Termination Benefits for Executives of Australian Companies

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1. Introduction

Over the last few years there has been increasing public concern about the size of termination payments to departing senior executives of publicly listed companies. When those termination payments are granted during or following a period of poor company performance, the controversy is exacerbated, with claims that management is being 'rewarded for failure'. One commentator has observed that, for the public, this is 'very hard to swallow … It's just pure greed'.[1]

This article provides a review of:

- the existing academic research into termination payments;
- 'public policy' material relating to termination payments;
- existing Australian, United Kingdom (UK) and United States (US) 'good practice' guidelines relating to termination payments; and
- publicly reported termination payments made to departing senior executives of listed Australian companies, during the period 1999 to 2004.

The article then concludes by outlining seven distinct issues that should be addressed as part of an informed debate in Australia about termination benefits.

A. What are Termination Payments?

To understand what termination benefits are, it is useful first to ask 'How do termination benefits arise?'. They generally arise in one of two ways. First, where the executive and the company agree 'up front' about payments on termination, and the service contract specifies what these payments will be (or, more likely, the formula to be used to calculate them at the time of departure). This is referred to in the UK as a 'liquidated damages' clause.

Secondly, a termination benefit can arise where the service contract does not specify a payment. Here, a termination benefit arises if the company agrees to pay out some or all of the remuneration that the executive would have received if she or he had remained with the company for the full contractual term. For example, if the contract is for a fixed term of four years, and the executive is forced out after only two years. Typically, there would be a period of negotiation after which there would be a payout representing an amount of up to two years' remuneration. In

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1 Joann S Lublin, 'Firms Rethink Lucrative Severance Pacts for Top Executives as Criticism Swells', *Wall Street Journal* (11 November 1991).

essence, the size of the termination payment is dictated either by the 'notice' period in the contract, or by the remaining term. Alternatively, some Australian executives are on 'rolling' contracts rather than fixed-term contracts. If an executive has a one-year rolling contract (which is now customary in the UK), on any particular day there is always one year to run on the contract. So, termination by the company would typically lead to a payout of up to one year's remuneration.

In either case, several other benefits may be provided to a departing executive that should be classified as termination payments. For example, if the company agrees to make an augmented payment to the executive's superannuation fund, at the time of departure, or where the company offers the executive a consultancy as part of negotiating an early departure.

B. Empirical Evidence

An informed debate on termination benefits in Australia would benefit from more data about executive service agreements. Three areas, in particular, would benefit from empirical study. First, liquidated damages clauses appear to be becoming more common in Australia. However, there is no empirical evidence of just how many Australian companies are using liquidated damages clauses and how many are using contracts that are silent about the amount payable on termination. Evidence on this would facilitate a more informed debate about termination benefits. Secondly, there is limited empirical evidence about the nature of liquidated damages clauses. The *Australian Financial Review* analysed the annual reports of 50 large companies in 2004, and ran a feature highlighting what those companies' Chief Executive Officers (CEOs) stood to gain from a liquidated damages clause in the event of termination.[2] However, being a newspaper article, the data provided was illustrative rather than comprehensive. Thirdly, for those companies that do not specify the termination payment in advance, there is no hard data on how many companies are using fixed-term contracts and how many are using rolling contracts, nor is there data on the average term of these agreements.

2. Overview of Academic Research

A. Theory

Executive remuneration has been the subject of public debate in recent years for several reasons, only one of which is termination payments to departing executives. While large annual grants of shares or options may be justified on the basis of corporate performance or aligning an executive's interests with those of shareholders[3] termination payments are often viewed as no more than 'rewards for failure'.

2 Damon Kitney & Fiona Buffini, '$100m Payout Bonanza for CEOs', *Australian Financial Review* (6 December 2004) at 1, 15; Damon Kitney, 'In Line for a Golden Parachute', *Australian Financial Review* (6 December 2004) at 15.

3 Dan Dalton, Catherine Daily & Idalene Kesner, 'Executive Severance Agreements: Benefit or Burglary' (1993) 7 *The Academy of Management Executive* 69 at 70.

When considering the rationale behind the provision of termination payments to senior executives, the question that should be asked is: Why should an executive be rewarded at the moment his or her contribution to the company ceases to exist? The literature reveals four main arguments in support of such payments.

First, termination payments can reward departing executives for long-term and/or outstanding service to the company.[4]

Second, termination payments provide an incentive not to disclose corporate information to competitors or cause adverse publicity when leaving the company (whether through litigation or otherwise).[5]

Third, termination payments can help a company attract talented executives, as well as serve as a safety net, encouraging executives to take more risks in the interests of shareholders. This is particularly the case where an executive is hired to turn around a failing company. Usually the best people for the job have a secure position elsewhere, and thus the promise of a payment on departure can help convince an executive that he or she will be adequately compensated for taking the risk, even if that risk ultimately does not pay off.[6]

Fourth, if there is a possibility of a company merging or being taken over, termination payments ensure a measure of objectivity on the part of executives during negotiations. Executives may otherwise not act in the best interests of shareholders because they are more concerned about losing their jobs following the change in management that will occur if their company is taken over by another.[7]

These justifications for termination payments are not accepted universally. The notion of granting departing executives termination payments for outstanding service can be a misnomer. In many instances, executives who are dismissed do not reach this standard.[8] The analysis of publicly reported termination payments made to departing senior executives of listed Australian companies later in this article reveals several instances where executives have been granted very large termination payments despite the fact that the market value of their companies had fallen considerably while they were at the helm. In relation to encouraging executives to take risks or ensuring that executives act in the best interests of shareholders during merger or acquisition negotiations, termination payments can, in fact, have the opposite effect. They may cause a passive attitude by executives who know that regardless of the actions they take, they will be compensated.[9]

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4 John Shields, Michael O'Donnell & John O'Brien, *The Buck Stops Here: Private Sector Remuneration in Australia* A Report Prepared for the Labour Council of New South Wales (2003) at 7; Philip Cochran & Steven Wartick, 'Golden Parachutes: A Closer Look' (1984) 26 *California Management Review* 111 at 120.

5 Shields, O'Donnell & O'Brien, above n4; Cochran & Wartick, above n4.

6 Dalton, Daily & Kesner, above n3 at 79.

7 Peter Scotese, 'Fold Up Those Golden Parachutes' (1985) 63 *Harvard Business Review* 168 at 170; David Maurer, 'Golden Parachutes: Executive Compensation or Executive Overreaching' (1984) 9 *J Corp L* 346 at 351.

8 Dalton, Daily & Kesner, above n3 at 70.

9 Maurer, above n3 at 352.

The academic literature reveals several other arguments against termination payments. First, it can be argued that they represent a giveaway that cannot influence future company performance. This in turn could be a factor of excessive executive influence over the board, and the remuneration committee. Secondly, they could undermine incentives from the threat of dismissal. That is, if an executive knows that he or she is going to receive a very large payout on termination, even for below-par performance, the threat of being fired does not have as significant a bearing on the executive's mindset.[10]

In a widely cited work, Bebchuk and Fried argue that many aspects of senior executive remuneration in the United States can be attributed to 'managerial power':

> Compensation arrangements deviate from those that arm's-length contracting would have delivered because boards (and remuneration committees) have been influenced by management, are sympathetic to executives, are insufficiently motivated to bargain over compensation, or are simply ineffectual in overseeing compensation.[11]

In support of their theory, Bebchuk and Fried point not only to overly generous grants of options, and option grants without demanding performance hurdles, they also cite several examples of substantial termination payments.[12] Bebchuk and Fried see a common factor increasing both the eagerness of the CEO to request large exit payments and the willingness of the board to provide them:

> That factor is the endgame nature of the situation. In each case, the CEO leaves the company. … [T]he impending departure of the CEO – whether resulting from forced resignation, acquisition, or voluntary retirement – presents both CEOs and boards with a "now or never" choice. CEOs have every reason to extract rents aggressively, cashing in whatever friendship and loyalty chips they have accumulated with directors. Likewise, directors know that this is their CEO's last request and their last opportunity to confer substantial financial benefits on their CEO. When faced with the choice between now or never, many directors opt for now and agree to provide a departing CEO with a golden goodbye.[13]

While Bebchuk and Fried's managerial-power thesis is difficult to prove empirically, some of the data presented later in this article can, at the least, be seen as consistent with it. Several large payments have, in recent years, been made to senior executives who left their companies following a period of very poor corporate performance. This does not prove that powerful executives rode roughshod over weak boards, but it is not inconsistent with that story either.

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10 David Yermack, 'Golden Handshakes: Rewards for CEOs Who Leave', Working Paper, Stern School of Business, New York University, October 2004 at 1.

