

Proxy Statements and Annual Meetings under Pennsylvania Law – 2010

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We are sending this alert to public companies incorporated in Pennsylvania to assist them in planning for their 2010 annual meeting of shareholders.¹ In addition to discussing the relevant provisions of Pennsylvania law, we also highlight certain aspects of federal law applicable to proxy statements of which public companies should be aware. We are available to respond to any questions that you may have regarding the matters discussed in this alert, or more generally in connection with your annual meeting.

Proxies and Electronic Voting

The technology to permit shareholders to vote their shares via the Internet or telephone is widely available and utilized by most public companies for their annual meetings. This practice is expressly contemplated by the Pennsylvania Business Corporation Law (BCL). Under BCL § 1759(b), a proxy must be properly executed or authenticated by the shareholder² or by the shareholder's authorized attorney-in-fact. This may be done (i) in writing or (ii) electronically if the transmission sets forth or utilizes a confidential and unique identification number or other mark furnished by the company to the shareholder for the purposes of a particular meeting. BCL § 1702(a) also permits notices of shareholder meetings to be given by e-mail or other means of electronic communication if the shareholder has given the company an address for that purpose. Under the BCL, any notice submitted electronically is deemed to have been given when sent. Before sending notices by e-mail or other means of electronic communication, companies should ensure that their bylaws permit this practice.

While the BCL requires a company to give notice of each shareholder meeting, it does not require that public companies supply shareholders with a proxy statement or annual report. Those documents are furnished to shareholders because they are required by the

¹ This alert updates our 2009 alert on the same subjects, available at www.drinkerbiddle.com/palaw2009. Although much of the discussion remains unchanged from last year, there are a few key differences, particularly with respect to the scope of proxy disclosure.

² "Shareholder" is defined in BCL § 1103 as "a record holder or record owners of shares of a corporation."

rules of the Securities and Exchange Commission (SEC). This distinction is important and accounts for significant and subtle differences between the required treatment of notices and proxy statements.

The formal notice of a shareholder meeting required by the BCL is typically bound with the company's proxy statement as its first page. Although that notice may be given electronically under the BCL, it is not sufficient for a company just to post the notice on its website along with the accompanying proxy statement. To satisfy the BCL requirement of notice, we recommend that when a company sends out its e-mail message to shareholders informing them that the proxy statement and annual report are available on its website that it include in the e-mail a notice of the annual meeting that satisfies the notice requirements of BCL § 1702. Similarly, although the SEC rules permit "householding" of proxy statements and annual reports, so that multiple copies of those documents are not sent to shareholders having the same address, the BCL does not permit householding of the notice of a shareholder meeting, so separate e-mails are necessary. Note, however, that the BCL provisions on notice only apply to record shareholders. The notice that is given to beneficial owners who hold shares in "street name" is not governed by the BCL.

Companies must also be mindful of the interplay between the BCL requirements of notice and the SEC's e-proxy rules. In 2007, the SEC adopted its e-proxy rules, which generally require public companies to post their proxy materials via the Internet. Under the e-proxy rules, a reporting company must post a complete set of proxy materials on a website (other than EDGAR) and provide notice of the availability of these proxy materials to its shareholders. Public companies generally have two choices for complying with the e-proxy rules: "notice and access" or "full set delivery." The SEC rules also permit a company to utilize a combination of these methods. Under the notice and access model, the company sends a Notice of Internet Availability of Proxy Materials drafted in accordance with Proxy Rule 14a-16 to its shareholders. The company would not mail its proxy materials to its shareholders. Instead, the Notice of Internet Availability of Proxy Materials would direct shareholders to a website where the proxy materials may be accessed. A company electing the notice and access model is required to send the Notice of Internet Availability of Proxy Materials to its shareholders within 40 calendar days before the shareholder meeting. This method is designed to allow companies to take full advantage of electronic delivery methods available to companies.

