Counting The Vote When There Are Three Choices

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Section 951 of the Dodd-Frank Act requires companies that are subject to the SEC's proxy rules to include in their proxy statements "a separate *resolution* subject to shareholder vote" to determine whether a shareholder vote on executive compensation will occur every 1, 2, or 3 years. However, the Dodd-Frank Act specifically declares that this vote shall not be binding on the companies or their boards of directors.

This leads to the question of how companies will describe the vote required with respect to these resolutions. *See* Item 21 of Schedule 14A. The Dodd-Frank Act and the SEC's proposed rule do not specify a particular voting rule.

Recently, I came across this description in a proxy statement:

> *The proposal on whether advisory votes on executive compensation should be conducted annually, biennially or triennially will be determined by a plurality of votes, which means that the choice of frequency that receives the highest number of "FOR" votes will be considered the advisory vote of the Company's stockholders. Abstentions and broker non-votes will not count as votes cast "FOR" or "AGAINST" any frequency choice, and will have no direct effect on the outcome of this proposal.*

The voting rule described above is a plurality voting rule. This means that the choice that attracts the highest number of affirmative votes will be considered to have "won" even if a majority of the shares voting on the matter do not vote in favor of that particular choice. For example, if the corporation has 100 stockholders and the vote is 25 for 1 year; 45 for 2 years; and 30 for 3 years, the stockholders will be considered to have approved the choice of 2 years even though it attracted far less than a majority of the votes and more stockholders preferred a different outcome.

Although the above excerpt is from a proxy statement filed by a Delaware corporation, I will, for the sake of discussion, address the disclosure from a California perspective. Pursuant to Section 602(a) of the California Corporations Code, an "act of the shareholders" requires the affirmative vote of a majority of the shares represented and voting at a duly held meeting at which a quorum is present provided the number of shares voting affirmatively constitute at least a majority of the required quorum. Thus, California imposes a modified

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majority vote rule. Moreover, it seems to me that this rule should be applied even when determining whether the shareholders have adopted an advisory resolution. This would be consistent with many companies' descriptions of the vote required with respect to ratification of the selection of auditors.

Thus, it is my view that the same voting rule should be applied to determine whether the shareholders have adopted a non-binding resolution as is used in determining whether they have adopted a binding resolution. In other words, an advisory resolution is still a resolution that can only be adopted by the voting rule imposed by or in accordance with applicable law.

When shareholders are given multiple choices, neither a plurality nor a majority voting rule provides directors with the best information regarding shareholder preferences. Thus, I have argued that corporations should be free to use other voting rules such as a Borda count or preference ranking system.

As a final note, there are two exceptions the California voting rule described above. First, a greater vote may be required by other provisions of the General Corporation Law or the articles of incorporation. Second, a special voting rule applies when there is a loss of a quorum during a meeting. *See* Cal. Corp. Code § 602(b).

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