General Counsel and Company Secretary: The dual role - Seminar

Section A: Independence and conflict arising from dual role

Section B: Changes to reporting practices following ASX amendments to listing rules and corporate governance principles and recommendations

Michael Hansel

m.hansel@hopgoodganim.com.au

Section A: Independence and conflict arising from dual role

Introduction

The purpose of this section of my report is to:

- identify and discuss some of the challenges and inherent tensions faced by General Counsel; and
- offer some practical suggestions in establishing and maintaining a General Counsel's independence.

Role of General Counsel

The role of General Counsel is substantial and complex. Most literature presented on the role of General Counsel recognises this and the inherent tensions that arise from the multiplicity of roles required to be played by General Counsel.

A good and valued General Counsel, is a key cog in the decision making machine of its company.

General Counsel is in the enviable (and sometimes the invidious) position based on their depth of business and industry experience to appreciate and identify the commercial advantages and prospectivity of certain business decisions. Additionally General Counsel's legal acumen and experience places them in a better position than most to foresee and advise on the corresponding risks involved in that decision.

If that job description is not enough, the General Counsel, (by board of decree, professional responsibilities and public perception) is handed the weighty mantle of moral enforcer of its employer corporation.

The multiplicity of roles required to be discharged by the General Counsel is central to its competing duties and obligations[1].

In broad terms, General Counsel's roles within a company can be divided into four broad categories namely:

- legal advisor;
- member of the senior executive team;
- administrator of the legal department; and
- legal face for the broader world and in dealings with regulators and other third parties.

Professional framework – setting the scene

General Counsel, in discharging its obligations as a lawyer within an organisation is bound by the same rules as a practitioner in private practice.

The Australian Solicitors Conduct Rules (**Rules**) provides the framework for the making of ethical decisions for legal practitioners and confirms at Rule 1.1 that:

> *"These Rules apply to* ***all solicitors*** *within Australia, including Australian-registered foreign lawyers acting in the manner of a solicitor." (emphasis added)*

[1] Norman Veasey and Christine Di Guglielmo, *The Tensions, Stresses and Professional Responsibilities of the Lawyer for the Corporation* (The Business Lawyer; vol. 62, November 2006), page 5

The Rules recognise and codify the overriding nature of a solicitor's duty to the court by providing that:

> *"A solicitor's duty to the court and the administration of justice is paramount and prevails to the extent of inconsistency with any other duty."*

The recognition of uniformity of duties and responsibilities between external lawyers and in-house legal counsel is not new. Lord Denning observed in *Alfred Compton Amusement Machines Limited v Customs and Excise Commissioners* that in-house counsel are:

> *"Regarded by the law in every response in the same position as those who practice on their own account....They must uphold the same standards of honour and etiquette. They are subject to the same duties to their client and to the court. They must respect the same confidence. They and their clients have the same privileges."*[2]

The threshold and most fundamental principle imposed on General Counsel is that the duties are owed to the organisation and not to any particular person or officeholder or stakeholder in it. In theory, this is obvious. Practitioners working in the corporate arena understand the separation of the company as its own entity. However, when the lawyer is an employee of that corporate client, there are a number of inherent practical issues which render it difficult to maintain that separation and independence.

The purpose of this paper is to seek to address some of these practical issues and, where possible, suggest some measures that should be considered and, if thought appropriate, adopted by General Counsel in discharging its obligations.

What is independence?

The high profile corporate collapses in the US has spawned a significant body of analysis and commentary on the role of General Counsel and the corresponding independence obligations.

Considerations regarding the practitioner's professional independence apply equally to external and in-house counsel. Independence it has been said, has several aspects and must always be evaluated in terms of the specific circumstances of any proposed or ongoing representation.

Independence requires any lawyer to be in a position to *"exercise professional judgment in the interests of the corporate client, independent of the personal interests of the corporation's officers and employees"* and the lawyer's own personal interests.[3]

The key practical consideration here is that both General Counsel and the board of the relevant corporation need to be firstly, alive to and secondly, constantly vigilant of questions affecting or appearing to affect independence. It is not something that can be assessed on a theoretical or periodic basis as the relevant circumstances of the matter facing the corporation and the General Counsel is ever evolving as are the circumstances as that would otherwise affect Counsel's ability to independence discharge its obligations.

Who is the gatekeeper of independence?

Ultimately it is a matter for the board or the independent directors to decide on whether special or external lawyers are to be engaged on a particular matter. However it falls on General Counsel to provide guidance and where appropriate, institute some practical framework to assist in identifying where potential conflict issues may arise.

When considering and answering questions of independence, General Counsel must be vigilant in assessing whether there is any issues that would affect or be seen to affect independence and also be sufficiently brave or courageous to

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[2] [1972]2 QB102 at 129 quoted in Martin Meredith and Sascha Hindmarch, *Legal Professional Privilege: an in-house prospective part 1* (2011)33(9) Bulletin at page 10
[3] Veasey and Guglielmo, above n1, page 9

bring the matter to the Board or Committee of independent Directors who must ultimately decide how the issue should be addressed.

