Boardroom battlefield – winning the right to re-elect directors in company boards

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While some companies have resisted the campaign to split CEO and chairman roles, Skadden partners Lorenzo Corte and Scott Simpson write that shareholders have been hugely successful in winning the right to annually re-elect directors

Corporate governance practices continue to evolve in the US, with increased focus on board and director-related practices. In today's challenging environment – marked by public distrust of corporate management and board 'insiders' and increased shareholder activism – the US corporate governance environment is a battleground.
Over the past decade, traditional proxy advisory groups – such as Glass Lewis and International Shareholder Services (ISS) – and several corporate reform groups have gained significant influence over many corporate issuers and institutional investors with respect to corporate governance practices.In addition, new diverse corporate reform groups have entered the arena, with some having attained a significant following, such as the Harvard Law School's Shareholder Rights Project (SRP) and the Council of Institutional Investors.

The 2013 proxy season has been another year of corporate governance battles, including a shareholder activist-led effort to separate the roles of chairman and CEO at JP Morgan Chase, which grabbed headlines for several weeks. The 2013 season has been comparable to past years with 96% of all proposals passed being corporate governance-related, according to Proxy Monitor.

Below is a short review of the corporate governance trends for board and director practices that highlighted the 2013 proxy season and currently define the corporate governance landscape.

Split or twist
A recurring topic of heated debate is whether US corporations should separate the roles of chairman and CEO, with shareholder advisory groups advocating for chairman independence as a way to encourage effective oversight of management.

The trend over the past 10 years has been towards separating these roles, which is the standard in Europe (for example, statistics from consultancy firm Russell Reynolds show more than 90% of FTSE 100 companies have split roles).

According to data from another consultancy, Spencer Stuart, the number of S&P 500 members with split roles has more than doubled, from 21% to 44% between 2001 and 2012. Furthermore, recruiters say 62% of companies in the NASDAQ 100 had split CEO and chairman roles in 2011, up from 45% in 2005.

Even though the trend is towards the split, Proxy Monitor says the 2012 proxy season saw three shareholder proposals pass out of 33. Arguably the most covered story during the 2013 proxy season was JP Morgan Chase's success in defeating – for the second year in a row – an independent board chair proposal that was strongly supported by both ISS and Glass Lewis.

Although this defeat may be attributable more to the specifics of the JP Morgan Chase case than to a reversing of the trend towards independent board chairs, it does demonstrate that a number of institutional investors will not follow the recommendations of proxy advisory firms blindly.

While these organisations continue to wield a great deal of power on the outcome of decisions at annual general meetings, large institutional investors are increasingly establishing their voting policies internally or questioning the wisdom of proxy advisory recommendations on significant decisions.

Executive approval

In contrast to the debate over the separation of CEO and chairman roles, executive sessions (meaning meetings attended only by directors who do not have a management role in the company) have been nearly universally adopted by US public boards. Executive sessions are required by the listing standards of both the New York Stock Exchange (NYSE) and NASDAQ.

The executive session is seen as a very positive development in the corporate governance environment because it gives non-management directors the opportunity to openly share and discuss concerns about the company and management's strategy, and provides a forum to evaluate the performance of the CEO and the management team behind closed doors.

In addition, the sessions are useful in building chemistry among the independent directors and empowering the voice of the independent directors on the board.

While there is little controversy over the merits of adopting executive sessions, some commentators have expressed concerns about how the practice is being implemented.

For example, best-practice guidelines and corporate governance advocates often recommend holding executive sessions after every board meeting with clear guidelines and avenues to relay information back to management.

However, it is still common that executive sessions are only called occasionally when situations arise that require a closed session. Commentators are concerned that these occasional sessions are not productive and are held to simply 'tick the box' in respect of applicable listing rules.

Taking the lead

The desire for increased management oversight has also precipitated the rise of lead and presiding independent directors. Originally, the lead director role grew out of the NYSE listing requirements for executive sessions that require oversight by a 'presiding' director.

Today 92% of S&P 500 boards have a lead or presiding director. Among the 8% with no identified lead director, 5% have an independent chairman and the remaining 3% (mostly smaller boards) report neither, according to recruiter data. Additionally, since 2004 the number of S&P 500 companies with boards designating an independent lead director has more than doubled.

Not only has the lead director role grown substantially in popularity, it has also grown in the amount of power afforded to those appointed to the role. In its most limited form, the lead director is charged with leading the board's independent directors to consensus and ensuring that independent consensus is communicated and implemented. However, the lead director's responsibilities are expanding into areas such as director evaluations, CEO evaluations and relationships with external constituents. These shifts towards increased independent director responsibilities are consistent with the other aforementioned corporate governance trends.

Shareholder success

Finally, there has been a strong and successful movement in the US to declassify public boards. This activity got a significant boost of support from the SRP, a clinical programme at Harvard that works to improve corporate

governance at publicly traded companies in conjunction with institutional investors, most of which are public pension funds.

A declassified board is popular with many shareholders because it gives them the ability to re-elect all board members annually rather than on a staggered or 'classified' basis, thus increasing shareholder influence over the subject company.

Furthermore, classified boards have the effect of making hostile takeover attempts more difficult, requiring hostile bidders to win more than one proxy fight at successive shareholder meetings to exercise control of the target board. During 2012 the SRP worked with six institutional investors to file declassification proposals at 89 companies. As a result, more than a third agreed to declassify their boards. As of 2013 89% of S&P 500 companies have annual director elections, compared to 82% at the end of 2012 and 40% in 1999, according to Factset Research Systems. In addition the SRP says that, of the 122 companies receiving proposals for 2012 or 2013 annual meetings or both, 98 companies have agreed to move towards annual elections.

Shareholder support of board declassification is further backed by the fact that board declassification is the only class of shareholder proposal to win shareholder support a majority of the time (14 of 15 proposals passed in 2013, and 38 of 48 in 2012, says the SRP).

Although some companies have resisted the force of the SRP, most of those targeted by these proposals have declassified to avoid the consequences of failing to respond to a successful shareholder classification proposal.

Overall the 2013 proxy season, in addition to recent changes in corporate governance regulations and norms, shows that the boardroom is ever evolving and that there is no 'one size fits all' solution or structure that is followed by US boards. Instead, the movement is toward creating and maintaining more independent and responsible boards to meet the demands of the growing number of corporate governance reformists and activist shareholders.

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