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2 September 2013

Australian Securities Exchange

ASX Corporate Governance Council

By email: **mavis.tan@asx.com.au**

Dear ASX and Council members,

Response to Consultation Paper *(Review of Corporate Governance Principles and Recommendations, 16 August 2013)* – Principle 2 and 'Independence'

Rationale for submission

We consider that there is insufficient transparency regarding matters that may affect independence of directors, meaning that both boards and shareholders have insufficient information when being asked to make decisions regarding the appointment of directors that are intended to be independent.

An element of compulsion around disclosure and a 'real' consequence for failure to provide honest disclosure will assist in remedying the matter.

We consider that changes to the corporate governance policy alone will not be sufficient to deliver the necessary compulsion and consequences, but rather, changes to the ASX Listing Rules are also needed to support any change in policy.

Principle 2

The proposed amendments[1] to the Corporate Governance Council Principles and Recommendations (**CG Rules**) contain (as part of Principle 2), Recommendation 2.2, namely that 'A majority of the board should be independent directors.'

The CG Rules provides guidance on what it means to be independent, including the following statement:

[1] As outlined in the proposed third edition of the *Principles and Recommendations* published on 16 August 2013.

> *"Security holders will interpret that description as meaning that the director is **free of any interest, position, association or relationship** that might influence, or reasonably be **perceived** to influence, his or her capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally."*

The CG Rules also contain further guidance (in Box 2.1) on the types of relationships or factors that may affect independence.

Our Concern

Despite Recommendation 2.2[2], there is insufficient transparency regarding potential relationships, dealings or past patterns of behaviour to enable boards, or members, of listed entities to assess the independence of persons who are held out to be (or proposed to be appointed as) independent directors of a listed entity.

We are often asked to provide advice (in our capacity as legal advisers to listed entities and their boards), to some members of a board (**Concerned Directors**) in circumstances where they believe that there are undisclosed relationships of other board members (**Other Directors**) that may impact on the independence of the Other Directors.

Generally these requests for advice arise in circumstances where the Concerned Directors believe that these undisclosed matters are affecting the judgement of the Other Directors, and this has led to:

1. a perception amongst the Concerned Directors that certain interests (or shareholders) are being favoured above all else;

2. a suspicion that the market is not fully informed of all relevant matters (including during any capital raising or control transactions), and a concern that the Concerned Directors are unable to uncover the information necessary to remedy this situation;

3. the Other Directors voting down (or preventing resolutions from being put to the vote) any transaction or matter that might be contrary to particular interests that do not necessarily represent the interests of the company as a whole; or

4. the board becoming dysfunctional and unable to make (or put forward) important decisions.

This is a particularly difficult situation as the lack of proof or information often leads to inaction on the part of Concerned Directors. This is a dangerous situation and ultimately detrimental to shareholders.

Due to sensitivity of current matters and client confidentiality we are presently unable to give details of our own recent experiences in order to demonstrate our concerns. However, we **attach** an article

[2] This statement is made on the basis that Recommendation 2.2 (together with a policy to require disclosure) has existed for some time, previously being Recommendation 2.1.

from today's Courier Mail as it is illustrative of the consequences that can flow from inadequate disclosure by board candidates in situations where self-regulation by entities has failed.

Our Suggestion

Recommendation 2.2 should stand as is.

However, it would be beneficial to provide a mechanism to ensure that an adequate level of disclosure regarding relationships or circumstances that may affect independence is *compelled* (by market operators) at each point in time when either a board or members of a listed entity are required to make a decision in relation to the initial or ongoing appointment of a director who is intended to be independent.

As reflected in Recommendation 2.2, the matter is also one of perception. Our contention is that this perception must be informed.

Currently, the element of compulsion is lacking. Boards and shareholders are therefore not fully informed at the time of decision making.

We believe that companies, particularly at the smaller end of the market, find it more difficult to source and secure appropriate directors and often, this leads to a desire to not 'upset the applecart', including by asking probing questions of a board nominee. This situation may be alleviated by requiring disclosure to be given in a prescribed form and at the insistence of ASX, rather than the company.

We put forward the following for consideration by ASX as our suggestion for a potential remedy to this situation:

1. Each time a person is put forward for consideration for appointment as a director of a listed entity the nominee be required to provide a signed statement in a form prescribed by ASX (**Independence Statement**) to the company, answering the questions set out in Schedule 1 of this letter and if any matter is disclosed in answer to those questions, including a statement as to why the nominee believes that they are nevertheless 'independent'.

