typically expressed as a notice period), should a company terminate the contract.[28]

3.28 Guerdon Associates also spoke about the potential need for higher payments during the first year of a contract:

> That would be a particular concern, I believe, to an individual. That is the high risk time for them—the short period of time after leaving one employer to arrive in Australia and take on a role which is terminated shortly thereafter. They would be entitled after three months only to a payment of three months…We just feel it is unduly harsh to have a pro-rating in the first year. That is very limiting in terms of what can be achieved, unless of course there is an opportunity to go to shareholders to achieve something higher than that, but that brings obvious uncertainties to the individual at the critical time of recruitment.[29]

3.29 Similarly, in the case of persons who have held a position for three years or more, the bill states that the average salary will be based on 'the average annual base salary that the person received from the company and related bodies corporate during the last 3 years of the relevant period'.[30] Chartered Secretaries Australia argued 'this does not take into account a change in position that may occur for a particular executive, for example, an executive could be promoted to CEO'.[31] Origin Energy and Hay Group shared these concerns about the methodology used for setting 'average annual base salary'.[32]

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27 Law Council, *Submission 23*, p. 7.

28 AICD, *Submission 12*, p. 3.

29 Mr Peter McAuley, Director, Guerdon Associates, *Proof Committee Hansard,* 25 August 2009, p. 59.

30 Schedule 1, Item 31, paragraph 200F(4)(e); Item 37, paragraph 200G(3)(e).

31 Chartered Secretaries Australia, *Submission 18* p. 8.

32 Origin Energy, *Submission 2,* p. 2; Hay Group, *Submission 6*, p. 4.

3.30 Treasury advised that they were aware of these arguments:

> We believe that the pro rata is the fairest, most equitable outcome. We do note that, if executives are seeking a payment above that [either as a sign-on payment or agreement on a termination payment] before they start, there is capacity under the existing rules for them to negotiate that before they start…That would be allowed under the current framework, so you could get a vote on that grounds already. You would have to question, though, whether or not an executive saying that they needed a couple of years payment before they started would be an overly good way to start a new job.[33]

Global competition for talent

3.31 A number of submissions argued that the bill could put Australia at a competitive disadvantage in recruiting talented executives from overseas, or in restraining talented Australian executives from seeking more highly paid positions overseas. These views were noted by Hay Group, Origin Energy, the Australian Compliance Institute, Ernst & Young and IFSA.[34]

3.32 The AICD expressed this view as follows.

> A one year base pay approval threshold for termination payments is materially lower than approval thresholds in comparable jurisdictions overseas. Australian companies will be at a distinct disadvantage in the market for executive services compared to companies domiciled overseas or local subsidiaries of foreign companies…In other words, Australian companies will be put at a competitive disadvantage both overseas and in the domestic market.[35]

3.33 The ABA conceded that the majority of Australian banks currently provide for notice periods of between 6 and 12 months to their executives.[36] Even so, they argued the bill could impose a constraint in recruiting from abroad:

> What the boards are showing is that they have responded to pressure that has come from shareholders groups over—talking to some of their professionals in this area—probably four years and from the community in general. They do not like contracts that have got provisions for large termination payments. The banks have responded to that...But our point is that we do not want a legislative constraint because the banks may want to

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33 Mr Bede Fraser, Manager, Corporations and Financial Services Division, Treasury, *Proof Committee Hansard*, 25 August 2009, p. 79.

34 Hay Group, *Submission 6*, p. 4; Australian Compliance Institute, *Submission 3, Attachment*, p. 1; Origin Energy, *Submission 2*, p. 3; Ernst & Young, *Submission 20*, p. 7; IFSA, *Submission 25*, p. 2.

35 AICD, *Submission 12*, p. 1.

36 Mr Nicholas Hossack, Director, Prudential, Payments and Competition Policy, ABA, *Proof Committee Hansard*, 25 August 2009, p. 47.

> engage an executive who will not agree to a contract without two years or whatever it is. So we do not want that constraint on the banks.[37]

3.34 The ABA proposed that ideally, an international agreement (such as the recent G20 agreement on executive remuneration) should address termination payments. Failing this, they proposed an appropriate international benchmark (i.e. the US threshold of three times base pay plus bonus) should be adopted.[38]

3.35 Guerdon Associates provided data on the source of Australia's executives:

> Given that 17% of ASX 200 executives are recruited from overseas (according to the ACSI Productivity Commission submission), where termination provisions are more generous, the new maximum of "one times" is too low. The combination of geographic isolation, onerous taxation structures and the dislocation of moving families extensive distances to Australia militate against Australian companies' success in attracting executives. This problem will be exacerbated if those potential recruits, required to relinquish existing financial and employment security to accept a role in Australia, cannot have reasonable certainty of adequate compensation in the event of early termination equivalent to what they would otherwise receive in their source country.[39]

3.36 A variation of these arguments is that it may not be possible to fill positions on subsidiaries of Australian companies abroad. The BCA raised this issue,[40] as did Insurance Australia Group Limited (IAGL):

> For overseas subsidiaries of IAGL there are also issues of the potential conflict between the regulatory requirements of their home jurisdiction and those under the Australian law. We understand that the EU is considering caps on termination payments at two years salary. This difference in the levels of termination payments is likely to have an adverse impact on the recruitment of appropriately qualified individuals in these jurisdictions.[41]

3.37 Mr Alex Christie, Deputy Head of Group, Human Resources, IAGL, expanded on this issue further before the committee:

> …if we have a company in United Kingdom, which we do, and we need a managerial person to sit as a director on that company, the standard in the UK may be two years— the cap for termination payments that has been talked about in the EU—then clearly we would have a different arrangement, which is one year. So we can see the potential for those managers, when we recruit them, raising that as an issue in the context of

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37 Mr Nicholas Hossack, Director, Prudential, Payments and Competition Policy, ABA, *Proof Committee Hansard*, 25 August 2009, p. 52.

