

Client Alert

Corporate Department

July 2009

Elimination of Broker Discretionary Voting in Director Elections

On July 1, 2009 the Securities and Exchange Commission approved the amendment to the New York Stock Exchange (the “NYSE”) Rule 452 eliminating the ability of brokers to vote in elections of directors without shareholder instruction. The rule changes will take effect for shareholder meetings held on or after January 1, 2010. The changes will not apply to any meeting originally scheduled to be held in 2009 that is properly adjourned to January 1, 2010 or later.

Previously, the NYSE Rule 452 permitted brokers to vote in their discretion for “routine” matters when they did not receive voting instructions from the beneficial owners at least ten days before a scheduled shareholder meeting. The uncontested election of directors was deemed routine, therefore permitting brokers to vote in elections of directors without receiving voting instructions from the beneficial owners. The amendment to Rule 452 makes the uncontested election of directors a non-routine matter, requiring that brokers may only vote on such matter pursuant to instructions received from the beneficial owners. If the broker does not receive instructions from the beneficial owner with respect to the election of directors such shares will not be voted on that matter. The changes to Rule 452 will apply to all brokers that are members of the NYSE, and will affect the voting ability of such brokers regardless of the stock exchange on which a company’s securities are listed.

Potential Consequences of the Rule Amendment

- The elimination of broker discretionary voting in uncontested elections will likely lead to an increase in “Vote No” or “Withhold” campaigns waged by activist shareholders. Previously, “Vote No” and “Withhold” campaigns, without competing solicitations, did not meet the definition of “contested” elections and brokers could still cast their discretionary votes. Elimination of broker discretionary voting in the election of directors will enhance the potential effectiveness of “Vote No” and “Withhold” campaigns. Such campaigns will be especially effective where the company has majority voting requirements and the bylaws require a director to resign or offer their resignation if they do not receive a majority vote. Additionally, depending on the requirements of the company’s bylaws and applicable state law, directors on staggered boards who do not receive a majority vote could be up for election again the following year, leading to a possible election of up to two-thirds of the board at the next annual meeting.

- The changes may have a significant impact on companies with majority voting requirements. Generally, broker discretionary votes have been cast “For” the company nominees and have represented a significant percentage of the total vote in elections of directors. Without such votes company director nominees may have a more difficult time achieving the majority vote required, and companies should plan accordingly.
- The rule changes may make it more difficult to obtain a quorum at shareholder meetings. If there are no “routine” matters to be voted on at a meeting the broker discretionary votes will not be counted in establishing a quorum. As a precautionary measure companies should include on the meeting agenda a “routine” matter under Rule 452, such as the ratification of auditors, in order to ensure that a quorum is obtained.
- There may be an increased cost to shareholder meetings as companies, no longer able to rely on broker votes to elect their nominees, need to spend more time and effort soliciting shareholder votes. Companies will need to expend resources to educate shareholders that, without submitting instructions to their brokers, their shares will not be voted in the election of directors.
- Proxy advisory services (e.g. RiskMetrics Goup, Inc., Glass Lewis & Co. and Proxy Governance, Inc.) may have an increased impact on the election of directors. The elimination of broker discretionary voting may lead to reduced voting returns from retail investors, thereby increasing the influence of institutional investors. Since institutional investors often follow the recommendation of proxy advisory services, companies should review the proxy advisory services’ policies regarding boards of directors in an effort to avoid a withhold recommendation for their nominees.

Please feel free to contact any of the partners listed below or any corporate partner with whom you work if you would like to discuss the proposed rules and their potential ramifications.

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