



## Proxy Disclosure Recommendations

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**Editor's note:** [Steven B. Stokdyk](#) and [Joel H. Trotter](#) are global Co-Chairs of the Public Company Representation Practice Group at Latham & Watkins LLP. This post is based on an article by Mr. Stokdyk, Mr. Trotter, [Erica S. Koenig](#), [Jean F. Meraz-Debraine](#), [Brian Miller](#), and [Regina Schlatter](#).

In February 2016, the SEC warned that among a broad selection of companies, poorly-drafted, ambiguous and sometimes incorrect proxy disclosure for the method by which votes will be counted for director elections may necessitate new, tougher disclosure rules.<sup>1</sup> This post offers guidance on how to avoid the most common proxy drafting pitfalls and provides tips on drafting disclosure that is both precise and compliant with proxy rules.

### Background: Regulatory Framework

Regulation of the shareholder voting process comes from federal and state corporate and securities laws, stock exchange rules and the company's own organizational documents. With regard to director elections, the voting standard for electing a director typically comes from either a state law default (e.g., plurality voting is the default standard under Delaware law) or the standard adopted in the company's charter or bylaws.

In a director election or any other matter put to a shareholder vote, a company's proxy statement must:

- State the vote required for a proposal to be approved (e.g., by an affirmative majority of the votes cast)
- Disclose how votes will be counted, including the treatment of abstentions and broker non-votes (e.g., stockholders may "for," "against" or "abstain" with respect to a proposal, and abstentions and broker non-votes will have no effect on the vote)<sup>2</sup>

Because companies seek a variety of votes, companies must act with extra care to draft proxy disclosure that accurately and clearly reflects the voting choices available to the shareholder, and what each choice means.

In a statement at the Practising Law Institute's "SEC Speaks" conference, Michele Anderson, the SEC's new Associate Director of the Division of Corporate Finance, described proxy statements her staff had reviewed as "confusing," "imprecise" and "outright sloppy":

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<sup>1</sup> "Sloppy' Proxy Disclosures May Necessitate SEC Rule," *Bloomberg BNA*, February 22, 2016, <http://www.bna.com/sloppy-proxy-disclosures-n57982067566/>.

<sup>2</sup> Item 21, Schedule 14A of the Securities Exchange Act of 1934.

- Proposals using a plurality voting standard erroneously offered an “against” option when the only options should have been “for” and “withhold”
- Proposals using a majority voting standard erroneously omitted an “against”
- Some companies referred to their “plurality-plus” voting standard (a plurality vote standard coupled with a mandatory resignation policy for nominees who fail to achieve an affirmative majority of votes cast) as a majority standard
- Some companies failed to explain the effect of a “withhold” vote
- More generally, many companies used confusing and unclear language that could “undermine” shareholders’ “essential right” to elect directors

In light of these common issues, the SEC has said it will carefully assess this year’s proxy disclosures in determining whether a more stringent rule on disclosures is necessary.

## Necessities for Drafting Clear, Precise and Fully-Compliant Disclosure in Director Elections and Other Proposals

### Getting the Voting Options Right

A threshold issue in drafting clear proxy materials is offering the correct voting options to shareholders on the proxy card, and describing those options accurately in proxy disclosure. The need for clarity in this area is even higher when proposals on a company’s proxy statement have different voting standards, such as when directors are elected under a plurality voting standard but other proposals use a majority voting standard.

### Clearly Identify the Voting Standard and How It Works

Proxy disclosure should clearly and accurately state the voting standard by which proposals are approved, as well as provide shareholders a complete picture of how the voting process works. This requires more than simply stating whether a majority or plurality voting standard is being used. Clear proxy disclosure will:

- If using a majority vote standard, distinguish between a *majority of votes cast*, *majority of shares present and entitled to vote*, and a *majority of votes outstanding* standard
- If using a plurality voting standard, only offer “for” and “withhold” as voting options
- Briefly explain what the majority vote standard actually means (e.g., that under a majority of votes cast standard, the shares voted “for” a nominee must exceed the number voted “against” that nominee)
- If applicable, include a brief reference to the company’s director resignation policy, informing shareholders how the policy is triggered and its effect on the director nominee
- Describe the effect of abstentions and broker non-votes for each proposal, reflecting the fact that abstentions and broker non-votes typically have a different effect depending on the type of majority voting standard used (see below)
- Distinguish between true majority voting and so-called “plurality-plus” voting (so shareholders are not misled under a plurality-plus voting standard described as majority voting)

- Inform the shareholder what happens if they sign and submit a proxy card without voting instructions

### Explain the Effect of a Withhold Vote or an Abstention

While Schedule 14A requires explaining the effect of broker non-votes and abstentions, it does not require explaining the effect of a “withhold” vote, which may not be clear to the shareholder. “Withhold” as an option under a majority vote standard may create ambiguity, though “withhold” typically means the same as and replaces the “abstain” option. Therefore, we recommend using “abstain” in place of “withhold” when there is a majority voting standard. “Withhold” should only be used under a plurality voting standard.