Under the e-proxy rules, the Notice of Internet Availability of Proxy Materials may only contain the information specified in Proxy Rule 14a-16 and it must be sent separately from other types of shareholder communication, including the form of proxy.³ The SEC, however, does permit companies to modify the Notice of Internet Availability of Proxy Materials to include additional information required to be included in a notice of shareholder meeting under state law, or to include with the Notice of Internet Availability of Proxy Materials a copy of any notice of shareholder meeting required under state law if that notice is not combined with the Notice of Internet Availability of Proxy Materials.⁴ If a company chooses not to send a separate notice to shareholders, we recommend that the company reviews its Notice of Internet Availability of Proxy Materials in relation to BCL § 1702 to ensure that its notice contains all of the information required in a notice of shareholder meeting required by the BCL. While the Notice of Internet Availability of

³ In October 2009, the SEC proposed amendments to its e-proxy rules that would permit issuers to provide their own explanation of the "notice and access" model on the Notice of Internet Availability of Proxy Materials, rather than use the standard legend that is currently required by the SEC. As of this date of this alert, the SEC has not adopted these rules.

⁴ The SEC proposed amendments would also allow issuers to include a separate explanation of the "notice and access" model with the Notice of Internet Availability of Proxy Materials.

Proxy Materials may be householded, a notice of a shareholder meeting under the BCL, as described above, may not. Thus, householding the Notice of Internet Availability of Proxy Materials would not be sufficient for giving notice under the BCL.

Under the “full set delivery” method, companies will continue to mail paper copies of their proxy materials to their shareholders as they have done in the past, but must include additional language in the proxy materials regarding the availability of proxy materials on the Internet. This method does not require a company to substantially alter the default method in which it delivers proxy materials to its shareholders.

We recommend that companies evaluate each year whether the notice and access model, the full set delivery model, or a combination of these models is preferable. This evaluation may include the cost of implementing the notice and access model versus retaining the full set delivery method, and the ability of the company to meet the 40 calendar day notification required by the Proxy Rules, which is substantially more time than currently required under the BCL. Additionally, companies that have used the notice and access model in the past should analyze whether they are receiving similar voter turnout as when they used a full set delivery method. Companies may find it preferable – and a way to reduce costs – to implement notice and access for certain shareholders, such as beneficial owners, while retaining full set delivery for others, such as registered holders.

Quorum and Vote Requirements

Quorum. BCL § 1756(a) provides that, unless the articles or a bylaw adopted by the shareholders provides otherwise, the presence, in person or by proxy, of the holders of a majority of the votes that all shareholders are entitled to cast on a particular matter to be acted upon at a meeting will constitute a quorum for purposes of consideration and action on that matter.

Election of Directors. Unless otherwise provided in the articles for the election of directors, BCL § 1758(b) provides that the candidates for election as directors receiving the highest number of votes cast (known as a plurality) up to the number of directors to be elected will be elected. Plurality voting is why the typical proxy card does not provide for a vote against a director or an abstention since only the number of votes cast *for* each candidate is relevant. Plurality voting is also why management should never go into a meeting with proxies that authorize votes for a number of candidates that is less than all of the open board seats, unless the company has a valid and applicable bylaw requiring advance notice of nominations. Otherwise, any shareholder present at the meeting will be able to nominate a candidate who may be able to win election just on the basis of the number of votes cast at the meeting. If the company intends to reduce the size of the board in connection with the annual meeting, that action should be taken before the convening of the meeting.

Majority Voting. Even though plurality voting is the default rule in Pennsylvania, the recent trend for reporting companies to implement majority voting for election of directors has been well publicized. For companies that have majority voting provisions, particular attention must be paid to the treatment of abstentions under the BCL, described more fully below. Additionally, companies should be mindful of the impact of broker “non-votes” (also described below) on the election of directors.

For companies that have not implemented majority voting, in the past several years, public companies have been increasingly subject to shareholder proposals requesting that the company implement a majority voting standard. A majority voting standard typically has been implemented through either the bylaws or the articles. In Pennsylvania, however, the rules are different. Pursuant to BCL § 1758, a majority voting standard can only be adopted by an amendment to the articles and not the bylaws.⁵ Accordingly, any shareholder proposal asking the company to implement a majority voting provision in the bylaws potentially can be excluded pursuant to Proxy Rule 14a-8(i)(1) as “improper under state law.”

