

Board self-selection: Should the dictatorship be supported?

Dr Thea Voogt



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Paper outline:

Board self-selection = über shareholder control mechanism

1. Allocation of rights - Critical analysis of soft-law
2. Do theories of the corporation justify board self-selection?
3. Grounds to argue board self-selection is a stronger and more effective shareholder control mechanism than corporations law protected right to appoint and remove directors
4. Do ASX 100 company boards understand?



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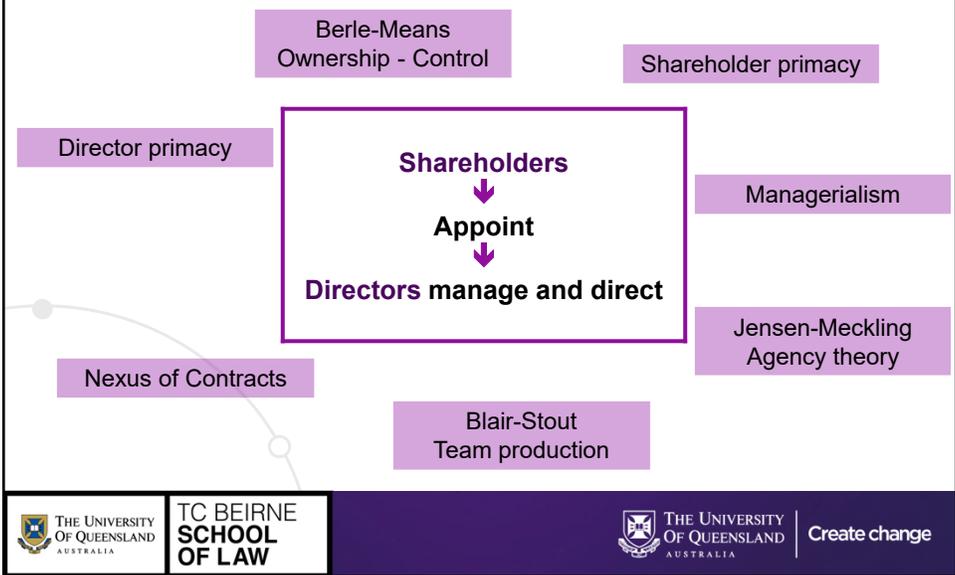
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Basis:

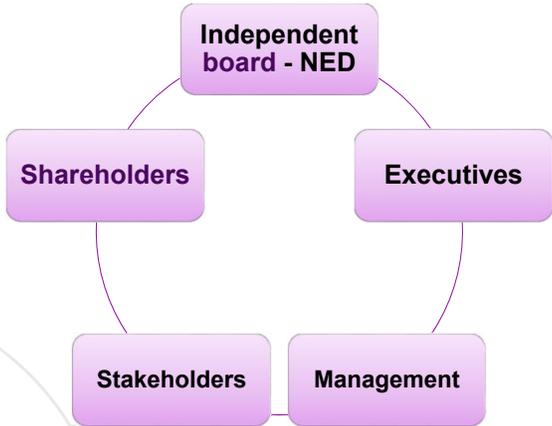
- Thea Voogt, 'A Conceptual Assessment of Board Skills in ASX 100 Companies' (2018) 46 *Australian Business Law Review*.
- Thea Voogt and Martie-Louise Verreynne, 'Director Appointments: Expressing Board Care and Diligence' (2018) 41(4) *University of New South Wales Law Journal*.
- Thea Voogt, 'Tall Trees and Digital Literacy: Lessons from *Palkon v Holmes*' (2017) 31(3) *Australian Journal of Corporate Law* 344.
- Thea Voogt, 'Articulating Care, Skill and Diligence Standards for Non-executive Directors' (2017) 35(2) *Company and Securities Law Journal* 128.