38 ABA, *Submission 24*, pp 1-2.

39 Guerdon Associates, *Submission 1*, pp 3-4.

40 BCA, *Submission 9*, p. 5.

41 IAGL, *Submission 14*, p. 5.

> their remuneration. That could lead us to a higher fixed pay component or potentially to a sign-on payment or something else, restructuring them for that perceived disadvantage that they might suffer.[42]

3.38 This appears to suggest that the European Union is contemplating a hard 'cap', rather than allowing higher payments subject to shareholder approval. This would be much tougher than the proposal contained in this bill.

3.39 Ernst & Young argued that there may be a potential conflict between Australian and local laws allowing payments of over 12 months' base salary for overseas based executives. This 'may give rise to a claim against the employer under local employment law'.[43] QBE Insurance has also expressed concern about the application of the proposed law to its employees overseas.[44]

3.40 Other submissions questioned arguments about international competitiveness. Professor Peetz argued that the evidence did not support the view that there was significant leakage of Australian executives to other jurisdictions:

> …an examination of executive appointments and departures at the 50 largest ASX companies over the 2003-2007 period showed that only 4 per cent of confirmed departures 'were as a result of an executive being recruited by an offshore employer'. Indeed, only 17 per cent of departures were due to executives being recruited by another employer in Australia or overseas – most were terminations or retirements. Amongst CEOs, departures were even less common – only 7 per cent of CEO departures were to join another employer, including less than 4 per cent (one CEO) going overseas.[45]

3.41 Professor Peetz also disputed the argument that executive remuneration is influenced by international rates of pay more than that of ordinary workers:

> If the recent growth over the last two decades of executive remuneration was due to the move to this international labour market for executives while labour markets for ordinary workers were still national then you would find quite different rates of pay between countries in local labour markets because that would reflect those local labour market circumstances. It would reflect differences in productivity and technology between Australia, New Zealand, Sweden, the US and so on. So you would have big differences in wages for ordinary workers between countries that have similar wages for CEOs because they are all part of an international labour market… But the data does not actually support that. The data indicates that there are differences in CEO pay between countries. I mentioned Sweden and the US. A Swedish hamburger flipper gets about eight per cent more

42 *Proof Committee Hansard*, 25 August 2009, p. 5.

43 Ernst & Young, *Submission 20*, p. 7.

44 QBE Insurance, *Submission 26*, p. 1.

45 RiskMetrics data, cited in Professor David Peetz, *Submission 15*, p. 10.

> than an American one. But an American CEO gets 4¾ times more pay than a Swedish CEO. So there is not an international labour market.[46]

3.42 ACSI stated that claims relating to international competition are overstated.[47] RiskMetrics data provided by ACSI indicates that the most common causes of retirement by CEOs were retirement (57.1 per cent) and termination (28.6 per cent).[48]

3.43 Treasury stated it does 'not believe the draft Bill will have the stated impact',[49] referring to the lack of consistent global requirements and ACSI data on reasons for executives leaving a corporation cited above. They also argue:

> The concerns raised by stakeholders would be more valid if a cap or upper limit on termination payments was being introduced. However, the proposed reforms do not introduce a cap, but rather allow payments of higher amounts provided that shareholder approval is obtained.[50]

Increased base salaries or 'golden hellos'

3.44 A number of submissions warned that a likely consequence of reducing termination payments to one year's base salary would be to increase base salaries, or to see increases in other aspects of executive remuneration.

3.45 AICD described this possibility in the following terms:

> …attempts to restrict termination payments are likely to result in a "squeezing the balloon" effect, by which we mean artificial restrictions on one component of executive remuneration will cause upward movement in another components.[51]

3.46 The Law Council of Australia expressed similar views:

> For many executives in large corporations, base salary represents less than half the value of their remuneration package…this proposal will actually limit termination payments to less than 6 months total remuneration, which is likely to be viewed as inadequate compensation for the risks to tenure of executives in these organisations…the likely consequence of the proposal will therefore be to increase base pay levels, both in absolute terms and as a proportion of an executive's total remuneration.[52]

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46 *Proof Committee Hansard*, 25 August 2009, p. 15.

47 ACSI, *Submission 13*, p. 2.

48 ACSI, *Submission 13, Attachment 1*, p. 6.

49 Treasury, *Submission 22*, p. 9.

50 Treasury, *Submission 22*, p. 9.

51 AICD, *Submission 12, Attachment,* p. 9.

52 Law Council of Australia, *Submission 23*, p. 2.

3.47 The Law Council warned that could lead to increased use of 'golden hellos' when executives commence a new position. The Law Council warned that this reduction in the proportion of an executive's remuneration linked to performance was a 'systematic distortion of remuneration structures in a manner which is disproportionate to the issue being addressed'.[53]

3.48 Two reasons were provided to the committee on why the increase in the size of base pay as a proportion of the total was undesirable. The first reason was that it would reduce the percentage of pay that is linked to good performance – in other words, it reduces the incentive to perform. Chartered Secretaries Australia noted this possibility:

> One thing that springs to mind is that the sort of behaviour it could lead to is that the fixed component of remuneration packages relative to the at-risk component could go up so that we might actually perversely end up encouraging less pay for performance and a bigger base…If I were an incoming executive wanting to look after myself the best, I would be trying to negotiate a higher fixed salary component rather than a variable component. It would be human nature that you would expect that.[54]