It would be dangerous, and in fact wrong, to assume that the board is simply aware of whatever potential conflict there may be and, for their silence or lack of engagement on the issue to infer any form of acquiescence or sanctioning that the matter may proceed without full and transparent disclosure and assessment.

The effectiveness of any framework or policy dealing with the independence of in-house Counsel, once established, is entirely dependent on the collective will of both General Counsel and the Board of Directors enforcing it. Enforcement from an in-house counsel perspective requires both awareness (of the ethical issues) and courage (to bring it to the attention of the Board). Courage is often cited as the critical quality that allows a lawyer to express and advocate independent views and to be confident in the framework and or board members to raise issues affecting the office's independence[4].

Factors affecting independence

Financial independence

General Counsel has one client, its employer corporation. The corresponding ethical and independence question is: How can a counsel provide fiercely independent advice, where such advice could be limited or severely affected by personal interest, namely job security and financial independence?

A related but separate conundrum identified when addressing the compromising nature financial dependence could have on in-house counsel independence[5] is the structure of the remuneration package of General Counsel: Is it proper practice to compensate or include in the remuneration package of the General Counsel share options or, remuneration incentives tied to the share price of a corporation which then imposes similar pressures (or perceived pressures) faced by senior management whose key performance indicators are linked into the financial performance and corresponding share price of the corporate client.

Commentary in this area suggests that some practical measures can be put in place, which are addressed below, to deal with (or at least mitigate) factors that may or be seen to affect the independence of General Counsel. There is no "silver bullet" approach here and each General Counsel, and board of directors will need to assess and implement the most appropriate reporting line and remuneration structure to maintain the required level of independence and, in turn, adequately compensating and incentivise General Counsel.

The threshold step to be taken here requires the directors to be educated on and to fully understand the pressures being placed on General Counsel.

US commentary on this issue strongly advocate that the board of directors (not the CEO) approve General Counsel's appointment, retention and compensation.

The insertion of this buffer between the General Counsel and the CEO, would serve to "reduce the pressure on General Counsel to accede to questionable management plans".[6] By imposing the board as a buffer between the General Counsel and CEO, the benefits arising from that are that the General Counsel should be in a position to more vigorously fulfill his or her duties to the company as the issue of retention and remuneration has been removed from the CEO, it, in turn would also ensure that the directors remain cognisant of the role as complex as it is, and responsibilities of General Counsel to the corporation.[7]

This delineation of reporting lines also serves as a practical application when:

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[4] Veasey and Guglielmo, above n1, page 11
[5] Veasey and Guglielmo, above n1, page 12
[6] Ibid page 13
[7] Ibid

- mitigating issues associated with misdirected and potentially excessive loyalty of General Counsel to senior management; and

- demonstrating the requisite level of independence when invoking legal professional privilege.

The question of including share options as part of any General Counsel remuneration package is an interesting one. The two broad and competing schools of thought here are:

- **Against** - tying General Counsel's financial reward to the share price of its employer company could compromise the ability of General Counsel (or perceived ability) to discharge their responsibilities to provide fiercely independent and objective advice; and

- **For** - if General Counsel see their investment in the long term, such investment would therefore create an obvious incentive for the counsel to be tied to the fortunes of its employer company and to its long term value – consequently, providing counsel with a real incentive to be aligned with the fortunes of the company for the benefit of that company and its shareholders.

Instituting a remuneration structure that rewards the independent legal work (rather than short term corporate financial performance basis) would assist in addressing these criticisms. Such a structure could include a bonus system which includes both cash and share option components, the payment or issue of which is triggered by key performance indicators that are tied more directly to the role and responsibilities of the General Counsel (for example the provision of that legal advice).

Flow on measurement issues would arise here given the intangibility of what constitutes "good legal advice". However, this could be addressed by the establishment of an independent committee such as a remuneration committee and forming a view on it or setting some meaningful and objective criteria. A structure including components rewarding independent legal advice could logically be seen as compelling evidence should the issue of legal professional privilege be sought and then challenged.

Misdirected and excessive loyalty

General Counsel is, in most instances, a most valued and trusted member of the senior executive team. General Counsel is however required to maintain that independence or (in this instance more appropriately described as *"professional detachment"*) in being able to provide legal advice as and when required. This dual role has been described by the ABA Taskforce on Corporate Responsibility as the "Partner – Guardian" tension which arises from the General Counsel's dual role as business advisor and legal advisor to its employer corporation.[8]

These dual roles are by no means mutually consistent. Tension is exacerbated by the extent to which General Counsel, over the tenure of their employment, develops loyalty to or an affiliation with other members of the management and executive team.

Deborah DeMott[9] has included some extreme, but cautionary, examples of consequences associated with General Counsel careering down what could only be the most slippery of slopes towards misguided loyalty to the detriment of the General Counsel's independence and the employer corporation.