11 Lucian Bebchuk & Jesse Fried, *Pay Without Performance* (2004) at 4.

12 Id at 87-89.

13 Id at 94.

B. Yermack Study

New York University Professor of Finance David Yermack has recently conducted the first empirical study of severance benefits paid to CEOs of US companies who retire or get dismissed by their boards.[14]

Yermack examined the terms on which 164 CEOs of Fortune 500 companies left their firms between 1996 and 2002. He found that:

- 79 per cent of the executives in the sample collected some form of compensation on leaving.
- The average (mean) present value of severance payments was US$4.52 million.
- For the sub-sample of CEOs who were dismissed (as opposed to leaving voluntarily), 84 per cent received severance packages of some type, with a mean present value of US$7.11 million.
- 21 of the 164 sample CEOs received termination payments with present values in excess of US$10 million.
- The top payout was US$43.6 million. This was for a forced termination. The largest pay-out for a 'planned' exit was US$43.47 million.
- Only 24 per cent of CEOs received some or all of their termination payment in the form of liquidated damages (ie an amount agreed when they signed on). Other common mechanisms used were: payments for signing a non-compete or a consultancy agreement; augmentation of pension entitlements; compensation for forfeiture of stock or options; and employment contract payout.
- A large number of companies permit the departing CEO to retain their unexercised options for their full remaining terms of up to 15 years – rather than having them cancelled or being required to exercise them in a truncated period.

The payout received by Michael Ovitz when he left The Walt Disney Company in 1996 was not included in Yermack's study because Ovitz was Disney's President, not its CEO and the study covered only CEOs. The value of Ovitz's payout was estimated at US$140 million. It arose because Ovitz was hired on a five-year contract that specified a payment for 'non-fault termination'. There was an irreconcilable breakdown between Ovitz and the rest of Disney's senior management team, within one year of Ovitz joining the company. After legal advice indicated there were no grounds on which to dismiss Ovitz for 'cause', Ovitz was terminated without cause – triggering the non-fault termination clause. Under this clause, he received (i) the salary for the remaining four years of the contract (US$1 million per year); (ii) US$30 million, representing four years of unaccrued annual bonuses at a rate of US$7.5 million per annum; (iii) the immediate vesting of three million options (which would otherwise have vested in equal parts at the end of years three, four and five); and (iv) a US$10 million lump sum in lieu of a second tranche of options that Ovitz would have been granted if the five-year employment contract had been renewed.[15]

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14 Ibid.

C. Other US Empirical Studies

Apart from the Yermack study, most other empirical research has concerned the incidence and size of 'golden parachutes' as opposed to termination payments in general.[16] The term 'golden parachute' is usually used to denote a compensation package granted to a senior executive who leaves the company as a result of it being taken over. Termination payments, on the other hand, refer not only to a situation where an executive leaves because of a takeover, but also where an executive has been dismissed, forced to resign or even departed voluntarily. The focus on golden parachutes in the (primarily American) academic literature may be viewed as a response to the mergers and acquisitions wave of the early 1980s that gave birth to this managerial perquisite.

A survey of employment contracts and golden parachutes among the Fortune 1000 found that the number of employment contracts containing golden parachute provisions more than doubled between 1979 and 1982.[17] In 1987, 35 per cent of companies in the Fortune 1000 had golden parachute plans, with this number increasing to 81 per cent in 2001.[18]

In terms of the actual size of these golden parachutes, a study of the termination policies and practices of companies in the Standard and Poor's 500 (S&P 500) found that departing CEOs in 2001 and 2002 received an average golden parachute of $US16.5 million, with calculations based on only the cash compensation paid to these executives.[19]

Generally speaking, golden parachutes are only awarded to the top five executives of a company, with the average package including three years worth of salary, bonus and principal benefits, as well as the immediate vesting of all equity awards.[20]

There have also been a few studies that have analysed the factors that influence the adoption and magnitude of golden parachutes.[21] Board and remuneration committee composition, the probability of takeover threats and the proportion of

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15 *In re the Walt Disney Company Derivative Litigation*, 825 A 2d 275 (Del Ch 2003). This case involved a derivative lawsuit brought against the company's CEO and non-executive directors, alleging negligence in relation to the setting of the contractual terms (in particular the non-fault termination clause), and in allowing the termination to be conducted as a without-cause termination, triggering the massive non-fault termination pay-out. The action failed.

16 See, for example, Cochran & Wartick, above n4; Harbir Singh & Farid Harianto, 'Top Management Tenure, Corporate Ownership Structure and the Magnitude of Golden Parachutes' (1989) 10 *Strategic Management Journal* 143; Philip Cochran, Robert Wood & Thomas Jones, 'The Composition of Boards of Directors and Incidence of Golden Parachutes' (1985) 28 *Academy of Management Journal* 664; Charles Knoeber, 'Golden Parachutes, Shark Repellents, and Hostile Tender Offers' (1986) 76 *American Economic Review* 155.

17 Ward Howell International Inc, *Survey of Employment Contracts and 'Golden Parachutes' Among the Fortune 1000* (1982).

18 Randy Myers, 'Minimise Parachute Penalties' (2001) 192 *Journal of Accountancy* 33 at 39.

19 The Corporate Library, *Golden Parachutes and Cushion Landings* (2003), cited in 'Study Examines Golden Parachute Plans' (2003) 24 *Corporate Board* 28.

20 Myers, above n18 at 39.

21 Singh & Harianto, above n16; Cochran, Wood and Jones, above n16; Knoeber, above n16.

shares owned by management have all been found to influence, to varying degrees, the adoption and size of golden parachutes.[22] For example, where a senior executive owns only a small portion of the company's shares, he or she will usually seek out a golden parachute contract.[23] Similarly, the greater the probability that a company will be taken over, the more likely it is that golden parachutes will be included in senior executives' employment contracts.[24] The tenure of an executive also has an impact upon the magnitude of his or her golden parachute. Where an executive is longer tenured, the size of the golden parachute tends to be larger.[25]

3. Public Policy Material

The purpose of this section is to analyse public policy material relating to termination payments. The three documents that are of particular relevance are:

- Parliamentary Joint Committee on Corporations and Financial Services (Parliamentary Joint Committee), *CLERP (Audit Reform and Corporate Disclosure) Bill 2003*, Part 1: Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters (June 2004).
- UK Department of Trade and Industry (DTI), *'Rewards for Failure' Directors' Remuneration – Contracts, Performance and Severance: A Consultative Document* (June 2003).
- UK Parliament, House of Commons, Select Committee on Trade and Industry, *Rewards for Failure* (September 2003).

The focus of the Australian report is markedly different from that of the two UK reports. This is probably a by-product of the fact that the Joint Committee report is concerned largely with matters other than executive remuneration (eg auditor independence), and that the public policy debate relating to executive remuneration is better developed in the UK than in Australia. As such, the Joint Committee's report focuses mainly on the need for the proper disclosure of termination payments, whereas the DTI Consultative Document focuses much more on the length of contract and notice periods and the way in which compensation relating to termination payments should be paid to departing executives.

A. The Parliamentary Joint Comittee Report

The Joint Committee report relates to the exposure draft version of the CLERP (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) (CLERP 9 Bill) – which during the process of the Committee's inquiry was introduced into Parliament on 4 December 2003. The Joint Committee report emphasises the increasing public concern surrounding termination payments that have been granted to Australian executives in recent years. The Committee expressed five main views on termination payments.

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22 Singh & Harianto, above n16.
23 Singh & Harianto, above n16 at 144.
24 Knoeber, above n16 at 166.
25 Singh & Harianto, above n16 at 153.

First, the Committee recommended that disclosure requirements should ensure that shareholders have a thorough understanding of the type and value of the payments made to departing executives.[26] The CLERP 9 Bill's amendments to s300A of the *Corporations Act* 2001 (Cth) would probably address this issue to the Committee's satisfaction. The Bill amended s300A by inserting subsection (1)(e)(vii): For each executive director and each of the five highest-paid executives below board level, the directors' report (in the annual report) must set out: the duration of the contract of employment; the periods of notice required to terminate the contract; and the termination payments provided for under the contract.

Second, the Committee said disclosure requirements should ensure that shareholders are made aware of the relevant provisions of a contract – particularly any that would ultimately result in a large termination payment – at the time an executive contract is agreed.[27] The CLERP 9 reforms did not address this issue. What CLERP 9 did was amend s300A, as described above. This information is required to be disclosed in the annual report, however the annual report could, of course, appear many months after an executive's contract was agreed.

Third, the Committee recommended that any loopholes in the legislation that allow companies to grant termination payments to executives without disclosing such payments to shareholders should be closed off.[28] If companies comply with new accounting standard AASB 1046, this recommendation should be accomplished.

Fourth, the Committee said boards should be aware of the importance of tying executive remuneration to company performance and should ensure that the granting of a termination payment does not 'reward failure'.[29] Given that the Australian Stock Exchange (ASX) Corporate Governance Council has endorsed the use of pre-determined termination payments (that is, liquidated damages), this issue is likely to continue to be problematic.