3.49 The other reason was the likely increased cost to business, given that base salary components are guaranteed whilst performance based aspects of salary only arise if the conditions are met:

> I think the issue we would see, for instance, is if the additional remuneration is in base salary, it is a certain additional cost to the company. A contingent remuneration based on the way of termination, whether it is redundancy or a merger or acquisition—whatever reason leads to that termination— is a cost that may or may not arise. From a company's point of view you would much prefer to have the possibility of not having to pay anything than clearly having a frontloaded or higher base. I guess it is a cost issue for the company from that point of view.[55]

3.50 Other submitters to warn about possible increases in base pay included Guerdon Associates, BCA, Ernst & Young, Origin Energy, ACCI, the ABA, the Insurance Australia Group and IFSA.[56]

3.51 The AMWU warned that treating termination payments in isolation could lead to manipulation of other aspects of remuneration:

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53 Law Council of Australia, *Submission 23*, p. 2.

54 Mr Peter Abraham, Chartered Secretaries, *Proof Committee Hansard,* 25 August 2009, p. 71.

55 Mr Alex Christie, Deputy Head of Group, Human Resources, Insurance Australia Group, *Proof Committee Hansard*, 25 August 2009, p. 9.

56 Guerdon Associates, *Submission 1*, p. 5; BCA, *Submission 9*, p. 3; Ernst & Young, *Submission 20*, p. 7; Origin Energy, *Submission 2*, p. 4; ACCI, *Submission 4, Attachment*, p. 5; ABA, *Submission 24*, p. 2; Insurance Australia Group, *Submission 14*, p. 5; IFSA, *Submission 25*, p. 1.

…there is a natural tendency of the self-interested to manipulate the form of remuneration for their own benefit. This realisation must be reflected in wider regulation of those same corporate players across the entire scope of their remuneration, or any attempted control of retirement remuneration will be ultimately meaningless.[57]

3.52 Professor Peetz stressed the importance of culture in setting overall remuneration, and argued that it did not necessarily follow that narrowing termination payments would lead to increases in other areas of pay:

It is not as though there is a fixed amount of money that goes to executive pay and it is just a matter of divvying it up; the amount of money that goes to executive pay is shaped by the relative power of the occupation and the culture that is involved in determining executive pay. If you create a culture that says excess is fine then all of the elements of executive pay will go up. Termination payments, base pay and bonuses will all go up. It is not as though you squeeze one and the other goes up. It is not a fixed balloon, the size of the balloon varies.[58]

3.53 The ACSI were less concerned about the likelihood of base salaries increasing due to existing rules allowing shareholder votes on the overall remuneration package.[59]

3.54 Treasury argued that current rules on setting executive base salaries would act as sufficient restraint on increasing salaries as a result of this bill:

…there is greater transparency and accountability with respect to the payment of base salary during the tenure of the director or executive. Such payments are required to be disclosed in the company's remuneration report, and the company is required to clearly explain the policy for determining the nature and amount of remuneration, and a discussion of the relationship between such policy and the company's performance. These requirements operate to provide a measure of accountability and transparency, particularly if a company seeks an unjustified increase in base salary. Shareholders also have the opportunity to cast a non-binding vote on the company's remuneration policies and anecdotal evidence suggests that companies are increasingly responsive to the non-binding vote.[60]

3.55 Or to use the analogy of 'squeezing the balloon':

I would expect that, generally, the balloon will shrink somewhat and that it is unlikely you will see exactly the same amount bulge out the other side if it changes. But even if it does…it is a bulge that will show up, for example,

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57 AMWU, *Submission 10*, p. 7.

58 *Proof Committee Hansard*, 25 August 2009, p. 14.

59 Ms Ann Byrne, Chief Executive Officer, Australian Council of Super Investors, *Proof Committee Hansard*, 25 August 2009, p. 26.

60 Treasury, *Submission 22*, p. 10.

> in the remuneration report, so it will be part of your normal salary and will be shown in the remuneration report and there is a non-binding vote sitting over the top of that remuneration report….at least it pops out somewhere where there are other rules.[61]

3.56 The Explanatory Memorandum indicates a post-implementation review of the amendments will be undertaken within 'one to two years of the commencement of the new requirements'.[62] The committee sees this review as an opportunity to examine any impacts that might occur on base pay.

A new 'floor'

3.57 A concern was raised in some submissions that lowering the threshold could lead to an increase in payments up to the new level, in effect transforming it into a 'floor.' Guerdon Associates raised this risk in their submission:

> By extending shareholder approval to cover employees other than executive directors, it is possible that an unintended consequence of the proposed Australian Corporations Act changes could be a rapid increase in termination benefits for employees below the CEO, from the current median of about 4 months' pay.[63]

3.58 Professor Peetz referred to this risk as an argument in favour of a lower threshold for seeking shareholder approval:

> A danger, perhaps not large, is that the new ceiling on termination payments, of one year's salary before shareholders' approval must be sought, may also become a floor. Consideration should be given to a lower limit.[64]

3.59 In response to these concerns, it is worth noting that no evidence has been provided to suggest that payments are routinely being made up to the existing (admittedly very generous) 'floor'.

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61 Mr Geoffrey Miller, General Manager, Corporations and Financial Services Division, Treasury, *Proof Committee Hansard*, 25 August 2009, p. 77.

62 Explanatory Memorandum, p. 3.

63 Guerdon Associates, *Submission 1*, p. 3 (footnote).

64 Professor David Peetz, *Submission 15*, pp 25-26.

What is included in 'termination benefit'?

