Governance Institute of Australia

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Manager
Corporate Governance and Reporting Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
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Email: Corporations.Amendments@treasury.gov.au

Dear Senator Cormann

Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014

Governance Institute of Australia (previously Chartered Secretaries Australia) is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our Members hold primary responsibility within listed and unlisted entities for developing governance policies, ensuring compliance with the Corporations Act and ASX Listing Rules and supporting the board on all governance matters. Their familiarity with the practical aspects of how to implement best practice governance frameworks and ensure sound reporting to members has informed the comments in this submission.

Governance Institute of Australia welcomes the opportunity to comment on the Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014 (the draft bill).

Executive summary

Governance Institute supports the following amendments contained in the draft bill:

- Removing the obligation to hold a general meeting on the request of 100 shareholders
- Requiring companies to include a general description of their remuneration governance framework, to the extent that it is not included elsewhere in the annual report
- Removing the requirement to disclose the value of options granted to key management personnel, replacing it with a requirement to disclose the number of lapsed options and the year in which they were granted
- Relieving certain disclosing entities from the obligation to prepare a remuneration report
- Amendments to the test for payment of dividends (the dividends test)
- Exempting certain companies limited by guarantee from the need to appoint or maintain an auditor
- Minor technical amendment to clarify that directors may vary their financial year by up to seven days, regardless of the length of previous years.

Our detailed comments on our reasons for supporting these amendments are set out on the following pages.

Director nomination threshold

Governance Institute is of the view that there is another matter that should be subject to stakeholder consultation that affects the operation of the Corporations Act.

We refer to a proposal by Herbert Smith Freehills to introduce a minimum level of shareholder support to apply to the nomination of external director candidates to the boards of listed companies (nomination threshold). Their briefing paper is attached.

We are of the view that this proposal needs consideration by all stakeholders, as there can be differing views on it. For example, we understand that there could be concerns that the board would control the process of director nominations should such a reform be introduced. We also note the concerns that there is an increasing use of the platform of director nominations where the individual is campaigning on a specific issue with no prospect or genuine expectation of election. We also recognise that this issue is of concern to the large listed entities and not all companies.

Given that at present the Corporations Act provides for 100 members to be able to put a resolution on the agenda of the annual general meeting (AGM) and request the company to distribute a statement to all its members, which we believe is an essential component of corporate governance, we are of the view that it would be reasonable to consult with stakeholders as to whether a candidate for a board position should have a similar level of support from shareholders before nominating for that board position. That is, we are of the view that Treasury could set up a roundtable to consult with stakeholders as to whether a board candidate should be able to demonstrate a level of support from shareholders before resources of time and shareholder monies are allocated to that nomination.

We would be more than happy to meet with you to discuss our comments.

Yours sincerely

Tim Sheehy

Tim Sheehy
Chief Executive

Removing the obligation to hold a general meeting on the request of 100 shareholders

Our Members strongly support the repeal of the rule allowing 100 members to requisition general meetings of companies (the 100-member rule) as set out in s 249D. Indeed, Governance Institute has been advocating for the repeal of s 249D of the Act for more than a decade.

We also continue to support the retention of the right of members with at least five per cent of the votes that may be cast at a general meeting to call a general meeting.

In 2006 we led a coalition calling for the repeal of the 100-member rule. The coalition comprised our organisation, Australian Institute of Company Directors, Business Council of Australia, Australian Shareholders' Association, Investments and Financial Services Association (now the Financial Services Council), FINSIA, Australasian Investor Relations Association and Australian Employee Ownership Association. I have attached a copy of the coalition's letter to the then Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP. The coalition also wrote to the Attorney-General of each state and territory setting out our support for the repeal of the 100-member rule.

Ongoing support for shareholder activism
It is often claimed that the repeal of the 100-member rule is intended to suppress shareholder activism. Governance Institute supports shareholder activism, which it believes is an essential component of corporate governance.

However, we are of the view that the opposition to the repeal of the 100-member rule often derives from a misunderstanding of the role of ss 249N(1)(b) and 249P(2)(b) in ensuring shareholders can bring matters to the attention of other members of the company at the annual general meeting (AGM).

Our Members support shareholders being able to put issues on the agenda of an AGM and to instigate a debate at the meeting. This shareholder right is of particular importance to retail shareholders, who, unlike institutional investors, do not necessarily have the opportunity to meet with the company prior to the AGM.

