More Directors Face Yearly Votes

By JOANN S. LUBLIN

More U.S. corporate directors are getting ready to face yearly re-election votes.

This proxy season, an unusually high proportion of companies have accepted activists’ demands that all board members stand for annual elections by shareholders, replacing staggered terms for directors that typically last three years. Proponents of the popular corporate-governance measure say it boosts a board's accountability on key issues like acquisitions and executive pay.

Classified boards, or boards whose members usually have the staggered three-year terms, discourage hostile takeovers. It is tough for outsiders to alter a board's composition when only a third of the directors are up for re-election each year.

The Florida State Board of Administration and the Nathan Cummings Foundation, advised by Harvard law professor Lucian Bebchuk, recently dropped half of 28 resolutions seeking yearly elections after 14 of the big companies they targeted agreed—ahead of a vote—to support the change at 2011 or 2012 annual meetings. Among them are Life Technologies Corp. and Eaton Corp., whose boards now want investors to approve the switch at their annual meetings later this month.

The institutional investors had separately identified the 14 potential targets among companies where they hold shares. Cummings had never introduced a declassification resolution before, and the Florida agency hadn't done so in nearly 20 years.

Investors rarely withdraw annual-election resolutions because the company decides to endorse their idea. Fewer than 25% of such proposals offered by stockholders between 2005 and 2010 failed to reach a vote for any reason, including negotiated settlements, according to ISS, a proxy-advisory firm. “The shift reflects a changing culture in the boardroom and directors’ increased efforts at bridge building,” says Stephen Davis, head of the Millstein Center for Corporate Governance and Performance at Yale University's School of Management.

Staggered boards began to stir an investor outcry a decade ago. Nonbinding measures favoring annual elections garnered majority support, on average, every year since 2000, ISS says. The number of Standard & Poor's 500 companies with classified boards has fallen to 139 from 303 in
1998, according to research firm FactSet SharkRepellent. Among them: McDonald's Corp., Best Buy Co. and Juniper Networks Inc.

But now, some companies are embracing annual elections without the impetus of a vote on a shareholder proposal, partly because board members already feel vulnerable: Many major corporations recently adopted rules requiring, for instance, that directors in uncontested elections win a majority of votes cast.

A majority-vote rule at Life Technologies influenced its endorsement of annual elections following talks with Cummings, the investor that submitted this year's resolution at Life Technologies and 13 other companies and won commitments from half of them.

"You can't make a decision about annual elections without taking into account the broader evolution of corporate governance that's taking place" such as majority-voting rules, says John Cottingham, chief legal officer at Life Technologies. However, he cautions, directors "are not governing the company worried about their re-election."

If annual meeting attendees clear the change April 28, the entire board of the life-sciences concern will face yearly re-election starting in 2014. The same timetable looms at Eaton, another target with which Cummings succeeded. The diversified manufacturer holds its annual meeting April 27.

"A classified board may contribute to diminished director accountability," Eaton said in its latest proxy statement. "Many investors believe that the election of directors is the primary means for shareholders to influence policies."

Lance Lindblom, founder and chief executive of Cummings, believes annual board elections "are a big deal because they really affect other governance issues."

Mr. Bebchuk and a colleague at American Corporate Governance Institute LLC, a new research and advisory group Mr. Bebchuk heads, helped Cummings and the Florida agency so each institution could identify 14 businesses for annual-election proposals. The agency, a veteran activist investor, oversees public-employee pension funds with assets of about $150 billion.

Board declassification "could be expected to benefit shareholders by improving firm value and performance," Mr. Bebchuk says.

The Florida agency's resolution "was a catalyst" for Biogen Idec Inc. directors after it previously rejected declassification, recalls Naomi Aoki, a spokeswoman for the biotechnology business. Shareholders will vote on the idea June 2.
If it wins shareholder support, every director will stand for a one-year term starting that day. Their immediate election would be "an even more accelerated time frame than the state of Florida had proposed," Ms. Aoki notes. Three of Biogen's 12 directors represent Carl Icahn, a wealthy activist investor.

This year's push for yearly elections didn't go very smoothly at CME Group Inc., owner of the Chicago Mercantile Exchange. Terrence A. Duffy, executive chairman, and Daniel Glickman, chairman of the board's governance committee, conferred by phone with Cummings and ACGI officials about the resolution in early January, according to a person close to the situation.

Negotiations lasted two months. During that time, CME asked the Securities and Exchange Commission for permission to exclude the proposal from this year's ballot.

The board discussed the declassification resolution and agreed to seek shareholder approval of yearly director contests at the 2012 annual meeting, a CME spokesman says. He declined to comment on who participated in the talks with Cummings and ACGI. The SEC had yet to act when CME settled with Cummings.

EBay Inc. met Cummings halfway. The online-auction company refused to endorse the foundation's 2011 measure. Its board instead expects to complete a review of its classified structure by July, says Kathy Chui, an eBay spokeswoman.

In Mr. Cottingham's view, wider acceptance of annual elections appears inevitable. "Classified boards are going to disappear because that's what shareholders want," the Life Technologies executive predicts.