CLEARY GOTTLIEB Alert Memo

NEW YORK JULY 1, 2009

www.clearygottlieb.com

Responding to Elimination of Broker Discretionary Voting in Elections of Directors

Brokers will no longer vote "uninstructed shares" in director elections as a result of the SEC's approval on July 1, 2009, by a 3-2 vote, of an amendment of NYSE Rule 452. This change to rules governing brokers that are NYSE members will apply to all stockholder meetings of publicly-listed companies, whether or not listed on the NYSE, commencing January 1, 2010.

Supporters of the amendment have long bridled against the voting of shares by brokers generally in favor of company slates when stockholders do not provide voting instructions. Whatever the view of the merits of this sentiment, this change raises a number of practical issues that public companies of all sizes need to keep in mind.

How Rule 452 Works

Beneficial owners of stock in a listed company that hold their shares in "Street" name receive proxy solicitation materials and vote through their brokers. If the beneficial owners do not provide their brokers with voting instructions, then the brokers may vote the uninstructed shares in their discretion on matters the NYSE deems "routine." Today's amendment reclassifies uncontested elections of directors from "routine" to "non-routine" (the same classification applicable to contested elections) and thereby eliminates discretionary voting by brokers of uninstructed shares in all elections of directors. The amendment does not affect foreign private issuers because Rule 452 deems all votes at their stockholders meetings to be "non-routine" since they are not subject to U.S. proxy rules.

Impact of Amendment

Broker Voting in Support of Company Slates

- Under the current regime, the majority of brokers vote uninstructed shares in accordance with the recommendation of the board. Most other brokers vote uninstructed shares in proportion to instructions actually received from retail holders – an approach that has similarly resulted in brokers' voting most uninstructed shares in favor of the company slate of directors.

- Factors that may exacerbate the significance of losing the affirmative vote of uninstructed shares in director elections include:

  - Loss of Voting Block Immune to Proxy Advisory Services. The leading proxy advisory services, in particular, RiskMetrics and Glass-Lewis, are adopting an ever-growing list of automatic and potential triggers for recommendations to their institutional stockholder clients to vote "against" or "withhold," as opposed to "for," company slates. The holdings of these institutional investors typically will not constitute uninstructed shares. The loss of the uninstructed votes of retail holders, who as a rule are much less likely to adhere to (or even be aware of) the recommendations of the proxy advisory services in uncontested elections, will eliminate a counterweight at some companies to the influence of the proxy advisory services.

  - "Notice and Access". The use of the notice and access model for Internet distribution of proxy statements, while saving significant printing and mailing fees, has resulted in an increase in the number of uninstructed shares. Companies with significant retail holdings may need to apply greater efforts in future proxy seasons to accelerate retail holders' becoming familiar and comfortable with this model so that the incidence of uninstructed shares decreases.

  - Majority Voting Standards. Nearly 70% of the S&P 500 has adopted one of the means for implementing "a majority of the votes cast" standard in uncontested elections of directors. While the percentage of smaller companies that have adopted majority voting is considerably lower, and while larger companies generally have lower percentages of retail voters and therefore are less impacted by this amendment, in some cases the consequence of not having the support of what has typically been a safe block of votes for the company slate will be significant. Only 32 directors of U.S. public companies failed to receive a "majority of the votes cast" in 2008 according to RiskMetrics data. We may see this figure increase in the 2010 proxy season as a result of the amendment of Rule 452.

  - "Vote No" Campaigns. Campaigns to cast "against" or "withhold" votes on company proxy cards for the election of company slates, when unaccompanied by support for any alternative nominees, are inexpensive because these campaigns can be run without the need to distribute a proxy statement or proxy card. The increased likelihood of success for these types of campaigns that may result from the subtraction of the safe block of uninstructed votes may encourage the use of these campaigns.

- Quorum Risks. Uninstructed shares will not count toward a quorum where only "non-routine" matters are on the agenda (e.g., only the election of directors). Some companies, particularly those with small market capitalization where retail holders beneficially own a majority or even a significant minority percentage of the outstanding shares, may find it difficult to obtain a quorum in 2010 without counting uninstructed shareholdings.

Next Steps for Boards of Directors and Management

Refocus on Stockholder Outreach

- The board should stay updated about the stockholder profile of the company, recent feedback from stockholders and what issues are on the horizon for the company that may trigger a proxy advisory service to issue a negative recommendation on director re-election. In addition, boards should be discussing with management the advisability of non-deal roadshows by management to enhance investor relations and feedback and consider involvement of a lead independent director or other non-management directors in targeted outreach efforts.

