

2004 Governance Review

Options and scenarios for the Nominet board

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1. Introduction

1.1 What has been done

This document has been prepared following extensive discussions of corporate governance at board meetings over the past year. It has also taken into account the feedback given by the Policy Advisory Board members in their one-to-one interviews with the chairman.

The paper documents the final decisions made at the board meeting on 24 August based on the chairman's recommendations to that meeting.

The paper re-states clearly the mission and objectives of Nominet and summarizes the framework underpinning and the component parts of a governance system for the company. It addresses the structure of the board and methods of election/selection of non-executive directors. By way of background, it discusses the options for each component and presents the range of outline scenarios which the board considered in reaching its decisions.

A timetable for the implementation of the changes is also given.

The PAB is asked to consider the decisions of the board and provide feedback in order that a paper can be published for final and wider consultation early in 2005.

1.2 What still needs to be done

Further aspects of Nominet's governance structure remain to be addressed and will be dealt with in the next stages of the governance review.

For now, this paper assumes some form of membership model. The form, number and nature of the members require further study. The board has already decided that membership and tag-holder fees should independently be on a cost-recovery basis. The board has also agreed that the tag holders' agreement should be objective and standards-driven. In themselves, both of these decisions could change the nature and number of members and tag holders.

Secondly, consideration of the "thick/thin" registry/registrar model also needs further debate and discussion. This is essentially concerned with the business relationships between the tag holders and Nominet rather than a true integral part of the governance structure. However, one of the strengths of Nominet has been the tight coupling between tag holders and members, reflecting the principle that governance influence should be based (but not exclusively so) on economic involvement with the company. It is important, therefore, that this business relationship be considered as part of the overall governance review.

Given the imminent change of Nominet's chair, the target for these two further areas is not yet certain but would certainly be required before any changes to the Memorandum and Articles of the company could be made (unless the issue of board composition is addressed separately) by way of an Extraordinary General Meeting, hopefully, in early to mid-2005.

2. Summary of Board Decisions

The board agreed that *Scenario C: Combining election with appointment* offered the best fit to Nominet's needs.

It was agreed that three-year terms would be more effective than the present two-year terms and that the board be increased to six non-executive positions, of which the members would elect three and a Nominations Committee would appoint three.

It was agreed to create a Nominations committee consisting of the chairman and two non-executives (who are not involved in the particular annual cycle). The committee will be supported by the Company Secretary and would take appropriate professional recruitment advice.

It was agreed that limitation in tenure should only apply to appointed non-executive directors since the voting membership could act to limit the terms of the elected non-executive directors as they see fit.

It was agreed to make *no* changes to the voting mechanism or cap for the time being, pending further review as part of the membership/tag-holder study.

The outline annual timetable in section 5.5 was approved in principle so that the election/selection is concluded in advance of and distinct from the AGM resolutions appointing the directors.

The board agreed in principle to move to electronic balloting, subject to security concerns being addressed. There would need also to be assurances that votes would be cast at the appropriate level within member organizations.

3. Process followed

It was decided at the outset that we could not move immediately into discussion about detailed changes without first determining a common framework that could be used to evaluate the impact of any changes. The key points of this framework are presented in section 4.

The next step was to look at the individual issues/areas of change and consider the reasons for and against such change. These components and the associated reasoning is presented in section 5.

The final step was to take these options and build some fleshed out scenarios that could be used to help build a full picture of the impact of a suite of changes. These are summarized in section 6.

4. Background agreed framework

The board reviewed Nominet's mission and its corporate and strategic objectives. It agreed the following:

- Mission
 - “Nominet's purpose is to control, manage and operate the *.uk* country code top level domain and provide complementary registry services in the interests of the relevant stakeholder communities.”
- Corporate Objectives
 - Efficient
 - Non-discriminatory
 - Cost-recovery not profit-oriented business model
 - Technical and service excellence
- Corporate Constraints
 - Ensuring effective management of the domain does not either hinder a competitive market place between members/tag holders, nor risk non-compliance with competition law
 - Maintaining a specific business focus
 - Avoiding onerous regulation
 - Dealing with behaviour of some members which has an adverse effect on the interests of the Internet community
 - Balancing the economic interests of the members
 - Degree/kind of trust placed by members on the board
- Governance Objectives
 - Corporate effectiveness
 - Transparency
 - Legitimacy
 - Checks and balances
 - Protection against capture
 - Inclusiveness

5. Component parts of corporate governance system

The key elements of the corporate governance system that the board considered, and the choices relating to them, are listed in this section.

