CORPORATE ALERT

SEC APPROVES RULE CHANGE ELIMINATING BROKER DISCRETIONARY VOTING FOR ELECTION OF DIRECTORS

At its open meeting on July 1, 2009, the Securities and Exchange Commission (SEC) approved a rule change proposed by the New York Stock Exchange to eliminate the ability of brokers to exercise their discretion in voting for directors in uncontested elections. The rule change, which was approved by a 3-2 vote of the commissioners, will make uncontested director elections at all public companies a “non-routine” matter, and, thus, brokers will be prohibited from voting on the election of directors absent specific instructions from their customers. Because brokers typically cast discretionary votes in favor of management’s nominees for director in uncontested elections, the rule change is expected to have a major impact on companies with majority voting for the election of directors and may also make it more difficult for companies to obtain a quorum for their annual meetings. The rule change will apply to all shareholder meetings held on or after January 1, 2010. The rule change applies to all brokers that are NYSE members and, therefore, will affect all public companies regardless of the stock exchange on which a company’s stock is listed.

CHANGE TO NYSE RULE 452

Current rules require brokers to deliver proxy materials to the beneficial owners of shares in advance of a shareholder meeting and request instructions from the owners as to how to vote their shares at the meeting. NYSE Rule 452 allows brokers to exercise their discretion in voting shares on all “routine” matters for which the broker did not receive instructions by the 10th day before the meeting. Until the recently approved rule change, uncontested director elections were considered a routine matter for which brokers could exercise discretionary voting authority, but contested elections were considered “non-routine” matters for which brokers could not vote uninstructed shares. As amended, Rule 452 will provide that uncontested director elections are a non-routine matter, and, thus, brokers will be prohibited from voting uninstructed shares in all director elections. The NYSE originally requested such a rule change in 2006, but the SEC did not take any action at that time because it was considering a broader initiative on proxy access.

The NYSE resubmitted its proposal in February 2009, and many believed that the proposal would be considered by the SEC only in the context of a broader initiative on proxy access. In May 2009, the SEC voted to propose a broad set of rule changes that would give shareholders the right to have their nominees included in the company’s proxy materials. Those proposals are subject to a 60-day comment period that expires on August 17, 2009. The SEC, however, has separately approved the change to Rule 452 eliminating broker discretionary voting in director elections. The change to Rule 452 will take effect on January 1, 2010, regardless of whether or in what form the SEC’s proxy access proposal is ultimately adopted.

1 Other than registered investment companies.
2 If a meeting was originally scheduled to be held prior to January 1, 2010, but was properly adjourned to a later date, the amendment to Rule 452 will not apply to the adjourned meeting.
IMPLICATIONS FOR PUBLIC COMPANIES

The change to Rule 452 is expected to have a major impact on public companies.

- **Majority Voting.** Companies with majority voting for the election of directors may find it more difficult to achieve that threshold. A significant number of companies, including more than 70 percent of S&P 500 companies, have some form of majority voting, which typically requires that a nominee receive a majority of the votes cast in order to be elected and that an incumbent director up for reelection resign or offer to resign if the director does not receive a majority of the votes cast. Because brokers typically cast discretionary votes in favor of management’s nominees, the elimination of broker discretionary voting may make it more difficult for a nominee to achieve a majority vote.

- **Quorum.** The change to Rule 452 may make it more difficult for companies to obtain a quorum at the annual meeting. Many companies, particularly those with large retail investor bases, rely on broker discretionary votes to reach a quorum. Consequently, companies should make sure that they have at least one “routine” matter on the agenda (such as ratification of auditors), so that brokers can cast votes that can be counted for purposes of determining a quorum.

- **E-proxy.** The elimination of broker discretionary voting in director elections may further discourage companies from taking advantage of the SEC’s e-proxy rules. Many companies are already reluctant to use e-proxy, particularly if they have non-routine matters on their agenda, because of the significant decline in voting by retail investors of those companies using e-proxy. Amended Rule 452 may cause more companies to choose the full set delivery option—despite the cost savings and reduced environmental impact associated with e-proxy—to increase the likelihood of receiving the necessary votes from shareholders without the need for additional solicitations.

- **Institutional Investors and Proxy Advisors.** The influence of institutional investors will likely increase as a result of the rule change, as institutional shareholders are more likely to vote their shares than are retail investors. Also, since institutional investors often follow the advice of proxy advisory firms, these firms will also likely gain more clout. In recent years, proxy advisory firms, such as RiskMetrics Group, have increasingly recommended that their clients withhold votes or vote against director nominees of companies that do not abide by the advisory firm’s corporate governance policies.

- **“Vote No” Campaigns.** The change to Rule 452 will likely increase the impact and frequency of “vote no” campaigns. Without the inclusion of broker discretionary votes in favor of management nominees, “vote no” campaigns waged by activist shareholders will have a greater influence on director elections, as there will be fewer votes cast “for” management’s nominees to outweigh those votes that are “withheld” or voted “against” such nominees.

- **Expenses.** The rule change will likely increase the cost of the annual meeting, as some companies will likely abandon the less-expensive option of e-proxy, and many companies will find that they need to spend more time and effort wooing shareholder votes, especially those of retail investors, to ensure a successful meeting.

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