

# **LINX Governance Review**

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## INTRODUCTION

The LINX Board is proposing some significant changes to LINX's main governance documents at an EGM scheduled during the LINX96 Members' Conference. The details of this review, changes to the Memorandum and Articles of Association, have already been published to members. The changes follow on from previous consultations by the LINX Board of the LINX membership. This document summarises the history of these changes from 2013 when they were first discussed.

## THE NEED FOR CHANGE

As LINX approached its twentieth year, it was becoming apparent that the structure and role of the Board was no longer appropriate to the organisation with over 500 members and a very significant infrastructure. The Board had moved on from its relatively hands-on role in the start-up phase to a supervisory role with an experienced management team, but the structure had not. An external review was commissioned from KPMG, and consideration given to its report.

Most significant was that the process of the election of the Board from a relatively specialised community gave heavy responsibilities to already busy people. Consequently:

- There was no certainty that any of the Board would have the time to devote to the role of Chairman.
- Even if there was an increase in targeting of Board candidates with the skills to ensure the Board as a whole would have the skills to cover the range needed, there was no certainty that those candidates would be elected.
- The processes in place did not help the Board members concentrate on their supervisory role.

Whilst LINX had evolved to have an experienced senior management team who would attend the relevant parts of Board meetings, this did not provide a smooth decision making process. Only one executive, the CEO, was involved as an equal on the Board, which limited the points of view expressed.

## THE JOURNEY

### INTERNAL DEVELOPMENT

The initial phase of change was to move to a more formal timetable for Board involvement in the management of LINX. A formal strategy review, a better protocol for Board meetings and the papers for consideration and a specific annual calendar for major topics were all developed.

### THE CHAIRMAN

The first constitutional change concerned the post of Chairman. It was clear that this was a larger role than the election process could deliver reliably, which in turn led to the proposal that the Chairman should be an independent role, nominated by the Board but ratified by the membership. A consultation with the membership was held, and LINX's M&A amended to allow this to proceed. Our first independent Chairman, Murray Steele, was duly appointed. A key requirement, for which Murray was well qualified, was extensive experience with organisational governance.

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## THE BOARD STRUCTURE

The next stage was to review the Board's structure for relevance and to provide the best performance in the future. Here, Murray's experience of governance matters was a significant help in turning the issues highlighted in the KPMG report into a way forward that fitted LINX and addressed the problems effectively.

The preferred approach was a wider Board, to include both non-executive directors and executive directors. This would bring the required breadth of expertise into the Board and improve the involvement of the senior management team in wider Board decisions. The option of simply including the senior managers into Board meetings as attendees was considered. But it was felt that this would not fully get their involvement, nor would they have the same level of wider responsibility.

A typical mix of executives and non-executives on the Board of a for-profit, shareholder owned company would put the executives in the majority, but the Board was very aware of LINX being a member controlled organisation. The Board was also mindful of other member-led organisations where issues had occurred to lose effective member control. It was felt that the the Board should provide a balance, with the members' elected directors remaining in the majority, and that LINX should also go beyond that by reserving to the elected directors certain controlling powers. Whilst this does offend part of the principle of bringing the managers into the Board as equals, it was felt not to inhibit their sense of full involvement.

This change to the Board was duly put to the LINX membership in a consultation document published in advance of November 2016's LINX Members' Conference, LINX95. In particular, we highlighted in call-out boxes the specific areas we wanted member feedback on. Murray gave a presentation and Q&A on this during the meeting. The response to that, gave the LINX Board confidence that it should proceed and take the changes forward to a resolution at an EGM during LINX96. To do this involved LINX consulting its lawyers on the detailed changes to the M&A necessary – first a briefing on the changes and then a series of refined drafts to ensure that the changes did reflect the Board's brief.

An overview of the changes with links to the original consultation document, an in depth description of how each topic is handled, an article-by-article comparison of all the changes and a "clean" copy of the new M&A is on the website and acts as an index to everything being proposed. This is at: <https://www.linx.net/governance-brief>

A key aspect of reserving certain powers to the elected directors was that this could in some extreme cases lead to conflict. Ideally, where such conflicts were not easily resolvable, the members should make the final decision. However this might not always be possible, for example where the conflict involved matters of commercial confidence with suppliers. This issue was included in the consultation in November, and has since been refined into a section of the M&A. It covers a series of decisions of increasing sensitivity and decreasing likelihood, but should ensure that conflicts ultimately be resolved by the members or their elected directors. A summary of this is attached as a supplement below.

