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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 Financial Services, Superannuation and Corporate Law,
the Hon Chris Bowen MP)

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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>

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: Sections 1 to 3 of the Bill commences on Royal Assent. Schedule 1, part 1 of the Bill commences on the day after Royal Assent. Schedule 1, part 2 commences immediately after part 1 commences. Schedule 1, part 3 commences on the day after Royal Assent.

Financial impact: This Bill has no significant impact on Commonwealth expenditure or revenue.

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. Instead, a post-implementation review of the new amendments will be made within one to two years of the commencement of the new requirements.

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 the 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	The day after this Act receives the Royal Assent.	

Clause 3: Schedules

1.3 Each Act that is specified in a Schedule to the Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to the Act has effect according to its terms.

Chapter 2

Schedule 1 — Amendments

Outline of chapter

2.1 Schedule 1 amends the *Corporations Act 2001* (the Act) 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 Act 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 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 or 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. The new arrangements will apply to contracts that are entered into and renewed or extended.

2.7 Additionally, the arrangements will apply to existing contracts for which a variation of a condition is made. Minor changes to an existing contract would not be considered a variation of a condition. However, changes that effect an essential term, including any term relating to remuneration would be considered a variation of a condition.

2.8 The amendments strengthen the existing regulatory framework applying 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.

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 or key management personnel of the entity, where the company is a disclosing entity.	Requirements relating to termination benefits apply only to company directors.
The definition of a termination benefit has been clarified and expanded. The Bill requires a broad interpretation of the term benefit and requires that the substance should prevail over its legal form. The Bill also includes a regulation making power to specify whether certain types of payments are a termination benefit or not.	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.
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.
Retirees, that hold shares in the company, can no longer participate in a shareholder vote on their termination benefit except when acting as a proxy.	All shareholders are able to participate in a vote on termination benefits.
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

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

2.10 Particularly, the definition of 'base salary' has the meaning specified in regulations made for the purposes of this definition [*Schedule 1*,

Part 1, Item 1]. Given the fluidity of the definition of ‘base salary’ in application, this allows flexibility for the law to respond to an environment of rapid change and ongoing developments. Flexibility is also required as the new arrangements will facilitate greater understand in this area and may reveal a case for change to provide clarity and certainty.

2.11 The meaning of ‘benefit’ is defined in section 200AB [*Schedule 1, Part 1, Item 7, section 200AB*].

2.12 Consequential renumbering of existing references to section 200A is made in this Bill [*Schedule 1, Part 1, Item 5 and 6*].

2.13 Consequently, the existing provisions and notes that refer to repealed definitions are repealed in this Bill [*Schedule 1, Items 16 and 18, subsection 200C(1) note 1 and subsection 200D(1) note 1*].

Lowering the threshold for shareholder approval

2.14 Section 200B of the Act provides that termination benefits require shareholder approval, unless an exemption applies. Exemptions to section 200B are contained in sections 200F, 200G and 200H of the Act.

2.15 The exemptions in sections 200F and 200G apply unless the benefit exceeds a certain threshold contained in subsections 200F(3) and (4) and 200G(2) and (3) [*Schedule 1, Items 30 and 36, paragraphs 200F(2)(b) and 200G(1)(c)*]. 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. 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 [*Schedule 1, Item 12, subsection 200B(1)*].

2.16 Consequential changes to subsections 200B(1A) and 200B(3) are made as a result of the new arrangements in subsection 200B(1) [*Schedule 1, Items 13 and 14, subsections 200B(1A) and 200B(3)*].

2.17 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.

- 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 31 and 37, sub sections 200F(3) and (4) and 200G(2) and (3)].

2.18 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 38, subsection 200G(5)].*

2.19 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 39, subsection 200G(6)].*

Extending the scope to executives

If the company is a disclosing entity

2.20 For a company to which section 300A of the Act applies, the Bill extends the scope of the provisions 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 200AA*].

2.21 The person is taken to hold the managerial or executive office for the whole of the current financial year unless and until the person retires from an office or position in the company before the end of the financial year [*Schedule 1, Item 7, section 200AA*]. This is to capture persons who have not been previously included in the remuneration report as key management personnel and who retire in the year that they are included.

Otherwise

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

2.23 The Bill extends subsection 200A(1) to reflect the changes made in section 200AA [*Schedule 1, Item 9, paragraph 200A(1)(f)*].

2.24 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 15, 17, 29 and 32, paragraphs 200C(1)(a), 200D(1)(a), 200F(2)(b), subsection 200F(5)*].

2.25 Additionally, where there is existing reference to ‘office’, the provision is now extended to include ‘or position’ to clarify the law [*Schedule 1, Items 8, 11, 14, 25, 26, 27, 33 and 35, subsections 200A(1), 200A(2), 200B(3) and 200F(2), paragraphs 200F(1)(a), 200G(1)(a) and 200G(1)(c), subparagraph 200F(2)(a)(ii)*].

Meaning of termination benefit

2.26 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 200AB 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 200AB*].

2.27 The Bill inserts a new section 200 which provides that a broad interpretation to ‘benefit’ should be given and the substance should prevail over its legal form [*Schedule 1, Item 7, section 200*]. This is similar to the provisions in section 229 of the Act.

