

RESEARCH REPORT

**SEVEN: THE CORPORATIONS ACT, CORPORATE
GOVERNANCE, AND TERMINATION PAYMENTS
TO SENIOR EMPLOYEES**

Kym Sheehan

PhD Candidate
Melbourne Law School
The University of Melbourne

Colin Fenwick

Director, Centre for Employment and Labour Relations Law
The University of Melbourne

**Centre for Corporate Law and Securities Regulation
The University of Melbourne
and
Centre for Employment and Labour Relations Law
The University of Melbourne**

2007

Published in Melbourne by the Centre for Corporate Law and Securities Regulation and the Centre for Employment and Labour Relations Law

The Centre for Corporate Law and Securities Regulation

Faculty of Law
The University of Melbourne
Victoria
Australia 3010
Phone: 61 3 8344 5281
Fax: 61 3 8344 5285
Email: cclsr@law.unimelb.edu.au
Website: <http://cclsr.law.unimelb.edu.au>

Centre for Employment and Labour Relations Law

Faculty of Law
The University of Melbourne
Victoria
Australia 3010
Phone: + 61 3 8344 8924
Fax: + 61 3 8344 4623
Email: celrl@law.unimelb.edu.au
Website: <http://www.law.unimelb.edu.au/celrl>

Sheehan, Kym and Fenwick, Colin

Seven: The Corporations Act, Corporate Governance, and Termination Payments to Senior Employees

© 2007 K Sheehan and C Fenwick

This publication is copyright. Except as permitted under the Copyright Act 1968 (Cth), no part of this publication may in any form or by any means (electronic, mechanical, microcopying, photocopying, recording or otherwise) be reproduced, stored in a retrieval system or transmitted without the specific written permission of the publisher.

Centre for Corporate Law and Securities Regulation

The Centre for Corporate Law and Securities Regulation was established in January 1996. Its objectives are to:

- undertake and promote research and teaching on corporate law and securities regulation
- host conferences to disseminate results of research undertaken under the auspices of the Centre or in other programs associated with the Centre
- develop and promote links with academics in other Australian universities and in other countries who specialise in corporate law and securities regulation
- establish and promote links with similar bodies, internationally and nationally, and provide a focal point in Australia for scholars in corporate law and securities regulation
- promote close links with peak organisations involved in corporate law and securities regulation
- promote close links with those members of the legal profession who work in corporate law and securities regulation

The Director of the Centre is Professor Ian Ramsay.

The Centre has an Australian Advisory Board chaired by The Hon Mr Justice Kenneth Hayne of the High Court of Australia and comprising senior legal practitioners, company directors and directors of the Australian Securities and Investments Commission and the Australian Securities Exchange. The Centre also has an International Advisory Board comprising leading judges and corporate law academics.

The Centre's previous publications include:

- Ann O'Connell, *Employee Share Ownership Plans in Australia: The Taxation Law Framework*
- Ingrid Landau and Ian Ramsay, *Employee Share Ownership Plans in Australia: The Corporate Law Framework*
- Ingrid Landau, Ian Ramsay, Richard Mitchell and Ann O'Connell, *Employee Share Ownership: A Review of the Literature*
- Ingrid Landau, Ian Ramsay, Richard Mitchell and Ann O'Connell, *An Overview of Existing Data on Employee Share Ownership in Australia*
- Kirsten Anderson, Shelley Marshall and Ian Ramsay, *Do Australian Institutional Investors Aim to Influence the Human Resource Practices of Investee Companies?*
- Nicholas Lew and Ian Ramsay, *Corporate Law Reform and Delisting in Australia*
- Chris Miller, Rebecca Campbell and Ian Ramsay, *The Takeovers Panel- An Empirical Study*

- Andrew Barnes, Tanya Josev, Jarrod Lenne, Shelley Marshall, Richard Mitchell, Ian Ramsay and Cameron Rider, *Employee Share Ownership Schemes: Two Case Studies*
- Ian Ramsay and Benjamin Saunders, *Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action*
- Kirsten Anderson and Ian Ramsay, *From the Picketline to the Boardroom: Union Shareholder Activism in Australia*
- Richard Mitchell, Anthony O'Donnell and Ian Ramsay, *Shareholder Value and Employee Interests: Intersections of Corporate Governance, Corporate Law and Labour Law*
- Jarrod Lenne, Richard Mitchell and Ian Ramsay, *Employee Share Ownership In Australia: A Survey of Key Issues and Themes*
- Paul James, Ian Ramsay and Polat Siva, *Insolvent Trading: An Empirical Study*
- Susan Woodward and Shelley Marshall, *A Better Framework: Reforming Not-For-Profit Regulation*
- Ian Ramsay, *Use of Prospectuses by Investors and Professional Advisers*
- Helen Bird, Davin Chow, Jarrod Lenne and Ian Ramsay, *ASIC Enforcement Patterns*
- Nicole Calleja, *The New Takeovers Panel - A Better Way?*
- Paul Ali and Martin Gold, *An Appraisal of Socially Responsible Investments and Implications for Trustees and Other Investment Fiduciaries*
- Larelle Chapple and Phillip Lipton, *Corporate Authority and Dealings With Officers and Agents*
- Anne-Marie Neagle and Natasha Tsykin, *'Please Explain': ASX Share Price Queries and the Australian Continuous Disclosure Regime*
- Ian Ramsay (ed), *Company Directors' Liability for Insolvent Trading*
- Ian Ramsay and Geof Stapledon, *Corporate Governance: The Role of Superannuation Trustees*
- Ian Ramsay, Geof Stapledon and Joel Vernon, *Political Donations by Australian Companies*
- Geof Stapledon, Sandy Easterbrook, Pru Bennett and Ian Ramsay, *Proxy Voting in Australia's Largest Companies*
- Asjeet Lamba and Ian Ramsay, *Share Buy-backs: An Empirical Investigation*
- Jeffrey Lawrence and Geof Stapledon, *Do Independent Directors Add Value?*
- George Gilligan, Helen Bird and Ian Ramsay, *Regulating Directors' Duties – How Effective are the Civil Penalty Sanctions in the Australian Corporations Law?*
- Vivien Goldwasser, *Stock Market Manipulation and Short Selling* (jointly published with CCH)
- Pamela Hanrahan, *Managed Investments Law* (jointly published with CCH)
- Ian Ramsay and Geof Stapledon, *Corporate Groups in Australia*
- Ian Ramsay, Geof Stapledon and Kenneth Fong, *Institutional Investors' Views on Corporate Governance*
- Cally Jordan, *International Survey of Corporate Law in Asia, Europe, North America and the Commonwealth*

- Ian Ramsay (ed), *Corporate Governance and the Duties of Company Directors*
- Ian Ramsay and Richard Hoad, *Disclosure of Corporate Governance Practices by Australian Companies*
- Megan Richardson (ed), *Deregulation of Public Utilities: Current Issues and Perspectives*
- Geof Stapledon and Jeffrey Lawrence, *Corporate Governance in the Top 100: An Empirical Study of the Top 100 Companies' Boards of Directors*
- Ian Ramsay (ed), *Gambotto v WCP Ltd: Its Implications for Corporate Regulation*
- Phillip Lipton, *The Authority of Agents and Officers to Act for a Company: Legal Principles*

The Centre's contact details are:

Tel: 61 3 8344 5281

Fax: 61 3 8344 5285

Email: cclsr@law.unimelb.edu.au

Website: <http://cclsr.law.unimelb.edu.au>

Table of Contents

I	Introduction.....	8
II	Prior Literature on Termination Payments.....	12
III	Regulation of Termination Payments	18
IV	Methodology	25
V	Termination Payments: Prevailing Practice	29
VI	Thresholds and Exempt Payments	38
VII	Alternative Thresholds: ASX and ACSI	40
VIII	Conclusion	44

SEVEN: THE CORPORATIONS ACT, CORPORATE GOVERNANCE, AND TERMINATION PAYMENTS TO SENIOR EMPLOYEES

Abstract

This paper presents an empirical study of the operation of regulation of termination payments found in Part 2D.2 of the *Corporations Act 2001* (Cth) and ASX Listing Rule 10.19, as well as limits endorsed in the ACSI Corporate Governance guidelines. Based on the termination payments contemplated by the executive service contracts of a sample of ASX 50 managing directors, the empirical results demonstrate the sheer magnitude of the Part 2D.2 and ASX thresholds and highlight problems with classifying share-based remuneration payments according to the current s 200F and s 200G descriptions. The prevalence of contractual or share plan terms which permit share-based payments to be made without reference to the underlying performance conditions is also noted.

I INTRODUCTION

Publicly listed companies are subject to much regulation of payments to senior executives and directors. Regulation may take the form of mandatory rules requiring companies to disclose all forms of remuneration received by key management personnel.¹ Other rules require shareholders to approve particular payments or benefits, but do not allow shareholders to determine how much is paid or given.² Further regulation takes the form of advisory guidelines or principles which companies can choose to adopt or not, with a requirement to explain “if not, why not” should the company choose to not adopt the practices recommended.³ Further rules are provided by accounting standards which mandate how items are to be valued for the purposes of the company’s financial statements.⁴

For the most part, private and unlisted public companies are spared this regulation. One notable exception is the requirement under Part 2D.2 of the *Corporations Act 2001* (Cth). Section 200B(1) makes it an offence for companies to give benefits to officers upon

¹ *Corporations Act 2001* (Cth) s 300A, Corporations Regulations 2001 (Cth) reg 2M.03.

² Approval of issues of securities to directors is required under ASX Listing Rule 10.14; approval of related party transactions is required under Corporations Act 2001 (Cth), s 208 and approval of termination benefits is required under s 200E. A resolution to adopt the Remuneration Report is required at a listed company’s AGM but is advisory only: s250R(2), (3). Investment and Financial Services Association, *Non-binding shareholder vote* (2005) and *Executive share and option scheme guidelines* IFS Guidance Note No. 12 (2000), guideline 9 both stress the importance of disclosure to shareholders to enable them to make an informed vote on these resolutions.

³ ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations* (2003); ASX Listing Rule 4.10.3; Australian Council of Super Investors Inc (ACSI), *Corporate Governance Guidelines* (2005); Investment and Financial Services Association (IFSA) *Corporate governance: a guide for fund managers and corporations* (Blue Book) (2004).

⁴ Corporations Regulations 2001 (Cth) reg 2M.03.03 specifies the accounting standard to be used for the purposes of reporting remuneration under s 300A. AASB 124 *Related Party Transactions* and AASB 2 *Share-based payments*; AASB 1046 *Director and Executive Disclosures by Disclosing Entities* was the relevant accounting standard for the period covered by this empirical study.

retirement from office without prior shareholder approval unless the benefit falls within one of the limited exceptions in s 200F(1) or the total benefits given fall below thresholds specified in s 200F(3), (4)⁵ and s 200G(2), (3).⁶ Regulation of this particular remuneration practice is long-standing⁷ but has received little attention empirically in Australia.⁸ As far as we are aware, this is the first study to empirically explore the operation of the thresholds sanctioned by Part 2D.2, ASX Listing Rule 10.19 and ACSI Corporate Governance Guideline 14.1 respectively.

