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Majority Vote to Elect Directors

The Model Business Corporation Act and Delaware corporation law provide for the election of directors by a plurality vote. Activist shareholders, led by union pension funds, have proposed precatory proxy resolutions to change the system. They want companies to adopt bylaws that provide for election of directors by a majority vote. The SEC has taken the position that companies may not exclude these proxy proposals and now ISS has adopted a policy supporting these proposals.

As is recognized by ISS, a requirement that directors be elected by a majority vote raises a number of technical and practical issues, and would almost certainly have unintended and unforeseen consequences. The committee of the American Bar Association that recommends changes to the Model Act is considering whether to amend the Act to require a majority vote and to deal with the technical and practical problems that would be created by abandoning a plurality vote. These problems can be dealt with in several ways, but all will result in increasing the ability of activist shareholders to accomplish their special interest objectives. Requiring a majority vote would give activists huge leverage by allowing them to threaten to withhold enough votes to defeat a nominee even though the withheld votes are substantially less than a majority of the outstanding shares. This shift in leverage to special interest activists would also be a further deterrent to competent people accepting nominations as directors.

While there is surface appeal to a majority vote requirement, it thus has the potential to cause serious disruption of the existing system. In contrast, there would be far less reason to object to a bylaw (a) that provides that if a majority of the outstanding shares vote to withhold against a nominee who has been nominated by the board, that nominee is not elected and (b) that deals with the technical and practical problems that that change entails. In light of the requirement that all members of the nominating committee be independent directors and the new SEC rules relating to the nomination process and its disclosure in the proxy statement, the burden to prove the will of the majority should be on the shareholders opposing the board's nominees, not on the nominees. This change would be far less disruptive and should not deter competent people from accepting nomination as directors. In weighing these issues, it should be kept in mind that activist shareholders have the ability to solicit shareholder proxies and elect their own nominees by a plurality vote. With the large percentage of the outstanding shares of most major companies held by institutional investors, this is a practical solution if in fact the majority of shareholders have lost confidence in management.

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