Classic corporate governance model:



This paper's focus – S&P ASX 200:



Shareholder decisions - Pragmatism:

Corporations Act 2001 (Cth)	Shareholder rights
136, 157, 162, Pt 2F.2, 254H, 256B...	Change: constitution, company name, company type, rights attached to shares, reduce share capital, buybacks
201G	Appoint directors
201P	Approve director limits on board size < stated in constitution
203D	Remove directors
Ch 2E	Approve certain related party transactions
Pt 2M.4	Appoint and remove auditors
Pt 2D.2	Approve certain retirement benefits to directors
250R	Advisory vote on remuneration report, 'two-strike rule'
491, 411, 611	Initiate winding up, approve scheme of arrangement, approve change in control that would have contravened takeover

Largest shareholdings Commonwealth Bank:

Top 20 Shareholders as at 30/07/2018 CBA

Shareholder	Effective Date	Capital (%)	Shares	Notes
HSBC Custody Nominees (Australia) Limited	30/07/2018	21.07	370,746,865	
J P Morgan Nominees Australia Limited	30/07/2018	12.98	228,386,048	
Citicorp Nominees Pty Limited	30/07/2018	5.59	98,454,740	
National Nominees Limited	30/07/2018	3.25	57,172,719	
BNP Paribas Noms Pty Limited	30/07/2018	2.92	51,468,942	
Bond Street Custodians Limited	30/07/2018	0.83	14,656,952	
Australian Foundation Investment Company Limited	30/07/2018	0.45	7,900,000	
Navigator Australia Limited	30/07/2018	0.21	3,670,568	

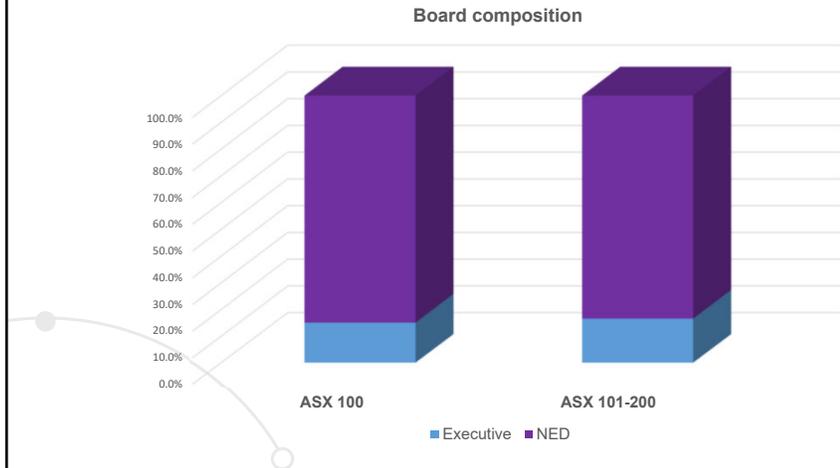
Dictator:

One holding complete autocratic control: a person with unlimited governmental power

Dictatorship:

Autocratic rule, control, or leadership or a form of government in which absolute power is concentrated in a dictator or a small clique

S&P ASX 200 boards:



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S&P ASX 200 boards:

- Board size 8/9
- ASX 100 NED fee \$222,692
- ASX 101–200 NED fee \$128,385
- 3 NED positions \$853,518



BHP Billiton NED → 50 days

Walker Review, UK Bank NED → 30-36 days

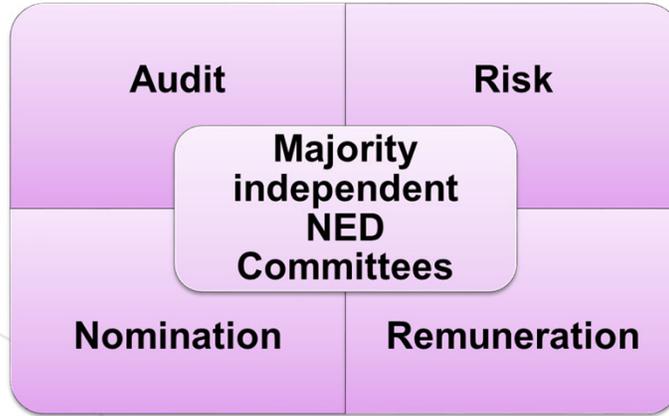


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S&P ASX 200 boards:



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Commonwealth Bank 2017:

Committee Meetings

Director	Risk Committee		Audit Committee		Remuneration Committee		Nominations Committee ⁽¹⁾	
	No. of Meetings Held ⁽²⁾	No. of Meetings Attended	No. of Meetings Held ⁽²⁾	No. of Meetings Attended	No. of Meetings Held ⁽²⁾	No. of Meetings Attended	No. of Meetings Held ⁽²⁾	No. of Meetings Attended
Catherine Livingstone ⁽³⁾	1	1	8	8	1	1	3	3
Ian Narev ⁽⁴⁾	-	-	-	-	-	-	-	-
Sir John Anderson ⁽⁵⁾	3	2	3	2	-	-	3	2
Shirish Apte ⁽⁶⁾	8	8	8	8	-	-	-	-
Sir David Higgins	8	8	-	-	10	10	-	-
Launa Inman	-	-	8	8	10	10	-	-
Brian Long	8	8	8	8	-	-	7	7
Andrew Mohl	8	8	-	-	10	10	-	-
Mary Padbury ⁽⁷⁾	-	-	-	-	10	10	5	5
Wendy Stops	-	-	-	-	10	10	-	-
David Turner ⁽⁸⁾	4	4	-	-	5	5	4	4
Harrison Young ⁽⁹⁾	8	8	8	8	-	-	7	7

(1) Formerly named the Board Performance & Renewal Committee.



