

2008 - 2009

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

CORPORATIONS AMENDMENT (IMPROVING ACCOUNTABILITY ON
TERMINATION PAYMENTS) BILL 2009

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Minister for Superannuation and Corporate Law,
Senator the Hon Nick Sherry)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
Bill	Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009
Act	<i>Corporations Act 2001</i>

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General outline and financial impact

Outline

The Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009 (the Bill) strengthens the regulatory framework relating to the payment of termination benefits to company directors and executives.

Date of effect: Each provision of this Act specified in column 1 of the table commences, or is taken to have commenced, in accordance with column 2 of the table. Any other statement in column 2 has effect according to its terms

Commencement information		
Column 1	Column 2	Column 3
Provision(s)	Commencement	Date/Details
1. Sections 1 to 3 and anything in this Act not elsewhere covered by this table	The day on which this Act receives the Royal Assent.	
2. Schedule 1, Part 1	The day after this Act receives the Royal Assent.	
3. Schedule 1, Part 2	Immediately after the provision(s) covered by table item 2.	
4. Schedule 1, Part 3	At the same time as the provision(s) covered by table item 2.	

Financial impact: Nil.

Compliance cost impact: Nil.

Summary of regulation impact statement

Regulation impact on business

Impact: The Office of Best Practice Regulation has been consulted and has advised that a Regulation Impact Statement is not required due to the Government's prior announcement to progress reforms in this area.

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Chapter 1

Introduction

Clause 1: Short title

1.1 The Act may be cited as the *Corporations Amendment (Improving Accountability on Termination Payments) Act 2009*.

Clause 2: Commencement

1.2 Each provision of this Act specified in column 1 of the table commences, or is taken to have commenced, in accordance with column 2 of the table. Any other statement in column 2 has effect according to its terms.

Commencement information		
Column 1	Column 2	Column 3
Provision(s)	Commencement	Date/Details
1. Sections 1 to 3 and anything in this Act not elsewhere covered by this table	The day on which this Act receives the Royal Assent.	
2. Schedule 1, Part 1	The day after this Act receives the Royal Assent.	
3. Schedule 1, Part 2	Immediately after the provision(s) covered by table item 2.	
4. Schedule 1, Part 3	At the same time as the provision(s) covered by table item 2.	

Clause 3: Schedules

1.3 Each Act that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this Act has effect according to its terms.

Chapter 2

Schedule 1 — Amendments

Outline of chapter

2.1 Schedule 1 amends the *Corporations Act 2001* to strengthen the regulatory framework relating to termination benefits.

Context of amendments

2.2 In March 2009, the Government announced reforms aimed at curbing excessive termination benefits paid to company executives. There is significant community concern about excessive pay practices, particularly at a time when many Australian families are being hit by the global recession. The Government is determined to ensure regulation of executive pay keeps pace with community expectations.

2.3 The current regulatory framework allows for termination benefits to reach up to seven times a director's total annual remuneration package before shareholder approval is required. Additionally, only company directors' termination benefits are subject to shareholder approval.

2.4 The Bill introduces amendments to the *Corporations Act 2001* to improve the existing regulatory framework for executive pay. The reforms address growing community concern on termination benefits and provide businesses with certainty.

Summary of new law

2.5 The Bill introduces a significantly lower threshold at which termination payments 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. The Bill also clarifies the types of benefits that are subject to shareholder approval.

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

2.7 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.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Termination benefits for directors and executives exceeding one year's base salary is subject to shareholder approval	Termination benefits can reach up to seven times a recipient's total annual remuneration before shareholder approval is required
Scope of the regulations is expanded to include senior executives and key management personnel of the entity.	Requirements relating to termination benefits apply only to company directors.
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.	There is currently some legal ambiguity as to whether certain types of payment meet the definition of a termination benefit, and therefore require shareholder approval.
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.	The shareholder vote on termination benefits can be held at any point in time before the benefit is paid.
Unauthorised termination benefits must be repaid immediately. Any unpaid benefits will continue to be held on trust for the company.	There is no express requirement to repay an unauthorised termination benefit. The benefit is required to be held on trust for the benefit of the company.
The penalty provisions have been strengthened to 180 penalty units for a natural person and 900 penalty units for a body corporate, whilst retaining the option of six months imprisonment.	The penalty provisions for breaches of sections 200B, 200C and 200D are currently 25 penalty units for natural person and 150 penalty units for a body corporate, together with the option of six months imprisonment.

