

KIRKLAND ALERT

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SEC Approves NYSE Rule Change to Eliminate Broker Discretionary Voting in Director Elections

Nearly three years after the original proposal, the NYSE's Rule 452 will be amended to provide that the election of directors is not a routine matter for which NYSE member firm brokers would be permitted to cast votes for uninstructed shares.

After almost three years, the SEC has approved by a three-to-two vote the New York Stock Exchange's (NYSE) proposal to amend Rule 452 to provide that the election of directors is not a routine matter for which NYSE member firm brokers would be permitted to cast votes for uninstructed shares. The NYSE-amended rule will be applicable for proxy voting for shareholder meetings held after January 1, 2010. Although a NYSE rule, it is applicable to all member firm brokers and applies regardless of the stock exchange upon which a company is listed.

The amendments were first proposed by the NYSE in October 2006 but were delayed by the SEC as it continued its broader review of shareholder access issues. In her statement at the SEC Open Meeting on July 1, 2009, Chairman Mary L. Shapiro recognized the delay, stating: "[T]his proposal has essentially been awaiting Commission approval for nearly three years. Keeping hard decisions on hold indefinitely does not solve problems, so I think it is time for us to move forward. That said, there are related areas of shareholder communication and voting that the Commission will be studying carefully this year." Chairman Shapiro is likely referring to the SEC's proxy access rule proposal published for public comment on June 10, 2009, titled "Facilitating Shareholder Director Nominations." The 250-page proposal contains more than 170 specific areas on which the SEC has specifically requested comments and, if adopted, would provide unprecedented shareholder access in nominating and electing directors.

The SEC has argued that the Rule 452 change "will enhance corporate governance and accountability by helping assure that investors with an economic interest in the company vote on the election of directors." Prior to these amendments, Rule 452, titled "Giving Proxies by Member Organizations," allowed brokers to vote on "routine" proposals if the beneficial owner has not provided specific voting instructions to the broker at least ten days before a scheduled meeting. Uncontested elections of directors were considered a "routine" proposal and contested elections only included those elections that were the subject of a counter-solicitation or were part of a proposal that was being opposed by management. Because brokers generally vote uninstructed shares in accordance with the board's recommendations, shareholder activists argued that the rule had the effect of dampening shareholders' efforts to express disapproval of a board's conduct through a "just vote no" campaign.

For those companies that have adopted majority voting, the elimination of discretionary voting will make it more difficult for incumbent directors to achieve a majority of the vote. While many companies elect directors by plurality vote, an increasing number of companies have adopted majority voting either voluntarily or in response to investor demands or have instituted requirements that their directors voluntarily resign if they do not receive a majority of the votes cast. Companies with majority voting will need to increase efforts to communicate with their shareholders on the importance of instructing their brokers in voting for directors.

The elimination of discretionary voting in the election of directors may also make it more difficult for companies, particularly smaller companies, to obtain the quorum necessary to transact business at meetings. Companies can address this concern by adding a "routine" proposal to the agenda such as the ratification of the approval of the company's auditors so that broker non-votes for the routine proposal will be counted in determining whether a quorum is present.

In preparation for the 2010 proxy season, companies should consult with their proxy advisors and legal counsel now to assess the probable impact of the rule change on their annual meeting and the election of their directors.

If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.



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