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VOTING IN 2013: THE POWER OF INCUMBENCY

In some respects, 2013 continued the status quo for shareholder voting observed in the past three years. Management backed directors continued to receive large votes in their favour, with the average vote for a management-backed director resolution 94.6 percent across the S&P/ASX 300 (in 2012 it was 95 percent) and very few management backed resolutions of any type outside of remuneration reports were defeated.

There were 22 'strikes' on S&P/ASX 300 remuneration reports, up from 20 'official' strikes recorded in 2012, and one 'spill resolution' actually put to shareholders after two were put to shareholders in 2012.

Even the companies incurring strikes were familiar - with Cabcharge and Linc Energy incurring strikes for the third consecutive year (under the two strikes regime a company that has experienced its second strike has its number of strikes reset to zero meaning neither Cabcharge nor Linc Energy were required to put a resolution seeking to spill the board to shareholders).

There were however some unusual features of voting in 2013: The year featured two full scale attempts by activist shareholder groups to unseat directors and change company direction, at befuddled junior resources company Intrepid Mines in June 2013 and at struggling clothing company Billabong in December.

The year also saw the uncanny ability of management to triumph in close vote results reinforced with no fewer than seven resolutions passing by well under 1 percent of votes cast.

The close ones

Table 1 below lists the seven resolutions where management's margin of victory was less than 1 percent (with abstentions excluded). Of the seven, six were decided by less than 0.5 percent – four of these 'cliffhanger' resolutions involved remuneration reports – and at Elemental Minerals and Metminco no poll was called despite the closeness of the result. Where no poll is called the resolution is decided on a show of hands among those present at the meeting with each shareholder present having one vote. The proxy votes received are then released to the ASX and a full vote count (a poll vote) is not undertaken.

This was the second year in succession where Elemental, which held its 2012 and 2013 annual meetings in May, avoided a strike on its remuneration report and did not call a poll. In 2012 Elemental did not call a poll despite the proxy results showing a vote against its remuneration report of 25.2 percent (Elemental was in fact listed in last year's version of this report as having incurred a strike).

Table1: Close votes in the S&P/ASX 300 in 2013

Company	Resolution	Margin (%)	Poll called	Margin in votes (votes cast)
Iress Limited	Equity grant to CEO	0.01	Yes	10,026 (89,157,081)
STW Communication Group Limited	Remuneration report	0.21	Yes	651,751 (309,682,300)
Elemental Minerals Limited	Remuneration report	0.35	No	415,833 (143,801,348)
Metminco Limited	Remuneration report	0.36	No	529,384 (577,695,091)
Lynas Corporation Limited	Remuneration report	0.39	Yes	1,693,857 (433,614,871)
Intrepid Mines Limited	Constitutional change	0.42	Yes	1,329,379 (313,751,489)
Aurora Oil & Gas Limited	Equity grant to director	0.73	Yes	2,214,232 (304,526,851)

Incumbent management's ability to win close votes has been remarked upon on in other jurisdictions.[1] In 2013, across the 1,866 resolutions put to shareholders at S&P/ASX 300 entities 19 had margins of less than 5 percent and of these 19, 12 were won by management with the seven defeated all being remuneration reports. Of 'ultra-close' resolutions, those decided by less than 1 percent, management won seven of nine and of the 'cliffhangers' involving margins of less than 0.5 percent, management won all six.

Similar results were apparent in 2012, with 25 resolutions out of 1,874 having margins of less than 5 percent and management winning 16 of 25. Of the eight close resolutions in 2012 which management apparently lost, six involved remuneration reports (including at Elemental Minerals, where the board determined no strike had been incurred), and the others were a placement involving an effective change of control at Noble Minerals (where Resolute Mining launched a counter proposal to the placement) and a constitutional amendment. Of the five resolutions where the margin was less than 1 percent (including Elemental's 2012 remuneration report) management won three and lost two (or one - if Elemental is excluded).

Close results are significant given problems with the electoral system for Australian corporate elections. Not only is the voting process non-transparent and overseen by management but the actual process by which votes are lodged and counted is fraught with risk. Other

[1] See for example Listokin, Yair, 'Management Always Wins the Close Ones', 2008, Faculty Scholarship Series, Paper 556, http://digitalcommons.law.yale.edu/fss_papers/556.

research has highlighted the multiple steps involved in an institutional investor's vote being lodged and the potential for error created by this system although there remains only one public example of a voting error changing a the result of a resolution, at Emeco's 2011 remuneration report where a 'strike' was found to have been caused by 'double voting'.[2]

Management's advantages in corporate elections are considerable: They have information on the running total of results and so can lobby shareholders for support as the vote tallies become known; they also can, through s. 672A of the Corporations Act, compel custodians to reveal ***prior*** to the actual meeting date the identity of investors who voted against resolutions.[3] Management can also spend shareholders' funds on lobbying efforts, including employing third parties such as proxy solicitors. In the 2013 annual meeting season for example a number of institutional investors were surprised to find themselves contacted by investor relations staff or proxy solicitors lobbying for votes in favour of management as voting cut-offs approached.

