



**Australian Government**

**The Treasury**

# **Post-Implementation Review:**

**Improving Accountability on Termination Payments**

## Contents

<b>1. Introduction</b> .....	<b>3</b>
1.1 Purpose of the Post-Implementation Review .....	3
<b>2. Background to the law on termination benefits</b> .....	<b>4</b>
<b>3. Problem being addressed by the legislation</b> .....	<b>5</b>
3.1 Excessive Termination Payments .....	6
3.2 Lack of transparency .....	7
<b>4. Impact of the legislation</b> .....	<b>8</b>
4.1 Impact by Effect.....	8
Effect on Termination Benefits .....	8
Terms of Engagement for Executives .....	9
Extent and Costs of Shareholder Engagement .....	10
Impact on Executives of Subsidiaries.....	12
Other .....	12
4.2 Impact by Stakeholder Group .....	13
<b>5. Conclusion</b> .....	<b>14</b>

# 1. Introduction

In 2007, the Government became aware that some companies were paying large termination payments (known as 'golden handshakes') to outgoing executives and directors of companies.

The law at that time required shareholders to approve the payment of termination benefits only if the termination payment exceeded seven times the recipient's total annual remuneration. This threshold permitted large termination payments to be paid without shareholder scrutiny and, with rising levels of executive remuneration, in excess of community and investors' expectations.

In response to these concerns, the Government introduced the *Corporations Amendment (Improving Accountability on Termination Payments) Act 2009*. The Act received Royal Assent on 23 November 2009, and the key amendments included:

- lowering the threshold from seven times the total annual remuneration package to one year's average annual base pay;
- expanding the scope from directors to include key management personnel (KMP);
- broadening the definition of what constitutes a 'benefit', and the creation of a new regulation-making power to specify whether certain types of payments are, or are not, a termination benefit;
- introducing an express obligation on the recipient to immediately repay a termination benefit that was given in contravention of the requirements; and
- increasing the penalty provisions associated with unauthorised payments to 180 penalty units (from 25) for a natural person and 900 penalty units (from 150) for a body corporate, with the option of six months imprisonment being retained.

## 1.1 Purpose of the Post-Implementation Review

Under the Australian Government's Best Practice Regulation Handbook (July 2013) a Regulation Impact Statement (RIS) is required for all decisions made by the Australian Government and its agencies that are likely to have a regulatory impact on business or the not-for-profit sector, unless that impact is of a minor or machinery nature. A proposal that proceeds to the decision maker without a RIS requires a Post Implementation Review (PIR) commencing within one to two years of the regulation being implemented.

The 2008-09 Best Practice Regulation Report issued by the OBPR reported that the Treasury did not prepare a RIS at the decision making stage of the policy to require shareholder approval of executives' termination benefits exceeding one year's average base salary, and that Treasury was required to undertake a post-implementation review on the amendments to the *Corporations Act 2001* (Corporations Act) to strengthen the regulatory framework relating to termination benefits for executives.

The Department has assumed the responsibility to conduct the PIR to ensure its compliance under the best practice regulation requirements.

The purpose of this PIR is to assess the efficiency and effectiveness of the above decision in meeting its objective to strengthen the regulatory framework relating to termination benefits for executives.

## 2. Background to the law on termination benefits

The payment of some benefits in connection with retirement from board or managerial office has required shareholder approval for some time.

For example, since at least 1975 genuine pension and lumps sums payable on retirement have required shareholder approval where they exceeded a certain threshold. Originally, the threshold was three times average annual remuneration over the previous three years. This was amended in 1981 to the level of seven times average annual remuneration over the preceding three-year period.<sup>1</sup>

It has been suggested this change was due to the higher rates of inflation prevailing in the 1970s and early 1980s, and the structure of, and taxation laws applicable to, private sector superannuation schemes at that time which saw employer contributions for executive employees being considerably higher than the employee's own contribution.<sup>2</sup>

In 2004, the requirement for shareholder approval for benefits in connection with retirement from board or managerial office was extended to include certain other payments payable upon retirement from office ('termination benefits'). The threshold for shareholder approval was a benefit that exceeded seven times the recipient's total annual remuneration, mirroring the existing provision in relation to pension and lump sums.<sup>3</sup>

