

15 November 2013

ASX Corporate Governance Council
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By email: mavis.tan@asx.com.au

Dear ASX Corporate Governance Council

Review of the *Corporate Governance Principles and Recommendations: 3rd edition* (draft)

Leighton Holdings Limited (“**Leighton**” or “**the Company**”) welcomes the opportunity to provide comments in relation to the ASX Corporate Governance Council’s draft third edition of the Corporate Governance Principles and Recommendations (“**Principles and Recommendations**”). Leighton supports and values the efforts by the ASX Corporate Governance Council to assist listed entities, their investors and the wider Australian community by providing recommended standards for corporate governance practices across Australia.

Leighton is generally supportive of the stated intentions of the Principles and Recommendations, namely:

- to capture and reflect developments, both in Australia and internationally, in corporate governance practices since the second edition was published in 2007;
- to afford greater flexibility to listed entities to publish their corporate governance disclosures electronically via their website rather than in their annual report;
- to modify the Principles and Recommendations to establish a stronger linkage between each principle and the relevant supporting recommendations; and
- the structural changes to the Principles and Recommendations which, in our view, facilitate compliance with Listing Rule 4.10.3 (predominantly the rearranging of applicable reporting requirements so that they are contained within each relevant principle).

We have reviewed the Principles and Recommendations and set out our comments below. Our submission has been prepared in consultation with a number of key business functions within Leighton and is primarily directed at specific areas which may require additional clarification in order to assist Leighton and other ASX listed entities in complying with the suggested practice.

In preparing our response, we have also given consideration to the draft response provided by the Governance Institute of Australia.

Specific Comments

PRINCIPLE 1: LAY SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT

Recommendation 1.2:

This recommendation suggests that a listed entity should undertake appropriate checks before appointing a person, or putting forward to security holders a candidate for election, as a director and that a listed entity should provide security holders with all material information relevant to a decision on whether or not to elect or re-elect a director.

The commentary in relation to Recommendation 1.2 suggests that appropriate checks include criminal records, bankruptcy, education and character references. These checks are to be undertaken before a director is appointed or is put forward to security holders as a new candidate for election. Depending on the nature of the checks, we note that there may be some delay in receiving the results and that this delay may be inconsistent with the timing required to provide security holders with material information relevant to the decision on whether or not to elect or re-elect a director.

Consequently, Leighton recommends that the commentary should clarify whether an entity would comply with the recommendation if it had provided to security holders all material information known to the entity *as at the time of issuing the relevant disclosure* (i.e. despatch of Notice of Meeting). This would address the situation where the appropriate checks had been commissioned but results had not been received in the requisite timeframe.

Subject to the above, where the Board is recommending the election of a particular director, we would assume that the resolution to appoint the director would include a qualification that such election will be subject to the receipt of the results of the appropriate checks. Where the Board is not recommending the election of a director, we would assume that the company would not be required to commission these checks and that customary practice would apply (being that the entity would only provide to its security holders information that had been provided by the nominee director).

PRINCIPLE 2: STRUCTURE THE BOARD TO ADD VALUE

Recommendation 2.1:

This recommendation suggests that a listed entity should disclose, amongst other things, the length of service of each director. Box 2.1 outlines the defining characteristics of an independent director and suggests the independence of a director may be in doubt where the director has been a director of the entity for more than 9 years.

The commentary in relation to Recommendation 2.1 provides guidance as to the defining characteristics of an independent director. We believe that this is a helpful basis on which to determine the independence of a director, however, it is our view that independence may not necessarily be assessable with reference to a specific limit on the tenure of directors. All Boards should seek to strike an appropriate balance between directors who have developed a deep

insight and understanding of the Company and its operations and who can therefore provide an increasing contribution to the Board as a whole, and the appointment of new directors who bring fresh ideas and viewpoints.

It is our view that freedom from influence (not a tenure threshold) should be the central tenet of independence of judgment and therefore it is Leighton's recommendation that the reference to a specific limit on tenure be removed from the commentary in relation to this Recommendation and be replaced with wording to the effect that independence in relation to tenure may be assessed with reference to whether a director has served on the Board for a period which could *reasonably be perceived* to interfere with the Director's ability to act in the interests of the company.