The benefits of incumbency: Galaxy Resources

After a dreadful year, Galaxy's 31 May AGM coincided with a major recapitalisation. On 31 May Galaxy announced it would adjourn one item of business, the reelection of chairperson Craig Readhead, until 7 June noting that "holders of approximately 75 million shares had indicated to the company prior to the commencement of the meeting that they intended to vote in favour (of Readhead's reelection) … Proxies and/or corporate representatives in relation to these approximately 75 million shares were not eligible to be voted at the Meeting, due in part to technical and administrative processes".

When results of the adjourned meeting were released to the ASX on 7 June, Readhead was reelected with 158.02 million votes in favour and 114.58 million against. Without the meeting adjournment and the opportunity to include the 75 million ineligible proxies, Readhead would not have been reelected.

Dissidents

The advantages enjoyed by incumbent management make attempts to change the direction of a company through imposing new directors on a board a forbidding challenge. Proxy contests run by activist shareholders such as hedge funds seeking to remove incumbent board members and elect new ones are relatively common in the United States – where barriers to other forms of corporate activity such as hostile takeovers are much

[2] See 'Institutional Proxy Voting in Australia', a report commissioned by the Australian Council of Superannuation Investors and prepared by Ownership Matters, October 2012, http://acsi.org.au/images/stories/ACSIDocuments/detailed_research_papers/12%20Institutional%20Proxy%20Voting%20in%20Australia.Oct%2012.pdf. For Information on the Emeco voting error see 'ASX announcement, Emeco investigating GAM voting error, 9 December 2011, available at http://www.asx.com.au/asxpdf/20111209/pdf/42361ws3kgv882.pdf.

[3] The 'tracing provisions' of the Act exist to enable companies to determine whether supposedly non-associated investors are in fact acting in concert; they are now however routinely used by listed company management to obtain information on which institutional investors are voting against resolutions such as remuneration reports.

higher than in Australia – but to date have seldom occurred seldom in S&P/ASX 300 companies. In 2013 a group of dissident investors sought to remove incumbent directors at Intrepid Mines, after the company's board had presided over a substantial investment in an Indonesian gold project with a problematic ownership structure which resulted in Intrepid's project partners declaring Intrepid had no ownership in the mine. At Billabong, which received a number of competing proposals during 2013 as it sought a recapitalisation to reduce its debt, a group of activist investors sought to block board-endorsed recapitalisation proposals through removing directors and electing new ones as well as through amending the constitution.

At Intrepid and Billabong the activists' attempts were unsuccessful although relatively well-supported – the average vote in favour of the dissident proposals at Intrepid was just under 35 percent while at Billabong the dissident proposals received an average 26 percent in favour. In both cases the activist investors were not based in Australia; activism through shareholder resolutions aimed at changing management in Top 300 Australian companies to date has largely been confined to strategic shareholders and/or disgruntled former management rather than institutional investors as seen in cases such as West Australian News, Aspen Group, Molopo Energy, Troy Resources and in 2013, at Canadian company Teranga Gold.

Strikes

In 2013 votes against remuneration reports in the S&P/ASX 300 followed the pattern of 2012. There were 22 strikes in 2013, up from 20 in 2012 (excluding Elemental Minerals' apparent strike in 2012) with these again concentrated outside of S&P/ASX 100 companies. Of the 22 'strike' companies in 2013, three were in the Top 100 (two in 2012) and 11 were ranked 201 to 300. Of the 22, 18 received a strike for the first time in 2013 although this included St Barbara which prior to the introduction of the 'two strikes' regime in 2011 had seen its remuneration report defeated – ie. a majority of votes cast against – in both 2008 and 2009. For the third year in a row only two S&P/ASX 300 companies – Next DC and Alumina - received a majority of votes against their remuneration report. Prior to the introduction of two strikes at least five S&P/ASX 300 companies had received majority votes against their remuneration reports each year from 2008 to 2010 despite management shareholders being entitled to vote on remuneration reports prior to July 2011.

The four companies to again receive a strike in 2013 were Cabcharge and Linc Energy and as already noted, both received their third consecutive strike although Linc Energy redomiciled to Singapore following its AGM and is no longer subject to the two strikes regime. The others were Cash Converters, where the spill resolution was easily defeated, and Automotive Holdings which incurred a strike in 2011. Red Fork Energy narrowly avoided a second strike with a 23.5 percent vote against on proxies on its 2013 remuneration report although the resolution was not put to a poll.