A shareholder proposal requesting a Pennsylvania company to implement a majority voting standard by amending the articles must be precatory. BCL § 2535 provides that “[t]he shareholders of a registered corporation shall not be entitled by statute to propose an amendment to the articles.” Further, under BCL § 1912 and § 1914, an amendment to the articles, unless approved by the board, is not deemed to have been adopted by the company, regardless of whether the board has directed the submission of the amendment to the shareholders for a vote.⁶

Action on Other Matters. For most other shareholder actions, BCL § 1757(a) provides generally that action at a properly convened shareholders meeting requires only the affirmative vote of a *majority of the votes cast* at the meeting. BCL § 1103 provides that recording an abstention or failing to vote on a matter does not constitute “casting a vote.” For certain types of shareholder action, a company’s articles or bylaws, the rules of the NYSE, or other exchanges or markets may establish various higher vote requirements.⁷

Broker “Non-Votes” and Abstentions

If shares are held for a shareholder by a nominee or in “street name,” a broker is permitted by applicable NYSE rules to vote the shares on certain routine issues if no instructions are received from the beneficial owner. The broker, however, is not permitted to vote on more significant issues, such as election of directors. If no instruction is received on an issue on which a broker is not authorized to act without instruction, a broker non-vote results on that issue if the broker returns a proxy for the shares involved.

To deal with the problem that broker non-votes could create when establishing the presence of a quorum, BCL § 1756(a)(4) provides that if a proxy votes shares on any issue other than a procedural motion, the shares will be considered present at the entire meeting for all quorum purposes. Thus, shares voted by a broker on any issue will be considered present for each matter to be voted upon even if the shares are not voted on every matter.

⁵ BCL § 1758 provides that “[t]he candidates for election as directors receiving the highest number of votes from each class or group of classes, if any, entitled to elect directors separately up to the number of directors to be elected by the class or group of classes shall be elected.”

⁶ RiskMetrics generally recommends a vote for precatory and binding resolutions requesting the board to adopt a majority voting policy, provided it does not conflict with state law. Even though shareholder proposals to amend the articles must be precatory under the BCL, companies, and particularly directors, should be mindful of the consequences of not implementing these proposals. RiskMetrics recommends a withhold/against vote for all members of the board if the board failed to act upon a shareholder proposal that received majority support. RiskMetrics guidelines may be found at http://www.riskmetrics.com/sites/default/files/RMG_2010_US_SummaryGuidelines20100108.pdf

⁷ See, e.g., N.Y.S.E. Listed Company Manual § 312.07 (vote of more than 50 percent in interest of all securities entitled to vote required to approve certain issuances of additional or new securities), § 313.00(C) (creation of senior equity security requires two-thirds vote of outstanding preferred shares in certain circumstances).

As a result of the recent amendments to NYSE Rule 452, which eliminate discretionary voting in uncontested director elections, we recommend that companies seek shareholder approval of their auditors or some other routine matter for which brokers have discretionary authority to vote. If a broker votes on a routine issue, the shares voted by the broker will be considered present for each matter on the agenda for the purposes of a quorum.

An abstention or failure to vote, which would include a broker non-vote, is not equivalent to a negative vote. BCL § 1103 provides that “voting” or “casting a vote” does not include recording the fact of abstention. Since the required vote on matters other than election of directors is generally a majority of the votes cast, abstentions and broker non-votes do not have an impact under the BCL on approval of actions at a shareholder meeting once a quorum has been established.

If the vote required is a majority, including any majority voting provisions for election of directors, or other percentage of all the votes entitled to be cast, the effect of an abstention or a broker non-vote will be the same as a vote against the proposal because an absolute percentage of affirmative votes is required and neither a negative vote nor an abstention or broker non-vote is an affirmative vote.

Item 21(b) of Schedule 14A of the Proxy Rules requires the proxy statement to disclose the treatment and effect of abstentions and broker non-votes under state law, and questions frequently arise as to the proper disclosure of the effect of broker non-votes on vote requirements. In light of the differing impact that abstentions and broker non-votes will have on specific proposals, companies must pay particular attention to their disclosures in their proxy statements in order to adequately inform their shareholders as to how a vote, abstention or broker non-vote will be treated at a meeting, which may require a tailored disclosure for each proposal included in the proxy statement. It should also be noted that new Item 5.07 of Form 8-K requires disclosure of the results of each matter voted upon by the shareholders within four business days, broken down by the number of votes cast for, against or withheld, as well as the number of abstentions and broker non-votes as to each matter.⁸

Deadlines for Shareholder Proposals

Proxy Rule 14a-5(e) requires the proxy statement to disclose (i) the deadline for submitting shareholder proposals *for inclusion in the proxy statement and proxy card* for the next annual meeting calculated in the manner provided in Rule 14a-8(e) (Question 5), and (ii) the deadline after which submission of a shareholder proposal will be untimely, calculated as provided in Proxy Rule 14a-4(c)(1) or under an applicable advance notice provision.

