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## SEC Approves Elimination of Broker Discretionary Voting in Uncontested Elections of Directors

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On July 1, 2009, the Securities and Exchange Commission approved by a 3-2 vote amendments to New York Stock Exchange Rule 452 and Section 402.08 of the NYSE Listed Company Manual that eliminate broker discretionary voting in uncontested elections of directors, other than for companies registered under the Investment Company Act of 1940. The amendments are effective for shareholder meetings held on or after January 1, 2010. Because many large brokerage firms in the United States are member organizations of the NYSE and subject to its rules, these changes may affect not only companies listed on the NYSE, but also companies listed on NASDAQ and other national securities exchanges, to the extent that the clients of NYSE-member brokerage firms hold stock of such companies.

The amendments are the product of an NYSE review of its rules regulating the proxy process that was commenced in 2005 and headed by the specially convened NYSE Proxy Working Group. Although the final approval process had been stalled at the SEC for much of the last two years, the movement to eliminate broker discretionary voting in elections of directors regained momentum with the recent change in SEC leadership. The amendments respond in part to criticism of the NYSE by institutional shareholders and shareholder activist groups that the allowance of broker discretionary voting

in director elections, which has historically been heavily in favor of the nominees proposed by boards of directors, had the effect of diluting "just vote no" campaigns and other efforts to marshal opposition votes to incumbent directors that fell short of a full-blown proxy contest.

Under NYSE rules, brokerage firms controlling shares held in street name are required to furnish the beneficial holders of such shares with copies of all proxy materials distributed with respect to the shares, accompanied by materials allowing the beneficial holder to direct the voting of the shares. If the brokerage firm has sent a request for voting instructions but has not received a response from the beneficial holder by the tenth day preceding a shareholder meeting, NYSE Rule 452 and Section 402.08 of the NYSE Listed Company Manual allow the brokerage firm to nevertheless vote the shares in its discretion on matters deemed "routine" by the NYSE. However, brokerage firms cannot exercise discretionary voting and must receive voting instructions from beneficial holders in order to vote on specified "non-routine" matters, which have historically included contested director elections and, with the amendments approved by the SEC, now include all elections of directors, other than for companies registered under the Investment Company Act.

For companies with low shareholder response rates to annual meeting solicitations, these amendments will presumably reduce the number of shares voted by proxy in elections of directors. This is likely to be especially true for mid-cap and smaller companies, whose stock is generally held in higher proportion by retail investors, who have historically lower response rates than do institutional shareholders. A reduction in proxy voting could have several consequences:

1. Companies may encounter greater difficulty in achieving a quorum for

## shareholder meetings.

One of the principal functions of broker discretionary votes has been the establishment of quorums at meetings of shareholders at which routine matters are presented for consideration. Many state corporation statutes, including the Delaware General Corporation Law, provide that a quorum, once established for a meeting, is valid for all matters voted on at the meeting. As a result, the allowance of broker discretionary votes for routine matters could help establish a quorum that would be valid for non-routine matters, notwithstanding the fact that such non-routine matters may have had an insufficient number of shares represented by proxy and voting to establish a quorum on their own.

The elimination of uncontested elections of directors as a routine matter removes one potential matter that may be used by a corporation to help establish a quorum for a meeting of shareholders. This change leaves the ratification of auditors as the only well-established routine matter for shareholder voting. As a result, shareholder votes on ratification of auditors may become more common as companies seek to continue the use of broker discretionary votes for quorum purposes. If there are no routine matters on a meeting agenda, companies may have to rely on proxy solicitation firms, and incur the associated costs, to ensure the presence of a quorum, and some may consider lowering their quorum requirements if allowed under applicable state law.

## 2. Election of directors may become more difficult for companies that have adopted majority voting provisions.

Companies that have instituted majority voting provisions in their by-laws with respect to the election of directors are required to obtain a majority

vote in favor of the slate of directors up for election. Without the benefit of broker discretionary votes, companies may have to rely on proxy solicitation firms, and incur the associated costs, to accumulate the necessary affirmative votes. This may lead companies that are considering adopting majority vote provisions to abandon those efforts.

### 3. Institutional shareholders may gain increased leverage over boards of directors.

While contested elections of directors are relatively rare, in recent years institutional shareholders have increasingly sought to challenge incumbent directors in uncontested elections through the use of "just vote no" campaigns. These campaigns have provided a vehicle for major shareholders to apply pressure to boards of directors without incurring the costs of a full-blown proxy contest. In light of the increasing frequency of such challenges, boards of directors have become increasingly receptive to the demands of significant shareholders. The elimination of broker discretionary voting in uncontested elections of directors may further increase the leverage of institutional shareholders over boards, as the low historical response rate of retail investors to proxy solicitations suggests that any reduction in votes cast in an uncontested election by virtue of the elimination of broker discretionary voting is likely to come disproportionately out of the voting of shares held by retail investors. Such a reduction in voting of the shares held by retail investors would effectively increase the voting power of shares held by institutional shareholders, consequently increasing the threat of a "just vote no" campaign and the leverage held by the institutional shareholders that might commence such a campaign.

In addition to adopting the amendments relating to broker discretionary voting detailed in this alert, the Commission also voted to propose rule

amendments regarding shareholder approval of executive compensation applicable to institutions receiving financial assistance under the Troubled Asset Relief Program (TARP) and rule amendments to enhance proxy disclosures and solicitations. These proposals are discussed in this linked [July 1, 2009 Email Alert](#).

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