

## *NYSE Implements New Restrictions on Broker Discretionary Voting*

BY LEIGH P. RYAN, MICHAEL L. ZUPPONE & REBECCA A. BROPHY

### **Overview**

As the 2012 proxy season begins, public companies should be aware of recent changes to Rule 452 of the New York Stock Exchange LLC and NYSE Amex Equities LLC (collectively, the "NYSE") that restrict broker discretionary voting on certain types of corporate governance proxy proposals. As a result of these changes, public companies may find it more difficult and more expensive to obtain stockholder approval of certain corporate governance related proxy proposals that are supported by company management. The recent changes to Rule 452 are part of a continuing trend by Congress, the U.S. Securities and Exchange Commission (the "SEC"), and the NYSE to limit the use of broker discretionary voting.

As described below, each public company should consider the impact of Rule 452 changes based on its own circumstances, including what constitutes a quorum at its annual meeting and the percentage of ownership represented by institutional investors, as it determines how to proceed with the solicitation of proxies in favor of proposals supported by management.

### **Rule 452 Changes**

On January 25, 2012, the NYSE announced that it would discontinue its previous approach under Rule 452, which allowed brokers who do not receive voting instructions from their customers to vote the uninstructed shares on certain corporate governance proposals that are supported by company management.

The NYSE generally allows a broker to exercise discretionary voting authority on behalf of its customers on all "routine" proxy proposals if the broker has not received specific voting instructions from the customer. Previously, the NYSE treated many management-supported corporate governance proposals as routine matters, which allowed brokers to exercise discretionary authority in voting on these proposals, typically resulting in a favorable vote. In its January 25, 2012 announcement, however, the NYSE changed that position so that proxy proposals relating to the following will be treated as "Broker May Not Vote" matters:<sup>1</sup>

- De-staggering or de-classifying a company's board of directors
- Effectuating majority voting in the election of directors
- Eliminating supermajority voting requirements
- Providing for the use of written consents by stockholders
- Providing rights to call a special meeting of stockholders

- Overriding certain types of anti-takeover provisions

The changes to Rule 452 are not surprising in light of recent regulatory and public policy developments that have restricted broker voting of uninstructed shares and favored direct participation of stockholders, including retail investors, in corporate governance matters.<sup>2</sup> The intent behind these developments is to enhance corporate governance and accountability by ensuring that investors with an economic interest in a public company play an active role in voting.<sup>3</sup> Public companies should consider how the developments will impact annual meeting proposals beginning with the 2012 proxy season.

### The Practical Impact of Rule 452 Changes

Public companies should consider whether the changes to Rule 452 will increase the difficulty and expense of obtaining stockholder approval of any management-supported corporate governance proposals. Although the impact of Rule 452 changes on any particular public company will depend, in part, on factors unique to the company, such as the quorum and voting requirements in its charter documents, and the composition of its stockholder base, all public companies should consider the following factors in planning their 2012 proxy solicitation to ensure a successful annual meeting:

- **Routine Proposals Help Establish a Quorum:** Broker discretionary votes on routine matters often help establish a quorum for an annual meeting. As long as there is at least one routine proposal on the proxy card, broker non-votes (i.e., an indication from a broker that it has not received instructions from a client on a routine matter) are generally counted for purposes of establishing a quorum for an annual meeting under Delaware law, including for non-routine matters. The NYSE has specifically noted that the ratification of independent auditors continues to be a routine or "Broker May Vote" matter. Therefore, public companies should consider including the ratification of independent auditors or another routine matter on the proxy card in order to help establish a quorum.
- **Heightened Influence of Institutional Investors and Proxy Advisory Firms:** In general, institutional investors are more likely than retail investors to vote on proxy proposals and to follow the advice of proxy advisory firms, such as Institutional Shareholder Services. A public company with a large retail investor base may have more difficulty obtaining enough votes to approve a proxy proposal than one with a large institutional investor base. The changes to Rule 452, therefore, highlight the need for a public company to understand both the composition of its stockholder base and the positions taken by proxy advisory firms on certain proxy proposals because institutional investors and proxy advisory firms will play an increasingly important role in obtaining stockholder approval of certain management-supported corporate governance proposals.
- **Additional Proxy Solicitation Efforts May be Necessary:** Brokers often vote on routine matters based on management's recommendation, increasing the chances of approval for management-supported proposals. Now that brokers will not be able to vote uninstructed shares on certain management-supported corporate governance proposals, active participation by retail investors will be increasingly important in obtaining stockholder approval. In many cases, absent additional proxy solicitation efforts, it may be difficult to obtain sufficient support of retail investors. As a result, public companies should consider expanding their proxy solicitation efforts, including by: (i) ordering a "non-objecting beneficial holder" ("NOBO") list to enhance communications with retail investors who hold their shares in street name; (ii) engaging a proxy solicitation firm to utilize the NOBO list and other information resources to communicate with stockholders; (iii) abandoning or supplementing the cheaper and environmentally-friendly option of electronic delivery of proxy materials; or (iv) distributing additional proxy materials to remind stockholders to

