Institute for governance
of private and public organizations

Who should pick board members?

Proxy Access by Shareholders to the Director Nomination Process

Policy Paper Nº 8

2015

Toward Value-Creating Governance®

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Who should pick board members?

Proxy Access by Shareholders to the Director Nomination Process

—

Policy Paper Nº 8

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2015

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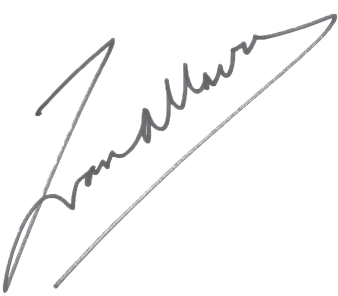
Message of the Executive Chair

This is the eight policy paper issued by IGOPP since its creation. As in previous instances, this paper addresses a subject matter of significant importance: the pros and cons of granting to shareholders the right to nominate members of the board of directors of a publicly listed corporation. As usual, IGOPP takes a clear position on this issue based on its evaluation of all facets.

I wish to thank warmly members of IGOPP's board who have participated on the working group created to prepare this policy position: Andrew Molson, Louis Morisset, Robert Parizeau and Guylaine Saucier.

I acted as Chair of this working group and Francois Dauphin, Director of Research at IGOPP acted as its secretary.

This policy position was formally adopted[1] by the board of IGOPP on September 30th 2015.



Yvan Allaire, PhD (MIT), FRSC
Executive Chair

1 As per policy of the AMF, Louis Morisset, President and CEO of the *Autorité des marchés financiers*, abstained.

Executive Summary

The prerogative of boards of directors to nominate the members of the board for election by the shareholders is now challenged by institutional investors determined to acquire the right, under certain conditions, to nominate their own candidates. This challenge to a board prerogative is called *proxy access by shareholders to the director nomination process*.

As a result of amendments to the existing regulations in the United States, there has been a flood of proposals from shareholders to institute rules granting them access to the nominating process. In Canada, a form of access is already provided for by the Canadian Business Corporations Act (CBCA), but the conditions of this access are not perceived – by institutional investors, in particular – as sufficiently congenial because, among other factors, of the differential treatment for candidates put forward by shareholders.

Several plausible arguments may be marshalled in support of access to the nominating process by shareholders, such as the enhanced legitimacy of the directors sitting on the board. However, this proposal also raises a host of issues related to the logistics of its application and the potential adverse effects on governance and board dynamics. After an in depth analysis of the arguments for and against proxy access, IGOPP concludes that any process that would grant shareholders the right to put forward candidates for election to the board, whether such a process arises from new regulations or spontaneous proposals from shareholders, **is unwise and likely to create serious dysfunctions in corporate governance.**

We do recommend however that the nomination committee of the board implement a robust consultation process with the corporation's significant shareholders and report in the annual *Management Information Circular* on the process and criteria adopted for nominating any new director.

Given the popularity of proxy access proposals among institutional shareholders, this policy position includes an appendix outlining the typical features, conditions and mechanics proposed for this shareholder access to the director nominating process. All these aspects of the proxy access initiative raise difficult questions to which we unfortunately find few satisfactory answers.

Introduction

Over the last 15 years, in the United States – and in Canada as well, though in a more restrained way-, institutional investors have come to believe that directors were failing to discharge adequately their responsibilities and, thus, did not fully deserve the trust of shareholders. As a direct result of this sombre observation – which for some has taken the allure of a dogma – institutional shareholders claimed they should have a more direct influence over key decisions of the corporation.

This notion of shareholder-driven governance replacing the conventional, strictly board-driven governance has taken hold in parts of academia, in various organizations promoting "good" governance and among influential institutional investors. It has manifested itself in a tangible way through the initiative of the advisory vote on executive compensation (***say on pay***). Similarly, the massive support of institutional investors for the initiatives of so called activist hedge funds provides more evidence of this phenomenon as, generally, these *activists* challenge the decisions, orientations and strategies adopted by boards of directors.

More recently, the prerogative to nominate the members of the board, which has historically been the sole responsibility of boards of directors, has now been challenged by institutional funds determined to acquire the right, under certain conditions, to nominate their own candidates. The challenge to this board prerogative is called *proxy access by shareholders to the director nomination process*.

In this paper we review the arguments for and against this initiative and adopt a policy position on this issue.

A Brief Historical Review

Over the years, the *Security and Exchange Commission* (SEC), the U.S. regulatory body, made several unsuccessful attempts to institute such a measure, especially after the passage of the Sarbanes Oxley Act[2]. However, under the Dodd Frank Act, adopted in July 2010, the SEC was required to implement regulations allowing shareholders to propose a certain number of nominees to the board, these nominees being treated in the same manner as management's nominees and appearing on the same proxy form sent to shareholders.

The SEC thus introduced new regulations in August 2010, which allowed shareholders holding at least 3% of a public corporation's shares, and having held these shares for at least 3 years, to propose nominees to the board (for up to a maximum of 25% of the members of the existing board).

This new regulation was immediately challenged in the courts and had to be withdrawn when it was struck down. However, an amendment to the general regulation of shareholder proposals (amendment made by the SEC to accommodate its proposed regulation on proxy access) remained in force; its purpose was to allow shareholders to submit proposals on proxy access rules, which, if adopted by a majority of shareholders, were to be made part of the corporation's by-laws.

This change provoked a tsunami of proposals from institutional investors, as shown in the list (Table 1) of U.S. corporations where this type of proposal received a favourable vote in 2014-2015[3]. Some corporations also sought to avoid any confrontation by voluntarily proposing proxy access rules (Table 2).

This access to voting proxies is fast becoming a part of the governance landscape in the United States; it is very unlikely that major corporations will try to oppose the movement as many institutional investors are fiercely supportive of this new «right». However, the eventual impact of this initiative on corporate governance remains to be assessed.