3.60 The definition of 'benefit' is to be determined by regulations (Item 7, Schedule 1 of the bill). Several organisations have put forward views about what should, and should not, be included in the list of benefits subject to shareholder approval.

3.61 Ernst & Young called for a distinction between payments for past service (e.g. equity awards that have already vested, mandated holding of bonuses, incentives, accrued leave) and ex-gratia payments made in respect of termination. Payments for past service should not be subject to shareholder approval.[65]

3.62 Chartered Secretaries Australia suggested currently the bill is not sufficiently clear that accrued statutory benefits are not subject to shareholder approval:

> In fact, we are saying that the people we are most concerned about under this draft legislation are the mail boys made good, who have worked their way up through the organisation, been there 30 years, got up to a very senior position and have been made redundant. We want to make sure that this does not work a mischief to actually put them in a worse position. Ironically, it can put someone in a position where they can decline a promotion because their accrued entitlements, unless this is made right, may actually be in jeopardy. That is the biggest mischief. We are putting our hands up to say, 'We don't want to take issue with this bill in general, but please make sure you get that right.'[66]

3.63 The ABA, BCA, Hay Group, Regnan, and Rio Tinto also sought the exclusion of statutory entitlements.[67]

3.64 BHP Billiton noted that its current remuneration includes long term incentives in plans which are already approved by shareholders. It argued that these benefits should not require additional approval by shareholders.[68]

3.65 Several submissions referred to superannuation, including voluntary contributions to superannuation. For example, Regnan, RiskMetrics and ACSI and IFSA argued that voluntary super contributions should not be subject to shareholder

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65 Ernst & Young, *Submission 20*, p. 6.

66 Mr Peter Abraham, LRC Committee, Chartered Secretaries Australia, *Proof Committee Hansard*, 25 August 2009, p. 67.

67 ABA, *Submission 24*, p. 3.; BCA, *Submission 9*, p. 6.; Hay Group, *Submission 6*, p. 4.; Regnan, *Submission 7*, p. 5.; Rio Tinto, *Submission 17*, p. 3.

68 BHP Billiton, *Submission 5*, p. 3.

approval.[69] Bluescope Steel, Guerdon Associates and KPMG also sought clarification of the treatment of superannuation.[70]

3.66 Regnan argued that the inclusion of superannuation benefits could lead to clashes in obligations for superannuation trustees:

> In particular we note that under the Bill, superannuation trustees will be subject to criminal penalties if a benefit is paid to a member where that benefit (taken together with other benefits covered by the proposed provisions) exceeds the new limits…Where the trustee is aware of the restrictions in relation to the particular member, and withholds payment, this will result in a breach of other superannuation law.[71]

3.67 KPMG, the ABA and IFSA sought clarification in relation to the inclusion of 'deferred bonus'.[72]

3.68 RiskMetrics urged that regulations on the definition of 'benefit' should clarify whether deferred benefits are to be excluded from consideration, but in so doing, care should be taken to ensure companies do not seek to avoid shareholder approval requirements by 'categorising amounts paid on cessation of employment as bonuses for services prior to departure'.[73]

3.69 ACSI also saw 'merit in "carving out" unvested performance pay and deferred bonus incentives from termination pay calculations', but urged caution to ensure that this did not become a 'loophole'.[74]

3.70 Treasury provided evidence that statutory benefits will be excluded by the legislation:

> The legislation itself does exclude the statutory entitlements. However, there is still clearly confusion as to whether they do or do not, and so we have made recommendations that those specific statutory entitlements go into the regulations just for clarity, I suppose.[75]

3.71 The committee welcomes this reassurance by Treasury.

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69 Regnan, *Submission 7*, p. 5; RiskMetrics, *Submission 11*, p. 2; ACSI, *Submission 13,* p. 2; IFSA, *Submission 25*, p. 3.

70 Bluescope Steel, *Submission 8*, p. 1; Guerdon Associates, *Submission 1*, pp 4-5.; KPMG, *Submission 16*, p. 2.

71 Mercer, *Submission 27*, p. 1.

72 KPMG, *Submission 16*, p. 2; ABA, *Submission 24*, p. 3; IFSA, *Submission 25*, p. 3.

73 RiskMetrics, *Submission 11*, p. 3.

74 ACSI, *Submission 13*, p. 2.

75 Mr Geoffrey Miller, General Manager, Corporations and Financial Services Division, Treasury, *Proof Committee Hansard*, 25 August 2009, p. 74.

Contract Disputes

3.72 Some submissions pointed to the risk that the bill could lead to increased numbers of contract disputes on key terms, and heightened risk of litigation as a result.

3.73 The Law Council of Australia noted that the proposed definition of 'benefit' (in regulations) includes 'voluntary out of court settlements' as a matter requiring shareholder approval. They argued:

> This provision will have the effect of forcing employees with legitimate claims against employers, for breach of contract, unfair dismissal, harassment, discrimination and other breaches of the law, to litigate at material expense in order to win damages award from a court, rather than accept a "voluntary settlement" from the employer. This is clearly an inappropriate consequence of these reforms.[76]

3.74 Treasury indicates that the explanatory statement to the Regulations will provide guidance on what is meant by voluntary out of court settlements.[77]

3.75 It should be noted that the Law Council do not question the scope of the regulation-making power relating to the definition of benefits, only the detail of what that regulation says.