5.1 Change or not

The first issue considered by the board was whether there was a need for dramatic change to the board selection process, or whether the current concerns, particularly regarding the voting system, could be addressed by relatively small changes to the existing system. Two possible minimal change scenarios which were considered are outlined in section 6.1.

5.2 Use of a nomination committee

It was considered important to explore whether a more substantial change might be more appropriate for this stage in Nominet's development, the most likely mechanism for which would be the creation of a Nomination Committee. This would potentially give Nominet access to a wider range of skills and expertise, and scope to fill in any recognised gaps within the board but its use would have particular implications for the extent to which Nominet members could influence decision-making at board level. However, some form of Nomination Committee would help to overcome inertia among the membership in terms of proposing new candidates for election. Publication of the selection criteria would also help to answer concerns about transparency.

5.2.1 Composition of the nomination committee

A key consideration related to the composition of any nomination committee. The following categories of individual could be drawn upon for membership of a balanced, workable and responsible Nomination Committee. The pros and cons of each were debated.

5.2.1.1 The chairman

- Pros: knowledgeable about performance of current board and skill sets required
- Cons: lack of transparency, susceptible to allowing capture by 'allies', already captured by being one person, weak legitimacy

5.2.1.2 The non-executives who are not standing down

- Pros: knowledgeable about performance of current board, accountable themselves to the members
- Cons: lack of transparency, potential for capture, weak legitimacy

5.2.1.3 A set drawn from the largest tag holder members

- Pros: would ensure stability of the company, would represent bulk of economic support
- Cons: capture by a particular stakeholder group, transparency and legitimacy to whole membership

5.2.1.4 A selection of large, medium and small tag holder members

- Pros: representative of the whole membership, checks and balances as a counter to capture by any one group
- Cons: how to select participants - a random selection could lead to lack of commitment or outright refusal to participate; an election would simply push the problem to yet another level and not be very efficient; it could suffer from all the perceived problems of the current system

5.2.1.5 Totally independent 'good and great' individuals

- Pros: independence, protection against capture
- Cons: possibly little knowledge of the company, the requirements of its board and the skill sets needed, questionable commitment (would presumably need to be paid), questionable legitimacy or transparency

5.2.1.6 A recruitment agency

- Pros: professional, independent
- Cons: possibly little knowledge of the company, the requirements of its board and the skill sets needed, 'detached' commitment to the company, questionable legitimacy or transparency

5.3 Output of the nomination committee

If a Nomination Committee were to be used, its role would have to be determined. It could be requested to generate either of the following outputs:

5.3.1 To choose board members

This would be beneficial in ensuring that any recognised gaps with the board were filled and that the overall board composition offered a balanced, wide range of skills and expertise. Although it could be time-consuming for the Nomination Committee, who would have to take soundings and investigate potential candidates, removal of the election element potentially shortens the external process (see table 5.5.2 below).

5.3.2 To choose a slate of candidates for election

This would combine access to a wider range of candidates with the involvement of the members in voting for the non-executive members of the board.

5.3.2.1 Benefits

- The membership would feel re-enfranchised by giving it the last say. In addition they would be pleased that the vetting process would improve the overall quality of the candidates and information available on them.
- It would retain a measure of transparency to the process even though the initial vetting and selection would have taken place behind closed doors.
- It would give the members the opportunity to effect a gradual change in board membership over a number of years.
- It would help persuade the membership that the potential weaknesses of the existing process would be outweighed by the introduction of some management of the process.
- It would reduce personal risk to those involved in the selection process in that the members would have the final say.

5.3.2.2 Risks

- It would still leave the possibility for election of an unbalanced board unless *all* candidates on the 'slate' are chosen to fill particular needs and the members select the right mix of candidates.
- It would still leave the complications and uncertainty surrounding the election process.
- It could lead to those involved in the selection process not taking the job so seriously as the risk is offloaded on the membership for the final selection.
- It would be less efficient, i.e. is less managed

5.4 Board composition

From the start, Nominet's board has consisted of two executive directors supported by four elected non-executive directors. Clearly the governance review had to consider both the size and balance of this formula.

5.4.1 Balance between executives and non-executives

Although advisers Burson Marsteller (BM) (in a long telephone consultation with the chairman) pointed out that Nominet is unusual in having a majority of non-executives, there also appeared to be little impetus for change. The current composition was originally introduced because of Nominet's membership model and the need to be perceived as acting as a trustee of the .uk namespace on behalf of the Internet community as a whole. This rationale still stands.

