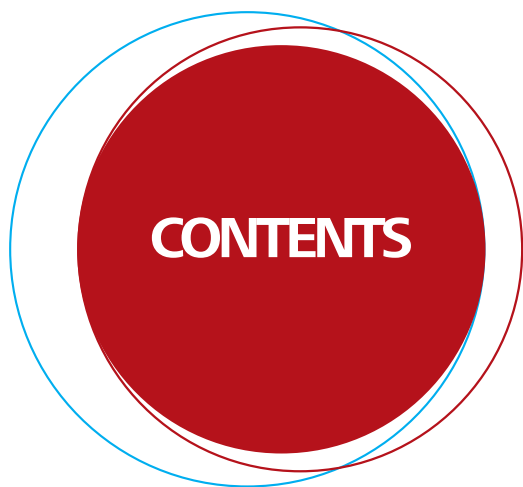


MALLESONS STEPHEN JAQUES



DIRECTIONS 2011

Current issues and challenges facing
Australian directors and boards



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INTRODUCTION

Australian directors and boards are at a crossroads. They face more challenges than ever before, in a world of ongoing market volatility, regulatory changes, increasing compliance burdens, and increasing demands for engagement by a range of stakeholders.

In times of actual or perceived crisis, there is a tendency to focus on governance issues in the search for the causes of market failures and investor losses, and to attach blame to directors as the visible face of the company. This reflects a widening expectation gap between the public perception of the proper role and capability of boards, and what they are actually able to achieve.

In December 2010 we undertook an online survey of directors to capture the current opinion of directors on a variety of issues. This report contains the results and our analysis of that survey.

Current hot topics such as diversity, risk management, director and management remuneration, and increasing personal culpability for breaches of law have dominated recent debate. However, these topics are pieces of the broader governance framework for the proper oversight and management of companies. The quality and commitment of individual directors, and their “fit” with the rest of the board and management, is a critical contributor to overall board effectiveness.

This report explores current issues and challenges facing Australian directors and boards in 2011:

- board composition, which examines the attributes required of directors and the diversity of the board;
- the role of boards and directors, which examines risk taking and risk management, as well as information flows and time commitments;
- the regulatory landscape, which examines regulatory and compliance burdens, as well as class actions;
- engaging with stakeholders, which examines communication challenges, the role of AGMs and proxy advisors;
- the outlook for 2011, including the opportunities and challenges for M&A activity.

Our report reviews the impact of the fallout of the global financial crisis on Australian directors and boards, and finds that the extent of the regulatory changes and the populist focus of reforms may have serious adverse consequences.

We hope that our report makes a useful contribution to the ongoing debate regarding the proper role and responsibilities of directors and boards in Australia.



Meredith Paynter

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KEY THEMES

Role of boards and directors

Directors should have a deeper safe harbour

Increasing potential personal liability for management actions

Information: "Volume is the killer"

Information should be clear, concise and lead to recommendations

Increasing time commitment

Expectation gap between what is expected and what directors can do

Regulatory and compliance issues demand too much of directors' time

Regulatory landscape

Piecemeal and populist reforms creating adverse consequences

Liabilities should relate directly to directors' obligations and capabilities

The continuous disclosure test is a key concern



Board composition

The most important criteria for board appointment is business acumen and experience

Diversity initiatives are a key focus

Need to develop pipeline: identifying and developing talent takes time

Engaging with stakeholders

It's time for an overhaul of the annual general meeting to make it relevant

Communication with stakeholders should be effective, engaging and modern

Dealing actively with a broader range of stakeholders

Outlook for 2011

Key issue: challenges identifying attractive opportunities

Concerns with implementation in a volatile market

M&A activity on the rise

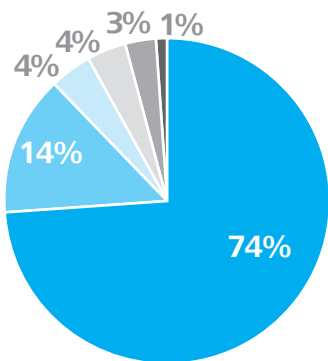
Escalating regulatory change and compliance burdens

Taking calculated risks is key to achieving shareholder returns

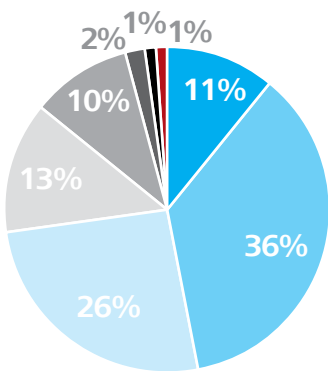
BOARD COMPOSITION

The most important criteria to board appointment is **business acumen**.

Important skills and knowledge a director may possess



Ranked 1st



Ranked 2nd

- Strategic/commercial acumen and business skills
- Industry knowledge/experience
- Financial management
- Risk management
- Communications and stakeholder management
- Legal skills
- Knowledge of political processes
- Specific regulatory knowledge

Board composition, and the related issues of board skill sets and diversity, have been the subject of renewed focus since the global financial crisis.

The ASX's Corporate Governance Principles and Recommendations (ASX CGPRs) provide that companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties. Recommendation 2.6 requires ASX listed entities to include in their corporate governance statement in their annual report an outline of the mix of skills and diversity which the board of directors is looking to achieve in the membership of the board.

Board skill sets

An appropriate skill set across board members is a critical component of board effectiveness, and is necessary for well informed oversight and decision making.

Strategic and commercial acumen and business skills considered most important

Survey respondents were asked to rank in order of importance a list of different skills, knowledge and experience that a director may possess. Although what constitutes an appropriate skill set for a particular board may be, to a degree, industry and entity dependent, some clear themes and consistency of views emerged from the survey results.

Perhaps unsurprisingly, an overwhelming 74% of survey respondents ranked "strategic/commercial acumen and business skills" as the most important qualities that a director may possess, with 36% of survey respondents ranking "industry knowledge/experience" as the second most important attribute. "Financial management" was ranked as the third most important attribute, followed closely by "risk management" and "communications and stakeholder management".

The qualities considered least important by survey respondents were specific regulatory knowledge, knowledge of political processes and legal skills.

The ranking of attributes for directors illustrates a fundamental difference between the more desirable "general" business and commercial skills, knowledge and experience of the individual, and specific technical or professional skills and knowledge which can be accessed through management and/or external advisers and consultants. These "general" attributes are important in assisting a director to properly discharge their duties to oversee the strategic direction, and the management and operations, of the company, and to make decisions. None of these functions can typically be "outsourced". In considering desirable attributes for a director, one survey respondent noted that a "devil's advocate role is important and even beneficial in terms of transparency, risk response and public perception".

We would expect that the key exception to this delineation of attributes relates to a director having a level of financial and accounting skills and experience.

Leadership, clear thinking and teamwork also important

Of the 39% of survey respondents who considered qualities outside of those noted above to be important, the most commonly cited were:

- leadership skills and "decision making experience in high stakes environments";
- corporate governance skills;
- teamwork and "team IQ" - both at board level and with management;
- negotiation skills; and
- human resource management skills and experience.

These attributes reflect the importance of directors being able to work effectively together, and with management, in order to discharge their duties.



*“Diversity is about gender, race, religion, and all of the things we normally consider when we hear the word diversity; but it is also about **unique experiences, expertise, fields of study, and other factors** that contribute to new ideas and innovation of solutions...”*

The survey results illustrate one of the key challenges to achieving greater diversity on boards in the near future. If the attributes of “strategic/commercial acumen and business skills” and “industry knowledge/experience” are widely considered to be the most important attributes that a director should possess, the relative scarcity of women with private sector senior management or line reporting experience would seem to be a key factor contributing to the perceived lack of female board candidates with the experience and skills considered necessary by existing directors.

Diversity

Research published in recent years by various bodies, including the Corporations and Markets Advisory Committee (CAMAC), the Commonwealth’s Equal Opportunity for Women in the Workplace Agency (EOWA) and the Productivity Commission, has identified a significant lack of diversity at board level in Australia. For example, the EOWA 2010 Census of Women in Leadership found that, compared with New Zealand, UK, Canada, US and South Africa, Australia had the lowest percentage of women on boards (as at 30 April 2010). The findings also showed that the percentage of board seats in the ASX 200 companies held by women had barely changed since 2004.¹

This has fuelled public debate by key political and shareholder groups and the media, and made diversity a high profile corporate governance issue in 2010.

Do we have a meaningful definition of “diversity”?

When asked their views on what constitutes a meaningful definition of diversity, approximately 60% of survey respondents commented that diversity encompasses differences in backgrounds, qualifications and experiences, and also to differences in approach and viewpoints. While diversity includes gender, age, ethnicity and cultural background, the focus in commentary and in the ASX CGPRs has been on gender diversity. We presume this emphasis is because gender is the most readily identifiable and quantifiable aspect of diversity, compared to other measures of diversity.

A lack of diversity considered to be detrimental...