We strongly support the retention of ss 249N(1)(b) and 249P(2)(b) that preserve the rights of shareholders (members) to use a 100-member test to put a resolution on the agenda of the AGM and request the company to distribute a statement to all its members. We believe these provisions protect the rights of small groups of members to have their concerns addressed, and that the continued support for the preservation of these rights is too often forgotten in the debate about the repeal of the 100-member rule.

Most resolutions put forward on the AGM agenda through the use of the 100 member rule in ss 249N(1)(b) and 249P(2)(b) have not been carried. However, the debate generated by such resolutions has been central to shareholder engagement with corporations, and Governance Institute strongly supports this.

We believe that it is important to confirm that the important shareholder rights set out in ss 249N(1)(b) and 249P(2)(b) will remain intact should the 100-member rule set out in s249D be repealed.

The vexatious use of the 100-member rule in s 249D with attendant costs to shareholders
Governance Institute is opposed to the vexatious use of the 100-member rule in s 249D to call an extraordinary general meeting (EGM) at substantial cost to the company, *and therefore its shareholders*, when:

a) the avenue remains open of raising the issue of concern by placing a resolution on the agenda of the AGM and having statements relating to that resolution distributed to members at the cost of the company through the utilisation of ss 249N(1)(b) and 249P(1)(b), and

b) it has been noted by those who have called an EGM that it is not expected that the resolutions put forward at the EGM will carry.

To put corporations and their shareholders, the majority of whom are not expected to support the resolutions put forward at an EGM, to the expense of the meeting, is a mischief that we believe can be prevented through the repeal of the 100-member rule in s 249D.

We note that opposition to the proposed reform fails to apprehend that it is shareholders who bear the cost of the special meeting.

Our Members query how it can be anything other than vexatious to have 100 shareholders force a company such as Telstra, for example, to call a special meeting, when 100 members of Telstra would represent approximately 0.001 per cent of the shareholders. This would enable that minority to force an EGM that has absolutely no chance of achieving anything other than costing shareholders millions of dollars.

The potential for abuse

The Parliamentary Joint Committee on Corporate and Financial Services in its report[1] on this matter clearly noted that, while there is little history of the rule being abused, its potential for abuse remains clear. Both political parties have noted that it is not necessary for parliament to wait until some quota of abuses is observed before reforming the provision. We firmly support this view.

Our Members note that their companies at various times have been approached by special interest groups threatening the use of the 100-member rule in s 249D to call an EGM unless the corporation negotiates with the special interest group on its favoured issue. From our point of view, such a threat, with its attendant costs to shareholders despite the reality that any such resolution put forward by the special interest group would not be carried at the meeting nor receive the support of the majority of shareholders, constitutes mischief.

The threat of calling an EGM by splitting 100 shares, giving people one share each, then calling a meeting between annual meetings, toys with the company's profit and, consequently, the share price and dividend stream. Thus, it is shareholder return that is being threatened when the threat to invoke s 249D (the 100 member rule) is made.

Rationale against alternative proposals

We note that various groups have proposed alternatives to the 100-member rule. For example, the Australian Shareholders' Association has called for the Corporations Act to be amended so that only 10 signatures from shareholders with marketable shares are required for shareholders to place a resolution on the agenda of an AGM.

In support of their proposal, they cite the legal regime in the United States, which allows a single shareholder who has held $2,000 continuously over 12 months to put a resolution on the agenda at an AGM, and note that this is 'easier' than their proposal of 10 shareholders holding a marketable parcel of shares.

The US provision can only be understood within the full context of its legal regime governing shareholder rights (which are substantially fewer than those operating in Australia). The United

[1] Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Exposure Draft of the Corporations Amendment Bill (No 2) 2005*, June 2005

States also has a very stringent and detailed ‘no action’ regime which allows companies to reject proposals from shareholders for resolutions to go on the agenda at the AGM.

Under the laws in the United States, the company can disallow any proposed resolution to appoint an external board member or remove an existing board member. The company can also disallow proposals relating to the company’ ordinary business operations and also disallow any proposal relating to a part of the business that accounts for less than five per cent of assets and revenue.

Even if a shareholder is able to surmount these obstacles, there are also detailed procedural provisions relating to the ‘no action’ regime – both for the shareholder (including having to lodge the proposal *120 days prior* to the meeting materials being sent out) and the company in question.

Governance Institute is of the view that the situation for shareholders in relation to their capacity to place resolutions on the agenda at an AGM is considerably more constrained in the United States than in Australia.

The attached letter from the coalition also clearly sets out the case against a square root rule, which has been proposed in the past.

