

## Update: Executive Termination Benefits Exposure Draft

As part of its plan to curb excessive executive termination payments, the Federal Government has released exposure drafts of:

- the *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009* (Exposure Draft), setting out proposed amendments to the *Corporations Act 2001* (Cth) (Act); and
- a draft *Corporations Amendment Regulations 2009* (Draft Regulations).

If passed in their current form, the Exposure Draft and Draft Regulations (Drafts) would require shareholder approval, after departure, for executive termination payments:

- in excess of 1 year's base pay (a much lower threshold); and
- for a wider range of executives.

Once in operation, the changes will impact negotiations with the highest paid executives in companies in relation to new contracts and extending existing arrangements. In particular, remuneration structures that comprise a relatively low base salary complemented by incentives are unlikely to be attractive structures for executives going forward.

In the meantime, the changes may prompt executives on fixed term arrangements to seek to negotiate ongoing employment agreements, to lock in termination entitlements above the cap before the new laws take effect.

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### Overview of the changes

The Drafts seek to significantly reduce the current threshold for shareholder approval of a departing executive's termination benefits by:

- requiring shareholder approval for a termination benefit to an executive, if the benefit exceeds a new cap of one year's base salary;
- expanding the list of who is an "executive", and hence when shareholder approval is required, to include anyone listed in the directors' report for the previous financial year;
- expanding the list of benefits included, and hence when shareholder approval is required;
- requiring shareholder approval to be secured after the executive's departure;
- requiring shareholder approval before making payments agreed before the changes come into effect, if those arrangements are extended after the law changes.

Executives on pre-existing fixed term arrangements will be caught by the changes if those arrangements are extended once the changes take effect. To avoid that outcome, such executives may seek a shift to ongoing employment agreements before the changes come into effect.

Shareholders will be unable to pre-approve termination benefits above the threshold for any new executive hired by the company.

### Who does the new cap apply to?

*The holder of a "managerial or executive office":* The Drafts would require shareholder approval before paying termination benefits above the threshold to the holder of a "managerial or executive office". The meaning of "managerial or executive office" is different for listed and non-listed entities.

*A listed company:* The holders of a "managerial or executive office" of a listed company for any financial year are those whose details are included

in the directors' report for the previous financial year. Primarily, they are:

- the directors of the listed entity or group for the previous financial year; and
- the five most highly remunerated officers of the listed entity or group for the previous financial year, named in the previous financial year's directors' report (whether or not they are also directors).

While the list may change from year to year, it is fixed for the (current) financial year, so the named person is taken to hold the office for the entire year (unless departing part way through).

An executive not listed in last year's directors' report will require shareholder approval of termination benefits on a pro rata basis.

At present the directors' report must disclose the remuneration of the key personnel. However, only the directors of a listed entity are subject to the current shareholder approval requirements. The Drafts expand that list.

**A non-listed company:** The "managerial or executive office" holders of a non-listed company are:

- the directors of the company; and
- the directors of a related body corporate.

The Drafts do not expand the list of executives of a non-listed entity.

**Pre-existing contracts generally exempt:** While the changes do not have direct retrospective effect, shareholder approval would be required for benefits paid under:

- a new agreement made once the new laws commence; or
- an existing agreement that is extended once the new laws commence (even if the extension changes no other terms).

A potential issue will be whether a variation of employment terms amounts to a new contract that will be subject to the new regime. This will present particular problems for executives on fixed term arrangements, as soon as the existing terms expire, and they want to extend existing terms or enter into a new arrangement. Many will look to roll existing

fixed terms into indefinite hire arrangements on similar terms before the law changes.

## What is the proposed threshold?

**Significantly lower benefits threshold:** The Drafts significantly reduce the termination benefits that do not require shareholder approval.

Termination benefits in excess of *one year's base salary* will need shareholder approval. Currently, shareholder approval is not required unless the value of the benefits exceeds a threshold of up to *seven years' total remuneration*.

The threshold applies on a pro-rata basis for service of less than one year, effectively reducing the threshold further in those circumstances.

The Drafts therefore lower the threshold by:

- using base salary as the reference point, rather than remuneration;
- lowering the threshold from seven years' to one year's earnings; and
- pro-rating the threshold for service of less than one year.

Shareholder approval will be required for significantly lesser benefits, and for a wider range of executives of listed entities.

## What is included in calculating the threshold?

**Extended meaning of "benefit":** The Draft Regulations expand the list of "benefits" that count towards meeting the threshold, making shareholder approval essential for a wider range of executives. The Drafts would add:

- accelerated or automatic vesting of options;
- payments in lieu of notice;
- pension payments; and
- superannuation payments greater than the current statutory minimum.

The Draft Regulations would also give the Government the power to include other benefits, effectively expanding when shareholder approval will be required.

## Timing: When can approval be given, and when can shareholders be asked?

*Timing of the Vote:* Shareholders cannot validly approve termination benefits unless the director or executive has already ceased to hold the managerial or executive office in question.

The change may have an impact on a listed entity's negotiations with a prospective executive if the executive has above-threshold termination benefits locked into their current contract with another entity. The listed entity cannot obtain shareholder approval to resolve any uncertainty. The Drafts do not limit the base salary a company may offer. Therefore, an increase in an executive's base salary is one obvious means of seeking to maintain above-threshold termination benefits.

A listed company's ability to attract and retain executives may therefore increasingly depend on:

- its remuneration structures; and
- securing shareholder approval after the event, knowing its remuneration structures will be subject to greater shareholder scrutiny.

*Calling a vote just to approve a benefit:* The Drafts prohibit the calling of a meeting of shareholders for the sole or dominant purpose of passing a resolution to approve a termination benefit in excess of the threshold.

This prohibition may pose practical compliance issues for non-listed companies, particularly if they do not have regularly scheduled shareholder meetings, but need to approve termination benefits for a departing executive.

## Other aspects

*Obligation to repay benefits:* The Drafts require directors and executives to immediately repay to the company any unauthorised payments (without the need for a demand). The Act currently contains no obligation to repay. Unauthorised payments will be held on trust for the company; a measure intended to impose additional accountability on the part of the executive.

*Significantly Greater Penalties:* Those who breach the provisions will be subject to the following maximum penalties:

	New Penalty	Old Penalty
Individual	\$19,800	\$2,750
Corporation	\$99,000	\$16,500

These are strict liability offences and the option of six months' imprisonment remains.

## Which departures?

*Resignation v something wider:* Despite broader statements in the Explanatory Memorandum, the Exposure Draft states the Government's intention to limit termination benefits on resignation of an executive, as follows:

*"The amendments [...] apply in relation to **resignations** of offices, or positions of employment, held under agreements entered into, or extended, on or after the commencement of [the changes]" [Emphasis added].*

However, that intention is not reflected in the substantive changes proposed to the Act. They are expressed to apply more broadly, to any "**retirement from an office or position**" [emphasis added]. The Act already defines those words to include resignation, loss of office for any reason including performance based dismissal, dismissal for serious misconduct, redundancy of position etc and death while holding office.

If you would like further information about the proposed changes, please contact a member of our Corporate or Employment & Workplace Relations teams.

Click [here](#) to view the exposure draft.

Click [here](#) to view the draft regulations.

Click [here](#) to view the explanatory memorandum.

This article was produced by Herbert Geer.

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