We draw a sample of 28 managing directors from the S&P/ASX 50 as at 1 July 2005 and use details of the remuneration, service contracts and relevant share plans rules (where available) for each managing director to explore the nature and size of payments that would have been made if that managing director's employment was terminated by the company on 1 March 2006. We then compare the size of these payments to the thresholds permitted by Part 2D.2, the ASX Listing Rules and the ACSI Corporate Governance Guidelines. This comparison highlights the large termination benefits companies can give under both Part 2D.2 and the ASX Listing Rules. Only four of the 28 termination payments would require prior shareholder approval under Part 2D.2, with payments as large as \$129 million sanctioned by Part 2D.2 thresholds. The ASX Listing Rule threshold is unlikely to be breached by the termination of one executive, but could be triggered if there was some larger-scale termination of a number of senior executives, possibly as the result of takeover or merger and

⁵ If the benefit is given under section 200F(2). See below Part III(B).

⁶ If the benefit is a lump sum payment for past services or pension that falls within the ambit of s 200G(1).

⁷ The first statutory provisions are contained in the state *Companies Acts*, for example, *Companies Act 1938* (Vic), s150(1), based on the *Companies Act 1928* (UK) 18 & 19 Geo. V, c. 45 s 82 and the *Companies Act 1929* (UK) 19 & 20 Geo. V, c.23 s 150. The introduction of thresholds into the legislation appears for the first time in the 1950s: for example, *Companies Act 1958* (Vic) s 108(5)(d).

⁸ Geof Stapledon's study on termination payments is the only prior Australian empirical study on this point: Geof Stapledon, 'Termination benefits for executives of Australian companies' (2005) 27 *Sydney Law Review* 683.

acquisition (M&A) activities. The ACSI threshold was exceeded by all but one payment. Based on these findings, we question whether a threshold-based approach to deciding which payments are acceptable (in the sense that prior shareholder approval is not required) and which payments should be approved by shareholders in advance may prove unworkable in practice.⁹

In a further contribution to the corporate governance literature, we undertake an empirical analysis of the termination provisions of executive service contracts. Given a hypothetical termination date of 1 March 2006, nine of the 28 companies examined would have paid an amount equivalent to at least 18 months' cash remuneration by way of contractual termination payment to the managing director. These companies would also permit some of the accumulated share-based payments to vest. While the remaining contracts allowed for lower levels of cash remuneration to be paid on termination, these contracts likewise permitted some, if not all, of the accumulated share-based payments to vest. Shareholders should be interested in how such vesting occurs, especially when no adjustment is made to recognise the reduced period over which performance is measured. If no adjustment occurs, an executive who is in effect sacked is rewarded for performance that has either not actually occurred (because the performance conditions are waived or deemed to be satisfied) or is as yet to occur (because the original vesting period is maintained, and the executive reaps the benefits of performance that occurs after he or she has left the company).

⁹ The Parliamentary Joint Committee on Corporations and Financial Services in its review of the CLERP (Audit Reform and Corporate Disclosure) Bill 2003 stated 'The difficulty for the Committee is in endorsing the threshold set by the proposed legislation. It is concerned that the provision sets down a formula that establishes a relatively high benchmark – a payment above this point requires shareholder approval, a payment below it is exempt from approval.' Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *CLERP (Audit Reform and Corporate Disclosure) Bill 2003, Part 1: Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters* (2004) [5.73]. ACSI also has concerns about the thresholds: ACSI above n 3, Guideline 14.1.

These two empirical findings, while shedding light on current practices, raise serious questions about the operation of Part 2D.2. The causal link between a benefit received and the termination is whether paying the benefit has ‘something to do with’¹⁰ the retirement or termination.¹¹ Merely entering into an agreement which contemplates giving such a benefit does not trigger the requirement for shareholder approval; only the act of payment itself does so.¹² That the payment and the executive’s retirement are contemporaneous is relevant to, but not determinative of, the existence of the requisite connection.¹³ Establishing this causal link is difficult for share-based payments: does earlier vesting provide sufficient causal link for the purposes of Part 2D.2? If so, how should the payment be valued, given that current accounting standards expense share-based payments on a fair value basis measured at the date of grant?¹⁴

This paper is structured as follows: in section II we examine some of the prior empirical literature on termination payments, including discussion of Geof Stapledon’s empirical study of termination payments observed over the period 1999 to 2004. Section III explores the nature of termination payments and outlines the operation of the Part 2D.2 provisions. We also explore briefly the history of the statutory thresholds in an attempt to understand how a threshold based on seven years’ remuneration was adopted. The methodology of our study is outlined in section IV. Section V presents the results of our analysis of executive service contracts and current remuneration practice. Section VI models the thresholds that would

¹⁰ *Claremont Petroleum NL v Cummings* (1992) 110 ALR 239, 280, relying on his earlier reasoning on the meaning of the phrase ‘in connection with’ as it appears in the *Broadcasting Act 1942* (Cth), s25B in *Our Town FM Pty Ltd v Australian Broadcasting Tribunal* (1987) 16 FCR 465, 479-480.

¹¹ The legislation uses the term ‘retirement’ which is defined in s 200A(1)(e) to include loss of office. Throughout this paper, we will use ‘termination’ which falls within the meaning of retirement in s 200A(1)(e).

¹² *Fox v GIO Australia* (2002) 56 NSWLR 512, 533 per Walton J; recently endorsed in *Silver v Dome Resources NL* [2007] NSWSC 455, [85] and *Orrong Strategies Pty Ltd v Village Roadshow Ltd* [2007] VSC 1, [660]-[663].

¹³ *Whitlam v Insurance Australia Group* (2005) 52 ACSR 470, 531.

¹⁴ AASB 2, paragraphs 10–15.

apply under Part 2D.2 and compares those thresholds with the actual termination payments identified in Section V. Two alternative thresholds to Part 2D.2 are provided by the ASX Listing Rules and the ACSI Guidelines: both are explored in section VII. Section VIII concludes with a series of questions we have in relation to the operation of Part 2D.2. Our further analysis of these questions is the subject of a second paper.¹⁵

II PRIOR LITERATURE ON TERMINATION PAYMENTS

To date, termination payments have received little empirical attention in Australia; the Stapledon study is one notable exception, discussed below, although we note the *Australian Financial Review* report on liquidated damages clauses.¹⁶ Many articles on termination payments from US-based scholars look specifically at golden parachutes and are based on the seminal 1985 paper by Richard Lambert and David Larcker on this phenomenon.¹⁷ A golden parachute may be triggered as a result of M&A or takeover activity, thus the focus of many studies is on whether the presence of a golden parachute influences managerial decisions and recommendations to shareholders on M&As or takeovers. We explore US empirical literature on other types of termination payments and retirement benefits in part A, while in part B we discuss the Stapledon study and the AFR report and highlight how our work extends these studies.

¹⁵ Colin Fenwick and Kym Sheehan, 'Share-based remuneration and termination payments to executive directors: what are the rules?' (Research Report, Centre for Corporate Law and Securities Regulation & Centre for Employment and Labour Relations Law, The University of Melbourne, 2007)

¹⁶ Damon Kitney and Fiona Buffini, '\$100m payout bonanza for CEOs' *Australian Financial Review* (6 December 2004), 1, 15; Damon Kitney, 'In line for a golden parachute' *Australian Financial Review* (6 December 2004), 15.

¹⁷ R A Lambert and D R Larcker, 'Golden parachutes, executive decision-making and shareholder wealth' (1985) 7 *Journal of Accounting and Economics* 179.

A US empirical studies on retirement and termination payments

Studies by David Yermack¹⁸ and Lucian Bebchuk and Jesse Fried¹⁹ look at termination payments other than golden parachutes. David Yermack's study examined the separation payments made to a sample of 179 *Fortune 500* CEOs who left their firms during the period 1996 to 2002. He found that only 24 per cent of the CEOs in his sample received some or all of their termination payment in the form of liquidated damages (an amount agreed at the time the CEO started in this role). Secondly, he observed many companies deviated from their stated share plan policies on how stock options or other share-based payments would be treated at termination. Observed deviations included 'waiver of forfeiture rules, more generous vesting than usual and longer exercise periods'.²⁰ As we report below in Table 1, our research suggests that Australian companies do provide more extensively for a termination payment in the form of liquidated damages. However, there is also considerable flexibility in terms of how share-based payments are dealt with (see the discussion below in section V) and we note the practices observed by Yermack are frequently provided for contractually or within share-plan rules in Australia. This can be explained by the fact that all managing directors within our sample had employment contracts; only one third of the CEOs in his sample had written employment contracts at the time of the CEO's exit.²¹ We further

¹⁸ David Yermack, 'Golden handshakes: separation pay for retired and dismissed CEOs' (2006) 41(3) *Journal of Accounting and Economics* 237.

¹⁹ Lucian Bebchuk and Jesse Fried, 'Stealth compensation via retirement benefits' (2004) 1 *Berkeley Business Law Journal* 291.

²⁰ Yermack above n 18, 249, footnote 8.

²¹ *Ibid*, 245.

note, as Yermack too observed,²² that it is not uncommon for a CEO to be allowed to retain his or her right to as yet unvested share based payments after leaving the firm.²³

Bebchuk and Fried's study examines retirement benefits from the managerial power perspective. This perspective argues that senior executives will seek to avoid shareholders becoming incensed over the size of payments made to executives by concealing this pay. In the US, retirement benefits to senior executives are primarily delivered via defined benefit schemes known as supplemental executive retirement plans (SERPs). As Bebhuk and Fried note, companies are only required to report the total liability of the company's retirement or pension plans. Accounting standards do not require separate reporting of SERP liability for each executive, thus shareholders do not see the steady increase in the executive's SERP benefits as another year of service accrues.²⁴ Bebhuk and Fried do not quantify the potential benefits that such executives will obtain due to a lack of disclosure, but suggest that such benefits are likely to be sizeable.²⁵

A study by Lucian Bebhuk and Robert J Jackson Jr quantifies these payments by undertaking an actuarial analysis of the pension plan benefits of two samples of CEOs: a sample of former S&P 500 CEOs who left that role during a 17 month period from January 2003 to the end of May 2004 and a second sample taken from all CEOs in the ExecuComp database between the ages of 63 and 67.²⁶ Their study reports the average *annual* pension

²² Ibid, 249.

²³ See Table 1 below. The recent departure of Matthew Slatter as CEO of Tabcorp Ltd illustrates the practice of share-based remuneration being retained beyond the date of termination and allowed to vest subsequently. Tabcorp Limited, 'Tabcorp's Matthew Slatter leaves the company' (Press Release, 14 March 2007).

²⁴ Bebhuk and Fried above n 19, 305–307.

²⁵ Ibid, 308.

