"JUST VOTE NO" CAMPAIGNS IN UNCONTESTED DIRECTOR ELECTIONS — RENEWED VITALITY FOR THE 2010 PROXY SEASON

Recent developments have set the stage for increased effectiveness of "just vote no" campaigns in uncontested director elections. With greater effectiveness than in the past, and in an environment that places greater emphasis on corporate governance and shareholder democracy, these low-cost campaigns are likely to show renewed vitality in the 2010 proxy season.

In the past, "just vote no" campaigns have been a favored tactic of institutional shareholders seeking governance reform rather than changes in management or corporate strategy. With changes imminent in the rules governing proxy voting, and a heightened focus by boards on shareholder concerns, "just vote no" campaigns may start to be used more widely by hedge funds and institutional shareholders as a tactic for corporate change, in some cases even as an alternative to a "short slate" proxy contest.

"Just Vote No" Campaigns as a Tactic for Corporate Change

"Just vote no" campaigns in uncontested director elections seek to withhold as many votes as possible from the board nominees who have been targeted. By achieving a compelling "withhold" vote, which may be more or less than a majority of the shares voted, the campaign seeks to send a strong message to the company's board of directors that shareholders are dissatisfied with some aspect of governance, management or corporate strategy. However, because a "just vote no" campaign does not propose alternative candidates for the board, the message sent when shareholders "vote no" is advisory and can be rejected by the board, regardless of whether the company has a plurality or majority voting requirement.[1] Nonetheless, there is more than anecdotal evidence that "just vote no" campaigns work. One study found that campaigns motivated by firm performance and strategy concerns, rather than by general governance practices, resulted in boards taking a variety of value-enhancing actions, including replacement of the CEO (in 31% of the target companies studied) and other strategic changes (in 50% of the targeted companies that did not dismiss their CEOs).[2]

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[1] In most public companies today, directors are elected by a plurality vote, so a director nominee who receives *any* votes in an uncontested election will be elected. A growing number of public companies have majority vote policies, where directors who are not elected by a majority of the votes cast on their election are required to submit their resignations to the board and the board may decide whether or not to accept those resignations. In the relatively infrequent case where a majority vote is actually required for election, an incumbent director who is not reelected by a majority vote may continue on the board as a "holdover" director.

[2] *Do Boards Pay Attention when Institutional Investor Activists 'Just Vote No'?*, Diane Del Guercio, Laura Seery and Tracy Woidtke, available at http://ssrn.com/abstract=575242 (January 2008).

While "just vote no" campaigns have been around for years and have enjoyed notable successes, shareholders seeking to effect corporate change have often chosen to employ other means. In part, "just vote no" campaigns have suffered in comparison to other outlets for shareholder discontent — they cannot by themselves force a change in corporate governance or strategy, and they will not result in the election of even a minority, or "short slate," of opposition directors. In addition, the rules and practices that have governed voting in corporate elections have made it difficult to achieve a compelling result in a "just vote no" campaign.

Despite these apparent shortcomings, "just vote no" campaigns have held significant advantages for shareholders seeking to effect corporate change. A "just vote no" campaign can be substantially less expensive than a proxy contest, can take much less time for a shareholder to manage, and can avoid some potential disadvantages of fielding a slate of opposition nominees. Because there are no opposition nominees in a "just vote no" campaign, attention remains focused on the shareholder concerns motivating the campaign and is not diverted by attacks on the experience and leadership qualities of opposition nominees. In addition, by not proposing a slate, the shareholder leading the fight does not risk subjecting itself to potential restrictions and liabilities that may result if one or more of its nominees are elected to the board, such as trading restrictions, fiduciary duty issues, conflict of interest concerns, and reporting obligations and short-swing profit liability under Section 16 of the Securities Exchange Act of 1934.

What's Changed for the 2010 Proxy Season?

In an uncontested election of directors, company management solicits proxy cards that allow shareholders either to vote "for" the board's nominees or to "withhold" voting authority. When a shareholder affirmatively chooses to "withhold authority" on one or more director nominees, those voting instructions are effectively treated as "no" votes, adding to the percentage of shares "withholding" and reducing the percentage of shares voting "for" the uncontested nominees.

