Across the Board news

ISSUE 170 14 March 2006

Editor Erica Vowles

SHAREHOLDER RELATIONS
Increased calls for direct voting ¶1074
SHAREHOLDER ACTION
Study finds modest gains for derivative actions, while class actions power ahead ¶1075
REPORTING
Survey finds majority read corporate governance statements ¶1076
PUBLIC SECTOR
New guidance to educate public servants on ministerial interaction ¶1077
Increased uncertainty prompts rethink of current PPP models ¶1078

SHAREHOLDER RELATIONS

¶1074 Increased calls for direct voting

Chartered Secretaries Australia (CSA) has reopened the debate about the proxy voting system with a discussion paper that calls for companies to introduce direct voting for shareholders who cannot attend annual general meetings.

In releasing the paper, the organisation's chief executive, Tim Sheehy, has claimed that the current system was "outdated and widely misunderstood" — in contrast, he said the introduction of direct voting would mean the process of appointing a proxy to vote at AGMs would be less open to abuse.

> "Introducing direct voting would ensure that when a shareholder votes, there is no possibility that their vote can be directed any other way than how the shareholder intended: and that's not necessarily the case with appointing a proxy to vote", said Mr Sheehy.
>
> "Initiating direct voting as an option should be a top priority for companies keen to be at the forefront of good governance", he added.

He claimed direct voting should not be a complex or convoluted process to implement, as no changes are needed to the Corporations Act.

> "The current proxy system allows some undesirable practices such as cherry-picking, the use of different proxy forms, and failing to call a poll to avoid an outcome a chairman considers unfavourable. But there are also questions about the integrity of data collected. In one investigation into 'missing votes', the company described a 'cumbersome, manual' voting process that involved at least six pairs of hands", Mr Sheehy said.

> "There's a common misunderstanding that appointing a proxy is the same thing as voting. However, the truth is that appointing a proxy means shareholders transfer some of their rights to another party over whom they have no control. At the end of the day proxy holders can still turn up at a meeting with a briefcase full of proxies, and for one reason or another, exercise only some, or even none of the proxies they are holding", he added.

The discussion paper lists a variety of ways in which the proxy system can, and has been, abused, such as the case involving former NRMA chairman Nick Whitlam, who failed to sign the poll papers that constituted the votes of almost 4,000 NRMA members. Also highlighted is the case of Solomon Lew, who left the Coles Myer AGM with a large number of proxies that were not voted.

Previously, the Parliamentary Secretary to the Treasurer Chris Pearce has welcomed any industry initiatives that "enhance transparency and shareholder participation".

Shadow Minister for Corporate Governance and Responsibility Senator Penny Wong has responded to the discussion paper by calling for an introduction of direct voting, claiming it would be a positive step for shareholder rights and the integrity of ballot procedures.

> "Adding the option of a direct voting system would ensure full voting rights to all shareholders, those who attend the AGM and those who do not", Senator Wong said.

> "Direct voting will also improve the integrity of AGM ballots, reducing the procedural problems that can result from proxy voting."

However, Senator Wong emphasised that direct voting should not be seen as reducing the importance of the AGM.

> "Most shareholders with a long-term interest in a company want to be able to look their directors in the eye and on occasion, ask them a question."

According to CSA, introducing a system of direct voting is reasonably simple. Companies would need to set up a system whereby shareholders who cannot attend an AGM fill in voting forms which can be lodged by post, fax or electronically, within 48 hours before the meeting, as is the current practice with proxies.

Sources: CSA media release, 9/3/2006; Media statement by Senator Penny Wong, 9/3/2006.

SHAREHOLDER ACTION

¶1075 Study finds modest gains for derivative actions, while class actions power ahead

By Erica Vowles

Despite the dire predictions, a study by the University of Melbourne has found modest gains for shareholders using statutory derivative action law actions against companies whose directors have breached their duties.