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Commonwealth Bank 2018:

Directors' meetings

The number of Board and standing Board Committee meetings held during the financial year that each Director was eligible to attend, and the number of meetings attended by each Director, were:

Director	Board				Committees ⁽¹⁾							
	Scheduled Meetings		Unscheduled Meetings		Risk ⁽²⁾		Audit ⁽²⁾		Remuneration ⁽²⁾		Nominations	
	Held ⁽³⁾	Attended	Held ⁽³⁾	Attended	Held ⁽³⁾	Attended	Held ⁽³⁾	Attended	Held ⁽³⁾	Attended	Held ⁽³⁾	Attended
Catherine Livingstone AO	10	10	17	17	10	10	9	9	15	15	13	13
Matt Cormyn ⁽⁴⁾	2	2	7	7	-	-	-	-	-	-	-	-
Shirish Apte	10	10	17	15	10	10	9	9	-	-	-	-
Sir David Higgins	10	10	17	17	10	10	-	-	15	15	-	-
Brian Long	10	10	17	16	10	10	9	9	-	-	13	13
Andrew Mohl	10	10	17	17	10	10	-	-	15	15	-	-
Mary Padbury	10	10	17	17	-	-	-	-	15	15	13	13
Wendy Stops ⁽⁵⁾	10	10	17	16	-	-	7	7	15	14	-	-
Anne Templeman-Jones ⁽⁶⁾	3	3	8	7	-	-	2	2	-	-	-	-
Rob Whitfield ⁽⁷⁾	8	8	15	15	8	8	-	-	-	-	7	7
Ian Narev ⁽⁸⁾	8	8	10	3 ⁽⁹⁾	-	-	-	-	-	-	-	-
Launa Inman ⁽¹⁰⁾	5	5	2	2	-	-	2	2	4	4	-	-
Harrison Young ⁽¹¹⁾	5	5	2	2	2	2	2	2	-	-	6	6



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What does the law say about what NEDs should do?

All directors

- ➔ Manage + Direct (s 198A)
- ➔ Rely (s 189)
- ➔ Delegate (s 190)

Duties:

Act with loyalty and good faith
Best interest of corporation
s 181, 182...

Apply care, skill and diligence
s 180



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What does the law say about what NEDs should do?

List of duties, responsibilities in *Corporations Act 2001* (Cth)?

My case law analysis:

1. Managing and directing the business, stewardship
2. Setting the goals of the company
3. Overseeing the management team's plans, including the allocation of financial and human resources
4. Taking responsibility for the financial statements
5. Guiding, managing, monitoring and reviewing management's progress to attaining goals
6. Becoming familiar with the fundamentals of the business, understanding the business and the risks involved and staying informed by asking for information
7. Applying informed judgement



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What do Codes say about what NEDs should do?

Roles and responsibilities

Leximancer-analysis:

Australia, UK, Singapore, G20/OECD, South Africa

Theme 1: Setting, implementation, ensuring, monitoring

Theme 2: Strategy

Theme 3: Risk management

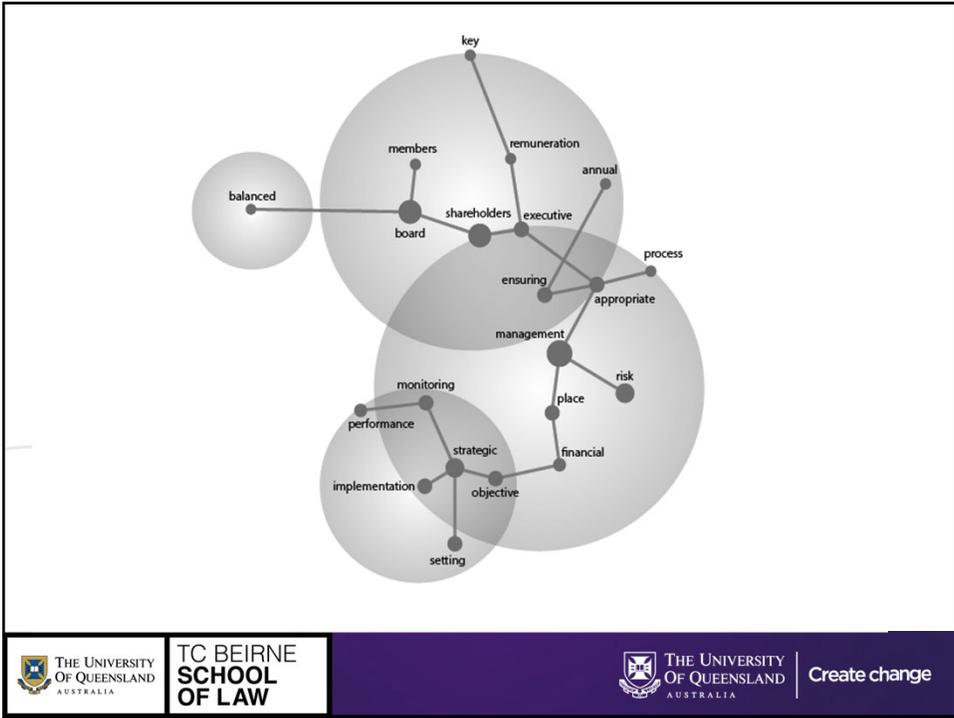
Theme 4: Interdependence



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What does the law say about NED skills?

List of skills in *Corporations Act 2001 (Cth)*?

My case law analysis:

1. Leadership
2. Business acumen
3. Financial literacy
4. Oversight and delegation
5. Risk management
6. Change management
7. Strategy
8. Legal skills

Legal standard – NED ‘skills for the job’:

	Leadership	Business acumen	Financial	Oversight, delegation	Risk management	Change management	Strategy	Legal
1. Managing – Directing – Stewardship	✓			✓		✓	✓	✓
2. Setting company goals	✓	✓			✓	✓	✓	
3. Overseeing management’s plans, resources		✓		✓	✓			
4. Financial statements		✓	✓		✓			✓
5. Management’s progress: Guiding – Managing – Monitoring – Reviewing	✓	✓	✓	✓	✓	✓	✓	
6. Understand, familiar: Business – Risks		✓	✓	✓	✓	✓	✓	
7. Applying informed judgement	✓	✓	✓	✓	✓		✓	✓



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Self-selecting the right NED for the job:

Pro's:	Con's:
Formal, rigorous, transparent	Closed process to shareholders
Independent director involvement = Protection	Self-evaluation
Ability to work as a team	Independent directors?
Focus on duty to company	Groupthink, small group dynamics
Board skills gaps are known	Board capture → Knowledge capture
Board knows future strategy	No guarantee



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Do theories of the corporation justify board self-selection?:

- Shareholder primacy
- Director primacy
- Agency theory
- Separation of ownership and control
- Nexus of contracts
- Directors as trustees



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**Board self-selection
is (can be) a
stronger, more effective
shareholder control mechanism
than
corporations law protected
right to
appoint and remove directors**



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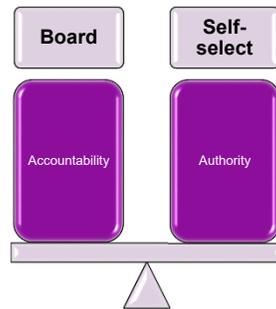
Grounds to support board self-selection:

- Enlightened shareholder is no fool
- More shareholder involvement not balanced with accountability
- Personal risk for NEDs
- Amendments ASX Code R 1.1: Role of board and management – Define entity’s purpose



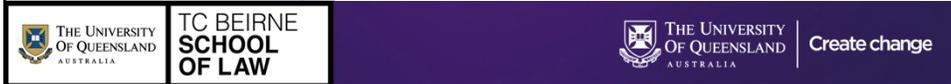
Grounds to support board self-selection:

‘The power to hold to account is ultimately the power to decide’
Economist Keith Arrow – Nobel laureate



Keay's stages of accountability:

1. Board must provide accurate information about its decisions and actions
2. Explain and justify their actions, acts and omissions
3. Question and evaluate the reasoning of the board
4. Imposing consequences