In theory, when a shareholder does not return a signed proxy card, the number and percentage of shares voting "for" the nominated directors should not be affected. However, when the shareholder holds its shares through a broker and fails to return a signed proxy card in an uncontested election, the broker is permitted under New York Stock Exchange ("NYSE") Rule 452 to vote those "uninstructed" shares in its discretion.[3] Since many brokers automatically vote uninstructed shares in favor of management's nominees, uncontested elections generally result in an artificially high vote in favor of the nominees and an artificially low "withhold" vote. At times, broker discretionary voting has been very significant. For example, as a result of the highly successful "just vote no" campaign against Chairman and CEO Michael Eisner at Walt Disney Company's 2004 Annual Meeting, 45% of the votes cast on Mr. Eisner's reelection to the

[3] NYSE Rule 452 governs proxy voting even in cases where the company is not listed on the NYSE because the rule applies to all brokers that are members of the NYSE, which includes virtually all brokers through which shareholders hold stakes in public companies.

board were "withhold" votes; had broker discretionary voting not been permitted at that time, the withhold vote would have been 54% of the votes cast.[4]

However, for shareholder meetings held on or after January 1, 2010, the landscape has changed. NYSE Rule 452 has recently been amended to prohibit brokers from voting uninstructed shares starting in 2010.[5] As a result of this change, the percentage of "withhold" votes will no longer be artificially depressed and a "just vote no" campaign should have at least the same chance of success in the balloting as would a proxy contest to replace the targeted directors. In fact, because many shareholders may be willing to send a "message" to the board through a "just vote no" campaign but may not be prepared to replace directors through a proxy contest, a "just vote no" campaign may have even greater chances of success than a proxy contest waged over the same set of issues.

Another important development that will likely affect the success of "just vote no" campaigns in the 2010 proxy season is a pending SEC proposal to amend the principal exemption from the proxy rules under which "just vote no" campaigns are run. When the exemption was introduced in 1992, a shareholder running a "just vote no" campaign was permitted, based on the informal view of the SEC's staff, to distribute unmarked copies of management's proxy card, which could be included with a "fight letter" urging shareholders to use the accompanying card to "vote no." However, a court decision in 2004 reversed the SEC staff position by holding that the exemption was not available for persons that distribute management's proxy card.[6] In response, the SEC recently proposed amending the exemption to override the court's decision.[7] Assuming this amendment is adopted, which seems likely, shareholders conducting a "just vote no" campaign will be able to facilitate immediate action by shareholders that are swayed to "vote no." While this tactic may add somewhat to the relatively low cost of a "just vote no" campaign, it may also make such a campaign much more likely to succeed.

"Just Vote No" Campaigns Under the SEC's Proxy Rules

The key to running a low-cost, easily manageable campaign is qualifying for and complying with one or more exemptions from the SEC's proxy rules. If an exemption is available, a shareholder can solicit against management's nominees without having to produce a proxy statement, "clear" it through the SEC or mail it to shareholders.

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[4] Report and Recommendations of the Proxy Working Group to the New York Stock Exchange, available at http://www.nyse.com/pdfs/PWG_REPORT.pdf, page 9 (June 5, 2006). The 45% withhold vote received by Mr. Eisner was widely reported as having been a factor in his resignation as Disney CEO later that year.

[5] Our July 10, 2009 Client Memorandum, Discretionary Voting by Brokers Prohibited in Director Elections, available at http://www.willkie.com/firm/pubs.aspx, describes the amendment to Rule 452 in detail.

[6] *MONY Group, Inc. v. Highfields Capital Management L.P.*, 368 F.3d 138 (2d Cir. 2004).

[7] Exchange Act Release No. 60280, available at http://www.sec.gov/rules/proposed/2009/33-9052.pdf (July 10, 2009).

Under the proxy rules, any communication reasonably calculated to result in the withholding of a vote is deemed to be a "solicitation" and is subject to all of the SEC's requirements for proxy solicitations. As a result of this broad definition of "solicitation," each communication within a "just vote no" campaign must be covered by an exemption in order for the soliciting shareholder to avoid the proxy statement requirements.

In general, there are two separate exemptions available for running a public "just vote no" campaign. The first, which permits certain widespread public statements of a shareholder's voting intention, is actually an exception to the definition of the term "solicitation."[8] If a communication falls within this exception, it is not subject to any of the SEC's proxy rules. The exception allows a shareholder to state how it intends to vote and the reasons why the shareholder intends to vote that way. The reasons can be explained as extensively as the shareholder likes, and the shareholder is not limited in the number of times it can issue a statement under this exception. However, communications intended to come within this exception cannot solicit others to withhold their votes — the exemption is strictly limited to announcing and explaining the shareholder's own voting decision and therefore may have limited influence on other shareholders.

