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Alerts for Shareholder Voting in 2010: Broker Discretionary Voting and Updates to RiskMetrics' U.S. Policies

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Elimination of Broker Discretionary Voting in Uncontested Director Elections

On January 1, an amendment to New York Stock Exchange Rule 452 went into effect that eliminated a broker's authority to vote in its discretion in uncontested director elections when not given explicit instructions by the beneficial owner of the stock. Rule 452 allows brokers that hold shares of stock in "street name" to vote on certain "routine" matters at shareholders' meetings if the beneficial owner of those shares, after having received proxy solicitation materials from its broker, does not provide voting instructions to such broker within ten days of the shareholders' meeting. Prior to the new amendment, Rule 452 did not list uncontested director elections as a "non-routine" matter (or a matter for which a broker was prohibited from granting a proxy to vote if the broker lacks instructions from the beneficial owner). As a result many "withhold the vote campaigns" fail due to broker discretionary votes, which overwhelmingly are cast in favor of management nominees. However, the amendment revises the Rule to include uncontested director elections in the list of "non-routine" matters so that management will no longer be able to rely on the broker discretionary vote to push through their slate of nominees.

The elimination of discretionary broker voting for uncontested director elections raises a number of issues related to voting at shareholders' meetings in general. Perhaps the most pressing concern for the upcoming proxy season relates to the issue of establishing a quorum. Achieving quorum for any matter brought forth at a shareholders' meeting (including a "routine" matter) results in a quorum for the entire meeting. Management can no longer depend on broker discretionary votes in uncontested director elections to attain a quorum since this will now be considered a "non-routine" matter. It is imperative that companies, especially ones with large retail investor bases, include at least one "routine" matter (such as independent auditor ratification) on their meeting agenda so that broker discretionary votes will count for at least one matter and a quorum can be achieved.

As noted above, there are other issues raised by the amendment to NYSE Rule 452. Without the "yes" votes from individual retail shareholders, some companies may find their slate of directors subject to the whim of certain institutional investors or "withhold the vote campaigns" initiated by activist investors. Companies that have large retail investor bases or that have majority vote bylaw provisions related to director elections (forcing directors who do not garner a majority of votes cast to submit their resignation) will need to have a well-planned strategy to educate and reach out to retail shareholders about the changes to the Rule and the importance of their vote; a contingency plan should also be in place in the event that there is a failed director election. In planning their investor outreach efforts, management should work closely with brokers in order to impact the greatest number of retail investors, since some of those investors may only be contacted via their broker, and in order to determine whether its outreach strategy comports with the company's or the broker's investor notification procedures under the newly devised e-proxy rules.

The new Rule 452 will invariably give more influence to institutional investors over director elections due to the lowered voting participation levels by retail investors that can be expected from such an amendment. Consequently, even more attention should be paid to the guidelines of proxy advisory service companies such as RiskMetrics that advise institutional investors and can recommend a "withhold" or "against" vote by such investors if a company's policies are not compatible with certain standards.

2010 Updates to RiskMetrics' U.S. Benchmark Policy Guidelines

Adoption or Renewal of Non-Shareholder Approved Poison Pills

The shareholder rights plan, more commonly known as a poison pill, is a familiar anti-takeover device and is viewed by some shareholders as a tool for management to entrench themselves and discourage transactions that could increase shareholder value. In general, RiskMetrics encourages all companies contemplating implementation of a poison pill to seek shareholder approval; however, if shareholder approval is not sought for pills adopted after November 19, 2009, RiskMetrics' updated policy will be to:

(1) In most cases, recommend "withhold" or "against" votes for all director nominees on the management slate if a company has adopted a long-term (greater than one year) poison pill or renews a short-term pill without shareholder approval. RiskMetrics will review full slate companies at least once every three years and companies with classified boards will be reviewed annually; or

(2) Consider, on a case-by-case basis, whether to recommend "withhold" or "against" votes for all director nominees on the management slate if the company has adopted a short-term poison pill. RiskMetrics will consider such factors as the timing of the adoption of the short-term pill, reasons for adoption, the company's governance structure and its track record for accountability in its case-by-case assessment.

RiskMetrics is clarifying its policy so that certain short-term pills that are put in place in response to a threat that could negatively affect shareholders are treated differently from pills that may be viewed as a tool to entrench management. It should also be noted that RiskMetrics has a separate policy for poison pills designed to protect a company's net operating loss.

Director Independence

For all companies, RiskMetrics currently determines whether an outside director is an "affiliated outside" director or truly "independent" based on a NASDAQ-based materiality test with regard to that director's professional and transactional relationships with the company. The distinction can be crucial, since RiskMetrics will recommend a "withhold" or "against" vote for any "affiliated outside" director who sits on the compensation, nominating or audit committees of the company's board. RiskMetrics' updated policy will more clearly define material professional services to be "advisory in nature" and will apply the NASDAQ-based materiality test (greater of $200,000 or 5% of the gross revenues of the entity affiliated with the director) to NASDAQ-listed companies, while applying an NYSE-based materiality test (greater of $1,000,000 or 2% of the gross revenues of the entity affiliated with the director) to NYSE- and AMEX-listed companies. NYSE- and AMEX-listed companies may want to reassess the make-up of their board committees in light of these revised standards.

Executive Compensation Evaluation

RiskMetrics' evaluation of executive compensation practices has been based on various guidelines and can affect its analysis and recommendations in a number of areas including proposals for compensation plans, board elections (particularly with respect to compensation committee members) and advisory votes on executive compensation, also called management "say-on-pay" (MSOP) proposals. In light of the recent increased focus on executive compensation as well as the possibility that Congress may soon mandate the use of MSOP proposals, RiskMetrics is updating its policies to provide for a holistic Executive Compensation Evaluation, which integrates its existing policies regarding Pay-for-Performance, Options Backdating and Poor Pay Practices with its policies on MSOP proposals.

RiskMetrics has made it clear that MSOP proposals will be the principal route by which it will express its views on executive compensation with recommendations for "withhold" or "against" votes for compensation committee or board members reserved for particularly egregious circumstances. However, if concerns are not rectified in the following year, RiskMetrics will recommend "against" votes for compensation committee or board members.

Additionally, as part of the newly organized Executive Compensation Evaluation, RiskMetrics has updated two of its policies as described below:

(1) In its Pay-for-Performance evaluation, in the event a company falls below a certain performance threshold, RiskMetrics will now assess the CEO's pay (as measured by total direct compensation) by aligning it with total shareholder return over a period of at least five years instead of three years; and

(2) In order to discourage pay practices that promote excessive risk-taking, RiskMetrics' Problematic Pay Practices evaluation will now include consideration of whether certain practices incentivize risky behavior; however, such negative evaluations can be mitigated by the use of clawback policies or stock ownership/holding requirements.

Greenhouse Gas Emissions

In recent years, there has been an increase in requests for socially responsible shareholder proposals that would require, if approved, the subject company to meet certain milestones regarding greenhouse gas emissions. RiskMetrics' updated policy is to evaluate these proposals on a case-by-case basis factoring in such concerns as whether the proposal is overly prescriptive, the quality of the company's disclosures and the feasibility of greenhouse gas reductions.

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