However, in the wider picture of shareholder litigation, class action suits are emerging as a greater threat to companies that breach their continuous disclosure obligations or directors' duties.

On 13 March 2000, Part 2F.1A of the *Corporations Act 2001* came into operation, enabling current and former members and officers of a company to bring an action on behalf of the company, or intervene in proceedings to which the company is a party.

This action, known as the statutory derivative action, was introduced to rectify some of the perceived inadequacies of the common law derivative action, following recommendations from several government reports.

These reports assessed the statutory derivative action as an important remedy available to minority shareholders to enforce their rights. However, the statutory derivative action was not uniformly welcomed with some commentators criticising the laws, claiming they had not significantly improved the position of shareholders.

A report by the Centre for Corporate Law and Securities Regulation at the University of Melbourne has assessed the impact that enshrining the laws in statutes has had on their effectiveness. Speaking on the report, the director of the centre, Professor Ian Ramsay, said the statutory derivative action had had a moderate impact on shareholder litigation.

> "It has had a modest, but positive impact. In the five years we investigated there were only 31 judgments, which is not excessive. There were some concerns expressed when this was enacted back in 2000. Some thought it would open the flood gates, that you would have excessive levels of shareholder litigation brought about by minority shareholders who would use it to badger company directors and disrupt the operation of companies."

> "On the other hand there were those that thought parliament had set the hurdles — that need to be cleared before this litigation can be put in place — too high."

However, he added that the study had found that enshrining the laws in legislation had dispelled some uncertainties that existed under the previous common law model.

> "While it has had a modest impact, it's also had a positive impact because under the prior law — the Common Law derivative action — there were a number of uncertainties left by court decisions. So I think this is an example of parliament helpfully clarifying what the law is."

However, Professor Ian Ramsay noted that compared with trends in the wider shareholder litigation, class actions have the potential to have a much greater impact on Australian companies. So far companies that have seen class actions and had those threatened include Telstra, Sons of Gwalia, Mediaworld, Aristocrat Leisure, Ion, Concept sports, GIO and most recently, AWB.

While statutory derivative actions tend to involve breaches of directors' duty, Professor Ramsay noted that shareholder class actions extended to other issues such as breaches of continuous disclosure rules.

> "Class actions extend well beyond this area of the law and in some respects I think class actions are having much more of an impact [than statutory derivative actions], although it is reasonably early days on class actions."

> "These have the potential to have much more of an impact. Statutory derivative actions involve small family companies, the class actions are brought against prominent companies with a large shareholder base, which lends itself to class actions, and where the damages sought are substantial."

Professor Ramsay said a number of factors were helping to contribute to the increased number of shareholder class action suits being brought against listed companies.

> "Number one is we've seen more focus on continuous disclosure and this is an important area for litigation because the rules in that area have been tightened. Number two issue is that we've seen the rise of professional litigation firms who are prepared to risk significant sums of money on a class action that might go for some years. We previously haven't had that in this country. Now we've got organisations like IMF Australia playing a prominent role in those class actions", Professor Ramsay noted.

However, the biggest impact was the clarification provided for shareholders, following the successful suit against GIO's directors.

> "In the class action against GIO, the argument was that GIO had made misleading statements while defending the company against a hostile takeover by AMP. That case was successfully settled in 2003 by the shareholders and their lawyers for $97 million."

He said company directors face an environment of heightened risk under this area of the law, and should concentrate on tightening up their regimes around continuous disclosure.

> "I've got no doubt that directors are operating in an environment where there is a heightened risk of class action. It is then critical that companies respond in terms of risk management by focusing in particular on continuous disclosure obligations."

> "This is particularly important when a company is in financial difficulties because this is where [the company] can be in the most difficult situation, juggling all sorts of commitments in communications. Companies can be very vulnerable, in relation to compliance with continuous disclosure, financial difficulty and in continuous discussions with major creditors and major lenders."

