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Katten Muchin Rosenman LLP

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Alerts for Shareholder Voting in 2010: Elimination of NYSE Broker Discretionary Voting in Uncontested Director Elections and Updates to RiskMetrics' U.S. Policies Now Effective

Broker Discretionary Voting Eliminated 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 (i.e., a matter for which a broker was prohibited from granting a proxy to vote if the broker lacked instructions from the beneficial owner). However, the newly effected 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 broker discretionary votes to help ensure that its nominees receive a requisite number of votes in their favor.[1]

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, or a minimum number of voting shares present at a meeting in order for business to be conducted. Achieving a quorum for any matter brought forth at a

[1] With the elimination of broker discretionary voting for uncontested director elections, in the context of director elections by plurality voting (in which directors need only receive the most votes cast in their favor, which, for uncontested elections, is simply a single vote), a potentially large percentage of opposition votes against a management nominee that may stem from a "withhold the vote" or "vote no" campaign can lead to public and investor relations concerns. In the context of director elections by majority voting (in which directors must receive a majority of the votes cast at the meeting), without the benefit of broker discretionary votes, "withhold the vote" or "vote no" campaigns can have an even more profound effect on corporate governance, as director nominees who fail to achieve such majority could be faced with the prospect of forced resignation from the board.

For more information, please contact your Katten Muchin Rosenman LLP attorney, or any of the following members of Katten's Securities Practice.

Chicago

Matthew S. Brown
312.902.5207 / matthew.brown@kattenlaw.com

Michael J. Diver
312.902.5671 / michael.diver@kattenlaw.com

Adam R. Klein
312.902.5469 / adam.klein@kattenlaw.com

Lawrence D. Levin
312.902.5654 / lawrence.levin@kattenlaw.com

Ram Padmanabhan
312.902.5520 / rp@kattenlaw.com

Jeffrey R. Patt
312.902.5604 / jeffrey.patt@kattenlaw.com

Herbert S. Wander
312.902.5267 / hwander@kattenlaw.com

Maryann A. Waryjas
312.902.5461 / maryann.waryjas@kattenlaw.com

Robert J. Wild
312.902.5567 / robert.wild@kattenlaw.com

Mark D. Wood
312.902.5493 / mark.wood@kattenlaw.com

Los Angeles

Mark A. Conley
310.788.4690 / mark.conley@kattenlaw.com

New York

Todd J. Emmerman
212.940.8873 / todd.emmerman@kattenlaw.com

Robert L. Kohl
212.940.6380 / robert.kohl@kattenlaw.com

David H. Landau
212.940.6608 / david.landau@kattenlaw.com

David A. Pentlow
212.940.6412 / david.pentlow@kattenlaw.com

Wayne A. Wald
212.940.8508 / wayne.wald@kattenlaw.com

Washington, D.C.

Jeffrey M. Werthan
202.625.3569 / jeff.werthan@kattenlaw.com

Frank Zarb
202.625.3613 / frank.zarb@kattenlaw.com

www.kattenlaw.com

shareholders' meeting (including a "routine" matter) results in a quorum for the entire meeting. Management will no longer be able to depend on broker discretionary votes in uncontested director elections to attain a quorum since this will now be considered a "non-routine" matter.[2] It will be imperative that companies, especially ones with large retail investor bases,[3] 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 retail shareholders, some companies may find that the votes of their institutional investors or "withhold the vote" or "vote no" campaigns initiated by activist investors have a larger impact on director elections. Companies 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), particularly those with large retail investor bases, 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 their proxy solicitors and transfer agents to impact the greatest number of retail investors and to determine whether their outreach strategy comports with the company's investor notification procedures under the e-proxy rules.[4]

The new Rule 452 invariably gives more influence to institutional investors over director elections due to the lowered voting levels by retail investors that can be expected. 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 RiskMetrics' standards.

RiskMetrics' Policy Updates for 2010 Take Effect

RiskMetrics Group is a highly influential proxy advisory service company whose voting recommendations are taken into account by institutional investors in determining how to vote at shareholder meetings. RiskMetrics updates its benchmark policy guidelines annually, and it is essential that public companies understand how these updates can affect voting on their shareholder meeting agenda items. The following summarizes some of the key updates to RiskMetrics' U.S. guidelines for 2010.