The effect of a “withhold” vote or abstention will depend on the vote required to elect the director or pass the proposal. The most common standards are (i) a majority of the votes cast; (ii) a majority of the shares present and entitled to vote; and (iii) a majority of the outstanding shares and (iv) for director elections only, a plurality of the votes cast. Because the effect of a “withhold” vote or an abstention and a broker non-vote will vary depending on the vote required, proxy disclosure should carefully explain the vote required under the given standard.

In all cases, abstentions and “withhold” votes count as present when determining a quorum. If the required vote is:

- **Majority of the votes cast**
  - An abstention will have no effect on the outcome of the vote because abstention does not count as a vote cast (the shareholder has chosen to abstain from casting a vote on that matter).
    - Note that under New York Stock Exchange (NYSE) guidance, if shareholder approval is required for equity compensation plans or stock issuance, NYSE treats abstentions as votes cast for such a proposal, in which case, such votes will have the effect of a vote “against” the proposal.
- **Majority of the shares present and entitled to vote**
  - An abstention will count as a vote “against” the proposal, because an abstention represents a share entitled to vote and thus is included in the denominator in determining the percentage approve.
- **Majority of the outstanding shares**
  - An abstention will count as a vote “against” the proposal because an absolute percentage of affirmative votes is required to elect a director, regardless of how many votes are cast, and an abstention is not an affirmative vote.
- **Plurality of the votes cast**
  - A “withhold vote” will have no effect on the vote’s outcome, because the candidates who receive the highest number of “for” votes are elected, and if candidates run unopposed they only need a single “for” vote to be elected. However, “withhold” votes may still have an effect on director nominees who are elected under a plurality voting standard. In companies that have adopted a director resignation policy and use a plurality voting standard (a “plurality-plus” standard), a director nominee receiving a specified amount of “withhold votes”

will trigger the policy (e.g., a director nominee must resign when “withhold” votes for their election exceed the “for” votes).

## Explain the Effect of a Broker Non-vote

A broker non-vote occurs when banks, brokers or others who hold shares in street name for a client return a proxy but provide no instruction as to how shares should be voted on a particular matter. The Dodd-Frank Act and stock exchange rules prevent brokers from casting votes on “non-routine” matters.<sup>3</sup> The definition of “non-routine matters” was tightened in 2012, so that the only remaining “routine matter” on which a broker may cast a vote is the ratification of the appointment of auditors. As a result, companies will likely need to address the effect of broker non-votes on all matters other than the ratification of the appointment of auditors.

Similar to abstentions and “withhold” votes, the effect of a broker non-vote will vary depending on the vote required, and companies must be careful in accurately reflecting this in the proxy. As long as there is at least one routine matter to be voted on at the meeting, proxies reflecting broker non-votes will be counted toward a quorum.

If the vote required is:

- **Majority of the votes cast**
  - Broker non-votes will have no effect on the vote’s outcome because they are typically not considered “votes cast” under state law.
- **Majority of the shares present and entitled to vote**
  - Broker non-votes will have no effect on the proposal because they are not “entitled to vote” on the matter.
    - Note that brokers are entitled to vote for the ratification of the appointment of auditors. Thus, because broker non-votes arise when a broker is not entitled to vote, broker non-votes should not exist as to the ratification of the appointment of auditors.
    - Note also that because the ratification of the appointment of auditors is the only proposal for which broker votes may be counted as present in determining a quorum, we recommend that companies keep this measure on the ballot to help ensure a quorum is reached.
- **Majority of the outstanding shares**
  - Broker non-votes will count as a vote “against” the proposal, because approval requires an absolute percentage of affirmative votes.
- **Plurality of the votes cast**
  - Broker non-votes will have no effect on the outcome of the vote because they are typically not considered “votes cast” under state law.

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<sup>3</sup> NYSE Rule 452 prevents all brokers, irrespective of the stock exchange on which a company is listed, from voting on non-routine matters.

## Avoid Excessive External References

For concise and easily understood proxy disclosure, avoid excessive cross-references and external references. Mentioning that the company's bylaws or corporate governance policy require that a director resign if he or she receives more "against" than "for" votes under the company's resignation policy may be useful. On the other hand, describing a proposal as having a majority vote standard except as otherwise provided by law, rule, charter or bylaws, may be unhelpful. Similarly, directing shareholders toward specific subsections of the Delaware General Corporation Law in describing what vote is required for director elections is unlikely to be helpful.