3.76 The Business Council provided the following evidence in relation to the current role played by termination benefits in avoiding contract disputes or litigation:

> Employment agreements for CEOs and other senior executives typically provide for termination payments with very little notice. And, when a board decides a CEO is not delivering acceptable results, it is in everyone's interests to encourage the CEO, through mutual agreement, to leave sooner rather than later. Protracted contractual disputes can be damaging to the business, including through the potential to affect important commercial factors such as public reputation, client relationships and staff morale. This means compensation for the risk of early termination is a priority issue in contract negotiations.[78]

3.77 A recent media report by Ian McIlwraith in *The Age* described this phenomenon more bluntly:

> Another element of the system, one companies do not want to talk about, is that some termination payouts are the equivalent of "hush money" for failed executives. So a parting pay-off is negotiated on the understanding there will be no unfair dismissal claims.[79]

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76 Law Council of Australia, *Submission 23*, p. 7.

77 Treasury, note on revised draft regulations, July 2009, p. 2.

78 BCA, *Submission 9*, p. 2.

79 Ian McIlwraith, 'Capping Salaries: a fraught business,' *Age*, 19 March 2009.

3.78 The AICD has described some of the issues surrounding dismissing an executive for non-performance:

> It is not uncommon for a board to believe a CEO is performing poorly while the CEO believes he or she is performing well…The CEO's position in a company is atypical of other executive positions. The company's board needs to have full confidence in the CEO. If the board loses confidence in the CEO it may need to terminate the CEO's contract even if the company is otherwise performing well. If so, the board needs to consider terminating the contract in a manner that takes into account the best interests of all shareholders.
>
> It can be difficult to proceed under a non-performance clause in a contract because of the many views that exist on what constitutes poor performance and how it is measured. This is often a subjective issue. For this reason, boards may prefer to have a clause in the contract entitling the company to terminate the contract on notice without the need to provide specific reasons.[80]

3.79 ACSI argued that these matters could be addressed in the company's remuneration policy:

> Currently companies are required to have their remuneration policy approved by their shareholders…it is non-binding approval. But it is still persuasive. Those who get close to a no vote or get greater than 50 per cent in our experience do then look at that. So if they have an appropriate remuneration policy then some of those issues should be covered off in that. I cannot see what circumstances necessarily would say that they have to give someone a golden handshake to get them to go quickly. Most people are on contracts of three or five years. If they wanted to come to shareholders and say, 'Well, we sign up for five-year contracts. We would think it reasonable that if someone is in year 3 and we want to get rid of them then we pay them out the rest of their contract,' the shareholders will consider that to see in effect if that is reasonable. Most of these people are on contracts so the golden handshake cannot go on forever; it has to be confined to what that particular contract is.[81]

'Total remuneration' versus 'base salary'

3.80 A number of submissions discussed whether it was better for the threshold for shareholder approval to be based on 'base salary' or 'total remuneration'.

3.81 Treasury argued that the change is justified due to the growing percentage of total remuneration represented by components such as performance pay. Treasury

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80 AICD, Position Paper No. 13, 'Executive Termination Payments,' October 2008, p. 4.

81 Ms Ann Byrne, Chief Executive Officer, ACSI, *Proof Committee Hansard*, 25 August 2009, p. 24.

referred to anecdotal evidence that base salary often represents 'one third to one half of total remuneration'.[82] Treasury argued:

> The inclusion of performance pay has the potential to significantly increase the threshold for shareholder approval, potentially by millions of dollars, which would undermine the purpose of the proposed reforms.[83]

3.82 This is in itself not a conclusive argument. If the concern is that 'total remuneration' might be too high, it could be possible to set the threshold as, for example, six months' total remuneration.

3.83 Treasury also argued that the use of base salary rather than total remuneration is 'consistent with best practice guidelines developed by industry, referring to ACSI 2005 guidelines.[84] In its submission, ACSI supports the change to 'base salary'.[85]

3.84 A number of submissions expressed a preference for 'total remuneration'. For example, the Law Council argued that 'total remuneration' was appropriate, due to the risk that the bill could lead to a possible decline in the proportion of remuneration based on long-term incentives.[86]

3.85 Other organisations preferring the retention of 'total remuneration' include the AICD, the ABA, Guerdon Associates and IFSA.[87]

3.86 Ernst & Young argued that the threshold:

> …should be based on a multiple of *fixed remuneration* (which includes base salary, fringe benefits, salary sacrifice benefits and superannuation) as most Australian companies remunerate executives using such an approach.[88]

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82 Treasury, *Submission 22*, p. 10.

83 Treasury, *Submission 22*, p. 10.

84 Treasury, *Submission 22*, p. 10.

85 ACSI, *Submission 13*, p. 1.

86 Law Council of Australia, *Submission 23*, p. 2.

87 AICD, *Submission 12*, p. 3; ABA, *Submission 24*, p. 2; Guerdon Associates, *Submission 4*, p. 4; IFSA, *Submission 25*, p. 2.

88 Ernst & Young, *Submission 20*, p. 4.

Key management personnel

3.87 The bill expands the number of positions which require shareholder approval for termination benefits. This attracted comment in submissions.

3.88 Chartered Secretaries Australia argued that that any expanded requirement should apply only to key management personnel and the five most highly remunerated executives in the previous accounting year.[89] Ernst & Young, whilst supportive of the expansion, recommended against reference to the 'five highest paid executives' as this group may vary from year to year.[90]

3.89 The Law Council of Australia expressed concern about the coverage of all persons mentioned in the remuneration report for listed companies on equity grounds:

> For executives of listed companies, the entitlement to termination benefits depends on whether they are listed in the remuneration report. This is an arbitrary measure, for several reasons. Inclusion may change from year to year depending on total remuneration relative to other executives in the company. Executives will not know from one year to the next whether their termination benefits are limited under the proposed new laws. Perversely, the inclusion of termination benefits in total remuneration will often cause a person to be named in the remuneration report for the first and only time in the year the person retires. Further, a person earning $100,000 in a small listed company may have their termination benefits restricted, but a person earning $2 million in a large listed company may not. This is an odd result, and does not appear to have any sound policy basis.[91]

3.90 The Law Council of Australia argued that it would be 'logical and less anomalous' for the rules to apply only to executives whose annual remuneration exceeds a nominated amount, and to treat listed companies, including subsidiaries, as a single entity.[92]

3.91 ACSI supported the scope of the regulations expanding to include 'key management personnel'.[93]

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89 Chartered Secretaries Australia, *Submission18*, p. 4.