Fifth, the Committee commented on what the CLERP 9 Bill proposed to do to s200F of the *Corporations Act* 2001 (Cth) – a proposal that was eventually adopted unchanged. Before the CLERP 9 amendments, shareholder approval was not required for a termination payment that could be characterised as damages for breach of contract, or as a fee agreed to before the executive joined the company as part of consideration for agreeing to sign on. CLERP 9 amended s200F so that these types of payments are now subject to shareholder approval if they exceed a size cap. The cap varies depending on how long the executive has been employed. For an executive who has been with the company for seven or more years, the cap is seven times the executive's average annual remuneration over the past three years. The Committee considered the threshold set by the CLERP Bill to be so high that most payments would not require shareholder approval. The Committee felt

26 Parliamentary Joint Committee, *CLERP (Audit Reform and Corporate Disclosure) Bill 2003, Part 1: Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters* (June 2004).

27 Id at para 4.31.

28 Id at para 4.30.

29 Id at para 4.32.

that s200F might, in fact, encourage the provision of termination payments that fall just below the threshold level.[30] The Committee's concerns would presumably be equally applicable to s200G, which adopts the same cap for a termination payment that can be characterised as a payment for past services.

B. The Two UK Reports

The Department of Trade and Industry (DTI) Consultative Document considered ways in which the corporate governance framework in the UK could be strengthened with regard to director contracts, performance and termination arrangements. The DTI advanced two ways in which the framework could be strengthened: (i) revising best practice guidelines; and (ii) legislative reform.

The report of the UK Parliament's Trade and Industry Committee followed an inquiry by that Committee into the 'extent of the problem and the solutions put forward by' the DTI. So, given that the Committee was effectively responding to issues raised by the DTI, the Committee's responses are outlined beneath the DTI's issues, below.

(i) Best Practice Guidelines

The DTI identified three areas that particularly warrant consideration.

First, the DTI felt that having best practice standards restricting notice periods could reduce the size of termination payments. This proposal relates to those companies that do not agree termination payments upfront. The rationale is that, for these companies, termination payments are largely determined by the length of an executive's contract and/or the length of the notice period. Therefore, a reduction in the notice or contract period to less than one year (the current UK industry standard is one year) could have a significant impact in limiting termination payments. However, the DTI noted those shorter notice periods may only serve to increase an executive's basic remuneration, with executives demanding more compensation to protect themselves against the risks associated with their jobs.[31]

Responding to this issue, the Trade and Industry Committee could see no reason why, in principle, the notice periods of executives should be any different from those of the rest of the population. The Committee said many other areas of employment can be considered as risky as senior executive roles in publicly listed companies, but do not have the benefit of such high salaries. The Committee urged companies not only to adopt one-year contracts, but also to specify separately the notice period, in order to bring the notice periods of executives more closely into line with those of other employees.[32]

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30 Id at para 5.73.

31 DTI, *'Rewards for Failure' Directors' Remuneration – Contracts, Performance and Severance: A Consultative Document* (June 2003) at paras 3.6–3.8.

32 UK Parliament, House of Commons, Select Committee on Trade and Industry, *Rewards for Failure* (September 2003) at para 25.

Second, the DTI said that having best practice standards, which cap the level of liquidated damages could reduce the size of termination payments. The DTI floated the idea of capping the level at six months of basic salary.[33] The Trade and Industry Committee was non-committal on this issue. It referred to it but did not give an indication of its view.

Third, the DTI suggested that having best practice standards, which endorse and recommend phased payments cuold reduce the size of termination payments. Where a company pays part of the compensation for termination in instalments – rather than in one lump sum – and stops the payments when the executive finds new employment, the amount of the termination payment can be reduced.[34] The Trade and Industry Committee was enthusiastic about phased payments, but it cautioned that companies need to enforce the duty to mitigate losses properly and to make the phased payments only whilst the recipient remains out of work.[35]

In relation to each of these three issues, the DTI appears to suggest that the proposed improvement should apply irrespective of the reason for termination.

(ii) Legislative Reform

The DTI considered that three areas might warrant legislative reform.

First, amending s319 of the *Companies Act* 1985 (UK) could reduce the size of termination payments. This section prohibits directors' employment with the company continuing for a period of over five years (except with shareholder approval), where the contract in question is a fixed contract. (There is no equivalent section in the Australian *Corporations Act* 2001 (Cth).) It is a widely held view in the UK that this limit of five years is excessive, especially given the generally accepted industry standard is now one year. The DTI was attracted by the UK Company Law Review's proposal of a limit of one year, but with flexibility to contract for three years on the first-time employment of an executive – with both limits subject to extension by shareholder vote.[36] The Trade and Industry Committee did not comment directly on this proposal.

Second, the size of termination payments could be reduced by amending the UK Companies Act so that it prohibits rolling contracts that have a notice or contract period in excess of the five-year period permitted by s319. This would ensure that rolling contracts are not used to circumvent the restrictions under s319 described above.[37] The Trade and Industry Committee did not comment directly on this suggestion.

Third, the size of termination payments could be reduced by prohibiting the use of specific termination payment covenants that allow companies to circumvent the statutory provisions by granting a departing executive more than would otherwise be the case by way of compensation for the loss of the balance of a one-year or

33 DTI, above n31 at para 3.9.
34 Id at para 3.10.
35 UK Trade and Industry Committee, above n32 at paras 37, 38.
36 DTI, above n31 at paras 3.16-3.20.
37 Id at para 3.21.

three-year contract. It suggested that the *Companies Act* (1985) UK could provide for the prohibition of such covenants.[38] The Trade and Industry Committee did not comment directly on this proposal.

4. Good Practice Guidelines

The purpose of this section is to analyse and compare existing Australian and overseas 'good practice' guidance on termination payments to senior executives. Three sets of Australian guidelines, three sets of US guidelines, four sets of UK guidelines and one set of Canadian guidelines are covered. The guidelines that are summarised throughout this section are:

- The principles and recommendations of the ASX Corporate Governance Council.[39] The ASX Corporate Governance Council brings together 21 groups from disparate business, financial, investment and professional advisory backgrounds;
- The Investment and Financial Services Association (IFSA) 'Blue Book' of governance guidelines.[40] IFSA is the industry association representing Australian investment management firms;
- The corporate governance guidelines of the Australian Council of Superannuation Investors.[41] ACSI is the industry association representing Australian superannuation funds in their capacity as shareholders in public companies;
- The governance policies of the Council of Institutional Investors.[42] The Council of Institutional Investors is a US industry association that was founded in 1985. It represents large pension funds and addresses investment issues affecting the size or security of plan assets;
- The proxy voting guidelines of the AFL-CIO.[43] AFL-CIO is the American Federation of Labour – Congress of Industrial Organisations. It is the peak council for U.S. trade unions;
- TIAA-CREF's corporate governance policy.[44] TIAA-CREF is the Teachers Insurance and Annuity Association – College Retirement Equities Fund. It is a financial services group, providing pensions and other financial products to US teachers and academics. It is one of the largest US institutional investors;
- The UK Listing Authority's Combined Code.[45] This is the benchmark set of governance guidelines against which UK listed companies must 'comply or

38 Id at para 3.22.

39 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations* (2003).

40 IFSA, *Blue Book: Corporate Governance: A Guide for Fund Managers and Corporations* (5th ed, 2004).

41 ACSI, *Corporate Governance Guidelines: A Guide for Superannuation Trustees to Monitor Listed Australian Companies* (2nd ed, 2005).

42 Council of Institutional Investors, *Corporate Governance Policies* <http://www.govn.info/topic/corpgov/ciipolicy04.pdf> (5 October 2005).

43 AFL-CIO, *Exercising Authority, Restoring Accountability: Proxy Voting Guidelines* (2003).

44 TIAA-CREF, *Policy Statement on Corporate Governance* (2004).

45 UK Listing Authority, *The Combined Code on Corporate Governance* (2003).

explain'.[46] The UK Listing Authority is the UK government regulator responsible for administering the listing rules of the London Stock Exchange. It is an arm of the Financial Services Authority;

- The joint statement on executive contracts and severance prepared by the Association of British Insurers (ABI) and National Association of Pension Funds (NAPF).[47] The ABI is the industry association representing UK-based insurance companies. Its guidelines on executive pay are the most detailed and refined guidelines in the world. The NAPF is the peak pension fund body in the UK;
- The governance and voting policy of Hermes Investment Management Limited.[48] Hermes is a UK fund manager which is owned by, and is the principal fund manager for, the BT Pension Scheme – the UK's largest pension fund. Hermes also manages portfolios for the Post Office Pension Plan and a number of other large pension funds;
- West Midlands Metropolitan Authorities Pension Fund's voting guidelines.[49] West Midlands Pension Fund is a UK pension fund for local authority (that is, local council) employees across the West Midlands area of the UK. It has had a strong interest in corporate governance for many years, reflected in its detailed guidelines; and
- The governance policies and voting guidelines of Ontario Teachers' Pension Plan.[50] Ontario Teachers' Pension Plan is a large Canadian pension fund for current and retired schoolteachers in Ontario. It has been a leading voice on corporate governance issues among institutional investors in Canada.

