



Davis Graham & Stubbs LLP

The End of Broker “Non-Votes” and The New Shareholder Approval Requirements For Equity Compensation Plans: Planning Considerations For Public Companies

On June 30, 2003, the Securities and Exchange Commission (SEC) approved and declared immediately effective new rules adopted by the New York Stock Exchange (NYSE) and Nasdaq requiring shareholder approval of equity compensation plans, including stock option plans, and of repricings and material plan changes to such compensation plans. This Client Alert focuses on a somewhat overlooked, but very important consequence of these new rules – the end of NYSE broker “non-votes” for stock option and other equity compensation plans.

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What is a Broker “Non-Vote”?

Many brokerage firms, including all NYSE member brokers, who hold shares in street name for customers have the authority to vote on certain “routine” items if they transmit proxy soliciting materials to those customers but do not receive voting instructions from such customers.

What Were the Old Broker Non-Vote Rules for Equity Compensation Plans?

Under old NYSE Rule 452, a NYSE member broker could cast broker non-votes with respect to the approval of stock-based plans or amendments to existing plans so long as the proposal would reserve less than 5% of the outstanding shares for the new or existing plan. NASD member brokers, by contrast, could not cast broker non-votes for any purpose, unless the NASD member was also a member of a national securities exchange (e.g., the NYSE) that permitted the casting of non-votes, and the NASD member made clear that it was relying on the NYSE rules for the purpose of casting those votes.

What Are the New Broker Non-Vote Rules for Equity Compensation Plans?

Under revised NYSE Rule 452, broker non-votes by NYSE members with respect to equity compensation plans are prohibited. The NASD prohibition of broker non-votes by NASD members also remains in effect.

Why Does This Matter to My Public Company?

The loss of these broker non-votes will require more active “get out the vote” campaigns for stock option plan amendments and other equity compensation proposals. Some things that you should keep in mind are:

- **Start Your Internal Planning Process Earlier and Devote Sufficient Internal Resources to the Proxy Effort.** You will need to more actively manage your internal proxy drafting procedures, and where appropriate, involve your investor relations department earlier in the process to help design an approach to educate shareholders and enable them to support the proposed equity compensation plan.
- **Leave Sufficient Time Between Filing Your Definitive Proxy and Holding Your Annual Meeting.** Consider whether your current annual planning schedule gives you enough time to mail the proxies and successfully procure the necessary shareholder votes, recognizing that you may need to contact shareholders multiple times in order to get the requisite approval.

- **Consider Hiring a Proxy Solicitor.** The increased burdens of managing the shareholder notification process and obtaining the needed affirmative responses may cause some companies to hire proxy solicitation firms, which could translate into increased proxy solicitation costs.
- **Investigate (In Advance) the Proxy Voting Guidelines of Your Institutional Stockholders.** The recent changes adopted by the SEC governing the proxy voting guidelines of registered investment advisers and of mutual funds could provide helpful information to public companies who are familiar with the composition of their existing institutional stockholder base.
- **Create and (If Necessary) Execute an Adjournment Contingency Plan.** Be prepared, from the outset, for the possibility that you may consider adjourning your annual meeting if you do not have the requisite votes to approve a proposed equity compensation plan. Keep in mind that the mechanics of adjournment will vary by state, including the need to set a new record date in some cases. The state law rules about setting the record date, length of adjournment and the practical difficulties of a new search for beneficial owners that come with a new record date make this a complex situation for which you will want to be prepared.

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These practical considerations touch on some of the issues that can be reasonably expected to affect future equity compensation plan approvals. Depending on your circumstances, other issues, such as the nature of the short position in your stock or the applicability of variable accounting treatment, may also affect your planning approach to making up any shortfall caused by loss of NYSE broker non-votes.

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