90 Ernst & Young, *Submission 20*, p. 8.

91 Law Council of Australia, *Submission 23*, p. 4.

92 Law Council of Australia, *Submission 23*, p. 5.

93 ACSI, *Submission 13*, p. 1.

Subsidiaries and unlisted companies

3.92 A number of organisations argued that the change would have a significant impact on companies with multiple boards of subsidiary corporations. Chartered Secretaries Australia explained the problem of subsidiary boards in the following terms:

> Large listed companies can have hundreds of non-listed subsidiaries in Australia. For example, BHP Billiton has over 200 (most of which are in Australia; ANZ has almost 100…The directors of the wholly-owned subsidiaries are often employees of the parent company, for example general managers. These persons are often not senior at the scale of the parent company and their potential termination payments are not at a level that would concern shareholders in the parent company or the community…if the definition of 'termination benefit' in the Regulations is extended to catch all types of payments, including accrued annual and long service leave and salary into superannuation, as was proposed in the exposure draft of the Bill, the calculation of termination payments to executives in subsidiaries could result in a payment larger that one year's fixed salary, as it would capture general managers retiring or resigning, or subject to retrenchment. CSA cannot point to any public benefit or benefit to shareholders in imposing a new and onerous requirement on companies that would require shareholder approval of termination payments of general management in the parent and subsidiary companies.[94]

3.93 Origin Energy, the BCA, Hay Group, KPMG the Law Council, the ABA, Rio Tinto and the Insurance Australia Group also raised concern about the impact on members of boards of subsidiaries.[95]

3.94 Rio Tinto gave an example of how their operations might be affected:

> In Rio Tinto's case, approximately 300 subsidiaries form the Rio Tinto Ltd group of companies and about 150 Rio Tinto employees would be classified as either a director or an officer. Importantly, a number of these employees hold positions within Rio Tinto below what would be viewed as senior management level. Given the new one-times base salary limit, this will mean that Rio Tinto will need to go to the trouble and expense of general meetings and accompanying notice papers to seek shareholder approval for payments to a large number of middle managers as they retire or leave.[96]

3.95 The Australian Bankers' Association also provided evidence on this issue:

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94 Chartered Secretaries Australia, *Submission18*, p. 4.

95 Origin Energy, *Submission 2*, p. 3; BCA, *Submission 9*, p. 5; Hay Group, *Submission 6*, p. 5; KPMG, *Submission* 16, p. 2; Law Council of Australia, *Submission* 23¸ pp 4-5; ABA, *Submission 24*, p. 2; Rio Tinto, *Submission 17*, p. 2; Insurance Australia Group, *Submission 14*, p. 4.

96 Mr Stephen Consedine, Company Secretary, Rio Tinto Limited, *Proof Committee Hansard*, 25 August 2009, pp 2-3.

> That has certainly been a concern of those HR professionals and compliance experts in the bank, but when they have looked at the legislation one bank with, I think, 200 subsidiaries and all are scratching their heads wondering whether this is going to apply. The reading of the legislation is that it is going to apply to all of those boards. That is just a compliance nightmare. I know a lot of the people serving on those subsidiary boards who are involved in issues with them and they are not the very senior people in the organisations. They are middle management.[97]

3.96 The AICD opposed the application of the measure to unlisted companies:

> …we would argue that the proposed reduction in the shareholder approval threshold for termination payments applying to companies regulated by the Corporations Act, which includes not-for-profits, charities, school boards, community boards et cetera, is too stringent. There is no evidence of any problem or community concern with the unlisted companies that would necessitate such changes.[98]

3.97 In response to concerns about the implications for subsidiaries, RiskMetrics proposed that any uncertainty 'could be resolved by specifying that in a listed entity, those holding managerial and executive office are *only* those persons whose remuneration details must be disclosed in the remuneration report'.[99]

3.98 Treasury clarified that the bill only will apply to middle managers if they are also the directors of companies. Treasury also clarified that the Act already applies to such persons. Treasury explained the prominence of this issue in submissions as follows:

> I am assuming that their termination payments before fell within the seven times and now their termination payments may be in excess of what this legislation is requiring. But we are not dragging in a whole group of people who were not there before.[100]

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97 Mr Nicholas Hossack, Director, Prudential, Payments and Competition Policy, Australian Bankers' Association, *Proof Committee Hansard*, 25 August 2009, p. 52.

98 Mr John Colvin, Chief Executive Officer, Australian Institute of Company Directors, *Proof Committee Hansard*, 25 August 2009, p. 37.

99 RiskMetrics, *Submission 11*, p. 1.

100 Mr Geoffrey Miller, General Manager, Corporations and Financial Services Division, Treasury, *Proof Committee Hansard*, 25 August 2009, p. 77.