The more useful "just vote no" exemption is Rule 14a-2(b)(1), which exempts from most of the proxy rules any communication made by a person that does not seek the power to act as a proxy for another shareholder and that does not furnish or request a form of proxy or revocation.[9] This is the principal exemption under which "just vote no" campaigns are run because it does not limit communications to any particular forum and does not limit the content of communications (although antifraud provisions do apply). As a result, a person using this exemption to engage in a "just vote no" campaign can fully develop its arguments to shareholders for withholding their votes from the targeted nominees and can communicate those arguments through personal solicitations, direct mailings or press releases and other media. For persons using this exemption who hold shares of the company's stock with a market value of more than $5 million, each written communication (other than certain widespread public communications such as press releases), and any script used for oral solicitations, must be filed with the SEC no later than three days after first use.

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8 Rule 14a-1(l)(2)(iv). The statements can be made "by means of speeches in public forums, press releases, published or broadcast opinions, statements, or advertisements appearing in a broadcast media, or newspaper, magazine or other bona fide publication disseminated on a regular basis." Most commonly, statements falling within this exemption are issued as press releases.

9 The prohibition on furnishing a "form of revocation" was the basis for the 2004 court decision, cited in note 6 above, that a shareholder's distribution of a blank management proxy card caused the loss of this exemption. The SEC has proposed to amend the exemption to provide that it will not be lost if a person furnishes to a shareholder a blank form of management's proxy card with instructions that it be returned to management rather than to the soliciting person.

The Rule 14a-2(b)(1) exemption is not available to certain persons, including any person that is required to report its beneficial ownership on a Schedule 13D, unless the person has filed a Schedule 13D and has not disclosed an intent or reserved the right to engage in a control transaction or a contested solicitation for the election of directors.[10] While this "13D exclusion" would seem to render the exemption unavailable for some of the candidates most likely to run a "just vote no" campaign — hedge funds and institutional investors that own more than 5% of the company's stock — there is ample scope for these larger holders to use the exemption. These shareholders may be required to report their beneficial ownership on Schedule 13D rather than on Schedule 13G because they hold their shares with a purpose or effect of changing or influencing control of the company, but it does not necessarily follow (and perhaps in most cases it does *not* follow) that they intend to take over the company (*i.e.*, engage in a control transaction) or run or actively support a slate of opposition nominees (*i.e.*, engage in a contested solicitation for the election of directors). To the extent these shareholders have filed Schedules 13D with broad "boilerplate" language that might be viewed as reserving the right to engage in these types of transactions, it may be possible for them to utilize the exemption by amending their Schedules 13D to eliminate the reservation of this right if they truly do not intend to take over the company or run or actively support a slate of opposition directors and if they intend to foreclose those possibilities.

Takeaways for the 2010 Proxy Season

"Just vote no" campaigns have the potential to be more potent than ever in 2010, creating low-cost opportunities for shareholders seeking corporate change and new concerns for boards and managements that are vulnerable to shareholder action. The fact that "just vote no" campaigns leave the ultimate decision up to the board is both their weakness and their strength — weakness because they cannot *force* a board to act and strength because the message is not muddied, as in an election contest, by concern on the part of shareholders that the cure of replacing directors might be worse than the disease.

From the shareholder perspective, "just vote no" campaigns are relatively easy to run and are substantially less costly in time and expense than election contests. They can be a powerful tool for catalyzing corporate change, but are not suitable for every situation and need to be carefully planned and executed to stay within the proxy rule exemptions and be effective. From the perspective of boards and managements, the fact that a shareholder has chosen to pursue a "just vote no" campaign rather than an election contest may indicate some level of faith in the wisdom of the board to "do the right thing" as the shareholder sees it and may present an opportunity for dialog and a less contentious outcome.

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[10] Another important exclusion from the Rule 14a-2(b)(1) exemption provides that a person is ineligible to use the exemption if, as a result of a substantial interest in the subject matter of the solicitation, the person is likely to receive a benefit from a successful solicitation that would not be shared pro rata by all other holders of the same class of securities, other than a benefit arising from the person's employment with the company. By its nature, this exclusion is more likely to apply to a "just vote no" campaign against shareholder approval of a transaction than to a campaign opposing management's director nominees.

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If you have any questions regarding “just vote no” campaigns or shareholder activism in general, please contact Michael A. Schwartz (212-728-8267, mschwartz@willkie.com) or the Willkie attorney with whom you regularly work.

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