

Securities Law Alert: SEC Approves Amendment to Stock Exchange Rule To Eliminate Broker Discretionary Voting in Director Elections

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On July 1, 2009, the Securities and Exchange Commission (SEC) voted to approve changes in NYSE Rule 452 to eliminate broker discretionary voting in the election of directors. This rule, applicable to brokers who trade in securities on all U.S. stock exchanges, not just the NYSE, permits brokers to exercise the right to vote shares on their clients' behalf where the clients have not provided the brokers with instructions as to how they wish their shares to be voted.¹ As described in this Securities Alert, issuers will need to evaluate their ability to achieve a quorum, and the potential impact on director elections for stockholder meetings held after January 1, 2010, now that brokers will no longer be able to exercise discretionary voting in director elections.

Background

Until the recent amendment to Rule 452, brokers were permitted to use their discretionary authority to vote in director elections on behalf of clients who had not provided instructions on how to vote, unless the director election was the subject of a proxy contest. It is estimated that brokers, banks, and depositories hold approximately three-quarters of all public company shares in the United States on behalf of their ultimate customers. When a public company holds a meeting of its stockholders, brokers who hold shares on behalf of customers are required to forward the company's proxy materials to those customers and to request instructions as to how the customer wishes its shares to be voted at the meeting. If no instructions are received, Rule 452 provides that brokers may vote on behalf of customers on "routine" matters. Brokers may not vote, however, on non-"routine" matters, including specifically enumerated matters such as the approval of mergers and equity compensation plans. The amendment to Rule 452 eliminates brokers' ability to vote clients' shares in all elections of directors, whether contested or not, at stockholder meetings that take place on or after January 1, 2010, by adding director elections to the list of items for which brokers may not give a proxy to vote without receiving instructions from the beneficial owner.

Why Did the SEC Take This Action?

The NYSE initially proposed the changes to Rule 452 in October 2006, but subsequently filed several amendments, most recently in February 2009. In approving this rule change, the SEC noted its view that director elections should not be considered "routine," given the importance of

the role played by the board of directors in the stewardship of a public company. The SEC noted that brokers should not be able to substitute their judgment for that of the stockholders on the crucial matter of governance of an issuer:

“...[T]he most fundamental way for shareholders to hold directors accountable for their performance of critical corporate duties is through the director election process. Given the...importance of corporate governance matters..., the Commission believes it is appropriate for the NYSE to eliminate broker discretionary voting in director elections. In making this determination, the Commission believes that the NYSE’s proposal, among other things, furthers the protection of investors and the public interest by assuring that voting on matters as critical as the election of directors can no longer be determined by brokers without instructions from the beneficial owner, and thus should enhance corporate governance and accountability to shareholders.”²

This view further highlights the SEC’s current stance regarding the desirability of strengthening stockholder influence over the process of director elections, and assuring that stockholders have meaningful participation in those elections. Another example is the SEC’s recently proposed rules that would allow stockholders greater access to company proxy statements for the purpose of nominating directors.³ This view appears to have gathered momentum in the wake of the worldwide financial crisis that began last fall and the SEC’s perception of directors’ roles in some companies that may have contributed to that crisis.

What Should Companies Do in Response?

The elimination of broker discretionary voting in the election of directors will mean that it may be harder for some companies to achieve a quorum for the transaction of all business at stockholder meetings. This is so because, previously, shares that were represented by broker votes on the election of directors were eligible to be counted towards the achievement of a quorum. With the election of directors now to be treated as a non-“routine” matter, companies should consider placing a matter on the ballot that will be considered “routine” in order to preserve the ability of brokers to vote uninstructed shares on at least one matter, and thereby contribute to the quorum.⁴ The most common of typical stockholder meeting matters still considered routine is the ratification of a company’s independent registered public accounting firm. Our recommendation for any company that is concerned that it may not achieve a quorum at a meeting is to include a proposal for stockholders to ratify the company’s accounting firm. Many companies already do this. Companies may also want to consider hiring proxy solicitors in order to help ensure that a quorum and necessary votes are achieved.

What Does This Mean for Directors?

This rule change is more likely to create issues with the re-election of directors in companies with (1) large numbers of retail, as opposed to institutional, stockholders, and (2) a majority, as opposed to a plurality, voting standard for the election of directors.

The level of participation in public company director elections has been steadily declining in recent years, and the advent of the SEC's e-proxy rules has seemingly resulted in even lower levels of participation.⁵ Companies with large retail holdings that previously had been able to rely on the broker discretionary vote to ensure both a quorum and the re-election of their directors may now see their voting levels drop precipitously. This effect will be more pronounced for companies with a majority voting standard for the election of directors, since the director nominees need the favorable vote of shares representing a majority of the votes cast at the meeting or represented by proxy in order to be elected. By contrast, in companies with a plurality voting standard for the election of directors, the nominees receiving the most votes will be elected as directors, regardless of whether the shares voted for an individual nominee represent a majority of the votes cast or represented by proxy. Thus, in companies with a plurality vote standard, a drop-off in the number of votes cast for individual directors will not adversely impact a director's ability to be elected, although it may be concerning to the company as evidence of a lack of stockholder involvement and participation.

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Please contact Mintz Levin if you have any questions or concerns regarding the elimination of broker discretionary authority for the election of directors, or wish to discuss strategies to prepare for the 2010 proxy season in light of these changes.

Endnotes

¹ This rule, entitled "Giving Proxies by Member Organizations," is part of a series of rules governing the conduct of brokers in publicly traded securities who are registered as such with the New York Stock Exchange (NYSE). Although the rule is issued by the NYSE, it governs the conduct of registered brokers who trade in securities on all U.S. exchanges, and thus will impact all companies whose securities trade on such exchanges, other than companies registered under the Investment Company Act of 1940.

² SEC Release No. 34-60215; File No. SR-NYSE-2006-92.

³ Please see our [Client Alert](#) for more detail on this proposal.

⁴ Under many states' corporate laws, if a quorum is present for one proposal that is presented for consideration at a meeting, it will be considered present for all proposals to be considered at the meeting.

⁵ See <http://www.sec.gov/comments/s7-28-07/s72807-169.pdf>.

For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.

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