The examples are extracted in full below:

[8] Michael Peregrine and Anne Murphy, *American Health Lawyers Association 2014* (in-house counsel program) June 29, 2014, page 10
[9] Deborah DeMott, *The Discrete Roles of General Counsel*, Fordhame Law Review Vol 74 at pages 975 to 977

Rite Aid

In 1965, following three years as a solo practitioner, Mr Franklin C Brown was hired to join Rite Aid by its founder. He felt "an overwhelming sense of loyalty to the company" over the years, and remained a trusted senior employee after Rite Aid went public in 1968 when many other newly rich executives departed. Mr Brown's personal loyalties shifted to the founder's son who became Rite Aid's CEO in 1995. According to Mr Brown's defence counsel, "the history of their relationship since [the son] was a kid" was that the son "got his neck in incredible situations" from which Mr Brown rescued him.

Rite Aid reported lower than expected earnings in March 1999, leading to the filing of class action suits and, subsequently a restatement of three years' pretax earnings in an amount that, at the time, set a record. The founder's son, the then CEO, resigned, as had Rite Aid's audit committee, having retained its own counsel and a forensic accountant, commenced an investigation, which led to the discovery of facts suggesting "conduct which appeared to constitute serious breaches of their fiduciary duties" by the CEO and CFO.

*Mr Brown and Rite Aid's now former CEO were indicted for conduct in connection with Rite Aid's internal investigation and a related investigation by the SEC. The Federal Bureau of Investigation (**FBI**) also commenced an investigation and persuaded Rite Aid's former president to tape conversations he would have with Mr Brown and the former CEO. In their conversations, the three agreed to backdate letters and to take other measures in an attempt to conceal fraudulent accounting practices. Mr Brown, additionally, paid his secretary $25,000.00 in exchange for altering documents. By this time, Mr Brown had retired but still made repeated visits to Rite Aid's office. He told the former president and the former CEO that he was "putting himself 'totally on the line for you guys'".*

As it happens, Mr Brown was the only Rite Aid officer to go to trial, as all others made plea agreements, several agreeing to testify against Mr Brown. Following his conviction, Mr Brown was sentenced to ten years in prison despite his age (76) and medical problems.

Computer associates

Computer Associates' general counsel faced obstruction of justice charges stemming from his "coaching" of the company's employees who were to be questioned by outside counsel and government investigators. A key concern appears to have been the counsel's dissuading the employees from revealing the company's practice well known within at least some circles of the company of using a "35 day month" system of keeping the company's books open at the end of fiscal periods to create the appearance that it had met revenue and earnings estimates. Indeed, the indictment alleged that the general counsel and CFO lied to outside counsel retained to conduct an internal investigation, knowing and intending that their false representations would be transmitted by outside counsel to the FBI, the SEC, and the US Attorney's office.

Clearly the above examples are extreme, but they are real and do demonstrate the competing tension counsel has to management and in maintaining independence. These case studies highlight also the severity of consequences facing a General Counsel where their independence has been compromised.

A lack or deterioration of independence results in a counsel being no longer able to adequately discharge its obligations to the corporation and is in fact tarnishing the corporation's reputation with other stakeholders and regulatory agencies.

The above catastrophic consequences resulting in excessive loyalty should always be balanced with the corresponding benefits derived from the General Counsel and corporation relationship. External lawyers are continuously striving to get a deeper understanding of their respective client's business operations. In contrast, General Counsel, possess a deeper knowledge of its employer's business operations, regulatory issues and inherent challenges faced by that corporation; rendering General Counsel and invaluable member of the executive team. This depth of knowledge and strong relationship will, in most cases, logically result in the General Counsel possession an elevated position in any executive decision making process and with third parties, including regulators.

The legal and business advisor dilemma – invoking legal professional privilege

In order to adequately discharge their multiple roles, General Counsel must be able to provide commercial and legal advice.

A common criticism a client will place at the feet (and sometimes ram down the throat) of external lawyers, is that lawyers are constantly throwing up barriers or road blocks to a client achieving their commercial objective.

In practice, most external lawyers, strive to be cognisant of not just this criticism but in recognising that the legal environment is but one aspect (and not the total environment) in which client's must operate. In other words, legal advice should, where and to the fullest extent possible, assist a client achieving its corporate objectives. That said, the pressure placed on lawyers arising from this criticism is both real and common. This form of pressure may be exacerbated towards a General Counsel, especially where a culture of "getting the deal done" permeates throughout the executive decision making team and board of directors.