## Sample Disclosure—Majority Vote for Director Elections

### How many votes are required to approve each item?

*Election of directors—Directors shall be elected by the affirmative vote of the majority of the votes cast (meaning the number of shares voted "for" a nominee must exceed the number of shares voted "against" such nominee). If any nominee for director receives a greater number of votes "against" his or her election than votes "for" such election, our Bylaws require that such person must promptly tender his or her resignation to the Board following certification of the vote. Abstentions and broker non-votes are not considered votes cast for the foregoing purpose, and will have no effect on the election of nominees.*

### How are votes counted?

*With respect to the election of directors, you may vote "for" or "against" each of the nominees for the Board, or you may "abstain" from voting for one or more nominees. If you "abstain" from voting with respect to one or more director nominees, your vote will have no effect on the election of such nominees. Broker non-votes will have no effect on the election of the nominees.*

## Sample Disclosure—Plurality Vote for Director Elections

### How many votes are required to approve each item?

*Election of directors—Directors shall be elected by a plurality of the votes cast (meaning that the [number of] director nominees who receive the highest number of shares voted "for" their election are elected). If any nominee for director receives a greater number of votes "withheld" than votes "for" such election, our Bylaws require that such person must promptly tender his or her resignation to the Board following certification of the vote. "Withhold" votes and broker non-votes are not considered votes cast for the foregoing purpose, and will have no effect on the election of the nominees.*

### How are votes counted?

*With respect to the election of directors, you may vote "for" or "withhold" authority to vote for each of the nominees for the Board. If you "withhold" authority to vote with respect to one or more director nominees, your vote will have no effect on the election of such nominees. Broker non-votes will have no effect on the election of the nominees."*

## Sample Disclosure—Other “Majority Vote” Proposals

### Majority of the Votes Cast<sup>4</sup>

#### How many votes are required to approve each item?

*Other proposals—Adoption of [the other proposal] requires the affirmative vote of the majority of the votes cast (meaning the number of shares voted “for” a proposal must exceed the number of shares voted “against” such proposal). Abstentions and broker non-votes are not considered votes cast for the foregoing purpose, and will have no effect on the vote for this proposal.*

#### How are votes counted?

*With respect to [the other proposal], you may vote “for,” “against” or “abstain” from voting on this proposal. If you “abstain” from voting with respect to this proposal, your vote will have no effect for this proposal. Broker non-votes will have no effect on the vote for this proposal.*

### Majority of the Shares Present and Entitled to Vote<sup>5</sup>

#### How many votes are required to approve each item?

*Other proposals—Adoption of [the other proposal] requires the affirmative vote of the holders of a majority of shares present in person or represented by proxy and entitled to vote on the matter (meaning that of the shares represented at the meeting and entitled to vote, a majority of them must be voted “for” the proposal for it to be approved). Abstentions will have the same effect as a vote “against” this proposal, and broker non-votes will have no effect on the vote for this proposal.*

#### How are votes counted?

*With respect to [the other proposal], you may vote “for,” “against” or “abstain.” If you “abstain” from voting with respect to this proposal, your vote will have the same effect as a vote “against” the proposal. Broker non-votes will have no effect on the vote for this proposal.*

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<sup>4</sup> NYSE Rule 312 and NASDAQ Rule 5635 require shareholder approval by a majority of votes cast for certain corporate actions, including approval of equity compensation plans and certain issuances of common stock.

<sup>5</sup> Under Delaware General Corporation Law Section 216, the default voting standard for approval of matters put to a shareholder vote is a majority of shares present and entitled to vote.

## Majority of the Outstanding Shares<sup>6</sup>

### How many votes are required to approve each item?

*Other proposals—Adoption of [the other proposal] requires the affirmative vote of the holders of a majority of the outstanding shares of common stock (meaning that of the outstanding shares of common stock, a majority of them must be voted “for” the proposal for it to be approved). Abstentions and broker non-votes will have the effect of a vote “against” this proposal.*

### How are votes counted?

*With respect to [the other proposal], you may vote “for,” “against” or “abstain.” If you “abstain” from voting with respect to this proposal, your vote will have the same effect as a vote “against” the proposal. Broker non-votes will have the same effect as a vote “against” this proposal.*

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<sup>6</sup> Certain actions require approval by a majority of the outstanding shares entitled to vote, such as approvals of mergers and amendments to the articles of incorporation under Delaware General Corporation Law.