Research is mixed as to whether having a more diverse board will lead to improved corporate performance:

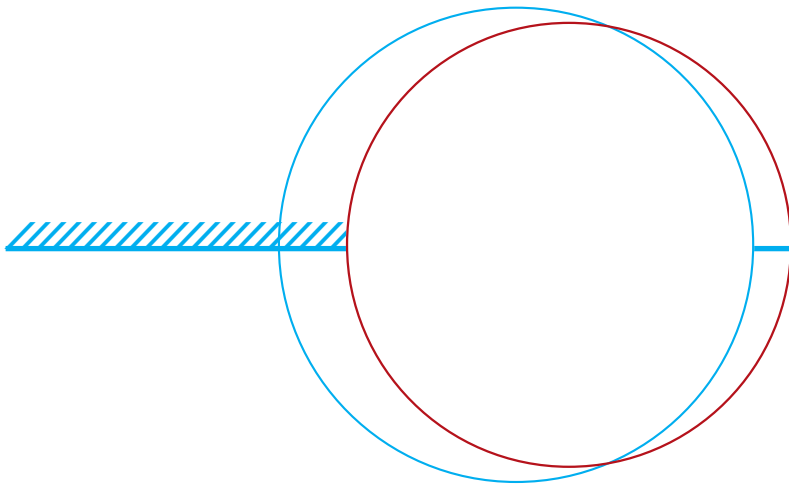
- A Goldman Sachs report suggests that achieving gender balance in the workforce could increase Australia’s GDP by 11%, and cited a 19 year study of 215 Fortune 500 firms which showed a clear correlation between a strong record of promoting women into the executive suite and high profitability.²
- However, some commentators have questioned whether there is in fact any reliable data or analysis supporting the existence of a systematic relationship between diversity and the performance of the board, arguing that business and industry knowledge (and not diversity) of the directors is the dominant factor influencing board performance.³

The views of our survey respondents were also mixed.

¹ The EOWA 2010 Census counted the number of male and female board directors and executive key management personnel in the ASX 200 companies (as at 30 April 2010). The EOWA 2010 Census Report notes that: (a) women chair 5 boards and hold 8.4% of Board Directorships in ASX 200 companies in 2010 compared with 8.3% reported in the 2008 Census (b) percentage of companies with no women directors has increased from 51.0% in 2008 to 54% in 2010 (c) women hold 6 CEO positions in 2010 compared with four in 2008 and 8% of executive key management personnel positions in ASX 200 companies compared with 7% in 2008.

² Goldman Sachs JBVere, *Australia’s Hidden Resource: The Economic Case for Increasing Female Workforce Participation* (Research Report, 2009).

³ See for example Bill Mountford ‘Diversity doesn’t drive shareholder wealth’, *Australian Financial Review*, 26 June 2010.



Is there a lack of diversity on Australian boards?

55% believe that there generally is a lack of diversity

39% believe this to be true of their own boards...

When asked their views on the impact of diversity, 55% of survey respondents were of the view that there was a lack of diversity on boards and in senior executive positions which is detrimental to corporate performance in Australia, 26% of survey respondents considered that there is currently sufficient diversity, and 19% of survey respondents were unsure.

Additional comments provided by survey respondents demonstrate a view that while achieving diversity should assist with achieving an objective that *“Boards and senior executive composition should reflect satisfactorily the gender, ethnic background and geographic mix of their constituencies - their staff, their customers, the communities in which they work and serve”*, with the result that debate and decision-making is more robust and *“the risk of ‘group think’ is minimised”*, such diversity should be relevant to the company. Selection criteria for directors based on diversity objectives such as gender, age, ethnicity or cultural background should not be pursued at the expense of other attributes which enable directors to properly discharge their duties.

Regardless of whether there is a direct link between diversity and corporate performance, it is generally accepted that achieving greater diversity is important to ensure that the pool of potential available talent is not wasted. The Productivity Commission’s 2009 inquiry into Executive Remuneration in Australia reported that the lack of diversity in the membership of Australia’s boards, particularly the low level of female participation, indicated that many companies were not adequately utilising available talent.⁴ CAMAC also noted in its 2009 report “Diversity on Boards of Directors” that the lack of diversity raises significant questions about the possible wastage of valuable talent.⁵

Steps to improve diversity - any progress in 2010?

On 30 June 2010, the ASX Corporate Governance Council responded to the diversity debate by introducing various amendments to the ASX CGPRs, including three new recommendations (with a focus on gender diversity):⁶

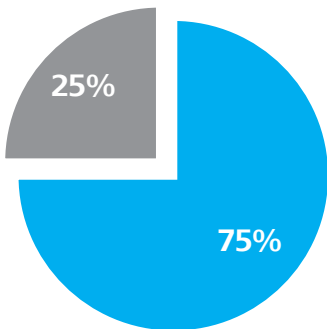
- that companies should establish a diversity policy and disclose the policy or a summary of the policy. The policy should include requirements for the board to establish measurable objectives for achieving gender diversity, and to assess annually both the objectives and progress in achieving them (Recommendation 3.2);
- that companies should disclose in each annual report the measurable objectives for achieving gender diversity set by the board in accordance with the diversity policy and progress towards achieving them (Recommendation 3.3); and
- that companies should disclose in each annual report the proportion of women employees in the whole organisation, women in senior executive positions and women on the board (Recommendation 3.4).

However, published data regarding whether there has been any progress on improving gender diversity on Australian boards in 2010 is mixed.

74% of survey respondents indicated that an organisation of which they were a director had made a board appointment in the last 12 months, with:

- 34% indicating that all of those appointments increased board diversity;
- 41% indicating that some of the appointments increased board diversity; and
- 24% indicating that none of the appointments increased board diversity.

Have you made any appointments to increase diversity?



- 75% Yes
- 25% No



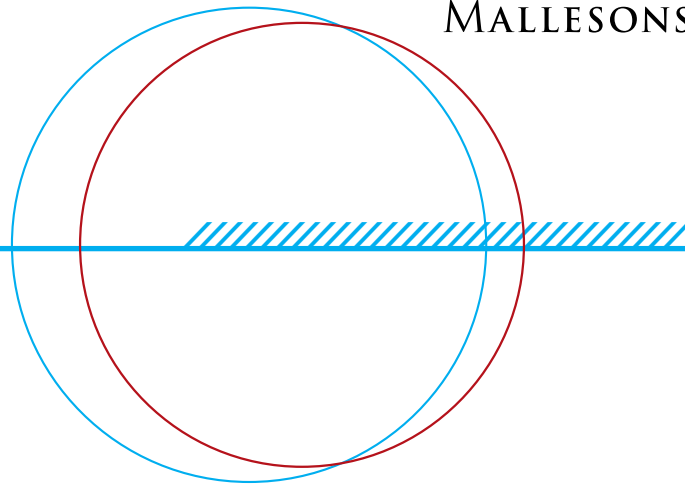
34% noted that ‘all appointments made increased board diversity’

41% noted that ‘some of the appointments made increased board diversity’

⁴ See: www.pc.gov.au/_data/assets/pdf_file/0008/93590/executive-remuneration-report.pdf

⁵ See: [www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2009/\\$file/Board_Diversity_B5.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2009/$file/Board_Diversity_B5.pdf)

⁶ These recommendations apply to a listed entity’s first financial year commencing on or after 1 January 2011.



The survey results are consistent with research released by the Australian Institute of Company Directors (AICD) in November 2010, which showed that in 2010 (to November), a total of 27% of appointees to ASX 200 boards were female, compared with 5% of appointees in 2009.⁷

How should female talent be identified and developed?

Early identification and development of female talent is clearly of significant importance in ensuring that there is a sufficient pipeline of appropriately qualified and experienced female candidates available for consideration when board positions become available. The current attrition rate for females in the workforce, particularly in listed companies, is regarded as being a key contributor to the current lack of female talent in senior management ranks, and therefore impacts upon the availability of suitably qualified and experienced female candidates for appointment to boards.

Survey respondents were asked their views on the most important areas for the identification and development of female talent for inclusion on boards.

In relation to areas for **identifying** female talent, 57% of survey respondents thought that "identification of talent in management ranks" was the most important area, 18% of survey respondents thought that recruiting from professional pools was the most important, and 10% of survey respondents considered networking/alumni organisations to be most important. 14% of survey respondents considered that other areas were the most important, with the responses suggesting that there needs to be a broader approach to identifying and evaluating candidates. This was reflected in comments such as:

"Willingness to broaden pool to ensure high calibre women are included in selection process."

⁷ Australian Institute of Company Directors, media release "Directors welcome a year of improvement in board diversity" (24 November 2010)

Areas for IDENTIFYING female talent for inclusion on boards...	%
Identification of talent in management ranks	57%
Recruiting from professional pools	18%
Networking/alumni organisations	10%
Recruiting from government	0%
Other (please specify)	14%

Areas for DEVELOPING female talent for inclusion on boards...	%
Undertaking management roles within organisations	34%
Early development training programs within organisations	18%
Executive mentoring relationships	17%
Non-executive director mentoring relationships	16%
Workplace practices that accommodate flexible working arrangements	4%
Business coaching	3%
Other (please specify)	8%

In relation to areas for **developing** female talent, 34% of survey respondents thought that undertaking management roles within organisations was the most important area for developing female talent. A similar number of respondents considered each of early development training programs within organisations (18%), executive mentoring relationships (17%) and non-executive director mentoring relationships (16%), to be the most important areas for developing female talent.