General Counsel (and lawyers generally) are continually faced with potential that the legal advice given is creating a roadblock to getting a deal done. Duncan Webb[10] summed up the potential for employer disenchantment and corresponding pressure placed on an in-house legal team when stating:

> *"Corporate Counsel may never fully recover from the consequences of appearing to stymie some project which is a central part of the overall corporate enterprise. Given that the costs of such a principle stand, it is unrealistic to expect that any but the most extraordinary individual would make such a stand, especially if a path of least resistance offered itself. An interpretation of the law which stretches it beyond breaking point is often that path."*[11]

A yielding to this pressure must effect the independence of General Counsel. A lawyer's (both internally and externally) unwillingness or inability to highlight legal consequences of certain actions or inactions has been identified as a key factor in several high profile corporate collapses; with the Enron collapse being the most often highlighted and relevant case study in this area. The Special Investigation Committee of the Enron Board into its collapse criticised *"an absence of forceful and effective oversight by Senior Enron Management and in-house counsel"* and while some in-house lawyers raised concerns, other Enron lawyers and managers stymied them.[12]

In-house counsel should recognise that there is no "one right way" in addressing this multiple hat (or legal/business advisor) dilemma. It is a matter of awareness; in particular, the counsel being aware of and communicating to the board (or executive) on which role is being discharged (or hat worn) and when it is appropriate to engage external lawyers.

The multiplicity of roles and the dilemmas faced where there is a homogenisation of business and legal advice, comes into sharp focus when considering the implications of legal professional privilege.

Legal Professional Privilege

Independence essential to privilege claims

Judicial authority and related commentary are united requiring in house counsel to demonstrate independence when seeking to rely on legal professional privilege.

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[10] Duncan Webb, *Ethics and the Role of Corporate Counsel: gatekeeper, whistleblower or friend?*, (2005) 23C&SLJ483
[11] Ibid page 487
[12] D Rhode and P Paton, "Lawyers, Ethics and Enron", in N Rapoport & B Dharan (Eds.), *Enron: Corporate Fiascos and Their Implications*, 2004 at 633. Also refer to R Gordon, "New Role for Lawyers?: The Corporate Counsellor After Enron", (2003) 35 *Conn.L.Rev* 1185 quoted in Martin Meredith, Sash Hindmarch, *Lawyer First, Employee Second? In-house Counsel's Ethical Tightrope* Bulletin, February 2012 edition

The tests for claiming privilege are well known. Client legal privilege can be invoked to protect (disclosure of) communications between a client and a lawyer made for the dominant purpose of seeking or providing legal advice or for the purpose of actual or anticipated legal proceedings. Similarly, the principal that for the communication to be privileged, the lawyer must be providing the advice in an "independent" capacity is critical and well known consideration given where a court is considering any claims for privilege. This consideration is heightened when that claim involves in house counsel.

The dominant purpose test creates a significant issue for in house counsel as the homogenisation of legal and business advice has threshold implications in establishing legal professional privilege. The duplicity or, indeed, multiplicity of roles undertaken by general counsel can affect the potential to claim privilege.

Whilst any determination of a privilege issue is inherently fact based and on a document by document basis, courts in Australia are heavily geared towards looking at evidence to demonstrate legal independence. In the context of in house counsel, it must be demonstrated that in house lawyers have a professional detachment (*ie independence*) in the employment relationship and their independence from the business. As highlighted above, the multiple roles and socialisation of in house counsel in the executive team render some practical issues in being able to demonstrate this independence. In the *Seven Network Limited v News Limited* decision, Tamberlin J highlighted this dilemma in stating that:

> *"...The courts recognise that being a lawyer employed by an enterprise does not of itself entail a level of independence. Each employment will depend on the way in which the position is structured and executed. For example, some enterprises may treat the in house advisor as concerned solely in advising and dealing with legal problems. As a matter of commercial reality, however, both internal and external legal advisors will often be involved in expressing views and acting on commercial issues.*
>
> *The authorities recognise that in order to attract privilege the legal advisor* ***should have an appropriate degree of independence****, so as to ensure that the protection of legal professional privilege is not conferred too widely."(emphasis added)*[13]

Key decisions on Privilege

The key decisions in the demonstration by in house counsel of privilege are *Dye v Commonwealth Securities Limited*[14] (**Dye**) and *Rich v Harrington*[15] (**Rich**).

In each case, evidence was led to demonstrate that the in house counsel maintained the requisite level of independence to enable it to claim legal professional privilege (where the documents met the dominant purpose test).

In Dye, evidence was adduced that the in-house legal team:

- maintained separate electronic files;
- sent communications on letterhead of general counsel; and
- demonstrated reporting lines from junior solicitors directly to general counsel.

In this instance, Justice Katzmann recognises the dual role of in-house counsel by holding that a lawyer is likely, in any in house counsel role, to perform both legal and non-legal functions and, this of itself, did not undermine the ability to claim privilege. In this instance the in-house team met the requisite level of independence.

The court also has held that in house counsel's other responsibilities (the multiplicity of roles) could affect independence. This however does not necessarily mean that communications cannot be privileged. Critically, it is

[13] [2005] FCA142 at [4] and [5] as quoted in Meredith and Hindmarch, n2, at page 11
[14] [2010] FCA950
[15] [2007] FCA1987

necessary to examine the precise capacity in which the lawyer was acting in at the time of communication on an objectively independent basis.

Contrast this with the decision in Rich where the office of general counsel of Price Waterhouse Coopers (**PwC**) where evidence demonstrated that the PwC office of general counsel:

- operated geographically as a separate unit within PwC;
- opened separate files; and
- had documents and current files kept securely within the offices of the in house counsel lawyers from and separate to the remaining PwC business unit.

