

Legal Updates & News

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Divided SEC Approves NYSE Amendment to Eliminate Discretionary Broker Voting in Uncontested Director Elections

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On July 1, 2009, the Securities and Exchange Commission (the “SEC”), in a vote divided along party lines, approved an amendment to New York Stock Exchange Rule 452 that will eliminate discretionary voting by brokers in uncontested director elections.^[1] Effective January 1, 2010, a broker will no longer be permitted to vote on behalf of a shareholder in any uncontested election for directors, unless the broker receives timely voting instructions from the shareholder.^[2]

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Background

Under the federal proxy rules, brokers holding shares on behalf of shareholders are required to submit corporate proxy materials to such beneficial owners in advance of a company’s scheduled shareholders’ meeting. Pursuant to rules of the New York Stock Exchange (the “NYSE”), brokers are required to receive voting instructions at least 10 days prior to the meeting. If no voting instructions are issued, brokers may use their discretion to vote the shares on “routine” matters. The NYSE has not defined “routine” in this context, but has identified certain circumstances which do not constitute “routine” matters. NYSE Rule 452.11 lists 18 examples of non-routine matters, including a contested election of directors. An uncontested director election, however, has long been considered to be a routine matter upon which brokers could cast votes in the absence of instructions from shareholders.

The amendment to NYSE Rule 452 concerning broker votes in director elections was first proposed in October 2006, based on the recommendations of the NYSE’s Proxy Working Group, as well as the NYSE’s own conclusion that the election of directors should no longer be deemed to be a routine matter.

On February 26, 2009, the NYSE resubmitted the proposal, as modified by four amendments. The SEC solicited comments on the proposal and received well over 100 comment letters during a short 30-day comment period.

Changes to NYSE Rule 452

As amended, NYSE Rule 452.11 will include an uncontested election of directors in the enumerated list of non-routine matters (except with respect to registered investment companies). All shareholders' meetings of public companies held on or after January 1, 2010 will be subject to amended NYSE Rule 452.

Public companies may face new challenges as a result of the amended rule. The NYSE's Proxy Working Group had acknowledged that changes to the requirements regarding broker votes may result in significant costs for companies that have a large retail shareholder base or receive a high percentage of broker-voted shares. Without discretionary broker votes, voting rates are likely to fall, resulting in increased shareholder outreach costs for such companies. Some companies may have difficulty obtaining a quorum, unless the agenda for the shareholders' meeting also includes at least one routine matter (such as the ratification of auditors), so that discretionary broker votes could be counted towards a quorum.

Impact of Other Recent Changes and Proposals Related to Director Elections

In addition to the NYSE Rule 452 amendments, other developments related to director elections are significantly changing the landscape for the 2010 proxy season. The SEC recently proposed a new Rule 14a-11, which, if approved, will provide certain shareholders with the right to include director nominees in the company's proxy statement.^[3] Similarly, the Delaware state legislature recently amended that state's corporate law to allow companies to adopt bylaws that would set forth procedures by which shareholders would be permitted to nominate directors to be included in a company's proxy statement.

These developments may take on even greater importance when companies consider the declining voting turnout among retail shareholders experienced as a result of the adoption of e-proxy requirements. With the loss of discretionary broker voting in uncontested director elections, it may be very difficult and expensive for some companies to obtain a majority vote for incumbent or management-supported directors. As such, amended NYSE Rule 452 may be seen as placing special interest groups, activist shareholders and institutional investors in a stronger position to mount opposition efforts. We can expect to see at least a pause in the trend of companies adopting majority voting standards as the impact of the recent and potential changes to the director election process are considered.

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In light of the many recent and proposed changes to the director election process, including the elimination of broker votes, the proposed shareholder access rules under consideration by the SEC, the amendments to Delaware corporate law, the problems encountered with the use of the e-proxy and the adoption of majority voting standards by an increasing number of companies, the 2010 proxy season promises to raise many unique problems for public companies. Public companies and their advisors should begin preparing for next proxy season now, by carefully assessing recent voting trends and shareholder demographics, and developing strategies for increasing shareholder participation in director elections.

Footnotes

^[1] The SEC's press release, "SEC Proposes Measures to Improve Corporate Governance and Enhance Investor Confidence," dated July 1, 2009, is available at <http://www.sec.gov/news/press/2009/2009-147.htm>. At the same meeting, the SEC also proposed rules (1) regarding enhanced compensation and corporate governance disclosures and (2) to implement the requirement that companies participating in the Treasury Department's Troubled Asset Relief Program include a proposal in their proxy statements seeking an advisory vote on executive compensation. For our discussion of the proposals related to compensation and corporate governance disclosures, see "[SEC Proposes Rules to Enhance Compensation and Corporate Governance Disclosures](#)."

^[2] The amendment to Rule 452 is not applicable to companies registered under the Investment Company Act of 1940.

[3] For our discussion of the SEC's proposals related to shareholder access to a company's proxy statement for director nominations, see "[SEC Issues Proposing Release for Rules to Permit Shareholder Access to a Company's Proxy Statement for Director Nominations.](#)"