As the overview below illustrates, there is a very strong consensus among guideline drafters internationally that companies should not provide executives with excessive termination payments in the case of poor performance or 'failure'.

The UK guidelines also highlight the relation between contract length and termination payments. One-year rolling contracts are supported by most of the UK guidelines; however, the ABI and NAPF guidelines state that 'shorter periods [of contract length] would be appropriate if other remuneration conditions would mean that a one-year contract period would lead to excessive severance payment'.[51]

In terms of the form severance payments should take, the UK guidelines suggest that phased payments, liquidated damages and the application of mitigation are all common approaches. However, the ABI and NAPF believe the phased payments approach – which involves continued payment, usually on a monthly basis for the outstanding term of the executive's contract – is the most

46 UK Listing Authority, *Listing Rules* (2004) at para 12.43A.

47 ABI & NAPF, *Best Practice on Executive Contracts and Severance – A Joint Statement* (2003).

48 Hermes Investment Management Limited, *Statement on UK Corporate Governance and Voting Policy* (2001).

49 West Midlands Metropolitan Authorities Pension Fund, *Company Voting Guidelines* (2003).

50 Ontario Teachers' Pension Plan, *Good Governance is Good Business: Corporate Governance Policies and Proxy Voting Guidelines* (2005).

51 ABI & NAPF, above n47 at para 25.

desirable, given that payments cease when the executive finds fresh employment. This is in line with the recommendations put forward by the UK Department of Trade and Industry and the UK Parliament's Trade and Industry Committee, as discussed earlier.

With the exception of the ACSI guidelines, the treatment of termination arrangements is not as comprehensive in Australian, US and Canadian guidelines as it is in UK guidelines. The ACSI guidelines were revised in 2005, and the 'acknowledgements' section indicates that, in revising the remuneration component of the guidelines, ACSI paid particular attention to UK developments and the ABI policies on remuneration.[52]

Interestingly, the ASX Corporate Governance Council recommends that termination payments should 'be agreed in advance' – that is, it supports liquidated damages – so that it is clear from day one how much the executive will be paid as a termination benefit in particular circumstances. ACSI also supports liquidated damages – but its support is qualified: the clause should provide for a maximum pay-out of no more than 12 months' base salary, and no payment (other than statutory entitlements) should be permitted where dismissal is for cause.

The inclusion of a liquidated damages clause was originally also endorsed – although with some hesitation – by the UK's Hampel Committee in 1998.[53] The first edition of the UK's Combined Code (against which listed UK companies must 'comply or explain') included a recommendation that the remuneration committee should 'consider the advantages of providing explicitly in the initial contract for … compensation commitments [in the event of early termination] except in the case of removal for misconduct'.[54] This was a reference to a liquidated damages clause. However, the revised edition of the Combined Code, effective since November 2003, makes no reference to liquidated damages. This omission may well be because major UK investor groups, including the ABI and NAPF, are now expressly opposed to liquidated damages because they believe these clauses often result in substantial payments to executives who are removed following periods of poor performance.

It is not clear how much debate was had, internally, when the ASX Corporate Governance Council decided expressly to endorse liquidated damages, without specifying an appropriate maximum pay-out. This is an issue that should be revisited by the Council.

A. Australian Guidelines

(i) ASX Corporate Governance Council

As indicated above, the ASX Corporate Governance Council explicitly supports liquidated damages clauses (but without using that terminology). Its guidelines

52 ACSI, above n41 at 26.

53 Committee on Corporate Governance ('Hampel Committee'), *Final Report* (January 1998).

54 London Stock Exchange, *The Combined Code: Principles of Good Governance and Code of Best Practice* (1998) at B.1.9.

recommend that termination payments 'be agreed in advance, including detailed provisions in case of early termination'.[55]

In terms of disclosure, the Council recommends that the termination entitlements of the CEO be disclosed at the time they are agreed as well as at the time the actual payment is settled.[56]

(ii) IFSA

The IFSA guidelines exhort boards to pay particular attention to increasing the transparency of termination and retirement payments for senior executives and directors.[57] While calling for full disclosure of termination and retirement payments, the guidelines do not specify the appropriate timing of disclosure.

In relation to quantum, IFSA recommends that termination and retirement payments should be 'reasonable in the circumstances of the departure'.[58]

(iii) ACSI

The ACSI guidelines recommend that a listed company should disclose its policy on notice periods and termination payments. The relevant 'triggers' for termination should also be disclosed.[59]

ACSI says an executive service agreement should provide a reasonable basis to procure the early termination of an executive, where there has been poor performance by the executive against previously agreed benchmarks. Companies are discouraged from paying out 'excessive and unreasonable termination payments' where termination is as a consequence of poor performance.[60]

As stated above, ACSI supports liquidated damages, provided that the clause permits a payout of no more than 12 months' base salary.[61] ACSI is also generally supportive of the use of phased payments.[62]

ACSI recommends that, where an executive is dismissed for underperformance (not amounting to cause), the executive service agreement should provide that all unvested performance and incentive-related elements of the remuneration package are forfeited. There should be a clearly defined, and not excessive, timeframe during which vested options and other incentive instruments may be exercised, provided that performance hurdles have been satisfied prior to termination.[63]

55 ASX Corporate Governance Council, above n39 at 56.
56 Id at 53.
57 IFSA, above n40 at 28.
58 Ibid.
59 ACSI, above n41 at 14.
60 Ibid.
61 Ibid.
62 Id at 15.
63 Id at 14.

B. Unites States Guidelines

(i) Council of Institutional Investors

The Council recommends that CEO compensation, including any severance payment, should be approved annually by at least a majority of a company's independent directors.[64]

(ii) AFL-CIO

The AFL-CIO guidelines recommend that shareholder approval be required for executive contracts that contain 'golden parachutes' (clauses providing for payout if the company is taken over). Further, any severance plan or stock option 'change in control' vesting feature should be contingent on a merger being completed, rather than merely approved, by shareholders (which is an earlier stage than completion).[65]

The guidelines support proposals to eliminate any severance package for senior executives that provides for benefits not generally offered to other company employees.[66]

(iii) TIAA-CREF

The TIAA-CREF guidelines say severance arrangements should not provide contractual payments to executives who are terminated for 'cause'. The guidelines also recommend that companies take account of 'reasonableness, competitive practice, and full disclosure' when dealing with termination benefits.[67]

C. United Kingdom Guidelines

(i) Combined Code

The Combined Code says each listed company's remuneration committee should carefully consider what compensation commitments (including pension contributions) directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. Specific reference is made to mitigation – the remuneration committee should 'take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss'.[68]

The Combined Code also deals with the length of contracts and notice periods – recommending periods of one year or less. Where longer notice or contract periods are offered to new directors recruited from outside, they should be reduced to one year or less after the initial period.[69]

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64 Council of Institutional Investors, above n42 at Section IV.
65 AFL-CIO, above n43 at 15.
66 Ibid.
67 TIAA-CREF, above n44 at 18.
68 UK Listing Authority, above n45 at B.1.5.
69 Id at B.1.6.

(ii) ABI and NAPF

The ABI and NAPF guidelines are more detailed than all other guidelines summarised in this section. The guidelines deal with a range of issues.

Disclosure of policy on executive contracts: Companies should have a clear, considered policy on directors' contracts that should be disclosed in the remuneration report. Boards should calculate all the material commitments the company would face in the event of severance for failure or underperformance.[70]

Design of executive contracts: The nomination committee (when negotiations are occurring with candidates for executive directorships) should work with the remuneration committee to ensure the contract is fair to all parties.[71]

Contract length: Contracts of one year or less are preferred. Shorter contract periods are appropriate if other remuneration conditions mean a one-year contract would lead to an excessive severance. In highly exceptional circumstances – for example, where a new CEO is being recruited to a troubled company – a longer initial notice period may be appropriate. These cases should be justified to shareholders and the longer notice period should apply to the initial term only.[72]

Performance-related components of pay: Executives should not automatically be entitled to any remuneration other than 'basic pay' and bonuses should be cut or eliminated when individual performance is poor. As courts may take account of some elements of variable remuneration when making awards to departing executives, clear performance conditions should be attached to variable pay. It may be appropriate to specify that a proportion of the bonus is for retaining the executive, and that this falls away in the event of severance.[73]

Safeguards for extreme underperformance: Companies should consider including in contracts a safeguard for more extreme cases. For example, that compensation is not payable where an executive is dismissed for designated types of financial failure (such as a very significant fall of the share price relative to the sector).[74]

Phased payments: A contract that provides for phased payments on severance has considerable advantages, but this approach does need to be specifically provided for in the contract with specific reference to the legal obligation to mitigate.[75]

Liquidated damages: Liquidated damages clauses are not generally desirable. Boards adopting this approach should justify their decision. They should also consider a modified approach – under which the company and the executive agree in advance that, in the event of severance, the parties will go to arbitration to decide how much should be paid.[76]

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70 ABI & NAPF, above n47 at para 2.2.
71 Ibid.
72 Id at paras 2.5–2.6.
73 Id at paras 2.4, 2.7.
74 Id at para 3.7.
75 Id at para 3.2.
76 Id at para 3.3.