Adoption or Renewal of Non-Shareholder Approved Poison Pills

A shareholder rights plan, more commonly known as a poison pill, is a familiar anti-takeover device that 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 and, as discussed below, has had guidelines regarding non-shareholder approved short-term (less than one year) and long-term pills.[5] RiskMetrics' updated poison pill policy is to evaluate all non-shareholder approved poison pills more rigorously than before, while also providing flexibility with respect to certain short-term pills that are implemented in response to a threat that could negatively affect shareholders and to ensure that they are treated differently from long-term pills that may be viewed as a tool to entrench management. *The revised guidelines do not apply to poison pills adopted*

2 If the only matters brought forth at a shareholders' meeting are "non-routine" matters, brokers cannot ever be expected to return a proxy for that meeting with respect to shares they hold other than those for which explicit voting instructions have been given by a beneficial owner. Accordingly, the shares for which no instructions have been received will not be included for purposes of satisfying the quorum requirement.

3 Unlike securities owned by institutional investors, it is common for securities owned by retail investors to be held by brokers in "street name."

4 Rather than the traditional method of sending its security holders a full set of proxy materials, under the e-proxy rules that went into effect for all issuers on January 1, 2009, issuers have the option of distributing proxy materials to their security holders by the notice and access method, which, generally speaking, consists of sending holders a notice of the availability of proxy materials on a public website. Broadridge statistics have shown that delivery of proxy materials using the notice and access method lowered voting rates among retail investors. With the increased importance of the retail vote due to the Rule 452 amendment, companies should carefully consider if and how to use the notice and access method.

5 RiskMetrics has a separate policy for poison pills designed to protect a company's net operating loss. It evaluates such pills on factors such as what triggers the pill, the value of the net operating loss, shareholder protective provisions and the company's governance structure and track record.

prior to November 19, 2009. But, for poison pills adopted or renewed after such date, if shareholder approval is not sought, RiskMetrics' updated policy is 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 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;[6] 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.[7]

Director Independence

For all companies, RiskMetrics previously determined whether an outside director was an "affiliated outside" director or a truly "independent" director based on a materiality test used by NASDAQ[8] with regard to that director's professional and transactional relationships with the company. The determination 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 apply the NASDAQ-based materiality test to NASDAQ-listed companies and apply an NYSE-based materiality test[9] to NYSE- and NYSE Amex-listed companies. NYSE- and NYSE Amex-listed companies may want to reassess the makeup of their board committees in light of these revised standards, since some of the individuals on their boards who RiskMetrics' would previously have found unqualified to sit on a compensation, nominating or audit committee may now be found to be qualified.

In addition, RiskMetrics has updated its director independence policy to more clearly define material professional services as those that are "advisory in nature, generally involving access to sensitive company information or to strategic decision-making, and typically having a commission or fee-based payment structure."[10]

Executive Compensation Evaluation

RiskMetrics evaluates executive compensation practices based on various guidelines; these evaluations affect RiskMetrics' 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 referred to as 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 inclusion of MSOP proposals in all shareholder proxies,[11] 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.

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6 Under its previous policy, RiskMetrics would only recommend "withhold" or "against" votes in the first year that a long-term pill was adopted. Under the new policy, a board may need to regularly review its poison pill provisions, as RiskMetrics will be reviewing the pill on an ongoing basis and, in most cases, recommending "withhold" or "against" votes so long as the pill stays in place.

7 As in the case of its updated long-term pill guidelines, the updated RiskMetrics' guidelines for short-term pills are also more stringent than its previous policy, which was to take no adverse actions against companies implementing short-term pills so long as shareholders were given the opportunity to ratify the pill within 12 months of its adoption. With the new "case-by-case" evaluation, board decisions to implement short-term poison pills will be scrutinized by RiskMetrics.

8 Professional or transactional relationships with the company of the greater of $200,000 or 5% of the gross revenues of the entity affiliated with the director.

9 Professional or transactional relationships with the company of the greater of $1,000,000 or 2% of the gross revenues of the entity affiliated with the director.

10 In its director independence analysis, RiskMetrics also factors in whether the professional services an outside director, or an entity affiliated with such director, provides to a company annually are in excess of a $10,000 threshold.

11 Congress has already mandated that entities receiving financial assistance under the Troubled Asset Relief Program (TARP) include an MSOP proposal on shareholder proxy statements until such time as their financial obligations to the government under TARP have been satisfied.

RiskMetrics has made it clear that MSOP proposals will initially 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 year following a failed MSOP proposal, 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 the median of industry one- and three-year total shareholder return, RiskMetrics will now assess the CEO's pay (as measured by total direct compensation) by evaluating whether it aligns 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 and/or stock ownership/holding requirements.[12]

[12] This updated policy follows the rules recently approved by the SEC requiring disclosure of a company's compensation policies and practices as they relate to risk management if those policies and practices create risks reasonably likely to have a material adverse effect on the company in order to help investors determine whether a company is encouraging excessive or inappropriate risk-taking by its employees.