

NYSE PROPOSES TO ABOLISH DISCRETIONARY BROKER VOTING IN ELECTIONS OF DIRECTORS

On October 24, 2006, the New York Stock Exchange announced the filing of a proposed rule change with the Securities and Exchange Commission that would prohibit NYSE members who hold shares as nominees from voting those shares, in the absence of instructions from their clients, in elections of directors. Specifically, the NYSE has proposed to amend Rule 452 of the NYSE Listed Company Manual to add the “election of directors” to the list of so-called “non-routine” matters on which an NYSE member organization may not give a proxy on behalf of its clients, the beneficial owners of shares, without instructions from the clients as to how to vote those shares¹.

Under current NYSE and SEC rules, brokers and other nominees must deliver proxy materials to their clients and request voting instructions in advance of an annual or special meeting of stockholders. Presently, Rule 452 allows a broker or other nominee to deliver proxies on behalf of a client on a “routine” proposal if the client has not provided specific voting instructions to the nominee at least 10 days before a scheduled meeting. This has always been considered an important element of a corporation’s ability to obtain a quorum at its stockholders meetings². Certain matters have been considered too important, however, to permit nominees to vote without client instructions. For instance, Rule 452’s list of “non-routine” matters includes any matter which “is the subject of a counter-solicitation, or is part of a proposal made by a stockholder which is being opposed by management (i.e., a contest)”³. Among other matters, this would include a contested election of directors.

Recently, however, numerous institutional investors and corporate governance activists have begun to view director elections that are the subject of a “just vote no” campaign as a contested election even though only one slate of candidates is on the ballot. Discretionary broker voting is especially irksome to these investors and activists because, historically, the brokers have tended to vote for incumbent directors in the absence of client

¹ A copy of the proposed rule change filed with the Securities and Exchange Commission is available at: [http://apps.nyse.com/commdata/pub19b4.nsf/docs/A2CC4C68070815068525721100589E90/\\$FILE/NYSE-2006-92.pdf](http://apps.nyse.com/commdata/pub19b4.nsf/docs/A2CC4C68070815068525721100589E90/$FILE/NYSE-2006-92.pdf).

² In the case of a proxy card which contains both “routine” and “non-routine” proposals, a nominee who has not received voting instructions from its client is currently permitted to submit the proxy card, and thereby have the shares covered thereby counted for purposes of a quorum, so long as the nominee physically crosses out those proposals as to which it does not have discretion to vote without instructions.

³ Other “non-routine” matters include mergers and consolidations, authorizations of preferred stock, alterations of the terms or conditions of existing stock or indebtedness, changes in quorum requirements and, most recently, the implementation or material revision of any equity compensation plan.

instructions to the contrary. With the advent of majority voting for directors (under which the votes cast in favor of an incumbent director's re-election must outnumber the votes cast against (or withheld from) the candidate's re-election), a "just vote no" campaign coupled with the inability of brokers to vote without instructions could become a powerful weapon in the hands of disgruntled stockholders seeking to defeat the re-election of incumbent directors without staging a formal (and expensive) proxy contest.

Responding to these complaints, the NYSE appointed a "Proxy Working Group" in April 2005 to review the NYSE rules regulating the proxy voting process, with a particular focus on Rule 452 and discretionary voting. In June 2006, the Proxy Working Group produced a draft report recommending, among other things, that an uncontested election of directors should no longer be viewed as a routine matter⁴. The NYSE has accepted this recommendation and proposed amending Rule 452 to include all director elections as non-routine matters on which nominees cannot vote without instructions from their clients. According to the NYSE's press release announcing the proposed amendment, "The goal of the NYSE has been to not allow the broker to vote on any proposal that substantially affects the rights of shareholders. ... As mentioned in the report, today the election of directors is simply too important to ever be considered routine, even where the election is uncontested. Shareholder voting on the election of directors is a critical component of good corporate governance."

The proposed NYSE amendment of Rule 452 must be approved by the SEC before becoming effective. The SEC is soliciting public comments on the proposed amendment. As has been the case with other proposed SEC rule changes that impact elections of directors, a heavy lobbying effort from both supporters and opponents can be expected. If the proposed amendment is adopted, it will be effective for all meetings of stockholders held on or after January 1, 2008.

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⁴ A copy of the Proxy Working Group Report is available at: http://www.nyse.com/pdfs/PWG_REPORT.pdf.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

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In addition, if you would like copies of our other Client Alerts or the NYSE's submission to the SEC with respect to the proposed amendment to Rule 452, please contact any of the attorneys listed above. You can also obtain this and our other Client Alerts by visiting our website at <http://www.milbank.com> and choosing the "Client Alerts & Newsletters" link under "Newsroom / Events".

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