*“Unbiased evaluation of needs and talent judged on merit, **not patronage or mateship.**”*

*“...there are **more than enough** appropriately qualified and experienced people...”*

However alternative views were also expressed - *“I do not think that there is a need to specifically develop female talent ... it should be a question of the **best person for the position, I think there is sufficient female talent out there for board positions.**”*

Pipeline a key challenge for diversity

These results, and survey respondents' views on key director attributes, are consistent with the broad consensus from commentators and industry participants that one of the biggest challenges to improving board diversity is addressing gender disparity at the senior executive level and increasing the representation of women in senior management ranks. The AICD noted in November 2010 that *“one area where further work is needed is building the pipeline of women available for future board positions, particularly by addressing the obstacles to women gaining positions in senior management ranks that could prepare them for future directorship roles and also removing obstacles to women remaining in such positions”*.⁸

Our survey results support the proposition that a significant majority of companies look for new director appointees who have listed company CEO or CFO experience. This selection criteria would automatically rule out a large percentage of potential female candidates who are under-represented in these management positions.

It also highlights the importance of initiatives such as the 'C-Suite' Project, which was launched by the Business Council of Australia (BCA) in March 2010 with the aim of increasing the number of female CEOs and CFOs in the ASX 200 companies. This initiative involves leading CEOs mentoring high-achieving women employed by other BCA member companies.

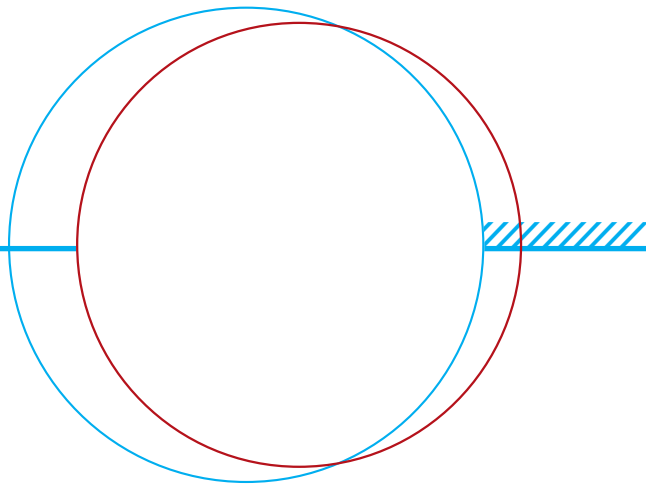
Support for diversity... but limited support for measures beyond ASX reporting obligations

Despite the majority of survey respondents agreeing that there is a lack of diversity on boards and in senior executive positions which is detrimental to corporate performance in Australia, **62% of survey respondents indicated that they would not support measures beyond ASX's "if not, why not" reporting obligations to improve board diversity** if current levels do not increase. Of the 38% of survey respondents who indicated that they would support additional measures, the measures most commonly proposed related to quota requirements or mandated numbers. There seems to be a preference to improve diversity on boards through a focus on improving diversity in senior management roles and through mentoring.

Some commentators are of the view that the ASX approach may be insufficient to improve diversity on boards. In response to the introduction of the new ASX CGPRs in relation to diversity, the Australian Human Rights Commission recommended that, if *“after five years, there is a lack of substantial progress, the Australian Government should consider introducing mandatory gender quotas for boards, at least on ASX publicly listed companies, with penalties for failing to meet quotas within a specified period of time.”*⁹ Whilst many commentators here and overseas have argued that the introduction of a quota system will detract from a system of meritocracy, others argue that without such a quota system, no substantial changes will be seen. Figures from the European Professional Women's Network's survey on the representation of women on European boards showed that of the top 300 European companies in 2008, 9.7% had women on their boards, versus 8.5% in 2006 and 8% in 2004.

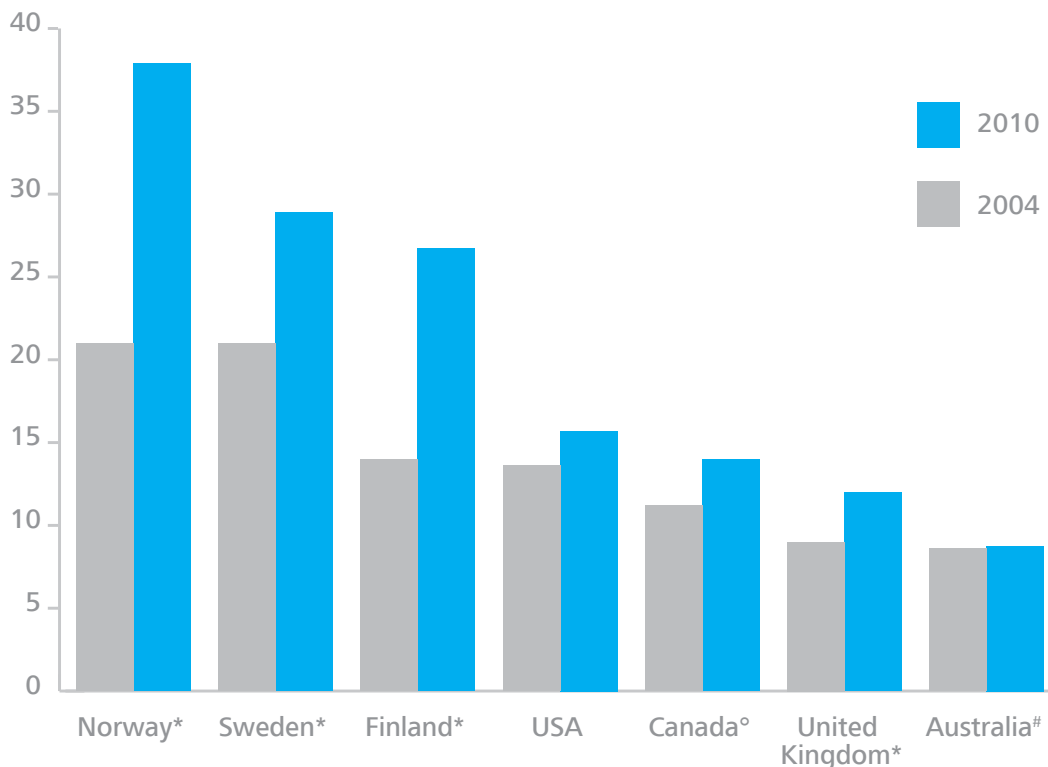
⁸ Australian Institute of Company Directors, media release “Directors welcome a year of improvement in board diversity” (24 November 2010)

⁹ Australian Human Rights Commission, Submission to the Australian Government office for Women, Review of the Equal Opportunity for Women in the Workplace Act and Agency, November 2009 at: www.hreoc.gov.au/legal/submissions/2009/20091030_EOWA.html



European countries such as Norway, Sweden, Finland and now France, who found that voluntary reporting measures were insufficient to bring about change, have introduced a quota system. The number of female directors jumped to 44.2% in Norway in 2008, and then levelled to 37.9% in 2010 following the introduction of quota legislation. Similarly, in Sweden, the number jumped to 25.6% and in Finland, the number moved to 25.2%. Interestingly, in Norway, Sweden and Finland, following the introduction of quota legislation mandating that at least one woman should be on the board, the average number of women on boards has exceeded three per board, which suggests that these countries have moved away from mere tokenism in the representation of women on boards.

Female board members by country



* Based on figures from the European Professional Women's Network (Top 300 companies by market capitalisation)
 # Based on information from Equal Opportunity for Women in the Workplace (based on ASX200)
 ° Based on Fortune 500 results in the Catalyst Census, *Women Board Directors*, December 2010

ROLE OF BOARDS AND DIRECTORS

Risk taking and risk management

There is a widening expectation gap between the public perception of the proper role and capability of boards and what they are actually able to achieve.

In particular, the role of directors in relation to the oversight and management of risk, their relationship with management, and the increasing time commitment required from directors to enable them to properly discharge their duties, are all topics which were the subject of substantial media comment in 2010.

The global financial crisis has highlighted the risks faced by individuals who assume the role of directors, and has led to a renewed focus on risk taking and risk management.

Has the global financial crisis made boards too risk averse?

Interestingly, 56% of survey respondents indicated that they considered that the global financial crisis had made boards too risk averse.

This highlights the need for companies to take a balanced approach to risk. While minimising and managing risk is important, a level of calculated risk taking by an organisation is essential in creating value. This requires an accurate assessment of the nature and level of risks that a company can safely assume and manage, and an appropriate understanding of the risks faced. In this regard, it has been noted that, while some organisations are taking a more conservative approach to risk taking, those which have been able to show organisational resilience through the economic downturn may be retaining, or even increasing, their risk profile.¹⁰

The importance of maintaining adequate risk management systems is recognised by ASX in

Principle 7 of the ASX CGPRs, which provides that companies should establish a sound system of risk oversight and management and internal control. The commentary to Principle 7 states that risk management can *“enhance the environment for identifying and capitalising on opportunities to create value and protect established value”*.

However, while establishing risk management systems and policies is essential, they will not provide adequate oversight of, and protection against, risks if the implementation of those systems and policies is lacking or the culture of the organisation does not support implementation. Companies should aim for a culture that encourages a high degree of transparency that promotes an open discussion of both good news and bad news, and a preparedness to question and challenge the accepted view, and the status quo.