In contrast to the Dye decision, Branson J in dealing the claim of privilege indicated that the relationship between PwC in house counsel and its remaining business units was not of an independent character supporting a claim for legal client privilege.

Commentators have[16] sought to rationalise the apparent discrepancy in the findings in these cases on the basis that the PwC decision revolved on the capacity of some senior in house lawyers (as partners of PwC) and were likely then to have inherently conflicting duties and interests in discharging independent advice where they were also partners of the broader PwC business unit.[17]

Practical Considerations

Following these decisions, commentary, suggested mostly in non-specific terms that it would be prudent for businesses to take precautions to mitigate or remove the risk that general counsel is no longer “independent”.

A snap shot of some of the practical measures to that general counsel should consider adopting to maximise their capacity to assert legal professional privilege is set out below. Each general counsel and corresponding employer corporation will need to undertake a cost benefit analysis of instituting all of these practices and processes. However, it does give a guide to best practice as well as some insight into what Courts are looking for or what criteria they will impose when assessing the independence of a general counsel looking to invoke legal professional privilege.

Location

Where possible, the office of general counsel and the in-house legal team should, separate from the remaining business units of the corporation. In-house counsel officers should be able to be locked and not accessible at any time by other business units within the corporation.

Reporting lines

It is recommended that in-house counsel hold clear and delineated reporting lines. Lawyers within the legal department should report directly to general counsel rather than, for example, managers of the respective business units to which they are assigned. The risk here, is where there is a reporting line from in-house counsel to a non-lawyer, the non-lawyer does not in general terms fully appreciate the professional requirements of a practising lawyer and the impact that this would have on a lawyer’s independence. The non-lawyer reporting line also has practical implications in the socialising of lawyers (within the management structure) and in the misdirection of loyalty issues touched on above.

[16] See, for example, Meredith and Hindmarch, n2, at page 12
[17] [2007] FCA1987 at [59]

File management

In-house counsel team should open their own separate files and those files should not be accessible to non-lawyers within the remaining business units of the organisation. It is suggested that in-house lawyers should use letterhead depicting that the relevant correspondence has been generated from the in-house counsel legal department or similar.

In-house counsel employee requirements

Holding a practising certificate would logically be a threshold criteria in establishing the requisite independence and scope of responsibilities required of each in-house lawyer. However, related commentary in reviewing the authorities on this issue suggest that the question here is more appropriately described as whether the in-house lawyer is admitted to practice.[18]

Courts have reviewed the terms of in-house lawyer's employment contract assessing the independence criteria. This would logically require that in an in-house lawyers contract include a specific obligation to act independently and provide independent legal advice in the discharge of that practitioner's legal role within the organisation.[19]

Whilst the issue does not seem to have been specifically addressed by judicial authority or commentary, the setting of certain key performance indicators within an in-house lawyers contract of employment and remuneration package (for example an incentive scheme) relating to the provision of independent legal advice (as suggested above), would be probative evidence of the independent expectations required of in-house lawyers.

Delineating roles

The issue facing in-house counsel who act as legal advisor and business advisor is the potential dangers inherent in any claim for legal professional privilege arising from communications involving that practitioner.

To establish legal professional privilege is to be maintained it would be necessary for such a practitioner to establish:

- the purpose for which the communication came into existence (and if more than one purpose) via compelling evidence that the dominant purpose is one to which privilege would attach; and

- what role was played by that in-house counsel and, in particular, their independence in the creation of the relevant piece of communication[20].

Some of the practical considerations arising from this criteria include:

- where possible, commercial and legal advices should not be combined into one document;

- the use of watermarks or stamps on documents or correspondence containing the words "privileged – brought into existence for the dominant purpose of seeking or giving legal advice" or similar[21].

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[18] See, for example, Meredith and Hindmarch, n2, at page 12
[19] *Banksia Mortgages Limited v Croker and Ors* [2010] NSWSC 535
[20] Anthony Lo surdo, *Legal Privilege: Drawing the line Professional or client legal privilege for in-house counsel* NSW Law Society journal, February 2008, page 66
[21] Speech by Graham J "*Establishing and maintaining a claim* for legal professional privilege in light of Telstra Corporation Limited v Minister for Communications Information Technology and the Arts (No.2) [2007] FCA 1445: The Quandry facing in-house counsel" – 9 April 2008 as quoted in Meredith and Hindmarch, n2, at page 13.

Section B: Changes to reporting practices following ASX amendments to listing rules and corporate governance principles and recommendations

Introduction

New changes to the ASX Listing Rules and the new (3rd) Edition of the Corporate Governance Principles and Recommendations will take effect on and from 1 July 2014.

The purpose of this section of the paper is to set out the key Listing Rule amendments and key updates to the Corporate Governance Principles and Recommendations issued by the ASX Corporate Governance Council and in particular how those changes will impact on the reporting requirements of complying entities.