²⁶ Lucian Bebhuk and Robert J Jackson Jr, 'Putting executive pensions on the radar screen' (Discussion paper no. 507, Harvard John M Olin Center for Law, Economics and Business, 2005), 13. The justification for this second sample is to enable the researchers to calculate a realistic value for the final pension, as this value will

benefit to the retired CEOs in the first sample was US\$1.1 million (US dollars) for life. The current median actuarial value of this pension benefit was US\$14 million. The average annual pension of the second group of CEOs was US\$1.5 million, with a current median actuarial value of more than US\$15 million.²⁷ They estimate the median ratio of pension benefits to total executive compensation (including equity based compensation) received as CEO was 34.5 per cent for the first group and 27.8 per cent for the second group.²⁸ In our empirical study below, we do not take into consideration accumulated superannuation entitlements. Thus any amounts we show as a termination payment will not include superannuation. As noted below we observed an average superannuation expense of \$202,600 in our sample of 28 managing directors, with one managing director's company contributing over \$620,000 by way of superannuation. As Bebchuk and Jackson Jr argue, any consideration of executive remuneration that does not take into consideration the amount of retirement benefits given by way of pensions (superannuation) is underestimating the value of executive compensation.²⁹

Finally, we note survey research on the reasons behind CEO terminations as provided by the annual study of CEO turnover in the world's largest 2,500 public companies compiled by Booz Allen Hamilton (BAH). In its most recent study, BAH reports that turnovers due to conflicts within the board increased from 2 per cent of turnovers in 1995 to 11 percent in 2004 – 2006, with one in three turnovers being involuntary (including turnovers due to merger or private equity buyout).³⁰ This suggests the type of termination we use as the trigger

depend on the years of service and on the elements of compensation that are used to determine the final average salary of the CEO.

²⁷ Ibid, 15, 18.

²⁸ Ibid, 21.

²⁹ Ibid, 22.

³⁰ Chuck Lucier, Steven Wheeler and Rolf Habbert, 'The era of the inclusive leader' (2007) 47 *strategy + business* <http://www.strategy-business.com/media/file/sb47_07205.pdf> at 13 June 2007.

event in our empirical study – a termination initiated by the board for reasons other than misconduct or ‘for cause’ - is not some remote possibility.

B *The Stapledon study*

Geof Stapledon’s 2005 study of termination payments to Australian executives was the first such analysis of its kind, despite recent public concern over remuneration of company executives.³¹ Aside from a comprehensive survey of the academic literature, public policy analysis, and good practice guidelines relating to termination payments to company directors, it presented empirical findings based on the termination payments made to 40 executives of listed companies over the period 1999 to 2004. Stapledon notes the average termination payment was \$3.65 million, with a median payment of \$3 million;³² nine of the 40 termination payments observed exceeded \$6.5 million.³³ One feature of this analysis is that the headline figure reported as a termination payment in the media does not discriminate between the actual termination payment and other accumulated payments legally due to the executive (for example, accumulated long service and annual leave).³⁴ Stapledon suggested one issue to be addressed as part of an informed debate on termination payments is the generosity of the statutory caps. He further called for an empirical analysis of executive service agreements, with detailed analysis of the provisions of liquidated damages clauses, to inform the debate as to whether such clauses are optimal.³⁵

Our work, while building directly on Stapledon’s, also has some key points of differentiation in its focus and methodology. Our study indeed sheds light on current practice as he suggests

³¹ Stapledon, above n 8, 683.

³² Ibid, 709.

³³ Ibid, 701.

³⁴ Ibid, 708.

³⁵ Ibid, 710-712.

in both its empirical analysis of executive service agreements in section V and Tables 1-3 and the analysis of the statutory caps below in Section VI and Table 4. While we also draw our data from company annual reports, our data is taken from 2005 annual reports, the first year of company reporting under the new disclosure requirements in the *Corporations Act*. This material provides unprecedented information not only about remuneration payments, but also about contractual termination provisions. This detail provides the data to demonstrate what the new limits in Part 2D.2 of the Act might actually allow in practice. As far as we are aware, ours is the first study to use this information for this purpose. As will be explained in section V, our methodology is based on using real remuneration and contractual provisions to explore the hypothetical situation of a forced termination, whereas Stapledon's study relies upon actual terminations reported. We note in particular that Stapledon's study did not explicitly consider the fate of share-based payments, but relied on the termination payment disclosed as such in the annual report. Based on our empirical results in Table 4 and our analysis of the provisions of executive service contracts in Table 1 it is possible that many executives received additional benefits over and above what has been disclosed as a termination payment.

Our work further extends the review of contractual termination benefits highlighted by the *Australian Financial Review*³⁶ by undertaking more detailed analysis of the contractual provisions featured in that article. We analyse how the contractual terms fit into the s 200F and s 200G exemptions and thresholds in section V and Table 3 below. We extend their analysis by illustrating how share-based payments will be treated upon termination in section V and Table 1 below.

³⁶ Kitney and Buffini and Kitney, above, n 16

III REGULATION OF TERMINATION PAYMENTS

In this section we examine the nature of termination payments, the current *Corporations Act* requirements as well as presenting a brief history of the Part 2D.2 thresholds.

A *The nature of termination payments*

By its nature, a termination payment signifies the end of the employment relationship between the executive and the company. As noted above, regulation of executive remuneration is largely disclosure-based rather than prescriptive or proscriptive. Shareholders might choose to use mechanisms such as the advisory vote on the Remuneration Report, the re-election of directors or votes to approve issues of securities to signal their disapproval of current practice.³⁷ There is no system of shareholder redress against an executive once he or she ‘left the building’ after a termination payment is made, although the executive and non-executive director labour markets will take note of the reasons for the executive’s forced departure if and when the executive seeks a subsequent position.³⁸

A more fundamental problem with termination payments from a shareholders’ perspective exists: the contracts entered into with the executive are negotiated with the board of directors and signed on the company’s behalf by the board and are not subject to shareholder approval.³⁹ When contractual provisions are settled at the time of the executive’s initial

³⁷ Kym Sheehan, ‘Is the outrage constraint an effective constraint on executive remuneration: evidence from the UK and preliminary results for Australia’ (Working paper, 2007) 24-29, 41-43. <<http://www.ssrn.com/abstract=974965>> at 19 March 2007.

³⁸ Jeffrey Sonnenfeld and Andrew Ward, *Firing back: how great leaders rebound after career disasters* (2007), 123-134.

³⁹ Recent US legislation (before the US Senate as at the time of writing) seeks to allow shareholders an advisory vote on golden parachute provisions in CEO contracts: Shareholder Vote on Executive Compensation Act, H.R. 1257.RH, s 2. Alternative approaches mooted by the Department of Trade and Industry in the UK during the ‘Rewards for failure’ consultation were to strengthen best practice guidelines (which would give shareholders some input into the contractual process) or to legislate to achieve the same outcome (by limiting the length of 18

hiring, the executive has a number of bargaining chips he or she can use to influence the final contractual provisions (most notably the fact the company wants to hire this executive).

Termination provisions negotiated in this climate may seek to insure the executive against financial loss on termination, rather than protect the company from paying out too much to an executive that, for one reason or another, it no longer wishes to employ. From the managerial power thesis perspective, the board is effectively 'captured' by the executive and is unable to be relied upon to negotiate an arm's-length bargain that would best serve shareholder interests.⁴⁰ In the case of contracts subsequently renegotiated by an incumbent executive, a likely climate is one in which the executive, armed with information from a remuneration consultant on market practice, together with the advice of his or her lawyer, seeks a contract that reflects his or her value in the labour market. Given the value of the executive to the company, the board may feel pressured to meet the market for this particular executive.⁴¹

Corporate governance guidelines offer pithy advice for boards: ensure the contract permits the company to terminate the executive's employment in a variety of situations, including but not limited to misconduct; agree termination payments in advance (by liquidated damages clauses, for example); distinguish between terminations for misconduct ('for cause') and other terminations when determining payments; deal specifically with share-based payments, both vested but unexercised and unvested; and, above all, avoid making excessive payments in situations where the reason for the termination is that the executive has failed to perform.⁴²

contracts or, subject only to member waiver, declaring certain contractual provisions void). Department of Trade and Industry, *Rewards for failure Directors' remuneration – contracts, performance and severance* (2003), 10, 15-16. Ultimately, the best practice route was adopted.

⁴⁰ Lucian Bebchuk and Jesse Fried, *Pay without performance: the unfulfilled promise of executive compensation* (2004), 87-94.

⁴¹ *Ibid*, 70-72.

⁴² ASX, above n 3, 56, and ACSI, above n 3, Guideline 14.1.

Regulation of termination payments has to balance the competing interests of an executive forced from managerial office (namely, his or her interest in securing a fair financial outcome, especially where the termination is not due to misconduct) with those of the company's shareholders (who do not want the company's funds dissipated through unnecessary payments to executives). While both statutory corporate law and the general law of fiduciary duties seek to manage such conflicts of interest arising from the position of managing director and company,⁴³ something else is needed in these circumstances. Thus Part 2D.2 allows payments to be made up to a certain threshold without shareholder approval, but requires prior approval for payments in excess of the threshold.

B Corporations Act 2001 requirements

Section 200D makes it an offence for a person who has held board or managerial office in a company to receive a benefit if that benefit contravenes either s 200B or s 200C. Section 200B makes it an offence for a company, its associates or a prescribed superannuation fund to give a benefit in connection with a person's retirement from office unless shareholder approval is obtained under s 200E.⁴⁴ Shareholder approval is not required for exempt benefits under s 200F or genuine payments of pension or lump sum under s 200G. In both cases exempt benefits are defined with reference not only to the type of payment but also to a threshold contained in the relevant sections.

The following payments are exempt from the requirement for shareholder approval:

- Benefits given under an agreement signed earlier than 1 January 1991

⁴³ R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (13th edition, 2007), [9.030], [9.580].

⁴⁴ Section 200C requires shareholder approval for benefits given on the transfer of the whole or part of the undertaking or company property. The exemptions in s 200F and s 200G do not apply to s 200C. Our focus is upon payments likely to be captured by s 200B.

- Payment made for a leave of absence under an industrial instrument
- Benefits given under a court order
- Benefits given by companies to superannuation funds or by one superannuation fund to another superannuation fund where the benefit is subsequently given to the employee.

In relation to the last issue, Justice Austin and Ian Ramsay suggest that superannuation payments need to be separately considered: the payment from the company to the superannuation fund falls within s 200F and the prescribed circumstances in s 200B(3) while the payment of the superannuation fund to the executive falls under s 200G.⁴⁵

Section 200F(2) is the key provision for contractual benefits, whereas s 200G(1) allows benefits given in relation to past services, such as superannuation or an accumulated lump sum to be exempt from the operation of s 200B, provided the amount falls within the thresholds specified in s 200G(2), (3). Section 200G will exclude contributions made by the person towards superannuation⁴⁶ or lump sums but will cover gratuitous payments.⁴⁷ Section 200G clearly provides for the circumstance where the employee has been a full-time employee of the company in determining the size of the threshold, thus allowing a higher threshold for a longer serving employee (up to the maximum multiplier of seven), whereas s 200F only takes into consideration the period in board or managerial office. Section 200F also takes into consideration payments given via s 200G but s 200G disregards payments made under s 200F for the purposes of determining that threshold.

⁴⁵ Austin and Ramsay, above n 43, [9.580].

⁴⁶ Section 200G(4). However the case of *Whitlam v IAG* highlights that salary sacrifice contributions do not count as personal contributions but as contributions by the company. *Whitlam v Insurance Australia Group Ltd* (2005) 50 ACSR 470, 534.

