California Corporate & Securities Law

Are Social Investors Mounting A Campaign For Minority Rule?

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As discussed in this prior post, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires that companies include in their proxy statements not less frequently than every six years "a separate resolution subject to shareholder vote to determine whether votes on the resolutions required under paragraph (1) [the advisory vote on executive compensation] will occur every 1, 2, or 3 years." In response to this requirement, the Securities and Exchange Commission proposed an amendment to Rule 14a-4 to specify the form of proxy that issuers must use. The SEC has proposed that shareholders only be permitted to vote on one choice. My own view is that the SEC's proposal limits shareholder choice and is not the best way to ascertain shareholder intent. In my comment letter, I urged that the Securities and Exchange Commission allow shareholders more choice.

However, others have submitted comments supporting reduced choice. For example, Walden Asset Management, a firm that manages "investments for clients who seek to integrate environmental, social and corporate governance", submitted this comment:

> *We endorse the voting options offered by the commission-every **one**, **two** or **three** years, or to **abstain**-with the understanding that pluralities would often be the result and that they need to be considered the stockholders' advice to the board. Specifically, the highest vote, whether a majority or a plurality, should be considered the investor's [sic] advice to the board, which should take this input seriously even while it is not binding.*

Almost identical comments were submitted by the Social Investment Forum and First Affirmative Financial Network, LLC, including even the bold face type.

Here's why I believe that requiring shareholders to cast their votes for one alternative could lead to the tyranny of the minority. Assume a corporation has three shareholders and 100 shares outstanding. Shareholder A casts 40 votes for "3 years"; Shareholder B casts 35 votes for "1 year"; and Shareholder C casts 25 votes for "2 years". Shareholder A's choice "wins" even though 60% of the stockholders did not vote in favor of that choice.

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A better approach is to allow shareholders to cast votes on each alternative. There is nothing unusual about this process as it is the way votes are cast for directors under "straight" voting. For example, if Shareholder A prefers a frequency of one or two years, Shareholder B prefers a frequency of two or three years, and Shareholder C prefers a frequency of two years, the votes for each frequency would be as follows:

One-Year - 40 votes (Shareholder A's vote)

Two-Year - 100 votes (Shareholder A's vote, Shareholder B's vote and Shareholder C's vote)

Three-Year - 35 votes. (Shareholder B's vote)

Allowing this type of voting, permits the corporation to determine the alternative with the most support.

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