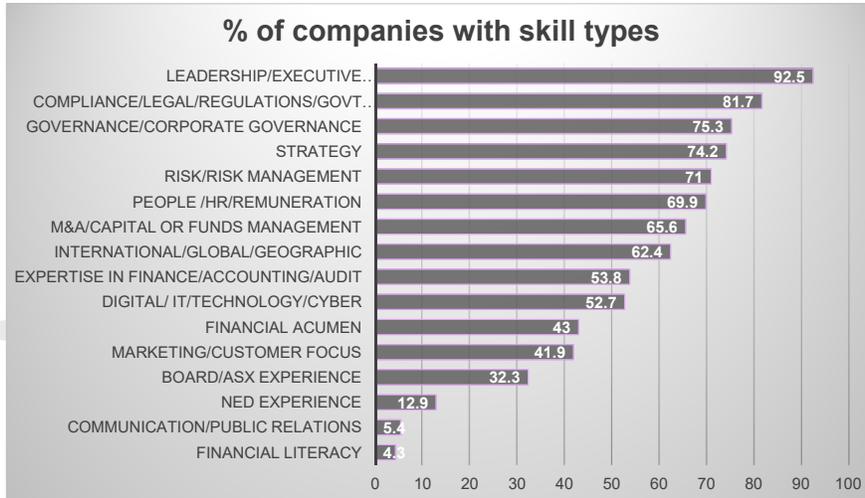


1. Provide accurate information about its decisions and actions

- Biographical detail, qualifications, experience, skills they bring to the board, details of other material directorships, are they independent, does the board support
- Result of board evaluation
- ASX code: Recommendation 2.2: 'A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.'



ASX 100 Skills matrix data 2016:



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2. Explain and justify their actions, acts and omissions

- Historic or aspirational?
- Assurance about minimum legal skills?
- Match to actual duties?
- Links to strategic direction, business environment, risks?



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Commonwealth Bank Case Study: 2016

Further to the Directors' individual details above, the following table summarises the collective key skills and experience of the Board:

Skills and Experience	No. of Directors
Retail and Corporate Banking/ Financial Institutions	5
Financial Acumen	12
New Media/Technology	5
Experience as a non-executive director of at least two other listed entities	7
General management exposure to international operations	12
Held CEO or similar position in non-financial organisation	7
Expert experience in financial regulation or legal expertise	7



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Commonwealth Bank Case Study: 2017

The graph below identifies the Board's current skills, expertise and experience.

Board Skills Matrix



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Commonwealth Bank Case Study: 2018



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Solution – Connecting the dots

Integrated disclosure:
Risk – Skills – Strategy – Actual tasks



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Question
Are shareholders able to identify what the minimum skills of all directors should be?
Did the board inform shareholders about the processes to ensure that all nominees have the minimum skills required of all directors?
Is there clear disclosure that each nominee is financially literate?
Is there clear, concise, focussed disclosure of the aggregate skills required of the board, and how these skills relate to the company's strategy and each of the disclosed key risk categories? Have each of the key risks been addressed by specific skills?
If directors stand for re-election, is there clear disclosure of the reasons why their skills are suited to address the current and future risks in the company.
Is there clear disclosure of the future skills required of directors to address future risks such as those associated with technology? How will the shareholders know which of the nominees have these skills?
Will shareholders know how the existing skills of the board fit into the future strategy set for the company?
How is the experience of nominees relevant to the strategic objectives and risks in the company?
Will shareholders be able to form an opinion about how the directors aim to govern, manage and direct the corporation by considering the skills required of the board?
Will shareholders be able to determine how nominees are able to make a contribution to board renewal?
Are shareholders able to see how nominees' experience, particularly industry experience, is relevant to their role?
If a nominee makes the board more diverse, in what way does their diversity relate to the company's strategic objectives?
Has the biographical information disclosed of nominees explained how their qualifications, professional memberships, gender and time availability (in reference to other positions they hold) relate to the company's strategy and key risks?
Will shareholders have access to all these relevant aspects prior to the AGM so that they have sufficient time to appoint and instruct a proxy?

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- **Recommendation 2.7:** *A listed entity with a director who is not fluent in the language in which board or security holder meetings are held or key documents are written should disclose the processes it has in place to ensure the director understands and can contribute to the discussions at those meetings and understands and can discharge their obligations in relation to those documents.*
- **Recommendation 5.2:** *A listed entity should ensure that its board receives copies of all announcements under Listing Rule 3.1 promptly after they have been made.*



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