⁴⁷ *Randall v Aristocrat Leisure Ltd* [2004] NSWSC 411, [538]

Section 200F is the primary focus of this article.⁴⁸ Under s 200F a benefit given either as genuine payment by way of damages for breach of contract or given under an agreement as part of the consideration for taking up the office is exempt, *if* the sum of that benefit, together with all other payments paid or payable in connection with retirement from office does not exceed a threshold (calculated by reference to years in office and average annual remuneration). The relevant formulae is given in s 200F(3):

$$\frac{\text{Total remuneration} \times \text{Relevant period}}{3}$$

The relevant period is the time that the person held office in the company,⁴⁹ or seven years, whichever is the lesser,⁵⁰ while total remuneration means the person's total remuneration received from the company and from related bodies corporate in the last three years of the relevant period.⁵¹ Remuneration is defined in s 9 by reference to the applicable accounting standards for disclosure of remuneration in the Remuneration Report.⁵² Appendix 1 to AASB 1046 (the applicable standard for the period of this study) has a list of what is to be included as remuneration. While share-based payments are to be reported at their fair value in accordance with AASB 2, any gains on exercise of share-based payments (for example,

⁴⁸ The treatment of share-based payments is discussed more fully in our second paper, Fenwick and Sheehan, above n 15, 26-33. Specifically, we consider whether such payments may fall under s 200G as a payment for past services.

⁴⁹ The case of *Orrong Strategies Pty Ltd v Village Roadshow Ltd* [2007] VSC 1, [669] suggests board or managerial office should be given an interpretation that fits with the circumstances in which someone will be considered to be involved in the management of a corporation for the purposes of Corporations Act 2001 (Cth) s 206A. This relies upon primarily comments from R P Austin, H A J Ford AM and I M Ramsay *Company directors: principles of corporate law and governance* (2005), [2.47].

⁵⁰ *Corporations Act 2001* (Cth) ss 200F(3) and (5) and 200(G)(3).

⁵¹ *Corporations Act 2001* (Cth) ss 200F(3) and 200G(3).

⁵² AASB 124 *Related Party Disclosures*, Aus25.4 requires disclosure of 'compensation' for each key management person (defined in clause 9 to include directors). Aus 9.1.1 clarifies that while 'compensation' rather than 'remuneration' is used in AASB 124, 'both words refer to the same concept and all references in the Corporations Act to the remuneration of directors and executives is taken as referring to compensation as defined and explained in this Standard.'

where unvested share based payments are permitted to vest upon termination and are exercised by the executive) are not considered to be remuneration and are not required to be reported.⁵³ Remuneration includes superannuation payments made by the company, so the total remuneration figure reported will include all cash payments, non-cash benefits, share-based remuneration granted and superannuation payments made by the company in that financial year. As noted recently, the policy of the Act and the accounting standards is to give remuneration in s 9 ‘an ample definition: the policy is to catch anything that is, in reality, a reward to the director.’⁵⁴

C A brief history of the Part 2D.2 thresholds

The actual thresholds in Part 2D.2 are generous: the original threshold of three times average annual remuneration over the previous three years⁵⁵ was amended in 1981 to the current level of seven times average annual emoluments (the term then used to describe what is now termed remuneration) over the preceding three-year period.⁵⁶ It was justified in the Explanatory Memorandum to the 1981 Bill as being a change to the averaging formula to take account of inflation.⁵⁷ It is important to remember that the 1970s and early 1980s were times of double-digit inflation in Australia. While the highest levels of inflation as measured by the consumer price index were recorded in the quarters September 1974 to June 1975 (percentage change from the corresponding quarter of the previous year was 16.4 per cent, 16.3 per cent, 17.6 per cent and 16.9 per cent respectively), the inflation rate did not drop

⁵³ AASB 1046 paragraph 5.2.14.

⁵⁴ *Silver v Dome Resources* [2007] NSWSC 455, [98] (Hamilton J). For the contrary view that s 200F and s 200G do not cover every type of termination payment see Stapledon above n 8, 712.

⁵⁵ *Companies Act 1958* (Vic) s 108(5)(d).

⁵⁶ *Companies Act 1981* (Cth) s 233.

⁵⁷ Explanatory Memorandum, Companies Bill 1981 (Cth) [569].

back to single digits until December 1977 and went back to double figures for the period December 1979 to September 1980 (percentage change from the corresponding quarter of the previous year was 10.1 per cent, 10.7 per cent, 10.8 per cent and 10.1 per cent respectively). The exposure draft of the Bill was released for consultation in mid-April 1980 and the comments about inflation have to be viewed against this background.⁵⁸

The need to adjust the threshold could reflect the nature of executive remuneration payments at that time. Superannuation provision to private sector employees in the 1970s was ‘status-related’ and a 1972 Department of Labour survey noted that of 703 schemes surveyed, 73 were funded purely by employer contributions and for other schemes the report hints that employer contributions for executive employees were considerably higher than the employee’s own contributions.⁵⁹ A typical superannuation benefit paid to a retiring senior executive of a medium to large firm around that time would be a lump sum of seven times final average salary (over a three year averaging period) provided a minimum service requirement of between 20 to 30 years. Lower amounts were payable for senior executives with less extensive service periods. This lump sum payment was provided on a non-contributory basis: in other words, no contributions were funded by the senior executive.⁶⁰ The formula for determining the final payment for superannuation purposes appears to have been driven by limits on the ability of superannuation funds to claim a tax exemption on income pursuant to *Income Tax Assessment Act 1936* (Cth) s23F.⁶¹

⁵⁸ Australian Bureau of Statistics, Consumer Price Index, 6401.0, Series A2325847F.

⁵⁹ National Superannuation Committee of Inquiry, *Occupational superannuation in Australia* Final Report, Part 2 (1977) 8, 17.

⁶⁰ Bruce D Crook, ‘Superannuation benefit design in the 1980s’ (Seminar Presentation, June 1980, Leon Cussen Institute for Continuing Legal Education, Melbourne) 9.

⁶¹ M J Walsh, ‘Superannuation’ (Seminar presentation, June 1980, Institute for Continuing Legal Education, Melbourne) 29-30. Section 23F was repealed in 1987 by *Taxation Laws Amendment Act (No. 4) 1987* (Cth) s 8.

That there is a distinct similarity between the taxation legislation thresholds and the formulae adopted under the then equivalent of Part 2D.2 is perhaps unsurprising. To a certain extent, trends in executive remuneration have been driven by taxation initiatives, as both companies and executives seek to optimise their respective taxation situation. For example, data for the period 1971 to 1981 shows that the percentage of executive base salary as a percentage of total remuneration decreased from 87.1 per cent in 1971 to 79.2 per cent in 1981.⁶² Fringe benefits at that time comprised a large part of the total remuneration of chief executives: data from Cullen Egan Dell shows that at December 1983, fringe benefits represented 32.0 per cent of total remuneration.⁶³ The top personal income tax marginal rate at the time was around 60 per cent.⁶⁴ Introduction of the capital gains tax in 1985⁶⁵ and fringe benefits tax in 1986,⁶⁶ together with any subsequent changes to taxation treatment of superannuation payments are likely to have an impact on executive remuneration practices.

IV METHODOLOGY

Relying upon actual remuneration data disclosed in the annual report of a sample of listed companies this study seeks to identify:

⁶² By way of comparison: base salary formed a much smaller part of managing director remuneration in 2005, representing 35.11 per cent of total remuneration. The other significant component of annual remuneration was the cash short-term incentive, representing around 32 per cent of total remuneration. ISS Proxy, *CEO Pay in the Top 100 Companies: 2005* (2006) 19 (Table 6).

⁶³ Advisory Committee on Prices and Incomes, *Changes in executive incomes and benefits* (1985), 9 – 13.

⁶⁴ Sam Reinhardt and Lee Steel, 'A brief history of Australia' tax system' (Paper presented at 22nd APEC Finance Minister's Technical Working Group meeting, Vietnam, 2006) 15.

⁶⁵ *Income Tax Assessment Amendment (Capital Gains) Act 1986* (Cth).

⁶⁶ *Fringe Benefits Tax Assessment Act 1986* (Cth).

- (1) The total value of the payments that would have to be made if the managing director's employment had been terminated on 1 March 2006;⁶⁷
- (2) The total value of the payments that would be made if the managing director was entitled to a payment equal to seven times his or her average annual remuneration, or some lesser total based on his or her actual years in office (the Part 2D.2 limits);
- (3) Whether the total value of the payment in (1) exceeds either of the limits in (2);
- (4) Whether the total value of the payment in (1) would exceed the limits recommended in the ASX Listing Rules and the ACSI corporate governance guidelines.

Readers should be aware that it is not possible to calculate the *actual* payment that would be received in the case of an individual managing director within our sample. This is because of (i) the lack of full disclosure of executive service agreements in Australia, and (ii) the lack of disclosure of accumulated superannuation benefits. In addition, boards typically exercise broad discretions in relation to accelerated vesting of share-based payments in termination situations; it is not possible to know in advance how the board of any one company would exercise that discretion. It is because of this inability to be more precise about the actual payment that we have chosen not to identify by name either the companies or managing directors in our study. Rather, each executive was assigned a letter and in all results noted below in Tables 1 through Table 5, these letters are used.

As we have indicated, our sample of executives was drawn from the S&P/ASX 50, as at 1 July 2005. We focus on the position of managing director/chief executive officer on the basis

⁶⁷ As we explain below, the chosen date of 1 March 2006 is only one of a number of simplifying assumptions that were used: see below, page 21 and the accompanying text.

that it is usually the highest paid executive director's position within the company. We excluded over 20 companies and managing directors from our sample. First we excluded any managing director who had taken up their position during or after the 2004/2005 financial year, as the remuneration reported in the 2005 annual report would not represent remuneration for 12 months in the managing director's role. On this basis, nine managing directors were excluded. Secondly we excluded companies that had not released remuneration data for 2005 by 15 March 2006. Six managing directors were excluded on this basis. Thirdly, we excluded companies that are not domiciled in Australia: not being incorporated in Australia they are not subject to the same reporting requirements. Fourthly, we excluded companies where the managing director was a major shareholder, as in this case the need for shareholder protection is (at least) different than for most publicly listed companies. These two considerations led to the exclusion of four companies. Two managed investment schemes were also excluded, because they are not companies subject to the detailed remuneration disclosure requirements of the Act. One further managing director was excluded on the basis that the company had undergone a major restructure, and the remuneration reported did not reflect current responsibilities. Of the 50 managing directors potentially in the sample, the final sample was therefore 28 managing directors.

The main data source for the study is the Remuneration Report contained in the 2005 annual report. Details of remuneration, service contracts and share plan rules disclosed in these reports were the primary data source used (see section V below for further information). Key provisions of the executive service agreement were examined to determine what provision was made for any future termination of the managing director in three circumstances: a termination without cause, a termination due to a change in control, or a termination initiated

by the executive due to a material change in duties.⁶⁸ As these contracts may defer to the rules of any share-based remuneration plan on termination of employment prior to vesting, these rules were also reviewed. We relied principally on disclosure in the 2005 annual report, supplemented (where necessary) by disclosure in a Notice of Meeting at which shareholder approval was obtained for the issue of securities to the managing director.⁶⁹

A number of simplifying assumptions were made to determine what provisions of the executive service contract would apply to the termination and what value could be attributed to each of the benefits given by that contract. In making these assumptions, we have sought to optimise the amount the MD would receive:

- the MD's termination was initiated by the company;
- the date of cessation of employment was 1 March 2006;
- the managing director was treated as a 'good leaver';
- the managing director was paid in lieu of notice as required under the contract;
- the total remuneration reported in the 2005 annual report was equivalent to the average annual remuneration of the managing director for the previous three years;
- the managing directors' holdings of securities were as stated in the annual report, and valued as at 1 March 2006 using the closing share price;

⁶⁸ A termination without cause would include a mutual agreement to separate or situations of poor performance. A termination due to a change of control can occur as early as the receipt of an unconditional offer to acquire more than 50 per cent of the company's share capital. Both these terminations would be triggered by the company. A termination due to a material change in duties allows the managing director to terminate the employment relationship and will require the company to pay higher amounts than would be typical in the case of a managing director terminating to take up another corporate role. More information on the terms of the service agreements examined in this study is presented in Tables 1 and 2.

