To exert influence, shareholders must do more than withhold votes

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Majority voting policies and non-binding "say-on-pay" votes are ineffective means for shareholders to voice their concerns on board decisions on executive compensation. To exert their relevant influence as owners, shareholders need the right to vote against the election of directors, not simply to withhold a vote, and to be granted more practical proxy access to nominate individuals for election as directors. The rights to vote against nominees and for their own nominees underpin the core principle that directors are elected by the shareholders.

The 2015 shareholder-meeting season demonstrated shareholder displeasure at disconnects between aberrant executive compensation decisions and median financial performance. While companies sang the lyrics "pay for performance," the discordant melody was often composed for a different tune. For example, the 2015 say-on-pay non-binding vote at Canadian Imperial Bank of Commerce was 57-per-cent against. At Barrick Gold Corp., it was 73-per-cent against.

The selection of nominees for election as directors at an annual meeting is made by incumbent directors. Shareholders are not offered the option to vote against the election of the board's nominees. When a shareholder does not favour the election of a nominee, the shareholder is restricted to the ineffectual alternatives of not voting at all, or of expressing dissatisfaction with the nominee by withholding his vote.

Withholding a vote on the election of directors is only a signal of protest and does not produce the desired result. Once nominated by the board, the individual will be elected in any event in uncontested director elections as long as one vote is cast in his or her favour. Without an effective right that results in a vote against the election of a board nominee, shareholders are denied fundamental shareholder rights.

Currently, structured majority-voting policies for uncontested director elections fail to convert a withhold vote into a meaningful against vote. Majority voting is not an effective or enforceable policy that empowers shareholders to defeat director nominations. Such policies are structurally flawed, are not founded on enforceable regulation and do not ensure that boards will comply with expressed shareholder voting.

This is not advocacy that shareholders should exercise the business judgment that determines corporate wages. The board of directors has the duty and responsibility for compensation policies and practices. But having accepted that obligation, a board must then be accountable for its actions. Responsibility requires accountability and accountability requires consequences for actions taken. Boards should be accountable to the stakeholders of the company for their governance practices, and especially to shareholders who have the right to vote on the election of directors. The lack of an effective right that results in a vote against the election of a board nominee is a fundamental obstacle to the ability of shareholders to hold directors accountable for their decisions.

There is also an absence of practical means for shareholders to challenge incumbent directors' compensation decisions that they consider inappropriate. Shareholder litigation is not an answer, as virtually all directors' decisions, except a very few careless ones, are protected within the broad shield of the deferential business judgment rule. Understandably, compensation committees generally hire consultants, who provide the directors with the defences of reliance on expert opinion and due diligence and evidence that the directors made informed and reasonable business judgments.

Another major reason for the lack of accountability for board decisions on executive compensation is that it is most impractical for shareholders to nominate directors of their choice. In the United States, however, proxy access – the ability of shareholders to place nominees for election as directors in the company's proxy circular without undertaking an expensive proxy solicitation – moved forward in 2015, with broad-based support. Following earlier Securities and Exchange Commission endorsement, the key typical parameters accepted by major U.S. companies and shareholders for "proxy access" are that the

nominating shareholders have to own at least 3 per cent of the shares, with a three-year minimum ownership period, and up to 20 per cent of board members could be elected pursuant to proxy access bylaws.

In Canada, institutional shareholders have exhibited little interest for expanded rights to nominate candidates for election as directors at annual shareholder meetings. Those arguing against proxy access point to existing but archaic and unused legal provisions that permit not more than 15 shareholders holding at least 5 per cent of the shares for at least six months to submit a proposal that may include nominations for the election of directors. The additional statutory right to requisition a special shareholder meeting has been used not to nominate directors at regular shareholder meetings, but rather to seek influence or control by restructuring the board.

The debate in Canada to provide substance to the principle that shareholders elect directors is nascent and divided. The Canadian Coalition for Good Governance published a policy proposal to draw attention to enhancing proxy access for Canadian companies. The CCGG proposal assumes effective majority voting is in place, which may be an unreliable premise. The Institute for the Governance of Private and Public Organizations considers that "proxy access is ill-advised and may result in negative effects on governance practices" and that it "is opposed to the process whereby shareholders may nominate director candidates."

It falls, therefore, to Canadian shareholders to commit themselves to the task of achieving effective rights to influence board decisions on executive compensation. To do so, they need to actively seek substantive shareholder rights to nominate directors and to exercise effective votes in their election. If you want change, you can't continue doing the same thing.

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