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## Proposed NYSE and Delaware Law Changes Could Facilitate Election of Activist Nominees to Boards of Directors

Changes would not be effective until at least 2010 proxy season

To Our Clients and Friends:

Last week, legal changes were proposed that have the potential to impact significantly the election of directors. The proposed changes, if adopted, would not be effective until at least the 2010 proxy season.

In this report, Georgeson describes the proposed changes and their practical impact, as well certain questions raised by them. Their practical impact is identified throughout this report under the headings **"HOW COULD THIS IMPACT YOU?"**

### Highlights

Two sets of changes are being proposed:

1. The New York Stock Exchange (the "NYSE") has asked the Securities & Exchange Commission (the "SEC") to approve a change to NYSE Rule 452 to eliminate broker discretionary voting in director elections; and
2. The Delaware State Bar Association will be asking the Delaware General Assembly to amend the Delaware General Corporation Law (the "DGCL") with respect to, among other things, proxy access, reimbursement of shareholder expenses, and separate record dates for notice and voting at shareholder meetings.

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### 1. PROPOSED ELIMINATION OF BROKER DISCRETIONARY VOTING IN DIRECTOR ELECTIONS

On February 26, 2009, the NYSE proposed that the SEC approve an amendment to NYSE Rule 452 to eliminate broker discretionary voting in director elections. This amendment, an earlier version of which was first submitted to the SEC in October 2006, would eliminate the discretion that brokers currently have to vote their clients' shares when their clients do not otherwise provide them with voting instructions for director elections. Depending on what occurs during and after the SEC's comment period, this proposed change would affect shareholder meetings held some time on or after January 1, 2010.

Although, as of this report, the SEC has not published the proposed rule in the Federal Register, the proposed rule and its history can be found on the NYSE web site.

There has been general support for the proposition that director elections are important enough to make them a non-routine item for purposes of broker discretionary voting. However, there are several other regulatory and practical roadblocks that make this issue difficult to resolve in a vacuum. These include:

- > the strong current trend in favor of majority voting for directors (which makes broker non-votes take on greater significance),

- > the continuing distinction permitted by SEC rules between NOBOs (non-objecting beneficial owners, who permit themselves to be identified to companies) and OBOs (objecting beneficial owners, who refuse to identify themselves to companies). It is impossible for companies to communicate with OBOs who do not provide voting instructions to their brokers on non-routine matters,
- > the heightened focus put on director elections by the proxy advisory firms, who increasingly make recommendations against company directors due to a growing scrutiny of a company's governance and executive compensation practices,
- > so-called "Notice & Access" mailing and voting, which have had the impact of disproportionately lowering the number of retail shareholders who vote at any shareholders meeting, and
- > the likely enactment, at the state and/or federal level, of new forms of proxy access for shareholders in director elections.

These issues are likely to be raised during the SEC's comment period. Many interested parties hope that the SEC conducts an overall review of shareholder voting and communication issues, instead of considering this one issue in isolation. Such a review could help to develop a comprehensive framework that takes account of these disparate provisions.

Companies should be aware that over the past two years, as the proposed change to Rule 452 has been debated, several brokers have taken matters into their own hands. Thirteen brokers have completely refused to vote if they have not received voting instructions from the beneficial owners of the shares held in their brokerage accounts. Another ten brokers have decided to vote all shares that remain without voting instructions in the same proportion as those shares for which the brokers have received voting instructions. This factor is already impacting companies, without any further change to Rule 452. As a result, it is crucial that companies work with their proxy solicitors now to identify what percentage of their retail shareholders hold shares at these brokerage firms, in order to plan effective and successful proxy solicitation campaigns.

**HOW COULD THIS IMPACT YOU?** The proposed change to NYSE Rule 452 could impact companies in the following ways:

- > It could become even more time-consuming and costly to achieve, if at all, the necessary quorum to hold a shareholders meeting. The additional costs could include follow-up mailings to, and telephone solicitation of, identifiable shareholders who have not yet voted. This would be likely to impact disproportionately small and medium-sized companies, which historically have had a higher level of retail, versus institutional, shareholders.
- > Where companies have adopted majority voting for directors (and likely in years to come, in the case of proxy access for director elections), it could make it more difficult to achieve majority support for directors. This could in turn result in the proffered resignations and loss of valued company directors. Again, this could be expected to impact disproportionately small and medium-sized companies, especially where one or more of the board's director nominees have been targeted by a proxy advisory firm and/or a disgruntled shareholder waging an "against" or "withhold-the-vote" campaign in opposition to such nominee(s).
- > It could increase the influence of proxy advisory firms' recommendations in the final vote outcome for director elections.
- > It could lead to greater shareholder activism in the form of "Vote No" campaigns against directors, as the withheld/against votes would likely have a greater impact on the final election outcomes.
- > It could discourage "Notice & Access" mailing and voting and, therefore, eliminate a potential opportunity for company cost savings.

## 2. PROPOSED AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW REGARDING DIRECTOR ELECTIONS AND SHAREHOLDER VOTING

Each year the Delaware General Assembly generally reviews and amends portions of the DGCL. As part of this process, the Delaware State Bar Association proposes amendments for consideration to the Delaware legislature. This year, three of these proposed amendments, which (if enacted into law) would become effective August 1, 2009, concern director elections and shareholder voting.

