

Improving accountability: Draft legislation to give shareholders unprecedented power over the remuneration of company executives

On 23 February 2011, a Bill was introduced into the house of representatives in a bid to curb excessive and inappropriate remuneration practices by company executives. Dispute Resolution Lawyer, Garrett Williams, discusses the proposed amendments.

Introduction

The Parliamentary Secretary to the Treasurer recently released the *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011* (Bill) containing measures to strengthen the regulatory framework relating to the remuneration of company directors and executives.

The Bill provides shareholders with the power to hold company directors accountable for their decisions relating to executive remuneration, to eradicate possible conflicts of interest in the decision-making process, and to increase transparency and accountability in remuneration matters.

The Bill

The key changes proposed by the Bill, most of which arise from recommendations made by the Productivity Commission, are set out below (see page 5 for a summary of the current law):

'Two-strikes and re-election'

- Under the new law, a 'two-strike' process will be introduced in relation to the non-binding vote on the remuneration report.

- The first 'strike' occurs where a company's remuneration report receives a 'no' vote of 25 per cent or more. If this happens, the company's subsequent remuneration report must provide an explanation on whether shareholders' concerns have been addressed, and either how they have, or why they have not, been taken into account.
- The second 'strike' occurs if the subsequent remuneration report receives a 'no' vote of 25 per cent or more. If this happens, shareholders will vote at the same meeting as to whether or not the directors will need to stand for re-election within 90 days (Spill Resolution). If the Spill Resolution passes with 50 per cent or more of eligible votes cast, then the directors will stand for re-election within 90 days (Spill Meeting).

Remuneration consultants

- The proposed law requires companies which are considered disclosing entities to disclose details of their use of remuneration consultants.
- Moreover, remuneration consultants must be engaged by non-executive directors, and must report to non-directors or the remuneration committee, rather than company executives.

Prohibiting KMP from voting

- The Bill prohibits Key Management Personnel (KMP), and their closely related parties, that hold shares from voting on matters regarding their own remuneration, as part of the non-binding vote (see page 5 for a definition of KMP).
- The Bill also prohibits KMP from voting undirected proxies on all remuneration related resolutions.

Prohibiting hedging of incentive remuneration

- The new law prohibits KMP, and closely related parties, from entering into an arrangement that has the effect of limiting the KMP's exposure to risk relating to an element of his or her conditional remuneration.
- For example, where a director receives equity-based remuneration (such as shares and options) that is subject to disposal restrictions, the equity award remains 'at risk' until it vests. The director cannot mitigate his or her personal financial interest in the company's success by entering into transactions (such as hedging contracts) which transfer the risk of fluctuation in the value of the securities to another.

- The Government proposes to set out a non-exhaustive list of examples in the Regulations that would, and would not, be considered to be in breach of this provision.

No vacancy rule

- The Bill requires public companies to obtain member approval for a declaration that there are no vacant board positions, in circumstances where the number of board positions filled be less than the maximum number specified in the company's constitution.

Cherry picking

- Under the new law, proxy holders will be required to cast all of their directed proxies on all resolutions.

Simplification of remuneration disclosure requirements

- Measures to simplify remuneration reporting have also been introduced. The Bill proposes to confine the disclosure in the remuneration report to the KMPs for a consolidated entity, or the company if consolidated financial statements are not required.

Conclusion

As expressed in a number of the submissions made to the Australian Government (submissions closed 20 January 2011), there are many instances where these rules are seen to give shareholders unprecedented and, arguably, unnecessary powers. For example, there is a strong risk that the 'two-strikes' rule may be used strategically by major shareholders to spill a board of directors, instead of being used genuinely for the disapproval of executive remuneration.

The Bill is due to come into effect on July 2011.

Watch this space for further updates.

Definition of 'Key Management Personnel':

'Key Management Personnel' is defined in the *Australian Accounting Standard* as persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

Summary of the current law as it relates to the proposed amendments:

'Two-strikes and re-election'

- Under the *Corporations Act 2001 (Cth) (Act)* no consequences are provided for where a board proceeds with its remuneration policies despite a negative shareholder vote.

Remuneration consultants

- Under current law, there is no requirement on companies to disclose any details relating to the use of remuneration consultants.
- Furthermore, there is no requirement for remuneration consultants to be engaged by, and their advice provided directly to, non-executive directors or the remuneration committee.

Prohibiting KMP from voting

- Pursuant to current law, KMP can participate in the non-binding vote, including by exercising undirected proxies.
- Prohibiting hedging of iricentive remuneration
- While KMP are permitted to hedge their exposure to remuneration, companies are nevertheless required to disclose their hedging policy in the annual report.

No vacancy rule

- There is no equivalent to this provision under the current Act.

Cherry picking

- As per existing law, proxy holders, other than the Chair, are not required to cast all of their directed proxies on all resolutions, but instead may be selective as to which proxies to cast.

Simplification of remuneration disclosure requirements

- Under section 300A of the Act, companies are required to disclose remuneration details of the KMPs and the five most highly remunerated officers (if different) in relation to both the parent entity and the consolidated entity.

For further information contact:

Garrett Williams, Lawyer
gwilliams@piperalderman.com.au