Change of control: Other than in highly exceptional circumstances — for example, the recruitment of a new CEO by a troubled company — contracts should not provide for compensation for severance as a result of change of control. Where exceptional circumstances apply, this type of clause should relate only to the initial contract term.[77]

Pension enhancements: Boards should not support enhanced pension payments without first becoming fully aware of the costs. Boards should disclose the full cost for pension enhancement at the earliest opportunity. Boards should distinguish between the pension amount that is a contractual entitlement and the amount of discretionary enhancement agreed as part of a severance package. Contracts should specify that there will be no enhancement in the event of early retirement unless the board is satisfied that the objectives set for the executive have been met or the enhancement is merited.[78]

(iii) Hermes

The Hermes guidelines state a preference for one-year rolling contracts. Hermes is also supportive of an initial appointment on a two-year fixed contract that subsequently reduces to a one-year rolling contract.[79]

Hermes recommends against contracts that increase compensation paid for early termination in the event of a takeover.[80]

(iv) West Midlands Pension Fund

The West Midlands guidelines support the general reduction of notice periods to no longer than one year, combined with the application of mitigation and the phased payment of compensation. In exceptional circumstances — for example, relocation or a high-risk move to a problem company — a longer initial fixed contract period (not exceeding two years) may be appropriate in order to recruit a new executive, provided that the remuneration committee discloses the circumstances effectively, and the period reduces to no more than one year after the initial period.[81]

West Midlands recommends that a liquidated damages clause not exceed one year's pay.[82]

D. Canadian Guidelines

(i) Ontario Teachers' Pension Plan

The Ontario Teachers guidelines indicate that the plan will review severance arrangements on a case-by-case basis. 'Golden parachutes' that are deemed excessive will not be supported. On the other hand, the plan recognises the need

77 Id at para 3.8.
78 Id at paras 4.1, 4.3.
79 Hermes, above n48 at 6.
80 Ibid.
81 West Midlands, above n49 at para 6.8.
82 Id at para 6.9.

for competitive severance arrangements, particularly to enable management to continue making decisions in the best interests of a company and its shareholders regardless of their own welfare in the event of a successful takeover.[83]

5. *Termination Payments – The Past Six Years*

This section provides an overview of termination payments made to executives of ASX-listed companies between 1999 and 2004.[84] The list is not comprehensive; it was constructed using a key-word search of major newspapers.

Table 1 summarises the termination payments made during the six years from 1999 to 2004, ranked from largest to smallest. Table 2 shows a break down of those executives' total remuneration — including termination payments — for the year in which they exited their respective companies.[85] Table 2 also details the $32.75 million that Mr Chris Cuffe received in the year he left Commonwealth Bank. Mr Cuffe is not included in Table 1 because the component of the $32.75 million that could accurately be described as a termination benefit was never disclosed.

It should be noted that several of the executives listed in the tables were not removed from office before the end of their contractual term due to poor performance. Rather, they completed their agreed term but were nevertheless contractually entitled to an end-of-employment payment. Examples include Paul Anderson (BHP Billiton), Dennis Eck (Coles Myer) and John Fletcher (Brambles).

When examining the figures in Table 2, two issues should be borne in mind. First, many executives left the company only a few months into a financial year, so the figures for base salary, superannuation contributions, etc, may be lower than they would have been for a full 12 months. Secondly, in some instances, the equity instruments to which the column 'Options / Share Value' relates may have vested early (that is, before the normal vesting period and performance hurdles had been satisfied). The disclosed information was insufficient to determine where this was, and was not, the case. As indicated below, one of the issues that should be included in the debate in Australia about termination benefits is the appropriateness of accelerated vesting for options and other equity incentives.

The termination payments range from about $800,000 to $9.99 million. The average (mean) termination payment was $3.65 million and the median was $3 million.

83 Ontario Teachers, above n50 at 25.

84 The tables only include termination payments made to executives that were located using a key-word search of the following publications between the years 1999 and 2004: *The Age, The Australian, The Australian Financial Review, Business Review Weekly* and *The Herald Sun.* This was supplemented by searching the Crikey database: <www.crikey.com.au>.

85 Details of the breakdown of remuneration were obtained from company annual reports.

Table 1: Termination Payments to Australian Executives, 1999–2004

Executive	Company	Termination Payment ($A)	Year of Payment
Brian Gilbertson	BHP Billiton	9,991,631[i]	2003
Paul Anderson	BHP Billiton	9,133,974[ii]	2002
Peter Macdonald	James Hardie	8,242,466[iii]	2004
Sheryl Pressler	Lend Lease	7,993,705[iv]	2001
John Fletcher	Brambles	7,711,000	2001
George Trumbull	AMP	7,500,000	1999
David Higgins	Lend Lease	6,677,755[v]	2003
Frank Cicutto	National Australia Bank	6,618,595[vi]	2004
Peter Yates	Publishing and Broadcasting Ltd	6,541,292	2004
Len Bleasel	AGL	4,814,563[vii]	2001
Dennis Eck	Coles Myer	4,713,359	2001
Tom Fraser	AMP	4,684,000	2002

i Converted from US to Australian Dollars at the rate of $US1.00 = $A1.48965 (30 June 2003). Includes an amount of $1,411,023 relating to pro-rated cash bonus paid in relation to Mr Gilbertson's services for the year ended 30 June 2003.

ii Converted from US to Australian Dollars at the rate of $US1.00 = $A1.77683 (30 June 2002).

iii This figure has been estimated based on the following disclosure in the company's Form 20-F filing with the SEC: 'The severance agreement with Mr Macdonald was consistent with the terms of his employment agreement. We made a lump sum payment to Mr Macdonald equal to two times his current annual salary at the time of his departure plus twice the annual bonus paid in the year immediately preceding the year of termination, plus fiscal year ending 2004's notional balance under our Economic Profit Incentive Plan.' The figures used in the calculation were therefore: two times annual salary (2 x US$822,500, which may be an underestimate because this is the salary figure for the financial year ended 31 March 2004), plus two times the annual bonus from 2004 (2 x US$1,745,390), plus 2004 notional balance of long-term incentive (US$593,558). Converted at the average US$ / AUD exchange rate (0.6951).

iv Converted from US to Australian Dollars at the rate of $US1.00 = $A1.96078 (30 June 2001).

v Includes a payment of $1,609,566 made in July 2003 for his compliance with the terms of a restrictive covenant preventing Mr Higgins, after his cessation of employment, from working in competing businesses or soliciting employees or customers of the Lend Lease Group.

vi This figure also includes annual leave, long-service leave and bank extended leave accrued but not taken before cessation of employment.

vii Loyalty Release of Debt and Non-competition deed payment.

Table 1: Termination Payments to Australian Executives, 1999–2004 cont.

Executive	Company	Termination Payment ($A)	Year of Payment
Peter Shafron	James Hardie	4,417,583[viii]	2004
Keith Lambert	Southcorp	4,377,899[ix]	2003
Geoff Tomlinson	AXA Asia Pacific Holdings (formerly National Mutual)	4,160,385	1999
John Akehurst	Woodside Petroleum	3,552,099[x]	2003
James Strong	Qantas	3,479,065	2001
Ted Kunkel	Fosters	3,412,864[xi]	2004
Richard Humphry	ASX	3,300,000	2004
Nick Falloon	Publishing and Broadcasting Ltd	3,000,000	2001
Tom Park	Southcorp	2,993,212	2001
Hugh Morgan	WMC Resources	2,700,000	2003

viii This figure has been estimated based on, first, the following disclosure in the company's Form 20-F filing with the SEC: 'The severance agreement with Mr Shafron was consistent with his employment agreement. We made a lump sum payment to Mr Shafron equal to the sum of his current annual salary at the time of his departure plus his annual target bonus plus fiscal year ending 2004's notional balance under our Economic Profit Incentive Plan. In addition, Mr Shafron will receive an annual bonus which relates to the Company's economic profit results following the finalization of the fiscal year 2005 accounts, pro-rated to the date of resignation. Mr Shafron will not be entitled to receive any discretionary component of this bonus.' Secondly, in its 2nd quarter results release on 22 November 2004, the company disclosed that it would incur costs of US$8.8 million in relation to severance arrangements with Mr Macdonald and Mr Shafron. Mr Shafron's severance has been calculated by deducting the figure calculated for Mr Macdonald (US$5,729,338) from US$8.8 million. The figure for Mr Macdonald was easier to estimate because the formula for his termination payment referred mostly to data that is in the 2004 annual report, whereas the formula for Mr Shafron (see above) refers mostly to data that will appear in the 2005 annual report, which had not been released at the date this article was finalised.

ix Includes service agreement and statutory entitlements upon severance ($2,946,449) and payments under a 12 month non-compete agreement ($1,431,450).

x Figure also includes the value of allowances and benefits including travel, motor vehicle and health insurance.

xi The disclosure in the Fosters 2004 annual report is confusing. The figure of $3,412,864 is taken from the remuneration table on page 38 of the annual report. However, on page 39 it is stated that after 36 years with the company, including 12 as CEO, Mr Kunkel's termination payments included (among other things) superannuation, long-service and annual leave entitlements accrued, totalling $12,255,064.