The chairman of Maurice Blackburn Cashman, Bernard Murphy, the firm which successfully concluded the GIO case in favour of shareholders, told *Across the Board* that while the growth in shareholder class action was not quite as "spectacular" as the media had portrayed, it was an area of increased vulnerability for directors.

> "We've had in total only nine shareholder class actions since 1992, which is a long way from an explosion. But it is true that since the GIO class action, there have been a number of actions following it, seeking to vindicate the rights of shareholders who have been misled by companies and their boards of directors."

Mr Murphy said that the GIO suit paved the way for other class actions to occur in Australia.

> "The GIO case was the first time that the class action regime had been used to the benefit of shareholders and what it has done is it has allowed shareholders to have some heart that they can use the remedies in Corporations law to bring to account companies and their directors who have misled them or who have breached the continuous disclosure regime."

He agreed that the recent strengthening of continuous disclosure rules has also given shareholders increased power to launch cases against companies and their directors.

Mr Murphy said a number of actions by companies tended to have the effect of triggering a class action — both here and in the United States. These included companies overstating their profit forecasts, in a bid to drive their share price up, or making selective announcements to the ASX in order to drive their share price up. Both actions can be construed as breaches of the continuous disclosure regime.

Mr Murphy also believes that increased interest expressed by institutional shareholders in class actions was also an important trend that would lead to more class actions.

> "The institutional shareholders are finally starting to understand that one of their obligations is to stop this type of conduct from occurring and they are starting to claim

> these losses when they arise."
>
> "I recall back in 1998 when GIO started, going around Sydney and seeing which of the institutions would join that case. Now, we had 22,000 clients but very few of the institutions joined in. In 2003 when I was starting the Aristocrat class action, the interest level from institutions was significantly greater and of that claim value which is $120 million, 94% comes from the institutions."

Sources: Report by the Centre for Corporate Law and Securities Regulation: "Litigation By Shareholders And Directors: An Empirical Study Of the Statutory Derivative Action", released February 2006; interview with Professor Ian Ramsay 2/3/2006; interview with Bernard Murphy 3/3/3006.

REPORTING

¶1076 Survey finds majority read corporate governance statements

A survey of the impact of the stock exchange's corporate governance guidelines has found the majority of private investors and organisations and professionals use governance information in analysing or reviewing their investments.

The survey, released by the Australian Stock Exchanges Corporate Governance Council, found that 80% of private investors and 75% of organisations and professionals surveyed use corporate governance information in analysing or reviewing equity investments.

Survey respondents also gave the annual reports of BHP Billiton, Wesfarmers, Westpac, ANZ and Woolworths the thumbs up in terms of good corporate governance reporting.

However, when asked how reporting could be improved, investors suggested greater clarity of reporting about remuneration, and more information about board members' experience and affiliations was needed.

Of those who used corporate governance reports in their investment assessments, 84% said financial reporting was of most interest. Board structure and responsibilities was particularly of interest to organisations/professionals (69%), while private investors also remained interested on remuneration (67%). Some 56% of organisations and professionals were interested in risk management, while 59% were interested in shareholder/stakeholder management.

When asked how governance information in reports could be improved, 26% said existing information could be clearer and more concise, while 11% said existing information could be more accessible. Some 9% wanted increased disclosure on boards, such as board experience, independence and affiliations, commitments, share trading, committees (including composition), policies and review processes.

More clarity of information concerning remuneration of directors and key personnel was particularly highlighted by private investors (9%). Also, some 7% of those surveyed believed a summary statement of whether companies are adopting/exception reporting against the ASX Corporate Governance Council Principles and Recommendations would be useful.

Members of the bodies comprising the ASX Corporate Governance Council were surveyed during November and December 2005 to find out the value users place on corporate governance information and the questions they want companies to answer about their corporate governance practices. There were 729 respondents to the survey.

Chairman of the ASX Corporate Governance Council, Eric Mayne, said the council would use the survey results in its current review of the stock exchange's governance principles and best practice recommendations.

