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ASX Corporate Governance Council
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Dear Ms Tan,

Submission on the Review of the 4th Edition of the Corporate Governance Principles and Recommendations

Arnold Bloch Leibler (**ABL**) is pleased to provide this submission in response to the consultation paper - *Review of the Corporate Governance Council's Principles and Recommendations* (**Consultation Paper**) and the exposure draft of the 4th edition of the Corporate Governance Principles and Recommendations (**Exposure Draft**) released by the ASX Corporate Governance Council (the **Council**) on 2 May 2018.

ABL supports the Council's efforts to improve best practice in corporate governance for listed entities, their investors and the wider Australian community.

This submission comments on four key issues of the Exposure Draft which, if addressed, we submit would improve the effectiveness of the Corporate Governance Principles and Recommendations (**Principles and Recommendations**).

It is important to note at the outset that in our experience listed companies treat the commentary to the Principles and Recommendations as if it is also part of the primary recommendation. They do not see them as simply guidance or advice, but follow the commentary closely and prescriptively as they would the recommendation. Accordingly, great care must be taken to ensure that the commentary does not impose obligations on companies which would result in a 'one size fits all' approach to corporate governance.

1 Director independence

1.1 Issue

The Principles and Recommendations require a majority of directors to be independent and provide a prescriptive list of factors used to determine independence. A listed company then measures their directors against those factors to determine and disclose a director's independence or lack thereof.

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In our view, this approach to independence is too broad. Critically, it does not recognise the important distinction between independence from management and other forms of affiliation and potential conflict. The fundamental measure of independence should be whether a director is affiliated with management, with all other factors secondary to this.

A focus on independence by reference to management is essential because independence must be considered in light of the nature of a director's fiduciary duties and core legal obligations to act in the best interests of the shareholders.

In practice, this means a board's role is first and foremost to closely monitor and oversee management to ensure it is carrying out day-to-day operations in the interests of, and on behalf of, shareholders. This need for board oversight recognises the reality that management's interests are not always perfectly aligned with those of shareholders. It therefore follows that a director who is affiliated with management should not be considered independent.

In light of this fundamental focus on independence from management we submit that beyond this measure every other director should be presumed independent until other contrary factors indicate otherwise.

For example, in the current Principles and Recommendations a director affiliated with a substantial shareholder is immediately deemed not independent. In our view, a director's links to a substantial shareholder is no more determinative of non-independence than a director who sits on multiple boards earning fixed annual director fees. On the contrary, a director who is aligned with company performance and shareholder returns - whether through affiliation with a shareholder or due to performance based remuneration - will often be more incentivised to monitor management and act in all shareholders' interests than a director without any 'skin in the game'.

In the current era in which proxy advisers wield significant influence and promote a 'one size fits all' box-ticking approach to corporate governance, companies are afraid to challenge the status quo for fear of receiving a 'board strike'. The primary function of corporate governance is to hold management to account, and to improve shareholder value. Why then, aren't directors with significant equity stakes recognised as more likely to protect shareholder interests and embraced as independent? We believe a significant reason why shareholder activism has become so prominent in Australia in recent years is because of an increasing frustration that boards without 'skin in the game' lack incentive to take risks and therefore fail to create shareholder value.

Our proposed approach to independence is consistent with the approach taken by the world's most prominent securities exchange, the New York Stock Exchange (**NYSE**). The NYSE focuses its attention on independence from management and expressly states that it "*does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding*". An effective corporate governance model recognises that there is no 'one size fits all' approach. A board should have the flexibility to assess corporate governance in light of its unique circumstances.

1.2 Recommendation

We recommend the commentary to the Principles and Recommendations appropriately distinguish between independence from management and other forms of affiliation and potential conflict. A board should consider independence by reference to all relevant factors and circumstances. Directors who are unaffiliated with management should be presumed independent unless the circumstances dictate otherwise. Specifically, a director affiliated with a substantial shareholder should not prima facie be considered non-independent.

2 Interests of stakeholders

2.1 Issue

We note that the commentary relating to Principle 3 provides that a listed entity should have regard to the views of a broader range of stakeholders, rather than just its securityholders.

Consideration of a broader range of stakeholders is an important aspect of good corporate governance, provided that such considerations are not inconsistent with the fiduciary duties and obligations that directors owe to shareholders at law.

We acknowledge that, at least in most instances, shareholders will expect companies to be “good corporate citizens”. However, being a good corporate citizen should not mean a company has to prioritise the interests of external stakeholders over the interests of shareholders.

Provided that a company complies with all laws, it should be a matter for the board to determine which other stakeholders’ interests it considers, and to what degree.

We do not agree that securityholders would “expect” companies to have regard to the interests of all the stakeholders listed in the Exposure Draft. Nor do we consider that securityholders would “expect” companies to “not engag[e] in aggressive tax minimisation strategies” which are legal. By discouraging companies from exploring legal tax minimisation strategies that may result in greater returns for shareholders being achieved, the Council is placing directors in a conflict between complying with the Principles and Recommendations and the legal obligation imposed on directors to act in the best interests of shareholders.

2.2 Recommendation

We recommend that the existing commentary in Principle 3 remain unchanged.

3 Hybrid meetings

3.1 Issue

We refer to the commentary relating to Recommendation 6.3 that addresses the use of hybrid meetings to facilitate shareholder engagement.

We are fully supportive of any regime which assists in creating more effective communication between listed entities and their shareholders. Hybrid meetings are just one element of this modernisation. Hybrid meetings could be an important part of reinvigorating the annual general meeting process as a whole and bringing it in line with other leading jurisdictions, such as Delaware in the United States. In particular, we are supportive of a shareholder communication model that promotes real retail shareholder engagement with companies rather than overly influential proxy advisors who are currently the self-appointed voice of all retail shareholders.

Our concern with the proposed commentary in Recommendation 6.3, however, is the legal enforceability of hybrid meetings. This issue was considered by the Corporations and Markets Advisory Committee (**CAMAC**) in 2012 and it has been suggested that legislative amendment should precipitate the introduction of hybrid meetings. In our view, the law in respect of hybrid meetings should first be clarified before the Council approaches this issue. We submit that without legislative clarity on the issue, there is a risk that listed companies may seek to hold hybrid meetings which may not be legally permissible at this time.

3.2 Recommendation

We recommend that the Council remove the commentary in relation to hybrid meetings until there has been legislative amendment that clarifies this issue.

4 Consultancy agreements

4.1 Issue

The new Recommendation 8.4 seeks to prevent listed companies entering into consultancy agreements with directors or executives unless the company has first obtained independent legal advice that the services are outside the ordinary scope of the individual's duties.

The *Corporations Act 2001* (Cth) and the ASX Listing Rules already provide shareholders with sufficient protections in relation to the entry into and disclosure of consultancy agreements. Further, the new recommendation would be unduly onerous, costly and burdensome on companies.

On a practical level, it may be difficult for companies to obtain independent advice which satisfies the recommendation - there is no 'bright line' test for any of the three limbs set out in Recommendation 8.4 on which an independent adviser would be required to opine. Further, in our view legal advice alone may not be capable of opining on all three limbs given the issues may require detailed market and remuneration analysis.

4.2 Recommendation

We recommended the removal of Recommendation 8.4 in its entirety.

Arnold Bloch Leibler welcomes the opportunity to provide further submissions and participate in consultation in respect of the Consultation Paper and Exposure Draft.

Yours sincerely
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