California Corporate & Securities Law

SEC Rule 14a-21(b) – "Extraordinarily Unfair" To Shareholders?

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When the Securities and Exchange Commission was considering the adoption of its say-on-pay rules, I submitted this comment letter recommending that issuers be given flexibility to adopt voting procedures that they determine to provide the most effective means of assessing shareholder preferences. The SEC staff declined to follow my recommendation. Instead, the SEC adopted a rule, Rule 14a-21(b), which is not only very confusing for issuers to implement but also an exceptionally poor mechanism for determining shareholder preferences.

My point is illustrated by the following voting results that one issuer recently reported in its Form 8-K:

One Year	7,381,362
Two Years	10,032,295
Three Years	2,964,236
Abstain	42,794
Broker Non-Votes	7,287,829

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According to this issuer's proxy statement, the option that "obtains a plurality of votes cast by the shares present or represented by proxy and entitled to vote at the Annual Stockholders Meeting will be deemed to have received the advisory approval of our stockholders." Given this statement, one can presume that the option of two years "won" (this was the option recommended by the Board of Directors).

On closer analysis, however, it is clear that more shareholders actually expressed a preference for either a one or three year interval – a total of 10,345,598 votes were cast for these intervals compared to 10,032,295 votes cast for the two year option. This is the problem with plurality voting when more than two choices are given.

Thus, I was very interested when the Ninth Circuit Court of Appeals issued its opinion last week in Dudum v. Arntz in which the court rejected a constitutional challenge to San Francisco's instant runoff voting (IRV) system for certain municipal elections. An IRV system allows voters to rank, in order of preference, candidates for a single office. An IRV system can save money because no runoff election is required.

My point is not that an IRV system is better, but that the SEC, like the Court of Appeals, should recognize the limitations of a plurality voting rule. If the point of the Dodd Frank Act's requirement is to provide a mechanism for conveying shareholder preferences to company boards, then the SEC should be open to voting rules that may better achieve that result.

The reference to "extraordinary injustice" is Charles Dodgson's comment on the plurality voting system. The Ninth Circuit Court of Appeals cited and discussed the mathematics lecturer's comment in its opinion.

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