

SEC Approves NYSE's Elimination of Broker Discretionary Voting, Proposes New Proxy Disclosure Requirements and Proposes "Say on Pay" Vote for TARP Recipients

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On July 1, 2009, the SEC took three significant actions affecting public companies. First, the SEC approved a proposed NYSE rule change to prohibit brokers from voting proxies in director elections without instructions from beneficial owners. Second, the SEC proposed rules to strengthen proxy disclosure requirements relating to executive compensation and corporate governance. Third, the SEC proposed rules to require public companies receiving TARP financial assistance to provide an annual advisory shareholder vote on executive pay in proxy solicitations. These items are summarized below.

Approval of NYSE Rule Change to Eliminate Broker Discretionary Voting

The SEC approved a proposed amendment to NYSE Rule 452, *Giving Proxies by Member Organizations*, that will eliminate broker discretionary voting in director elections. Under current proxy rules, brokers are required to deliver proxy materials to beneficial owners and request that beneficial owners provide voting instructions. If brokers have not received voting instructions by the tenth day preceding the meeting date, Rule 452 allows brokers to vote uninstructed shares on certain matters which the NYSE considers to be "routine." Uncontested elections are currently considered "routine" matters on which brokers may cast discretionary votes. The amendment to Rule 452 will add director elections to the list of items identified by the NYSE as "non-routine," thereby eliminating broker discretionary voting in director elections. The amendment will apply to shareholder meetings held on or after January 1, 2010. The amendment contains an exception for companies registered under the Investment Company Act of 1940.

The amendment to NYSE Rule 452 will likely affect numerous areas.

- *Quorum.* The amendment will likely to make achieving a quorum at a meeting more difficult because broker votes often comprise a large percentage of shares represented at a meeting. If the meeting agenda contains other routine items on which the brokers may exercise discretion (the ratification of auditors), broker votes would count toward a quorum. If there are no routine items on the agenda, companies may want to consider adding such an item.
- *Majority Voting and "Vote No" Campaigns.* For companies with majority voting, it may be more difficult to obtain required votes for election. Because brokers typically cast discretionary votes in favor of management's nominees, companies may lose a large percentage of support for their nominees. Further, the rule will likely increase the frequency and effectiveness of "vote no" campaigns. Without broker votes in support of the company's nominees and the corresponding reduction in "for" votes, these campaigns will be more effective.
- *Increase in Institutional Investor Influence.* With the potential significant decrease in retail shares voted, institutional investors, who are more likely to vote their shares, may see their influence increase.
- *Expense.* The amendment will likely increase the costs of uncontested elections, as issuers may have to expend more money and effort to reach shareholders who historically have not voted. They may also be dissuaded from implementing e-proxy

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and other cost cutting measures, and may spend more time and effort contacting shareholders and soliciting votes.

Proposed Enhanced Proxy Disclosure Requirements

The SEC proposed a series of rule changes to enhance proxy disclosures relating to the following executive compensation and corporate governance items:

- *Expanded Risk Discussion Within CD&A.* Companies would be required to provide information about how their overall compensation policies create incentives that can affect risk and risk management. Specifically, within the Compensation Discussion and Analysis, a company would be required to discuss and analyze the risk attributes of its broader compensation policies and overall actual compensation practices for its employees generally, including non-executive officers, if the risks arising from such policies or practices may have a material effect on the company.
- *Revised Disclosure of Equity Awards.* Within the Summary Compensation Table and the Director Compensation Table, companies would be required to disclose the aggregate grant date fair value of stock and option awards computed in accordance with SFAS No. 123R (instead of the dollar amount recognized for financial statement reporting purposes for the fiscal year).
- *Expanded Disclosure of Directors and Nominees.* Companies would be required to disclose, for each director and nominee, (i) the particular experience, qualifications, attributes or skills that qualify such person to serve as a director and as a member of any committee on which he or she serves, (ii) directorships with public companies during the past five years (instead of only currently held directorships) and (iii) involvement in certain legal proceedings over the past 10 years (instead of five years). The proposal also seeks comment on whether the SEC should require disclosure regarding board diversity, including whether diversity is considered when nominating director candidates.
- *Disclosure of Leadership Structure.* Companies would be required to discuss the form of, and justification for, their leadership structure, including (i) whether and why the company has combined or separated its CEO and chairman positions, (ii) whether the company has a lead independent director and (iii) how the board's role in the company's risk management process affects the way it has organized its leadership structure.
- *Expanded Disclosure of Compensation Consultants.* If a compensation consultant provides consulting services related to executive or director compensation and any additional services to the company, it would be required to provide additional disclosure regarding the nature, amount and approval of such services.
- *Accelerated Disclosure of Voting Results.* Companies would be required to disclose, on Form 8-K, the results of a shareholder vote within four business days after the meeting date (instead of in its periodic report for the period in which the vote occurs).

Proposed Say on Pay Vote for TARP Recipients

The Emergency Economic Stabilization Act of 2008 requires shareholder approval of executive compensation during the period in which any obligation arising from financial assistance provided under TARP remains outstanding. To implement this requirement, the SEC proposed amendments to the proxy rules to require that TARP recipients provide a separate advisory shareholder vote to approve the compensation of executives (as disclosed under Item 402 of Regulation S-K) in connection with shareholder meetings for which proxies will be solicited for the election of directors. TARP recipients would also be required to explain the general effect of the vote, such as whether the vote is non-binding.

This client alert is for general information purposes and should not be regarded as legal advice.