Requiring companies to include a general description of their remuneration governance framework, to the extent that it is not included elsewhere in the annual report

Governance Institute supports this amendment.

The vast majority of listed disclosing companies already provide a description of their remuneration governance framework. It is a good governance outcome for any listed entities that do not currently report on their remuneration governance framework to provide such disclosures. Indeed, we note that the ASX Corporate Governance Council’s *Corporate Governance Principles and Recommendations* require the establishment of a remuneration committee and attendant disclosures. This is effectively the same as the discussion on remuneration governance as required by this provision, which suggests there is the possibility of duplication of compliance for listed entities.

Removing the requirement to disclose the value of options granted to key management personnel, replacing it with a requirement to disclose the number of lapsed options and the year in which they were granted

Governance Institute supports this amendment.

The current requirement to report the value of lapsed options as if they had not lapsed causes confusion for readers of the remuneration report. The amendment will remove this confusion.

Relieving certain disclosing entities from the obligation to prepare a remuneration report

Governance Institute supports this amendment.

Opportunity for wholesale review of remuneration reporting disclosures

Governance Institute recognises that the proposed amendments are part of the deregulatory measures introduced by the government, but we also note that they constitute deletions or amendments of a minor nature that do not significantly reduce red tape in relation to remuneration reporting.

A great deal of work was undertaken by stakeholders in response to a previous consultation on executive remuneration by the Corporations and Markets Advisory Committee (CAMAC)[2], in an effort to simplify the approach to remuneration reporting disclosures. Stakeholders provided significant input on how the legislative architecture could be revised to reduce the complexity of remuneration reporting.

The current legislative framework results in remuneration reports being prepared by concepts drawn from, and couched in, technical language based on accounting standards, both by virtue of s300A of the Corporations Act 2001 and the obligation to conduct an external audit of such reports. This is not conducive to communicating executive remuneration to ordinary shareholders in a readily understood and comprehensible fashion. The ongoing tension between the Corporations Act and regulations — as interpreted by those from a legal background — and the accounting standards — as interpreted by those from an accounting background — adds to the confusion. The Corporations Act and the accounting standards are meant to interact and align, but this is not always the case. There is considerable tension between lawyer and accountants as to definitions of terms, and this is exacerbated by auditors taking views based on auditing standards, where definitions can vary still further.

Governance Institute is of the view that there is an urgent need for a wholesale review of and approach to legislative requirements concerning remuneration reporting that aims to simplify reporting, in order to provide investors with the clarity they seek. This would significantly reduce red tape.

Many companies have put considerable effort into drafting their remuneration reports as clearly and simply as possible over the past few years, but due to the interaction with the accounting standards the outcome has not been as effective as hoped. This is compounded by the addition of new pieces of legislation over time, which further complicate remuneration reporting, making it extremely difficult for investors to gain a clear picture of how remuneration decisions are made and applied in entities, or to gain transparency as to how much key management personnel (KMP) are paid and how it is calculated. Governance Institute is of the view that additional disclosure obligations have not resulted in meaningful disclosure.

The UK approach

Governance Institute has examined the United Kingdom (UK) approach to remuneration reporting with interest. The UK approach was aimed at the simplification of remuneration reporting, as it identified the issue of multiple figures being disclosed for each executive and how this added to the complexity and confusion, rather than providing clarity to shareholders.

In order to achieve accessibility and clarity, it was recognised by the UK Government that:

- existing legislation needed to be repealed in order to implement a new approach
- shareholders, in discussion with investor bodies, companies and remuneration experts, were better placed than public servants to develop an approach to remuneration reporting that met investor needs

[2] In 2010, the Federal Government referred aspects of Australia's executive remuneration framework to CAMAC. The reference asked CAMAC to review the existing reporting requirements in s 300A and related regulations and asked CAMAC to identify areas where the legislation could be revised to reduce its complexity and more effectively meet the needs of shareholders and companies.

- the new requirements developed by shareholders were to replace the existing requirements.

Accordingly, in January 2012, the Secretary of State for Business in the UK announced a series of proposals relating to executive pay and its disclosure. These proposals addressed four areas of focus, one being 'greater transparency so that what people are paid is clear and easily understood'.