The council's review takes into account the CLERP 9 amendments, reporting trends to date, the need for any additional guidance, and the emerging debate about non-financial risk reporting and corporate responsibility. However, the council noted the review would also encompass the request to the council from the Minister for the Environment and Heritage, Senator the Hon. Ian Campbell, to consider ways to encourage non-financial reporting.

Source: Statement by ASX CGC, 6/3/2006.

PUBLIC SECTOR

¶1077 New guidance to educate public servants on ministerial interaction

A breakdown in the traditional mentoring process for junior staff that once existed in the Australian Public Service (APS), combined with an increase in the number of public servants being in direct contact with ministerial staffers, has prompted the APS to release new guidance.

Launching the guidance: "Supporting Ministers, Upholding the Values", Public Service Commissioner Lynelle Briggs noted last week that it was now more important than ever for public servants to know their roles and legal responsibilities when coming into contact with ministers and their staff.

> "Increases in use of email means that a wide variety of public servants are having direct contact with ministerial staffers, sometimes without the public servant knowing what their legal obligations are", Ms Briggs noted.

She said along with the growth in the ranks of staff filling ministerial positions, so had grown the number of APS employees having contact with them.

> "There are many more ministerial advisers now making more demands. This development is not unique to Australia — though here it may also reflect among other things the increased office space available following the move to new Parliament House — but it is important to the way we do business. According to the 2003–04 State of the Service Report, at 1 May 2004, the total number of government personal staff was 392, an increase of 89% compared to 207 in April 1983."

> "Not surprisingly, there are also more people on the receiving end of demands from ministerial offices. In 2004–05, 73% of Senior Executive Service (SES) employees, 35% of Executive Level (EL) employees and 15% of APS 1–6 employees reported having had direct contact with ministers and/or their advisers in the preceding year. Most of this contact was related to the supply of advice and factual information, which was provided by public servants at all levels."

However, she noted that despite the increased levels of staffer-public servant contact, many members of the APS did not know what their legal obligations were in such situations.

> "For example, we know that agency protocols require that oral briefing to Ministers or Ministers' staff on key issues is confirmed in writing (including emails or follow-up minutes). Nine large agencies reported in the 2004–05 State of the Service agency survey that they had this protocol in place, and yet between 37% and 66% of employees working in those nine large agencies who had had contact with their Ministers' offices were not sure whether their agency had such a protocol."

> "These people do not know whether they should be keeping records of their oral advice any more than new ministerial advisers may know whether they can ask that records not be kept. It is in situations like this that public servants can make the kind of poor decisions that come back to haunt us as 'politicisation'."

Traditional mentoring relationships that once existed between junior and senior public servants can no longer be relied upon to ensure a broad-based understanding of the protocols the APS was required to work within.

> “I hold it as a simple fact that we can no longer assume that the guidance that has been developed over time to apply to interactions between the political and the administrative arms of government will be assimilated and understood by APS staff before they are required to understand and apply that guidance.”

> “Due to the changing nature of public service work, it is no longer possible to rely on mentoring promising junior staff so that when they arrive at positions of leadership they know how responsiveness and apolitical professionalism are meant to work in practice. Junior staff are being contacted by ministerial advisers before they arrive at leadership positions.”

She said that it was also important that public servants understood the role they were required to play within the service.

> “I do want to make it clear, however, that public servants are neither political advisers nor consultants. As well as our roles and responsibilities, we have professional standards and a legislative basis for our employment that distinguishes us from both groups. If we do not understand and keep to those standards and to the law, then we have nothing to offer the Government that is not available elsewhere, and the public service has no future.”

The document, “Supporting Ministers, Upholding the Values” can be downloaded from the Australian Public Service Commission website .

Source: Address by Lynelle Briggs, 9/3/2006.

PUBLIC SECTOR

¶1078 Increased uncertainty prompts rethink of current PPP models

A new report from Deloitte in the United Kingdom claims governments must look beyond current models that focus on private financing to deliver large-scale projects, as these structures are unlikely to address all future infrastructure needs.