2 For many years, the SEC has sought to introduce proxy access. A more detailed history appears in Appendix 1.

3 As of September 8 for year 2015.

Table 1

List of corporations in which a proposal for access to the process whereby shareholders may nominate director candidates was submitted for a vote and obtained a majority (2014-2015*)

Name of the corporation	Market cap. (US$ billions)	Origin of proposal	Threshold in % of the shares	Holding period	Ceiling of directors in % of the board	% of votes in favour
Alliance Data Systems Corp.	15.39	Shareholder	3%	3 years	25%	55.5%
Alpha Natural Resources, Inc.	0.01	Shareholder	3%	3 years	25%	65.9%
American Electric Power Comp.	25.77	Shareholder	3%	3 years	25%	66.5%
Anadarko Petroleum Corp.	34.72	Shareholder	3%	3 years	25%	58.7%
Anthem, Inc.	37.16	Shareholder	3%	3 years	25%	66.2%
Apache Corporation	16.06	Shareholder	3%	3 years	25%	92.4%
Apartment Inv. & Mngt Comp.	5.45	Shareholder	3%	3 years	25%	57.6%
AvalonBay Communities, Inc.	21.34	Shareholder	3%	3 years	25%	64.5%
Avon Products, Inc.	1.92	Shareholder	3%	3 years	25%	75.4%
Big Lots, Inc.	2.38	Management	3%	3 years	25%	89.3%
CBL & Ass. Properties, Inc.	2.44	Shareholder	3%	3 years	25%	68.9%
CenturyLink, Inc.	14.74	Management	3%	3 years	20%	95.8%
CF Industries Holdings, Inc.	12.93	Shareholder	3%	3 years	25%	56.9%
Cheniere Energy, Inc.	13.27	Shareholder	3%	3 years	25%	62.9%
Chesapeake Energy Corp.	4.84	Management	3%	3 years	25%	97.7%
Chevron Corporation	144.18	Shareholder	3%	3 years	25%	54.8%
Cimarex Energy Co.	10.13	Shareholder	3%	3 years	25%	56.1%
Citigroup Inc.	153.49	Shareholder	3%	3 years	20%	86.8%
Cloud Peak Energy Inc.	0.24	Shareholder	3%	3 years	25%	70.8%

Name of the corporation	Market cap. (US$ billions)	Origin of proposal	Threshold in % of the shares	Holding period	Ceiling of directors in % of the board	% of votes in favour
ConocoPhillips	58.22	Shareholder	3%	3 years	25%	53.8%
Darden Restaurants, Inc.	8.78	Management	3%	3 years	25%	90.1%
Devon Energy Corporation	16.50	Shareholder	3%	3 years	25%	57.9%
DTE Energy Company	13.46	Shareholder	3%	3 years	25%	60.9%
Duke Energy Corporation	46.99	Shareholder	3%	3 years	25%	61.7%
eBay Inc.	32.26	Shareholder	3%	3 years	25%	59.3%
Electronic Arts Inc.	20.69	Shareholder	3%	3 years	25%	53.3%
EOG Resources, Inc.	42.23	Shareholder	3%	3 years	25%	50.5%
EQT Corporation	11.15	Shareholder	3%	3 years	n.d.	65.8%
Equity Residential	25.18	Shareholder	3%	3 years	25%	56.0%
Exelon Corporation	25.61	Management	5%	3 years	20%	52.1%
Expeditors Int. of Washington	9.05	Management	3%	3 years	20%	69.1%
Fidelity National Financial, Inc.	10.04	Shareholder	3%	3 years	25%	60.6%
FirstEnergy Corp.	12.92	Shareholder	3%	3 years	25%	70.5%
FirstMerit Corp.	2.87	Management	3%	3 years	20%	86.5%
Freeport-McMoRan, Inc.	10.10	Shareholder	3%	3 years	25%	64.0%
Hasbro, Inc.	9.41	Shareholder	3%	3 years	25%	68.4%
HCP, Inc.	16.51	Shareholder	3%	3 years	25%	55.3%
Hess Corporation	16.18	Shareholder	3%	3 years	25%	50.5%
Kohl's Corporation	9.99	Shareholder	3%	3 years	25%	73.0%
Marathon Oil Corporation	11.08	Shareholder	3%	3 years	25%	62.1%
McDonald's Corporation	89.33	Shareholder	3%	3 years	25%	60.9%
McKesson Corporation	44.81	Management	3%	3 years	20%	87.7%

*As of September 8, 2015; data source: SharkRepellent.net

Table 1 (continued)

List of corporations in which a proposal for access to the process whereby shareholders may nominate director candidates was submitted for a vote and obtained a majority (2014-2015*)

Name of the corporation	Market cap. (US$ billions)	Origin of proposal	Threshold in % of the shares	Holding period	Ceiling of directors in % of the board	% of votes in favour
Murphy Oil Corporation	4.95	Shareholder	3%	3 years	25%	52.8%
Netflix, Inc.	42.09	Shareholder	3%	3 years	25%	70.7%
Occidental Petroleum Corp.	53.21	Shareholder	3%	3 years	25%	61.2%
PPL Corporation	19.88	Shareholder	3%	3 years	25%	60.0%
Precision Castparts Corp.	31.57	Shareholder	3%	3 years	25%	58.1%
Range Resources Corporation	6.18	Shareholder	3%	3 years	25%	60.8%
Republic Services, Inc.	14.00	Shareholder	3%	3 years	25%	89.0%
Roper Technologies, Inc.	15.73	Shareholder	3%	3 years	25%	66.4%
SBA Communications Corp.	14.74	Management	5%	3 years	20%	51.6%
SLM Corporation	3.34	Management	3%	3 years	20%	92.1%
Southwestern Energy Company	5.91	Shareholder	3%	3 years	25%	56.3%
St. Jude Medical, Inc.	19.62	Shareholder	3%	3 years	25%	72.2%
TCF Financial Corporation	2.56	Shareholder	3%	3 years	25%	59.9%
The AES Corporation	7.53	Shareholder	3%	3 years	25%	66.1%
The Priceline Group, Inc.	63.14	Shareholder	3%	3 years	25%	53.5%
Verizon Communications Inc.	182.22	Management	3%	3 years	20%	94.0%
Vertex Pharmaceuticals Inc.	31.07	Shareholder	3%	3 years	25%	58.3%
Visteon Corporation	4.07	Shareholder	3%	3 years	25%	74.2%

*As of September 8, 2015; data source: SharkRepellent.net

Table 2

Voluntary adoptions by corporations
(not submitted for a vote)

	Threshold as a % of shares	Holding period	Cap on number of directors	Cap on number of shareholders forming a group
General Electric, YUM! Brands, Prudential Financial, Bank of America, Rite Aid, United Therapeutics, H&R Block, McKesson, The Coca-Cola Company **(9 corporations)**	3%	3 years	20% of the board	Limit of 20
CF Industries, Arch Coal, Priceline Group **(3 corporations)**	5%	3 years	20% of the board	Limit of 20
HCP, Cabot Oil & Gas, New York Community Bancorp **(3 corporations)**	5%	3 years	20% of the board	Limit of 10
Boston Properties **(1 corporation)**	3%	3 years	25% of the board	Limit of 5
Biogen **(1 corporation)**	3%	3 years	25% of the board	Limit of 20

Source: Avrohom J. Kess, "Proxy Access Proposals", Simpson Thacher & Bartlett LLP, August 10, 2015. <http://corpgov.law.harvard.edu/2015/08/10/proxy-access-proposals/>, addition Coca-Cola on September 3, 2015.