The UK Department of Business Innovation and Skills (BIS) set out more detail on the proposed disclosure requirements in mid-2012, one of which was for 'one single figure for total remuneration of each director'. As there was no agreed basis for calculating this 'single figure', at the request of BIS, the Financial Reporting Lab (established under the auspices of the Financial Reporting Council)[3] agreed to undertake a short-term project to obtain the views from the investment community on how a 'single figure' might be measured and presented, with the objective that the output would be made available to help inform BIS's thinking in developing this disclosure requirement. The group that was formed consisted of shareholders, investor bodies, companies and remuneration experts. Importantly, the main driver was to develop remuneration reporting requirements that met investor needs — the principles of comparability and clarity underpinned the work of the group.

The Financial Reporting Lab recommended to the UK Government — and the government adopted the recommendation — a method that focuses on share awards with a link to current year performance. The new rules specify in detail how the components of pay are to be calculated and reported, which means they are comparable across companies.

The overall project to arrive at a new approach to remuneration reporting in the UK was subject to nine months' detailed consultation. By the time the single figure was announced, all parties had had ample time to participate in the consultation process and provide their input and feedback.

Governance Institute Members do not recommend that Australia should simply import a concept from the UK, given that the UK concept had been designed to meet the needs of a particular jurisdiction. However, we note that:

- the consensus approach provided for frank and robust discussion of investor needs and how best to meet them
- the final approach to the development of a single figure has been greeted with approval by shareholders, investor bodies, companies and remuneration experts
- there is agreement that the single figure provides greater transparency to investors so that what people are paid is clear and easily understood.

On this basis, Governance Institute is of the view that Australia should explore the UK approach. This could be effected through roundtables involving shareholders, investor bodies, companies, remuneration experts, lawyers, accountants and bodies such as Governance Institute representing those involved in preparing disclosures, to tease out the issues and robustly test any suggested approaches to remuneration reporting.

A stakeholder group already exists in the form of the ASX Corporate Governance Council (the Council). Given that a fresh approach to remuneration reporting does not relate to the listing

[3] The Financial Reporting Lab was launched in 2011 to provide an environment where investors and companies could come together to develop pragmatic solutions to reporting needs. It operates as both a learning space, where companies can use the Lab to test new reporting formats with investors, and investors can indicate areas where management can add greater value through the information they provide; and also as a hub to support innovation in reporting. The Lab's focus on gathering and sharing evidence from the market provides the broader corporate community with feedback from shareholders on the value that new reporting formats bring. It has already worked with over 50 different companies and more than 40 investors to bring insight and understanding to a number of key areas of disclosure.

rules, we are not proposing that the Council deal with this issue. However, the stakeholder bodies that constitute the Council, with their experience in rigorously developing consensus approaches to governance disclosures, could be constituted as the equivalent of a Financial Reporting Lab, with secretariat support provided by Treasury so as to facilitate practical outcomes.

Amendments to the test for payment of dividends (the dividends test)

Governance Institute welcomes the clarification of various areas of concern as to the application of the test for the payment of dividends from capital and supports the amendments contained in the draft bill.

Governance Institute is of the view that the draft bill increases the flexibility of companies to make distributions (pay dividends) and:

- addresses the concern with the issues associated with the use of ‘declared’ in the existing legislation
- addresses the concern that, by tying the calculation of assets and liabilities to the International Financial Reporting Standards (IFRS) in the existing legislation, companies that are not currently obliged to prepare their financial statements in accordance with IFRS are required to consider and apply IFRS before paying a dividend
- clarifies that the dividend test is a straightforward solvency test
- clarifies its application to group companies
- clarifies that a dividend paid under the new provision can be an authorised reduction of share capital that does not have to satisfy the requirements of Chapter 2J of the Act.

However, we note that such clarification is relevant only to ordinary shares. If companies have preferred shares or seek a distribution of assets (for example, a demerger) this would not be possible under the provisions of the draft bill, except out of profits. **Governance Institute recommends** that the issue of preferred shares also be addressed in the final bill, so that the legislation applies equally to ordinary and preferred shares.

Finally, we also note that there is widening gap between what constitutes a dividend in the Corporations Act and what constitutes a dividend for tax purposes. Following the amendments to s 245T in 2010, an amendment was made to the Tax Assessment Act 1936, in order to provide that a dividend paid out of an amount other than profits would, in normal circumstances, be capable of being franked.

However, Governance Institute Members are of the view that the legislation provides that the Australian Taxation Office (ATO) can disallow the franking benefit to dividends paid other than out of realised profits (such as reserves) and that any such disallowance operates against the policy objectives of the repeal of the ‘profits test’, which was not intended to interfere with the current imputation rules.