## OTHER AREAS

The review of the Board's processes, and later the review of the M&A, did expose some further areas which the Board felt could be improved

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- The timetable for electing directors meant that many members had already voted by the time of the LINX meeting where the hustings were held – the session where the candidates for election present their statements in person and join in a Q&A with members. The choice was to bring forward the hustings, or to put back the voting period for directors. It was felt less than ideal to have to have a special meeting just for the hustings or to run them as a webcast, so it is proposed to delay voting for LINX directors until after the hustings.
- Some years ago, a term limit of nine years was introduced for the elected directors, requiring them to take a break of one year before being able to stand for election once more. This was felt not to have achieved the desired aim of ensuring a sufficiently refreshed Board, and it was proposed to increase the break to three years for directors who had run the full nine, and two years if they had been in office for six.
- The rule governing the election of a director to replace a director who retires early could lead to a short term of office. A simple mechanism to work around this has been introduced, and will ensure that any director will know the length of their term when they are elected.
- The consultation in November 2016 agreed that LINX would use the review of the M&A detail to update the M&A to be a more modern document where this was possible. In addition, when reviewing its detail some areas were found not to have been updated in line with LINX's practice, for example the process of a new member joining LINX. Both of these were also addressed following our lawyer's advice.

### THE DECISION

The proposal to adopt the new Memorandum and Articles of Association will be voted on during the EGM held as part of LINX96 on Tuesday 21<sup>st</sup> February 2017.

This is an important resolution as LINX Board believes it will improve the governance of LINX. This document recaps the process over the last three years that has resulted in this proposal. More detail on the recent consultation is given in the referenced documents:

<https://www.linx.net/governance-consultation> and  
<https://www.linx.net/governance2017>

As part of the first day of LINX96 on Monday 20<sup>th</sup> February, the LINX Board will be holding a panel session devoted to these changes. You will be able to participate in this either in person by attending LINX96 in London or remotely as the session will be webcast and you will be able to put questions remotely.

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## **SUPPLEMENT – CONFLICTED DECISIONS BETWEEN EXECUTIVE AND NON-EXECUTIVE**

This supplement sets out how a motion before the Board would be treated under different scenarios, being different levels and sources of support for the motion. Please refer to the decision tree below for a flowchart of how the process might develop.

### **SCENARIO 1: UNANIMITY**

If all Board members support the motion, it carries.

### **SCENARIO 2: LONE, OR ONLY TWO, DISSENTERS**

If there are only two directors that oppose the motion, it carries.

### **SCENARIO 3: ELECTED NEDS UNITED IN FAVOUR**

If the six elected NEDs vote for a motion, that constitutes a majority on the Board. There being no applicable mechanism to block it, the motion carries.

### **SCENARIO 4: ELECTED NEDS UNITED IN OPPOSITION**

If the six NEDs are opposed to the motion, that still constitutes a majority on the Board. The motion fails.

### **SCENARIO 5: ELECTED NEDS ARE SPLIT, CHAIR AND EXECUTIVE IN FAVOUR**

If three of the elected NEDs join with the CEO and the Chair to support a motion, that constitutes a majority. The motion will carry.

However, the three dissenters will have the opportunity to exert their special reserved power. This gives rise to sub-scenarios:

#### **Scenario 5a. Dissenting NEDs accept defeat**

It is possible that the dissenting NEDs will take the view that this is a legitimate difference of opinion and respect the position of their fellow directors. They may feel that in such circumstances it is inappropriate to seek to override the Board majority: after all, the special reserved power to stay the decision was put in place to protect the interests of the membership and preclude an “executive takeover”, not to ensure that any particular NED’s view should prevail. If half the NEDs support the motion, this isn’t a conflict between the elected NEDs on behalf of the membership and a rogue executive, but a difference of opinion between directors as to how the membership’s interest is best honoured.

In such circumstances, the dissenting elected NEDs may decide that it is inappropriate to exercise the power they have to stay the decision. If that happens, the Board’s decision will take effect.

#### **Scenario 5b. Dissenting NEDs exercise reserve power.**

With three elected NEDs opposing the motion, they have the power to stay (i.e. veto) the decision even though half the NEDs and the executive support it.