The ASX Corporate Governance Council undertook a comprehensive review of its principles in 2012/13 and this third version of the Principles and Recommendations represent the Council's response to shifts in corporate behaviour and governance codes arising and learned from the Global Financial Crisis (GFC). The updated version of the Corporate Governance Principles and Recommendations applied to listed entities first at full financial year commencing on or after 1 July 2014. In other words, for entities with a 30 June year end, means the financial year ending 30 June 2015.

Whilst most of the corresponding amendments to the ASX Listing Rules were intending to compliment and give effect to the reforms proposed by the Corporate Governance Principles and Recommendations, ASX has used this as opportunity to include a number of other amendments, some of which will affect your company's disclosure within its Annual Report[22].

The Corporate Governance Council warn that if certain trends or concerns emerging in recent years within the area of corporate governance are not addressed in the Corporate Governance Principles and Recommendations on a regular basis, then Australia may be forced into a more prescriptive (read onerous) legislative response to corporate governance failures arising from the GFC.

The manifestation of this warning and concern is the focus on disclosure and management of risk. There is also an additional requirement of that entities disclose their exposure to economic, environmental and sustainability risks[23].

Amendments

Key amendments to the Listing Rules and Corporate Governance Principles and Recommendations will require that:

- a listed company must prepare a statement, in accordance with Listing Rule 4.10.3, which discloses the extent to which it has followed the Corporate Governance Principles and Recommendations during a particular period (**Corporate Governance Statement**);
- a listed company may include its Corporate Governance Statement in its annual report or in a separate document given to the ASX at the same time as it gives the ASX its annual report (Listing Rule 4.7.4);
- if the entity does not include the Corporate Governance Statement in its annual report, it must include it on its website and must include in its annual report the website URL where the Corporate Governance Statement is located (Listing Rule 4.10.3); and

[22] See Recommendation 7.4 of the Corporate Governance Principles and Recommendations
[23] Jeremy Baskin, *Value, values and sustainability; corporate responsibility in merging market companies* available at SSRN 1094573(2006)

- a listed company must give the ASX a completed **Appendix 4G** and its Corporate Governance Statement (if it isn't included in its Annual Report) at the same time as it gives its annual report to the ASX (Listing Rules 4.7.3 and 4.7.4).

Key reporting disclosures

Appendix 4G - Key to governance disclosures

Previously the Corporate Governance Principles and Recommendations state that certain information should be publicly available or disclosed – in some, but not all, cases prescribing a suggested location for such disclosure. In practice, this resulted in entities complying with a recommendation without identifying where it has disclosed the information relevant to the recommendation.

The Appendix 4G is therefore intended to serve as a guide as to where a company's governance disclosures can be found.

The Appendix 4G is not intended to detract from the requirement for listed entities to include a Corporate Governance Statement in its annual report or website, but is intended to ensure that the disclosures made in accordance with the Listing Rules or in connection with the Corporate Governance Principles and Recommendations are readily identifiable and easily located (including by investors and regulators).

This will also assist companies to conduct a verification process (which the ASX has in its guidance encouraged companies to undertake) to confirm that statements in the annual report have a reasonable basis and are not misleading. This will obviously clearly allow ASX a clearer line of sight on monitoring and regulating an entities disclosure of its governance disclosure.

Appendix 4G is self explanatory and requires an entity to confirm, in a checklist format, whether or not it has:

- followed the relevant recommendation in full for the whole of the relevant period;

- if the recommendations are followed, inserting the location (either in the corporate governance statement or another location) of where that disclosure is made; or

- if the recommendations are not followed, an explanation of why that it is so in the relevant corporate governance statement.

Employee share scheme purchases – One off annual disclosure only

The ASX had initially proposed a new Listing Rule 3.19B which would have required a listed company to disclose, within five business days after the purchase, certain information regarding each on market purchase of securities made by the company on behalf of employees or directors or related parties (**Prescribed Person**) under an employee incentive (share) scheme (**EIS**).

That proposed new listing rule was designed to close a gap under Listing Rule 10.14, which meant that while the acquisition of securities by a director (or an associate) under an EIS without shareholder approval is prohibited, no disclosure or shareholder approval is required where an acquisition under the EIS is made by the company.

The ASX has decided not to proceed with the introduction of Listing Rule 3.19B. The ASX rationale for electing not to proceed with the more onerous disclosure requirements is that the on-market purchase does not dilute the interests of other security holders and, because the acquisitions are affected at market prices, do not raise the same concerns about pricing as an issue of security. Instead, the ASX is now proposing new Listing Rule 4.10.22 which will only require a listed entity to disclose the following information, which is substantively the information that would have been required under LR 3.19B, it in its annual report:

- the number of securities purchased during the reporting period;

- the average price per security purchased during the reporting period; and

- the name of any director or related party for whom securities were purchased on behalf of or allocated to, along with the correlative number of securities.

The notation to the ASX Listing Rules provides that:

- this rule applies regardless of whether the acquisition of the securities was undertaken by the entity, its subsidiary or an independent trustee of the employee's incentive scheme where the entity or the subsidiary has directly or indirectly provided funds for that purpose; and

- disclosure required by or under this rule may be included in the remuneration report included within the entity's annual report.