Determine Pro Forma Impact

- Boards should consider having their proxy solicitors run pro forma calculations of election results at recent annual meetings giving effect to today's Rule 452 amendment.
  - In 2003, the SEC approved an amendment of Rule 452 to reclassify votes on equity compensation plans as "non-routine" and thereby eliminated broker discretionary voting for these plans. Accordingly, an examination of recent voting patterns on these matters may be a good proxy for assessing the impact that today's amendment will have on director elections.

Take Steps to Protect Ability to Achieve a Quorum

- Companies dependent upon retail holders to satisfy quorum requirements (mostly small caps) should assure that a "routine" item (e.g., ratification of the outside auditor) appears on each stockholder meeting agenda. Brokers may use uninstructed shares to satisfy quorum requirements, for purposes of all agenda items, only if at least one of the agenda items qualifies as a "routine" item for purposes of Rule 452.

Review Majority Voting Standards

- All "majority voting" standards are not the same. Some purport to remove automatically any incumbent director who fails to receive a majority vote, while others grant boards different degrees of discretion and for different periods of time to assess the context before permitting the removal or resignation of an incumbent director. Whether a board is considering the adoption of a majority voting standard or already has one in place, it may be worthwhile to revisit the particulars of majority voting provisions and fully understand their consequences in view of the increased difficulty that some directors may face satisfying this standard as a result of the amendment of Rule 452.

Review Board Succession Plans

- The board should review its director succession plans. While many companies already undertake some degree of succession planning, today's changes spotlight the need to intensify these efforts. Developing and periodically reviewing with the full board a list of possible candidates with a range of experience, skills and other qualifications will allow the board to respond on a timely and thoughtful basis if an incumbent fails to be elected.

Stay Tuned

- At today's SEC open meeting, the Commissioners remarked that the SEC would be revisiting other elements of the "plumbing" of the proxy voting process during 2009. Among the topics we expect the SEC to address are:

  - "empty" voting (i.e., when a stockholder retains the right to vote shares owned on the record date, even though the stockholder ceases to own the shares at the date of the meeting),

  - "objecting beneficial owners" or "OBOs" (i.e., investors holding in "Street" name that object to disclosure of information to the company that would enable the company to contact them directly), and

  - improvements to the "notice and access" model.

  These initiatives may result in rule changes that offset some of the impact of today's amendment of Rule 452. The OBO situation in particular, which is the result of the SEC's own outdated rules in this area, could be profitably addressed to lead to a greater ability of companies to communicate with stockholders and more and better informed retail participation in the voting process.

While today's amendment of Rule 452 may put more pressure on management and boards, there are many large cap companies where institutional ownership is large enough relative to retail ownership that there will be no meaningful impact. But perhaps the most important factor that may mitigate the impact of the amendment will be a growing responsiveness of companies to the concerns of stockholders.

* * *

For further information on this subject, please contact any of your regular contacts at the firm or any of our partners and counsel listed under "Capital Markets," "Corporate Governance" or "Mergers, Acquisitions and Joint Ventures" in the "Our Practice" section of our website (http://www.clearygottlieb.com).

CLEARY GOTTLIEB STEEN & HAMILTON LLP

CLEARY GOTTLIEB

Office Locations

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
1 212 225 2000
1 212 225 3999 Fax

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
1 202 974 1500
1 202 974 1999 Fax

PARIS
12, rue de Tilsitt
75008 Paris, France
33 1 40 74 68 00
33 1 40 74 68 88 Fax

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
32 2 287 2000
32 2 231 1661 Fax

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
44 20 7614 2200
44 20 7600 1698 Fax

MOSCOW
Cleary Gottlieb Steen & Hamilton LLP
CGS&H Limited Liability Company
Paveletskaya Square 2/3
Moscow, Russia 115054
7 495 660 8500
7 495 660 8505 Fax

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
49 69 97103 0
49 69 97103 199 Fax

COLOGNE
Theodor-Heuss-Ring 9
50668 Cologne, Germany
49 221 80040 0
49 221 80040 199 Fax

ROME
Piazza di Spagna 15
00187 Rome, Italy
39 06 69 52 21
39 06 69 20 06 65 Fax

MILAN
Via San Paolo 7
20121 Milan, Italy
39 02 72 60 81
39 02 86 98 44 40 Fax

HONG KONG
Bank of China Tower
One Garden Road
Hong Kong
852 2521 4122
852 2845 9026 Fax

BEIJING
Twin Towers – West
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
86 10 5920 1000
86 10 5879 3902 Fax