



MEMO

To: Board of Directors
From: Company Secretary
Subject: **REMUNERATION ACCOUNTABILITY**

In response to your enquiry about the current requirements under the Corporations Act governing the rules surrounding Director and Executive remuneration for listed companies, I address various aspects below.

The objective of these provisions is to strengthen Australia's remuneration framework, empower shareholders to hold directors accountable for their decisions relating to executive remuneration, and eliminate conflict of interest in the remuneration setting process.

Remuneration Report

Section 300A of the Act requires a Remuneration Report to be included in the annual Directors' Report detailing remuneration, payments, policies, etc for directors and key management personnel.

That Remuneration Report must then be voted on by shareholders at the Annual General Meeting – s.250R(2) – but, under s.250R(3) the decision is 'advisory' only and is not binding on the directors.

Voting on Remuneration Report

Directors and key management personnel (and their closely related parties who hold shares) are not allowed to vote on the Remuneration Report at the AGM. This is to avoid conflicts of interest with key management personnel voting on their own remuneration.

'Two-strikes' Test

The Act strengthens the voting process by setting out consequences in the event that the shareholders vote against the Remuneration Report.

The 'first-strike' occurs where the Remuneration Report receives a 'no' vote of 25% or more at the AGM. If this happens, the company's next subsequent Remuneration Report must explain whether and the extent to which shareholders' concerns have been taken into account.

The 'second-strike' occurs if the company's subsequent Remuneration Report receives a 'no' vote of 25% or more. If this happens, the shareholders will vote at the



same AGM whether the directors will need to stand for re-election within 90 days ('spill resolution'). Directors and key management personnel and their 'closely related parties' (i.e., controlled entities, spouse, children, etc) will not be allowed to vote on this resolution. If the resolution is passed with 50% or more of votes, then a 'spill meeting' must take place within 90 days.

And just in case it is needed.....notice of the spill resolution must be included in the notice of meeting for that AGM to ensure due notice has been given in the event that the second-strike is triggered. The notice must explain the circumstances in which the resolution will apply and invite shareholders to appoint a proxy to vote on the spill resolution (i.e., included on the Proxy Form with the other resolutions).

Spill Meeting

The company will then need to provide the minimum notice period for holding the spill meeting and comply with any minimum notice period in its constitution for the nomination of candidates (to ensure shareholder nominated candidates can seek endorsement at the spill meeting).

At the spill meeting, the directors required to stand for re-election are those directors (other than the managing director) who were directors when the Directors' Report was presented at the most recent AGM. These directors cease to hold office immediately after the spill meeting (although if none of these directors are still on the board at that time, then the spill meeting is abandoned).

If the company fails to hold the spill meeting within 90 days after the spill resolution is passed, each director of the company at the end of those 90 days (other than any appointed after the last day on which notice of a meeting must be given) will have committed an offence under the Act.

Proxy Voting

A vote must be cast for all directed proxies, if there is a call for a poll. So, when voting on the Remuneration Report or a spill resolution, if a nominated proxy holder does not vote the proxy will default to the chairman who is required to vote all directed proxies.

Remuneration Consultants

Companies are required to disclose in their Remuneration Report any detail relating to the use of remuneration consultants to allay concerns that remuneration consultants may be placed in a position of conflict if asked to express an opinion on the remuneration of officers that are in the position to determine if the consultant's services will be retained.

And to avoid conflicts of interest, remuneration consultants must be hired by non-executive directors and report to non-executive directors or the remuneration committee, rather than to the company executives.



Hedging of Incentives

The Act prohibits key management personnel (and their closely related parties) from hedging remuneration that depends on the satisfaction of a performance condition, as otherwise might defeat the purpose of having incentive remuneration.

'No Vacancy' Rule Disallowed

Allied to the above issues is the board size and the board's ability to 'control' who the directors are.

Many company constitutions state a maximum number of directors the company can have or say it is such other number as decided by the directors. This is known as the 'no vacancy' rule. This rule makes it difficult for nominees not endorsed by the board to be voted onto the board, because the directors have the ability to declare that there are no vacancies.

To nullify this possibility the Act does not allow the board to decide the maximum number of directors without first obtaining shareholder approval at the AGM (or extraordinary general meeting). The notice of meeting must include an explanatory statement stating the board's reasons for proposing to set a limit on the maximum number of directors. Any limit approved by shareholders will expire immediately before the next AGM and must then be voted on again.

DISCLAIMER

The comments in this memo reflect some commercial aspects and observations on the matter experienced or observed by the writer in practice as he understands them. The information is given as a guide only and does not represent a definitive or legal view of any of the issues raised, covered or referred to and the reader is urged to seek his own professional advice on all aspects of, or pertaining to, this and any related matter.