5.4.2 Increase in board size

However, the advisers also indicated that the current board is small for an organisation of its size, and expansion would benefit Nominet by enabling the remuneration and audit committees to be independent of each other. It would also increase the range of perspectives available to Nominet. However, there would be a need to balance the wider experience, skills and knowledge that expansion would achieve against the potential for decision-making to become unwieldy and difficult. Options considered for expansion included the election of additional candidates, appointment of additional members or the inclusion of the company secretary or members of the current senior management team (bearing in mind the strongly held need to maintain a majority of non-executives).

It was agreed that whatever decisions were taken about the size and composition of the board, it was essential that Article 26 of Nominet's Memorandum & Articles of Association be changed to allow for future flexibility, i.e. the inclusion of "at least" in front of the number of both executive and non-executive directors.

5.4.3 Term of office

The present term of office of two years has been criticised as only just permitting a non-executive to get to grips with the job. Three years was suggested as a better period. To avoid elections/appointments at non-yearly intervals, such a change would work better with an increase in non-executive numbers to a multiple of three, and this option was included in the majority of the scenarios in section 6.

5.4.4 Tenure

The question of tenure of non-executive directors has been debated among the members for some time. Suggestions have been made that this should be limited to two consecutive terms of three years or three consecutive terms of two years with some consideration of returning after a suitable break (e.g. of at least one term). In certain circumstances, this might be overridden as long as a suitable explanation was made to both members and stakeholders (the comply or explain principle). Limitations in tenure would be less important if those making the decision could adopt their own views on appropriate tenure. However, even in those cases a policy decision to limit tenure would remove any feelings of embarrassment for re-standing candidates and also those making the decisions.

5.5 Process and timings

5.5.1 Declarations by candidates

There was little dissent about the principle that all candidates, whether for appointment or election to the board, should be required to make declarations regarding their skills, availability, independence and interests.

5.5.2 Change to current timings

Consideration was given to the feedback received from members that the current voting system was confusing, particularly regarding proxies to the Annual General Meeting. The timing of the announcement of the election results was criticised for not fitting in well with the AGM. Some changes, therefore, had to be considered concerning the current process timings. In order to be able to declare the results of the election and/or allow a resolution at the AGM to confirm the new board members, the following table was developed for the steps and the likely time required.

Where either type of election is used		Where appointment without election is used	
<i>Steps in the process</i>	<i>Timing</i>	<i>Steps in the process</i>	<i>Timing</i>
1. Call for nominations (or formal invitation to be considered for appointment to slate)	AGM-12 wks	1. Formal invitation to be considered for appointment	AGM-8 wks
2. Candidate statements and declarations (and interviews for potential appointees)	AGM-9 wks	2. Interviews and declarations from potential appointees	AGM-6 wks

3. List of candidates and ballot papers issued electronically	AGM-7 wks	3. Announcement of chosen appointees and publication of their statements	AGM-4 wks *
4. Interaction with candidates, whether online or by hustings	AGM-6 wks	4. Resolution(s) put to AGM	AGM
5. Online voting	AGM-5 wks	5. If resolution(s) not passed by AGM, the meeting is adjourned by the chair to see if acceptable alternative candidate(s) can be found	
6. Announcement of results	AGM-4 wks *		
7. Resolution(s) put to AGM	AGM		
8. If resolution(s) not passed by AGM, the meeting is adjourned by the chair to see if acceptable alternative candidate(s) can be found			

* to allow for a confirmatory resolution to be brought to the AGM with the appropriate notice and to give at least one week for a wildcard candidate to be put forward by members at the AGM following the requirements of the Companies Act.

Separating the selection and/or election of non-executives from the AGM resolutions appointing them, and bringing the election process forward in this way would clarify the current confusion about the role of proxies appointed for the AGM. The whole wording of the proxy and corporate representation forms would also need to be changed to clarify and simplify the process.

6. Scenarios

Five scenarios considered by the board are presented here for consideration. They represent possible models of corporate governance, which combine the above components in a variety of ways, any of which would be workable for Nominet at this stage in its development. Each was put together in such a way as to offer a balanced model, but leaving the possibility to 'mix and match' components if alternative options might be preferred. Each model's advantages and disadvantages, based on feedback from a number of sources, were discussed and are documented here.

6.1 Minimal change

While there is agreement that the current system needs at least some repair, this scenario stays with the current system as its basis but offers some changes to overcome the perceived shortcomings. It therefore represents minimal disruption for Nominet, its board and its members, but could be open to the perception that nothing significant has changed.