Access to the nominating process in Canada

In Canada, access to the director nomination process by shareholders is already part of the Canadian Business Corporations Act (CBCA). Thus:

> *A proposal may include nominations for the election of directors if the proposal is signed by one or more holders of shares representing in the aggregate not less than five per cent of the shares or five per cent of the shares of a class of shares of the corporation entitled to vote at the meeting to which the proposal is to be presented […]*[4].

In order to do so, "*If so requested by the person who submits a proposal, the corporation shall include in the management proxy circular or attach to it a statement in support of the proposal […]. The statement and the proposal must together not exceed the prescribed maximum number of words*"[5]. According to the regulation in force, the number of words is limited to 500.

To be eligible to submit a proposal, a person "must be [or have the support of persons who have been], for at least the prescribed period, the registered holder or the beneficial owner [or collectively as a group] of at least the prescribed number of outstanding shares of the corporation"[6].

The regulatory number of shares for proposals pertaining to the nomination of directors is defined by the Act to be 5% of the shares, as previously referred to (the threshold is lower for other kinds of shareholder proposals). However, the period applies uniformly and is defined by regulation: "[f]or the purpose of subsection 137(1.1) of the Act, […] the prescribed period is the six-month period immediately before the day on which the shareholder submits the proposal"[7]. Furthermore, the shareholder must remain the holder of the shares at least up to and including the day the meeting is held; otherwise, the corporation is not required to set out the proposal in the management proxy circular.

If the total number of shareholders solicited (by a shareholder wishing to form a group to reach the required ownership threshold) is more than 15, the solicitation will be considered to have been made by a dissenting shareholder, which would result in the shareholder in question being responsible for assuming all the costs related to sending the documentation to all the shareholders. This restriction therefore limits the number of shareholders to fifteen who may join together to reach the 5% threshold.

4 *Canada Business Corporations Act,* R.S.C. 1985, c. C-44, art. 137 (4)

5 *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, art. 137 (3)

6 *Ibid*. art. 137 (1.1)

7 *Canada Business Corporations Regulations*, 2001, SOR/2001-512, paragraph 46(b)

A noteworthy fact: a regulation specifies some particular cases, including where a shareholder would repeatedly seek to have one or several nominees nominated after failing to win a vote. Thus, the Act specifies that the corporation is not required to set out the proposals of a shareholder in the management proxy circular when "substantially the same proposal was submitted to shareholders in a management proxy circular or a dissident's proxy circular relating to a meeting of shareholders held not more than the prescribed period before the receipt of the proposal and did not receive the prescribed minimum amount of support at the meeting"[8]. The regulation stipulates that:

> *[…] the prescribed minimum amount of support for a shareholder's proposal is*
>
> *a) 3% of the total number of shares voted, if the proposal was introduced at an annual meeting of shareholders;*
>
> *b) 6% of the total number of shares voted at its last submission to shareholders, if the proposal was introduced at two annual meetings of shareholders; and*
>
> *c) 10% of the total number of shares voted at its last submission to shareholders, if the proposal was introduced at three or more annual meetings of shareholders*[9].

In the opinion of the Canadian Coalition for Good Governance (CCGG), among others, the present terms of the process make it very unattractive to shareholders who might wish to make use of this provision, for the following reasons: 1° the absence of requirements to include information on the shareholder's nominee in a similar format to and at the same place as the management's nominees; 2° the 500 word limit for supporting the shareholder's nomination while the response of the board and/or management is unlimited in length; 3° the limit on the number of shareholders who may form a group to reach the required ownership threshold, which is itself too high for large market cap corporations.

Nevertheless, access to the director nomination process is already in place in Canada and parameters are set out in the Act and under the regulations. Thus, the challenge lies mainly in determining the clauses by which shareholders become qualified for the process and the restrictions on the exercise thereof, although any changes to such clauses would likely require amendments to the CBCA.

In practice, whether on account of the restrictions referred to by the CCGG or other reasons, this provision of the Canadian Act has almost never been used.

8 *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, art. 137 (5) d)

9 *Canada Business Corporations Regulations*, 2001, SOR/2001-512, paragraph 51(1)

RECENT CHANGES IN CANADA

However, this issue has recently taken on a higher profile in the context of a consultation conducted by Industry Canada on the *Canada Business Corporations Act* (CBCA), one purpose of which was precisely to consider this issue of proxy access. Numerous submissions were filed and many stakeholders expressed their views on proxy access (see Table 3).

Table 3

List of organizations having filed a comment on proxy access in the context of the consultation on the Canada Business Corporations Act, and positions adopted by these organizations on access to the nominating process

Submission filed by…	For	Against
Alberta Investment Management Corp.	X	
Canadian Bar Association		X
Bennett Jones LLP		X
BlackRock	X	
Borden Ladner Gervais LLP		X
British Columbia Investment Management Corporation	X	
Canadian Coalition for Good Governance,	X	
Chartered Professional Accountants (CPA)	X	
Conseil du Patronat du Québec		X
Council of Institutional Investors	X	
Hermes Equity Ownership Services	X	
Institute of Corporate Directors		X
International Corporate Governance Network	X	
Caisse de dépôt et placement du Québec	X	
Norton Rose Fulbright		X
PSP Investments	X	
CPPIB	X	
OMERS	X	
Ontario Teachers' Pension Plan	X	
Osler, Hoskin & Harcourt LLP		X

Submission filed by…	For	Against
Pension Investment Association of Canada	X	
Qube Investment Management Inc.	X	
Royal London Asset Management	X	
Shareholder Association for Research and Education	X	
USS Investment Management Limited	X	

NOTE: IGOPP participated in the consultation but did not officially take a position for or against the principle of proxy access. However, IGOPP suggested that the proposed change should maintain a 5% threshold, but add a minimum 2 year holding period if the legislator wished to proceed.

It should be noted that all the institutional investors who chose to express their views did so in favour of the modified measures for access to the nominating process, while the law firms and the organizations representing the business community took positions against this initiative.

The CCGG has recently taken an official position in favour of proxy access, a position which is quite striking as it shuns any minimum period of shareholding to obtain access to the nominating process. Thus, the CCGG policy position should provoke a vigorous debate on this issue in Canada.

If, over the last 15 years, the audit and human resources committees have in turn been the subject of close scrutiny by all stakeholders, **the issue of proxy access will focus attention on the nomination/ governance committees**.