Table 1: Termination Payments to Australian Executives, 1999–2004 cont.

Executive	Company	Termination Payment ($A)	Year of Payment
Ian Scholes	National Australia Bank	2,243,193*	2004
Philip Weickhardt	Orica Ltd	2,148,700	2001
Gary Traill	AMP	2,057,000	2002
Steve Jones	Suncorp Metway	2,052,000	2002
Tim Wade	AMP	1,962,000	2002
Warwick Foster	AMP	1,735,000	2002
Paul Batchelor	AMP	1,400,000	2002
Brent Harman	Prime Television	1,303,269	2003
Peter McKinnon	National Australia Bank	1,302,625*	2004
Maureen Plavsic	Seven Network	1,294,360	2003
Mike Laing	National Australia Bank	1,234,790*	2004
Bob Dalziel	Mayne Group	1,216,278	2001
Bill Kirk	Mayne Group	1,194,176	2001
Robert Atkins	Mayne Group	1,052,178	2001
Stephen Kwik	Peptech	998,571	2003
Ian Crouch	National Australia Bank	979,887*	2004
Shane Tanner	Mayne Group	960,824	2001
Graham Bradley	Perpetual	800,000	2003

* These figures also includes annual leave, long-service leave and bank extended leave accrued but not taken before cessation of employment.

Table 2: Total 'Final Year' Remuneration of Australian Executives, 1999–2004

Executive	Company	Salary	Super'n	Short term incentive payment	Long term incentive payment	Non-cash benefits/ other	Deferred bonuses	Accrued holiday pay[i]	Retire-ment benefits	Termi-nation payment[ii]	Options/ share value[iii]	Total
Brian Gilbertson	BHP	1,021,255	22,040,045	624,549		68,363			542,699[iv]	9,991,631	435,925	34,724,466
Chris Cuffe	CBA	2,820,000[v]		3,390,000		10,000,000[vi]	16,540,000[vii]					32,750,000
Paul Anderson	BHP	1,488,834		2,099,255		1,058,355				9,133,974	4,137,455	17,917,873

i In some cases, accrued holiday pay is included as part of 'Non-Cash Benefits / Other'.

ii See Table 1 for notes relating to figures in this column.

iii Where the value of options was not disclosed, the following calculation was used to estimate the value of options: (exercise price x 0.25) x number of options = estimated value of options at grant date.

iv The estimated benefit in respect of pensions includes contributions payable in respect of actual/notional contributions that would have been required to secure the defined benefit promises earned in the year. Mr Gilbertson participated in a defined benefit pension plan. Under the terms of that plan Mr Gilbertson had pensionable service from 1 April 1970. That service includes service to BHP Billiton and service that was transferred from former employers. Mr Gilbertson was entitled to take the retirement benefits or a pension or commute those benefits to a lump sum. At the date of the 2003 annual report Mr Gilbertson had not advised the group of his election.

v This figure of $2.82 million represented 'payment of statutory entitlements and remuneration' for the 6.5 months from 1 July 2002 until Mr Cuffe's resignation on 20 January 2003: Colonial First State Media Release: *John Pearse Assumes CEO Role Effective Immediately* (20 January 2003).

vi Mr Cuffe's employment contract with Colonial dated January 2000 provided for a $10 million retention payment provided Mr Cuffe was employed by Colonial on 30 June 2002: Commonwealth Bank Media Release: *Commonwealth Bank Statement* (13 February 2003).

vii This payment is predominantly for 'accrued bonuse' that had been earned (but not paid out) over several years while Mr Cuffe led the Colonial First State fund management business. Mr Cuffe released a statement on 13 February 2003 indicating that: 'All bonuses paid to me under [employment] contracts [with Colonial] were directly linked to profits generated by the company. The formula giving rise to such payments since 1993 meant that due to Colonial First State's unprecedented growth over the years that followed, the payments became significant in later years. In 1993 the total value of First State Fund Managers as it was known then, was estimated to be as low as $2 million, and executors at the time had considered closing down the operations. Under my stewardship and the management team that worked with me, the value of Colonial First State at the time I left the CBA group had grown to an estimated value of between $4 billion to $5 billion.' Commonwealth Bank released a statement later that day which clarified that 'The bonuses paid under [Mr Cuffe's January 2000 contract with Colonial] were based on a percentage of net revenue, as defined in the contract, and not profits generated by Colonial First State.'

Table 2: Total 'Final Year' Remuneration of Australian Executives, 1999–2004 cont.

Executive	Company	Salary	Super'n	Short term incentive payment	Long term incentive payment	Non-cash benefits/ other	Deferred bonuses	Accrued holiday pay	Retire-ment benefits	Termi-nation payment	Options/ share value	Total
Sheryl Pressler	LLC	3,937,071								7,993,705	3,106,464	15,037,240
George Trumbull	AMP	857,950	3,471,076	400,000	1,423,625	247,392				7,500,000	180,000	14,080,043
Peter Macdonald	JHX[viii]	1,183,282	39,840	2,510,991						8,242,466	853,917	12,830,496
Len Bleasel	AGL	1,236,234	60,000						5,601,574	4,814,563		11,712,371
Peter Yates	PBL	2,760,288[vix]	11,002			1,237,426[x]				6,541,292		10,550,008
Hugh Morgan	WMC	1,647,657[xi]				1,702,124[xii]			3,542,366	2,700,000		9,592,147
John Fletcher	BIL	151,000		735,000						7,711,000		8,597,000
David Higgins	LLC	1,262,432						406,722		6,677,755		8,346,909

viii The remuneration figures for Mr Macdonald are those for the financial year ended 31 March 2004 (taken from the 2004 annual report), because the company had not released its 2005 annual report at the time this article was completed. Converted from US to Australian Dollars at the rate of $A1.00 = $US0.6951 (average rate for year ended 31 March 2004).

vix Includes annual leave and long-service leave entitlements paid on cessation of employment.

x Relates to an interest-free housing loan made to Mr Yates as part of his service agreement, as well as the interest charged on a loan to Mr Yates to acquire PBL shares under PBL's Executive Share Plan.

xi Includes superannuation. Mr Morgan, as a member of the defined benefit category of the WMC Superannuation Plan, had a notional surchargeable contribution included in his fixed remuneration.

xii Includes incentive and retention payments consistent with contractual entitlements, relocation allowances, parking, telephone, health management, executive indemnity insurance and personal financial planning advice. Short-term incentive bonuses paid for 2002 are included in this figure.

Table 2: Total 'Final Year' Remuneration of Australian Executives, 1999–2004 cont.

Executive	Company	Salary	Super'n	Short term incentive payment	Long term incentive payment	Non-cash benefits/ other	Deferred bonuses	Accrued holiday pay	Retire-ment benefits	Termi-nation payment	Options/ share value	Total
Tom Park	SRP	717,500	161,750			131,259				2,993,212	3,840,000[xiii]	7,843,721
Frank Cicutto	NAB	677,649	3,952			7,340				6,618,595	229,623	7,537,159
Steve Jones	SUN	247,370	173,608							2,052,000	4,225,097	6,698,075
Keith Lambert	SRP	759,678								4,377,899	1,047,500	6,185,077
Tom Fraser	AMP	889,000	526,000							4,684,000		6,099,000
Peter Shafron	JHX[xiv]	442,382	67,077	540,859		23,530				4,417,583	518,230	6,009,661
Ted Kunkel	FGL	1,519,767	11,002			24,384				3,412,864	972,045	5,940,062
Geoff Tomlinson	AXA	1,209,312		192,297						4,160,385		5,561,994
Richard Humphry	ASX	907,225	50,286	466,500		110,470				3,300,000	698,708	5,533,189
Dennis Eck	CML	746,506								4,713,359		5,459,865
John Akehurst	WPL	720,000	7,093	516,670						3,552,099	589,442	5,385,304
Nick Falloon	PBL	1,908,559	148,500			215,310				3,000,000		5,272,369

xiii At the time of Mr Park's appointment, Southcorp assumed certain obligations relating to options in shares of Mr Park's previous employer. During the year, amounts equal to $3,840,000 were paid to Mr Park in respect to those options.

xiv The remuneration figures for Mr Shafron are those for the financial year ended 31 March 2004 (taken from the 2004 annual report), because the company had not released its 2005 annual report at the time this article was completed. Converted from US to Australian Dollars at the rate of $A1.00 = $US0.6951 (average rate for year ended 31 March 2004).

