Approval Voting And Determining Shareholder Intent

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In this post last week, I wrote about the Dodd-Frank Act's requirement that companies subject to the SEC's proxy rules include in their proxy statements a resolution regarding the frequency of shareholder advisory votes on executive compensation. I noted that a plurality vote rule is not be the best way to determine shareholder preferences and suggested that other voting systems are more useful. Some have asked me how these voting rules work.

Under an "approval voting" system, shareholders are allowed to vote for each alternative as opposed to only one alternative under a simple plurality voting scheme. The alternative that receives the most votes "wins". Thus, approval voting relies on plurality voting to determine the outcome. There is nothing terribly novel about approval voting. In fact, the SEC's current proxy rules mandate approval voting in the election of directors because Rule 14a-4(b)(2) in effect requires that a shareholder be able to instruct the proxy holder to vote for each nominee.

Issuers may find several advantages in an approval voting system. Among other things, an approval voting system provides the following benefits:

- It is easy to implement;
- It provides shareholders with more voting options; and
- It determines the preference with the greatest overall support.

Assume, for example, a corporation has 100 shares outstanding with shareholder A holding 40 shares, shareholder B holding 35 shares, and shareholder C holding 25 shares.   Let's assume that shareholder A's first choice is one year but also believes two years is acceptable, shareholder B's first choice is two years, but also finds three years to be acceptable, and shareholder C prefers only a frequency of three years. In a simple plurality system, the shareholders will only be able to vote for one alternative (presumably, their first choices). Thus, shareholder A will determine the result. Under an approval voting system, however, the votes for each frequency would be as follows:

Preference	Votes
One-Year (Shareholder A)	40
Two-Years (Shareholders A & B)	75
Three-Years (Shareholder B & C)	60

As the above example demonstrates, the use of an approval voting system would allow an issuer to determine the frequency with the broadest overall support rather than the first choice of the largest minority shareholder or shareholder group.

Of course, implementation of an approval voting system will require the SEC's assent. It must also be permitted under applicable corporate law.

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