⁶⁹ Required under ASX LR 10.14.

- if any share-based payments vested upon termination, they were exercised on 1 March 2006 at the closing share price of the company's ordinary stock (or stapled securities where relevant) on 1 March 2006 provided it was 'in-the-money';
- aggregate amounts of superannuation were excluded, as this information is not able to be identified from the information source we used – this means that any termination payment received by a managing director does not include any details of the aggregate superannuation *and is thus understated*;
- any taxation consequences were ignored; and
- no benefits awarded fell outside the thresholds due to the combined operation of s 200F(1) and s 1468(2) – these provisions relate respectively to agreements made prior to 1 January 1991, and to those that did not come into effect before 1 July 2004, which is when the CLERP 9 reforms began to operate.⁷⁰

V TERMINATION PAYMENTS: PREVAILING PRACTICE

In this section we consider the termination provisions contained in executive service contracts for our sample managing directors. Using this information plus 2005 total remuneration as disclosed in the annual report, we determine how much would be paid if the company terminated the appointment of the managing director, but not 'for cause'. Using this

⁷⁰ This is a major assumption, and together with the acknowledge understatement of termination payments due to lack of disclosure on accumulated superannuation, establishes that no termination payment can be definitively determined by an outsider based on disclosed information. For most of the managing directors in the sample, a proportion of any benefits at termination would most likely be covered by agreements made prior to 1 July 2004. However, it would turn on the exact wording of the agreement, in particular, any variation to the agreement, as to whether *Corporations Act 2001* (Cth) s 1468(2) would quarantine benefits under pre-existing agreements in terms of payment in lieu of notice, restraint of trade or other payments from the ambit of s 200F(2)(a).

information we construct a best case and worst case scenario of the termination payment, depending upon whether all share based payments lapse or vest on termination.

A Contractual provisions

An analysis of the termination provisions in the executive service contracts for the 28 managing directors in the sample is contained below in **Table 1**. It is important to note that we have not reviewed the full executive service contract but are relying upon the summary of the key terms as disclosed in the Remuneration Report.⁷¹

There is limited use of fixed term contracts which provide for the balance of the contractual term to be paid out on termination. Only 4 of the 28 contracts reviewed were fixed term contracts. The remaining contracts all provided for liquidated damages on termination in the form of a sum, ranging from 1 month to 40 months with no contract disclosing that the executive was expected to take steps to mitigate his or her loss or that the payments would be phased payments. Stapledon has questioned whether liquidated damages clauses are the best way to deal with terminations, as the executive can be paid what Yermack describes as ‘a lifetime income’ via a termination payment,⁷² only to be re-employed within a short time-frame.⁷³ Restraints of trade were less prevalent: only two contracts disclosed that a proportion of remuneration payable on termination was in exchange for a restraint of trade.

⁷¹ For a view that current disclosure of executive service contracts is inadequate, see Stapledon above n 8, 713-714

⁷² Yermack, above n 18, 255.

⁷³ Stapledon, above n 8, 710-711.

A further feature of note in relation to Table 1 is the treatment of share-based payments. In all but seven of the contracts reviewed,⁷⁴ share-based payments outstanding at the time of termination were allowed to vest, either immediately or according to the original vesting schedule. Where share rights vest immediately, they do so in one of three ways: as a result of deemed satisfaction of any performance conditions (that is, waiver of the original performance conditions); because of variation of the original performance conditions to pro-rated performance conditions; or because of variation of the original grant by pro-rating the quantum of awards (that is, reducing the number of awards) but retaining the original performance conditions and vesting schedule. In some instances, more than one method could be used to allow for immediate vesting. These rights are in addition to any rights provided by way of consideration for the breach of contract brought about by termination without notice. If so, this may be relevant in determining whether the payment falls within s 200F or s 200G, or whether the payment is indeed caught at all by these provisions.

B Categorising payments: s 200F and s 200G

The complexity of contractual arrangements for termination payments makes it difficult to apply the statutory provisions, as in the case of share-based payments noted above. Another difficulty arises in attempting to characterise particular elements of a termination payment package for the purposes of s 200F and s 200G. As noted above, the tests and formulate under these sections are not the same. Drawing on the decided cases for guidance,⁷⁵ we allocate the termination payments to s 200F and s 200G in **Table 2** below. For this exercise, we treated the various types of payments as follows:

⁷⁴ These are the contracts pertaining to managing directors J, K, M, O, Q, Z and BB. There was no disclosure of how share-based payments would be treated for B.

⁷⁵ Refer to Fenwick and Sheehan above n 15 for further discussion of this case law.

- Amounts showing as ‘genuine payments by way of damages for breach of contract’ under s 200F(2)(a)(i) reflect payments made in lieu of notice periods in the executive service contracts. These ranged from one month to 24 months’ notice as disclosed above in Table 1;
- Payments for restraints of trade are reflected in s 200F(2)(a)(ii) – while only two contracts contained restraints of trade, we speculate that many other companies might seek to impose restraints of trade via a deed of release and settlement at the time of termination, with a restraint accepted by the departing executive in consideration for an additional payment over and above those provided for in the executive service contract;
- Other contractually agreed amounts to be paid in the event of termination are also reflected in the amounts showing for the purposes of s 200F(2)(a)(ii);
- Payments under s 200G reflect a disclosed accumulated post-employment benefit;
- Amounts shown as gains from share exercise were calculated using the closing share price on 1 March 2006 as the relevant exercise price; where share options were exercised, the grant price was taken from the annual reports for each tranche; and
- No accumulated superannuation amounts are shown in s 200G due to a lack of disclosure of accumulated superannuation.

Table 2 shows the importance of the CLERP 9 reforms on contractual termination provisions. Previously, all amounts showing in the first two columns would have been fully exempt

from the requirement for shareholder approval under s 200B(1), irrespective of the amount of the benefit. Such payments are now only exempt if the amount of the payment, together with all other payments made in connection with retirement from office, fall below a threshold calculated in accordance with s 200F(3), (4).

The area of understatement in relation to superannuation is reflected in s 200G(1) payments. It is not possible to determine the amounts, if any, that could be included within s 200G(4) because Australian companies are not required to disclose accumulated superannuation entitlements for individual executives.⁷⁶ The retirement of David Murray from the Commonwealth Bank of Australia illustrates this well: his pay on leaving the bank totalled \$17.5 million, which included \$11.8 million in superannuation benefits. He occupied the managing director's position for 13 years, with almost 40 years with the same employer, a situation that most of today's managing directors are highly unlikely to match. Mr Murray is also entitled to further payments as long term incentive shares granted under plans during 2002, 2003 and 2004 vest over the period 2006 to 2009, a benefit valued by the bank in its 2005 Annual Report as \$5.2 million, based on an assumption that 50 per cent of the shares awarded are received.⁷⁷

Finally, we note in passing that three executives show 'nil' in the share payments column because the managing director had no outstanding share-based payments waiting to vest. This

⁷⁶ This contrasts with requirements for listed companies in the UK: *Companies Act 1985* (UK) c 6, Schedule 7A, paragraph 12(2) requires public companies to disclose in the directors' remuneration report changes in the year to accrued benefits in a defined benefit scheme plus the accrued benefits as at the end of that year, together with transfer values for both these items. Money-purchase schemes are required to disclose details of the contribution to the scheme paid or payable by the company for that year. The Listing Rules issued by the Financial Services Authority in its capacity as the UK Listing Authority also require this disclosure: LR 9.8.6R(7) and LR 9.8.8R(11) for money purchase schemes and (12) for defined benefit schemes.

⁷⁷ Commonwealth Bank of Australia, Annual Report 2005, 54. These shares were granted under the Equity Reward Plan. Disclosure in Note 29 Share Capital reveals the three year performance period for the grants is subject to 6 monthly retests up until the fifth anniversary of the grant. The TSR performance criteria are for 50 per cent to vest if the Bank's performance is equal to the 50th percentile as against a comparator group of banking and finance companies. For performance in the top quartile, 100 per cent of the share rewards will vest.

is an unusual situation: we interpret this as an indication that the particular managing directors were nearing retirement.⁷⁸

C Share-based payments

Tables 1 and 2 indicate that a typical managing director of a large listed corporation will hold, immediately prior to termination, a significant amount of potential wealth in the form of share-based payments. To understand the features of these share-based payments, we obtained details of all awards of share-based remuneration as disclosed in the Remuneration Report, supplemented by disclosure in the notes to the financial statements reported in the 2005 annual report. We also obtained details of the actual shareholdings of the managing director immediately prior to 1 March 2006 from Appendix 3B notices to the ASX as noted in the Aspect Financial Datanalysis database.

Table 3 reports on the share-based payments granted (but not exercised as at the date of the annual report), together with details of the size of any existing shareholding (in terms of numbers of shares and the value of these shares at the closing share price on 1 March 2006). There is considerable variation in the levels of share ownership within the sample, ranging from a holding of only 1,000 shares (executive N) to a holding of more than 4,000,000 shares (executive V).

Three different types of share-based payments are identified in Table 3: traditional share options, zero-exercise-price options or ZEPOs and other share-based payments. A traditional share option has an inbuilt performance component, namely the appreciation in the company's share price between the date of grant and the date of exercise. If the share price

⁷⁸ In one instance, the managing director in question exercised 3,000,000 options during the 2005 financial year, a fact which tends to lend support to our interpretation.

has failed to increase within this time, the share option will not be exercised. A ZEPO, however, always has value to the managing director, because he or she only pays a nominal price to exercise any number of vested ZEPOs.⁷⁹ Other share-based payments are of three types: deferred shares,⁸⁰ a conditional entitlement to shares⁸¹ and cash-settled performance shares.⁸² As Table 3 demonstrates, a managing director may have a mixture of the various types of share-based payments (for example executives C and Z have all three types, with many managing directors holding two different types) whereas other managing directors are rewarded using only one type of share-based payment (for example executives B, D, G, M, N, O, R, X, Y and BB).

To calculate the value of any termination benefit from share-based payments, we used the details contained in the share-based payments granted columns in Table 3 plus shares prices at the date of grant and on 1 March 2006. Shares already held by the executive do not form any part of the termination benefits or payments.

⁷⁹ G P Stapledon, 'The pay for performance dilemma' (2004) 13 *Griffith Law Review* 57, 59-60.