#### **Scenario 5b(i) The motion is “stayed”, and does not go into effect.**

If the three dissenting NEDs choose to exercise their special power, the Board as a whole must decide whether to refer the matter to the membership for ratification. The Board may decide not to do so. The Board’s reasons for not referring to the membership may well vary according to the particular circumstances; they may think that the decision is finely balanced, and choose to defer; they may be embarrassed by their failure to find consensus, and deem the reputational risk more serious than the substantive issue.

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Whatever the Board's reasoning, if it does not refer the decision for membership ratification then absent the Chair's intervention, the motion will be stayed; whatever was proposed in the motion will not happen.

### **Scenario 5b(ii) Reference to membership for ratification**

If the Board chooses to refer the matter to the membership, it must table a resolution at the next General Meeting (either as scheduled, or perhaps to call a General Meeting). The members will then vote on the resolution. The member's resolution takes priority in instructing the Board: an appropriately drafted resolution, if approved by the membership, will instruct the Board to carry out the proposal in the motion that way stayed, overriding the veto exercised by the elected NEDs. On the other hand, if the membership decline to pass the resolution, the veto stands and the Board may not carry the motion into effect.

### **Scenario 5b(iii) Chair believes the motion cannot be put to the membership for ratification**

If the Board declines to put the motion to the membership for ratification, it might be because doing so would be illegal. The most likely reason for this would be that the subject matter of the motion is something that the Board has a legal duty to keep secret or confidential, and disclosing it to the membership would breach that duty.

There are numerous examples where the Board might be in internal dispute about a secret matter. For one example, the Board might be arguing about whether to comply with a secret order from the government or to challenge it in court. Some such secret orders come with a legal duty of secrecy, such that it would be a criminal offence to disclose to the membership that it had been made. To place such a controversy in the membership's hands for their decision would expose Board members as well as LINX corporately to criminal sanction.

For another example, the Board might be arguing about whether to choose one vendor or another, based upon promises that have been made to them about forthcoming products the vendors have disclosed under NDA. To tell the members about these products before they are announced by the vendors and the NDA lifted would be a breach of confidentiality. So that necessary background could not be disclosed to the membership as part of a ratification procedure.

Whatever the precise circumstances, if the Chair decides that the Board would have wished to put the issue to the membership for ratification but was prevented because doing so would have been unlawful, the Chair has the power to lift the stay and allow the majority decision of the Board to go into effect.

NB: The Chair does not *have* to lift the veto, it is a matter for his discretion.

**In this scenario, the mantra “the elected NEDs, as representatives for the membership, should prevail” does not work: the elected NEDs are split on what best to do. Worse, it is impossible to ask the membership to resolve the dispute. We therefore turn to the independent Chair as the arbiter of last resort.**

If the Chair chooses to lift the veto, the elected NEDs still have the option of sacking the Chair. The Chair, CEO and Executive Directors will not get to vote on that.

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### **Scenario 5b(iv) Chair believes blocking the motion would result in LINX breaking the law or suffering catastrophic harm**

In this scenario, we also have a situation where a motion is supported by a majority of the Board, including some of the elected NEDs, but half the elected NEDs oppose it and have exercised the veto.

It is possible that the failure to approve the motion would cause LINX to break the law, or would otherwise be truly disastrous. If the independent Chair believes that is the case, he also has the power to lift the veto. The Chair will know that if he does so, he risks being sacked by the elected NEDs, but he may feel that it is his duty even if that is the consequence.

The alternative to giving the Chair this power, risks a situation where a minority of the Board force the company into unlawful behaviour. Under such circumstances, it is likely that the majority of the Board would feel compelled to resign, leaving the company under the control of the minority of directors who chose to take the legal risk.

In the event of the Chair being dismissed, both as Chair and as a director of LINX, the Board as their first act must elect one of the directors to act as Chair. As the Elected NEDs have the power to dismiss any future Chair as well, it would be futile for the majority to attempt to impose one that would extend the dispute. This process therefore ultimately forces the competing elements of the Board to compromise with each other.

### **SCENARIO 6**

In this scenario, the elected NEDs have exercised the power to stay the motion, and the Chair has exercised his power to lift that stay, claiming that the stay would cause LINX to act unlawfully. The elected NEDs may choose to accept that this is the Chair's responsibility to undertake. Alternatively, they may choose to sack him for it.

If 50% of the elected NEDs vote to dismiss the Chair, he is sacked; neither the Chair, the CEO nor the Executive Directors get to take part in that vote.

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## DECISION TREE