Recommendation 2.6:

This recommendation suggests that a listed entity should:

- a) have a program for inducting new directors and providing appropriate professional development opportunities for continuing directors to develop and maintain skills and knowledge needed to perform their role as a director effectively; and*
- b) disclose a summary of the main features of that program.*

The commentary in relation to Recommendation 2.6 suggests that appropriate professional development in the context of this Recommendation includes both entity-specific training and general skills and knowledge. It is Leighton's view that directors are appointed on the basis of their expertise, abilities, experience and diversity of backgrounds, and as such, they are recognised for their professionalism. It is this professionalism that brings an obligation and responsibility to bear on the individual directors themselves to maintain appropriate and continuing professional development of a general nature and not on the entity.

Leighton recognises that it has an obligation to provide its directors with entity and industry-specific training and briefings on governance and legal matters that may affect its directors. However, we are of the view that requiring companies to provide more generalist training would be overly burdensome and would, moreover, be inappropriate for directors who are on multiple boards (which is likely to be the case for many ASX listed companies).

Leighton therefore suggests that the commentary recognise that directors are professionals and as such understand and appreciate the responsibility that this bears upon them to maintain appropriate and continuing professional development (i.e. more generalist training) and that the commentary limits the entity's obligation to entity- and industry-specific training.

PRINCIPLE 8: REMUNERATE FAIRLY AND RESPONSIBLY

Recommendation 8.3:

This recommendation requires that a listed entity should:

- a) have a "clawback" policy which sets out the circumstances in which the entity may claw back performance-based remuneration from its senior executives;*
- b) disclose that policy or a summary of it;*

c) *disclose as at the end of each reporting period:*

- 1) *whether any performance-based remuneration has been clawed back in accordance with the policy during the reporting period; and*
- 2) *where performance-based remuneration should have been clawed back in accordance with the policy during the reporting period but was not, the reasons for this.*

Leighton agrees that a clawback mechanism is important in executive remuneration arrangements in order to ensure the alignment of executive and shareholder interests. We recognise that such mechanisms are often tailored by the individual entity and are not necessarily encapsulated in a standalone clawback policy. Through research and external consultation, Leighton determined that the most effective manner to incorporate a clawback mechanism with respect to the remuneration of our senior executives would be through the equity share plan rules (which are approved by shareholders and also disclosed annually in our Remuneration Report). Leighton considered designing a standalone clawback policy that would set out the circumstances in which a clawback may apply, however, this was deemed impractical given the broad range of reasons as to why the Board may choose to clawback awards (ie, financial misstatement or bringing the Company into disrepute) and the discretion afforded to the Board in those circumstances.

Whilst the commentary to Recommendation 8.3 recognises that the clawback policy may either be a standalone policy or included as part of a company's broader remuneration policy, this is not reflected in the actual wording of the Recommendation. Therefore, in order to allow entities who adopt a similar approach to Leighton to satisfy Recommendation 8.3, we propose that the wording of paragraph (a) of the Recommendation be amended to suggest that a listed entity should disclose *any* policy (rather than a specific 'clawback' policy) which sets out the circumstances in which the entity may claw back performance-based remuneration from its senior executives. We believe this would ensure the same governance objectives whilst allowing companies flexibility in determining appropriate remuneration policies.

Additionally, we note that the commentary suggests that a listed entity should include contractual provisions in the service agreements with senior executives that conform to the clawback policy and facilitate the recoupment of the remuneration from the senior executive in accordance with the policy. We would welcome further clarification as to whether this would be satisfied by the clawback mechanism being included in the broader set of remuneration policies applicable to the employment relationships with those senior executives on the basis that such policies are incorporated by reference into the terms of the senior executive contracts.

General Comments

We are of the view that the continued high level of reporting by Australian companies against the Principles and Recommendations reflects the fundamental nature of the "if not, why not" principle and the value of that approach to corporate governance in Australia.

We believe that the "if not, why not" principle is the key principle underpinning the Principles and Recommendations and are pleased to see that the ASX Council has retained this principle in the

most recent draft. In line with the submission provided by the Governance Institute of Australia, we would therefore welcome a greater focus on the principle in the section outlining the purpose of the Principles and Recommendations on page 3.

Yours faithfully
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