The Explanatory Memorandum to the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2004 (CLERP 9 Bill) stated that this was 'to ensure that payments made to directors upon their retirement from office are subject to shareholder scrutiny where they may be large relative to the length of time in office or overall remuneration practices of the company'.<sup>4</sup>

According to a parliamentary inquiry into the CLERP 9 Bill, this amendment followed strong public criticism of both the size of termination benefits that had been paid to some executives and the late disclosure of the benefit.<sup>5</sup>

The parliamentary inquiry also expressed concern that the amendment set the threshold for shareholder approval 'at quite a high level and in effect appears to sanction or even encourage termination payments that would fall just below this level'.<sup>6</sup> It recommended that all payments made to directors be subject to shareholder approval, including any termination benefit.<sup>7</sup>

- 
- 1 Sheehan, K and Fenwick, C., Research Report: The Corporations Act, Corporate Governance and Termination Payments to Senior Employees, Centre for Corporate Law and Securities Regulation The University of Melbourne and Centre for Employment and Labour Relations Law The University of Melbourne, 2007, page 23 citing s.108(5)(d) of the *Companies Act 1958* (Vic) and s.233 of the *Companies Act 1981* (Cth). This is now found in s.200G of the Corporations Act.
  - 2 Sheehan, K and Fenwick, C., Research Report: The Corporations Act, Corporate Governance and Termination Payments to Senior Employees, Centre for Corporate Law and Securities Regulation The University of Melbourne and Centre for Employment and Labour Relations Law The University of Melbourne, 2007, pages 23-25.
  - 3 Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004.
  - 4 Explanatory Memorandum to the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2004, page 171.
  - 5 Parliamentary Joint Committee on Corporations and Financial Services, Report on the CLERP (Audit Reform and Corporate Disclosure) Bill 2003, June 2004, page 94.
  - 6 Ibid, page 95.
  - 7 Ibid, Recommendation 16, page 73.

The reason for requiring shareholder approval of termination benefits can be seen in the competing arguments for and against the payment of such benefits. As noted by Chartered Secretaries Australia (CSA) in a submission to Treasury,<sup>8</sup> termination payments are paid to executives for the following reasons:

- to reward departing executives for long-term and/or outstanding service to the company;
- to provide an incentive not to disclose corporate information to competitors or cause adverse publicity when leaving the company, whether through litigation or otherwise;
- to help a company attract executive talent, and encourage executives to take risks in the interests of shareholders (this is especially the case where an executive is hired to turn around a failing company); and
- to ensure objectivity on the part of executives during negotiations, in cases where there is a possibility of a merger or acquisition.

Arguments against termination payments include that:

- they represent a giveaway that cannot influence future company performance; and
- the knowledge that an executive will receive a very large payout on termination undermines incentives from the threat of dismissal.<sup>9</sup>

Because of the conflicting arguments for and against termination payments, and the potential loss of value to shareholders, it is appropriate that there is transparency and accountability around their payment.

### 3. Problem being addressed by the legislation

The amendments to the Corporations Act made by the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009 aim to strengthen the existing regulatory framework which apply to termination benefits by:

- better empowering shareholders to disallow excessive termination benefits, particularly where they are a reward for poor performance;
- improving the accountability of company management in setting remuneration; and
- promoting responsible remuneration practices.<sup>10</sup>

With executive remuneration rising at a much faster rate compared to ordinary earnings,<sup>11</sup> the existing threshold permitted large termination payments to be paid without shareholder scrutiny

---

<sup>8</sup> The submission is available on the Treasury website at [http://archive.treasury.gov.au/documents/1584/PDF/Chartered\\_Secretaries\\_Australia.pdf](http://archive.treasury.gov.au/documents/1584/PDF/Chartered_Secretaries_Australia.pdf).

<sup>9</sup> Stapledon, G., 'Termination Benefits for Executives of Australian Companies' Sydney Law Review, Vol. 27: 683, 2005, page 686.