The report, looking at Private Finance Initiative (PFI) projects, known as Public Private Partnerships (PPPs), argues that a broader and more flexible range of approaches needs to be considered in order to deliver critical policy objectives.

Head of specialised finance at Deloitte, Michael Kerr, claimed that PFIs had enabled many projects to be delivered on time and to budget in the past, with Local Improvement Finance Trusts (LIFT) and Local Education Partnership (LEP) models extending some of the advantages of PFI into new areas.

> “However if Government infrastructure projects are to continue to be successful, greater consideration will need to be given to a wider range of approaches. There is increasing uncertainty over the way in which the provision of public services will be managed, and policy and accounting changes are putting increasing pressure on the current models used for their delivery.”

The Deloitte project noted that the PFI is best suited to large projects in conditions of relative certainty. Mr Kerr added that while the LIFT and LEP models can extend the reach of PFI, concerns have been expressed regarding their value for money due to a lack of competitive pressure. He noted in particular that there were significant risks from using either of these models where there is real uncertainty about the nature of future requirements.

> "Demands on infrastructure development are also changing. In many areas there is a need to carry out upgrades (rather than build from new), and implement infrastructure solutions, which are subject to considerable future risks and uncertainties (for example in technology or waste). These are areas in which PFI structures are either untested or may be unsuitable."

The Deloitte report analysed several new models, which are emerging to help address challenges currently facing the delivery of infrastructure projects. These included PFI schemes, in which the public sector underwrites some of the financial risk; variants on LEP/LIFT, which provide greater competitive pressure over time; and alliance and partnership models, which can respond better to ongoing uncertainties and changes.

> "The UK has been at the forefront of developing innovative models for the delivery of infrastructure projects. We should build on this through the inclusion of new models which reflect the changing environment in which these projects will be delivered", Mr Kerr said.

> "Policy makers need to support the development and use of these new models. Public sector managers and executives need to ensure they understand and review the full range of options available if they are to be successful in delivering public infrastructure successfully in the future. A key factor in determining their decisions should be the level of certainty they can have over their future requirements."

The report can be downloaded from the Deloitte website.

Source: Deloitte UK media release, 10/3/06.

EDITORIAL PANEL

Professor Bob Baxt AO; Colin Carter; David Gonski AO; Margaret Jackson AC; Dr Simon Longstaff; Dr Helen Nugent AO; John Phillips AO; Professor Ian Ramsay; Dr Peter Shergold AM.

IMPORTANT DISCLAIMER. No person should rely on the contents of this publication without first obtaining advice from a qualified professional person. This publication is sold on the terms and understanding that (1) the authors, consultants and editors are not responsible for the results of any actions taken on the basis of information in this publication, nor for any error in or omission from this publication; and (2) the publisher is not engaged in rendering legal, accounting, professional or other advice or services. The publisher, and the authors, consultants and editors, expressly disclaim all and any liability and responsibility to any person, whether a purchaser or reader of this publication or not, in respect of anything, and of the consequences of anything, done or omitted to be done by any such person in reliance, whether wholly or partially, upon the whole or any part of the contents of this publication. Without limiting the generality of the above, no author, consultant or editor shall have any responsibility for any act or omission of any other author, consultant or editor.

© 2006 CCH AUSTRALIA LIMITED

101 Waterloo Road, North Ryde, NSW 2113.

Postal address: GPO Box 4072, Sydney, NSW 2001.

Document Exchange: Sydney DX 812.

Head Office North Ryde Ph: (02) 9857 1300

Fax: (02) 9857 1600

CCH Customer Support Ph: 1 300 300 224

Fax: 1 300 306 224. For the cost of a local call anywhere within Australia.

All rights reserved. No part of this work covered by copyright may be reproduced or copied in any form or by any means (graphic, electronic or mechanical, including photocopying, recording, recording taping, or information retrieval systems) without the written permission of the publisher.