Compliance cost

3.99 The Explanatory Memorandum states that the compliance cost for companies associated with the bill will be 'nil.'[101] This has been disputed by some of the submissions.[102]

3.100 Guerdon Associates noted that the expanded number of persons who might be subject to the requirement for approval could impose added administrative costs:

> It could require companies to include quite a significant number of individuals, potentially, with all that that involves including the requirement to have lengthy details in shareholder notices and meeting notices. The more that is involved, obviously, the greater the administrative costs incurred. It seems to us to serve little purpose when you consider the level of payment that might be involved in absolute dollar terms.[103]

3.101 No Regulation Impact Statement (RIS) is provided. The Explanatory Memorandum states that the Office of Best Practice Regulation advised a RIS is not required 'due to the Government's prior announcement to progress reforms in this area'.[104] The BCA and Rio Tinto expressed dissatisfaction about the decision not to complete a Regulation Impact Statement.[105]

Cause of Termination

3.102 The bill does not specify different treatment for retirements which occur for different reasons. Some submissions saw this as a flaw in the bill.

3.103 The Australian Compliance Institute argued that the circumstances of termination should be taken into account:

> …in circumstances where an employee's employment is terminated as a result of undertaking an activity that is deemed to be either a significant breach of the organisation's compliance or governance plan and/or also in breach of the law, then that employee should forfeit any claim to a termination payment.[106]

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101 Explanatory Memorandum, p. 3.

102 BCA, *Submission 9*, p. 5.; Rio Tinto, *Submission 17*, p. 2; Chartered Secretaries Australia, *Submission 18*, p. 8; ABA, *Submission 24*, p. 2.

103 Mr Peter McAuley, Director, Guerdon Associates, *Proof Committee Hansard*, 25 August 2009, p. 59.

104 Explanatory Memorandum, p. 3.

105 BCA, *Submission 9*, p. 7; Rio Tinto, *Submission 17*, p. 4.

106 Australian Compliance Institute, *Submission 3*, p. 1.

3.104 A number of submission argued that termination payments in cases of *bona fide* redundancy are appropriate, particularly if the redundancy early in an executive's tenure. Rio Tinto also referred to the need to protect cases of *bona fide* redundancy.[107]

3.105 Chartered Secretaries Australia argued that the focus of the bill should be on 'ex gratia payments that might be made to very senior people after a period of poor performance'.[108] They argue that bone fide redundancies should be excluded.[109]

3.106 In 2005, Geof Stapledon noted one of the arguments often provided in favour of termination payments is compensation in cases of *bona fide* redundancy:

> …if there is a possibility of a company merging or being taken over, termination payments ensure a measure of objectivity on the part of executives during negotiations. Executives may otherwise not act in the best interests of shareholders because they are more concerned about losing their jobs following the change in management that will occur if their company is taken over by another.[110]

3.107 However, Stapledon also acknowledges the counter argument:

> …termination payments can, in fact have the opposite effect. They may cause a passive attitude by executives who know that regardless of the actions they take, they will be compensated.[111]

3.108 The ACSI were supportive of exclusion of redundancy payments, provides such payments were genuine redundancies:

> …we can understand why in relation to the termination benefits you exclude the statutory benefits, why you determine that the superannuation is not a benefit if it is a bona fide contribution and why you exclude redundancy payments—as long as it is a genuine bona fide redundancy. Consistent with industrial law…we are talking about where a position is genuinely surplus to requirements…We need to make sure that we do not have a loophole…[112]

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107 Chartered Secretaries Australia, *Submission 18*, p. 7; Rio Tinto, *Submission 17*, p. 2.

108 Ms Judith Fox, Director, Policy, Chartered Secretaries Australia, *Proof Committee Hansard*, 25 August 2009, p. 70.

109 Mr Tim Sheehy, Chief Executive, Chartered Secretaries Australia, *Proof Committee Hansard*, 25 August 2009, p. 66.

110 Geof Stapledon, 'Termination benefits for Executives of Australian Companies', *Sydney Law Review*, Vol 27, 2005. http://www.law.usyd.edu.au/slr/slr27_4/Stapledon.pdf, viewed 17 July 2009, p. 712.

111 Geof Stapledon, 'Termination benefits for Executives of Australian Companies', *Sydney Law Review*, Vol 27, 2005. http://www.law.usyd.edu.au/slr/slr27_4/Stapledon.pdf, viewed 17 July 2009, p. 712.

112 Mr Phillip Spathis, Manager, Strategy and Engagement, Australian Council of Super Investors, *Proof Committee Hansard*, p. 25.

3.109 Treasury argues that the amount provided for by the bill represents a 'reasonable amount' for redundancies.[113] They have also indicated that legitimate redundancy payments are still a matter being considered by the government.[114]

Technical Matters

Delegation of critical terms to the regulations

3.110 Several organisations expressed concern that definitions of critical terms (such as 'base salary' and 'termination benefit') in regulations were not available at the time of preparing their submissions. These include the BCA, Chartered Secretaries Australia, Bluescope Steel; Origin Energy and Rio Tinto.[115]

3.111 These submissions argued the bill and regulations need to be considered by the committee as a package. It is not clear if these organisations object to the scope of the regulation-making provisions in the bill, or simply to the unavailability of the draft regulations.

3.112 Treasury released an exposure draft of the regulations in May 2009, and developed redrafts of the regulations for targeted consultation with stakeholders. It is understood that this targeted consultation includes all organisations who made submissions on the exposure draft and others who request participation.

3.113 Treasury argue that it is necessary to specify the definition of 'base salary' in the regulations to provide 'flexibility for the law to respond to, and to quickly address, any attempts to manipulate the definition'.[116] The AMWU support this as 'an attempt to remain flexible and fleet of foot in response to rapidly rearranged executive pay packages which will circumvent the strictures of this Bill'.[117]

3.114 Treasury argues that the power to make regulations prescribing things to be, or not to be, a benefit is required in order to address 'some legal ambiguity as to whether certain types of payments are considered to be a termination payment requiring shareholder approval'.[118]

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113 Treasury, *Submission 22*, p. 3.

