More Power for Shareholders – Does It Undermine Board Stewardship?

Speech by Peter Dey at the 2010 ICGN Annual Conference

This is a conference/meeting about governance and I am pleased to participate because I have been a happy participant in the governance reform process – on and off – over the years both domestically and internationally.

This evening I would like to table my thoughts on two topics: first, I would like to add my thoughts to the ongoing discussion on how to make boards more effective; and second, in keeping with the theme of this conference, “The New Balance”, I want to table a concern I have about a trend in the balance of power between boards of directors and shareholders.

Making Boards More Effective

My direct involvement in governance reform began in the early 90’s when I chaired the TSX Committee which published the report entitled “Where Were the Directors?”.

Internationally I have been associated with the ICGN for the last 10 years and have been an active participant in the Global Corporate Governance Forum which is a joint venture of the OECD and the World Bank. As you may be aware, the Forum is a resource available to assist in the development of capital markets in emerging economies. “Where Were the Directors?” was a controversial title at the time of publication but it effectively focused the thinking of those involved in governance systems on the principal weakness of these systems.

As you all know, good governance really just requires a large dose of common sense and what we proposed in the course of that exercise were the standard guidelines, guidelines that reflect the practices in any good governance system. [A majority of independent directors (since extended to a majority of independent-minded directors); a chair who is not the CEO; the appropriate board committees; board evaluations; in camera meetings – all measures with which you are fully familiar.]

The response of the Canadian corporate community was very positive. There was a quick recognition that the markets would reward companies with enhanced governance systems.

As with all good public policy reform, the reform of governance standards was led by the private sector. Since that time I have simplified my thinking about how to advance the quality of governance – even dumbed it down. This is a result of sitting on a number of boards of companies listed in Canada, the United States and the UK and also the result of participating in a number of shareholder led initiatives to challenge boards.

My experience is that boards are generally comprised of responsible, hard-working individuals. I am currently focused on measures that can make boards more effective. A couple of examples:

The physical location of directors in the board room: It is critical that boards share a certain intimacy in their meetings. Directors should be oriented in the board room to achieve that intimacy, rather than being spread out amongst management and advisers.

Directors’ meetings must be their meetings: Boards must ensure that board meetings are their meetings – and not management’s. The chair of one of our banks recently told me he divides meetings into 3 2-hour periods: the first

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1 The International Corporate Governance Network honored PSAG Chairman Peter Dey with its Lifetime Achiever Award at its three-day summit in Toronto in June.
with only the CEO, with emphasis on strategy; the second on execution; and the third on committee reports. This is a board with strong leadership.

I think the chair of the board is the most under-appreciated position in governance systems. Strong leadership fosters openness and candor amongst directors and ensures that all issues, particularly the difficult ones, are on the table.

Acoustics: I had one CEO tell me that he favored mandatory retirement for directors because he realized that many of his older directors could not hear him or other directors. Acoustics in board meetings are critical. If directors cannot hear what others say, they have an obligation to interrupt the meeting and ensure they know what is going on.

Directors’ Comfort Zones: Scramble the membership on board committees. Keep testing the comfort zones of directors.

Industry Knowledge: Boards need to include directors with direct experience in, and knowledge of, the industry.

Director Courage: The greatest challenge for every director occurs when a director sees something, usually in a management presentation, that raises a concern in the director’s mind. The director must absolutely raise the concern. Sometimes this requires courage. The director’s intervention will interrupt the flow of the meeting and may create awkwardness – no matter. It requires courage and that’s what investors expect.

These initiatives are not profound in the broader scheme of governance reform but they can have a material impact on the effectiveness of board meetings and help directors to be more effective in creating shareholder value.

**Director-Shareholder Balance**

Some time following the publication of the TSX Report in 1994, and a recognition that governance reform is dynamic, I was asked about a sequel to “Where Were The Directors?”. At the time, I thought if there were to be a sequel it ought to be called “Where Were The Shareholders?”.

The answer to this question, from one perspective, is very clear. The shareholder community has been organized and answers this question on an ongoing basis. Indeed, the ICGN was formed and has been very effective in addressing the role of shareholders and the responsibilities of shareholders in governance systems globally.

Domestically, the Canadian Coalition for Good Governance was formed and is one of the most important developments in governance in Canada. The business community in Canada, on the other hand, does not have a counterpart to the Coalition and has been rather passive in the dialogue about the balance between boards and shareholder.

It is an ongoing challenge to find the right balance between the role of directors’ and the role of shareholders’ within the corporation. In the course of this dialogue, I am concerned that shareholders not become distracted from their principal role. That role is to elect and oversee effective boards of directors – by far, the most meaningful avenue for influencing corporate decision-making. I make this comment having participated in the governance process both as a shareholder advocate and as a corporate director. I have seen it from both sides.

There is a trend for shareholders to try to involve themselves in issues which, under our corporate model, should be within the purview of the board. I expect most of this involvement is to test directors, but nevertheless, there is a trend. Please understand that I have no allegiance to one particular constituent or another in governance systems, my interest is in ensuring that the corporation continues to function effectively.

An example is “Say on Pay” or, as we say in Canada, “Say on Pay, Eh”. Is “Say on Pay” the beginning of a trend? Will shareholders want to vote on a company’s environmental policy, on its health and safety policy, and so on?
In asking this question, I do not intend to be critical of the “Say on Pay” initiative. In some markets there was a huge disconnect between corporate performance and compensation. And we have witnessed the impact the vote has had on such major corporations as Glaxo Smith Kline in the UK and Motorola and Occidental Petroleum in the U.S. What would concern me is an organization, like the ICGN, leading initiatives which give shareholders increasing powers at the expense of the board.

