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New Developments Merit Nominating Committee Briefing

By Michael W. Peregrine

An exceptional series of recent governance developments warrants a briefing by the general counsel to the board's nominating committee.

These developments relate to board size, overboarding, director turnover and refreshment, and perceptions of slow progress on achieving board diversity. They arise from recent actions by several prominent companies, and an important new survey from The Conference Board.

For example, Tesla recently announced its decision to reduce the size of its board from 11 to seven directors over the next several years as part of a gradual effort to increase the number of independent directors on its board and more broadly to increase the effectiveness of board oversight (e.g., to reduce duplication of certain areas of experience or expertise among its directors).

The Tesla action is likely to attract broader attention in the corporate world. Many CEOs, focused on concerns of board efficiency, are attracted to the smallest board size possible. Yet particularly with boards of less than 10 members, questions about engagement and effectiveness of oversight are paramount.

There is no "hard and fast" corporate law rule on the proper size of the governing board. In its periodic consideration of board size, the nominating committee should be guided by factors that are intended to enhance director engagement and independent board oversight. The general counsel is well qualified to advise the nominating committee on these types of issues.

Also noteworthy is the latest development focused on "overboarding" and its relationship to director effectiveness. The asset manager Vanguard is taking a firm position on the issue of director overboarding. Its new proxy voting guidelines for U.S. portfolio companies essentially limit a board member to no more than four directorships (and only one outside board directorship for the CEO), in order to help address the

demands of board and committee membership.

Vanguard's action follows similar steps taken by proxy advisor companies such as ISS and Glass-Lewis, and large fund managers such as Blackrock and U.K.'s LGIM, to adopt guidelines that question the election of CEOs and directors who exceed specific thresholds on board commitment.

Vanguard's new proxy voting guidelines help sharpen the debate on director overboarding. The ultimate focus is on the governance relationship between experience offered by holding multiple board positions and the engagement risks arising from being over-extended by board service and other distractions. The general counsel can contribute significantly to the nominating committee's consideration of the debate.

But perhaps the most impactful development is a series of findings from a recent governance survey of the Russell 3000 conducted by The Conference Board. The survey notes that despite the " profound transformation" of corporate governance in the last two decades, the composition of the board of directors has not changed as rapidly as other governance practices. The survey's conclusion is that many public company boards do not experience any turnover that is not the result of retirement at the end of a fairly long tenure.

According to its review of SEC filings made in 2018, at least half of Russell 3000 companies and over 40% of S&P 500 companies disclosed no change at all in their board composition of directors. As noted by the survey, they neither added a new member nor replaced an existing one. In situations where a replacement or addition did occur, it was unlikely to affect more than one board seat. Moreover, only 25% of boards elected a first-time director who had never previously served on a public company board.

Thus, the survey concludes that despite the demand for greater refreshment and more diversity, the makeup of many public company boards remains unchanged. In addition, a recent article in The Wall Street Journal notes that while companies are appointing more women to board seats than ever, the overall share of female directors is not materially expanding. The Conference Board attributes this in large part to lengthy average director tenure rates. Board seats rarely become vacant and, when a spot is available, it is often filled by a person with substantial board experience as opposed to a newcomer.

The general counsel may appropriately share these observations with the board's nominating committee, to the extent that they could challenge director (and external) perceptions on the pace of evolution towards a more diverse governing board. This is especially the case given increasing emphasis on director refreshment, and growing legislative and regulatory pressures on adopting gender and ethnic based diversity.

The general counsel is a key advisor to the board's governance and nominating committee, given the nexus between board organizational issues and corporate law and regulation. These developments implicate principles of the duty of care as they relate to board formation and director engagement, disclosure and other reporting requirements, current and emerging laws relating to board composition/diversity, and matters of organizational reputation (as a board asset).

For these and other reasons, the general counsel is the logical corporate officer (perhaps teaming with the chief compliance officer or chief governance officer) to brief the committee on these and similar governance developments.

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