⁸⁰ A deferred share is a share 'issued' but held in escrow and not released until the expiration of a specified performance period. Dividends accruing on the shares are usually paid at the time of the shares release. An example is the Qantas Deferred Share Plan, approved at the 2006 annual general meeting. Qantas Limited, Notice of 2006 annual general meeting, 16 September 2006, 4 – 12, <<http://www.qantas.com.au/infodetail/about/investors/AGMNotice2006.pdf>> at 25 July 2007. Under the terms of this plan, shares are either issued or purchased on market at the time of the grant and held on behalf of each participant by the trustee for the plan until the expiration of a holding lock. The Qantas plan allows for early call of shares, with the plan specifying the relevant earliest dates for such a call.

⁸¹ A conditional entitlement to shares is an entitlement to receive up to a specified number of shares at the expiration of a performance period. The number of shares ultimately received will depend on the level of performance attained over the performance period and is governed by the share plan rules under which the shares are issued. The executive pays no consideration when the shares are issued. For an example, see ASX Limited, Executive Share Plan, clause 3, <<http://www.asx.com.au/about/pdf/executiveshareplan.pdf>> at 25 July 2007.

⁸² A cash-settled performance share scheme involves a nominal grant of a specified number of shares with vesting subject to performance conditions. Any final payment made to the executive will be paid in cash rather than 'settled' by a physical issue of securities.

D *Quantifying the termination payments made*

Due to the wide variations between contracts as disclosed above in Table 1 through Table 3, we derived dollar amounts for the termination payments by analysing the data in the context of two different scenarios, a 'worst case' and a 'best case'. To do so we made some additional simplifying assumptions:

Scenario one: Here we assumed that all unvested share-based remuneration lapsed on the date of termination: in this scenario the executive would receive only the payments provided for in their service agreement, such as cash payments, compensation in return for not competing against the company in subsequent employment, and payment in lieu of notice. From the managing director's perspective this is a 'worst case' scenario as he or she is forgoing significant financial benefits in doing so.

Scenario two: Here we assumed the contrary: that all unvested share-based remuneration vested and was exercised if in the money, that is, if the value of the share exceeded the cost of exercising the option (relevant only for traditional options, as ZEPOs always have value). This was true in the case of all but one of 33 option payments. This is the 'best case' scenario for the managing director; he or she gets to retain all the potential remuneration locked up in share-based payments.

In the first four columns of **Table 4** we show the 2005 total remuneration expense for each executive (column 2) together with the termination payments that would have been payable under these two alternative scenarios. Depending upon how the remuneration committee or the entire board of directors exercised its discretion, the actual termination payment made would fall somewhere between these two scenarios. Details of the contractual provisions in

Table 1 would indicate that in many instances, it is unlikely that the worst case scenario would prevail.

By comparing the results that would have been achieved in scenario 1 (column 3) with the actual remuneration received in 2005 (column 2), it is clear that some companies are exercising restraint in terms of the contractual entitlements to payments upon termination. This is clear from the relatively large number of cases where the figure in column 3 is not greater than the figure in column 2. The mean of the termination payments that could be made under scenario 1 was \$5,146,314 (median value of \$3,573,175), with payments ranging from \$1,460,856 to \$22,250,969.

The table also highlights the importance of share-based remuneration for most Australian managing directors. Columns 3 and 4 show the clear differences between the results in scenarios one and two: in almost every case the managing director would have realised a significantly higher gain upon termination under scenario two, in which it is assumed that all share-based payments vested and were exercised. It must be emphasized, however, that the calculation in scenario two relates to the exercise of *all* share-based payments held at the time of the hypothetical termination, not merely those payments granted in 2005. It does not, however, include the value of the managing directors' shareholding, as reported in the final column of Table 3.

The mean of the termination payments that could be made under scenario 2 was \$14,600,705 (median value of \$10,835,409), with payments ranging from \$1,977,684 to \$48,100,468.

VI THRESHOLDS AND EXEMPT PAYMENTS

In order to assess the scope of the limits imposed by the formula in s 200F and s 200G, we constructed two models to calculate and represent the maximum possible termination payments that would be permitted under the Act.

A *The maximum threshold: model 1*

In **Model 1** we assumed that the managing directors' 2005 remuneration figures represented their average annual remuneration in the previous three years, and that each had at least seven years' service.⁸³ For these purposes we used the headline remuneration figure reported in the 2005 annual report as total remuneration. The results are below in **Table 4**, column 5. This shows the maximum possible termination payments, as we have assumed the highest number of years of service that might be used in applying the formulae in s 200F and s 200G. It also shows that the genuine payments or exempt benefits that would be payable within the statutory formula are sizeable indeed.

Based on the data in column 5, the average threshold below which no shareholder approval is required for a termination payment is \$25,451,854, and the median is \$21,471,923. These figures are both notably higher than most actual termination payments observed by Stapledon over the period 1999 to 2004.⁸⁴

⁸³ This allows the highest multiplier of 7 to be used in the numerator as the relevant period.

⁸⁴ That study showed that the total 'final year' remuneration of Australian executives ranged from \$1.3 million to \$34.7 million, and that the actual termination payment disclosed by the company ranged from \$800,000 to just under \$10 million. Stapledon, above n 8, 701-707.

B *Varied thresholds: model 2*

In **Model 2** we applied the formula using the *actual* years of service of each managing director to define the relevant period. This calculation enables an assessment of what each managing director in the sample would in fact have been able to receive as a maximum termination payment but still fall within the threshold. As the sample selection excluded managing directors with less than one year's service as at 30 June 2005, the relevant periods (within the meaning of s 200F(3)) ranged from three to seven years. Unsurprisingly, these calculations show that in most cases the threshold limit increases as the number of years in the relevant period increases. The data are presented below in **Table 4**, column 8.

C *Comparison of best and worst scenarios with model thresholds*

In each model we compared the termination payments calculated under the two scenarios to with the relevant thresholds. Under scenario 1 (the worst case scenario) all share-based payments are assumed to have lapsed, while under scenario 2 (the best case scenario) it is assumed that all share-based payments vested and were exercised on 1 March 2006. We then compared these figures with the thresholds calculated for each model. The results are shown below in **Table 4**, columns 6 and 7 for the maximum threshold allowed (Model 1) and columns 9 and 10 for the MD's actual years of service (Model 2). The Figures in **bold** in the columns 6, 7, 9 and 10 indicate those payments that exceed the threshold limit in the particular model for that executive: these payments would be illegal without prior shareholder approval.

All possible termination payments under scenario 1 fell within each model's thresholds.

However one payment under scenario two fell outside the Model 1 threshold: executive C.

Using the model 2 thresholds based on actual periods in office, four termination payments under scenario 2 (in which all outstanding share-based payments are assumed to have vested and been exercised on the date of termination) would have triggered the thresholds in the Act, *if* the value to the executive of the shares included in the calculation of the termination payment was in all cases caught by relevant provisions. These are the payments due to executives C, F, P and Y. All had been with their companies for fewer than seven years at the time of termination and thus had a multiplier of less than seven in the applicable formula. Two of these managing directors had high levels of options relative to other managing directors in the study. The payments in columns 6, 7, 9 and 10 exclude superannuation payments: it is therefore possible that a number of other payments in Model 2, scenario 2 (column 10) would exceed the permitted threshold (payments to executives D, E, L, S and W).

As we have emphasized, our calculations have been made on the basis of certain assumptions. In what we have called scenario two the key assumption is that all share-based payments owing to an executive vested upon termination. Analysis of the contractual termination provisions considered for this study (Table 1) shows that such an assumption is not far removed from observed practice among the ASX 50.

VII ALTERNATIVE THRESHOLDS: ASX AND ACSI

In this section we consider how the worst case and best case termination payments to our sample of managing directors compare with the thresholds specified in the ASX Listing Rules and the ACSI guidelines.

A ASX Listing Rules

Two rules in Chapter 10 deal directly with termination benefits. For the purposes of the Listing Rules, termination benefits are defined as ‘payments, property and advantages that are receivable on termination of employment, engagement or office, except those from any superannuation or provident fund and those required by law to be made’.⁸⁵ The reference to ‘advantages’ suggests a broader concept of ‘benefit’ than under the Act. However, this is balanced by the narrower circumstances prescribed by the Listing Rules:

- termination benefits paid to an officer on a change of control;⁸⁶ and
- termination benefits paid to an officer or officers if the value of those benefits and the termination benefits that may or may become payable to all officers together exceed 5 per cent of the equity interests of the entity as set out in the latest accounts given under the listing rules.⁸⁷

We take the 5 per cent threshold from ASX LR 10.19 and use the company’s Statement of Financial Position or Balance Sheet as disclosed in the 2005 annual report, together with the relevant notes to the accounts, to calculate a threshold,⁸⁸ shown as the ASX Limit in **Table 5**, column 5. Taking the worst case and best case termination payments calculated described

⁸⁵ ASX LR 19.12

⁸⁶ ASX LR 10.18.

⁸⁷ ASX LR 10.19.

⁸⁸ Based on the definition of ‘equity interests’ in ASX LR 19.12, we obtained figures for paid up capital, reserves and accumulated profits or losses from the Statement of Financial Position or Balance Sheet for the consolidated entity. We then reviewed the notes to the accounts to ensure that the figures for contributed equity did not include redeemable preference share capital or any share capital attributable to outside equity interests.

above in Section V(D) and repeated in columns 3 and 4 of **Table 5**, columns 6 and 7 show that all the sample MD's termination payments fall comfortably within the ASX Limit, even where the best case scenario 2 termination payment is utilised. This demonstrates that the limit in ASX LR 10.19 is unlikely to be breached in the case of a one-off termination, although it has been used as a reason for seeking shareholder approval under s 200E.⁸⁹

B *ACSI guidelines*

Among the major corporate governance guidelines in Australia, the revised ACSI guidelines take the strongest stand against excessive payments, especially where the termination arises through poor performance against previously agreed benchmarks.⁹⁰ The strict application of Guideline 14.1 would require companies to seek prior shareholder approval for any termination payment valued at more than 12 months' fixed remuneration.

ACSI recommends clear disclosure and supports use of liquidated damages clauses that provide for payment of not more than 12 months' base salary, with no amount payable when the executive is dismissed for cause. The guidelines further provide that unvested performance and incentive-related elements of remuneration should be forfeited when an executive is dismissed for performance not amounting to cause. A clearly defined but not excessive time frame within which vested options and other incentive instruments can be exercised is suggested. ACSI supports UK-style phased payments that cease on an executive

⁸⁹ Macquarie Bank Ltd and Toll Holdings Ltd each sought approval of termination benefits by reference to both ASX LR 10.19 and s 200E at their respective 2005 AGMs, with Toll also seeking such approval at an EGM held on 28 May 2007. Macquarie Bank Limited, Notice of Annual General Meeting 28 July 2005, resolution 6 and see also page 10 of the accompanying explanatory notes. Toll Holdings Limited, Notice of Annual General Meeting Thursday 27 October 2005, resolution 6 and see also pages 6-7 of the accompanying explanatory memorandum. Toll Holdings Limited, Notice of General Meeting 28 May 2007, Resolutions 5-8, and see also pages 307 – 313 of the Explanatory memorandum for shareholders (found in the Restructure Scheme Book).