<sup>10</sup> Paragraph 2.8 of the Explanatory Memorandum for the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009.

and in excess of community and investors' expectations. There were also instances where very substantial termination payments were made following a period of poor financial performance by the company.<sup>12</sup>

### 3.1 Excessive Termination Payments

The information disclosed about termination benefits has improved since 1998 when the Corporations Act was first amended to require each company to include in its annual report 'details of the nature and amount of each element of the emolument of each director and each of the five named officers of the company receiving the highest emolument'.<sup>13</sup>

At that time, the disclosure of termination benefits that had not been approved by shareholders was regulated by a combination of section 300A(3) the Corporations Act, an ASIC Practice Note setting out ASIC's expectations on that provision,<sup>14</sup> abstracts issued by the Urgent Issues Group of the Australian Accounting Standards Board,<sup>15</sup> and accounting standards on related party disclosures.<sup>16</sup>

By contrast, today the Corporations Regulations specifically requires that a company disclose information for each member of the key management personnel on that person's post-employment benefits, divided into at least pension and superannuation benefits and other-post employment benefits, and that person's termination benefits.<sup>17</sup>

These changes in the law have improved the information on termination benefits available to shareholders. However, that improvement has been gradual and as a result, there are difficulties in obtaining thorough information on the termination benefits paid in the past, making it impossible to precisely quantify the extent and magnitude of excessive termination benefits. However, studies are available that suggest the payment of excessive termination benefits existed in the period preceding the new law.

A study of termination payments made to executives of ASX-listed companies between 1999 and 2004 found that termination payments ranged from about \$800,000 to \$9.99 million, with an average (mean) termination payment of \$3.65 million and a median of \$3 million.<sup>18</sup> This study obtained its data by using a key-word search of major newspapers.

The study also found that in several cases the termination benefits were made following a period of very poor corporate performance. The authors of the study concluded that proper disclosure may not be sufficient to reduce excessive payments.<sup>19</sup>

---

11 The Productivity Commission found that the ratio of CEO remuneration to AWE at the 100 largest companies was approximately 20 times in 1998, rising to approximately 40 times in 2008. Productivity Commission, Executive Remuneration in Australia, 4 January 2010, page 61.

12 For examples of large termination payments in circumstances of poor financial performance by the company, refer to Stapledon, G., 'Termination Benefits for Executives of Australian Companies' Sydney Law Review, Vol. 27: 683, 2005, page 708.

13 Section 300A(3).

14 ASIC Practice Note 68, issued 1 November 1998.

15 UIG Abstract 14 'Directors' Remuneration'.

16 AASB 1017 'Related Party Disclosures' and AASB 1034 'Information to be Disclosed in Financial Report'.

17 Regulation 2M.3.03 of the Corporations Regulations.

18 Stapledon, G., 'Termination Benefits for Executives of Australian Companies' Sydney Law Review, Vol. 27: 683, 2005, page. 700. A repeat and update of this study under the auspices of Proxy Australia found higher figures; termination payments range from about \$800,000 to \$26.5 million, the average (mean) termination payment was \$4,207,080 and the median was \$3,000,000 - ACSI, Termination Payments for Senior Executives of Listed Companies – Research Report prepared by Proxy Australia, March 2005.

19 Ibid, page 708.

A study of the chief executive officers of S&P/ASX 100 companies that ceased employment in the three years from 30 June 2005 found that the average CEO received just over \$3.4 million, or 201 per cent of their annual salary as a termination payment.<sup>20</sup> Of the 33 CEOs included in the sample, only five received no termination payment, with two out of three leaving with a payout in excess of \$1 million.