2.28 Existing section 200A will continue to define when a benefit is given in connection with departure from office.

2.29 The word ‘prescribed’ is omitted from subparagraph 200E(2)(b)(i), as it is not relevant [*Schedule 1, Item 21, subparagraph 200E(2)(b)(i)*].

2.30 Consequential changes are made to paragraphs 200F(2)(b) and 200G(1)(c) as a result of the meaning of termination benefit [*Schedule 1, Items 28 and 34, paragraphs 200F(2)(b) and 200G(1)(c)*].

2.31 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 200AB*]. 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)*].

2.32 The draft regulations will offer guidance and certainty, by providing a non-exhaustive list of specific examples of payments that will require shareholder approval, which could include, for example, the payment of employer superannuation contributions in excess of the statutory amount (excluding salary sacrificed amounts); and any amounts paid as voluntary out of court settlements.

2.33 The draft regulations will also prescribe, for the avoidance of doubt, a non-exhaustive list of specific examples of payments that will not require shareholder approval, which could include, for example, deferred bonuses; and payments from a defined benefits superannuation scheme that was in existence before the regulations commenced.

2.34 In addition, the draft regulations will prescribe circumstances in which a benefit is given in connection with a person’s retirement from an office or position. This could include for example, the automatic or accelerated vesting of options and payments in lieu of notice.

2.35 As with the regulation making power for the definition of ‘base salary’, regulations in this area allows for flexibility to respond to an environment in which executive remuneration conditions and allowances rapidly change and evolve.

2.36 Paragraph 200F(1)(b) will continue to provide the ability to prescribe circumstances under which a benefit given is exempt from shareholder approval.

Shareholder voting requirements

2.37 The Bill retains the existing requirement for the giving of the benefit to be approved by a resolution passed at a general meeting [*Schedule 1, Item 19, subsection 200E(1)*].

2.38 The Bill also retains the existing 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 20, subsection 200E(2)*].

2.39 The Bill restricts the retiree or an associate of the retiree from participating in the shareholder vote that includes their termination payment. This does not prevent the casting of a vote made by a retiree acting as a proxy [*Schedule 1, Item 22, subsection 200E(2)*].

2.40 The Bill contains a regulation making power to create regulations which may allow retirees to vote on their own remuneration. This is to provide flexibility in the event that circumstances arise which may give valid cause for retirees to exercise their vote [*Schedule 1, Item 22, subsection 200E(2C)*].

2.41 Consequential changes are made to subsections 200E(3) and 200E(4) as a result of the new arrangements in subsection 200E(2) [*Schedule 1, Items 23 and 24, subsections 200E(3) and 200E(4)*].

Requirement to repay unauthorised benefit and to hold on trust

2.42 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 40, 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 40, subsection 200J(1A)*]. This is intended to better facilitate recovery of benefits that have been given in contravention of the Act.

2.43 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 40, 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

2.44 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 41*] 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.

2.45 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.

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 42, paragraph 200F(1)(a)*].

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Schedule 1: Amendments

<i>Bill reference</i>	<i>Paragraph number</i>
Item 7, section 200AA	2.20, 2.21, 2.22
Item 7, section 200AB	2.26, 2.31
Item 7, section 200	2.27
Items 8, 11,14, 25, 26, 27, 33 and 35, subsections 200A(1), 200A(2), 200B(3) and 200F(2), paragraphs 200F(1)(a), 200G(1)(a) and 200G(1)(c), subparagraph 200F(2)(a)(ii)	2.25
Item 9, paragraph 200A(1)(f)	2.23
Item 10, subsection 200A(1A)	2.31
Item 12, subsection 200B(1)	2.15
Items 13 and 14, subsections 200B(1A) and 200B(3)	2.16
Items 15, 17, 29 and 32, paragraphs 200C(1)(a), 200D(1)(a), 200F(2)(b), subsection 200F(5)	2.24
Items 16 and 18, subsection 200C(1) note 1 and subsection 200D(1) note 1	2.13
Item 19, subsection 200E(1)	2.37
Item 20, subsection 200E(2)	2.38
Item 21, subparagraph 200E(2)(b)(i)	2.29
Item 22, subsection 200E(2)	2.39
Item 22, subsection 200E(2C)	2.40
Items 23 and 24, subsections 200E(3) and 200E(4)	2.41
Items 28 and 34, paragraphs 200F(2)(b) and 200G(1)(c)	2.30
Items 30 and 36, paragraphs 200F(2)(b) and 200G(1)(c)	2.15
Items 31 and 37, sub sections 200F(3) and (4) and 200G(2) and (3)	2.17
Item 38, subsection 200G(5)	2.18
Item 39, subsection 200G(6)	2.19
Item 40, paragraph 200J(1)(b)	2.42
Item 40, subsection 200J(1A)	2.42
Item 40, paragraph 200J(1)(a)	2.43
Item 41	2.44
Item 42, paragraph 200F(1)(a)	3.1

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Part 1, Items 1, 2, 3, 4, 5 and 6	2.9
Part 1, Item 1	2.10
Part 1, Item 5 and 6	2.12
Part 1, Item 7, section 200AB	2.11