Significant upgrades to risk management capabilities undertaken in 2010

This renewed focus on risk management is supported by the survey results, with 74% of survey respondents indicating that an organisation of which the respondent was a director had undertaken significant upgrades to internal risk management capabilities in 2010. These upgrades included:

“External reviews; more extensive peer reviews; more regular reviews; fully integrated into the strategic frameworks of the company.”

“...framework and processes where all types of risk can be uniformly assessed and then qualified and quantified. Risk mitigation strategies can then be developed and put in place.”

A potential issue with risk management through the engagement of internal and external risk management professionals and the use of risk management committees, is whether the management of business risks becomes too diffused (and uncoordinated), and whether risk management is better handled by the board. Clearly boards and risk professionals have different roles to play. The

“Defining the risk appetite and risk assessment frameworks.”

¹⁰ For example, see comments made by Brian Roylett of RMIA at: www.rmia.org.au/LinkClick.aspx?fileticket=LAuK1k3JF28%3D&tabid=103&mid=632 (Media Release, December 1, 2009).

*“Information that is **concise** and that **clearly articulates** the issues that the Board needs to focus on rather than verbose and dense epistles.”*

board’s role is to oversee the organisation’s policies, systems and culture - its organisational capacity - to ensure that risks and risk taking can be appropriately identified and managed, whereas the implementation of risk management systems and policies to identify, assess and manage specific risks and manage compliance issues more appropriately, fall to the risk professionals.

Information flows

Directors, and non-executive directors in particular, rely on the integrity and diligence of senior management for the quality and quantity of the information they receive in order to enable them to properly discharge their duties.

A breakdown in communications between directors and management, overloading a board with information, or the [selective filtering or presentation of information](#), are often cited as key issues contributing to corporate collapses and, in some circumstances, leading to allegations of breach of law or duty or in claims for civil redress.

A company which does not have a properly functioning board and governance structure may be able to operate successfully for a period, but cracks inevitably appear when economic and business conditions become more challenging, as evidenced during the global financial crisis.

As highlighted in the Economic Intelligence Unit’s Report “Beyond Box Ticking - A new era for risk governance”, a broader risk issue arises if the right information is not reaching the right people.¹¹

Management does provide sufficient information - but what constitutes quality information?

When survey respondents were asked whether, in their experience, management provided sufficient information to boards to enable directors to make informed decisions, a majority (65%) thought that

management provided an appropriate level of information and 19% considered that management provided too much information. Only 13% of survey respondents considered that management provided too little information.

However the quality of the information provided is also of significant importance. When survey respondents were asked what constituted quality information to assist in executing their duties as a director, a consistent theme running through responses centred around information that was clearly and concisely presented and that made clear recommendations.

Directors are looking for:

“Timely financials; crisp business performance summaries, and exception-based reporting for compliance issues. On projects and transactions, access to full documentation and reports.”

“Information that provides sufficient analysis that leads to a recommendation, and which also reflects industry comparisons and sets out main options etc.”

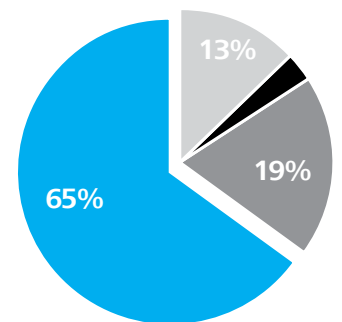
“Honest open warts and all.”

The Chairman has overall responsibility for ensuring the information flow to the board is comprehensive and that the board is kept properly informed. He or she also acts as a key conduit between management and the board, helping them to develop a constructive relationship.¹²

Therefore, [if a board considers that they are not receiving an appropriate and effective flow of information from management, the Chairman is responsible for attempting to rectify that situation.](#)¹³

For example, a Chairman may begin with a frank discussion with management. They might also consider constructively raising opportunities to train employees in the preparation of clear, concise and effective board packs, and encouraging board members, particularly

Does management provide sufficient information upon which to make informed decisions?



- 65% Appropriate level of information
- 19% Too much information
- 13% Too little information
- 3% Not sure

“Volume is the killer”

¹¹ Report from the Economic Intelligence Unit of The Economist; ‘Beyond Box Ticking - A new era for risk governance’, May 2009

¹² AICD Law Committee: Duties of the Chairman 31 March 2005

¹³ Report of the Royal Commission into the Failure of HIH Insurance 2003: Justice Neville Owen at 6.2.1

non-executive directors, to meet outside of formal board and committee meetings to discuss issues that may not fall within the formal meeting agenda.¹⁴

Time commitments

The commentary to Principle 2 of the ASX CGPRs identifies that an important issue when considering the selection and appointment of directors and assessing performance is that individual board members *“should devote the necessary time to the tasks entrusted to them. All directors should consider the number and nature of their directorships and calls on their time from other commitments”* and that the nomination committee *“should regularly review the time required from a non-executive director, and whether directors are meeting that requirement”*.

Commentary in recent years has consistently observed an increase in the time commitment required from both executive and non-executive directors. A 2008 Deloitte report on board effectiveness noted that the *“amount of time that non-executive directors are spending on the job has skyrocketed. Most board members participate in some 40 plus meetings a year, once committee and M&A activities are included”*.¹⁵

The survey results show that **directors are spending between 5 and 20 hours per board per month on board commitments**, but that figure increases dramatically in exceptional circumstances (for example, when a significant transaction is on foot), with more than one-third of respondents spending more than 30 hours per month on board commitments during those times.

A by-product of the level of time commitment required by directors is a view that there should be a limit on the number of board seats occupied by

individual directors so as to ensure they have the capacity to devote appropriate time and effort to their board and committee duties. The Australian Shareholders Association (ASA) has commented that *“[t]here is ample evidence of under-performance and inadequate supervision of companies whose directors have been unable or unwilling to give the time commitment necessary to execute their important roles. Too often this is because the number of companies with which individuals are involved as directors exceeds their capacity to do justice to all of them.”*

The Australian Shareholders Association’s position on non-executive directorships is that *“no person should hold more than five equivalent directorships. For this purpose, a position as chair is taken to be the equivalent of two directorships”*.¹⁶ This raises a broader dilemma for governance and directors, particularly non-executive directors. Firstly, companies should identify the most valuable contributions that a director can make to a company, and where a director’s time and effort is best directed.

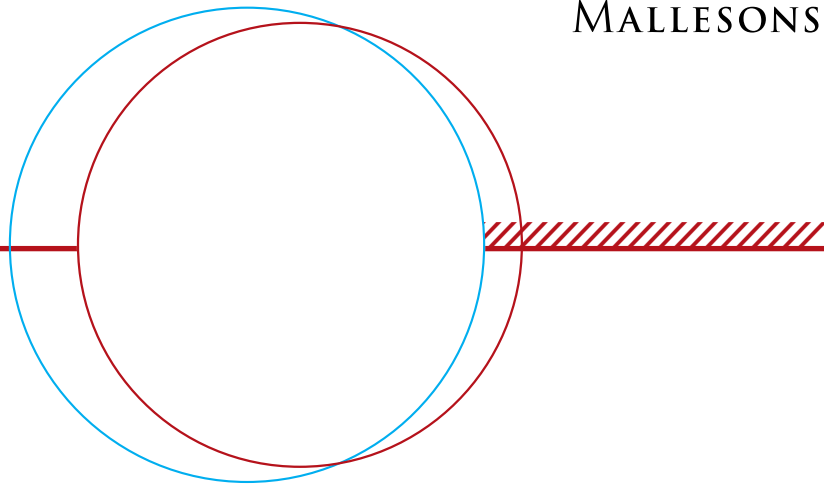
Survey respondents noted that a key challenge is “keeping abreast of change” and “dealing [with] the ever increasing compliance requirements”.

To the extent that directors are needing to spend time and effort understanding and managing these issues (and the associated risk of personal liability in the event of a compliance breach) they have less capacity to make contributions in other areas, such as in the development and assessment of growth strategies. This, arguably, is not the best approach for maximising shareholder returns.

¹⁴ Board Effectiveness and Performance - The State of Play on Board Evaluation in Corporate Australia and Beyond (October 2010), Centre for Corporate Governance, University of Technology, Sydney (Study commissioned by the Australian Council of Superannuation Investors),

¹⁵ Deloitte Report “Board Effectiveness: The Directors Cut”, Edition 1, 2007-2008, p 13.

¹⁶ ASA Policy Statement “Non-Executive Directorships” as amended on 15 September 2005.



Secondly, **at what point do the burdens and the risks of personal liability and reputational damage associated with acting as a director outweigh the benefits of acting as a director?** There is certainly an argument that non-executive directors should be better compensated to reflect the value of their contributions to an organisation (including the amount of time and effort that they need to commit to their role and the limited number of director positions that a director can hold at one time) and to ensure that individuals with the requisite skills and experience continue to be attracted to board positions.

Special duties of individuals at odds with collective action

While directors act collectively as a board, each director owes individual duties to the company as a whole.

This tension is highlighted by the prospect that the standard required to be met by an individual director in order to discharge their duties may differ from the standard applicable to a fellow director of the same company, or a director of a different company.