6.1.1 Scenario A1: Change current voting system

- Board members
 - 2 executive members
 - 4 non-executive members
- Selection mechanism(s) for the non-executives
 - Nominet membership openly nominate a slate; re-standing current board members require a member to nominate and second them, no statement from the board concerning them; election by the full membership using STV
 - Candidates produce a statement and declarations of skills etc
 - Either use the current weighted voting system but with a reduced cap (from 10% to 5% or 3%), one-member-one vote, or a form of weighted voting with less of a range between largest and smallest members
 - Two appointed each year for a two-year term
 - Optionally introduce tenure limitation to three terms of two years
- Advantages
 - Members are familiar with it
 - Represents the least change (and therefore least disruption)
- Disadvantages
 - Would probably limit the pool of candidates to those known to Nominet members
 - Possible imbalance of skills and experience
 - Possible 'wildcard' candidates

6.1.2 Scenario A2: Change current voting system and increase size of board

As above, but increasing the number of non-executives to six (and concomitantly the term of office to three years).

- Additional advantages
 - Gives scope for the remuneration and audit committees to be independent of each other, in line with best practice
 - Allows non-executives more time to get up to speed and make a contribution to the workings of the board
 - Coincidentally aligns tenure with the two terms of three years recommended by Higgs
 - Potentially broadens the skills, knowledge and expertise available to the board
 - Represents enough of a change for it to be noticed but limits any disruption by being similar to current system

6.2 Use of a nomination committee

These scenarios represent a more significant change from the current system, moving to a more managed process for appointing non-executives by whichever type of nomination committee is preferred, and therefore raising some issues around transparency and democracy. However, this is more in line with the way in which boards are chosen in the private sector. These scenarios also include increasing the term of office to three years and thereby the number of non-executives to a multiple of three.

6.2.1 Scenario B1: Appointment to a slate for elections

This scenario proposes using a nominating committee to choose the slate of candidates, from which Nominet members then elect the non-executive directors.

- Board members
 - 2 executive members
 - 6 non-executive members
- Selection mechanism(s) for the non-executives
 - Appointment to the slate of at least 4 candidates by the nominating committee (after advertising and/or taking soundings from membership and stakeholders throughout the year; possibly also interviews with the nomination committee)
 - Candidates produce statements and declarations
 - Election by the Nominet membership using STV
 - Either use the current weighted voting system but with a reduced cap (from 10% to 5% or 3%), one-member-one vote, or a form of weighted voting with less of a range between largest and smallest members
 - Two elected each year for a three-year term
 - Optionally introduce tenure limitation to two terms of three years
- Advantages
 - Permits the choice of candidates based on more objective criteria regarding skills, experience etc.
 - Gives scope for the remuneration and audit committees to be independent of each other, in line with best practice
 - Allows non-executives more time to get up to speed and make a contribution to the workings of the board
 - Potentially aligns with the two terms of three years recommended by Higgs
 - Retains the involvement of Nominet members
- Disadvantages
 - Open to criticisms re cronyism
 - Potentially reduces the pool of candidates to those known by the nominating committee

6.2.2 Scenario B2: Direct appointment

This scenario removes elections from the process, thereby simplifying it but opening it up to challenge regarding both transparency and democracy.

- Board members
 - 2 executive members
 - 6 non-executive members

- Selection mechanism(s) for the non-executives
 - Appointment by the nomination committee (after advertising and/or taking soundings from membership and stakeholders; possibly also interviews with the nomination committee)
 - Two selected each year for a three-year term
 - Candidates produce statements and declarations
 - Resolution (bearing two nominated candidates) put to the AGM for ratification
 - No particular need for limitation on tenure, although some norm should be indicated since the small nomination committee could be susceptible to accusations of bias

- Advantages
 - Permits the choice of candidates based on more objective criteria regarding skills, experience etc.
 - Allows gaps recognised by the board (but not necessarily seen by members) to be filled
 - Gives scope for the remuneration and audit committees to be independent of each other, in line with best practice
 - Allows non-executives more time to get up to speed and make a contribution to the workings of the board
 - Potentially a shorter process

- Disadvantages
 - Removes the direct involvement of Nominet members, which would probably be perceived negatively
 - Not transparent
 - Open to criticisms re cronyism
 - Potentially reduces the pool of candidates to those known by the nominating committee

6.3 Scenario C: Combining election with appointment

This scenario combines the democratic benefits of election with those of direct appointment, helping to balance the skills and experience of the resulting board. It also increases the size of the board. The two processes would need to be run in parallel, so that both the elected and the appointed member could be put to the AGM for ratification at the same time.