Detailed explanation of new law

Definitions

2.8 The Bill defines, repeals and amends several terms used in Schedule 1 [*Schedule 1, Part 1, Items 1, 2, 3, 4, 5 and 6*].

2.9 Consequently, the existing provisions and notes that refer to repealed definitions are repealed in this Bill [*Schedule 1, Items 15 and 17, subsection 200C(1) note 1 and subsection 200D(1) note 1*].

Lowering the threshold for shareholder approval

2.10 Section 200B of the Act provides that termination benefits require shareholder approval, unless an exception applies.

2.11 Sections 200F and 200G of the Corporations Act provide exemptions to the requirement to seek shareholder approval, unless the benefit exceeds a certain threshold contained in subsections 200F(3) and (4) and 200G(2) and (3). The Bill repeals the existing threshold and introduces a new threshold calculated by the average amount of base salary received by the person in the last three years of service [*Schedule 1, Items 28-9 and 34-5, subsections 200F(2) and 200G(1)*]. The requirement to use the last three years of service is intended to prevent the new law from being circumvented by a person not holding the relevant office immediately before they depart.

2.12 The Bill also sets out the methods of calculating one year's base salary where the person has held office for less than three years. [*Schedule 1, Items 29 and 35, subsections 200F(3) and (4) and 200G(2) and (3)*].

- Where the person has held office for less than one year, this threshold is adjusted on a pro-rata basis. For example, where the director served for three months, the threshold would be one-quarter of the annual base salary, and a benefit above this would require shareholder approval.
- Where the person has held office for one year, the annual base salary that the person received for the year is the threshold at which termination benefits would require shareholder approval.
- Where the person has held office for more than one year, but less than two years, the threshold is the average of the first year's annual base salary and an estimation of the base salary the person would have received after the first year of the

relevant period,(that is, in the second year of service) had the relevant period been two years.

- Where the person has held office for two years, the threshold is the average annual base salary during the relevant period of two years.
- Where the person has held office for more than two years but less than three years, the threshold is the average of the annual base salary of the first two years and an estimation of what the person would have received after the second year of the relevant period, (that is, in the third year of service) had the relevant period been three years.
- Where the person has held office for three years or more, the threshold is the annual average base salary during the relevant period of three years.

[Schedule 1, Items 29 and 35 ,sub sections 200F(3) and (4) and 200G(2) and (3)].

2.13 The Bill repeals subsection 200G(5) which defined the meaning of eligible employee for the purposes of the existing paragraph 200G(2)(a), as this definition is no longer necessary under the new arrangements *[Schedule 1, Item 36, subsection 200G(5)].*

2.14 The Bill amends subsection 200G(6) by inserting the definition of relevant period for the purposes of calculating the threshold at which termination benefits are subject to shareholder approval *[Schedule 1, Item 37, subsection 200G(6)].*

Extending the scope to executives

If the company is a disclosing entity

2.15 The Bill extends the scope of the regulations to apply to the key management personnel and the five mostly highly remunerated officers (if different) of the entity (that is, the officers named in the remuneration report), namely a person holding ‘managerial or executive office’.
[Schedule 1, Item 7, section 200].

Otherwise

2.16 For all other entities, the existing arrangements continue to apply *[Schedule 1, Item 7, section 200].*

2.17 The Bill extends subsection 200A(1) to incorporate the new arrangements made by extending the scope of the regulations for a disclosing entity [*Schedule 1, Item 9, subsection 200A(1)*].

2.18 As a consequence of the new meaning of managerial or executive office, existing references to ‘board or managerial office’ are omitted and substituted with ‘managerial or executive office’ [*Schedule 1, Items 14, 16, 27 and 30, paragraphs 200C(1)(a), 200D(1)(a), 200F(2)(b), subsection 200F(5)*].

2.19 Additionally, where there is existing reference to ‘office’, the provision is now extended to include ‘or position’ to clarify the existing law [*Schedule 1, Items 8, 11, 13, 23, 24, 25 31 and 33, subsections 200A(1), 200A(2), 200B(3) and 200F(2), paragraphs 200F(1)(a), 200F(2)(a), 200G(1)(a) and 200G(1)(c)*].

