

## **Supplementary Remarks**

**Senator Andrew Murray: Australian Democrats**

*Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002*

### **Context**

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

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

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

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

This legislation has to be seen in context. Executive and Director remuneration is a matter of great public and private interest. It lies at the heart of investor confidence and faith in the credibility of corporations and the share market.

It is a matter of great public interest because the extravagant greed of many directors and executives has not only caused a justifiable public outcry, but has also contributed to major company failures and market shocks.

It is a matter of great private interest because shareholders have been robbed by the syphoning off of their funds through board approved salary package rackets.

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

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

At the heart of the matter are a series of connected failures:

- Neither board practice nor the law prohibit arrangements where there is a conflict of interest. Those who benefit from devising clever concealed and costly salary/bonus/option packages (the executive and director mates on the board) are also those who approve those packages;

- Full disclosure of executive and director packages to shareholders and the market has been poor and the bare minimum, despite legislation<sup>1</sup> which explicitly encouraged it;
- Boards do not have independent directors. Directors are subject to the patronage of dominant executives or owners. Good democratic processes for director election are rare. Far too often it is still a mates arrangement;
- Accounting and auditing standards and practices have been deficient;
- The regulators (ASIC, the ASX and the ASB) have been weak in their efforts.

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

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

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

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

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

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

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

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

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

<sup>2</sup> AFR ‘Disclosure Pays Off’ Page 70 Thursday 13 March 2003.

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

And “Admittedly ASIC’s PN98 was also deficient in not specifically requiring accrued termination benefits and long-term incentives to be disclosed each year, and the Accounting Standards Board took years to issue an exposure draft...”<sup>3</sup>

## **Independence**

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

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

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

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

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

## **Separation of Powers<sup>5</sup>**

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

Directors’ duties are very wide on operational and management matters, and can create situations where major conflicts of interest, mismanagement and even corruption can go unchecked. As some of the recent corporate collapses show, directors and senior management can evade their full responsibilities to the company’s shareholders.

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

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<sup>3</sup> AFR Page 72 Saturday 15 March 2003.

<sup>4</sup> JCPAA Report 391 ‘Review of Independent Auditing by Registered Company Auditors’

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

- The main board would continue to be oligarchic (representing the oligarchy of financially dominant bodies), elected by share-holding (financial power) and would concentrate on strategic, business and operational issues;
- A Corporate Governance Board, elected directly by shareholders, not shareholding, (i.e. numerical or democratic power) would comprise not more than three non-executive directors. It should call and chair shareholders meetings; propose changes to the company constitution; manage the process of electing directors; resolve conflicts of interest; *determine the remuneration and packages of directors and executive management*; and ensure independent advisers by taking the appointment of auditors and other advisers such as valuers away from the main board.

### **Corporate Democratisation**

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

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

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

### **Related Companies**

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

When companies were originally conceived, it was intended that they would provide a benefit of limited liability to their owners – the shareholders. It was not intended that they would be manipulated to allow the separation of assets in one company and liabilities in another, resulting in those to whom money is owed having access to no significant assets to satisfy their entitlements.

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

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

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

### **Corporate Disclosure Rules**

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

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

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

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

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

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

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

### **Shareholder Approval of Retirement Payouts**

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

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

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

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

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

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

**Senator Andrew Murray**