Another study examined the remuneration arrangements of 28 managing directors from the S&P/ASX 50 as at 1 July 2005 to explore the nature and size of payments that would have been made if that managing director's employment had been terminated by the company on 1 March 2006. A comparison of the payments against the thresholds permitted by the Corporations Act showed that only four of the 28 termination payments would have required prior shareholder approval if the managing director's employment had been terminated, with payments as large as \$129 million sanctioned by the Corporations Act.<sup>21</sup>

This study also compared the potential termination payments against the limit endorsed in the Australian Council of Super Investors (ACSI) *Corporate Governance Guidelines*. It was found that every payment, from the lowest 'worst case' scenario payment upwards, fell outside the ACSI threshold. The study concluded the result 'indicates that at least one significant group of shareholders has a very different view to that of parliament and security exchange regulators on where the dividing line is between acceptable and unacceptable levels of payment'.<sup>22</sup>

More recently, the Australian Shareholders Association has stated that termination payments on resignation should be limited to a maximum of 6 months fixed pay.<sup>23</sup>

## 3.2 Lack of transparency

In its report the Productivity Commission noted that reported termination payments do not necessarily equate with the actual amount paid to departing executives.<sup>24</sup> The submission by RiskMetrics to the Productivity Commission inquiry observed that in some cases amounts actually paid to a departing executive were substantially larger than indicated in disclosures.<sup>25</sup> Other participants to the Productivity Commission observed that payments for unpaid leave, long service leave, and superannuation were sometimes incorrectly reported by the media as part of 'termination pay'.

In addition, the reason for termination of an executive's employment is not always clear, and this uncertainty surrounding the circumstances of departures makes it more difficult to determine whether the termination is due to poor performance (in which case a large termination payment is less justifiable), or due to unrelated factors such as health or retirement.<sup>26</sup>

The lack of transparency surrounding both the amount of termination payment made and the reason for termination makes it difficult for shareholders to assess whether the termination payment made by the Board is reasonable, and highlighted the need for measures to improve transparency and provide clarity.

---

20 RiskMetrics Group 2008, 'Shareholders pay the high cost of failure: Average CEO gets \$3.4 million to walk', viewed 24 November 2011, <<http://www.maynereport.com/images/2008/12/06-13R5XKT2H00.pdf>>.

21 Sheehan, K and Fenwick, C., Research Report: The Corporations Act, Corporate Governance and Termination Payments to Senior Employees, Centre for Corporate Law and Securities Regulation The University of Melbourne and Centre for Employment and Labour Relations Law The University of Melbourne, 2007, page 9.

22 Ibid, page 45.

23 Australian Shareholders Association, ASA Policy Discussion Paper, 19 August 2013.

24 Productivity Commission 2009, 'Executive Remuneration in Australia', No. 49, page 236.

25 See also ISS, Submission to the CAMAC inquiry into Executive Remuneration, 13 August 2010, page 2 and ACSI Submission to the CAMAC inquiry into Executive Remuneration, 31 August 2010, page 7.

26 Productivity Commission 2009, 'Executive Remuneration in Australia', No. 49, page 235.

## 4. Impact of the legislation

To assist in assessing the impact of the legislation, Treasury conducted targeted consultations with many of the bodies who provided submissions to the initial exposure draft. Feedback on the implementation of the legislation was requested from 26 organisations, and 10 submissions were received. The submissions received were from industry bodies representing company officers, companies and professional advisers to companies.

Some submissions to the Corporations and Markets Advisory Committee's (CAMAC's) information paper on Executive Remuneration released in July 2010 also addressed the issue of termination benefits. These too have been considered as part of the conducting this impact analysis.

Regard has also been had to concerns raised in the two rounds of consultations held with key stakeholders prior to the introduction of the reforms. An exposure draft of the Bill and draft regulations were exposed for a four week public consultation in May 2009, and 31 submissions were received. Subsequently, a revised draft of the regulations was issued for further, targeted consultation for a period of 10 days ending on 6 August 2009, and 15 submissions were received.

### 4.1 Impact by Effect

The impact analysis identified four major effects:

- effect on termination benefits,
- effect on terms of engagement for executives,
- extent and cost of shareholder engagement, and
- effect on executives of subsidiaries.

Some other impacts were identified which are also discussed below.

#### Effect on Termination Benefits

Several submissions received by Treasury indicated that the size of termination benefits has decreased since the Corporations Act was amended in 2009.

Research published by the Australian Council of Super Investors (ACSI) also show a fall in termination benefits<sup>27</sup> paid to CEOs of ASX Top 100 companies since 2008.