Proxy access elsewhere in the world

Access to the nominating process already exists in other jurisdictions. For instance, the U.K. law is very similar to Canadian law. In fact, under the *U.K. Companies Act 2006*, a shareholder may submit a proposal for the nomination of a director candidate if he holds 5% of the shares of the company, and the accompanying text may run to 1,000 words. In Australia, section 249 of the *Corporation's Act 2001* provides for exactly the same conditions (5% - 1,000 words). As in Canada, the U.K. and Australian measures do not call on the incumbent management and board of directors to treat these candidacies on an equal footing with those proposed by the nomination committee.

Other countries have adopted measures of various nature on this subject, as documented in various studies (e.g., CFA Institute, 2015; Lortie, 2015), but the governance culture and context in those jurisdictions are too unlike Canada's to be of relevance.

It is noteworthy that the three main Commonwealth jurisdictions have implemented shareholder access to the director nomination process, but that process is dependent on the submission of shareholder proposals. In its current form, this process is still rarely used in the three countries.

What are the arguments **in favour** of access to the director nomination process by shareholders?

In a previous policy paper on the legitimacy of directors, IGOPP has stated:

> *[B]oard members must be endowed with legitimacy. Only when a board is legitimate may it assert its authority over the management of the organization. That legitimacy flows from two sources:*
>
> 1. *Legitimacy based on independence from management as well as on a nomination and election process that ensures adequate representation for the organization's stakeholders, and in the case of exchange-listed companies, for its shareholders.*
>
> 2. *Legitimacy based on important, committed shareholding.*
>
> (*The Independence of Board Members: A Quest for Legitimacy*, IGOPP, 2008)

In this respect, shareholder access to the nomination process would certainly enhance board legitimacy. This is a strong argument. One could also argue that this right to nominate directors is symmetrical to the provision under section 109 of the CBCA that: … *the shareholders of a corporation may by ordinary resolution at a special meeting remove any director or directors from office*.

In addition to this legitimacy argument, defenders of shareholder rights make a number of additional claims:

CONTRIBUTES TO THE CREATION OF SHAREHOLDER VALUE

To the extent that the quality of the board has a beneficial effect on the performance of the corporation, the fact that shareholders may propose nominees to, presumably, improve the general competence of the board should have a positive effect on the stock market value of the corporation.

The CCGG, in particular, relies heavily on this argument, one that is purportedly demonstrated by various studies summarized in a report by The CFA Institute. However, the empirical support for this thesis becomes weak and unconvincing when the studies in question are subjected to a critical review, as we do in Appendix II hereof.

We may however take note here of a recent study on shareholder proposals of proxy access at Fortune 250 corporations in 2015 (reported by Copland and O'Keefe, 2015). The study, as subject to reservations as all others, shows that when shareholders of one of these corporations approved a proposal on access to the nominating process, the performance of that corporation's shares was on average 2.3% *lower* than that of the S&P 500 index. Conversely, when shareholders rejected such a proposal, the share performance was 0.5% *higher* than that of the same index.

GIVES ACCESS TO AN EXPANDED LIST OF CANDIDATES

Some observers (for instance, the Canadian Coalition for Good Governance (CCGG, 2015)) claim, a rather unsubstantiated claim, that new board candidates currently nominated tend to be drawn from a limited pool of acquaintances of incumbent directors (and sometimes even of the CEO) or that these candidates are selected because they espouse the prevalent view and support the status quo. Access to the nominating process by shareholders would expand the basin of potential candidates, ensure independent thinking (a quite different notion than the usual concept of board member independence) and bring a new perspective to the board's deliberations.

REPLICATES THE RIGHT TO NOMINATE BOARD CANDIDATES AT THE ANNUAL MEETING

Most shareholders of public corporations are henceforth investment funds geographically dispersed; very few attend annual meetings of shareholders. By the time of the annual meeting, most of the votes have already been submitted through proxies and counted; a nominee added on the day of the annual meeting would nowadays stand not a chance of being elected. However, the SEC partially justified its regulatory change by pointing out that facilitated shareholder access to proxies would sort of replicate the ancient right of nomination at annual meetings. The quest to somehow recapture a right which not so long ago belonged to the annual meeting of shareholders drives the insistence of many commentators particularly those located in academia (e.g. Bebchuk, 2003, 2009; Bebchuk and Hirst, 2010).

FOSTERS DIALOGUE BETWEEN DIRECTORS AND SHAREHOLDERS

Large institutional investors and pension funds have asked repeatedly (and usually got their way) to be consulted on board nominees; proxy voting advisers also urged increased dialogue between shareholders and directors. Such a dialogue makes obvious sense as long as it is well structured. According to supporters of proxy access, such a measure would foster an ongoing dialogue between shareholders and the board; it would therefore in some respects allow shareholders to influence the decision-making process of the board (for the benefit of all shareholders).

GIVES SHAREHOLDERS A MORE EFFECTIVE MECHANISM FOR INTERVENING THAN PROXY FIGHTS OR REVOCATION OF THE BOARD

When corporate performance falters, or for any other valid reason, shareholders must have access to a mechanism allowing them to change some or all members of the board of directors. This mechanism exists: presenting to shareholders an alternate list of nominees, a measure known as a *proxy fight.* These fights are costly for their initiator since it has to assume all the related costs. Furthermore, the fact that the list of new nominees is presented separately from the list of the board/management nominees is a significant hurdle.

In order to make this mechanism a lot more effective and accessible, the SEC had mandated in its original regulations that shareholder nominees must be included on the same proxy form with management nominees and that the corporation must pay all costs associated with proxy access.

ACTS AS AN ADDITIONAL INCENTIVE FOR BETTER PERFORMANCE BY MEMBERS OF THE BOARD

Academic observers, Bebchuk (2003) among them, and some fund managers believe that the world of business is dominated by opportunistic managers indifferent to the interests of shareholders. They view the "fear" of a contested election with its "risk" of being evicted from the board as a salutary "incentive" for better performance by board members. Every board would fear being targeted by a proxy access proposal, every board member would fear losing out in a contested election; therefore all boards would raise their game as a result.

MAY FACILITATE THE PROMOTION OF A DIVERSITY OF SKILLS ON THE BOARD

Shareholders may benefit from access to the nominating process to remedy what they have concluded are shortcomings in certain areas by the current board membership; that would amount to an indictment of the nomination committee. Of course, shareholders have another effective remedy: voting against the members of the nominating committee!

What are the arguments **against** shareholder access to the director nomination process?

THE BOARD OF DIRECTORS SHOULD GOVERN, NOT THE SHAREHOLDERS. THAT IS THE LAW!

The traditional view of corporate governance, anchored in law and customs, grants to the board of directors, once elected by shareholders, the responsibility of making all decisions in the interest of the corporation. That responsibility and accountability includes, *inter alia*, appointing senior management and setting their compensation, declaring dividends, nominating board members for election, approving strategic orientations and budgets.

