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# How a proposed new 'right' for shareholders could badly damage corporate boards

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There is a frenzied rush to get/give a new 'right" to shareholders, the right to put up their own nominees for board membership. Boards of directors, so goes a dominant opinion, are not to be fully trusted to pick the right kind of people as directors or to shift the membership swiftly as circumstances change, unless some Damocles sword is installed over their heads.

By the end of the 2017 proxy season, 60% of S&P 500 companies had, voluntarily or forcibly, adopted proxy access for board nominations. The following provisions have become standard: *ownership of 3% of a company's voting shares for at least three years, and the right to nominate up to 20% of the board by a shareholder or group of up to 20 shareholders*.

This access to voting proxies is about to become an integral part of corporate governance in Canada. All banks have come on board, though still claiming that the existing legal threshold of 5% should be maintained.

The Canadian Coalition for Good Governance (CCGG) has now come out swinging in support of this practice for all publicly traded companies. (Janet McFarland and James Bradshaw, ***Globe and Mail***; November 30th 2017)

It is very unlikely that major corporations will try to oppose the movement as many institutional investors are fiercely supportive of this measure. However, the eventual impact of this initiative on corporate governance raises important issues that seem totally absent from the discussions around this new "right" of shareholders.

**Proxy access may have adverse effect on internal board dynamics**

Shareholder access to the director nomination process brings forth a host of issues related to its application as well as a significant risk of adverse effects on board dynamics including:

- A partial takeover of a responsibility historically assumed exclusively by the board;
- the implicit belief that directors are only accountable to the shareholders and have a duty to promote exclusively the interests of shareholders, in spite of two Supreme court's interpretation of the board's responsibility to include other stakeholders;
- the reputational issues of the directors submitted to a contested election and the self-protective behaviour this would bring about;
- the actual risk of secret negotiations being held between management and investors who are intending to propose nominees;
- the overwhelming influence accruing to proxy voting advisory firms, whose clients would expect their voting recommendations on the nominees;

- the risk that the independence of directors nominated by shareholders would be compromised or so perceived;
- the risk of creating factions and a poisonous atmosphere within the board, which would hinder the proper functioning of the board;
- the risk of ending up with a board deficient in relevant experience or competence;
- the risk that the process be hijacked by single-issue groups of shareholders.

The consequences for an individual director being very publicly voted out of a board would be significant and painful, both in economic and reputational terms; this is true for both incumbent nominees and the new nominees proposed by the shareholders.

Faced with the risk and arbitrary nature of a contested election, the directors would try to promote their personal contributions with institutional investors (and proxy advisors), thus generating an unhealthy competition among colleagues. In any event, how would the thousands of shareholders, called upon to choose between several nominees, decide for which nominees to vote, which nominees to dismiss when the voting proxy contains more nominees than available seats?

Smaller institutional funds may well come to rely on proxy advisors (such as ***ISS*** or ***Glass Lewis***), again increasing by tenfold the influence of these outfits on the governance of public corporations. These proxy advisors will propose, as per their usual practice, some obvious, measurable criteria to make this choice: age of the directors, number of years as a member of the board, which are, in fact, arbitrary criteria, uncorrelated with actual performance.

*Even more likely*, boards of directors will initiate discussions and negotiations with institutional investors who have indicated their intention to propose their own nominees in an effort to reach common ground. These secret negotiations are likely to result in some of the nominees proposed by institutional investors *becoming the nominees of management* and some current directors presumably viewed, more or less deservedly, as being weaker (older, longer tenure) forcibly retired.

Anyone believing that this process is likely to produce stronger boards in the long run needs to consider anew the risks imposed on current and prospective board members as well as the likely impact on the climate and dynamics of boards.

This list of plausible consequences from granting shareholders the right to propose their nominees for the board should give pause to this seemingly unstoppable rush and get some thoughtful governance specialists to push back.

*Opinions expressed here are the author's own.*