   We believe that this latter statement should be given by the individual proposed for appointment, not by the company (as proposed for the latest revision of the CG Rules). The company could of course make additional statements on the company's belief regarding independence (in any notice of meeting materials) if the company considers it appropriate. Generally speaking, the nominee will be in the best position to explain, in the first instance, why his/her relationships or circumstances will not affect judgement.

2. We propose that the Independence Statement must be:

   a. received by the full board prior to voting on any resolution to appoint the nominee as a director;

   b. incorporated into any notice of meeting materials for any meeting at which members are asked to vote on the initial appointment, affirm an appointment

(made previously by the board) or re-election (including upon retirement by rotation) of any person as director (as applicable);

c. updated and re-submitted by any director:

i. prior to any re-election (including upon rotation); and

ii. if at any time (after the giving of the original Independence Statement), any fact, matter or circumstance changes and that change would result in different disclosures than those made in the original Independence Statement – within 5 Business Days of such change.

3. We propose consideration be given to inclusion of a new listing rule to require the giving of the Independence Statement (in a form prescribed by ASX – perhaps a new Appendix 3W) at those times suggested above.

4. We also propose that if any person is found to have provided materially false information in an Independence Statement, that ASX have the discretion to prohibit that person from being a director of a listed entity for a prescribed period of time.

These suggestions are consistent with the policy and underlying objectives of Recommendation 2.2, including that disclosures be given by proposed directors and that regular assessments of independence be conducted by a company.

We consider that the current 'policy' based approach assists, but alone is not enough to ensure that boards and shareholders are acting with sufficient information. The current approach also does not provide sufficient disincentive for dishonest behaviour.

Why we propose a broader range of questions than those proposed by the Council?

We have set out in Schedule 1 a suggested form of the Independence Statement for your consideration.

In preparing Schedule 1 (and in particular the questions we have proposed), we have considered (and incorporated) the matters listed in the proposed updated form of Box 2.1. However, we have also considered a broader range of indicia which may point to the existence of associations, including indicia that have been found by the Takeovers Panel to be persuasive in drawing inferences of associations. These include (among other things) social dealings, common patterns of investment behaviour and financing of transactions on non-arm's length terms. We have included footnotes to our additional suggested questions to draw these to your attention.

Managing confidentiality?

We recognise that answering some of the proposed questions may give rise to confidentiality concerns. While the existence of confidential matters concerning the company may be innocent, we consider that it many cases there are good reasons to be suspicious of confidential arrangements involving the subject matters. This is of particular concern when a person who is to be held out as an 'independent' director is privy to or party to 'secret' information that may affect the affairs of the company.

In these circumstances, if any director or nominee has concerns that providing the information requested will breach confidentiality; we would propose that there is an obligation for the matter to be disclosed to the Chairman. It will then be incumbent on the Chairman to consider whether he is satisfied that confidence prevents disclosure to the market and if so, whether the nature of the matters disclosed impacts on independence.

In those circumstances, the prescribed Independence Statement should indicate where a matter has been privately disclosed to the Chairman in lieu of provision of a detailed response, and the Chairman should provide an additional statement as to whether he is satisfied that the matters disclosed do not impact upon independence. If the Chairman is not so satisfied, he should be obliged to recommend that the proposed candidate is not elected to the board, or alternatively, is not put forward as an independent candidate or held out to be independent.

We would welcome the opportunity to discuss this matter further with you.

Yours sincerely
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Schedule 1 – Suggested form of Independence Statement[3]

Questions to be answered by proposed director/director

Provide answers to each of the questions below, giving details where required.

No.	Question	Response/Details
1.	Are you, or have you been, employed in an executive capacity by the entity or any of its related entities and there has not been a period of at least 3 years between ceasing such employment and serving on the board?	
2.	Are you, or have you within the last 3 years been, a partner, shareholder, director or senior employee of a professional adviser or consultant to the entity or any of its related entities?	
3.	Are you, or have you within the last 3 years been, a material supplier or customer of the entity or any of its related entities, or an officer of, or otherwise associated directly or indirectly with, such a supplier or customer?	
4.	Are you a substantial shareholder of the company or an officer of, or otherwise associated directly or indirectly with, a substantial shareholder of the company?	
5.	Are you associated, directly or indirectly with any other top 20 shareholders of the company?[4]	
6.	Do you have a material contractual relationship with the company, its related entities, its other directors or substantial shareholders, other than as a director?	

