

# Broker Discretionary Voting in Director Elections Is Eliminated

On July 1, 2009, the Securities and Exchange Commission (SEC), by a 3-2 vote of the commissioners, approved an amendment to NYSE Rule 452 to eliminate broker discretionary voting in the election of directors. Since nearly all brokerage firms are members of the New York Stock Exchange (NYSE), this rule change will affect all elections of directors for U.S. public companies. The amendment takes effect for stockholders meetings held on or after January 1, 2010 (but not a meeting originally scheduled to be held in 2009 that is properly adjourned to a date on or after January 1, 2010). The new rule will not apply to registered investment companies.

The amendment was originally proposed in October 2006 and has been subject to extensive comment and debate. The new rule could have a great effect on director elections, especially for companies with a large retail stockholder base, as retail holders often do not vote in annual elections and brokers tend to vote overwhelmingly in favor of management's nominees where they have had discretionary voting in director elections.

Most stockholders of U.S. public companies hold shares indirectly through a brokerage firm, bank nominee or other custodian. Such ownership is referred to as being in "street name" rather than being held directly as a record holder in the company's stock record books. Where shares are held in street name, the brokerage firm rather than the beneficial owner votes the shares.

The NYSE has rules that apply to its member brokerage firms that address the firms' obligations in connection with the voting of shares held in brokerage accounts. Under these rules, when a public company furnishes proxy materials to its record holders, the brokerage firms are required to deliver the materials to their customers who hold the securities in their accounts within a certain time frame and request voting instructions from the customers. If a customer returns voting instructions to the broker on a timely basis, the broker votes the shares in accordance with the instructions.

The rule change addresses what happens when a beneficial owner does not provide voting instructions on a timely basis. The NYSE rules divide voting matters between "routine" items, where the broker is authorized to vote in its discretion if voting instructions are not received by the tenth day before the meeting date, and

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non-routine items, where the broker does not have authority to vote without instructions from the beneficial owner. Rule 452 includes a list of 14 items that are generally considered non-routine, including any action that is subject to a "contest" between management and another party. Uncontested elections of directors have been considered routine.

The amendment to Rule 452 will include all director elections as non-routine, and as a result a broker will not be able to vote in a director election unless it receives instructions from the beneficial owner.

As evidenced by the 3-2 vote of the SEC commissioners to approve the amendment and the long delay and numerous comment letters, the amendment eliminating broker discretionary voting in director elections is controversial. The SEC's release approving the rule change addressed a number of issues raised by commentators in connection with the change:

- It may be more difficult or more expensive to achieve a quorum for an annual meeting, particularly for companies with a large retail stockholder base. Inclusion of a routine item, such as the ratification of auditors, should allow a company to avoid this potential issue since brokers would still have discretion to vote on such a routine item.
- The rule change may increase the influence of institutional investors and the proxy advisory firms that provide recommendations to institutional investors.
- The rule change may increase the risk of the defeat of management nominees for a company that has adopted a majority voting standard and may discourage companies from adopting majority voting in the election of directors.
- The impact of the rule change may be magnified if the SEC makes other changes to the proxy rules, including the proposed change to allow certain stockholders access to management's proxy and proxy statement for a limited number of director nominees.<sup>1</sup> A number of commentators requested that the SEC delay approval of the NYSE rule change in order to consider the change in the context of a broader overhaul of the proxy rules.

If you have any questions about the amendment to NYSE Rule 452, please contact your Reinhart attorney or a member of [Reinhart's Securities Team](#).

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<sup>1</sup> The SEC recently proposed rules requiring U.S. public companies to provide proxy access to stockholders and stockholder groups meeting certain ownership thresholds to nominate a limited number of director candidates to run against



management's nominees. See "Facilitating Shareholder Director Nominations," Release No. 34-60089 (June 10, 2009).

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