Governance Institute recommends that the government clarify that any dividends paid other than out of realised profits (such as reserves) also attract the franking benefit.

Exempting certain companies limited by guarantee from the need to appoint or maintain an auditor

Governance Institute supports this amendment.

This addresses the misalignment in the existing legislation whereby certain companies limited by guarantee that are not required to conduct an audit are nonetheless required to appoint or maintain an auditor.

Minor technical amendment to clarify that directors may vary their financial year by up to seven days, regardless of the length of previous years

Governance Institute supports this amendment.

Transferring the remuneration setting responsibility for the offices of the Financial Reporting Council (FRC), Australian Accounting Standards Board (AASB), and the Auditing and Assurance Standards Board (AUASB) to the Remuneration Tribunal

Governance Institute has no comment on this amendment.

Improving the efficiency of the Takeovers Panel, by allowing the Panel to perform Panel functions while overseas

Governance Institute has no comment on this amendment.

Transitional provisions

1549 Application of amendment relating to declaration or payment of dividends
Governance Institute notes that additional wording is required in the transitional provisions to clarify that a dividend can only be declared before it is paid, but the solvency test in such situations will be applied when the dividend is paid and in such situations the date of declaration is irrelevant.

We therefore recommend that this provision (1549) state (our suggested additional words in italics):

> This section applies if:
> 21 (a) before the commencement of this section, a company declared *or resolved to pay* a dividend; and
> 23 (b) as at the commencement of this section, the dividend has not been paid

1551 Application of amendments relating to directors' reports
Governance Institute notes that if the amendments set out in the draft bill are introduced prior to 30 June 2014, companies will be able to prepare remuneration reports in accordance with the draft bill.

However, should the amendments not be introduced until after 30 June 2014, companies will be required to wait another 12 months before they can apply the amendments to their remuneration reports.

Governance Institute therefore recommends that this provision be amended to state that 'The amendments of sections 300 and 300A made by the amending Act apply in relation to directors' reports for financial years starting on or after 1 July 2014'.

Proposal to introduce a nomination threshold for external director candidates

1 Introduction

This paper sets out a proposal to introduce a minimum level of shareholder support to apply to the nomination of external director candidates to the boards of listed companies (**Nomination Threshold**).

The Nomination Threshold would broadly align the director nomination process with the requirements that apply to other types of shareholder-requisitioned resolutions. It would therefore reduce the scope for inappropriate use of the director nomination process for non-governance related objectives and would also help to ensure that candidates have a meaningful minimum level of shareholder support before the company is required to include their candidacy in the notice of meeting.

The proposal is intended to strike an appropriate balance between ensuring that shareholders can directly nominate a non-Board endorsed candidate while avoiding the need for companies to unnecessarily incur the additional costs and inconvenience associated with the governance and procedural steps required by any new director candidacy.

2 Proposed section

The proposed threshold for director nominations to be inserted into the Corporations Act 2001 (Cth) (**Act**) as new section 201EA is as follows:

201EA Special rules for the nomination of director candidates for listed companies

(1) A person may only be elected to the office of a director at a general meeting of a listed company if the person has been nominated by:

(a) the directors of the company in accordance with a resolution of the directors;

(b) members with at least 5% of the votes that may be cast on a resolution to elect a director; or

(c) at least 100 members who are entitled to vote at the meeting.

(2) This section applies despite anything in the company's constitution.

3 Discussion

3.1 Current landscape

Australian law does not currently mandate a threshold level of shareholder support for an external candidate to be nominated to the board of a listed company. Under the Act, the only restrictions in respect of eligibility for election as a director are that the candidate be over 18 years old and have given consent prior to their appointment. Similarly, the ASX

Listing Rules only limit the time within which nominations must be received (ASX Listing Rule 14.3), and do not impose any eligibility requirements on nominating.

Corporate practice has developed so that a candidate may typically be nominated with the support of only one member of the company, subject only to nominations deadlines and the candidate's consent. This represents a nominal procedural requirement that:

- is significantly less onerous than the director nomination requirements that apply in comparative jurisdictions;
- is out of step with the thresholds applying to other shareholder requisitioned resolutions; and
- is therefore open to abuse by protestors who can (and do) use the director nomination process as an "easier alternative" to the more appropriate shareholder requisition procedures.

3.2 Summary of rationale to introduce a Nomination Threshold

The introduction of the Nomination Threshold would closely align the thresholds applying to the director nomination process with other shareholder requisitioned resolutions and statements. This would remove the current distortion where protesting shareholders have a rational preference for using a director nomination procedure in order to receive a platform from which to criticise a particular activity or project being undertaken by the company.