This is because the degree of care and diligence required of each director will be *“the degree of care and diligence that a reasonable person would exercise if they:*

- *were a director of a company in the company’s circumstances; and*
- *occupied the office held by, and had the same responsibilities within the company, as the director.”*

This assessment will be made not only on the basis of company specific factors such as:

- the size and business of the company;
- the company’s financial affairs;
- the urgency and magnitude of any problem;
- the company’s constitution; and
- the composition of its board,

but also factors particular to the individual director. Such factors include the responsibilities of the director within the company (both formally delegated by the board and informally assumed in the factual circumstances of the company) and, more broadly, the experience or skills that the director brings to their office, whether or not the director was appointed to the board specifically for possession of such expertise or skills.

At the same time, it is important to note that although special qualifications or a special responsibility within the company will be relevant to determining the scope of the duty of care, a director appointed because of special expertise in a particular area will not be relieved of the duty to pay attention to the company’s affairs falling outside that particular area.

Accordingly, directors with a background in a particular field need to be especially vigilant with respect to matters coming before the board which relate to their particular skills and background.

This characterisation of the duties of a director creates uncertainty as it is difficult in practice for an individual to positively assure themselves that in any particular circumstance they have fully discharged their duties. We consider there is room for dialogue about whether these differential standards recognise the practical reality of collective decision making and responsibility for board decisions.



REGULATORY LANDSCAPE

Since the onset of the global financial crisis, there has been a marked increase in regulatory change affecting companies and business, including as a result of regulatory changes in the US and the UK. This global re-regulation trend is arguably not surprising given that one of the key findings of the recently released Financial Crisis Inquiry Report found that *“dramatic failures of corporate governance and risk management at many systematically important financial institutions were a key cause of this crisis”*.¹⁷

The regulatory landscape is currently marked by three features:

- **regulatory reform** - governments around the world, including Australia, are undertaking numerous, and significant, regulatory reforms aimed at addressing perceived or actual gaps in the oversight of business and companies in order to better protect the community and the economy. Interestingly, much of this reform involves legislative change and potential criminal liability for breaches, rather than the introduction or amendment of best practice guidelines (such as the ASX CGPRs);
- **scrutiny from regulators** - increased levels of investigation and enforcement actions by regulators such as the Australian Securities & Investments Commission (ASIC). In particular, there has been a focus on compliance by, and enforcement against, listed companies in respect of their continuous disclosure obligations under ASX Listing Rule 3.1; and
- **private enforcement actions** - there has been an increase in private enforcement actions against companies through the rise of class actions,¹⁸ particularly shareholder class actions as disgruntled investors seek to recoup investment losses.

¹⁷ Financial Crisis Inquiry Committee, “Financial Crisis Inquiry Report”, January 2011.

¹⁸ Product liability class actions, such as Vioxx and the potential action against Vodafone, have been around for a while and we have also seen some cartel class actions against airlines.

Regulatory and compliance burdens

With the heightened focus on regulatory reform and enforcement, companies and directors have had frequent and ongoing regulatory and compliance issues to attend to in recent years. While reform may be necessary or desirable in many circumstances, it brings with it increased burdens on companies and business. In particular, their boards and senior executives are required to dedicate time and resources to understand, and then comply with, the new or changed requirements, and any related recording, monitoring and reporting obligations.

Directors are confronted with many varied regulatory burdens

When asked to rank the top 5 compliance issues which have been of most concern to directors in the past 12 months, the most commonly cited by survey respondents were financial reporting compliance and disclosure (79%), workplace and employee issues (including OH&S issues) (64%), regulating/implementing internal controls (64%), industry-specific regulatory compliance (62%) and continuous disclosure compliance (55%).

The nomination of financial reporting compliance and disclosure as the issue most survey respondents included in their top 5, together with the high ranking of regulating/implementing internal controls and continuous disclosure compliance, is a likely reflection of the uncertainty of outlook for markets and business performance as we emerge from the global financial crisis.

These results also tell a story of directors having many varied challenges and regulatory burdens which they have had to consider over the last year. In particular, directors have devoted significant amounts of time to monitoring and understanding the impacts of regulatory changes.

*“The regulatory pendulum swinging towards **excessive, mindless and indiscriminate** regulatory interference in “good” businesses”*

What are the Top 5 compliance issues of most concern?	Ranked 1st	Ranked top 5
Financial reporting compliance and disclosure	23%	79%
Industry-specific regulatory compliance	19%	62%
Continuous disclosure compliance	18%	55%
Workplace and employee issues	13%	64%
Regulating/Implementing internal controls	11%	64%
Compliance with ASX Corporate Governance Principles and Recommendations	6%	41%
Remuneration disclosure obligations and impact of security holder vote	4%	38%
Tax compliance	3%	35%
Environmental issues, including carbon emissions policies	1%	30%
Product liability/consumer law issue	1%	18%
Trade Practices (antitrust) compliance	1%	11%

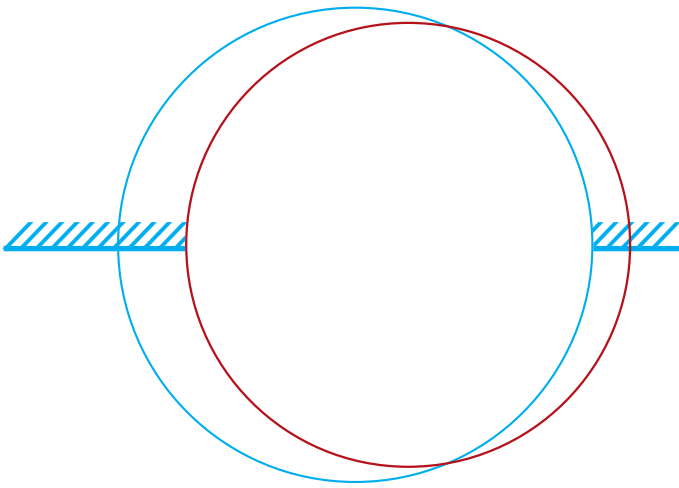
This was reinforced in the responses given by survey respondents to the question regarding their biggest challenge in 2011, with a large number of the survey respondents citing regulatory change. Within these responses, two common themes emerged. First, that directors are dealing with frequent regulatory change.

Responses such as “keeping up to date with changing regulatory and reporting rules” and “keeping up with the pace, and practical implications, of change” were prevalent.

Second, there was a clear sense of frustration that much of the regulatory reform has been carried out in a piecemeal fashion, with attention focused squarely on addressing specific topical or populist issues rather than looking at the broader picture. Statements such as *“ridiculous and meaningless governance and reporting requirements”* and *“uninformed global regulatory change”* captured the tenor of these types of responses.

This reflects a broader concern that there has been a lack of transparency and genuine consultation with the business community in proposing and implementing the current wave of reforms, and that many of these reforms will have unintended and adverse consequences for business.

For example, the proposed reforms relating to director and executive remuneration, which include the introduction of a “two-strikes” test for directors in respect of a “no” vote regarding



a company’s remuneration report and a new regime for the use of remuneration consultants overseen by non-executive directors, raise a number of significant issues regarding their workability and broader implications for governance and the allocation of responsibilities between directors and management.

What would help?

When asked what regulatory change would make the most significant improvement to their role as a director, the broadening of the business judgment defence was cited by 46% of survey respondents. The current formulation of that defence is contained in section 180(2) of the Corporations Act. In addition to the existing requirements that the director:

- make a judgment in good faith and for a proper purpose;
- not have a material personal interest in the subject matter of the judgment;

- inform themselves about the subject matter of the judgment to the extent appropriate; and
- hold a rational belief that the judgment is in the best interests of the company,

industry bodies have suggested that a culpability element should be introduced into the rule. Many hold the view that negligence is the appropriate default standard for civil matters not involving a breach of fiduciary duties. Moreover, a more productive reform for directors would be one that removes any doubt that they do not bear the onus of proof when relying on the business judgment defence, particularly as it appears this was the parliamentary intention when the defence was first introduced.¹⁹ Mallesons and the Law Council of Australia have lobbied unsuccessfully on many occasions for a suitable revision of the “safe harbour” provisions under the Corporations Act, and an expansion of the business judgment defence, to bring Australia into line with existing overseas provisions.²⁰

Pursuant to early general law, it is clear that directors need not personally perform every task within the scope of their duties. Section 198D of the Corporations Act makes it clear that the directors of a company may delegate any of their powers to an employee of the company or any other person, unless the company’s constitution provides otherwise. However, if the directors delegate powers to such a person, they are responsible for the exercise of the power by the delegate as if the power had been exercised by the directors themselves.²¹ Most company constitutions also reflect this position.

This concept of directors being responsible for the actions of management is also reflected in some pieces of State and Territory legislation, such as the Occupational Health and Safety (OHS) laws, pursuant to which directors are deemed to have

Which regulatory changes would make a significant improvement to your role as a director?	%
Introducing a broader business judgment defence	46%
Relaxing directors duties in relation to responsibility for management actions	14%
Streamlining OH&S systems across all States and Territories	12%
Relaxing the ‘immediate’ timeframe for continuous disclosure	7%
Relaxing directors duties in relation to insolvent trading	6%
Simplifying disclosure requirements relating to remuneration	6%
Relaxing insurance and indemnification restrictions	2%
Increasing regulation of proxy advisers	2%
Relaxing ACCC merger review processes	2%
Other	3%

¹⁹ We note paragraphs 6.1-6.10 of the Explanatory Memorandum to the Corporate Law Economic Reform Program Act 1999 (Cwth)
²⁰ For example, the United States’ formulation of the business judgment rule, as derived from case law.
²¹ Pursuant to section 190 of the Corporations Act. That provision extends a director’s liability to the conduct of his or her delegate beyond the position at general law, with only very limited exceptions.



committed the same offence as the relevant company, unless they can make out certain limited defences - in effect, there is a reverse onus of proof and elements of individual fault or actual involvement in the breaches are not necessary to establish an offence.