Boards Skills – The Matrix

Recommendation 2.2 now requires a listed entity to disclose a board skills matrix setting out the mix of skills and diversity that the Board currently has or is looking to achieve in its membership.

Prior to this amendment, a listed entity needed to disclose a statement in more generic terms as to the mix of skills and diversity for which the Board of Directors is looking to achieve in its membership of the Board.

The purpose of this amendment would appear to heighten the consideration given an assessment of the current specific skill set of the Board as it now stands and also what skill set the Board is seeking to achieve.

It is worth noting that the disclosure only needs to be given collectively across the board as a whole without identifying the presence or absence of particular skills by a particular director.

Increase focus on Risk

Principle 7 of the ASX Corporate Governance Principles and Recommendations requiring an entity to *"Recognise and Manage Risk"* is not new. Specifically, this principle requires a listed entity to establish a sound risk management framework and periodically review the effectiveness of that framework.

The latest rounds of amendments to these Principles and Recommendations reflect a sharp increase in focus ASX now has on listed entities and their risk management framework. Arguably, these are the most significant reforms in this package, especially for members of the executive and in-house legal team of listed entities charged with the establishment, audit and monitoring of the risk management framework.

Commentary in the Principles and Recommendations provide that investors are required to have sufficient information to understand and assess investment risk in order to be better informed in making investment decisions.

Amendments to Recommendation 7.1 set out the need for a company's board to have a risk committee or committees. Companies who elect not to establish this special purpose committee will need to provide an explanation as to why not as well as the board's approach to overseeing its risk management framework. Contrast that with the previous guidelines which require disclosure on how management has designed and put in place the required risk management system and the corresponding obligation on management to report to the board on its effectiveness.

The effect of this change is to place a greater responsibility on the board (as a whole or via its special purpose committee) to review and critically assess, at least on an annual basis, the risk management framework of the relevant listed entity. Part of this assessment will require the board (or committee) to reflect on any changes in any material business risk to ensure that those risks remain in the risk framework and corresponding risk appetite of the board.

Commentary contained in this principle requires that the risk committee members should have the "necessary technical knowledge" as well as efficient understanding of the industry in which the entity operates to effectively discharge the committee's mandate.

Given the role of general counsel, it is likely that a significant amount of the preparatory work will need to be undertaken by the in-house counsel office to ensure that the risk committee (or the board itself) is in a position to discharge these heightened obligations.

Amendments to Recommendation 7.4

Amendments to recommendation 7.4 heightens the sustainability reporting obligations of listed entities.

Recommendation 7.4, as amended, requires an entity to *"disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks."*

A key change from the final version as adopted from the consultation draft is that disclosures are now limited to situations where an entity has a *"material exposure"* to the sustainability risks. In this context, commentary defines "material exposure" to mean a real possibility that the risk in question could substantively impact the listed entity's ability to create or preserve value for security holders over the short, medium or long term.

Following the consultation process the final Principles and Recommendations contain definitions of "economic sustainability", "environmental sustainability" and "social sustainability" which focus on the ability of a listed entity to continue carrying on operations over the long term.

Entities that currently publish a sustainability report are able to satisfy this requirement by cross-referring to that report.

Commentary in this area suggesting that further guidance on expectation on the level of disclosure would be useful to listed entities in discharging its obligations, however it would seem that entities that currently prepare and distribute sustainability reports may address the expected level of disclosure given the commentary specifically provides that the provision of such a report may (but not necessarily will) meet this recommendation.

The requirement of listed entities to sharpen its corporate social responsibility focus has already gained traction globally. In 2007, the United Kingdom introduced providing for a concept of "enlightened shareholder value". This obliged directors to have regard to the longer term and various corporate social responsibility factors including the interests of stakeholders, consumers and the environment generally. South Africa, Hong Kong, Singapore and Brazil have made corresponding triple bottom line reporting reforms.

Proxy forms – no more "Chairman's Box"

The ASX has removed the requirement for the so-called "chairman's box" in a proxy form. This is currently required by Listing Rules 14.2.3A and14.2.3B and a shareholder must tick to authorise the Chair to vote on a resolution if the Chair becomes the shareholder's proxy by default or because the shareholder does not appoint another person as proxy, but is otherwise excluded from voting on that resolution by the Listing Rules.

Now, the Proxy Form will need to include a statement as to how the Chair intends to vote undirected proxies.

The amendments are proposed to take effect on 1 July 2014, in time for most entities' next annual general meeting.

Proposed changes – Left on the cutting room floor

Summary

A number of changes proposed in the Council's consultation drafts were not included in the final version of the Corporate Governance Principles and Recommendations, the rejection of which are relevant to the listed entities reporting requirements include:

- the recommendation regarding clawback policies; and
- proposed amendments to the direct independence criteria.