Allowing candidates to seek election as a director without a minimum baseline level of support for their nomination leads to significant additional expense and distraction on the company's part compared to that which would be associated with a requisitioned resolution or statement. In particular, great care and attention is required from a governance perspective with any director nomination for a listed company. The Board (or its nomination committee) must:

- conduct appropriate reference checks, including background and police checks (in accordance with the *ASX Corporate Governance Council's Principles & Recommendations*) ;
- objectively consider and assess a candidate's suitability to join the board and the merits of their candidacy; and
- then inform shareholders with disclosure that must be carefully crafted so as to present all of the information material to their vote in a manner that is objective and respectful to the candidate without overstepping the boundaries prescribed by the *Advance Bank Australia v FAI Insurances Ltd* case, (where the directors were found to be personally liable for the costs as a result of being considered by the Court as having 'campaigned' in the context of a contested director election).

Where a director candidacy is genuine and has at least a reasonable measure of support, those costs and procedures are appropriate. The Nomination Threshold being proposed would not affect candidacies in this category. The election of any director requires the support of a majority vote of shareholders at the general meeting. It is clear that the Nomination Threshold proposed would not meaningfully diminish the ability of shareholders to elect a director candidate irrespective of Board support.

Shareholder "protests" by a small number of members are more appropriately the domain of a shareholder requisitioned resolution or statement. The requisitioned resolution or statement procedure already mandates a threshold of support equivalent to that being proposed for the Nominations Threshold – thus giving rise under the current law to the distorted "encouragement" for protestors to instead nominate a director. Under sections 249P and 249N of the Corporations Act, a statement or resolution can only be

HERBERT SMITH FREEHILLS

requisitioned by members with at least 5% of the votes that may be cast on the resolution or at least 100 members who are entitled to vote at the meeting.

While a Company is required to include a validly requisitioned resolution on the agenda for the meeting, the Board is able to provide a clear recommendation (without the need to resort to lawyers and advisers to ensure that they are not at risk of personal liability) and is not required to undertake the separate checks, reviews and assessments associated with director candidacies.

3.3 International practice

As flagged above, the Australian position is in contrast to the requirements that apply in comparative jurisdictions, including Canada (where the threshold is a 5% shareholding), Switzerland (where the threshold to nominate is a shareholding with a nominal value of 1 million Swiss francs or 10% shareholding), the United States and the United Kingdom.

In the United States, the current rules effectively preclude an external director candidate from being added to the notice of meeting published and distributed by the company. The only way for an external candidate to run for a US company board is by way of a proxy contest, which involves the candidate, or the candidate's supporters, printing and mailing out to all shareholders (at their own expense) a proxy form and supporting information. An attempt by the SEC to allow shareholders who satisfied a threshold hurdle to add a director candidate to the company's notice of meeting (known as "proxy access" in the US) was struck down by a federal court in 2011.

Under the United Kingdom Companies Act, nomination of director candidates is treated as being equivalent to other shareholder-proposed resolutions. A company is only required to add a director candidate to the notice of meeting if it receives a request to do so from shareholders who hold at least 5% of total voting rights or at least 100 shareholders who hold shares on which there has been paid up an average sum, per shareholder, of at least £100.

As will be obvious from the proposal above, the threshold being suggested for Australia is still significantly lower than comparable international benchmarks.

19 September 2006

The Hon Chris Pearce MP
Parliamentary Secretary to the Treasurer
Parliament House
CANBERRA ACT 2600

Dear Chris

Corporations Amendment Bill (No 1) 2006: '100-member rule' (s 249D)

We note your recent letter to the majority of the signatory bodies to this letter on the issue of State opposition to the repeal of the rule in s 249D allowing 100 members to requisition general meetings of companies (the 100 member rule) and State support for the introduction of a square root rule.

Square root rule

The coalition represented by the signatory bodies to this letter remains firm in its belief that a square root rule is not feasible. We note that such a provision does not exist in any other jurisdiction. Comparable jurisdictions employ a percentage test for shareholder-requisitioned general meetings:

- United Kingdom 10%
- USA 10%
- Canada 5%
- New Zealand 5%
- European jurisdictions between 5% and 20%.

A percentage test is simple and easy to understand. For example, there are difficulties attached to calculating a square-root rule for an investor based in another jurisdiction. Such a rule would disenfranchise shareholders, who could not look to the law in an any other jurisdiction for guidance as to their rights.