vote. Of course, these additional efforts could increase the timeline and costs of a proxy solicitation.

## Conclusion

The changes to Rule 452 necessitate a hard look into previous quorum and voting experiences when a public company advances a corporate governance proposal. Given the direction of current policy, it is possible that in the future the NYSE will treat additional management-supported proposals as “non-routine.” Such treatment places greater importance on maintaining effective communications with stockholders to foster more favorable conditions when seeking stockholder approval of what were previously considered “routine” corporate governance proposals.

*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

### Atlanta

Elizabeth H. Noe  
1.404.815.2287  
elizabethnoe@paulhastings.com

Reinaldo Pascual  
1.404.815.2227  
reinaldopascual@paulhastings.com

### Chicago

Thaddeus (Thad) J. Malik  
1.312.499.6020  
thaddeusmalik@paulhastings.com

### Hong Kong

Neil Torpey  
852.2867.9902  
neiltorpey@paulhastings.com

Steven D. Winegar  
852.2867.9003  
stevenwinegar@paulhastings.com

### London

Joel M. Simon  
44.20.3023.5122  
joelsimon@paulhastings.com

### Los Angeles

Siobhan M. Burke  
1.213.683.6282  
siobhanburke@paulhastings.com

Robert R. Carlson  
1.213.683.6220  
robcarlson@paulhastings.com

Robert A. Miller, Jr.  
1.213.683.6254  
robertmiller@paulhastings.com

### New York

Michael K. Chernick  
1.212.318.6065  
michaelchernick@paulhastings.com

Keith C. Gartner  
1.212.318.6398  
keithgartner@paulhastings.com

Yariv C. Katz  
1.212.318.6393  
yarivkatz@paulhastings.com

Jeffrey J. Pellegrino  
1.212.318.6932  
jeffreypellegrino@paulhastings.com

Keith D. Pisani  
1.212.318.6053  
keithpisani@paulhastings.com

Scott R. Saks  
1.212.318.6311  
scottsaks@paulhastings.com

William F. Schwitter  
1.212.318.6400  
williamschwitter@paulhastings.com

Michael L. Zuppone  
1.212.318.6906  
michaelzuppone@paulhastings.com

### Orange County

Stephen D. Cooke  
1.714.668.6264  
stephencooke@paulhastings.com

John F. Della Grotta  
1.714.668.6210  
johndellagrotta@paulhastings.com

### Palo Alto

Robert A. Claassen  
1.650.320.1884  
robertclaassen@paulhastings.com

Jeffrey T. Hartlin  
1.650.320.1804  
jeffhartlin@paulhastings.com

### San Diego

Leigh P. Ryan  
1.858.458.3036  
leighryan@paulhastings.com

Teri O'Brien  
1.858.458.3031  
teriobrien@paulhastings.com

### San Francisco

Thomas R. Pollock  
1.415.856.7047  
thomaspollock@paulhastings.com

### Tokyo

Kenju Watanabe  
81.3.6229.6003  
kenjuwatanabe@paulhastings.com

- 
- <sup>1</sup> The NYSE left open the possibility that other management-supported governance proposals will be treated as non-routine “Broker May Not Vote” matters. Public companies should consult with the NYSE staff as to how other matters not listed in the NYSE’s guidance are impacted by the changes to Rule 452.
  - <sup>2</sup> In 2009, the SEC approved a NYSE proposal to ban brokers from voting uninstructed shares in uncontested board elections (excluding directors of registered investment companies). The Dodd-Frank Wall Street Reform and Consumer Protection Act endorsed this approach, and also prohibited brokers from voting uninstructed shares on proposals related to executive compensation, including management say-on-pay votes.
  - <sup>3</sup> One unintended effect of Rule 452 changes may be that certain stockholder-friendly proposals supported by company management, such as repealing supermajority threshold rules or declassifying a board, may be more difficult to get approved by stockholders.