As noted in the Introduction to this paper, there has been a move afoot over the last few years to push the notion of shareholder-driven governance as a sort of replacement for the conventional, strictly board-driven governance.

The proposed access to the nominating process by shareholders would constitute a new interference by the shareholders in an area of responsibility which *is implicitly devolved on the board of directors by the* CBCA[10].

Indeed, as Allaire and Rousseau wrote (2014):

> *[T]he Canada Business Corporations Act (CBCA) clearly stipulates that boards of directors must act in the interest of the corporation. The Supreme Court of Canada has interpreted the scope of this duty in two relatively recent judgments: Peoples Department Stores Inc. (Trustee of) v. Wise (2004) and BCE Inc. v. 1976 Debentureholders (2008)*
>
> *These two judgements are peremptory: the board, in its decision making process, must grant no preferential treatment to the interests of the shareholders or any other stakeholder; they must act exclusively in the interest of the corporation on whose board they sit.*

Even if the law grants shareholders the exclusive right to elect the members of the board of directors, shareholders cannot demand that the board be exclusively dedicated to their interests. Therefore, it seems odd that some would *grant shareholders the right to nominate directors whom would ostensibly be chosen to represent the sole interests of the shareholders nominating them!*

Many U.S. jurists (e.g. Bainbridge, 2002, 2006; Stout, 2007; Strine, 2006, 2014) also question the notion that shareholders are the only relevant stakeholders of public corporations.

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10 **102**. (1) Subject to any unanimous shareholder agreement, the directors shall manage, or supervise the management of, the business and affairs of a corporation.

122. (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

a) act honestly and in good faith with a view to the best interests of the corporation; and

b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

PROXY ACCESS MAY HAVE ADVERSE EFFECT ON INTERNAL BOARD DYNAMICS

Among the arguments supposedly supportive of shareholder access to the nominating process described earlier, one is particularly noxious: the notion that "fear" among board members of being singled out for replacement would lead to higher level of performance.

Presumably and contrary to evidence, shareholders are able to assess individual contribution to overall board performance. Other questions immediately arise: how would a board member communicate his/her performance to shareholders so as not to be singled out for expulsion? What would be the resulting impact on board dynamics from individual board members trying to tout their own merits?

Be that as it may, the consequences for an individual director being voted out of a board would be very significant and painful, both in economic and reputational terms; this is true for both incumbent nominees and the new nominees proposed by the shareholders.

Faced with the risk and arbitrary nature of a contested election, the directors would try to promote their personal contributions with institutional investors, thus generating an unhealthy competition among colleagues. In any event, how would the shareholders, called upon to choose between several nominees, decide for which nominee to vote, which nominee to dismiss when the voting proxy contains more nominees than available seats?

Will smaller institutional funds rely on proxy voting consultants (such as **ISS** or **Glass Lewis**), again increasing by tenfold the influence of the latter on the governance of public corporations? These proxy voting consultants will propose, as per their usual practice, some obvious, measurable criteria to make this choice: age of the directors, number of years as a member of the board, etc., which are, in fact, arbitrary criteria, uncorrelated with actual performance.

Once these criteria are well understood, it is very likely that corporations will try to preventively replace directors to avoid conflicts with large shareholders and make rooms for their nominees. Therefore, directors would be shown the way out because they no longer satisfy the arbitrary criteria selected by proxy voting advisors without taking into account their actual contribution.

Even more likely, boards of directors will initiate discussions and negotiations with institutional investors who have indicated their intention to propose their own nominees in an effort to reach common ground; the result of such secret negotiations will often be that some of the nominees proposed by institutional investors will become the nominees of management, thus resulting in the forcible retirement of directors presumably viewed, more or less deservedly, as being weaker.

THE SHAREHOLDER ACCESS TO PROXIES IN SUCCESSIVE YEARS RAISES STILL UNANSWERED QUESTIONS

If a group of shareholders can nominate and cause to be elected, say, 25% of the board every year, that group could technically obtain 100% of the seats in 4 years with an ownership interest of 3% to 5% (depending on the relevant threshold). Clearly, the process must include specific rules, for example, restricting the ability of a particular group of shareholders, whose candidates were elected in a given year, to again propose candidates in following tears so long as their elected nominees are still sitting on the board. But could members of that group join another group the next year? Should all members of a group be prohibited from joining another group the following year (following two years?)

If the nominees of a shareholder group are elected to the board, may another shareholder group propose nominees the following year? As this process could mean that half of the board would consist of new members within 2 years, should a clause be added stipulating that when nominees of shareholders are elected in a given year, no shareholder nominations could be accepted the following year?

If the nominees of a group of shareholders are not elected in a given year, can the same group resubmit them as candidates the following year? Would additional conditions apply?

DUAL NOMINATION PROCESS MAY LEAD TO SERIOUS ISSUES WITH THE MAKE-UP OF THE BOARD

A nomination committee is normally careful in selecting nominees on the basis of specific competencies, skills, abilities and experience that are complementary to those of the current board membership. Furthermore, the selection process will also factor in less tangible factors such as compatibility, reputation for team work, contribution to favourable board dynamics. Therefore, human factors should play a major role in the selection process as it is essential to assemble a group of people capable of, and effective at, making important decisions (Leblanc and Gillies, 2005).

Sharfman (2011) maintains that access to the nominating process by shareholders can only result in a process relying on information which is considerably inferior to that held by the directors. Considering the current nature of the shareholding of listed corporations, it would be illusory to expect shareholders to truly take the time to assess the nominees based on a skills matrix and analyze each nomination in the same way a nomination/governance committee would.

External members nominated according to selection criteria which do not, cannot, factor in the more subtle aspects of the selection process may well undermine the effectiveness of the board, generate the emergence of factions among board members, fracture the mutual trust among directors. A toxic climate on the board would be highly detrimental to the corporation’s performance.

THE PROCESS MAY BE HIJACKED!

Opponents of shareholder access to the nominating process express the concern that interest groups may hijack the process for their own benefit. Groups of shareholders who champion specific causes (e.g., social, environmental or religious) may use this new “right” to nominate board candidates who espouse their priorities, to the possible detriment of other stakeholders of the corporation.

Obviously, if, as suggested by the CCGG, no minimum holding period were required for shareholders to be given access to the nomination process, that would open the door wide to “activist” hedge funds – or any other form of short term investors. These funds could then play their usual games with great ease and at much lower costs than under their current business model. That would not benefit the long-term interests of Canadian corporations but may well benefit investors in the short term.

SHAREHOLDERS COME IN DIFFERENT SHAPES AND COLORS

Shareholders are diverse in their investment goals, strategies, holding period and expectations. (Lipton and Rosenblum, 2003). The objectives of a portfolio manager who has to achieve better monthly performance than some average of the industry are significantly different from those of investors like Warren Buffett or Stephen Jarislowsky, for whom the investment horizon is measured over a long period of time. How can a nominee proposed by the first type of shareholders also serve the interests of the second type?