---

<sup>27</sup> Termination Benefits does not include pension or superannuation benefits. ACSI defines it to include payments in lieu of notice, contractual entitlements on termination, any ex gratia payments, bonuses paid for part-year worked and the value of any equity incentives allowed to vest early as a result of departure, although shares released from deferred bonus arrangements are excluded.



	2008	2009	2010	2011
<b>Aggregate</b>	\$83,028,043	\$34,563,870	\$5,701,176	\$35,018,308
<b>Number of payments</b>	13	13	5	12
<b>Average</b>	\$6,386,773	\$2,658,759	\$1,140,235	\$2,918,192
<b>Median</b>	\$3,504,000	\$2,202,408	\$1,260,000	\$2,000,000
<b>Minimum</b>	\$793,333	\$168,000	\$513,079	\$566,667
<b>Maximum</b>	\$18,309,786	\$6,386,465	\$1,681,897	\$10,900,000

The report from ACSI notes that the largest termination payment received in 2011 was by the departing CEO of Leighton Holdings and that it distorted the average figures. If he is excluded, ACSI calculates that the average termination payment fell to \$2.193 million. While ACSI is not clear on why this CEO should be excluded, it may be because according to the 2011 annual report from Leighton Holdings the payment was made pursuant to an employment contract entered into in 2005<sup>28</sup> and thus the payment was not subject to the new requirements introduced by these amendments to the Corporations Act.<sup>29</sup>

## Terms of Engagement for Executives

Some submissions indicated that remuneration structures had been amended in response to the changed treatment of termination benefits. In particular, it was submitted that:

- As the cap is calculated by reference to base salary only, and does not cover the ‘at risk’ components of an executive’s remuneration package, short-term and long-term incentive plans must be structured carefully to ensure the cap is not unintentionally exceeded as a result of payment being made to an executive under the plan on their termination. In such circumstances, companies may obtain shareholder approval for termination payments paid under an incentive plan.
- Rates of fixed pay increases for CEOs and other KMP have been higher than historical trends indicate may have applied. However, ACSI stated in its most recent review of CEO pay in the Top 100 companies that in its view, ‘... the prediction of management lobbies in 2009 that capping senior executive termination payments at 12 months’ salary without shareholder approval would lead to an explosion in fixed pay is not apparent from the data for the Top 100’.<sup>30</sup>
- There is a tendency for notice periods to be taken as ‘gardening leave’, rather than paid in lieu. This allows a 12 months payment to be made after six months non-work, so in effect an 18 months payment. This is not economically efficient, in that it denies the market expertise to create value.
- More companies have structured incentive plans to allow long-term incentives to remain ‘on foot’ post-employment, rather than vest on termination. This was regarded in submissions as a positive development, as executives would be more concerned to leave a company with good future prospects.
- Fixed term contracts have been replaced by rolling term contracts, usually with a notice period based on a defined number of months (typically up to 12 months for a CEO). Where a fixed term contract was terminated early, it usually resulted in severance payment equal to the remainder of the contract.

---

28 Leighton Holdings, 2011 Annual Report, page 85.

29 Part 3 of the Corporations Amendment (Improving Accountability on Termination Payments) Act 2009.

30 Australian Council of Superannuation Investors, CEO Pay in the Top 100 Companies: 2011, page 14.

It was also submitted that recruitment of foreign executives is now more difficult as the limit on termination benefits is lower than those that apply in other jurisdictions.

## Extent and Costs of Shareholder Engagement

A number of submissions indicated that shareholder approval for termination benefits is now sought more often. That is, shareholders are now better able to disallow excessive termination benefits and directors are more accountable for their decisions regarding termination benefits.

One submission also stated that shareholder engagement had increased since the new laws were passed. This comment may, however, also reflect other government initiatives, such as the introduction of the 'two strikes' rule, aimed at giving shareholders more power to influence the levels of executive remuneration.