The coalition would also like to point out that the utilisation of the square root rule will, in the majority of cases, have the unintended consequence of concentrating the power to call an extraordinary general meeting (EGM).

Given that approximately 90 per cent of companies listed on the Australian stock exchange have fewer than 10,000 shareholders, the use of the square root rule means that the vast majority of companies will be subject to fewer than 100 members being able to call an EGM, perhaps as few as 22. The square root rule will therefore increase the likelihood of an EGM being called where there is little chance of carrying the resolutions.

While the coalition supports a policy objective of ensuring that small groups of members can have their concerns addressed at general meetings (see our comments below on ss 249N(1)(b) and 249P(2)(b)), we do not believe that the square root rule will provide an outcome that is beneficial to shareholders generally.

Misunderstanding of the role of ss 249N(1)(b) and 249P(2)(b) in effecting shareholder rights

It is important not to overlook the fact that all members of the coalition support the retention of ss 249N(1)(b) and 249P(2)(b) that preserve the rights of members to use a 100-member test to put a resolution on the agenda of the Annual General Meeting (AGM) and request the company to distribute a statement to all its members. We believe these provisions protect the rights of small groups of members to have their concerns addressed, and that the continued support for the preservation of these rights is too often forgotten in the debate.

Indeed, we believe that there is considerable confusion as to what, exactly, the repeal of the 100-member rule in s 249D will alter, given that it is not proposed to alter the 100-member rule in ss 249N(1)(b) and 249P(2)(b).

For example, we refer to an issue of the online newsletter *UnionSafe* that says:

> *The government is looking to raise the threshold for shareholders being able to place items on the agenda of annual general meetings from the 100 signatures currently required to having 5% of the company's capital value. For a company such as Westpac that would mean having to own $1.7 billion worth of shares. Geoff Derrick from the Financial Sector Union said the changes were part of a broader move to silence shareholder activism.*[1]

Clearly, there is a misunderstanding in relation to which provision is being proposed for reform.

The vexatious use of the 100 member rule in s 249D with attendant costs to shareholders

It has been claimed by opponents to the repeal of the 100 member rule in s 249D that the reform is intended to suppress shareholder activism. For example, the minutes of the meeting of the Labor Council of NSW on 21 July 2005 state that:

> *Australian Manufacturing Workers' Union: - outlining to Unions NSW their opposition to the Federal Government's decision to amend the corporations' law and gut the capacity for shareholder activism. The Union said that the right of all shareholders, employees and other stakeholders to speak up at corporate AGM's, ask questions and demand accountability was fundamental to proper corporate governance principles and was a democratic right that should not be undermined. The Union said that defending proper corporate governance and the rights of all shareholders (including workers and proxy holders) was of particular importance to the Union... The Union said the active use of these rights promoted stakeholder rights, community rights, workers' rights and promoted a healthy corporate sector.*[2]

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[1] 'Feds to Clamp Down on Shareholder Activists', *UnionSafe*, 27 July 2005, <http://unionsafe.labor.net.au/>

[2] Labor Council of NSW, Minutes of Meeting 21 July 2005, <http://council.labor.net.au/minutes/>

The coalition is not opposed to shareholder activism, which it believes is an essential component of corporate governance. The coalition supports shareholders being able to put issues on the AGM agenda and to instigate a debate at the meeting. This shareholder right is of particular importance to retail shareholders, who, unlike institutional investors, do not necessarily have the opportunity to meet with the company prior to the AGM.

Most resolutions put forward on the AGM agenda, through the use of the 100 member rule in ss 249N(1)(b) and 249P(2)(b), have not been carried. However, the debate generated by such resolutions has been central to shareholder engagement with corporations, and this is supported by the coalition. An article in *Green Left Weekly* notes that:

> *Shareholder resolutions on environmental and progressive social issues have never won a majority at a company AGM, and they are never likely to. Greenpeace and the AFL-CIO often claim 'victory' after gaining the votes of as few as 5% of shareholders. Domini Social Investments, which works with the ICCR, explains: 'Filers of social issue resolutions don't expect their resolution to receive a majority vote and be adopted by management. Rather, filers use these resolutions to get management's attention.*[3]

In the research report, *From the Picketline to the Boardroom: Union Shareholder Activism in Australia*, Professor Ian Ramsay and Kirsten Anderson note that:

> *Where unions have been successful in gaining significant support from institutional shareholders or from a group of shareholders representing a significant stake in a company, this may signal to the board that issues of concern to unions may also be of concern to the wider shareholder base*.[4]

However, the coalition is opposed to the vexatious use of the 100 member rule in s 249D to call an EGM at substantial cost to the company, *and therefore its shareholders*, when:

a) the avenue remains open of raising the issue of concern by placing a resolution on the agenda of the AGM and having statements relating to that resolution distributed to members at the cost of the company through the utilisation of ss 249N(1)(b) and 249P(1)(b), and
b) it has been noted by those who have called an EGM that it is not expected that the resolutions put forward at the EGM will carry.

