The Minister for Superannuation and Corporate Law, Senator Nick Sherry, has released an exposure draft of the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009, associated regulations and draft commentary to explain the amendments.

The Bill will give effect to the Government’s announcements in its March press releases on the payment of termination benefits to company directors and executives, brought to your attention by Guerdon Associates [HERE].

The Bill introduces a significantly lower threshold at which termination payment benefits must be approved by shareholders. Under the new arrangements, termination benefits for company directors and executives exceeding one year’s average base salary are subject to shareholder approval. In addition, the range of personnel whose termination benefits can be subject to shareholder approval is expanded from directors to also include senior executives and key management personnel for whom remuneration details were disclosed in the prior year’s directors’ report. The Bill also clarifies the types of benefits that are subject to shareholder approval.

The new arrangements will not apply retrospectively to existing contracts that have already been settled.

According to the Government, the amendments strengthen existing regulations on 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.

The amendments to the Corporations Act 2001 have some significant changes to current provisions in addition to the reduction in the maximum that can be paid. These are summarised below, with Guerdon Associates’ comments in italics.

- **Termination benefits for directors and executives exceeding one year’s base salary are subject to shareholder approval.** *GA comment: The analogy used by several commentators already is that remuneration is like a balloon. Squeeze one end and it will expand at the other. Arguably, too tight a squeeze on termination provisions may have the unintended consequence of an increase in some other aspect of pay, such as base salary or an upfront payment on recruitment. What of non-compete agreements or post-termination consulting agreements (already popular in Europe and North America)? These are not subject to regulation (yet...). In addition, the level suggested is too low. Many of Australia’s larger listed companies search offshore to fill executive vacancies. Standard market practice in Europe is 2 times (and this is sanctioned as “good governance” – see [HERE](#)), and in the US it is 3 times base plus bonus (in effect, also “sanctioned” as an allowable level under US tax regulation). Requiring shareholder approval beyond 1 year’s base salary will be an uncertainty too great for most offshore executives. While Guerdon Associates suggest that the one time standard is appropriate in most circumstances, there may be exceptions. We have suggested a method to cope with this before (see [HERE](#))**

- **Scope of the regulations is expanded to include senior executives and key management personnel of the entity.** *GA comment: This is regulation venturing into the board*
of directors’ operational domain. While there should be no argument with shareholders having a binding say in some way on director remuneration, operational matters, including the pay of executives, has always been a board accountability. Shareholders have the power to appoint and dismiss directors they believe do not carry through on these accountabilities effectively. So one could question why this aspect of operational accountability should be treated differently.

- The definition of a termination benefit has been clarified and expanded to include the accelerated or automatic vesting of options and payments in lieu of notice. GA comment: Clarification of “remuneration” in the Corporations Act has always been necessary. In addition, in many cases we believe executives should be encouraged to hold equity through retirement as an incentive to do the right things during their tenure, if the tax system could be made more cooperative (see HERE and HERE)

- The shareholder vote must be held after the director or executive has departed to ensure that shareholders are in a better position to exercise an informed vote. GA comment: The justification for this is stated to be that it will ensure that shareholders are in a better position to assess whether the proposed termination benefit is appropriate, as shareholders would have an understanding of how the director or executive has performed before exercising their vote. As the Bill prohibits companies from calling a general meeting for the sole or dominant purpose of holding the vote on the termination benefit, it is possible that shareholder judgement might be delayed for up to 12 months, by which time judgement could be clouded by any number of issues beyond the control of the departing executive. In addition, in certain circumstances of separation, such as ill health, undue delay in obtaining approval could be unreasonable.
• Unauthorised termination benefits must be repaid immediately. Any unpaid benefits will continue to be held on trust for the company. GA comment: Good luck. As the US experience with Sarbanes-Oxley has shown, clawbacks are difficult to regulate (see HERE)

• The penalty provisions have been strengthened, whilst retaining the option of six months imprisonment. GA comment: There are probably far more material aspects of managing a company that need more penalty attention than this, so focusing on relatively immaterial factors will not make it any easier to recruit qualified directors.

We have not the space or time to list some of the issues immediately apparent in the drafting of the proposed legislation. We will comment on these in our submission.

The Government is seeking written submissions on the exposure draft legislation by close of business Tuesday 2 June 2009. This is not much time, given that many will need to respond to the APRA regulation due out in the week 18 May and the Productivity Commission enquiry.

We urge readers to consider this regulation and respond accordingly.

Details of the regulation and amendments can be found HERE.