Without reviewing the notice of meeting for each company's annual general meeting — a substantial task and Treasury is not aware of any database that has extracted this information — it is impossible to determine how many resolutions have been necessary to consider termination payments. However, the Productivity Commission in its report on executive remuneration did conclude that '... the one year threshold would seem unlikely to cause difficulties in most circumstances'.<sup>31</sup>

It was submitted that shareholder approval of termination payments has been sought in three circumstances:

- Approval of a quantum following termination: submissions indicated that only a limited number of major Australian companies had sought shareholder approval for such termination payments and that shareholders had approved the payment in each case. This is contrary to the expectation expressed by some in the consultations on the exposure draft of the bill that there would be no incentive for shareholders to agree to termination payments once the executive had left his/her position.
- Approval of incentive plan provisions prior to termination: it was submitted that this has been the most common method of shareholder approval and is relevant as vesting of share-based payments at termination (by virtue of the share plan rules, or because of the exercise of discretion by the board or pursuant to the executive's employment contract) may constitute a termination benefit.
- Approval of the terms of contract for specific individuals as the outset of employment where there is the potential for termination benefits to exceed the one times base salary cap.

In relation to the last two instances, it was submitted that the vote for those types of approval has ranged between 60 per cent to 100 per cent votes in favour of the resolution (that is, all have been approved by the requisite 50 per cent).

Shareholder approval is obtained by way of resolution at the annual general meeting (AGM). A listed company must hold a general meeting every year at which a number of resolutions required by other provisions of the Corporations Act or under ASX Listing Rules would need to be considered. The cost of an additional resolution to consider the approval of a termination benefit would not materially add to the costs of holding the annual general meeting and distributing and printing the notice of meeting. However, as discussed below, legal costs may be incurred in relation to determining the need for, and form of, the resolution.

---

31 Productivity Commission 2009, 'Executive Remuneration in Australia', No. 49, page 239.

In relation to approving a termination benefit in the context of an incentive plan, the resolution could also deal with the requirement for approval under ASX Listing Rule 10.14 or follow such a resolution. Listing Rule 10.14, which pre-dates the amendments being discussed here, requires shareholder approval prior to the issue of securities under an employee incentive plan to a director. The table below details some examples of such resolutions undertaken at annual general meetings since the amendments, and particularly demonstrates that the marginal wording in the resolution required for shareholder approval is minor.<sup>32</sup>

<b>AGM Year</b>	<b>Company</b>	<b>Form of Resolution for Shareholder Approval in the Notice of Meeting</b>
2010	The Westpac Group	'To approve the grant of shares under the CEO Restricted Share Plan and performance share rights under the CEO Performance Rights Plan to the Managing Director & Chief Executive Officer, Gail Patricia Kelly, in accordance with the rules of those Plans and on the terms summarised in the Explanatory Notes'.*
2010	Sandfire Resources NL	'That for the purposes of Listing Rules 10.11 and 10.19, section 200B and Chapter 2E of the Corporations Act, and for all other purposes, Shareholders hereby approve the issue of the Retirement Shares to Mr Miles Kennedy as described in the Explanatory Memorandum'.
2011	Asciano Limited	'That approval be given for the grant of a maximum of 1,548,558 options to acquire shares in the Company to the Managing Director and Chief Executive Officer, Mr John Mullen, in accordance with the rules of the Asciano Option and Rights Plan on the terms summarised in the Explanatory Notes'.*
		'That approval be given for the grant of a maximum of 1,344,432 rights to acquire shares in the Company to the Managing Director and Chief Executive Officer, Mr John Mullen, in accordance with the rules of the Asciano Limited Long Term Incentive Plan on the terms summarised in the Explanatory Notes'.*
2011	Woolworths Limited	'That the grant of 96,479 Performance Rights to the Managing Director and Chief Executive Officer of the Company, Mr Grant O'Brien, under the Woolworths Long Term Incentive Plan, as described in the Explanatory Notes accompanying the Notice convening this meeting be approved for all purposes, including for the purpose of ASX Listing Rule 10.14'.*
2011	Fosters Group Limited	'That approval be given for the grant of 480,044 performance rights to acquire shares in the Company to the Chief Executive Officer, Mr John Pollaers, in accordance with the terms of the 2011 offer under, and the rules of, the Foster's Long Term Incentive Plan on the terms summarised in the Explanatory Notes'.*
		'That approval be given for the grant of 480,044 performance rights to acquire shares in the Company to the Chief Executive Officer, Mr John Pollaers, in accordance with the terms of the 2012 offer under, and the rules of, the Foster's Long Term Incentive Plan on the terms summarised in the Explanatory Notes'.*
2012	Pacific Brands Limited	'That approval is given for all purposes including for the purpose of ASX Listing Rules 7.1 and 10.14 and, in relation to the treatment of the following rights in certain circumstances of termination, for the purposes of sections 200B and 200E of the Corporations Act, to the issue to the Chief Executive Officer of the Company, Mr John Pollaers, of: (a) 2,016,949 performance rights in the Company under the Pacific Brands Limited Performance Rights Plan; and (b) additional rights to acquire 762,712 fully paid ordinary shares in the Company, as described in the Explanatory Notes accompanying and forming part of the notice of this meeting'.
2012	Avalon Minerals Ltd	'That for the purposes of Listing Rule 7.2 Exception 9(b) and sections 200B and 200E of the Corporations Act and for all other purposes, Shareholders approve the: a) grant of Performance Rights under the Avalon Minerals Ltd Performance Rights Plan (Performance Rights Plan or Plan), a summary of which is set out in the Explanatory Memorandum; and b) giving of termination benefits under the Performance Rights Plan by the Company to a person or their associates in connection with that person ceasing to hold a managerial or executive office role in the Company or a related body corporate of the Company as set out in the Explanatory Memorandum'.