All of this means that as a matter of law, **directors may have potential responsibility and personal liability for operational and compliance matters which are practically undertaken and overseen by management.** We question whether this is fair in light of the strategic oversight role and actual capability of boards, and we suggest that it is a contributing factor to the widening expectation gap between what directors can do, and what the general public considers them capable of doing as regards day-to-day management and supervision of the company.

The survey shows that 14% of respondents considered, as a priority second only to the introduction of a broader business judgment defence, that the responsibility of directors for actions of management should be relaxed; this would involve **revisiting and revising sections 190 and 198D of the Corporations Act**, and would involve an amendment to corresponding articles in relevant company constitutions.

Continuous disclosure

When a matter arises which may require disclosure under the continuous disclosure regime set out in ASX Listing Rule 3.1, directors must consider whether disclosure is required and, if so, what needs to be disclosed and when the company needs to make that disclosure. Further, in light of recent decisions such as *James Hardie*, *Citrofresh* and *Fortescue Metals*, directors have become increasingly concerned about personal liability arising from alleged defective disclosure.

Determining whether disclosure is required under the continuous disclosure regime is a key concern for directors

When making an assessment as to whether information must be disclosed, directors are required to consider whether the information is material and price sensitive, and whether the exception to disclosure is available. In many circumstances, the decision becomes a judgment call for the directors and management.

Case law such as *James Hardie*, *Citrofresh* and *Fortescue Metals* make clear that the existence of compliance procedures and systems in relation to a company's disclosure obligations will be of utmost importance.

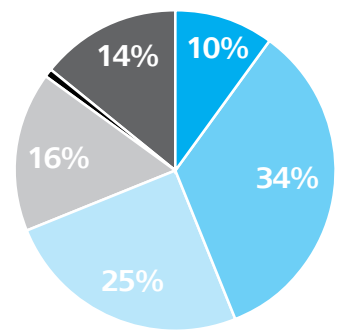
When asked whether, as a result of the continuous disclosure regime, companies disclose items that are too uncertain or are unlikely to be material, 10% of survey respondents said that this occurred "often", while 34% said "sometimes" and 25% said "occasionally". Just 16% said "rarely" and 1% "never".

This suggests that, where a company has information which is not clearly material and there is a question as to whether it should be disclosed, **companies are erring on the side of disclosure.** Where this is the case, there is a risk that companies are disclosing information that is not material and which is of no benefit to the market, or they are disclosing information prematurely which may create a false or misinformed market.

The requirement to "immediately" disclose should be relaxed to "as soon as practicable"

The words of ASX Listing Rule 3.1 state that disclosure should be made "immediately". The purpose of this requirement is to ensure that all investors have equal access to information and there is not a false market in a company's securities.

Do companies disclose items that are too uncertain or are unlikely to be material?



- 10% Often
- 34% Sometimes
- 25% Occasionally
- 16% Rarely
- 1% Never
- 14% Not applicable

"Our business is subject to an increasing stream of **unregulated and specious** class actions where **no code of conduct** applies to media comment nor class solicitation."

However, ASIC Deputy Chairman Belinda Gibson recently acknowledged that *"how quickly information needed to be disclosed would always depend on the circumstances."*^{22 23}

In the context of a material transaction, it is always advisable to have a leak strategy prepared in advance because the requirement to disclose "immediately" means that a company may not have time to assess the information which has arisen, consult with professional advisers if necessary and frame an appropriate announcement.

There was overwhelming support from survey respondents for a modification to ASX Listing Rule 3.1 to require that information be disclosed "as soon as practicable" rather than "immediately".

64% of survey respondents either agreed or strongly agreed that such a change would be in the best interests of the market, with only 22% not favouring the change (14% had no opinion).

These results reflect a view that investors will receive disclosure which is more accurate and less likely to be misleading in circumstances where companies have had the benefit of some additional time to properly assess the information and to prepare a considered and appropriately worded ASX release.

The current wording of ASX Listing Rule 3.1 and its history of enforcement are such that it would be desirable to give directors and senior management more time to form an appropriate judgment on matters which will, or may, require disclosure.

Hurried or premature disclosure may in fact be less desirable in circumstances where market certainty is the aim.

²² Durkin, P.; 'ASIC toughens line on disclosure'; *The Australian Financial Review*, 7 December 2010.

²³ For example, when confidentiality was lost in merger discussions between Rio Tinto and Alcan Inc., ASIC issued Rio Tinto with an infringement notice on the basis that 72 minutes was too long to satisfy the requirement to disclose "immediately".

Class Actions

Class actions are of concern to many directors

There has been a rise in class actions over recent years as disgruntled investors have sought to recoup investment losses.

These class actions generally allege that loss has been suffered after the share price has fallen stemming from either misleading and deceptive disclosure or a failure to disclose material price sensitive information to the market in a timely manner.

It is usually claimed that loss has been suffered as a result of investors either acquiring shares when they would otherwise not have done so (focusing on opportunity cost), or acquiring shares at a price which is higher than would otherwise have been the case (a difference in the value of the shares). Typically the claims relate to shares purchased on market.

Notable shareholder class actions in the past few years have included actions alleging delayed disclosure of write downs, the failure to disclose various material matters to ASX in a timely manner, and the failure to adequately disclose the nature and extent of debt obligations and risks.

As well as proceedings being commenced against listed entities, a number of class actions are also on foot in relation to the insolvency or freezing of managed investment schemes, such as Octaviev (previously MFS), Great Southern, Willmott Forests and Westpoint.

The survey results show that 34% of survey respondents have been involved in an organisation that has given attention to class action issues in the previous 12 month period.

When asked to provide some detail on what that attention involved, the responses generally indicated that survey respondents were in one of two camps:

- The first group were those who were facing an actual or potential class action against their organisation, with a number of survey



respondents indicating that specific websites had been set up in connection with a class action or that they were aware of potential class actions facing the organisation.

- The second group were those with an “awareness of risks of class actions” and concerned with “identifying potential issues and risks” which could lead to a class action.

Another factor contributing to the rise of class actions is the emergence and growth of litigation funding companies and plaintiff law firms. Litigation funding companies fund the costs associated with class action litigation, in return for a percentage of any damages or settlement awarded.

With six or more listed entities engaged in funding Australian class actions, there are more potential matters being announced than ever before. While the use of litigation funding suffered a setback in 2009, when the Federal Court concluded that funding arrangements constituted a managed investment scheme (and was therefore subject to regulation by ASIC), this was overcome by the introduction of temporary class orders.

It is expected that a permanent exemption from the managed investment scheme requirements will be formulated during 2011.

However, concerns that the rise of litigation funders could take Australia down a US-style litigation model should be assuaged by the fact that the Australian legal system provides for the payment of a proportion of the company’s costs if the action against it is unsuccessful.

This is to be contrasted with the US, where costs orders are not generally made even if a company successfully defends proceedings, reducing the risk for plaintiffs in commencing litigation.

In addition, there are now more forums in which class actions can be pursued, with a representative action regime in New South Wales, as well as the existing Victorian and Federal Court systems.

Finally, class actions are now recognised, and in some cases preferred, as a means of recovery in a range of areas. In addition to shareholder enforcement, class actions are being used to pursue consumer and product liability matters as well as breaches of the competition/antitrust laws, and for all types of action there is the possibility that directors could be pursued directly.

Companies now have a greater risk of exposure to a class action, and directors are having to turn their minds to addressing actual or potential class action risks. [We expect that this is a trend that will continue to accelerate](#) over the coming period, and bears close attention when considering the key risks confronting directors.

“A press article was published alleging claims of misleading disclosure; also a specific website was set up by [a plaintiff law firm].”



ENGAGING WITH STAKEHOLDERS

As shareholders have become more “active” in engaging with companies, and technological developments continue to facilitate different and more effective communications, companies are expanding and improving their investor relations capabilities.²⁴

While it is generally expected that this trend will continue as companies seek to tailor communications to specific types of shareholders, and as the law and regulation catches up with technological advances, it is worth considering:

- how companies will seek to engage with other stakeholders; and
- the implications of these developments for general meetings, particularly Annual General Meetings (AGMs).

Stakeholders other than shareholders

The directors of a company are required to act in the best interests of the company as a whole. Additionally, in some circumstances, a director can owe duties to individual shareholders or other stakeholders.

For example, directors also have a duty to take into account the interests of creditors when the company is insolvent or approaching insolvency but this is only part of the director’s broader duty to act in good faith in the best interests of the company.

There are a number of other stakeholders, including employees, customers and suppliers, who play an important role in the successful operation of a company’s business, and are relevant to the company’s standing in the community.