[3] This could be adopted as a new Appendix 3W to the ASX Listing Rules, to be given by the director or candidate for release to the market at the various times indicated in the covering letter.

[4] Often groups that collude to control a company will spread holdings amongst various entities. These holdings alone may be insignificant, but when aggregated are sufficient to requisition meetings or create a blocking stake within the company.

7.	Do you have or have you had previously in the last 3 years, any associations with any directors of the company?	
8.	Do you have any close family ties with any person who falls within any of the categories described above?[5]	
9.	Do you have or have you had previously (in the last 3 years) any common directorships with any other directors or top 20 shareholders of the company?[6]	
10.	Do you have or have you had previously (in the last 3 years) any common investments with any other directors or top 20 shareholders of the company?[7]	
11.	Have you been a director of the entity for more than 9 years?	
12.	Are you or any person or entity that you are involved with, either now or in the past 3 years, a party to any arrangement to finance the acquisition of shares in the company?[8] If so, provide details of the purpose of and the terms of those arrangements?	
13.	Do you hold (or have you held in the past 3 years) any shares in the company as bare trustee (including where such holding does not give rise to a relevant interest[9]) for any other person?	
14.	Provide details of any action that you have taken (in the past 3 years) either alone, or with any other director or shareholder of the	

[5] The Takeovers Panel considers that both: (1) familial connections (*CMI Limited 01* [2011] ATP 4 (**CMI Case**)); and (2) social dealings (*Mesa Minerals Limited* [2010] ATP 4) are relevant in determining an association.

[6] Structural links and common directorships was one factor considered by the Takeovers Panel as part of the factual matrix to infer an association: CMI Case

[7] The existence of common investments was one factor considered by the Takeovers Panel as part of the factual matrix to infer an association: CMI Case.

[8] The Takeovers Panel considers that: (1) actions or dealings that are uncommercial may indicate an association; and (2) provision of funding for share acquisitions, particularly on non-arm's length terms may indicate association: CMI Case.

[9] Corporations Act 2001 (Cth), s.608 definition to be applied.

	company, to change the board of the company or another entity?[10]	
15.	Are you aware of any agreement, arrangement or understanding to control the board or the affairs of the entity?[11]	
16.	Provide details of any other matter that may be perceived by another to impact on your independence?	

Independence Statement

If any matter is disclosed in answer to any of the questions above, provide a statement as to why you believe that you are independent and able to adequately fulfil the role of an independent director?

Signed (Director/candidate) Dated

[10] Prior collaborative conduct was one factor considered by the Takeovers Panel as part of the factual matrix to infer an association: CMI Case

[11] Relevant to the various tests for associations set out in the Corporations Act 2001 (Cth).

Chairman's Independence Statement

If any matter is disclosed to the Chairman in lieu of providing a detailed answer to any of the questions above (for reasons of confidentiality), the Chairman:

☐ is satisfied that the matter disclosed does not affect the director/candidate's ability to be independent?

OR

☐ considers that the matter disclosed does affect the director/candidate's ability to be independent, and either:

☐ does not recommend the director/candidate for election to the position as director;

OR

☐ confirms that the director/candidate is suitable for election, but may not be considered to be an independent director.

Signed (Chairman) Dated

CAUGHT OUT: Colin Ryan resigned as chairman of the Royal Children's Hospital Foundation after it was found he failed to disclose criminal charges stemming from a company collapse

Flaws exposed in checks on candidates for boardrooms

LIAM WALSH
QUEENSLAND INK

IN APRIL 2010, corporate blue-blood Colin Ryan filled in a form as chairman of a leading charitable foundation, declaring he was not facing any criminal charges.

He lied.

The handwritten denial came despite New Zealand authorities months earlier filing criminal charges against him over the $150 million collapse of property lender Capital+Merchant Finance.

His action, revealed today by The Courier-Mail, shows potential flaws with some self-regulating checks at state-associated boards. More than 60 such entities exist, from the Queensland Art Gallery to the Residential Tenants Authority.

The peak directors' institute thinks proper due diligence could occur, but rigorous verification would impose extra costs probing people who give time for little reward.