To put corporations and their shareholders, the majority of whom are not expected to support the resolutions put forward at an EGM, to the expense of the meeting, is mischievous.

> *The Union said a quick read of submissions to the Federal Government Inquiry by the NRMA, the ALP and the majority report indicated a preoccupation with financial cost and inconvenience to corporations rather than the importance of these rights for shareholders and stakeholders.*[5]

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[3] Sue Boland, 'Can 'Shareholder Activism' Change Society?' in *Green Left Weekly* (2000), <www.greenleft.org.au/back/2000/424/424p15.htm>

[4] Ian Ramsay and Kirsten Anderson, *From the Picketline to the Boardroom: Union Shareholder Activism in Australia*, Centre for Corporate Law and Securities Regulation and Centre for Employment and Labour Relations Law, The University of Melbourne 2005

[5] Labor Council of NSW, Minutes of Meeting 21 July 2005, <http://council.labor.net.au/minutes/>

The coalition believes that such a reading of the proposed reform fails to apprehend that it is shareholders who bear the cost of the special meeting.

For example, the NRMA has been subject to a number of uses of the 100 member rule in s 249D to call an EGM. Since 1996, requisitions signed by 100 members (0.005 per cent of a two-million membership base) have resulted in five special general meetings. A report by legal firm Minter Ellison Lawyers found it cost a company the size of the NRMA $4.5 million to arrange each special meeting.[6]

The coalition queries how it can be anything other than vexatious to have 100 shareholders force a company, such as Telstra for example, to call a special meeting that has absolutely no chance of achieving anything other than costing shareholders $2 million or $3 million.

The potential for abuse

It has been suggested by some commentators that, as the 100 member rule has not been used recently, it no longer requires reform. The Parliamentary Joint Committee on Corporate and Financial Services clearly noted that, while there is little history of the rule being abused, its potential for abuse remains clear. Both political parties have noted that it is not necessary for parliament to wait until some quota of abuses is observed before reforming the provision. The coalition firmly supports this view.

The various professional associations represented by the coalition note that their members have at various times been approached by special interest groups threatening the use of the 100 member rule in s 249D to call an EGM unless the corporation negotiates with the special interest group on its favoured issue. From the coalition’s point of view, such a threat, with its attendant costs to shareholders despite the reality that any such resolution put forward by the special interest group would not be carried at the meeting nor receive the support of the majority of shareholders, constitutes mischief.

The threat of calling an EGM by splitting 100 shares, giving people one share each, then calling a meeting between annual meetings, toys with the company's profit and, consequently, the share price and dividend stream. Thus, it is shareholder return that is being threatened when the threat to invoke s 249D (the 100 member rule) is made.

Conclusion

The coalition supports the retention of the right of 100 members to raise issues of concern by placing a resolution on the agenda of the AGM and having statements relating to that resolution distributed to members at the cost of the company through the utilisation of ss 249N(1)(b) and 249P(1)(b).

However, the coalition’s support of the repeal of the right of 100 members to call an EGM utilising s 249D is based on the need to prevent mischief. The five per cent rule would nevertheless continue to operate and this is entirely consistent with thresholds set in other jurisdictions.

[6] Peter Weekes, ‘Give us a high five first’, *The Age*, 9 March, 2005

We trust that these additional comments can assist to clarify why the repeal of the 100 member rule in s 249D has received widespread support from multiple industry parties that represent a range of interests from retail shareholders to large institutions as well as bipartisan support during the six-year consultation process on this issue.

We would welcome the opportunity to meet and elaborate on these issues.

Yours sincerely

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Chartered Secretaries Australia

Stuart Wilson
Australian Shareholders' Association

Katie Lahey
Business Council of Australia

Gary Fitton
Australian Employee Ownership Association

Ralph Evans
Australian Institute of Company Directors

Richard Gilbert
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