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The compromises of tenure

By Neill May

Debate about governance initiatives continues unabated, but the catchy labelling industry seems to be napping. In recent years, the push for shareholder input on executive compensation resulted in "say on pay" shareholder proposals, once considered extraordinary and now somewhat commonplace. Much of the recent debate has focused on director tenure, as to whether there should be limits and whether at some point continued service compromises the director's independence. So I ask, was "say on stay" too obvious a moniker? For those directors who might be really overstaying their welcome, perhaps "say on decay"? Or if there is some sense of bias against older directors, "say on grey"? Please stop, you might pray.

The Allstate Corporation recently received a shareholder proposal requesting that its board adopt a rule that, wherever possible, its lead director have less than 12 years tenure on the board. The stated rationale for the proposal was a concern that a longer tenure compromises director independence.

The independence of directors is a key fulcrum for good governance. There are layers of securities law requirements, regulatory "best practice" recommendations, proxy advisory prescriptions and institutional investor voting guidelines that focus on director independence by addressing board composition as well as service on critical board committees (such as audit committees). Generally, independence turns on factors such as current or recent employment by the issuer and other relationships (professional or personal) that may affect, or may be perceived to affect, the director's ability to discharge her responsibilities in an objective and unbiased manner.

The apparent basis for concern about tenure is that long service may tend to result in an overly cozy relationship between the director and long-standing board members and chief executives. This issue has emerged not just in initiatives such as the Alcatel shareholder proposal but in ongoing discussions about director term limits. Although little regulatory change has yet occurred on this front, director term of service considerations are increasingly appearing as relevant considerations in voting guidelines of institutional shareholders and governance watchdog organizations.

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It may be partly a function of my advancing age that the equation of longevity with compromised effectiveness does not fully resonate. Putting aside my seniority (still unaccompanied by any sign of maturity), there are debatable aspects about tenure-based initiatives. Certainly, arbitrary standards may have the effect of sidelining directors who happen to be very effective. Further, more senior directors may, due to deeper familiarity with the business, accrued standing and credibility and/or the very relationships that lead some to question their independence, be better positioned to fulfil their board responsibilities. One could also argue that there are other means of monitoring board members' effectiveness. For example, boards annually perform a very substantial self-evaluation exercise that seems to be more thorough and detailed with every passing year. A significant feature of those evaluations is assessing board composition and the effectiveness of each member of the board; tenure, and the need for board renewal, should factor into those analyses. More generally, it can be argued that those best positioned to assess the effectiveness and functional independence of board members are the other members of the board who witness each other in action, rather than shareholders not directly involved in board processes.

An alternative direction in which this issue may head, like some other governance initiatives, is toward comply or explain territory, where issuers that don't embrace a given concept are required or pressured to explain why they don't. This solution is a tempting compromise for ideas that might have benefits but face headwind for being immutable and non-responsive to particular circumstances; though, of course, it is not an easy matter to explain to shareholders why a governance initiative is not being adopted.

How the Allstate proposal itself ends up remains to be seen. Allstate argued that it should be entitled to exclude the proposal on the basis that it "[q]uestion[ed] the competence, business judgment, or character of one or more nominees or directors," but the Securities and Exchange Commission rejected the argument.

Having said all of this, it is certainly the case that the underlying motives of encouraging board renewal and questioning other phenomena that may affect director effectiveness are healthy and important. But I do think that there are limits on assessments of effectiveness, which is why despite the pleasing rhyme I will resist any efforts for "Say on May" initiatives. **CL**

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