Inclusion in Proxy Statement and Proxy Card. If a shareholder proposal is submitted for inclusion in the proxy statement and proxy card for a regularly scheduled annual meeting, Proxy Rule 14a-8(e) (Question 5) provides that it must be received by the company at its principal executive office at least 120 calendar days before the first anniversary of the date the proxy statement was released to shareholders for the prior year’s annual meeting.

⁸ The new 8-K requirement applies to any shareholder meeting that occurs on or after February 28, 2010. For shareholder meetings that occur before this time, we direct you to Item 4 of Form 10-K and 10-Q, which includes the same disclosure for vote breakdowns.

Presentation at the Annual Meeting. A shareholder may opt not to submit a proposal for inclusion in the proxy statement and proxy card, but may still want to present the proposal at the meeting itself. The shareholder will be able to do so unless the company has a provision in its bylaws (or articles) requiring the shareholder to give the company advance notice of the proposal. BCL § 1758(e) provides that an advance notice bylaw is valid if the procedure it imposes is “fair and reasonable.”

Proxy Rule 14a-4(c)(1) provides that a proxy may confer discretionary authority to vote on shareholder proposals at an annual meeting if the company did not have notice of the proposal at least 45 days before the first anniversary of the date of mailing of the proxy statement for the prior year’s annual meeting and a specific statement to that effect is made in the proxy statement or form of proxy. A proxy may also confer discretionary authority to vote on any matter that the company does not have notice of by the date specified for receipt of notice in an advance notice bylaw.

As a result of these rules, if a company has an advance notice bylaw that requires notice earlier than the 45-day period required under Proxy Rule 14a-4(c)(1), the company only need disclose that deadline in its proxy statement. If the company does not have such an advance notice bylaw, the company will need to disclose the Proxy Rule 45-day deadline for submission of proposals. In light of the fact that Proxy Rule 14a-4(c)(1) does not prevent shareholders from presenting a proposal at an annual meeting even if a company did not receive advance notice of the proposal, companies should consider adopting an advance notice bylaw.

We recommend that all publicly traded Pennsylvania companies adopt advance notice bylaws. In addition, we urge companies that currently have such provisions to review periodically their advance notice bylaws. In the past year, we have seen an increase in the number of companies implementing “second generation” advance notice bylaws. These bylaws require shareholders seeking to make a proposal or to have their representatives placed on the board to disclose any hedged positions or derivative securities they have in the company’s stock.

Conduct of a Shareholder Meeting

BCL § 1709 imposes an express requirement that there be a presiding officer at every shareholder meeting. Except as otherwise provided in the bylaws, the presiding officer has express statutory authority to determine the order of business and to establish rules for the conduct of the meeting.

Postponements and Adjournments

In some circumstances, a company may consider postponing or adjourning an annual meeting. In doing so, a company must consider whether this would be permissible under Pennsylvania and federal law. BCL § 1755 provides that “[e]xcept as otherwise provided in the articles, at least one meeting of the shareholders shall be held in each calendar year for the election of directors at such time as shall be provided in or fixed pursuant to authority granted by the bylaws.” BCL § 1755 states further that “[i]f the annual or other

regular meeting is not called and held within six months after the designated time, any shareholder may call the meeting at any time thereafter.” BCL § 1792(a) allows a court to summarily order the annual meeting when failure to hold the meeting “has continued for thirty days after the date designated or appropriate therefor.”

If a company designates a meeting date and time, it has the right to either advance or delay the date, so long as it satisfies the notice requirements and record date requirements of the BCL.⁹ In doing so, companies must be aware that such action could be seen as an attempt to “disenfranchise the vote.” There is Pennsylvania case law, most notably *Jewelcor Management, Inc. v. Thistle Group Holdings, Co.* (2002 Phila. Ct. Com. Pl. Lexis 79), to this effect. In *Jewelcor*, the court stated, “[a] corporation’s board of directors acts improperly when it manipulates a corporate election to perpetuate its own control of the corporation.” *Id.* at 10.