Meaning of termination benefit

2.20 The Bill clarifies the definition of a ‘benefit’ that was previously contained in section 9 of the Act. The new definition is set out in section 200AA and provides that a benefit includes a payment or other valuable consideration, any kind of real or personal property, any legal or equitable estate or interest in real or personal property, or any legal or equitable right [*Schedule 1, Item 7, section 200AA*]. Existing section 200A will continue to define when a benefit is given in connection with departure from office.

2.21 There is currently some legal ambiguity as to whether certain types of payments are considered to be a termination benefit requiring shareholder approval. To address this, the Bill contains a regulation making power to create regulations which prescribe things to either be a benefit, or not to be a benefit [*Schedule 1, Item 7, section 200AA*]. The Bill also provides a regulation making power to create regulations which prescribe certain types of benefits that are taken to be given in connection with a person’s departure from office [*Schedule 1, Item 10, subsection 200A(1A)*].

2.22 The draft regulations will offer guidance and certainty, by providing a non-exhaustive list of specific examples of payments that will or will not require shareholder approval. The use of regulations will also enable any new payment methods to be easily identified as payments that require, or do not require shareholder approval.

2.23 The draft regulations prescribe, for the avoidance of doubt, that a benefit includes any kind of pension, the payment of superannuation in excess of the statutory amount, and an amount paid as a voluntary out of court settlement. The draft regulations also prescribe, for the avoidance of doubt, that a benefit does not include deferred bonuses (that is, bonuses that have been earned but not yet paid) and payments from a defined

benefits superannuation scheme that was in existence before the regulations commenced.

2.24 In addition, the draft regulations prescribe that the automatic or accelerated vesting of options and payments in lieu of notice are taken to be a benefit given in connection with a person's departure from office. This is intended to address current legal ambiguity as to whether such payments require shareholder approval.

Timing of shareholder vote

2.25 The Bill provides that any shareholder vote on the approval of a termination benefit must be held after the director or executive has departed from the office or position [*Schedule 1, Item 18, subsection 200E(1)*]. This is intended to 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.

2.26 In addition, the Bill prohibits entities from calling a general meeting for the sole or dominant purpose of holding the vote on the termination benefit [*Schedule 1, Item 18, subsection 200E(1)*]. This is intended to reduce compliance costs associated with holding an extraordinary meeting, and instead, require entities to vote on the issue at a future general meeting.

2.27 The Bill retains the requirement for details of the benefit to be set out in, or accompany, the notice of a general meeting that is to hold the vote [*Schedule 1, Item 19, subsection 200E(2)*].

Requirement to repay unauthorised benefit and to hold on trust

2.28 The Bill strengthens the regulatory framework by introducing an express obligation on the recipient to immediately repay a termination benefit that was given in contravention of the requirement to seek shareholder approval under the Act [*Schedule 1, Item 38, paragraph 200J(1)(b)*]. In addition, the Bill provides that the benefit is a debt due to the entity which may be recovered by the entity [*Schedule 1, Item 38, subsection 200J(1A)*]. This is intended to better facilitate recovery of benefits that have been given in contravention of the Act.

2.29 The Bill also retains the requirement for the recipient of an unauthorised benefit to hold the benefit on trust for the entity [*Schedule 1, Item 38, paragraph 200J(1)(a)*]. This is intended to impose an additional level of accountability on the recipient, particularly where they have failed to repay the benefit immediately.

Penalty provisions

2.30 The Bill significantly strengthens the penalty provisions associated with giving a benefit that has not received the necessary approval by shareholders in contravention of the Act. The penalty units in sections 200B, 200C and 200D have been increased from 25 penalty units to 180 penalty units for a natural person [*Schedule 1, Item 39*] and from 150 penalty units to 900 penalty units for a body corporate, whilst retaining the option of six months imprisonment. In addition, the offences will remain strict liability offences.

2.31 This represents a substantial increase to the penalty provisions and is intended to reflect the seriousness of giving a termination benefit where it has not been approved by shareholders in accordance with the Act, and to provide a sufficient deterrent to such unauthorised benefits.

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Chapter 3

Part 2 — Other Amendments

Detailed explanation of new law

3.1 The Bill removes the exception in section 200F for pre-1991 contracts [*Schedule 1, Item 40, paragraph 200F(1)(a)*]. This amendment does not apply retrospectively.

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