- Board members
 - 2 executive members
 - 6 non-executive members

- Selection mechanism(s) for the non-executives
 - 3 appointed by the nomination committee (after advertising and/or taking soundings from membership and stakeholders; possibly also interviews); prepare statements and declarations; resolution put to the AGM for ratification
 - 3 elected by Nominet members. Nominet membership openly nominate a slate; re-standing current board members require a member to re-nominate and second them, no statement from the board concerning them;
 - Voting using STV and the current weighted voting system but with a reduced cap (from 10% to 5% or 3%), one-member-one vote, or a form of weighted voting with less of a range between largest and smallest members
 - 1 of each selected each year for a three-year term
 - Optionally introduce tenure limitation to two terms of three years

- Advantages
 - Retains direct involvement of Nominet members in the election of some of the non-executives
 - Permits the choice of some candidates based on more objective criteria re skills, experience etc.
 - Allows gaps recognised by the board (but not necessarily seen by members) to be filled
 - Gives scope for the remuneration and audit committees to be independent of each other, in line with best practice
 - Allows non-executives more time to get up to speed and make a contribution to the workings of the board
 - Potentially aligns with the two terms of three years recommended by Higgs
 - Avoids capture by either large members, 'wildcard' candidates or 'pet' appointees
 - Easier for members to understand the implications of STV i.e. that they are voting for a single candidate each year

- Disadvantages
 - Could be seen as unnecessary duplication of effort

7. Summary of the board's deliberations

Consideration was first given to the broad scenarios in section 6. These scenarios were not presented as exclusive choices, rather as examples of new structures to help focus in on the details.

Feedback suggested that it is unlikely to be acceptable to remove the transparency associated in the members' and stakeholders' minds with the freedom to nominate and elect at least some of the board. This would eliminate scenario *B2: Direct appointment*. However, almost all to whom the chairman spoke accepted that imbalances might occur with the current scheme and would accept a part-appointed board. This would encourage a move to either *Scenario B1: Appointment to a slate for elections* or *Scenario C: Combining election with appointment*.

With respect to *Scenario B1: Appointment to a slate for elections*, it was considered that difficulties might be met in approaching potential, senior, non-domain-name-industry candidates to accept a nomination if the consequence is having to put their name on an electoral slate with a range of others. It is also important that it is the nomination committee which manages the process of balancing the experience and skills required for the board otherwise it might be susceptible to the vagaries of the current voting system. This suggested rejection of *Scenario B1: Appointment to a slate for elections*.

The board agreed therefore that *Scenario C: Combining election with appointment* offered the best fit to Nominet's needs.

Advice had been received from professionals in corporate governance and encouraged by member and PAB discussions that the board is smaller than would be expected of a company at Nominet's stage of development. However, few would support boards of greater than 12. It is also important to remain in line with good governance practice to separate the membership of the remuneration and audit committees. This has also the advantage of requiring each of the sub-committees to report and explain to the full board and to spread the load across more individuals.

It is clear that three-year terms allow for a more productive use of a non-executive after initially taking some time to get up to speed.

It was agreed therefore that three-year terms would be more effective than the present two-year terms and that the board be increased to six non-executive positions, of which the members would elect three and a Nominations Committee would appoint three.

After consideration of the pros and cons of who might be members of a Nominations Committee, it was agreed to create a Nominations committee consisting of the chairman and two non-executives (who are not involved in the particular annual cycle). The committee would be supported by the Company Secretary and would take appropriate professional recruitment advice. It was felt that this combination would give the most transparent and stable mechanism to ensure the appropriate balance of skills and experience to complement the elected members.

The board discussed the pros and cons of limiting tenure of directors. It was agreed that limitation in tenure should only apply to appointed non-executive directors since the voting membership could act to limit the terms of the elected non-executive directors as they see fit, whereas the Nomination Committee should have clear guidelines on limiting tenure, for example, to a maximum of two appointments of three years each.

The outline annual timetable in section 5.5 was also approved in principle so that the election/selection is concluded in advance of and distinct from the AGM resolutions appointing the directors. It also permits the appropriate notices to be given under the Companies Act.

The board agreed in principle to move to electronic balloting, subject to security concerns being addressed. There would need also to be assurances that votes would be cast at the appropriate level within member organizations.

8. Timetable for implementation

The following is the timetable to be followed to complete this part of the governance review.

Action	When
Board decision on which option(s) to pursue	August 2004 meeting
Present board decision to the PAB	Oct 2004 meeting
Feedback from the PAB	Dec 2004 meeting
Member consultation	Jan/Feb 2005
Develop self-assessment/declaration forms	Jan/Feb 2005
Announce EGM and distribute voting papers	Early - mid-2005
EGM, changes to Articles or by-laws as required	tbd
Introduction of the new system	If possible in advance of 2005 elections/AGM