114 Mr Bede Fraser, Manager, Corporations and Financial Services Division, Treasury, *Proof Committee Hansard*, 25 August 2009, p. 76.

115 BCA, *Submission 9*, p. 3; Chartered Secretaries Australia, *Submission 18*, p. 2; Bluescope Steel, *Submission 8*, p. 1; Origin Energy, *Submission 2*, p. 2; Rio Tinto, *Submission 17*, p. 4.

116 Treasury, *Submission 22*, p. 11

117 AMWU, *Submission 10*, p. 7.

118 Treasury, *Submission 22*, p. 5.

3.115 The committee notes that these suggestions for improvement of the draft regulations do not argue that it is inappropriate for such matters to be delegated to regulation. The committee urges Treasury to continue working with stakeholders to resolve any remaining concerns, where possible.

Lack of clarity of transitional clauses

3.116 The government has stated that bill 'will not affect existing contracts, and will apply all new contracts which are entered into, extended or substantially varied after the commencement date'.[119] In its submission, Treasury states that 'where an essential term of the service contract has been varied (including terms relating to remuneration), the contract will be subject to the proposed new laws.[120]

3.117 Several organisations expressed a view that the transitional clauses were not clear in regard to what constitutes a 'substantial variation.' These include the ABA, BCA, Chartered Secretaries Australia, Bluescope Steel, Guerdon Associates, Ernst & Young, Rio Tinto and IFSA.[121] Clayton Utz and Mallesons Stephen Jacques have both referred to this issue in online advisories.[122]

Penalties

3.118 The bill increases penalties under subsections 200B(1), 200C(1) and 200D(1) from 25 to 180 penalty units (currently $2,750 to $1,980) for a natural person and from 150 to 900 penalty units (currently $16,500 to $99,000) for a body corporate. These provisions remain strict liability offences.

3.119 The Explanatory Memorandum argues that the increase 'is intended to reflect the seriousness of giving a termination benefit where it has not been approved by shareholders in accordance with the Act, and to provide a sufficient deterrent to unauthorised benefits'.[123]

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119 Hon Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, *Proof House of Representatives Hansard*, 24 June 2009, p. 21.

120 Treasury, *Submission 22*, p. 9.

121 ABA, *Submission 24*, p. 4; BCA, *Submission 9*, p. 7; Chartered Secretaries Australia, *Submission 18*, p. 8; Bluescope Steel, *Submission 8*, p. 2; Guerdon Associates, *Submission 1*, p. 5; Ernst & Young, *Submission 20*, p. 8; Rio Tinto, *Submission 17*, p. 4; IFSA, *Submission 25*, p. 4.

122 Clatyton Utz website, http://www.claytonutz.com/publications/news/200906/24/termination_payments_good_news_bad_news.page, viewed 9 July 2009; Mallesons Stephen Jaques website, http://www.mallesons.com/publications/2009/Jun/9966946W.htm, viewed 7 July 2009.

123 Explanatory Memorandum, paragraph 2.45, p. 15.

3.120 The AICD opposes a breach of the termination provisions being a strict liability offence (as currently provided under the Act). They also oppose the proposed increase in penalties.[124]

3.121 The AMWU 'appreciate that penalties have significantly increased, but are concerned that manipulation by the recipients of termination payments may not be adequately controlled by these penalties'.[125] The AMWU argue that the bill would be strengthened by inclusion of 'sanctions against avoiding or conspiring to avoid the shareholder approval required by this Bill'.[126]

Amount in excess of 12 months not specified

3.122 RiskMetrics has suggested that the bill as currently drafted would allow the board to seek approval for payments in excess of the 12 month base salary limit without specifying the extent to which the payments would be in excess of 12 months base salary'. They argue that the bill should be amended 'to require any advance approval of a termination payment to specify a maximum dollar cap that may be paid under the authority sought from shareholders'.[127] This concern was also raised by the ACSI.[128]

3.123 If accurate, this would represent a significant loophole in the bill.

Recommendation 1

3.124 The committee recommends that Treasury examine the bill to ensure that shareholders have the opportunity to approve a specific amount, and not an unnamed amount greater than 12 months' salary.

Removal of exemption for pre-1991 contracts

3.125 The drafting of amendments to 200F(1)(a) appears somewhat complex.

3.126 Item 25 (Schedule 1, Part 1) inserts words into the paragraph. Item 42 repeals the paragraph, and replaces it with new words. It is not clear from the Explanatory Memorandum why it is necessary to amend the paragraph twice in this way.

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124 AICD, *Submission 12*, p. 2.

125 AMWU, *Submission 10*, p. 7.

126 AMWU, *Submission 10*, p. 7.

127 RiskMetrics, *Submission 11*, p. 2.

128 Mr Phillip Spathis, Manager, Strategy and Engagement, Australian Council of Superannuation Investors, *Proof Committee Hansard*, 25 August 2009, p. 25.

3.127 Item 43(3) provides that the amendments made by item 42 do not apply for contracts entered into before 1991. As item 42 removes the exception which currently applies to contracts made before 1991, item 43(3) appears to negate the effect of item 42. The EM does not explain why this approach has been adopted.

3.128 These provisions were not raised in submissions. Accordingly, the committee makes no further comment

Recommendation 2

3.129 The committee recommends that the Senate pass the bill.

Senator Annette Hurley

Chair