It is also consistent with the theory of the “triple bottom line” which looks to assess a company on economic, environmental and social parameters, and the adoption of corporate social responsibility.

This approach also reflects that non-economic concerns of shareholders can be tolerated or even embraced in corporate governance, depending upon the relevance of the concern to the business and affairs of the company (and therefore its capacity to contribute to shareholder value and investor confidence).

Customers and employees are the most important stakeholders

Survey respondents were asked to rank the importance to directors of the interests of various non-shareholder stakeholder groups. The results of the survey showed that customers and employees are most important. **64% of the survey respondents rated the interests of customers as extremely important, with 89% considering their interests to be either important or extremely important.**

62% of the survey respondents rated the interests of employees as extremely important, with 88% considering their interests to be either important or extremely important.

It is not surprising that the interests of customers would be a major concern, given that understanding, and responding to, customer interests is important for growing and sustaining a business. Likewise, as a company’s operations are heavily reliant on its employees, it is not surprising that their interests are also important.

Balancing the interests of shareholders and other stakeholders can be difficult

While considering the interests of other stakeholders has been shown to be important to a company and its shareholders, directors nonetheless need to consider how to balance the interests of shareholders and other stakeholders in the best interests of the company. 53% of survey respondents agreed or strongly agreed that the interests of shareholders and other stakeholders are often hard to balance, while 42% either disagreed or strongly disagreed.

This frame of reference recognises that companies depend on a broad range of stakeholders, including government and the community, for their “social licence” to conduct business.

²⁴ “Survival Kit 2020 - 20 shareholder trends for 2020”, Tony Featherstone, Company Director, 1 December 2009

The relatively even split in these results is an interesting outcome. One conclusion is that it suggests that the nature and range of stakeholder interests is quite variable across companies, and balancing those interests is more challenging in some industries than in others. The nature and extent of competition and regulation in an industry may also be significant factors.

Companies should report to other stakeholders

Just over half of the survey respondents agreed or strongly agreed that companies should be reporting to their other stakeholders, while 39% either disagreed or strongly disagreed. Of those survey respondents who agreed or strongly

release pages on their websites, it would seem unlikely that they would need to materially modify their current communications practices or increase their level of “formal” reporting in order to implement this form of reporting to non-shareholder stakeholders.

The challenge for boards and management going forward will be to **identify and implement modern, tailored stakeholder communication** plans that facilitate an effective flow of information and reflect the views of the board and management.

AGMs and proxy advisers

Do we need to restructure the format of AGMs?

AGMs are meant to be the forum for shareholders of the company to meet with the board and management to hear about the performance of the company and have an opportunity to ask questions. Notwithstanding law reforms in 2003²⁵ which aimed to encourage greater shareholder participation in general meetings, there has been renewed debate as to whether there is still a role for AGMs or whether other forms of reporting would be more relevant and appropriate.

Commentators and groups such as the ASA largely agree that there is a place for the AGM in the corporate calendar because it is one of the few opportunities for retail shareholders to have access to the stewards of the company. In reality, most AGMs are *“generally well scripted, well advertised and very badly attended”*²⁶ and tend to be *“ritualistic affairs.”*²⁷

Companies should be reporting to stakeholders other than just shareholders:

52% ‘strongly agree’ or ‘agree’ to this, while

39% ‘strongly disagree’ or ‘disagree’.

For those who agree, they feel the communication should take the form of...	%
Website communications	76%
Announcements/press releases	55%
Annual report	50%
Meetings	32%
Targeted mail outs	23%
Other (please specify)	5%

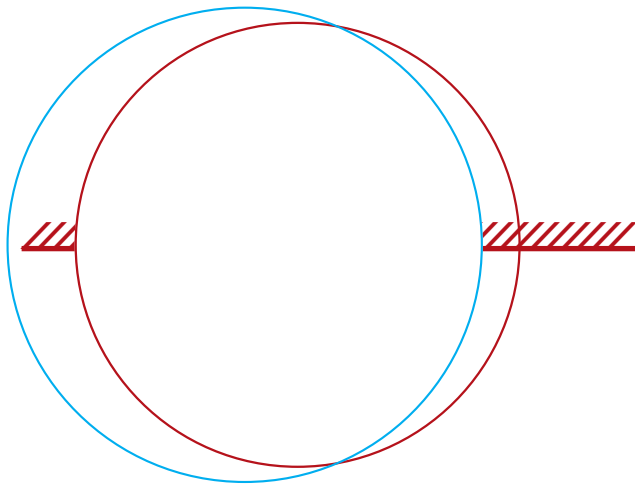
agreed, 76% nominated website communications as the preferred method of communication for this reporting, while 55% nominated announcements/press releases.

These preferred forms of reporting to non-shareholder stakeholders suggest that directors see these communications as being in the form of **general updates on important developments** impacting the company and those stakeholders, rather than reflecting formal reporting criteria which is prescribed by law or regulation. As most companies have investor relations and/or press

²⁵ The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2003 introduced reforms to encourage greater use of electronic facilities and increased freedom in the appointment of proxies.

²⁶ David Gonski, speech given to the Australian Shareholders Association, 3 April 2008.

²⁷ Simmonds, R, “Why must we meet? Thinking about why shareholder meetings are required”, *Company and Securities Law Journal*, Vol 19, p506.



64% of survey respondents either agreed or strongly agreed that the current AGM format should be revised; just 20% disagreed or strongly disagreed.

Some of the indicia cited in favour of a reworking of the AGM structure include that: only a small percentage of shareholders attend the meetings (and large institutional shareholders are rarely in attendance), the AGM is too formal and compliance-driven, and that shareholders are able to regularly access updated information from the company via the internet and ASX.

These indicia are less relevant to extraordinary general meetings, which are convened to consider “special business” and are usually far better attended, and more effective in achieving their aims.

Another factor commonly mentioned as a reason for the declining relevance of AGMs is that a significant number of votes are lodged through proxies ahead of the AGM. As a result, discussion and voting at meetings is largely irrelevant because in most cases resolutions are effectively decided before the meeting commences.

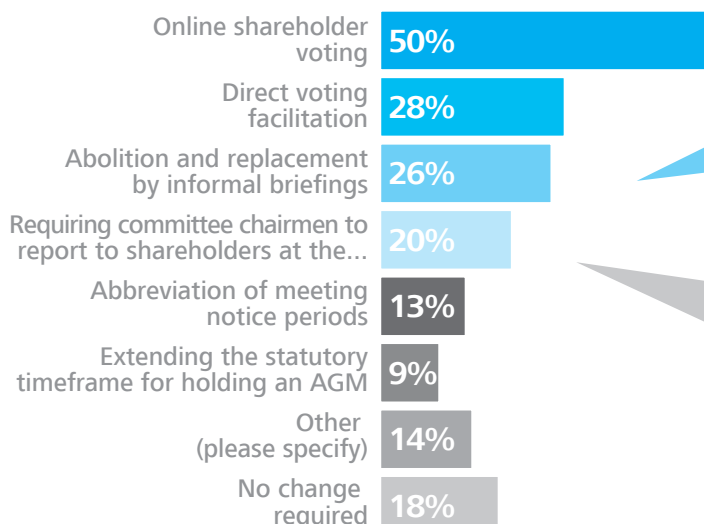
The proposal to permit online shareholder voting, with voting remaining open for some specified period of time after the AGM (eg 24 or 48 hours), would enable shareholders to either attend the AGM or view a webcast and then have time to consider the discussion before determining how to vote on the resolutions.

However, this proposal would not address proxy determination of a resolution before the meeting commences, and raises other issues such as the impact of the post-meeting voting period on directors who have retired from office with effect from the AGM and are standing for re-election at the AGM.

From the options provided, the most popular choices nominated by survey respondents for methods of improvement were:

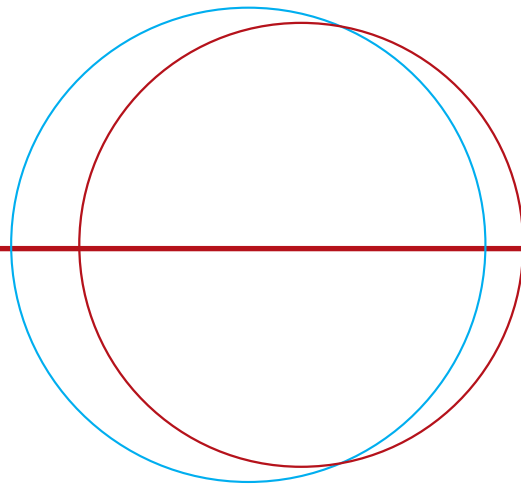
- online shareholder voting (nominated by 50% of survey respondents);
- direct voting facilitation (28%);
- abolition of AGMs and replacement by informal briefings (26%); and
- requiring committee chairmen to report to shareholders at the AGM (20%).

Methods to improve AGMs



Most agree that ‘the current format of AGMs has outlived its use by date’. **22%** ‘strongly agree’ and **42%** ‘agree’, while just **20%** ‘strongly disagree’ or ‘disagree’.

A generally neutral feeling towards the role of proxy advisers. **37%** believe proxy advisers have a neutral impact on achieving beneficial outcomes for shareholders, while the remainder feel they have a mild impact either way.