---

32 Various Notices of Annual General Meetings.

AGM Year	Company	Form of Resolution for Shareholder Approval in the Notice of Meeting
2012	Emeco	'That, for the purposes of ASX Listing Rule 10.14 and for all other purposes (including for the purpose of sections 200B and 200E of the <i>Corporations Act 2001</i> ) the grant of 1,498, 957 Performance Shares to Mr. Keith Gordon, the Managing Director and Chief Executive Officer of the Company, on the terms set out in the Explanatory Notes be approved'.
2013	Adelaide Brighton Ltd	'That, for the purposes of ASX Listing Rule 10.14 and section 200B of the Corporations Act, approval be given to the grant of 670,920 Awards to Mr M P Chellew, the Managing Director of the Company, under the Adelaide Brighton Executive Performance Share Plan on the terms set out in the Explanatory Notes to this Notice of Annual General Meeting'.
2013	Aristocrat Limited	Leisure 'That Mr JR Odell, Chief Executive Officer and Managing Director, be granted a maximum of 766,000 Performance Share Rights pursuant to the Company's Long Term Incentive Program, in the manner set out in the Explanatory Statement to this Notice of Meeting and that this be approved for all purposes, including for the purpose of ASX Listing Rules 7.1 and 10.14 and section 200B of the <i>Corporations Act 2001 (Cth)</i> '.

\*The Explanatory Notes stated that shareholder approval was being sought for the purposes 200B of the Corporations Act in addition to ASX Listing Rule 10.14.

We note literature that the practice of obtaining shareholder approval for termination benefits in the context of an incentive plan was occurring in some instances even before the amendments to the *Corporations Act in 2009*.<sup>33</sup>

## Impact on Executives of Subsidiaries

A number of submissions raised concerns about the scope of employees covered by the amendments.

Expanding the scope of the legislation to apply also to KMP (in addition to company directors) of the entity and its related body corporates have given shareholders the opportunity to disallow excessive termination benefits made to a wider range of personnel. With a lower cap on termination benefits there was a risk that companies would make staffing changes in the lead-up to an executive's or directors' retirement from the company to avoid being subject to the requirement for shareholder approval.

It was submitted that this expanded scope can, however, capture directors of subsidiaries and overseas subsidiaries whose remuneration are often immaterial and of little concern to shareholders. This can lead to costs associated with seeking approvals and implementing systems to ensure compliance, and reluctance from employees to join the subsidiary Boards. For large multinational companies, the broad application also could mean that some employees, many of who reside overseas and who have their remuneration contracts subject to overseas law, are also subject to the regulation.

