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# New Limits on Broker Discretionary Voting on Corporate Governance Proposals and other Proxy Season Considerations

The New York Stock Exchange (the "NYSE") recently announced a modification to the application of NYSE Rule 452 ("Rule 452") that will further restrict when brokers may exercise discretionary voting authority on certain corporate governance proxy proposals. This change affects nearly all public companies, not just NYSE-listed companies, because Rule 452 applies to all brokers that are NYSE members. This change could significantly increase the difficulty public companies will face in obtaining shareholder approval for such proposals. In addition, in light of last year's say on pay votes and the advent of shareholder proxy access proposals, public companies should consider additional actions and disclosure in the 2012 proxy season.

## *Elimination of Broker Discretionary Voting for Certain Corporate Governance Proposals*

On January 25, 2012, the NYSE issued an Information Memo to revise the application of Rule 452 to eliminate broker discretionary voting for certain corporate governance proposals. This change means that brokers affiliated with NYSE member organizations can no longer vote on certain corporate governance matters with respect to any public company without instructions from their clients. The change is effective immediately, so companies planning to submit corporate governance proposals for shareholder approval at their 2012 annual meetings will need to consider its potential impact.

Rule 452 provides that brokers affiliated with NYSE member organizations may exercise discretionary voting authority for certain routine matters, but may not vote on certain non-routine proposals without specific instructions from the shareholder. Given the recent regulatory and public policy trends disfavoring broker voting on uninstructed shares, the NYSE has further limited the proposals for which brokers may exercise discretionary voting authority. Specifically, the NYSE listed the following as examples of proposals that are now categorized as "Broker May Not Vote":

- proposals to de-stagger the board of directors;
- majority voting in the election of directors;
- eliminating supermajority voting requirements;
- providing for the use of written consents;
- providing rights to call a special meeting; and
- certain types of anti-takeover provision overrides.

Gerald Roach
Bio l 919.821.6668
groach@smithlaw.com

Amy Meyers Batten
Bio l 919.821.6677
abatten@smithlaw.com

Margaret Rosenfeld
Bio l 919.821.6714
mrosenfeld@smithlaw.com

The most direct implication of this change is that it will increase the difficulty faced by companies in obtaining the requisite shareholder approval of these and possibly other corporate governance proposals, particularly proposals that require the affirmative vote of a majority or more of a company's outstanding shares pursuant to the company's articles of incorporation or bylaws. With respect to such proposals, the broker non-votes resulting from this change in the application of Rule 452 will have the same effect as a vote against the proposal. Shareholder support of proposals requiring only the approval of a majority of the shares present and entitled to vote at a meeting may also become more difficult to obtain. In the past, broker discretionary votes may have assisted a company in obtaining the approval of a majority of the shares present and entitled to vote at a meeting, as brokers typically vote in accordance with management's recommendations. Due to increased difficulty in obtaining shareholder approval without broker votes, public companies may find they need to incur additional proxy solicitation costs to gather enough support for approval.

The change in the application of Rule 452 does not impact broker discretionary voting authority on ratification of auditors, which is still considered a routine matter as to which brokers may vote uninstructed shares. As long as brokers have discretion to vote on at least one proposal to be considered at a shareholder meeting, uninstructed shares can still be deemed present at the meeting for quorum purposes. Therefore, so long as they present an auditor ratification proposal, public companies may still use broker discretionary votes to ensure a quorum at shareholder meetings.

*Additional Proxy Season Considerations*

As we noted in our February 16, 2011 Client Alert, most companies were required to submit say on pay and say on frequency proposals for the first time at their 2011 annual shareholder meetings. Fortunately, the say on pay vote turned out favorably for the majority of companies, with most companies receiving support from their shareholders in excess of 90%. However, more than 40 companies failed to obtain shareholder approval of their say on pay proposal last year, and institutional investors may be more critical of companies' executive compensation practices in say on pay's second year. In fact, there has already been at least one failed vote in 2012. Last year, shareholders at more than 80% of companies voted to hold an annual say on pay vote, rather than once every two or three years. In addition, in the 2012 proxy season, we expect that shareholder proposals regarding proxy access will likely increase as a result of the new rules permitting such proposals. Below are some practical considerations to assist public companies as they prepare for the upcoming proxy season.

