



SEC UPDATE

The United States Securities Exchange Commission (the “SEC”) has been busy revisiting possible changes to some long-standing rules that will change the ways in which shareholders exert their influence on their investments. The Broker Vote Rule and the One Percent Threshold rule, if passed, will open the door for investors to nominate directors of public companies.

Broker Vote Rule

The elimination of the Broker Vote Rule will allow activist investors in the United States to exert more influence as previously, brokers were allowed to vote on their client’s behalf on routine items. The SEC, however, is going to change the rule so that items, such as election of directors, are no longer routine items thereby eliminating the ability of brokers to vote the shares either way without shareholder instructions. Other items that are not eligible for broker votes include shareholder proposals, resolutions regarding potential mergers and acquisitions or revisions to executive compensation.

The Broker Vote rule was put into place in 1937 and has long been sought by activist shareholders to be removed. Activist shareholders who have tried to replace underperforming boards have faced difficulty as the broker vote significantly dilutes their position. As many small shareholders do not vote, the elimination of broker votes, an activist investor who launches a proxy fight may find that they will have an easier time winning the votes necessary to replace a board. This is especially true as brokers have typically voted in favour of management.

A number of large companies in the United States have voiced their opposition towards the change. The primary reason offered for their resistance is the existence of broker votes enables the company to procure quorum for its meetings and allows them to avoid the additional costs of encouraging voter turnout. Activist investors suggest this argument is no longer applicable given the average low quorum for meetings and that because of large scale mailing, most companies are able to obtain quorum without difficulty.

This change, which is slated to be in place for the 2010 proxy season, is significant as approximately 80% of all shares in the United States are held through an investor’s broker. In addition, approximately 17% of all votes cast in 2008 were done so by broker votes.

One Percent Threshold

In addition to passing the broker vote rule, the SEC has recently voted to seek public comment on a proposal that will also give activist investors additional influence. The SEC may allow investors owning more than one percent of a company’s shares to nominate directors on proxy statements.



This proposed change is the SEC's response to investor complaints that directors who are too close to management have failed to interfere with actions that have led to massive write downs and losses during the global economic crisis. A number of investors are demanding accountability, responsiveness and transparency to prevent their investments from withering away further.

The proposal will allow shareholders who hold one percent of a company of a market cap of more than \$700 million for one year to have their director candidates listed on the proxy. The threshold would rise to three percent of shares issued and outstanding for companies with a market cap of \$75 million to \$700 million and five percent for companies of less than \$75 million.

Under the current regime, an investor would have to launch a proxy fight – a process that is too expensive and complicated for most investors to pursue. The new proposed rule affords investors an alternative process to nominate a director in order to create transparency in a company.

There are some restrictions to the new proposal, however. Shareholders will be limited to the number of directors they can nominate. For example, if a board has three members, shareholders could only recommend one director. If a board has more than three members, then shareholders will be restricted to nominating no more than 25% of the directors. In addition, the SEC has states that its proposal will not supersede any state laws that prohibit investors from nominating directors.

The proposed rule will be the subject of a lively debate over the next 60 day comment period. A number of politicians and financial professionals argue the merits of the proposal as many believe that this rule encroaches too much on corporate law and the internal affairs of a corporation. Others maintain the belief that this new proposal will simply afford more shareholders the ability to effect necessary change in corporations.

Whether the One Percent Threshold rule is passed we can be assured that through this and the Broker Vote Rule the SEC is clearly looking to protect shareholders. It remains to be seen, however, just how drastically these changes will affect the proxy landscape in coming years.

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