



KINGSDALE
Shareholder Services Inc.

THE NYSE BROKER DISCRETIONARY VOTING: WHAT DOES IT MEAN FOR YOU?

Executive Summary

On July 1, 2009 the Securities and Exchange Commission approved a change to New York Stock Exchange Rule 452 (and Section 402.08 of the NYSE Listed Company Manual) (the "Rule") that eliminates the ability of brokers to exercise discretionary voting in uncontested director elections. This change adds the election of directors to the list of "non-routine" matters on which NYSE member organizations are prohibited from voting a proxy without receiving voting instructions from a beneficial owner. Because the Rule applies to all brokers that are members of the NYSE, this change will have an impact on all U.S. public companies irrespective of the exchange on which they trade, not just NYSE-listed companies. It will also have an effect on Canadian inter-listed companies; however not as significant. The new Rule will have less effect on Canadian companies listed on U.S. stock exchanges due to the fact that discretionary votes from brokers typically do not make up a significant percentage of the shares represented at meetings. However, Canadian companies should take notice and understand the implications of this new Rule.

The Rule will become effective for all annual and or special meetings held after January 1, 2010 (other than previously scheduled shareholder meetings that have been postponed until after that date).

For U.S. companies, the Rule will be significant in that broker discretionary votes often make up a substantial percentage of the shares represented at annual meetings. Critics of the new Rule have argued that companies will now experience difficulty reaching quorum as a result of the lack of broker discretionary votes, as such, companies may need to include a routine item on their agenda in order to allow broker votes to be counted toward a quorum for the meeting. In addition, the Rule could increase the influence of special interest groups and shareholder activists and could make it more difficult for companies with "majority voting" provisions to achieve a successful election of its directors.

Activist shareholders have long criticized the discretionary voting rule's effect on corporate governance and have voiced concern at its thwarting shareholder rights by stopping them from just saying "no" on the election of directors. The Rule change is, therefore, welcomed by activist shareholders as in addition to hindering their ability to make changes to a board it technically produced flawed results in terms of participation and acceptance of the directors.

Regardless of whether the new Rule brings about the dramatic changes that have been predicted by numerous commentators, issuers may find that, at least in the short term, they need to spend more time soliciting the support of institutional and activist shareholders in advance of their annual meetings as well as to be more aware of their shareholder base and the historical shareholder turnout at uncontested meetings.

Some issuers who have not done so in the past may now find it advisable to include a routine item on the ballot for their 2010 annual meeting to help avoid potential problems with establishing a quorum. Issuers who anticipate significant difficulty with establishing a quorum could even consider lowering the quorum threshold to something less than a majority, if permitted by applicable state law.



The Rule's Background

In April 2005 the NYSE created a Proxy Working Group to review NYSE rules regulating the proxy voting process. The Proxy Working Group concluded that the election of directors should no longer be considered a "routine" event in the life of a corporation, in part because of the authority that directors have over the most fundamental issues of corporate governance, and recommended that brokers be prohibited from voting uninstructed shares with respect to any election of directors.

NYSE Rule 452 provides, in part, that an NYSE member organization may submit a proxy to vote stock on a matter without client instructions if the broker has transmitted proxy soliciting material to the client and has not received voting instructions on that matter at least ten days before the scheduled meeting. However, the Rule contains a specific list of matters on which brokers cannot submit a proxy to vote without first receiving instructions from the client. Generally, this list includes "non-routine" matters that would substantially affect the rights and privileges of shareholders, such as matters relating to a merger or consolidation or authorizing the alteration of the terms or conditions of existing stock.

The Rule's Impact

Upon further analysis of the Rule, it seems that one of the many issues that the Rule creates is that it could have a potentially significant impact on the ability of issuers to obtain sufficient votes for the election of directors. The Rule will afford institutional investors, key interest groups and activist shareholders greater influence over the election of directors for many public companies. A few of the potential issues the Rule changes create are:

1. Establishment of a Quorum

The Rule change, as written, could make it more difficult for an issuer to establish a quorum for the conduct of business at its annual meeting. That will occur if brokers do not receive voting instructions in an uncontested election situation, and no other routine matters are included on the ballot. Accordingly, where all matters on the ballot are non-routine, an issuer may be required to incur additional costs, to ensure the establishment of a quorum.

2. Majority Voting

The revised Rule will definitely affect issuers who have adopted, or are considering the adoption of, a majority voting standard. The inability of brokers to vote uninstructed shares makes it likely that fewer shareholder votes will be cast in an uncontested election of directors. Because fewer votes will be cast, it may be more difficult for a director standing for election to the board of an issuer that has adopted majority voting to receive the number of votes necessary for his or her election or re-election.

3. More Power to Activists & Institutional Investors

If the Rule change results in fewer shares of retail shareholders being voted, then the votes of other "groups", such as institutional investors and shareholder activists, will become more important in the determination of uncontested elections. This may give disproportionate influence to institutional investors and the proxy advisory firms that advise them. Furthermore the Rule may allow activist shareholders to wield greater power, especially in a "no" or "withhold" vote campaign waged on an issuer who has adopted majority voting for the election of its directors.

4. Higher Costs for Uncontested Elections

The revised Rule may force issuers to be more active in soliciting shareholder votes to achieve a quorum and to achieve a majority vote, which could materially increase the cost of uncontested elections. The Proxy Working Group itself noted that "[the rule change] is likely to increase the costs of uncontested elections, as issuers will have to spend more money and effort to reach shareholders who previously did not vote. These costs may increase substantially with the rise of majority voting for directors, as issuers have to obtain the votes from shareholders who may not realize



that their failure to vote constitutes a ‘no’ vote.” The Proxy Working Group went on to note that “[t]hese consequences could fall most dramatically on smaller issuers, who have a smaller proportion of institutional investors and/or have greater difficulty in contacting shareholders and convincing them to vote in uncontested elections.”

Recommendations

In order to prepare for the Rule change, issuers should take action now by analyzing historical shareholder trends and monitoring future extraordinary voting patterns. Senior executives and board members need to assess the impact of the Rule change on future annual meetings, especially in light of factors such as the size of the company’s retail shareholder base, equity holdings by activists, and recent election results.

In particular, companies should consider retaining the services of specialized advisors that can assist them in reviewing and analyzing historical voting trends and shareholder identification.

Finally, issuers should understand the intentions of their larger investors, especially those with a history of activism, and should investigate voting policies by mutual funds and other more passive mainstream asset managers holding stock of the company, to recognize possible voting alliances with activists. To be in a position to do this analysis, issuers should regularly communicate with their ten largest institutional shareholders to inform them on the business strategy, including new efforts for improving shareholder value.

For further information on this or other proxy-related issues, please contact:
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