

Managing “Strike”, “Spill” Risks and Responses

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Introduction

The Corporations Act provisions that deal with “strikes” (25% or more negative votes on a remuneration report resolution at an AGM) have been in place for a few years, yet there seems to be lack of clarity for many boards on what action should be taken when a strike is received. This GRG Remuneration Insight reviews the relevant legislation and provides commentary on what may be considered to be “best practice” management of strike risks and how to respond to a first strike so as to manage the risk of a second strike which triggers the requirement for a “spill motion” and, if passed, an EGM. Most boards are caught unprepared because **some essential actions need to be taken even before a first strike is received.**

In this regard it should be noted that strikes tend to fall into two broad categories being:

- **Protest Votes** which often relate to poor company performance or shareholder dissatisfaction with board decisions on matters unrelated to key management personnel (KMP) remuneration, and
- **Voicing Concern Votes** which reflect that shareholders do not agree with KMP remuneration policies and practices or feel that disclosures in relation to KMP remuneration are inadequate. Good corporate governance is increasingly seen as critical to improved corporate performance and KMP remuneration is an important aspect of good corporate governance.

The Law

Section 300A (1) (g) of the Corporations Act provides:

“if:

- (i) at the company's most recent AGM, comments were made on the remuneration report that was considered at that AGM; and
 - (ii) when a resolution that the remuneration report for the last financial year be adopted was put to the vote at the company's most recent AGM, at least 25% of the votes cast were against adoption of that report;
- an explanation of the board's proposed action in response or, if the board does not propose any action, the board's reasons for inaction”.

The wording of this section only covers strikes when comments were made on the remuneration report at the AGM. If there were no comments on the remuneration report at the AGM then s300A(1)(g) technically does not apply. However, the clear expectation of the market is that all concerns in relation to KMP remuneration should be addressed. Many concerns, such as those of proxy advisors, are not raised at the AGM but rather as part of other discussions. Even if proxy advisor concerns are discussed and addressed outside the AGM, shareholders have a right to be informed of the concerns raised on their behalf and the actions taken or not taken by the board to address those concerns. Thus good corporate governance would require boards to go well beyond the minimum requirements in s300A(1)(g). Further, s300A(1)(g) is only intended to apply to **Voicing Concern Votes**. This is because subsection (i) only relates to comments on the remuneration report. However, it needs to be noted that as remuneration reports

do need to include commentary on company performance it may, at times, be difficult to determine if a “strike” is the result of a Voicing Concern Vote or a Protest Vote. Subject to this qualification, companies do not need to take any action or make any disclosures in relation to Protest Votes where no comments are made on the remuneration report or remuneration practices. Of course, boards may wish to respond to Protest Votes but such action is outside the scope of this GRG Remuneration Insight.

Responding to Voicing Concern Votes

The wording of the law means that at all AGMs someone must be designated to record comments in relation to the remuneration report and remuneration practices, which tend to precede the vote on the resolution. Therefore, at the point when comments are made it is not known whether or not those comments will need to be responded to specifically as part of the next remuneration report.

This is where many boards have been caught out since the Company Secretary will typically only examine required responses to a strike at the point one has been received, in which case it is too late to record the comments made before the strike was received. The action required under the law is for the board to explain its proposed action in relation to the comments made at the AGM, or if no action is to be taken the reasons for inaction. However the expectation of the market, and arguably the intention of the law, is for all expressed concerns in relation to KMP remuneration to be addressed.

The Explanatory Memorandum which accompanied the Bill which introduced the strike elements into s300A of the Corporations Act indicated that boards who have received a strike “must explain whether shareholders’ concerns have been taken into account, and either how they have been taken into account or why they have not been taken into account”. To give effect to the intended operation of the law, boards need to ascertain what concerns about the remuneration report are held by shareholders. The concerns may be ascertained from comments made at the AGM in relation to the remuneration report or from additional comments shareholders may have made on KMP remuneration outside the AGM. The majority of strikes arise from proxy advisor concerns regarding remuneration practices or the quality of reporting and when this is the case it is common for these concerns not to have been raised at the AGM, as proxy advisors tend not to attend AGMs.

This is one of the reasons that it is prudent for companies in the ASX 300 in particular to meet with proxy advisors annually prior to publishing the Annual Report to talk through their views on remuneration practices. If the board has not been previously advised of proxy advisor concerns, it will be critical to meet with them subsequent to a strike having been received to understand whether and why they have concerns so that the board can manage the risk of a second strike and compulsory spill motion.

