

KIRKLAND M&A UPDATE

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Voting Standards Are Not That Standard

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As we enter the homestretch of the presidential election and the quadrennial bewilderment at the vagaries of the Electoral College system, it is an opportune moment to highlight that the voting standards for corporate shareholder approvals in the United States can be similarly confounding. The simple question of whether shareholder approval was obtained or a director elected is in fact subject to overlapping provisions of state law and the company's organizational documents (and occasionally Federal law and stock exchange rules) that can be confusing and lead to mistakes.

Corporate Votes. Voting on corporate matters typically falls in three primary buckets — director elections, certain specified fundamental matters (e.g., mergers, charter amendments, etc.), and all other approvals.

State Law. Within each of the three voting categories, the laws of the state of incorporation will dictate the applicable voting standard. In the case of director elections, the default standard is nearly universally a plurality of votes (i.e., whichever candidate receives the most votes), although as evidenced by the proliferation of companies adopting majority voting standards for director elections in recent years, states typically allow companies to opt for alternative standards such as majority voting (more “for” than “against” votes) or cumulative voting. For specified fundamental matters, the standard varies by state. For example, in Delaware, a merger must be approved by a majority of the outstanding shares, while in Texas and Ohio the threshold is two-thirds of the outstanding shares, and in New Jersey the threshold is a majority of votes cast (but two-thirds if the company was incorporated before 1969). For the third “catch-all” category, there are subtle differences among various state standards — in Delaware, the standard is a majority of shares present and entitled to vote on the matter; in California, the standard is a majority of the shares represented and voting at a meeting, but that majority must also represent at least a majority of the required quorum; in New York, the standard is a majority of votes cast for or against the action.

Charter and Bylaws. Many states allow a company to vary some or all of the “default” standards described above. For example, in Delaware and New York, many (but not all) of these variances can be in the charter or the bylaws; in California or Ohio, many must be in the charter. In some cases, the standard may be increased or decreased (e.g., in Texas, the charter may provide that a lower vote, such as a majority, is required for a merger), while in some cases it may only be increased (e.g., in California, the charter may only increase the required approval for mergers above the default majority of the outstanding shares). Other common variations included in a company's organizational documents are so-called “super-majority” approval provisions that require a higher threshold to approve certain charter or bylaw amendments or for certain business combination transactions. In addition, attention should be paid to charter or bylaw provisions that purport to repeat the statutory default standards — even the smallest variations in the language can have an impact on how votes are counted under the standard (e.g., for a Delaware corporation, changing “entitled to vote thereon” vs. “entitled to vote thereat” may affect whether broker non-votes have the effect of a vote against a proposal subject to that standard). Companies should note that charter provisions take precedence over bylaw provisions, so a bylaw voting provision may not be inconsistent with a corresponding charter provision (e.g., a company cannot implement majority voting in director elections via bylaw amendment if it has a charter provision mandating plurality voting).

Abstentions and Broker Non-Votes. Abstentions and broker non-votes can represent a significant percentage of the votes on a corporate matter and occasionally can determine the outcome. Abstentions are an affirmative decision by the stockholder to not vote on the relevant matter (a choice required to be offered by SEC rules),

while a broker non-vote occurs when a broker does not receive instructions from the owner of shares and does not have discretionary authority to vote on the relevant proposal (which today is the case for most votes other than auditor ratification). The impact of abstentions and broker non-votes varies significantly based on the applicable standard. Where the vote is based on a percentage of the shares outstanding such as a Delaware merger or charter amendment, the effect of an abstention and broker non-vote is the same as a vote against the proposal. In director elections, abstentions and broker non-votes will not have an impact under a plurality standard or the typical majority vote standard. By contrast, in the case of votes covered by the states' varying catch-all standards (which, as noted above, can be varied in the charter or bylaws), the impact of abstentions and broker non-votes diverges based on the relevant state. In Delaware, abstentions have the effect of a vote against (because they are present and entitled to vote), while broker non-votes do not have an impact (because they are not entitled to vote on that matter). In New York, the catch-all standard, by focusing only on votes "for" and "against", means that abstentions and broker non-votes are ignored (unless, as permitted by New York law, the charter or bylaws explicitly provide that abstentions are included in the count). In California, the analysis is even more muddled — while abstentions and broker non-votes are generally ignored, they count for determining whether an affirmative vote of a majority of the required quorum has been obtained and therefore could sway the results of a close vote.

Disclosure and Counting. The SEC's proxy rules require companies to disclose the required vote to approve each proposal and the effect of abstentions and broker non-votes on each matter. Companies should make sure their disclosures of the voting standards for each separate matter to be voted on, and their tabulation of the results, take proper account of all the variables imposed by state law and the company's organizational documents, as well as any other standards that may apply under other regulatory regimes (e.g., to qualify under Section 162(m) of the

tax code, performance goals in an incentive plan must be approved by a majority of votes cast, including abstentions if they count under the laws of the company's state, even if a lesser standard otherwise applies under the company's charter or bylaws). By way of example, the voting standard on "say-on-pay" resolutions appears to differ among Delaware corporations, with many applying the default catch-all standard but with others applying a majority-of-votes-cast measure (note that under Delaware law the lower standard would be clearly permissible if the bylaws were amended to mandate that standard for the "say-on-pay" vote).

Why it Matters? While the above discussion may strike many as esoteric, the real-world impact can be significant. In addition to raising potential questions about the validity of a corporate action if the wrong standard is applied, inaccurate disclosure about the voting standard may also give rise to disclosure-related claims. Both of these considerations arose in a 2014 lawsuit filed in Delaware against Cheniere Energy. The plaintiffs asserted that a reload of an equity compensation plan seemingly approved at the prior year's meeting was invalid because the company did not (and the proxy statement stated that it would not) take abstentions into account in determining whether approval was obtained in contravention of the applicable Delaware default catch-all standard. At the time of the suit, Cheniere was also seeking a similar approval of a reload at the upcoming annual meeting. In the face of the claim, Cheniere postponed its meeting and withdrew the pending proposal, and later settled the litigation making a number of governance concessions (including as to treatment of abstentions in future votes) and paying significant fees to the plaintiffs' lawyers. Looking further back, in 2002 Stanley Works, under pressure from the State of Connecticut, voided the results of a shareholder vote on a Bermuda reincorporation because of errors and resulting confusion in its disclosure of the impact of failures by 401(k) participants to give voting instructions on the outcome of the vote.

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

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