There are examples in addition to “Say on Pay”. Indeed, the issue of the shareholder role in governance first became graphically apparent to me a couple of years ago as a director of Goldcorp (the world’s second largest gold company by market capitalization).

The company proposed to make an acquisition which would be funded by a significant issuance of shares, equal to about 60% of the float. There was a robust debate at the board level as to whether shareholders should be offered an advisory vote. The law did not require a vote. One board faction expressed concern about dilution and advocated a shareholder advisory vote.

The other faction advocated deal certainty and opposed such a vote. The issue was litigated and ultimately no vote was required.

Of the many decisions that directors make which can have a material impact on the corporation, issuing equity is one that has been singled out for shareholder approval by a number of the major stock exchanges including the TSX.

As an aside, I note that if the governance process results in value creation, as was the case with Goldcorp, the process is assumed to have been correct.

“Say on Pay” has not been mandated by any regulator in Canada and those corporations which have accepted “Say on Pay” have offered the right to shareholders voluntarily. In Canada, the leaders in offering “Say on Pay” have been the banks. They have provided leadership in other areas of governance reform, notably the separation of the chair and CEO. It is too early to know whether “Say on Pay” will become as common as the separation of the chair and CEO.

Why am I concerned about this trend? I have a couple of reasons. First, the board is better positioned than the shareholders to understand the strategy of the corporation and to take action to develop the strategy, such as providing the proper incentives in the compensation system.

Second, I am concerned about diluting the ability of shareholders to hold boards accountable, if shareholders increase their involvement in decisions that should be made by the board.

Finally, it is not realistic for investors whose portfolios include hundreds of companies to take the time to critically assess compensation systems. Outsourcing this responsibility is not a satisfactory answer.

My concern about this trend to shareholder involvement in decisions properly made by the board is only valid and is conditioned upon shareholders having the tools, the legal authority, to elect effective boards of directors.

What powers do shareholders need to ensure that boards are constituted with effective directors? In Canada we have a series of provisions in our business corporations laws which give shareholders this power. The basic tools offered to Canadian shareholders to enable them to elect and constitute effective boards and to hold these board accountable are the following:

First, shareholders have the ability to solicit proxies from holders of voting securities – a common provision in all modern corporation laws.

Second, shareholders have the right to make any proposal, including a proposal to nominate a person to be a director of the corporation and request that the proposal be included in the Management Information Circular.
Third, shareholders holding more than 50% of the votes can remove and replace a director or an entire board. Shareholders can then elect a new board, but until we adopt majority voting, this can only be achieved by putting up an alternate slate which attracts more votes.

Fourth, shareholders holding not less than 5% of the issued shares of the corporation have the right to requisition a corporation to hold a shareholder meeting and the corporation, upon receiving the requisition, has to publish and circulate the Information Circular (at the corporation’s cost). This is the most lethal tool.

Fifth, shareholders have the ability to seek relief from the Court for oppressive conduct by the corporation.

Shareholders have other rights such as bringing a derivative action and seeking a court order directing an investigation of the corporation’s books.

These are the important and basic tools that should be available to shareholders in every market. It is my view that the investor community should give the creation and provision of these tools priority in their efforts to influence public policy, rather than trying to insert themselves into the director decision making process.

My experience is that boards are willing to be engaged on issues of concern to serious shareholders. If shareholder confidence in the board has dropped to such a degree that the shareholders are prepared to have a public confrontation with the board, there are other more effective ways of addressing this lack of confidence before provoking a public confrontation.

The Coalition’s approach to companies is instructive. The Coalition identifies companies in which its members have large holdings or sectors in which members have significant holdings and typically contacts the chair of the board and other director(s), depending upon the issue.

The Coalition’s phone calls are always answered. Shareholder concerns are almost always addressed in private without a public expression in a shareholder vote and the corporate action fully remains the responsibility of the board. This strategy is more effective, less costly to the company, and importantly, avoids the shareholders diluting the responsibility for the corporation’s action on the issues in question.

Maybe this is just a very “Canadian” way for shareholders to exert influence: avoid public confrontation by keeping some heavy artillery in the closet! Engage the board; assess the response and, in the extreme, requisition a shareholder meeting to change the board.

I would encourage the ICGN in its efforts to improve governance to develop a definitive template of legal rights which shareholders must have to set the stage for engaging boards of directors. The Canadian model is a good starting point (although being Canadian I am not allowed to brag!) I think the ICGN could apply its considerable energy and resources to this project going forward.

The corporation is the principal vehicle for commerce in our markets. We all have an obligation as participants in the markets to make sure that the corporation continues to be effective in addressing the needs of commerce and in addressing the needs of society as a whole. The ICGN has a critical role to play in ensuring that the legal framework within which the corporation functions responds to the needs of society.

I recognize that at the present time the markets have confronted you with significant investment challenges. Nevertheless, it is critical to the efficient functioning of our capital markets that you continue to give your time and attention to the issues of governance.

I congratulate the ICGN, and its members, for continuing to be leaders in ensuring that the corporate vehicle continues to excel in fulfilling its societal role.

Peter Dey
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