Companies may also consider adjourning an annual meeting until a later date. BCL § 2522 allows adjournment “for such period as the shareholders present and entitled to vote shall direct.” This section generally precludes the chairperson from adjourning a shareholder meeting without a shareholder vote. If a company is considering the option of adjourning a convened meeting or anticipates an adjournment may be necessary, it should specifically request discretionary authority to adjourn in its solicitation of proxies. The SEC Staff takes the position that if the proxy statement authorizes discretion only on “other matters,” that is not sufficient to give the proxies authority to vote for adjournment. The proxy card would need a separate voting item for adjournment with an accompanying disclosure in the proxy statement.¹⁰ Adjourning the meeting after conducting some business, but before voting on controversial items, may also implicate *Jewelcor* as discussed above.

Proxy Statement Disclosure

In December 2009, the SEC adopted rule amendments expanding proxy disclosure relating to risk management, compensation and corporate governance. The new rules apply to companies with fiscal years ending on or after December 20, 2009. A brief summary of these amendments follows.

Risk and Compensation Policies and Practices. The new rules require a narrative description under a separate proxy item of how a company’s overall compensation policies for employees, not only named executive officers (NEOs), create incentives that can affect a company’s risk and risk management. This disclosure is only required, however, if the risk would be reasonably likely to have a material adverse effect on the company. Under the existing compensation disclosure rules, the SEC already contemplated that a company will discuss risk as related to NEOs in the Compensation Discussion and Analysis (CD&A) to the extent material.

Compensation Table. Among other changes, the new rules require that stock and option awards for NEOs and directors be reported in the Summary Compensation Table and the

⁹ In addition to BCL requirements, the Proxy Rules and a company’s bylaws may require the company to provide additional time for shareholders to submit shareholder proposals if the annual meeting is postponed. Rule Proxy 14a-8 states that “if the date of this year’s annual meeting has been changed by more than 30 days from the date of the previous year’s meeting, then the deadline [for submitting shareholder proposals under Proxy Rule 14a-8] is a reasonable time before the company begins to print and send its proxy materials.”

¹⁰ Although this position has not been formally adopted, the SEC staffers have publicly stated it and issued it as a comment.

Director Compensation Table at the aggregate grant date fair values, computed in accordance with FASB Accounting Standards Codification Topic 718 – Compensation – Stock Compensation.

Director Qualifications. Under the new rules, companies must disclose annually the particular experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director of the company.

Issues Impacting D&O Questionnaires. The new rules require disclosure of any directorships currently or previously held at public companies in the past five years. In addition, the rules extend the disclosure regarding legal proceedings from five to 10 years and expand the list of reportable legal proceedings. In conjunction with modifying their disclosure, companies should ensure that their D&O Questionnaires are updated to reflect these changes.

Diversity. The new rules require disclosure of whether diversity is a factor considered in board composition. The SEC recognized that companies may have different definitions of diversity based on race, gender, professional experiences, education and other factors, and accordingly, did not define diversity.

Risk Oversight and Board Structure. The new rules require a discussion of why a company has chosen to combine or separate the positions of CEO and Chair of the Board. If these roles are combined, the company must disclose whether it has a lead independent director and the role this person has in company leadership. A company must also disclose why its board leadership structure is appropriate. Finally, the rules require a company to discuss the board's role in risk oversight for executive compensation.

Compensation Consultants. The new rules require disclosure, under certain circumstances, of fees paid to compensation consultants for executive compensation services and other unrelated services.

Other proxy statement and shareholder meeting issues involving Pennsylvania and federal law may arise. We are available to consult with you on any of the matters discussed above, to review the disclosures in your proxy statement, Form 10-K and annual report, and to answer any questions you may have concerning Pennsylvania and federal law as they apply to your proxy statement, proxy card and annual meeting.

For questions or more information about Proxy Statements and Annual Meetings Under Pennsylvania Law, please contact William H. Clark, Jr., at (215) 988-2804 or Willaim.Clark@dbr.com, or Audrey Sorokach Burns at (610) 993-1237 or Audrey.Burns@dbr.com.

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