Table 2: Strikes in the S&P/ASX 300 in 2013

Company	Against vote (%)	Company	Against vote (%)
Next DC Limited	57.8	St Barbara Limited	31.2
Alumina Limited	50.1	Southern Cross Media	31.1
Karoon Gas Limited	49.3	Linc Energy Limited	*30.6*
Cabcharge Limited	*45.3*	Greencross Limited	30.3
Shopping Centres Australia	43.1	Aurizon Limited	28.1
Forge Group Limited	40.6	iSelect Limited	27.8
Molopo Energy Limited	40.1	**Cash Converters**	**27.7**
David Jones Limited	39.5	Thorn Group Limited	27.5
Automotive Holdings Group	38.1	Hills Limited	26.5
Galaxy Resources Limited	37.8	Intrepid Mines Limited	26
Ausenco Limited	33.8	Super Retail Group	25.9

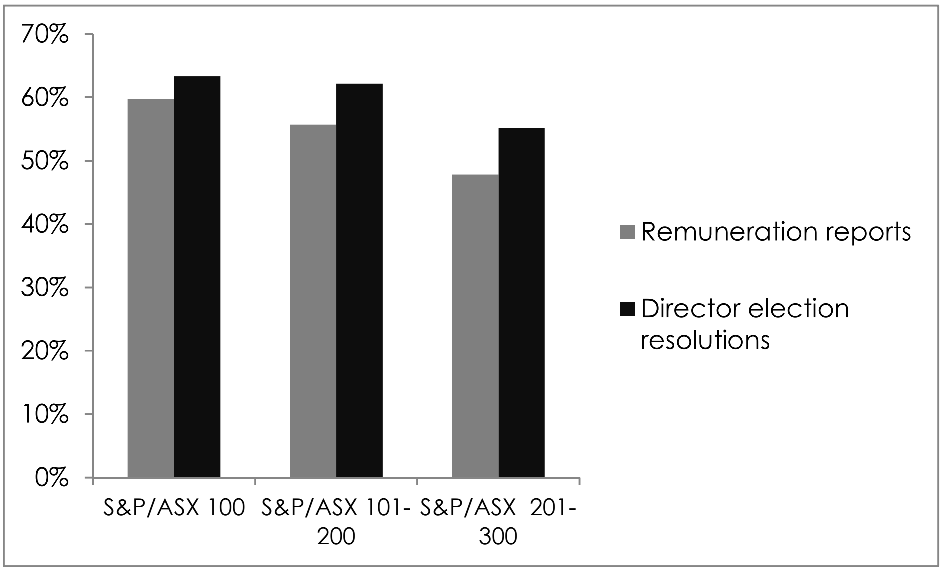
Note: Companies in bold are those that incurred a second strike; underlined companies incurred a third consecutive strike.

As noted in prior reports the two strikes regime has exaggerated votes against remuneration reports by excluding key management personnel – those persons disclosed in the remuneration report – from voting their shares. As shown in the graph below the impact of this exclusion has been to reduce votes cast on remuneration reports as a proportion of all shares on issue especially among smaller companies in the S&P/ASX 300. The gap between turnout on director election resolutions relative to remuneration reports among companies outside the Top 100 is well over 6 percent compared with less than 4 percent at the Top 100.

The exclusion has not completely removed the impact of major shareholders on vote results. Cash Converters, for example, would have experienced an outright majority vote against its 2013 remuneration report without the support of 32 percent shareholder EZ Corp. It was able to vote on the resolution despite having representatives serving on the board as these representatives did not have a direct personal interest in EZ Corp's shareholding.

At Village Roadshow the majority shareholding of Village Roadshow Corporation (VRC) was voted for the remuneration report despite three directors jointly having an interest in VRC (and controlling the exercise of power to vote or dispose of VRC's shareholding); without these votes Village Roadshow would have incurred a first strike. Outside of remuneration reports major shareholders also can also disguise substantial investor opposition. As an example, Leighton Holdings' request to increase its director fee cap during 2013 following a series of director resignations due to concerns over the influence of controlling shareholder ACS would have been heavily defeated but for ACS' support.

Graph 1: Turnout on rem reports relative to director elections



Absent opposition: Director elections

In 2013 the electoral margins enjoyed by management endorsed directors remained largely untouched. Across the S&P/ASX 300 the average vote in favour of board-backed director election resolutions was largely unchanged from 2011 and 2012 at about 95 percent. As in prior years, voting data suggests investors are more willing to oppose remuneration-related resolutions rather than director elections – in 2013, as shown in Graph 2, the average vote against management on a pay related resolution was much higher than the average against a director election resolution (across the S&P/ASX 300 votes against management are higher on average on **binding** executive pay resolutions compared with votes on the non-binding remuneration report).