***Consider Engaging Your Shareholders***. As mentioned above, most companies received significant support for their executive compensation practices, signifying an acceptable level of shareholder satisfaction. However, companies that did not receive approval of their say on pay vote, or received approval by a narrower margin than expected, should consider initiating discussions with their shareholder base to solicit reasons for the lack of support, particularly if they must hold another say on pay vote this year. In addition, it is important to consider and understand the impact of proxy advisory services' recommendations. Institutional Shareholder Services Inc. ("ISS") has stated that if a company does not receive at least a 70% support rate for its say on pay resolution, then ISS will have concern about such company's compensation practices and will give additional scrutiny to such company's compensation practices and disclosure. Knowing why shareholders did not vote in favor of a company's say on pay resolution last year will provide it with the opportunity to address these concerns in the company's upcoming proxy statement, or in the company's implementation of its compensation practices generally, to garner more shareholder support this year.

***Include Additional Disclosure in Your CD&A***. Certain rules issued by the Securities and Exchange Commission (the "SEC") require public companies to disclose in their Compensation Discussion and Analysis ("CD&A") whether the company has considered the results of the most recent say on pay vote in determining compensation policies and decisions and, if so, how that consideration affected the company's executive compensation decisions and policies. As 2011 was the first time many companies submitted a say on pay proposal for shareholder approval, this proxy season will be the first time most companies will be required to include this disclosure. The SEC will likely be monitoring compliance with this disclosure requirement in this year's proxy statements, so companies may want to consider providing this disclosure under a separate heading in their CD&A to highlight its inclusion.

***Prepare for Proxy Access Proposals from Shareholders***. Although the SEC's previously proposed rule mandating proxy access was vacated by the U.S. Court of Appeals for the District of Columbia Circuit in July of last year, the related amendment to SEC rules permitting shareholder proposals regarding proxy access was not affected by the court's decision and became effective in September 2011. Shareholders now have the ability to include nominees for director in a company's proxy statement so long as the company's bylaws permit it (referred to as "private ordering"). As a result, in the 2012 proxy season we expect that shareholder proposals requiring the adoption of bylaw amendments related to proxy access will increase. In preparation for these proposals, public companies should determine the likelihood of receiving such a proposal and the appropriate response. Companies may choose to preemptively adopt a proxy access bylaw that is more company-friendly than an expected shareholder proposal or take a "wait and see" approach. The risk of the "wait and see" approach is that a company may receive a shareholder proposal requiring the board to adopt a proxy access bylaw amendment with specific language that is less favorable to the company. A company that receives a proxy access shareholder proposal could seek the SEC's permission to exclude the proposal from the ballot by either (a) adopting a proxy access bylaw in advance of the shareholder meeting or (b) proposing its own proxy access bylaw for shareholder approval. In any case, all public companies would be well served to review their current bylaws and consider additions/amendments to any advance notice provisions or specific director qualifications in their bylaws. Some practitioners expect that, much like majority voting provisions a few years ago, proxy access bylaws may eventually become the norm, so public companies should give some consideration to how they might incorporate proxy access into their organizational documents and corporate policies as necessary or appropriate.

***Monitor Upcoming Rulemaking***. The SEC has issued a timetable setting forth its expected implementation of new corporate governance and disclosure requirements mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). The following is the estimated timetable of some notable rules expected to be adopted or proposed this year:

- January 2012 – June 2012:
    - adopt exchange listing standards regarding compensation committee independence and factors affecting compensation adviser independence;
    - adopt disclosure rules regarding compensation consultant conflicts;
    - propose rules regarding disclosure of pay-for-performance, pay ratios, and hedging by employees and directors;
    - propose rules regarding recovery ("clawback") of executive compensation; and
    - adopt rules regarding disclosure related to "conflict minerals."
- July 2012 – December 2012:
    - adopt rules regarding disclosure of pay-for-performance, pay ratios, and hedging by employees and directors; and
    - adopt rules regarding recovery ("clawback") of executive compensation.

This timetable has been in flux as the SEC tries to keep up with the large number of rules, regulations, and studies it must implement under the Act. Companies should actively monitor the SEC's progress in proposing and adopting these rules in order to allow sufficient time to ensure compliance with applicable rules.

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While every effort has been made to ensure the accuracy of this memorandum, it is not intended to provide legal advice as individual situations will differ and should be discussed with an expert and/or lawyer. For specific technical or legal advice on the information provided in this memorandum and related topics, please contact Gerald Roach (919.821.6668), Amy Batten (919.821.6677), or Margaret Rosenfeld (919.821.6714).

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**SMITH, ANDERSON, BLOUNT, DORSETT, MITCHELL & JERNIGAN, L.L.P.**

**Offices**:
Wells Fargo Capitol Center, Suite 2300
Raleigh, North Carolina 27601
**Mailing Address**:
Post Office Box 2611
Raleigh, North Carolina 27602
**Telephone**: 919.821.1220 **Facsimile**: 919.821.6800
**Email**: info@smithlaw.com **Website**: www.smithlaw.com