DIRECTORS MUST REMAIN INDEPENDENT

Regardless of the formal legal stipulations, whenever a person is nominated by a significant shareholder, concerns will arise that the person so nominated may in fact or in appearance be viewed as mandated to represent the interests of the nominating shareholders, which could bring into question the sacrosanct independence of directors vis-à-vis this particular group of shareholders.

IGOPP's Position

In the final analysis, there are three possible positions on shareholder access to the director nomination process: (1) making the process mandatory through regulations; (2) letting shareholders propose specific terms and conditions for access and letting all shareholders vote to decide on their proposal[11] (3) taking a clear and supported position against proxy access by shareholders.

IGOPP'S POSITION

For the reasons set out in this paper, IGOPP contends **that shareholder proxy access is ill advised and may result in negative effects on governance practices.** Therefore, IGOPP is opposed to the process whereby shareholders may nominate director candidates.

Access to the director nomination process is already provided for in the CBCA and parameters are set out in the regulations. However, this process remains imperfect, particularly as to the treatment of shareholder nominations compared to the nominations originating from the board.

IGOPP also recommends **that nomination committees implement a robust consultation process with the corporation's significant shareholders and report in the annual *Management Information Circular* on the process and criteria adopted for nominating any new director.** The committees should also report on how the company is complying with the guidelines of the Canadian Securities Administrators' Policy Statement 58-201, Part 3, sections 3.12 to 3.14[12].

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11 However, as previously discussed, this option would require legislative and regulatory amendments in Canada.

12 Policy Statement 58-201 to Corporate Governance Guidelines, Part 3. Sections 3.12 to 3.14 are the following:

3.12 Prior to nominating or appointing individuals as directors, the board should adopt a process involving the following steps:

(A) Consider what competencies and skills the board, as a whole, should possess. In doing so, the board should recognize that the particular competencies and skills required for one issuer may not be the same as those required for another.

(B) Assess what competencies and skills each existing director possesses. It is unlikely that any one director will have all the competencies and skills required by the board. Instead, the board should be considered as a group, with each individual making his or her own contribution. Attention should also be paid to the personality and other qualities of each director, as these may ultimately determine the boardroom dynamic.

The board should also consider the appropriate size of the board, with a view to facilitating effective decision-making.

In carrying out each of these functions, the board should consider the advice and input of the nominating committee.

3.13 The nominating committee should be responsible for identifying individuals qualified to become new board members and recommending to the board the new director nominees for the next annual meeting of shareholders.

3.14 In making its recommendations, the nominating committee should consider:

(a) the competencies and skills that the board considers to be necessary for the board, as a whole, to possess;

(b) the competencies and skills that the board considers each existing director to possess; and

(c) the competencies and skills each new nominee will bring to the boardroom.

The nominating committee should also consider whether or not each new nominee can devote sufficient time and resources to his or her duties as a board member.

OTHER OPTIONS EXAMINED BUT DISMISSED

Although we have taken a position against proxy access, we nevertheless carefully analyzed the two other options. For reasons already stated, we are against mandatory access to the nominating process, with parameters set by regulatory authorities (universal regulations).

The option to allow shareholders to submit to a vote proposals in support of access to the nominating process or corporations and let shareholders decide is worthy of some consideration, though we also rejected that option. However, as shareholder proxy access receives at this time massive support from institutional investors, we review in Appendix III all aspects of this process for the nomination of directors by shareholders and the specific questions which will have to be answered.

Conclusion

Shareholder access to the director nomination process may at first glance seem to enhance the legitimacy of directors, which is a desirable outcome; however, this proposal brings forth a host of issues related to the logistics of its application and the potential adverse effects on board dynamics including:

- the usurpation of a responsibility historically and legally devolved exclusively on the board;
- the implicit, yet false, postulate whereby directors are only accountable to the shareholders and are only responsible for the interests of shareholders;
- the reputational issues of the directors submitted to a contested election and the self protective behaviour this would bring about;
- the actual risk of secret negotiations being held between management and investors who are intending to propose nominees;
- the overwhelming influence accruing to proxy voting advisory firms, whose clients would expect their voting recommendations on the nominees;
- the risk that the independence of directors nominated by shareholders would be compromised or so perceived;
- the risk of creating factions and a poisonous atmosphere within the board, which would compromise the proper functioning of the board;
- the risk of ending up with a board deficient in relevant experience or competence;
- the risk that the process be hijacked by single-issue groups of shareholders.

For all of these reasons, IGOPP believes that shareholder proxy access as currently promoted will not enhance corporate governance and may prove harmful in the Canadian context.

Appendixes

APPENDIX I

Access to the director nomination process: a recurring concern of the SEC

In the United States, the *Security and Exchange Commission* (SEC – the financial markets regulatory authority) first proposed a regulation in 1942 aimed at allowing shareholders to directly appoint nominees using the proxy form. However, the response of corporations at the time was unanimous: such a regulation would be disastrous since it would lead to the appointment of unqualified nominees, in addition to creating confusion at the time of the vote because of the excessive number of candidates.

The SEC temporarily abandoned the project and amendments were codified (officially in 1976) in such a way as to exclude any shareholder proposal for the nomination or the election of directors (amendment made to rule 14a-8 on shareholder proposals). Therefore, it became impossible to use the traditional process of submission of shareholder proposals for this purpose. However, the SEC took up the issue again without success in 1991 and in 1992, and then with a much more vigorous proposal in 2003.

In the aftermath of Sarbanes-Oxley, shortly after the numerous scandals (Enron and others), the SEC wished to defuse the climate of dissatisfaction and mistrust by proposing to give shareholders direct access to the nomination process. Rule 14a-11 was therefore proposed for the first time, and was strongly supported by certain influential people in academic circles. However, numerous practitioners (lawyers), judges and corporate representatives also got involved in the campaign, advancing several arguments already raised 60 years earlier. The application of the regulation was judged to be too complex, and the SEC therefore shelved the proposal once again.

In 2007, the SEC was again forced to back down in the face of vehement opposition from the business community (particularly by the Business Roundtable, a group of CEOs from the largest U.S. corporations). But the 2008 financial crisis once again opened the door to a new attempt via the Dodd-Frank Act, adopted in July 2010. This time the SEC was finally successful, since a new regulatory proposal imposing proxy access was approved by a majority vote of the commissioners (3 to 2) in February 2009, with rule 14a-11 officially coming into force on August 24, 2010. To this end, rule 14a-8 was amended to permit shareholder proposals aimed at changing access to the director nomination process.