Table 2: Total 'Final Year' Remuneration of Australian Executives, 1999–2004 cont.

Executive	Company	Salary	Super'n	Short term incentive payment	Long term incentive payment	Non-cash benefits/ other	Deferred bonuses	Accrued holiday pay	Retire-ment benefits	Termi-nation payment	Options/ share value	Total
James Strong	QAN	118,875				57,298				3,479,065		3,655,238
Peter McKinnon	NAB	686,407	12,015	7,300		11,170				1,302,625	1,303,920	3,389,137
Ian Scholes	NAB	275,221	5,313			3,442				2,243,193	737,095	3,264,264
Mike Laing	NAB	590,233	10,753	65,000		12,964				1,234,790	941,348	2,855,088
Ian Crouch	NAB	743,776	12,015			7,091				979,887	1,110,553	2,853,322
Philip Weickhardt	ORI	577,000	113,800	121,700		27,100				2,148,700	386,100	3,374,400
Tim Wade	AMP	570,000	60,000			685,000				1,962,000		3,277,000
Maureen Plavsic	SEV	798,587	34,846			32,589				1,294,360	1,096,073	3,256,455
Paul Batchelor	AMP	1,332,103[xv]	119,525			66,871				1,400,000		2,918,499
Warwick Foster	AMP	455,000	48,000			592,000				1,735,000		2,830,000
Gary Traill	AMP	122,000	13,000							2,057,000		2,192,000
Stephen Kwik	PTD	428,336	80,213			23,762				998,571	194,298	1,725,180
Bill Kirk	MAY	164,390		300,000		56,554				1,194,176		1,715,120
Brent Harman	PRT	291,525	31,500			73,258				1,303,269		1,699,552
Graham Bradley	PPT	652,971	2,750	2,733		5,791				800,000		1,464,524
Shane Tanner	MAY	200,000		155,500		124,116				960,824		1,440,440
Robert Atkins	MAY	250,317				25,000				1,052,178		1,327,495
Bob Dalziel	MAY	65,949				24,720				1,216,278		1,306,947

xv Includes statutory entitlements.

Table 2 illustrates that some of the 'excessive' figures quoted in the media are more than just payments which relate solely to an executive's termination. In several cases, the media reports a headline figure which includes several other payments made to the departing executive – for instance, accrued leave entitlements, bonuses that have accrued over prior years but were not paid out until departure. Sometimes the media also focuses on how much the executive stands to gain by exercising options or selling shares awarded in prior years as part of her or his remuneration.

To take a recent example, on Frank Cicutto's departure from the National Australia Bank many media headlines quoted a $14 million termination payment.[86] However, the reality was that Cicutto's termination payment was approximately $6.6 million (of which about $3.3 million was a termination payment defined narrowly, and the remainder was accrued entitlements). The initial media reports were factoring in profits on unexercised options and on shares awarded as part of Mr Cicutto's pay in earlier years.[87]

Nevertheless, the tables show that some of the termination payments in question have been large. In several cases they have been made following a period of very poor corporate performance. For example, in 2002 five senior executives of AMP departed with close to $12 million, despite the fact that they had been in office while AMP lost more than $13 billion of its market value.[88] Similarly, in 1999 CEO George Trumbull received a $7.5 million termination payment following AMP's disastrous hostile takeover of GIO. In 2003, Southcorp's CEO, Keith Lambert, departed with a termination payment of $4.4 million, even though during his 19 months at the helm, Southcorp's shares lost 40 per cent of their value.[89]

These findings highlight the importance of an informed debate in Australia about termination payments. Proper disclosure may not be sufficient to reduce excessive payments. Thus, Australia would be wise to give careful consideration to the recommendations of the UK Parliament's Trade and Industry Committee and UK best practice guidelines (particularly those of the ABI and NAPF).

6. Conclusion - Issues for a Debate on Termination Payments in Australia

This article has highlighted a range of views on termination payments, expressed by academics, public policy bodies and institutional investors (and other bodies) through corporate governance guidelines. The empirical study of publicly reported termination payments made during the 1999 to 2004 period revealed that the

86 See, for example, Sharon Kemp, 'Bank Chief Quits with $14 million', *The Age* (3 February 2004); Duncan Hughes & Leonie Wood, 'Cicutto's Sweet Parting Package', *The Age* (31 May 2004).

87 Stephen Mayne, *Explaining the Cicutto Payout* 4 February 2004 <www.crikey.com.au>.

88 Stephen Mayne, *The Great AMP Bloodbath,* 27 February 2003 <www.crikey.com.au>.

89 Samantha Hughes, 'Axed Southcorp Chief's $4.4m Farewell Shout', *The Australian* (26 February 2003).

average payment was $3.65 million and the median was $3 million. Also, several large payments were made following a period of very poor corporate performance.

These findings indicate that there are several distinct issues that should be addressed as part of an informed debate in Australia about termination benefits.

A. Issue 1: Payment Despite Poor Performance

Under a typical liquidated damages clause, no termination payment is payable if the executive is dismissed for cause (for example, misconduct, wilful neglect or serious breach of the service contract). However, the notion of 'rewards for failure' has arisen partly because some liquidated damages clauses allow for termination payments even where the executive's performance has been below the required standard (but not so bad as to constitute 'cause').

At its 2004 annual general meeting, Boral Limited asked shareholders to vote on the termination payment component of the CEO's new service contract (that is, the liquidated damages clause). The clause dealt with termination for poor performance as follows:

> The Company may terminate the employment of Mr Pearse if Mr Pearse's performance of his duties under the contract is not at the level reasonably required by the Board and Mr Pearse does not improve his performance to the required level within the period specified by the Board (being a minimum of six months). In this situation, the Company will pay Mr Pearse an amount equal to Mr Pearse's base remuneration in the year of termination.[90]

Mr Pearse's 'base remuneration' in 2004 was $2 million.

Contractual entitlement to a termination payment even where an executive is dismissed for poor performance is clearly an issue worthy of debate. In terms of possible solutions, the UK-based proxy advisory firm Pensions & Investment Research Consultants (PIRC) cites a company (Low & Bonar) where the notice period for the CEO reduces if he misses performance targets. PIRC suggests that this 'should have the effect of reducing any payout after a period of underperformance'[91] That would be the case provided that the company has not agreed, at the time of signing the CEO's service agreement, to a liquidated damages arrangement that applies regardless of the notice period.

B. Issue 2: Should Performance-Related Components of Pay be Taken into Account?

Disclosures in annual reports indicate that it is not uncommon for a termination payment to be calculated by reference not only to fixed remuneration but also to one or more performance-related components of the executive's remuneration package (for example, short-term incentive/annual bonus, and long-term incentive/options).

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90 Boral Limited, *Notice of 2004 Annual General Meeting* (2004).

91 Pensions & Investment Research Consultants, *PIRC's Response to the DTI Consultation Document* (September 2003) at 8.

For example, at its 2004 AGM, Toll Holdings Limited asked its shareholders to approve the liquidated damages clause in the new service agreement for its CEO. The clause specifies various levels of termination payment, depending on the circumstances of termination. One possibility is where the company terminates Mr Little and, in lieu of notice, pays him the value of 18 months' fixed remuneration (base salary, superannuation and fringe benefits), plus an amount relating to short-term incentives:

> an amount in respect of a period of 18 months calculated pro rata by reference to Mr Little's short term incentive payment targets for that financial year and the extent to which Mr Little has met his short term incentive targets over the 3 previous completed financial years.[92]

In 2004 dollar terms, this 'short-term incentive' component could have added as much as $2.07 million to the CEO's payout. This amount is in addition to any short-term incentive payments that have accrued, but not been paid, at the date of termination.

As indicated above, the UK Parliament's Trade and Industry Committee could not see how significant performance-related elements of the remuneration package could legitimately be included in the severance package, where an executive is removed for underperformance.