Clawback policy

The Council's consultation draft proposed the introduction of placing an obligation on listed entities to implement and disclose a "clawback" policy which prescribed certain circumstances in which an entity was entitled to clawback performance-based remuneration (for example, performance rights from senior executives). The recommendation also requires listed entities to disclosure whether any clawbacks have been made and, if clawbacks where entitled to have been made, but were not, the reasons for this.

The responses to the consultation draft indicated a degree of support for the rationale behind the recommendation, however there were a number of concerns expressed on the probity and the implementation of this recommendation. The respondents cited the detailed regulation under the entity's remuneration report combined with the impact of the "two strikes" voting regime as providing sufficient coverage and disclosure in performance-based remuneration and senior executive remuneration generally.

Consequently, recommendation 8.3 was deleted from the final edition of the Corporate Governance Principles and Recommendations. However, recommendation 8.2[24] now contains additional commentary that suggested disclosure should include a summary of the entity's policies and practices regarding the:

- deferral of performance-based remuneration;
- reduction, cancellation or clawback of performance-based remuneration in the event of serious misconduct or a material mis-statement in the entity's financial statement.

Director independence

Recommendation 2.3 obliges a list of entity to disclose the names of each director considered by the Board to be *"Independent Directors"*. In addition, if a director has an interest of the type described in Box 2.3 but the Board retains its opinion that this does not compromise the independence of those directors, the nature of the interest, position, association or relationship in question and an explanation of why the board has said that that opinion must also be disclosed.

Box 2.3 initially sought to include a nine-year period of tenure as a threshold characteristic that could compromise the independence of a director. This proposed change, whilst receiving support from investor groups and proxy advisory firms met with some significant opposition from the remaining respondents.

Governance directions summarised as central opposition was that independence at its core required an open mindedness to new ideas rather than any specific indicator, including, tenure being applied in isolation[25]. The related and similar criticism of the proposed imposition of a tenure limit would be the risk of losing the corporate memory and inherent experience that would be brought by a long standing director to the Board.

Consequently, Box 2.3's proposed reference to a nine-year tenure has been replaced with a more qualitative consideration requiring the entity to consider whether the director in question "has been a director of the entity for such a period that his or her independence may have been compromised".

Consequently, the Board will need to give some consideration on a yearly basis in assessing any long standing independent directors whether that length of period could in fact compromise his or her independence and make the relevant disclosures required by the Corporate Governance Principles and Recommendations.

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[24] A listed entity should separately disclose its policies and practices regarding the remuneration of non-executive directors and the remuneration of the executive directors and other senior executives
[25] The Governance Directions, Journal of Governance Institute of Australia Limited, Volume 66, No. 3, April 2014 – Australian Corporate Governance Council review of Corporate Governance Principles and Recommendations by Judith Fox (National Director, Policy & Publishing), page 144

Other amendments

Other amendments that would be of interest to seminar participants would include:

Recommendation	Description
Recommendation 1.2: Pre-vetting of director nominees	Entities are required to undertake "appropriate checks" before appointing a director or putting up a person for election to the Board. Commentary suggests that Listing Rules may find the guidance in Australian Standard AS4811/2006 Employment screening Helpful in understanding the types of checks that may be undertaken. Commentary also suggests that checks as to the person's character, experience, education, criminal record and bankruptcy history should be undertaken. No rationale or additional commentary is provided in support of this amendment.
Recommendation 1.4: Company secretary reporting lines	Recommendation 1.4 has been amended to provide that a company secretary is accountable directly to the Board, through the Chair, all matters to do with the proper functioning of the Board. This was previously included as commentary in the second edition of the Corporate Governance Principles and Recommendations and has now been included as a recommendation. The commentary provides that the role of company secretary should include: • advising the Board and its committee on governance matters; • monitoring Board and committee policy and procedures; • coordinating the time of completion and dispatch of Board and committee papers; • ensuring that the business at Board and committee is accurately captured in the minutes; and • helping to organise and facilitate the induction and professional development of directors. Amendments made from the consultation version to the final version of the third edition of the Corporate Governance Principles and Recommendations were made to recognise a company secretary's dual reporting lines within its role.

Recommendation	Description
Recommendation 1.5: Disclosure of the entity's diversity policy	Amendments were made to allow for a relevant committee (as opposed to the Board as a whole) to set the measurable objectives for achieving gender diversity. There's also an amendment made to allow for an entity which is a "rule of an employer" under the Workplace Gender Equality Act to disclosure the entity's most recent "Gender Equality Indicators" as defined in and published under that Act[26]. Consequently, any relevant employer under the Workplace Gender Equality Act may report each Gender Equality Indicators rather than previously where it was required to disclose the respective proportions of men and women in the Board, in senior executive positions and across the whole organisation in discharge of its obligations under this recommendation 1.5.

HopgoodGanim

Contact: **Michael Hansel**
Partner
T 07 3024 0328
F 07 3024 0028
E m.hansel@hopgoodganim.com.au

[26] The Workplace Gender Equality Act according to the commentary applies to non-public sector employers with 100 or more employees in Australia and requires those employers to make annual filings with the Workplace Gender Equality Agency disclosing their respective Gender Equality Indicators.