The rule did not remain in force for long. Indeed, one month later, the Business Roundtable questioned the legality of the rule adopted by the SEC, and the case was brought before the D.C. Circuit Court of Appeals. On October 4, 2010, the SEC announced the temporary suspension of the application of rule 14a-11 pending the court's judgment. The ruling was issued on July 22, 2011 and the verdict was severely critical of the SEC. Indeed, the court criticized the lack of a cost-benefit analysis in support of the regulation, the arbitrary nature of several parameters set by the regulation, and its failure to convincingly show that access to the director nomination process would have the effect of improving the performance of boards and companies, and would result in the creation of value for shareholders.

The SEC decided not to appeal the decision, which would have propelled the case before the Supreme Court, and therefore once again indefinitely suspended its plan to apply the regulation. However, the amendment to rule 14a-8 was not contested by the Business Roundtable and therefore not struck down by the court. This amendment, which was closely related to the application of rule 14a-11, henceforth has the effect of permitting shareholders to submit a proposal to amend a company's articles to give shareholders direct access to the directors nomination process. This breach in the wall has not gone unnoticed. Thus, a number of institutional investors, proxy advisory firms, law firms and university professors have proposed various parameters for regulating this process. The arguments for and against access to the nominating process have multiplied, and the debate has gotten heated.

Since 2014, the number of proposals to this effect has skyrocketed. In 2015, the *Board Accountability Project* (an initiative of the Office of the Comptroller of the City of New York that administers several pension funds), alone, was the source of proposals in 75 different corporations. Some corporations have decided to voluntarily submit proposals to this effect in order to avoid a potential confrontation. In short, the issue is growing in importance and is back in the forefront of the governance scene.

APPENDIX II

A review of some studies claiming to show that shareholder access to the director nomination process has a positive impact on share price

The Chartered Financial Analyst (CFA) Institute conducted a meta-analysis of research studies that were done following the events of 2010-2011; the authors' objective was to show the effects of regulation (of access to the director nomination process) on the total market capitalization of companies subject to the regulation. These studies concluded that such regulation would enable total market capitalization in the United States to grow by an amount ranging from $3.5 to $140.3 billion. Of course, the high end of this range spurred people's imaginations, and the CFA institute document is now prominently cited as "evidence" that enacting regulations would promote the creation of value for shareholders.

However, looking individually at the studies considered by the CFA institute, we find a much more nuanced reality. Indeed, the five studies discussed were not unanimous on the effects (at least one of them showed negative effects), and we note that the CFA Institute deliberately chose to exclude two studies whose results showed abnormally negative performances (and therefore the destruction of value) following events-based analyses on proxy access.

Even among the studies which agreed that the effect was more favourable, the conclusions are not so firm and categorical. Cohn et al. (2012), for example, state that their results show that regulations promoting proxy access lead to a destruction of value when the shareholder base consists of investors sympathetic to workers' rights. As for Becker et al. (2013), their results are nuanced in indicating that the announcement of the regulatory change was not one of the major reasons leading to changes in share prices on the days covered by the study[13]; in addition, the results are not significant when the window of time covered in the study exceeded 3 days (there was no significant effect on the change in the share price beyond 2 days). Jochem (2012) states that his results show that proxy access reform has only had a small impact on markets; he found no change in the valuations of 1) large-cap corporations, 2) corporations with few counter-measures against hostile takeovers, and 3) corporations in which no investors had proxy access following the regulatory change. On the other hand, Campbell at al. (2012) found that there was a positive reaction in the market to the announced regulatory change, but their

13 The coefficient R^2 oscillates around 0.01 for various regressions proposed by the authors, meaning, in simple terms, that the regulatory change would explain about 1% of the change in share prices during the days under observation, while 99% of the change is explained by other factors not measured by the study.

sample was limited to large-scale firms (these results were however at odds with those of Jochem [2012]); also, in considering individual cases rather than the average, 101 of the 392 firms studied by Campbell et al. (2012) posted negative returns.

The CFA Institute decided not to take into consideration the studies of Larcker et al. (2011) and Akyol et al. (2012), pointing to methodological deficiencies. We could however identify similar deficiencies in the studies they ultimately did consider.

In short, because of the contradictory results in the studies underlying the CFA Institute's meta-analysis, one cannot possibly conclude that there is any true creation of value as a result of a regulatory change aimed at promoting access to the nomination process.

APPENDIX III

Main clauses and parameters

The positions taken by several institutional investors and proxy advisory agencies are shown in Table 4.

Table 4

Positions of various stakeholders

	Threshold as a % of shares	Holding period	Cap on number of directors
Canadian Coalition (CCGG)	3%†	None!	20% of the board
Institutional Shareholder Services (ISS)	Max. 3%	Max 3 years	25% of the board
Council of Institutional Investors (CII)	Betw. 3% and 5%	Min. 2 years	Less than 50%
Boardroom Accountability Project	Min. 3%	Min. 3 years	25% of the board
SEC	3%	3 years	25% of the board
T. Rowe Price	3%	Betw. 2 and 3 years	n.a.
Norges Bank	Max. 3%	Max 3 years	20% of the board
CalPERS	3%	Min. 2 years	Less than 50%
CalSTRS	3%	3 years	Less than 50%
Glass Lewis††	Minimum required	Period required	Cap required
Blackrock††	Substantial inv.	Period required	≠ takeover
TIAA-CREF	3%	3 years	25% of the board
Vanguard	5%	3 years	Max. 20% of the board

†5% for firms with market capitalization of less than $1 billion
††Case-by-case analysis, therefore no specific indicators

Below is a description of the clauses that have been adopted, as well as a brief discussion of the issues raised by each.

1) Ownership threshold required to access the director nomination process

It seems to be generally accepted that the privilege of gaining access to the nomination process is reserved for so-called "significant" shareholders. This threshold varies considerably depending on the observer, but the 3% chosen by the SEC seems quite close to the minimum for some and the maximum for others, and is therefore an acceptable threshold for the majority. However, the preliminary versions of the regulation proposed by the SEC contained some additional nuances based on the size of the company.

Three percent (3%) of a corporation with a market capitalization of $100 million represents an investment of $3 million to reach this threshold, while $300 million is required to achieve the same threshold for a corporation with a market capitalization of $10 billion. In short, this creates significant differences depending on size, and access to the process is therefore greatly facilitated in smaller cap as compared to large-cap corporations.

The CCGG therefore proposes two thresholds: 5% for capitalizations of less than $1 billion, and 3% for those exceeding this threshold.