Of course, boards may ignore comments made by shareholders at the AGM and elsewhere and simply disclose that they have not taken any action following a strike because they feel that the current KMP remuneration policies, procedures and practices are appropriate to their company’s circumstances. Such a response may not be appreciated by shareholders or other stakeholder representatives who feel that they have valid concerns that are not being taken seriously by the board. Generally an appropriate response would involve at least;

- a) Recording the comments made on the remuneration report at the AGM,
- b) Engaging with shareholders, particularly larger shareholders, and proxy advisors to understand their concerns with current KMP remuneration practices in addition to comments made, and
- c) Having KMP remuneration practices reviewed by an independent external remuneration consultant who will be able to advise of any changes that should be considered in the light of contemporary market practice and sound KMP remuneration planning principles and tailor them to the concerns of stakeholders.

The Remuneration Committee should then consider all of the above and decide if any changes are warranted. Proposed changes would need to be endorsed by the board. Before endorsed changes are implemented it would be prudent to road-test them with proxy advisors and major shareholders.

Because many strikes that are of the Voicing Concern type arise from poor or incomplete remuneration governance frameworks, the best responses include a review of the remuneration policies and procedures that form part of the framework in addition to reviewing the actual practices that were of concern. This manages the risk of future strikes since if the initial strike arose out of poor governance, it is likely that issues will arise again even if specific practices are changed following a strike. Remuneration practices that are appropriate change with company circumstances and only a fully developed remuneration governance framework can support the evolution of executive remuneration practices as a company's circumstances evolve. Such a framework should include:

- Remuneration Committee Charter,
- Senior Executive Remuneration Policy and Procedure,
- Non-executive Director Remuneration Policy and Procedure,
- Short Term Incentive Policy and Procedure (in addition to plan rules etc.), and
- Long Term Incentive Policy and Procedure (in addition to plan rules etc.).

A complete framework may also include other documents such as a Clawback Policy and Procedure and a Remuneration Engagement and Disclosure Policy and Procedure.

Given the need to report on action taken or not taken in the next remuneration report it will be important for boards to start the shareholder engagement and KMP remuneration review processes soon after the AGM at which the “strike” was received. This will enable the board to be in a strong position to report back to shareholders on the process it followed, the changes that are being implemented and why the resultant KMP remuneration arrangements are most appropriate for the company and support pursuit of superior returns for shareholders.

However boards need to be aware of the fact that the next remuneration report will generally not reflect the improved remuneration governance and practices implemented in response to the strike since these will generally take effect from the beginning of the following financial year. It is also notable that at the time of the AGM when a strike has been received the remuneration year is already several months expired, offers under the STI and LTI will likely already have been agreed and changes to the LTI plan will typically require shareholder approval at the next AGM. Therefore an early start, particularly when LTI plans need to be reviewed, is critical to managing the risk of a second strike.

Many boards fall in the trap of waiting until the regular remuneration review time to address the strike, towards the end of the financial year, at which point it is often too late to respond appropriately, re-draft the LTI or implement changes that may be reported on.

Equally important is ensuring that the following remuneration report goes above and beyond statutory requirements to disclose what the board’s intention is regarding remuneration on a forward looking basis, as the report itself will reflect old remuneration policies and practices, if only statutory requirements are met. To get this right, it is recommended that boards engage an external party that specialises in remuneration report writing to ensure this is done optimally.

An optimal remuneration report will clearly articulate the rationale for the new KMP remuneration policies that are being implemented to address the concerns raised when the strike was received as well as meet statutory disclosure requirements which tend to be backward looking rather than forward looking, when forward looking changes will be of greatest concern to shareholders and the board.

Good Corporate Governance

Rather than wait for a strike, good corporate governance would require Remuneration Committees to:

- Appoint someone to record comments on KMP remuneration at each AGM,
- Regularly engage with proxy advisors and shareholders to identify possible areas of concern,
- Go beyond statutory requirements when producing a remuneration report to ensure that shareholders understand the board's approach to KMP remuneration governance and that this disclosure is clear and logical,
- Regularly engage independent external remuneration consultants to review current KMP remuneration practices to ensure that they remain contemporary and reflect sound remuneration planning principles, and
- Properly document each component of KMP remuneration such that these policies and procedures represent a comprehensive remuneration governance framework that can be handed down through various memberships of the committee over time.

If the foregoing approach is adopted then it will be unlikely for a company to receive a strike due to a Voicing Concern Vote and the board will be in an optimal position to give a strong and confident response to any protest vote. The strongest response to a strike that results even from a protest vote is to be able to clearly articulate and demonstrate that the best possible corporate governance practices are already being applied in relation to remuneration policies, practices and procedures allowing for the conclusion to be drawn that the protest vote is an abuse of the strike process.