But first go back to the then Royal Children's Hospital Foundation. The Brisbane-based charity's mission was "working wonders for sick kids", and it raised $180 million in 26 years.

Ryan, 67, of Brisbane's northern suburb of Clayfield, was a founding director. His long resume included stints with Ariadne Australia and Brisbane Airport Corporation, plus he won an Order of Australia. Who's Who even listed him as a member at Royal Queensland Golf Club and Tattersalls. An eminent role was at the RCHF – he was passionate about charities.

But stewing away was C+M Finance. The NZ lender had 7000 investors, and operated for 10 years when Ryan came in 2006 and signed, with other directors, on prospectuses.

C+M collapsed a year later in the credit crunch.

Carnage across property lenders prompted NZ authorities to probe widely, and they laid charges.

C+M's chief Owen Tallentire was convicted of theft among offences. Non-executive directors were hit with lesser charges, Ryan's alleged wrongdoing included distributing a prospectus with an untrue statement.

He wrote of being served by summons in February 2010, and NZ's regulator in March 2010 said charges had been filed late in 2009.

Yet Ryan later falsely confirmed his spot as RCHF chairman. The confirmation form, bearing a State Government sun-emblem, asked if candidates knew of any charges or matters under investigation. It did not quibble about jurisdiction.

Ryan penned: "NO".

The Government was caught out when The Courier-Mail published the NZ charges.

"This matter may reflect negatively on the Government due to a lack of knowledge of the charges," said a briefing note to then Health Minister Geoff Wilson, obtained under Right to Information laws.

Public Service Commission chief executive Margaret Allison bluntly emailed that Ryan should stand aside given he had never informed the minister about the charges and their serious nature.

Ryan wrote excuses to the minister in a five-page letter.

NZ regulators were taking a "blanket approach", he wrote. "Legal advisers together with counsel are extremely clear that I have no cause to answer and that I will be cleared of any offence," he maintained.

Actually, Ryan later pleaded guilty to three charges.

He was sentenced this March to seven months' home detention, spent in an Auckland apartment, 300 hours of community service and to pay $NZ100,000 ($A79,000).

'Your failure was approaching gross negligence," Justice Geoffrey Venning said.

He said Ryan had honestly believed prospectus statements were correct but "the belief was not reasonable".

(Ryan declined an on-the-record interview. He faces another charge of knowingly misleading regulators to which he has pleaded not guilty.)

Back in Queensland, after Ryan resigned, the foundation proposed director Jenny Hutson as chairwoman.

She is well-known – a lawyer-merchant banker with an established corporate record, and famous for donning a lipstick-red leather jacket at corporate events.

But bureaucrats first hit cyberspace, googling an article about a civil legal stoush involving her firm Wellington Capital, and flagging it for possible further queries. Hutson never took that final step as chairwoman, saying she left the board voluntarily when RCHF months later merged with another entity.

She says the legal stoushes, in which Wellington was successful, were never an impediment.

But the RCHF board's backing for Ryan, after stories emerged, was questioned in a ministerial briefing note.

"Despite the serious nature of the issues surrounding the previous chair, the board issued a statement in full support for Mr Ryan," it said. Hutson backs the board decision.

The board, she says, had supported Ryan then as charges were only denied allegations, and he had contributed much.

Hutson is like others who argue they serve – she got no pay – to make a difference.

"It's a good reason to get up in the morning," she says.

The notion of public service is one reason people take board roles, says Keith De Lacy, Queensland president of the Australian Institute of Company Directors. The other he cites is as a stepping stone to more directorships.

Those becoming directors fill out a form, which asks a list of questions – have you been caught in state watchdog probe? Do you have a private conflict of interest?

De Lacy reckons it would be rare for candidates to not fully disclose matters, but he supports full checks, saying self-declaration is "not sufficient in itself".

The State Government says criminal history checks are done when a candidate would be legally ineligible due to convictions.

Lobbyist registers are also searched.

If someone fakes an answer, there are consequences. They're not severe – the minister can remove the director from the board.

TAKE THE TEST

Questions potential state government board members are asked

1 If selected, would you have any conflicts of interest, ie private interests that may affect or appear to affect your public duty?

2 Are you affected by bankruptcy action?

3 Do you have criminal convictions?

4 Are you aware of charges against you, or matters involving offences under investigation?

5 Have you been subject to a complaint to a professional body that was substantiated or is under investigation? This includes the CMC.

6 Are you on the register of lobbyists?