Regulatory hurdles for online shareholder voting should be removed; **online voting can only increase shareholder engagement and participation**. Also, offering informal briefings would enable a broader range of investors to have more intimate discussions with directors and management, to ask questions and to be provided with additional information and explanations. These sorts of briefings are frequently held for institutional shareholders and analysts, but are rarely held for retail shareholders. **Companies may consider trialling such briefings, perhaps online, as an adjunct to (but not a replacement of) AGMs.**

A role for proxy advisers

Proxy advisory firms provide independent governance analysis and proxy voting guidance to a very large proportion of Australia's superannuation funds and other institutional investors.

In practice, many institutional shareholders vote on resolutions prior to the shareholder meeting on the basis of their proxy adviser's voting recommendations.

As a result, the recommendations of proxy advisory firms are often cited as a key influence in, and indicator of, the voting outcomes at shareholder meetings.

It would appear from the survey results that opinion is divided over the influence of proxy advisers. **38% of survey respondents viewed their activities as mildly or strongly negative in achieving beneficial outcomes for the general bodies of shareholders over the past 2 years.** 37% of survey respondents thought their effect was neutral, while 25% indicated it was strongly or mildly positive.

These results reflect the mixed sentiment on proxy advisory firms:

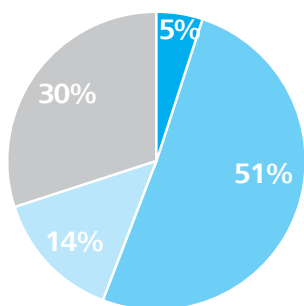
- Critics argue that proxy advisers are a negative influence, on the basis that many institutional shareholders simply follow their advice or recommendation without forming a view on

the issue at hand, and that advisers issue their recommendations in a formulaic way without properly engaging with a company to understand its circumstances and the assessments and recommendations made by its directors.

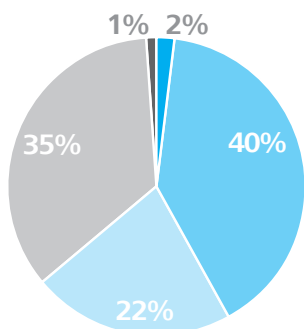
- Supporters counter that proxy advisory firms facilitate shareholder participation, by providing an analysis of company performance and proposals and recommend voting action accordingly, and that institutions are able to consider the proxy adviser's report in the same way they consider advice from other advisers such as brokers, bankers and lawyers, before forming a view and making their voting decision. Without the assistance of proxy advisor firms, many institutional investors would find it difficult to satisfy their duties and investment mandates which require them to actively participate in companies and vote their shares or proxies appropriately, as they lack the requisite in-house resources and time to perform these functions.

*While there is clearly a role for proxy advisors, the current economics of this sector should be reassessed to ensure that it is able to be **appropriately resourced and regulated**, in the interests of ensuring both the appearance and reality of integrity and improved standards.*

OUTLOOK FOR 2011



The GFC has made boards too risk averse generally



The GFC has made boards too risk averse in pursuing M&A opportunities

- Strongly agree
- Agree
- Do not have an opinion
- Disagree
- Strongly disagree

M&A activity on the rise

The global financial crisis had a significant impact on the level of M&A activity in Australia, although recent figures suggest that M&A activity is back to pre-global financial crisis levels.

According to Thomson Reuters (Full Year 2010 Mergers & Acquisitions Review), the value of announced M&A deals in Australia for 2010 totalled US\$164.4 billion, up from US\$68.8 billion in 2009, the highest deal volume since 2007.

Around two thirds of survey respondents anticipate that their companies will be involved in M&A activity in 2011.

This is despite 42% of survey respondents considering that the global financial crisis had made boards too risk averse in pursuing M&A activities. This risk avoidance behaviour is likely to be symptomatic of the fallout from the global financial crisis, rather than evidence of any systemic concerns regarding M&A activity in the Australian market.

It is expected that companies will revert to "usual" levels of risk taking and deal assessment as economic confidence and improvements in market stability return.

Challenges and impediments in implementing M&A	Ranked top 5	Ranked 1st
Risk of implementation/integration failures	79%	12%
Identifying opportunities that are attractive	76%	42%
Volatile market conditions	68%	11%
Ability to assess valuation issues	67%	6%
Ability to undertake adequate due diligence	66%	6%
Risk of regulatory review and regulator intervention	36%	9%
Risk of legislative and regulatory change	28%	1%
Direct access to appropriate independent advice	26%	5%
Managing conflicts of interest	23%	4%
Obtaining merger clearance	19%	3%
Obtaining foreign investment clearance	5%	1%

...but challenges remain

When asked which were the biggest challenges or impediments for executing M&A transactions, [identifying attractive opportunities was identified as the key challenge by survey respondents.](#)

Implementation risks and integration failures, volatile market conditions and the ability to assess valuation issues were also seen as key potential impediments.

Due diligence continues to be a high priority issue for companies when considering whether to undertake M&A transactions. The importance of undertaking adequate due diligence was no doubt re-emphasised by the global financial crisis, and is connected to the broader recognition by survey respondents of valuation, implementation and integration issues as potential deal impediments and value destroyers.

The importance of due diligence arguably reflects the bias towards pursuing friendly or recommended deals over hostile deals.

Issues which were not regarded by survey respondents as being key challenges or impediments for executing M&A transactions included:

- obtaining foreign investment or merger clearance;
- the risk of legislative or regulatory change;
- managing conflicts of interest; and
- having direct access to appropriate independent advice.

Obtaining merger clearance is only a potential deal impediment for organisations wanting to consolidate within certain industries.

While some organisations are unlikely to be able to pursue further significant M&A activity in Australia, in the ordinary course obtaining merger clearance is not seen as a critical potential deal challenge.

Similarly, Australia's foreign investment approval regime is generally considered to be relatively benign - unless the deal involves a sensitive sector or a government agency or sovereign wealth fund, in which case FIRB approval becomes a critical deal issue.

The relative unimportance generally attributed by survey respondents to the risk of regulatory intervention or change is interesting in the context of the current regulatory landscape and the broader political environment in Australia.

While 2010 was marked by political turmoil and uncertainty over the status of the proposed Minerals Resource Rent Tax and the proposed carbon emissions trading system, and some commentators introduced "sovereign risk" to their lexicon when describing their attitude to investment in Australia, it would appear that those attitudes are normalising, notwithstanding some residual scepticism about the longevity and effectiveness of the current hung Federal Parliament.

BIGGEST CHALLENGES IN 2011?

Survey respondents were asked what they considered would be the biggest challenge they would face as directors in 2011:

"Creeping regulation and overly political policy decisions."

"The fundamental problem is that boards spend too little time on the business and **too much time on governance** in its various forms."

"Risk/reward trade off.
Volatile markets and impact on Company."

"Regulatory reporting changes and government - overreaction to the GFC."

"Achieving business and financial objectives in the lesser of the '2 speed economy' in some sectors."

"Finding the right balance between understanding the company to properly add value as a director while not swamping management with requests/suggestions. That is the ongoing challenge."

"Growth companies have managed through a difficult period and now **need to grow.**"

"Legislation grows daily, which increases **risk aversion** and **stifles forward planning.**"

"Succession planing and performance; managing CEOs."



BACKGROUND TO THE REPORT

The report

This report examines key issues and challenges facing Australian boards and directors in 2011. The report reflects our expertise and experience advising on mergers and acquisitions and governance issues. It also reports on the responses to a survey of directors.

The Mallesons team that worked on this report and the survey included Meredith Paynter, Greg Golding, Nicola Charlston, Vanessa Coffey, Tim Downing, Sarah Turner and members of the marketing team.

The survey

The report captures the responses of 125 directors representing more than 300 organisations across a wide variety of industries to an online survey conducted in December 2010.

Survey recipients were asked to respond to a variety of multiple choice and free form questions with respect to 5 key themes; board composition, the role of boards and directors, the regulatory landscape, stakeholders and the M&A outlook for 2011.

This survey was developed by Mallesons to gain a better understanding of the issues and challenges that directors are facing in the current M&A environment in Australia.

Mallesons commissioned Lewers Research, an independent market research company, to assist us to conduct the survey and to ensure the integrity of the research process.

Lewers Research

Lewers Research is a small, Australian based research firm specialising in business and services research. Lewers has had long term relationships with a number of Australia's leading services firms, and provides extensive research services ranging from early product development, brand & advertising research, customer satisfaction and market/industry exploratory research.

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About Mallesons

Mallesons Stephen Jaques is Australia's most respected commercial law firm and is ranked among the very best law firms in the world. We are consistently rated as a market leader in Australia and the wider Asia-Pacific region, as recognised by numerous independent awards and market surveys. Over the last decade, the firm has won more major client service awards than any competitor in the Australian market, as voted by leading Australian corporates, including the BRW Client Choice Award for the past 2 years.

Mallesons has one of Asia Pacific's leading mergers and acquisitions and corporate advisory practices. We have advised on many of the region's largest and most complex transactions, and our experience is recognised by leading independent industry commentators such as Asia Pacific Legal 500, IFLR 1000 and Chambers Global.

In Asia, Mallesons has operated for over two decades, providing strategic legal advice to clients across the region. Our firm offers a full service commercial capability and has established strong working and referral relationships.

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