The idea of proposing variable thresholds is appealing at first blush, but the dollar value differs substantially around the cut-off point between the two thresholds (say $49 million for a corporation with a market value of $980 million and $30,000,000 for one valued at $1 billion!). The usual way of dealing with threshold issues would be to set the following rule: 5% for up to a $1 billion of market cap and 3% from $1 billion up, in terms of economic value invested (instead of votes). The CCGG is not clear on this point but we may assume that is what they mean.

Also, what date should be chosen for setting the threshold? Market capitalization at the end of the last fiscal year? On the date of purchase of the last share when the threshold was achieved? Market capitalization fluctuates daily, complicating the incorporation into a formula with different levels. On the other hand, a criterion based on a TSX or TSXV listing could be evaluated with a view to facilitating implementation.

While the issue of modulating the threshold according to size raises some resolvable issues, two other points also need to be resolved: 1° if the threshold is determined by a percent, is it a percentage of shares or votes? This nuance is important, particularly in a jurisdiction such as Canada where corporations with a class of multiple voting shares are numerous; 2° should borrowed shares, short-selling, total return swaps be factored in determining whether a shareholder meets the ownership criterion? The position usually taken, and it is a wise one, is that the ownership of shares must be absolute, without derivatives or other means to limit the economic exposure of the owner and such ownership must still be on-going at the time of the annual meeting of shareholders.

2) Group of shareholders

Can a shareholder solicit other shareholders to form a group of sufficient size to achieve the minimum ownership threshold? Most stakeholders consider that it is legitimate to combine shareholders, but what is the acceptable size of such a group? There is no unanimity on this second point, but several proposals seem to oscillate around a limit of 20 shareholders. Neither the SEC nor the CCGG specify any limit. Clearly, the larger the size of the group, the greater the difficulty of achieving a consensus on which nominees to put forward since the group acts as a single entity (with an official representative) at the time the proposal is filed.

A cap on the size of the group allows the corporation to more easily identify shareholders likely to form a group with a sufficient ownership level. Thus, the corporation may engage more readily in a dialogue upstream with its significant shareholders.

3) Length of holding period

This qualifying clause is probably the one that generates the most differences of opinion.

The CCGG recently took a position against any form of minimum holding period, justifying this decision on the basis that "[p]ast behaviour is not necessarily indicative of future intention and it cannot be assumed that a shareholder that purchased shares only recently does not have a long term perspective"[14]. Others believe that privileges granted after a minimum holding period contribute to creating two classes of shareholders.

It is nevertheless a way to offer long-standing shareholders an advantage, while limiting the use of the process by transitory shareholders.

Institutional investors, such as Blackrock, believe that any proposal for access to the nominating process must contain a form of assurance that "the mechanism will not be subject to abuse by short-term investors"[15], which implies support for some form of minimum holding period.

Except for the CCGG, all the stakeholders support the idea of a minimum holding period, varying between 1 and 5 years. Again, the SEC's proposal of 3 years reflects a middle ground which all consider relatively acceptable (see Table 3).

With the rise in shareholder activism (whose objectives differ greatly from the spirit behind the promotion of access to the nominating process), a minimum holding period is in our view imperative.

14 Canadian Coalition for Good Governance, "Shareholder involvement in the director nomination process: enhanced engagement and proxy access", *CCGG Policy*, May 2015, p.16

15 Blackrock, *Proxy voting guidelines for U.S. securities*, February 2015, p.7.

4) Cap on eligible candidates

The purpose of this clause is to restrict the number of candidates that can be put forward by shareholders using proxy access.

In general, one observes a tendency to set the cap at about 20% - 25% of the board members. The aim of this cap is to avoid a complete takeover of the control of the board by shareholders with a low ownership threshold (3% for example). The cap is also accompanied by a threshold expressed as a whole number for boards with fewer directors (generally a minimum of 1 director).

The setting of a cap brings forth a number of issues, which are discussed in points 5 and 6 below.

5) Maintaining the ownership interest of the shareholder or group of shareholders after the nominations

Canadian law is already clear on this: the ownership interest must, at a minimum, be maintained until the time of the shareholder meeting at which the vote will be held. However, one sometimes sees proposals that require the ownership interest to be maintained until the following election (one year after the vote) if the proposed candidate is elected.

Would it be logical for a shareholder (or group of shareholders) to be able to sell their ownership interest immediately after nominating candidates for director and having them elected? On the other hand, can one compel a shareholder to retain ownership of its shares? There are no easy answers to these questions.

6) Possibility of successive nominations

If a shareholder can propose and cause to be elected 25% of the board every year, he could technically obtain 100% of the seats in 4 years with an ownership interest of 3% to 5% (depending on the chosen threshold). There should therefore be additional rules to restrict the ability to present new candidates for so long as shareholders' representatives are still sitting on the board.

The issue of successive nominations raises numerous questions that illustrate the full complexity of the process:

- Can the same group of shareholders nominate directors for two consecutive years (or more)? If so, is there a limit on the number of successive nominations? If not, should there be a mandatory period of forbearance?
- If shareholders' candidates are elected to the board, may other shareholders nominate other candidates the following year? Since this could mean that half of the board would consist of new members within 2 years, should ***a clause be added stipulating that when shareholders' candidates are elected, no shareholder nominations could be accepted the following year?***
- Could members of the group in one year form a different group the following year for purposes of making new nominations?
- If the candidates of a group of shareholders are not elected in one year, can the same group resubmit them as candidates the following year? Would additional conditions apply?

Such questions would have to be answered, otherwise proxy access risks opening the door to unforeseeable and adverse consequences.

7) Determining priority among multiple nominations

Where several shareholders or groups of shareholders may wish to present candidates for the same election, selection criteria would have to be established to limit the final number of candidates to the cap provided for in the main clause. In general, priority would be given to the shareholder (or group of shareholders) with the highest ownership interest.

8) Process for presenting proxy access candidates

How should shareholder nominees be presented as compared with traditional candidates? Are they entitled to the same treatment (number of words for their description, on the same ballot, etc.)? Should information be disclosed on the shareholders submitting the candidacies?

How many words should be permitted to describe each candidate? Where should the names of the shareholders' candidates appear on the proxy solicitation form? The purpose of such details is to determine the treatment shareholder candidates must receive in the process leading up to the vote.

9) Assurance against a possible takeover attempt

Should shareholders using access to the nomination process sign a declaration of intent regarding a possible takeover?

10) Directors’ independence

What rules should be put in place to ensure that shareholder candidates are independent and will act in the best interests of the corporation and its stakeholders?

The issue of the independence of the shareholders’ nominees is certainly an important one (may the nominating shareholder pay them compensation in addition to their compensation as directors? Are they truly independent and do they serve the interests of the other shareholders and stakeholders?)

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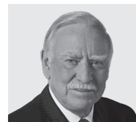

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