



OPINION

¶170 Independence — all those in favour?

By Alan Cameron, a former chairman of the Australian Securities and Investments Commission, who is now a partner in the firm Cameron Ralph, a company that aims to improve board performance.

More printer's ink has been spilt on the requirement (strictly, only a recommendation) for a majority of independent directors, than on any other aspect of the ASX Corporate Governance Council's (CGC's) Guidelines document released on 31 March this year.

A brief and necessarily incomplete recapitulation of the reactions may be in order, but it should first be noted that the

council has performed an excellent job of drawing together diverse interest groups with differing and sometimes conflicting agendas; even those of us who are critical of some aspects should be careful to acknowledge the enormity of their task, and the high degree of success they have achieved.

On independence, the criticisms were two-fold — first, that any such requirement was incongruous, unnecessary, or unlikely to produce better performance, with some risk of leading to worse; and/or, second, that the definition of independence was too narrow, so that genuinely independent folk would be deemed not to be independent.

These reactions were summed up famously by the leading market commentator Bill Beerworth who purported to quote his mother as saying that she would much rather the directors of companies in which she invested were competent, than that they should meet a narrow technical definition of independence.

These observations by market practitioners such as Bill found unexpected, and not widely noticed, support from perhaps an unlikely source — the HIH Royal Commissioner, The Hon Justice Neville Owen. He wrote in the report completed on 4 April, concerning the ASX CGC's definition of independence, to which he must have had early access: "Neither the matters raised during the [Royal] Commission nor my experience generally qualifies me to say whether all of the matters listed would necessarily deprive a person of independence.

"[A]n attempt to be unduly prescriptive might impose undesirable rigidity, and distract attention from the critical issue of freedom from possible influences, many of which may be subtle and not susceptible to a 'check list' approach. For example, it is not immediately clear to me why a substantial shareholding in the company should be regarded as compromising independence.... the critical question is not so much whether on objective criteria the individual is 'independent' but rather whether he or she is

subjectively capable of exercising independent judgment.”

This criticism is of the second kind, namely that you won't know whether the directors are genuinely independent simply because they pass the narrow tests — he is not querying the desirability of independence, and does not comment on the proposal for a majority.

So, are the ASX guidelines the prescriptive all-embracing definition of 'independence' that he believes should be no more than a guide? I think they might turn out in practice to be. The *Australian Financial Review* carried a short article recently concerning a debate in legal circles about the form of the recommendation. It includes a footnote which says that "independence" is defined in Box 2.1. Below, there is commentary and guidance that includes the statement: "A definition of independence is contained in Box 2.1." Much is now sought to be made apparently of the fact that it says 'A' definition, not 'the' definition, and a footnote is to be regarded as secondary to the main text.

Clearly the definition against which the board is expected to report is the definition in the box — the guideline says so, in those words, but does allow that a director may be considered independent despite a relationship of a kind listed in the box.

It should be noted that the requirement itself is being re-evaluated even at its source. The Higgs Report issued in January in England, contained a similar recommendation and definition which was clearly influential in the ASX Guidelines. The UK Financial Reporting Council now concedes that this recommendation "could be difficult for many smaller listed companies (below FTSE 350)", and for them the Code should provide for at least two, rather than a majority, and some encouragement to move towards a majority. A similar explicit concession to that effect here would be welcome. Other relaxations are contemplated as well — see <http://www.frc.org.uk> — and a revised text is due in July.

Even the New York Stock Exchange is relaxing its approach in some respects. They are now proposing that the rule requiring (in their case) a majority of independents not apply to controlled companies — companies in which more than 50% of the voting power is held by an individual, a group or another company. This seems logical at first look, and one wonders how many Australian companies are similarly "controlled" — Pan Pharmaceuticals leaps to mind, where the founder and former CEO held over 50%. How realistic is it to view any director of such a company as technically independent, since each can be removed almost at the stroke of a pen?

And these controlled companies are frequently the companies where the requirement is thought to produce odd results. In Australia we think immediately of the high performing companies which appear to break narrow rules — including Westfield, Harvey Norman, and News Limited. *The Economist* (May 31st) noted that it is frequently media companies world-wide where these "rules" sit oddly with the reality of strong control by media barons — not just News Limited, but thriving companies like Viacom and Hollinger. Until, like Disney, they cease to do so well, and the CEO's architect and the CEO's children's preschool director are removed from the board.

The last word, so far, goes to Peter Morgan, formerly a leading fund manager at Perpetual, now running his own funds. In a letter in the *Australian Financial Review* on 5 June, he treats the requirements as prescriptive rules (which shows how leading professional fund managers are regarding them), and adds several more high performers to the list of those who would fail the tests (including Berkshire Hathaway). He concludes: "The last thing in the world I need is to be forced [by investment benchmarking] to invest in mediocre companies governed by so-called independent directors who own no shares in the company concerned but take substantial retirement benefits that have no relationship to the company's performance."

We shall soon see how leading companies will deal with the issues in practice, as some ASX companies voluntarily report against them as at 30 June. Perhaps like Higgs in London, some early fine-tuning would be desirable to ensure the viability and credibility of the guidelines, and the necessary flexibility to permit optimal performance of Australian companies.

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