⁹⁰ ACSI, above n 3. Guideline 14.1 directs attention to terminations in circumstances where poor performance is the cause of the termination. The ACSI guidelines are silent about a termination initiated by a company for circumstances not amounting to cause nor amounting to poor performance.

finding new employment.⁹¹ It also supports legislative reform for shareholder approval of packages: it views s 200F and s 200G as too generous. ACSI also advocates US-style disclosure of executive service agreements.⁹²

The ACSI guidelines might be contrasted with those of the Investment and Financial Services Association (IFSA), which is the industry association that represents investment management firms. It recommends that boards pay particular attention to ‘increasing the transparency of termination or retirement payments to directors and senior management. It is important that termination or retirement payments should be fully disclosed to shareholders and that they are reasonable in the circumstances of the departure.’⁹³

To calculate a termination payment that satisfies the ACSI guidelines, we added the amounts reported as base salary, non-cash benefits and superannuation in the 2005 annual reports to arrive at a figure of 12 months’ fixed remuneration for each of our managing directors. This amount is shown below in **Table 5**, column 8. It is clearly a lower threshold than the thresholds provided under Part 2D.2 (see Table 4, columns 5 and 8). An assessment of our worst case and best case termination payments against the legislative thresholds (see Table 4, columns 6, 7, 9 and 10) contrast starkly with the amounts that would be payable under the same scenarios but subject to the ACSI threshold. As shown below in Table 5 column 9, only one worst case scenario payment fell within the ACSI guidelines (executive H), and one further payment equals the guidelines (executive Z). These two payments would likely fall

⁹¹ This requirement can be found in the *Best Practice on Executive Contracts and Severance – a joint statement by The Association of British Insurers and the National Association of Pension Funds*, (2002), paragraph 3.2.

⁹² *Securities Exchange Act of 1934* 15 USC § 78m, and Regulation S-K item 601(b)(10)(iii)(A) require a company to file a copy of the contract with Securities and Exchange Commission when a senior executive is hired and when there are material changes to the contract, with the filings typically occurring as exhibits to the Form 8-K. The Committee that considered the draft bill that led to the CLERP 9 reforms also recommended that there be disclosure at the time of the making of an executive service agreement, although this is not reflected in the legislative requirements: Parliamentary Joint Committee Report, above n 9, [4.31].

⁹³ IFSA, *Blue Book*, above n 3, [11.14].

outside the threshold in column 8 if accumulated superannuation was taken into account. That aside, it bears emphasizing the possibility of payments falling within the ACSI threshold is limited to scenario one, in which we assumed that unvested share-based payments lapsed at termination. In scenario two, all payments fell outside the ACSI threshold, in some cases by a very significant margin. Thus, if companies followed the ACSI guidelines, *all* the payments shown in columns 3 and 4 (in Tables 4 and 5) would have required prior shareholder approval. In other words, no ASX listed companies within our sample could be said to comply with the ACSI guidelines. Analysis of the termination provisions illustrated in Table 1 suggests that the likely scenario is a payment that falls somewhere between scenario 1 and scenario 2. Shareholders should not presume it would be at the lower, ‘scenario 1’ end of the spectrum.

VIII CONCLUSION

By using real remuneration data and contractual provisions to model the termination payments that could be made by a company to its former managing director, this study demonstrates that companies are prepared to give generous termination benefits to senior executives. It shows that a poorly performing senior executive can receive a sizeable termination payment because the terms of his or her executive service agreement provide for it. Our analysis in Section V reveals the widespread use of liquidated damages clauses. Stapledon has questioned whether such clauses are optimal; on the basis that many of the clauses analysed provided for a cash bonus and a multiple of annual base salary to be paid, they appear misaligned with the circumstances of a company-initiated termination.

Furthermore, a board exercising discretion is also likely to agree to permit some part of the executive's unvested share-based payments to vest, usually without reference to the underlying performance conditions. This too contributes to a sizeable payment on termination. While the 'best case' scenario two outlined in Section VI and Table 4 may seldom eventuate, it is feasible that a termination payment will fall closer to this high point than the low point 'worst case' scenario one. If a senior executive has a large amount of unvested share-based payments that were due to vest soon after the termination date, he or she is unlikely to simply walk away from these payments. A board of directors will be sensitive to this issue, preferring to reach a settlement than to face litigation.

Perhaps of even greater concern is that the thresholds in Part 2D.2 themselves permit a sizeable benefit to be given on termination or retirement. As our study shows, most payments would fall comfortably within the Part 2D.2 thresholds and all fall comfortably within the ASX threshold. While Stapledon's study gives an indication of the size of termination payments that have been made to departing CEOs in recent years, the legislation and the ASX Listing Rules would actually permit far more substantial payments to be made without prior shareholder approval. Every payment in our study, from the lowest 'worst case' scenario payment upwards, fell outside the ACSI threshold. We do not interpret this to mean that the ACSI guidelines have set the correct threshold. Rather, it simply indicates that at least one significant group of shareholders has a very different view to that of parliament and security exchange regulators on where the dividing line is between acceptable and unacceptable levels of payment.

Measuring the size of the termination payments against the thresholds for payments in Part 2D.2 of the *Corporations Act* also raises interesting questions about whether the thresholds

in the *Corporations Act* - thresholds based on average annual remuneration as defined by the accounting standards - have kept pace with remuneration practices. While share-based payments form a large portion of the total remuneration awarded to senior executives, the receipt of such payments as a result of termination may yet be excluded from the Part 2D.2 provisions simply because the causative link between termination and payment may not exist. The initial expensing of the fair value of the share-based payment as at the date of grant will be considered as remuneration for the purposes of determining the annual remuneration paid but the final gain (that is, what the executive actually receives either in shares or as cash in lieu) may fall outside the definition of 'a benefit given in connection with retirement from office'.

The study, while shedding some light on these practices, raises more questions than it answers. Space does not permit these issues to be explored here. In a second paper,⁹⁴ we examine the classification of the various payments typically made at termination by reference to the limited case law on Part 2D.2. We also consider whether share-based payments are actually caught by the legislation by illustrating four alternative methods of vesting contemplated in share plans and service agreements.⁹⁵ How such payments should be valued for the purposes of calculating the value of the termination payment is also highlighted: accounting standards that determine share-based remuneration is to be valued at its fair value at grant date may not sit comfortably alongside the notion of *giving a benefit* in connection with retirement that Part 2D.2 seeks to regulate. Finally, we examine s 200E; based on two case examples of practice, we note the observed practice of bundling shareholder approvals

⁹⁴ Fenwick and Sheehan, above n 15.

⁹⁵ These situations are (i) the exercise of vested options by a departing executive; (ii) the Board or Remuneration Committee exercising its discretion, in accordance with an executive service agreement or share plan rules, to waive or deem satisfied applicable performance conditions; (iii) a cash payment is made in lieu of an issue of securities; (iv) the executive retains his or her rights to unvested share base payments, such payments vesting according to their original schedule.

for different purposes into the one resolution.⁹⁶ In doing so, we suggest that companies might benefit from additional guidance on how to disclose these payments so that shareholders can make informed decisions under s 200E. While recent legislative initiatives in the area of executive remuneration are premised on detailed disclosure, additional disclosure alone that does not necessarily result in the provision of *information* should be avoided. Shareholders require clear and relevant disclosure to make informed decisions about whether to approve termination payments that may occur some years after the resolution seeking their approval. Ultimately legislators and regulators, together with companies and their shareholders will be well positioned to make decisions in this area if all remember why regulation of termination payments is required.

⁹⁶ Companies typically seek approval for the purposes of s 200B at the same time as seeking approval for an issue of securities to a director [usually an executive director] pursuant to ASX LR 10.14, as well as approval for a related party transaction pursuant to s 208 on the basis the issue does not fall within the reasonable remuneration exemption found in s 211. See Fenwick and Sheehan, n 15, 33-40.

Table 1: Contractual termination provisions

Managing Director	Length of notice period in months	Number of months' used to determine termination payment	Total months	Fixed remuneration ^a	Annual bonus ^b	Accelerated vesting of share payments? ^c	Deemed satisfaction of performance conditions for share payments? ^d	Retain unvested share payments and exercise according to original schedule ^e
A	FIXED TERM			✓		✓		
B	6	18	24	✓ ^f				
C	12	N/A	12	✓	✓	✓	✓	✓
D	1	24	25	✓	✓	✓		
E	6	12	33 ^g	✓	✓	✓		
F	12		12	✓	✓	✓	✓	
G	12	24	36	✓	✓	✓		
H	12 ^h		12	✓	✓	✓		
J	6	12	18	✓				
K			18	✓				
L	1	11	12	✓			✓	
M	12		18 ⁱ	✓	✓			
N	12		12	✓	✓	✓		
O	1		1	✓				
P	6	12	18	✓				✓
Q	24		24	✓				
R	12		12	✓	✓			
S	24		24	✓	✓	✓		
T	12		40	✓				✓
U	12		12	✓	✓			
V	24		24	✓	✓			
W	12			✓	✓			✓
X	6	18	24	✓	✓			
Y	FIXED TERM			LUMP SUM			✓	✓
Z	12		12	✓				
BB	3	12	15	✓				
CC	FIXED TERM			✓	✓	✓	✓	✓
DD	Fixed term contract			Fixed amount	✓	✓		

a Base salary plus superannuation

b All bonuses pro-rated to actual period in office during financial year

c Can provide for full or pro-rated number of entitlements as at date of termination and exercise within short-time frame. Alternatively, the performance condition can be adjusted to reflect a shorter performance period but the number of entitlements is unchanged.

d Performance conditions are essentially waived and the whole grant is available for exercise/ award

e Executive retains unvested share-based payments and can exercise only when performance conditions are subsequently satisfied. The number of entitlements may be pro-rated to reflect actual period of service.

f No specific discussion of share-based payments in contract

g An additional 15 months' base salary, pension and short-term incentive bonus for a non-complete clause is provided for in the contract and included in this total.

h Current contract due to expire in 2006 and the date from 1 January to expiry was used to calculate the termination payments. However, the normal contractual provision was for 12 months' base remuneration, superannuation and short-term incentive.

i Includes six months' fixed annual remuneration for a restraint of trade clause

Table 2: Termination payments separated into s200F and s200G payments

Managing Director	200F(2)(a)(i) 'genuine payment by way of damages for breach of contract' \$	200F(2)(a)(ii) 'given under agreement as consideration for holding the office' \$	200G(1) 'payment in connection with retirement from office and is payment for past services' \$	Total \$	Gains from share exercise \$
A	4,079,569			4,079,569	32,015,250
B	736,775	1,841,937		2,578,712	1,204,311
C	3,549,993			3,549,993	44,550,475
D	135,602	8,136,130		8,271,732	6,172,500
E	1,214,901	9,312,241		10,529,142	2,958,570
F		5,400,500		5,400,500	20,122,926
G		7,543,232		7,543,232	1,902,739
H	2,224,341			2,224,341	9,832,200
J	683,437	1,366,873		2,050,310	6,637,900
K	1,977,684			1,977,684	Nil
L	111,294	1,349,562		1,460,856	4,446,920
M	1,344,000	806,400	2,724,000	4,874,400	4,464,600
N	2,753,000	7,757,219		10,510,219	9,447,231
O	54,944		22,196,025	22,250,969	13,144,176
P	1,348,634	2,247,723		3,596,357	16,556,737
Q	2,730,000			2,730,000	6,884,277
R	1,888,050			1,888,050	6,335,000
S	2,367,235	17,538		2,384,933	3,133,161
T		7,640,038		7,640,038	11,700,639
U	3,301,000	4,396,500		10,998,500	5,734,490
V	4,730,379			4,470,739	Nil
W	3,000,000			3,000,000	13,974,420
X	3,079,134	452,907		3,532,041	1,068,800
Y		3,465,000		3,465,000	11,790,000
Z	1,490,732			1,490,732	1,850,041
BB	314,375	1,257,499		1,571,874	925,625
CC		4,026,878		4,026,878	27,878,960
DD	3,000,000		3,000,000	6,000,000	Nil