C. Issue 3: Is Early Vesting of Options Defensible?

When Michael Ovitz left The Walt Disney Company after only one year of a five-year contract, the business world was aghast at the reported value of his termination package: US$140 million. The largest component of this package was actually the value of options that were supposed to vest in three stages several years later – but which were allowed to vest immediately (under the terms for a without-cause termination agreed with Mr Ovitz at the time he was hired).[93]

ACSI recommends that, where an executive is dismissed for underperformance (not amounting to cause), the executive service agreement should provide that all unvested performance and incentive-related elements of the remuneration package are forfeited.

D. Issue 4: Are Liquidated Damages Clauses Optimal?

There has been a backlash in the UK about liquidated damages payments, which are typically made as one lump sum. The ABI and NAPF guidelines on termination payments state that 'shareholders do not believe the liquidated damages approach is generally desirable', because it involves the payment of lump sums, which in practice are not recoverable even where the executive quickly finds new employment.[94]

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92 Toll Holdings Limited, *Notice of 2004 Annual General Meeting* (2004).

93 See *In re the Walt Disney Company Derivative Litigation*, above n15.

94 ABI & NAPF, above n47 at para 3.3.

A witness before the UK Parliament's Trade and Industry Committee suggested that, because service contracts tend to be drawn up in a climate of optimism, there is a tendency for liquidated damages to be set higher than might have been the case with the benefit of hindsight.[95]

Many groups in the UK are now pushing for 'phased payments' rather than lump sum liquidated damages (for example, the ABI, NAPF and PIRC). The idea here is not to try to specify in advance how much will be paid out on termination. Instead, at the time of termination, the company continues to pay the former executive monthly payments, for the outstanding term of the contract. Payments cease if and when the executive finds new employment. Provided that specific reference and attention is given to the executive's obligation to mitigate his or her damage, this approach can result in a significantly smaller payout than a traditional liquidated damages clause. Mitigation means taking reasonable steps to try to find another job.

The DTI has floated the idea of 'capping' liquidated damages at six months of basic salary.[96] In its response to the DTI Consultative Document, the UK Parliament's Trade and Industry Committee referred to this idea, but did not state whether it supported or opposed it.[97] Some organisations, including the proxy advisory firm PIRC, have publicly endorsed a rule limiting termination payments (whether liquidated damages agreed up-front or otherwise) at six months of basic salary, unless prior shareholder approval to exceed that cap is obtained.[98]

E. Issue 5: Should Shareholder Approval be Required in More Circumstances?

As mentioned earlier, s200F of the *Corporations Act* 2001 (Cth) requires shareholder approval for a termination payment that could be characterised as damages for breach of contract, or a fee agreed to before the executive joined the company as part of consideration for agreeing to sign on, but only where the payment exceeds a certain size. For executives who have been with the company for seven or more years, shareholders do not have a right to vote on the payment unless it exceeds seven times annual remuneration. Section 200G adopts the same cap for a termination payment that can be characterised as a payment for past services.

The Parliamentary Joint Committee, when reviewing the CLERP 9 Bill, was troubled by the generous cap specified in ss200F and 200G. It considered that the cap (allowing up to seven times annual remuneration) was 'set at quite a high level and [could] in effect … sanction or even encourage termination payments that would fall just below this level'.[99]

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95 UK Trade and Industry Committee, above n32 at para 30.
96 DTI, above n31 at para 3.9.
97 UK Trade and Industry Committee, above n32 at 29.
98 PIRC, above n91 at 7.
99 Parliamentary Joint Committee, above n26 at para 5.73.

The level of debate on ss200F and 200G during the CLERP 9 process was negligible. This probably reflects the focus given to auditor independence and other issues (including other executive remuneration issues, like the non-binding vote on pay). However, the generosity of the cap in ss200F and 200G is worthy of further consideration.

As mentioned above, a proposal floated in the UK would require advance shareholder approval for any termination benefit worth more than six months' basic salary. The current Australian threshold of up to seven years' remuneration seems extremely generous in this light.

In any debate about ss200F and 200G, it must to be borne in mind that they do not cover every type of termination payment, and for a termination payment that does not fall within the scope of s200F or s200G, shareholder approval is automatically required regardless of the size of the payment. This is specified by ss200B and 200E. Interestingly, at least one major law firm interprets ss200F and 200G as being too narrow to cover the types of liquidated damages clauses included in CEO service contracts these days.

The termination arrangements for the CEOs of Boral Limited and Toll Holdings Limited, outlined above, were put to a shareholder vote because the legal adviser to each company advised that they fell outside ss200F and 200G. The Toll Holdings notice of meeting stated:

> The amounts of the termination payments provided in Mr Little's proposed new deed are significantly less than the prescribed multiple [i.e. up to seven times annual remuneration]. However, the Board has received legal advice that the payments do not technically fall within any of the categories of exception set out in the Corporations Act.

Boral's notice of meeting contained an almost identical statement.

F. Issue 6: Are service contracts too long?

An issue of major concern to institutional investors in the UK in the early 1990s was the incidence of rolling three-year and four-year (and even five-year) contracts. If an executive has an X-year rolling contract, on any particular day there are always X years to run on the contract. So, termination by the company would typically lead to a payout of up to X years' remuneration. The larger X is, the bigger the payout.

Institutional investor pressure, followed by interest from the Cadbury, Greenbury and Hampel Committees, has led to one-year rolling contracts now being the norm in the UK.

No such debate has occurred in Australia. But, as stated earlier, a lack of data is part of the problem in Australia. It is simply not clear how many executives are on lengthy contracts – whether fixed-term or rolling – in the Australian listed company space. Greater disclosure in company annual reports now makes it much easier to conduct research to scope out these issues.

G. Issue 7: Are Australia's Disclosure Requirements Adequate?

The CLERP 9 amendments to s300A of the *Corporations Act* 2001 (Cth), together with the new accounting standard AASB 1046, have undoubtedly bolstered Australian disclosure rules relating to termination payments.

Section 300A(1)(e)(vii) requires companies to disclose the length of the senior executives' contracts, what their notice periods are, and to what termination payments they are contractually entitled. Disclosure is in the annual report – which could appear many months after an executive's contract was agreed.

AASB 1046 also relates to disclosure in the annual report. It carefully differentiates between:

- Termination payments that are certain to occur (for example, where there is a liquidated damages clause in the executive's contract of service, and it provides for a certain level of payment regardless of the reasons for departure). These are supposed to be accrued over several reporting periods;[100] and
- 'Any additional benefits generated because the termination is involuntary or at the request of the entity'. These, 'by definition … arise in one reporting period' and therefore should not be accrued.[101]

In terms of disclosure at the time an executive is hired (or a new contract is signed with an existing executive), there is no express disclosure rule in Australia. At best, there is ASX Listing Rule 3.1 – the continuous disclosure rule. The ASX Corporate Governance Council used exhortation to try to stimulate a culture of 'timely' disclosure of key contractual terms:

> Entering employment agreements with key executives, or obligations under these agreements falling due, may trigger a continuous disclosure obligation under ASX Listing Rule 3.1. Where this is the case, disclosure to the market should include a summary of the main elements and terms of the agreement, including termination entitlements. … Shareholder concern about executive payments is often exacerbated by a lack of information concerning core entitlements when they are agreed. This can be alleviated if, for example, the nature of the termination entitlements of the chief executive officer (or equivalent) is disclosed to the market at the time they are agreed as well as at the time the actual payment is settled.[102]

Not all listed companies are going to agree with the ASX Corporate Governance Council's interpretation of the continuous disclosure listing rule. Therefore, some listed companies are not going to disclose any details about new executives' contracts until their next annual report comes out – which for a 1 July appointment would mean a delay of about 15 months.

In the light of this, an Australian debate on termination benefits should consider the disclosure rules adopted in the United States and the United Kingdom.

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100 AASB 1046, at paras 5.2.9, 5.2.19.
101 Id at para 5.2.19.
102 ASX Corporate Governance Council, above n39 at 53.

Listed US companies – and foreign companies with securities trading on US stock exchanges – to disclose 'a brief description of the material terms of any employment agreement' between the company and a new senior executive within four business days of the appointment (on Form 8-K).[103] They must then file a copy of the full contract itself as an 'exhibit' to the next periodic report (annual report or quarterly report).[104] A recent example of this was when James Hardie's former CEO Peter Macdonald left the company, but a consulting arrangement was struck with him. The company was obliged to file a copy of the entire consulting agreement as part of its Form 20-F filing on 22 November 2004.

Section 318 of the *Companies Act* 1985 (UK) requires UK companies to make available for inspection by shareholders copies of contracts of service between directors and the company or any of its subsidiaries. These must be available for inspection at the company's registered office during normal business hours and at the annual general meeting.

103 SEC Form 8-K is the 'current report' used to report material events or changes, which have not previously been reported by the company. Form 8-K provides more current information on specified events than would SEC Form 10-Q (the quarterly report required to be filed by most public companies) or Form 10-K (the annual report).

104 United States Securities and Exchange Commission, Regulation S-K, Item 601(b)(10)(iii)(A).

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