

SECURITIES ALERT

RECENT LEGISLATIVE CHANGES PROVIDE MOMENTUM FOR MAJORITY VOTING MOVEMENT



The 2006 proxy season has seen considerable and concerted efforts to install majority voting as the standard in uncontested elections of directors. This trend is likely to gain additional momentum with recent legislative changes aimed at further facilitating the majority voting movement. Of these changes, the most significant include amendments to the Delaware General Corporation Law (DGCL), which took effect on August 1, 2006, and amendments to the Model Business Corporation Act (MBCA), which were adopted by the ABA Committee on Corporate Laws in June 2006. With these changes, it appears that the majority voting movement will likely gain impetus in the 2007 proxy season and prove to be more than just the latest corporate governance trend.

RECENT CHANGES TO DELAWARE LAW

Over the past few years, institutional stockholders have turned their attention to changing the current plurality voting standard, which is widely prevalent in the United States, to a majority voting standard in uncontested director elections. The Delaware General Assembly recently passed legislation designed to facilitate this movement toward majority voting, which legislation took effect August 1, 2006. The legislation stems from institutional stockholders voicing their dissatisfaction with the existing law, which provided that even if stockholders proposed and succeeded in adopting a bylaw requiring majority voting, the board of directors would often have the power to amend the bylaw unilaterally back to the plurality voting standard. Further, a corporate governance policy requiring a director nominee to resign if he or she did not receive the requisite votes in an election was non-binding and unenforceable. The legislation addresses these concerns by amending two sections of the DGCL.

Stockholder-Adopted Bylaws Specifying Vote Required to Elect Directors. Under Section 216 of the DGCL, stockholders of a Delaware corporation can propose and adopt changes to bylaws, including changes establishing majority voting. However, such changes adopted by stockholders could be unilaterally reversed by action of the board of directors if the certificate of incorporation permits the board of directors to amend the bylaws. To address this concern, the newly adopted amendment to Section 216 prohibits repeal by the board through unilateral action of any stockholder-adopted bylaw that addresses the requisite vote for election of directors. Therefore, if stockholders adopt a bylaw requiring majority voting for the election of directors, such bylaw cannot be amended or repealed unless stockholders vote in favor of such amendment or repeal in a subsequent stockholder vote.

Director Resignations. The Delaware General Assembly amended Section 141(b) of the DGCL to allow a resignation by a board member to be effective at a later date or upon the occurrence of a future event, such as the failure to obtain a majority vote. Section 141(b) was further amended to allow a resignation conditioned upon the director failing to receive a specified vote for reelection to be irrevocable. Many of the majority voting proposals being adopted by companies, whether in their bylaws or corporate governance policies, require any nominee who is not elected by a majority vote to offer his or her resignation. Because directors are fiduciaries, directors could theoretically refuse to resign when called upon to do so by these non-binding provisions. With these recent amendments, a Delaware corporation will be able to enforce bylaws or governance policies requiring the resignation of a holdover director by obtaining from directors irrevocable resignations conditioned upon failure to receive a specified vote for reelection. It should be noted, however, that the amendment to the statute does not authorize a bylaw or governance policy that requires a director to resign without the director's consent.

These amendments to the DGCL, which ensure that stockholder modifications to bylaws may not be easily undone and that directors must resign if called upon to do so by corporate governance policies to which they have consented, will likely shape the approach taken by companies considering a majority voting policy in the future.

RECENT CHANGES TO MODEL BUSINESS CORPORATION ACT

In June 2006 the American Bar Association, through its Committee on Corporate Laws, adopted amendments to the MBCA, which serves as the basis for corporate laws in more than 30 states. These amendments focused in part on enabling majority voting through a modified plurality standard by which directors continue to be elected by a plurality of votes cast, but any director who receives more "withhold" votes than "for" votes in an uncontested election must submit his or her resignation. Pursuant to the amendments, either directors or shareholders may adopt a new voting standard through modification of bylaws that may not be reversed, except by a vote of the shareholders or, if enacted solely by directors, by a vote of the directors or shareholders. In addition, any director receiving more votes "against" than "for" must resign within 90 days or as soon as the board of directors finds a replacement, if earlier. Failure of the board of directors to find a replacement within 90 days would allow shareholders to find a replacement, unless provided otherwise in the articles of incorporation. Furthermore, similar to the Delaware amendments, the MBCA amendments allow corporations to adopt resignation policies tied to the occurrence of an event, such as failing to collect a majority of votes, that are binding and enforceable.

PROPOSED CALIFORNIA STATUTE

In addition to the recent legislative amendments discussed above, the California legislature is considering a proposed bill that could significantly affect the majority voting movement. The California Public Employees' Retirement System, in January 2006, facilitated the drafting of a California bill (SB 1207) to make majority voting the default structure for California corporations. Rather than the "opt in" approach taken by the ABA and Delaware, the California bill would instead require corporations to "opt out" of majority voting in an uncontested election through bylaw amendment. While this bill, if adopted, would apply only to California corporations, it could serve as a competing template for adoption by other states and public companies outside California that voluntarily begin to follow this model.

Each of the Delaware, MBCA and California legislative changes and proposals discussed above are geared toward majority voting and making such provisions enforceable. These changes will undoubtedly affect the 2007 proxy season and provide momentum for the majority voting movement.

CONTACT INFORMATION

If you have questions or would like to learn more about this topic, please contact the partner who represents you, or:

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