

July 6, 2013

New Momentum for Change in Corporate Board Elections

By **GRETCHEN MORGENSON**

SHAREHOLDER efforts that actually succeed in changing dubious corporate governance policies are so rare that when they happen, it makes you sit up and take notice. So it's worth examining the results achieved so far this year by the [Shareholder Rights Project](#), a program operating at the Harvard Law School. And with any luck, its success might shame do-nothing investment managers, like those running many mutual funds, into action.

The project has been around for the 2012 and 2013 proxy seasons, and has focused on eliminating classified boards — those whose directors do not stand for election each year. Such staggered elections, in which only a few directors are up for a vote each year, entrench boards by making it harder for shareholders to oust directors en masse for nonperformance. A far better approach for holding directors accountable, according to a significant body of academic research, is to make them stand for election annually.

So far this year, 35 companies approached by the Shareholder Rights Project have agreed to replace their staggered elections with annual ones. The companies on this list include Best Buy, Chipotle Mexican Grill, Monsanto and Moody's.

The project also sponsored successful proposals to declassify the boards of 18 other companies, including Foot Locker, Kellogg, NCR and Netflix. The proposals received the support of more than 80 percent of shareholder votes cast, on average, at these companies' annual meetings. Seeing such resounding support for an issue, companies often move to satisfy shareholders' wishes during the next year.

DIRECTED by [Lucian A. Bebchuk](#), a professor at the Harvard Law School and director of its [Program on Corporate Governance](#), the Shareholder Rights Project works with seven large pension funds and a foundation to effect change at companies whose shares they own. The pension funds, which include those managed by the [Florida State Board of Administration](#), the [Ohio Public Employees Retirement System](#), the [North Carolina state treasurer](#) and the [Illinois State Board of Investment](#), oversee more than \$400 billion in assets for more than three million beneficiaries.

Over the entire period that the Shareholder Rights Project has been active, 77 large companies have declassified their boards. At the beginning of 2012, Mr. Bebchuk said, some 126 companies in the Standard & Poor's 500-stock index had staggered boards. The project has worked with

more than half of them to change their ways.

“This is a noncontroversial, simple notion of governance that we feel duty bound to pursue,” said William R. Atwood, executive director of the Illinois State Board of Investment. “We’re very pleased. We are about to get into our third proxy season with the project.”

Mr. Atwood, who has been at the Illinois board for 10 years, said that joining forces with the Shareholder Rights Project was crucial to getting results. “We’ve been engaged in corporate governance before, but we are very, very resource-constrained and don’t have bandwidth to go out and pursue this kind of thing on our own,” he said.

Mr. Atwood is referring to the detailed and often complex administrative work required to engage companies on governance issues. Because each company’s bylaws can differ, and because the Securities and Exchange Commission’s rules must be followed, filing shareholder resolutions requires legal expertise and an attention to detail.

“The few times we have filed shareholder resolutions before, we have done it with other filers, and it requires some level of correspondence and back-and-forth with the company,” Mr. Atwood said. “You almost need to hire an attorney to shepherd the process; to do that for 25 filings is just very difficult.”

The Shareholder Rights Project began with six participants. Deploying a small group of part-time workers, some of whom are students at the Harvard Law School, the project did the necessary legwork to engage companies on the issue of staggered boards.

Michael P. McCauley, senior officer for investment programs and governance at the Florida State Board of Administration, is another project participant. He said he began talking with Mr. Bebchuk about working together in 2010.

“In the beginning there was a lot of uncertainty about how this was going to be received, how effective it would be,” Mr. McCauley said. “But it produced results immediately.”

The project is free for the pension funds and, Mr. McCauley said, offers the power of numbers: “We get a larger footprint than we would if we were doing it alone.”

Helping shareholders voice their concerns at companies they own is a step toward leveling the uneven ground on which investors operate. But the pension funds that the project represents are not the only beneficiaries, in Mr. Bebchuk’s view. “Many companies fail to adopt governance reforms that are broadly supported by shareholders because investors do not take the initiative to bring about such changes,” he said. Shareholders broadly support annual elections for directors, he says, and the project is making that desire a reality at these companies.

With the 2013 proxy season almost over, the Shareholder Rights Project is drawing up plans for

next year's engagements. Mr. McCauley says he hopes the project will expand to tackle more than the problem of classified boards.

"Hopefully, going forward it will branch out a bit," he said. "We've proposed that we go beyond the initial topic — continue it, but also look at proxy access or majority voting, which have all been key governance issues we've focused on." Generally, shareholders don't have a voice in nominating directors. Proxy access would allow them more of a say.

Mr. Bebchuk said an expansion of the project to issues beyond classified boards was being considered.

CLEARLY, the shareholder project is having a positive effect. Now if only mutual funds would join this bandwagon or construct their own.

Mutual funds hold billions of shares for individuals, many of whom are eager to see corporations shed anti-investor practices. These funds could easily hire the necessary staff to engage with companies on crucial proxy issues. Yet all too often, they sanction the status quo by voting with management and against change on these matters. It's past time mutual funds became part of the solution for investors rather than part of the problem. The Shareholder Rights Project is a model they might want to emulate.