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## SEC approves NYSE Rule change regarding Broker Non-Votes

The Securities and Exchange Commission (SEC) recently approved a New York Stock Exchange (NYSE) proposed amendment to NYSE Rule 452 to prohibit broker's from exercising "discretionary voting" in all director elections. The amendment will apply to shareholder meetings held on or after January 1, 2010. Importantly, the NYSE Rules apply to NYSE member brokers in all of their discretionary voting activities, including voting for publicly -traded companies whose shares are not listed on NYSE. The amendment does not apply to companies that are registered under the Investment Act of 1940.

### NYSE Rule 452

NYSE Rule 452 authorizes NYSE member brokers to cast votes in the broker's discretion for certain "routine" matters on behalf of "street name" shareholders who do not return the proxy card to the broker within 10 days prior to the shareholders meeting. Routine matters according to Rule 452 include any matter where the action to be taken is (i) adequately disclosed to the shareholders and (ii) does not include authorization for a merger, consolidation or any other matter which may affect substantially the rights or privileges of the stock. Under the existing Rule 452, brokers have been permitted to exercise their discretion to vote the shares of retail shareholders in an uncontested director election if the retail shareholder did not provide any instruction to the broker about how to vote. The amendment to NYSE Rule 452 prohibits brokers from voting the shares of retail shareholders in either contested or uncontested director elections unless the broker has instructions from the retail shareholder about how to vote.

Historically, the broker discretionary votes authorized by NYSE Rule 452 have amounted to a significant percentage of votes cast. According to RiskMetrics Group, approximately 80 percent of investors own their shares through brokers, and only one-third of retail voters vote their shares. Broker discretionary votes in uncontested director elections were generally voted in favor of the management slate.

### Practical considerations

The amendment has several practical implications:

- Eliminating broker discretion to vote in director elections will make it easier for activists to unseat sitting board members by reducing the number of votes cast in favor of directors. Rather than

propose a competing slate of directors, in companies with majority vote requirements, shareholder activists will have the option of unseating a director with a "just vote no" campaign.

- Companies that have adopted a majority vote threshold for the election of each director will be impacted by the amendment to NYSE Rule 452 as it will be more difficult for companies to secure the required majority vote. The amendment may make necessary increased proxy solicitation activity and expense to ensure that sufficient votes are cast by the street name holders to effect the election of directors. Companies that have not adopted a majority vote threshold for directors may want to delay to consider the practical implications of the Rule 452 amendment on their corporate governance activities.
- The inability of brokers to cast discretionary votes may impact a company's ability to establish a quorum for a shareholders meeting. If there are no "routine" matters to be voted upon, brokers may not submit the proxies and companies may have difficulty establishing a quorum. Companies may want to add "routine" matters to their proxy statements in order to establish the presence of enough shares to meet its quorum requirement.
- Companies that have a high percentage of their shares held in "street name" may need to take additional steps to educate their street name holders concerning their right to vote their shares. Appropriate steps may include: paying for telephone or additional solicitation services, evaluating options to simplify the voting procedure, providing for more time between proxy mailing and the meeting date, revising proxy disclosure to emphasize the importance of "street name" votes, simplifying the proxy disclosure to facilitate review, providing additional soliciting materials to encourage increased voting.

#### **Other limitations on Broker Discretionary Votes**

In addition to the amendment prohibiting broker discretionary voting in director elections, the supplementary notes to NYSE Rule 452 set out a non-exclusive list of 18 types of proposals that a NYSE member broker is prohibited from voting in the absence of the retail shareholder providing instructions about how to vote. Those are:

1. Proposals which are not submitted to stockholders by means of a proxy statement comparable to that specified in Schedule 14-A of the Securities and Exchange Commission;
2. Proposals that subject of a counter-solicitation, or are part of a proposal made by a stockholder which is being opposed by management;

3. Proposals that relate to a merger or consolidation (except when the company's proposal is to merge with its own wholly owned subsidiary, provided its shareholders dissenting thereto do not have rights of appraisal);
4. Proposals that involve appraisal rights;
5. Proposals that authorize the mortgage of property;
6. Proposals that authorize or create indebtedness or increase the authorized amount of indebtedness;
7. Proposals that authorize or create a preferred stock or increase the authorized amount of an existing preferred stock;
8. Proposals that alter the terms or conditions of existing stock or indebtedness;
9. Proposals that involve waiver or modification of preemptive rights;
10. Proposals that change existing quorum requirements with respect to stockholder meetings;
11. Proposals alter voting provisions or the proportionate voting power of a stock, or the number of its votes per share (except where cumulative voting provisions govern the number of votes per share for election of directors and the company's proposal involves a change in the number of its directors by not more than 10% or not more than one);
12. Proposals that authorize the implementation of any equity compensation plan, or any material revision to the terms of any existing equity compensation plan;
13. Proposals that authorize (i) a new profit-sharing or special remuneration plan, or a new retirement plan, the annual cost of which will amount to more than 10% of average annual income before taxes for the preceding five years, or (ii) the amendment of an existing plan which would bring its cost above 10% of such average annual income before taxes;
14. Proposals that change the purposes or powers of a company to an extent which would permit it to change to a materially different line of business and it is the company's stated intention to make such a change;
15. Proposals that authorize the acquisition of property, assets, or a company, where the consideration to be given has a fair value approximating 20% or more of the market value of the previously outstanding shares;

16. Proposals that authorize the sale or other disposition of assets or earning power approximating 20% or more of those existing prior to the transaction;
17. Proposals that authorizes a transaction not in the ordinary course of business in which an officer, director or substantial security holder has a direct or indirect interest; or
18. Proposals that reduces earned surplus by 51% or more, or reduces earned surplus to an amount less than the aggregate of three years' common stock dividends computed at the current dividend rate.

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