Table 3: Share-based payments and shareholdings

Managing Director	Share-based payments granted (but not exercised as at date of annual report)			Existing shareholdings (Shares owned outright) per annual report	Existing shareholdings as per annual report, valued at date of termination
	Share options	ZEPOs	Other	Number	\$
A	3,500,000	175,000		1,820,056	\$46,138,420
B		102,055		597,621	\$11,366,751
C	401,338	1,543,850	72,694 ⁱ	746,007	\$17,926,548
D		945,000		1,825,881	\$11,868,227
E	1,750,000	120,000		2,807,926	\$24,176,243
F	2,220,270	1,481,877		225,577	\$2,244,491
G		269,982		236,722	\$1,668,890
H	3,000,000	170,000		1,029,458	\$9,944,564
J		70,000		343,511	\$17,852,267
K				2,201,852	\$8,212,908
L			831,200 ⁱ	236,577	\$1,265,687
M		1,260,000		1,150,059	\$6,037,810
N		913,875		1,000	\$13,350
O	498,400			404,436	\$24,933,479
P	1,175,000	278,750		27,373	\$983,512
Q	500,000	33,537		11,097	\$233,037
R	1,750,000			239,613	\$1,634,161
S			574,892 ⁱⁱ	654,942	\$3,569,434
T		2,341,470	550,000 ⁱ	394,974	\$1,595,695
U	334,165	138,038		1,079,602	\$22,304,577
V				4,042,243	\$45,839,036
W	1,250,000	57,600		275,000	\$8,030,000
X			160,000 ⁱ	2,350,000	\$15,698,000
Y			600,000 ⁱ	74,491	\$1,463,748
Z	660,042	29,943	40,400 ⁱ	1,040,144	\$15,502,556
BB			800,000 ⁱⁱⁱ	61,000	\$427,000
CC	2,526,000	436,000		2,227,580	\$51,679,856
DD				293,165	\$5,379,578

i – deferred shares

ii – conditional entitlement to shares

iii – cash-settled performance shares

Table 4: comparison of worst case (scenario 1) and best case (scenario 2) termination payments against Model 1 and Model 2 threshold limits, based on *Corporations Act 2001 (Cth), Part 2D.2*

1	2	3	4	5	6	7	8	9	10
Managing Director	2005 total remuneration expense shown \$	Scenario 1 ^a \$	Scenario 2 ^b \$	Model 1 limit \$	Model 1 – Scenario 1 \$	Model 1 – Scenario 2 \$	Model 2 limit \$	Model 2 – Scenario 1 \$	Model 2 – Scenario 2 \$
A	7,209,922	4,079,569	36,085,819	50,469,454	46,389,885	14,383,635	50,469,454	46,389,885	14,383,635
B	2,665,002	2,578,712	3,783,023	18,655,014	16,076,302	14,871,991	15,990,012	13,411,300	12,206,989
C	6,445,189	3,549,993	48,100,468	45,116,323	41,566,330	-2,984,145	19,335,567	15,785,574	-28,764,901
D	4,562,432	8,271,732	14,444,232	31,937,024	23,665,292	17,492,792	18,249,728	9,977,996	3,805,496
E	3,627,488	10,529,142	13,487,712	25,392,416	14,863,274	11,904,704	18,137,440	7,608,298	4,649,728
F	7,072,000	5,400,500	25,523,426	49,504,000	44,103,500	23,980,574	21,216,000	15,815,500	-4,307,426
G	4,571,679	7,543,232	9,445,971	32,001,753	24,458,521	22,555,782	22,858,395	15,315,163	13,412,424
H	4,427,435	2,224,341	12,056,541	30,992,045	28,767,704	18,935,504	22,137,175	19,912,834	10,080,634
J	2,913,553	2,050,310	8,688,210	20,394,871	18,344,561	11,706,661	20,394,871	18,344,561	11,706,661
K	4,098,053	1,977,684	1,977,684	28,686,371	26,708,687	26,708,687	12,294,159	10,316,475	10,316,475
L	3,311,963	1,460,856	5,907,776	23,183,741	21,722,885	17,275,965	9,935,889	8,475,033	4,028,113
M	3,264,000	4,874,400	9,339,000	22,848,000	17,973,600	13,509,000	16,320,000	11,445,600	6,981,000
N	6,532,000	10,510,219	19,957,450	45,724,000	35,213,781	25,766,550	26,128,000	15,617,781	6,170,550
O	18,553,566	22,250,969	35,395,145	129,874,962	107,623,993	94,479,817	129,874,962	107,623,993	94,479,817
P	5,932,665	3,596,357	20,153,094	41,528,655	37,932,298	21,375,561	17,797,995	14,201,638	-2,355,099
Q	4,254,000	2,730,000	9,614,277	29,778,000	27,048,000	20,163,723	25,524,000	22,794,000	15,909,723
R	2,439,258	1,888,050	8,223,050	17,074,806	15,186,756	8,851,756	14,635,548	12,747,498	6,412,498
S	2,775,660	2,384,933	5,518,094	19,429,620	17,044,687	13,911,526	8,326,980	5,942,047	2,808,886
T	6,482,673	7,640,038	19,340,677	45,378,711	37,738,673	26,038,034	32,413,365	24,773,327	13,072,688
U	3,998,000	10,998,500	16,732,990	27,986,000	16,987,500	11,253,010	27,986,000	16,987,500	11,253,010
V	3,234,293	4,470,739	4,470,739	22,640,051	18,169,312	18,169,312	19,405,758	14,935,019	14,935,019
W	4,491,000	3,000,000	16,974,420	31,437,000	28,437,000	14,462,580	17,964,000	14,964,000	989,580
X	2,231,435	3,532,041	4,600,841	15,620,045	12,088,004	11,019,204	15,620,045	12,088,004	11,019,204
Y	3,530,093	3,465,000	15,255,000	24,710,651	21,245,651	9,455,651	14,120,372	10,655,372	-1,134,628
Z	3,177,621	1,490,732	3,340,773	22,243,347	20,752,615	18,902,574	12,710,484	11,219,752	9,369,711
BB	4,987,118	1,571,874	2,497,499	34,909,826	33,337,952	32,412,327	34,909,826	33,337,952	32,412,327
CC	7,451,730	4,026,878	31,905,838	52,162,110	48,135,232	20,256,272	52,162,110	48,135,232	20,256,272
DD	8,441,661	6,000,000	6,000,000	59,091,627	53,091,627	53,091,627	59,091,627	53,091,627	53,091,627

a: all share based payments lapse; b: all share based payments vested and were exercised at the closing share price on 1 March 2006

Table 5: comparison of worst case (scenario 1) and best case (scenario 2) termination payments against ASX and ACSI threshold limits

1	2	3	4	5	6	7	8	9	10
Managing Director	2005 total remuneration expense shown \$	Scenario 1 ^a \$	Scenario 2 ^b \$	ASX Limit \$'000	ASX Limit – Scenario 1 \$'000	ASX Limit – Scenario 2 \$'000	ACSI limit \$	ACSI - Scenario 1 \$	ACSI - Scenario 2 \$
A	7,209,922	4,079,569	36,085,819	880,150	876,070	844,064	2,331,182	-1,748,387	-33,754,637
B	2,665,002	2,578,712	3,783,023	163,380	160,801	159,596	1,227,958	-1,350,754	-2,555,065
C	6,445,189	3,549,993	48,100,468	1,065,850	1,062,300	1,017,749	1,793,270	-1,756,723	-46,307,198
D	4,562,432	8,271,732	14,444,232	172,865	164,593	158,420	1,627,226	-6,644,506	-12,817,006
E	3,627,488	10,529,142	13,487,712	123,510	112,980	110,022	2,024,835	-8,504,307	-11,462,877
F	7,072,000	5,400,500	25,523,426	161,685	156,284	136,161	3,086,000	-2,314,500	-22,437,426
G	4,571,679	7,543,232	9,445,971	71,835	64,281	62,389	2,046,616	-5,496,616	-7,399,355
H	4,427,435	2,224,341	12,056,541	186,500	184,275	174,443	2,269,736	45,395	-9,786,805
J	2,913,553	2,050,310	8,688,210	75,775	73,725	67,087	1,366,873	-683,437	-7,321,337
K	4,098,053	1,977,684	1,977,684	62,075	60,097	60,097	1,825,611	-152,073	-152,073
L	3,311,963	1,460,856	5,907,776	21,3295	21,834	207,387	1,335,523	-125,333	-4,572,253
M	3,264,000	4,874,400	9,339,000	195,050	190,175	185,711	1,344,000	-3,530,400	-7,995,000
N	6,532,000	10,510,219	19,957,450	138,625	128,114	118,667	2,753,000	-7,757,219	-17,204,450
O	18,553,566	22,250,969	35,395,145	158,900	136,649	123,504	659,323	-21,591,646	-34,735,822
P	5,932,665	3,596,357	20,153,094	1,206,100	1,202,503	1,185,946	2,247,723	-1,348,634	-17,905,371
Q	4,254,000	2,730,000	9,614,277	56,115	53,385	46,500	1,365,000	-1,365,000	-8,249,277
R	2,439,258	1,888,050	8,223,050	96,618	94,730	88,395	1,313,658	-574,392	-6,909,392
S	2,775,660	2,384,933	5,518,094	121,735	119,350	116,216	1,092,570	-1,292,363	-4,425,524
T	6,482,673	7,640,038	19,340,677	321,135	313,494	301,794	2,303,238	-5,336,800	-17,037,439
U	3,998,000	10,998,500	16,732,990	279,500	261,501	262,767	1,485,000	-9,513,500	-15,247,990
V	3,234,293	4,470,739	4,470,739	118,975	114,504	114,504	1,576,793	-2,893,946	-2,893,946
W	4,491,000	3,000,000	16,974,420	217,200	214,200	200,225	1,500,000	-1,500,000	-15,474,420
X	2,231,435	3,532,041	4,600,841	275,784	272,252	271,183	1,254,020	-2,278,021	-3,346,821
Y	3,530,093	3,465,000	15,255,000	212,800	209,335	197,545	1,252,756	-2,212,244	-14,002,244
Z	3,177,621	1,490,732	3,340,773	163,660	162,169	160,319	1,490,732	0	-1,850,041
BB	4,987,118	1,571,874	2,497,499	166,418	164,846	163,920	1,257,499	-314,375	-1,240,000
CC	7,451,730	4,026,878	31,905,838	694,600	690,573	662,694	2,326,878	-1,700,000	-29,578,960
DD	8,441,661	6,000,000	6,000,000	108,190	102,190	101,190	2,396,639	-3,603,361	-3,603,361

a: all share based payments lapse; b: all share based payments vested and were exercised at the closing share price on 1 March 2006