## Other

Submissions also raised a number of other issues:

- additional costs incurred for seeking legal advice on compliance with the legislation, and advice on structuring remuneration arrangements;
- uncertainty in assessing whether existing contracts may be grandfathered, or exceptions apply, which has led to costs incurred for seeking professional advice and the need to obtain shareholder approval more frequently;

---

<sup>33</sup> See Fenwick, C. and Sheehan, K, 'Share-based remuneration and termination payments to company directors: What are the rules?', (2008) 26 C&SLJ71.

- limitations of the calculation of ‘average base salary’ using the average of the past three years’ base salary, given the termination payout is typically calculated with reference to the ending salary. Concerns were also expressed relating to the calculation of the threshold for employees who have been in the position for less than twelve months; and
- some respondents also indicated their view that the cap should be calculated with reference to fixed pay rather than base pay, and the calculation should be based on years served in the company or in the group, rather than the time spent in the managerial or executive office.

## 4.2 Impact by Stakeholder Group

This section attributes the key impacts identified above to specific stakeholders to assist in assessing the costs and benefits of the new legislation.

The key stakeholder groups affected by this legislation are:

- KMP;
- companies; and
- shareholders.

The available data suggest that the impact for KMP has been reduced termination benefits. KMP of subsidiary companies may now also be captured by the operation of the legislation. Submissions indicated this was a particular issue for employees of overseas subsidiaries whose remuneration was governed by overseas law which permitted larger termination benefits. In those cases it was submitted that such employees may be reluctant to be appointed as directors of subsidiaries.

For companies, the impact of the new provisions has been additional costs incurred for legal advice on compliance with the legislation, and advice on structuring remuneration arrangements. Companies may have also incurred costs in relation to seeking any requisite shareholder approvals. The legislation may have also diminished the ability of companies to use termination payments as a tool in managing executive departures.

Both KMP and companies may, however, benefit from fewer expected instances of public criticisms and negative media reports since termination payments have declined and the accountability of such payments has increased. The absence of negative reports supports investor and community confidence in Australian corporates and their officers.

As more companies have now structured incentive plans to allow long-term incentives to remain ‘on foot’ post-employment, rather than vest on termination, the behavioural change among management that may result may also be beneficial for companies. Management will now have an incentive to remain focused on the long-term performance of the company.

Shareholders have also benefited from the legislation in relation to greater accountability around termination payments. They are now more involved in the determination of termination payments, and have the ability to veto unjustified termination payments. Changes in the structure of incentive plans as a result of the amendment are also consistent with responsible remuneration practices.

## 5. Conclusion

Treasury has examined the feedback provided in the submissions and, while acknowledging some issues around the comprehensiveness of relevant data, on balance considers that the submissions and other information obtained by Treasury indicate that the regulation has achieved its policy objectives.

The Act aimed to achieve three key objectives:

- better empowering shareholders to disallow excessive termination benefits, particularly where they are a reward for poor performance;
- improving the accountability of company management in setting remuneration; and
- promoting responsible remuneration practices.

The reforms have resulted in giving shareholders more control over the termination payments. While termination benefits continue to be negotiated and set by companies, lowering the threshold for shareholder veto has resulted in an increased level of shareholder control over termination payments made directly to KMP and greater accountability of company management for the decisions about termination payments.

The cost of seeking shareholder approval is considered minor and not to have outweighed the benefits of the reforms. Shareholder consent has been cost-effectively sought through AGMs where required and companies have obtained shareholder approval for termination payments. However, practical issues have arisen from the implementation of the regulation. In particular, the wide variation between companies in the arrangements that they enter into with KMP has resulted in the identification of cost burdens, particularly in establishing compliance systems and legal fees, and Australian companies potentially being put at a disadvantage when recruiting executive talent internationally.

Based on the feedback from consultation in preparing this review, further consideration could be given to improving the termination payments regime in relation to:

- the application of the legislation to directors of subsidiary boards and in particular overseas subsidiary boards;
- the lack of clarity around which contracts may be 'grandfathered', and around the exemptions that may be applied, that may have contributed to increased legal and professional costs for companies; and
- the use by some companies of alternative methods to pay their outgoing KMP, for example 'gardening leave' or post-employment consulting arrangements.