**Click here** to view all of the proposed Delaware State Bar Association amendments (as well as a synopsis of them). Only the three amendments that concern director elections and shareholder voting are discussed below.

Delaware companies would not be required to adopt any of the three proposed amendments. The first two proposals would permit, but not require, companies to include the applicable provisions in their by-laws. The third proposal would not appear in a company's by-laws, but rather would be a choice that a company's board would be entitled to make each year. The three proposals are:

- > **Proxy Access.** Under this proposal, companies would be specifically permitted to adopt by-law provisions permitting shareholder access to a company's proxy statement for the purpose of director elections. The proposal would permit the company to impose lawful conditions on the proxy access, such as minimum stock ownership requirements (in terms of the number of shares and related derivative rights, as well as how long the shares have been held), specified information about the shareholder and its nominees, the number of board seats being sought by the shareholder, and whether the nominations are related to the purchase of a significant percentage of the company's shares.
- > **Reimbursement of Shareholder Expenses.** This proposal would permit companies to adopt by-law provisions to reimburse shareholders who have incurred expenses in connection with their solicitation of proxies for director elections. Again, the company would be permitted to include lawful conditions to reimbursement, such as the number of persons nominated by the shareholder, the proportion of votes cast in favor of the shareholder's nominee(s), and whether the shareholder has sought similar reimbursement in the past.
- > **Separate Notice and Record Dates for Shareholders Meetings.** Under this proposal concerning shareholder meetings, a company's board would be given the option of selecting both (a) an initial "notice" record date for the purpose of giving notice of the meeting to those shareholders owning shares on the initial date (which would be a date currently considered the "record date") and then (b) a later "record" date (which could be any date on or before the date of the meeting) for the purpose of determining which shareholders would actually be entitled to vote at the meeting. Both dates would need to be identified in the initial notice of the meeting. The purpose behind this proposed amendment is to better ensure that those shareholders who have a continuing economic interest in the company are the ones voting at the meeting.

**HOW COULD THIS IMPACT YOU?** The proposed changes to the DGCL would impact only companies incorporated in Delaware and only those that elect to take advantage of the proposed changes (assuming they are enacted).

At first glance, these proposals appear to make it easier for shareholders to nominate directors to Delaware company boards and to work toward the elimination of so-called "empty voting" (which occurs when shareholders who owned the shares on the record date have already sold their shares by the time of the meeting date).

On closer review, however, these provisions raise several questions, which remain unanswered. For example, it appears likely that there will be a new federal law on shareholder access. Nevertheless, the proposed Delaware law could be used by companies to adopt by-laws that have more restrictive rules than the new federal law, such as a higher share ownership threshold for nominating persons as directors in a company's proxy statement. In such a case, there would need to be a resolution between conflicting federal and state laws.

In the case of the separate “notice” and “record” dates for a shareholders meeting, the logistics of obtaining votes from the shareholders owning shares on the later date could be quite cumbersome and costly. “Notice & Access” has already raised concerns about shareholders not having access to the necessary information to make informed voting decisions, as well as concerns regarding the ability to get retail and registered shareholders to vote at all. A later “record” date raises these issues again, as well as new questions as to (i) whether secondary notices and mailings would need to be sent to the “record” (versus “notice”) date shareholders and (ii) whether the “overvoting” and “undervoting” issues that have been raised in recent years would be exacerbated if there were to be a much shorter time period between the “record” and “meeting” dates, in which to reconcile actual share ownership and to determine which shareholders have the right to vote the shares in question

If Delaware law were to permit companies to adopt by-laws on proxy access and shareholder reimbursement of proxy expenses, this would likely cause shareholder activists to pressure Delaware companies to actually do so. If companies were then presented with the choice between a state and federal law version of proxy access, activists would also likely pressure companies to select the more shareholder-friendly version. All in all, by-law provisions on proxy access and shareholder reimbursement of proxy expenses could vastly expand an activist’s toolkit. When combined with the ongoing dismantling of company takeover defenses, some companies could become much more vulnerable to contested director elections and other forms of shareholder activism.

As with the proposed amendment to NYSE Rule 452, it is hoped that when the proposed Delaware law changes are considered, both federal and state regulators take a holistic review of the many different issues raised by shareholder voting and communications. Such a review would consider the proposals discussed in this report, along with such issues as (i) the elimination of the NOBO/OBO distinction, so as to allow for greater communication with all shareholders; and (ii) improvements in the “Notice and Access” process, e.g., to permit proxy voting cards to be sent to shareholders along with the initial “notice” card, so as to make it easier for registered and retail shareholders to vote their shares. Finally, while all of these potential changes are being debated, companies should carefully consider making any governance changes that could weaken their defenses and make them a target of the current increase in shareholder activism.

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Georgeson has a team of experts who will continue to monitor these regulatory developments for you and who are prepared to meet your needs in connection with preparing for the final rule changes. If you have any questions, please feel free to contact your Account Executive or any of the following Georgeson executives:

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