Investor reluctance to oppose director elections is also apparent from the lack of substantial dissenting votes on director elections. Across the S&P/ASX 300 7.8 percent of remuneration report resolutions received votes against of 25 percent or more compared with 4.4 percent of director election resolutions and if the activist shareholder attempts to change the boards of Billabong and Intrepid are excluded the proportion of high dissenting votes on director elections falls to 2.7 percent.

Graph 2: Votes against management on pay and directors

Votes based on board composition do not seem to have driven most large dissenting votes on directors in 2013. Of the 10 highest votes against directors, shown in Table 3 below, those at Teranga and Intrepid reflected proxy contests brought by disgruntled shareholders while the vote against Craig Readhead at Galaxy appeared to reflect frustration over company performance.

The only high dissent vote among the top 10 driven by board composition would appear to be at Sonic Healthcare where, unusually for a Top 100 company, executive directors hold half the board seats. On director elections the votes of strategic holders however do obscure results – for example, if votes cast by founder shareholders at Harvey Norman Holdings were excluded two executives seeking reelection in 2013, David Ackery and John Slack-Smith, would have been defeated.[4]

[4] See ASX announcement, 'Results of annual general meeting', 26 November 2013.

Table 3: Highest 10 votes against management on directors

Resolution	Against vote (%)
Teranga Gold – Alan Hill	45.2
Teranga Gold – Christopher Lattanzi	43.5
Teranga Gold – Alan Thomas	43.5
Galaxy Resources – Craig Readhead	42
Duet Group – Duncan Sutherland	38.9
Duet Group – Michael Lee	38
Intrepid Mines – Elect Campbell Baird	**36.4**
Intrepid Mines – Elect Cliff Sanderson	**36.4**
Intrepid Mines – Remove Laurence Curtis	**36.2**
Sonic Healthcare – Philip Dubois	36

Note: Resolutions in bold represent shareholder resolutions; in these cases the vote reflects the vote total against management's recommendation.

Defeated resolutions

The risk of management suffering defeat on any resolution was minor in 2013 as in prior years. Excluding remuneration reports, of the 1,584 resolutions put to shareholders there were four where management was defeated and six cases where resolutions were withdrawn seemingly in the face of shareholder opposition. Table 4 lists defeated resolutions or resolutions withdrawn in the face of defeat in 2013.

Table 4: Defeated resolutions

Resolution	Against vote (%)	Vote to defeat (%)	Withdrawn?
Newsat – equity issue to former exec	69.5	50.1	No
Newsat – equity issue to former exec	69.2	50.1	No
Energy World – option grants to execs	59.8	50.1	Yes
Shopping Centres – equity issue to former exec	52.8	50.1	No
Papillion Resources – constitution	37.1	25.1	Yes
Mirabela Nickel - constitution	34	25.1	No
Suncorp Group - constitution	31.9	25.1	Yes
Starpharma - constitution	31.7	25.1	Yes
Intrepid Mines – placement ratification	N/A	50.1	Yes
Astro Japan – management fee changes	N/A	25.1	Yes

The table of defeated resolutions does not include another resolution at Astro Japan relating to changes to the management fee which required a majority of votes cast to pass – this resolution was passed, according to statements made by the chairperson at the meeting, but was contingent on a constitutional amendment resolution also passing and this was defeated (this is the resolution included above). In another two cases - an issue of equity incentives to the interim CEO at Kingrose Mining and a director reelection at Energy World – it is not clear why the resolutions were withdrawn.

The list of defeated resolutions also makes it clear how rare it is for an outright majority of shares to be voted against a management endorsed resolution with this occurring on just seven resolutions (including remuneration reports) in 2013. The benefits to management of structuring major transactions as ordinary resolutions are clear – as an example, a company can effectively secure a change of control through an ordinary resolution authorising a share issue (a resolution seeking to do just this was narrowly defeated in 2012 at junior resource company Noble).

Overwhelming levels of support for management are a feature of most types of resolutions outside of executive pay. Resolutions seeking advance approval of placements or the ratification of past placements routinely receive substantial levels of support despite the potential for dilution and management entrenchment. Of the 138 placement resolutions put to S&P/ASX 300 shareholders in 2013, there were only 16 cases where more than 10 percent of shares voted were voted against and only three cases where the vote against was more than 20 percent: Intrepid Mines (where a resolution seeking ratification of a placement at a nominal price representing 5 percent of shares on issue was withdrawn), Billabong, where activist shareholders lobbied against part of a recapitalisation proposal being approved and Elemental Minerals where there was substantial opposition to a placement to board-endorsed acquirer Dingyi to provide short term financing. The Intrepid resolution was the only placement resolution to be defeated in 2013.