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Broker Non-Vote Decision on Board Elections Could Have Costly Implications for Closed-End Funds*

The Wall Street Journal recently ran an article discussing a proposal the New York Stock Exchange is considering to no longer allow "broker non-votes" in director elections. The term "broker non-votes" refers to shares held in street name for which the beneficial owner fails to return the proxy card. Although these shares have technically not been "voted" at all, to help companies obtain a quorum and prevent unnecessary proxy solicitation costs, under the current rules, these shares can be counted as "present" and brokers are permitted to vote the shares on certain, routine matters. The uncontested election of directors is considered routine and, for closed-end funds, is often the only item on the meeting's agenda.

Companies often rely on "broker non-votes" not only to obtain a quorum but also to get to the required threshold of votes to determine the outcome of an election. Closed-end fund shareholders are notoriously apathetic when it comes to voting their shares, so the change in the NYSE's stance on "broker non-votes" could be expensive for the industry. Depending on the way in which votes must be counted in the director elections, something that is usually spelled out in a fund's bylaws, some closed-ends could face the prospect of having to hire proxy solicitors every year. Warren Antler, of the proxy solicitation firm The Altman Group, estimates that the average closed-end fund could incur about \$10,000 to \$12,000 in solicitation expense per meeting for most director elections. But he points out that there are differences in the way votes are counted and how a quorum is obtained that could reduce the cost or eliminate the need for solicitation. For example, he notes that the NYSE is expected to allow broker non-votes to be counted toward a quorum for auditor ratifications, and once a quorum is established for the meeting, it is established for all matters, including the director elections.

A quorum is usually defined as a majority of the outstanding shares, although some funds use the lower threshold of 33%. Directors typically are elected by a plurality of the votes, majority of the votes cast, or a majority of the outstanding shares. Plurality is the most popular measure for closed-end funds—and easiest to obtain. In an uncontested election it would just be more votes "for" than "against", so, theoretically, directors could be elected with a very small number of actual votes, a potentially embarrassing prospect for the fund. Then again, in reality, this small number of *actual* votes is the same as the *actual* number currently electing directors—the number is just inflated with broker non-votes.

The other two measures: majority of votes cast and majority of outstanding shares are expected to require proxy solicitation to be obtained by many closed-end funds, and even with aggressive solicitation, a majority of the outstanding shares could prove to be a tremendous obstacle—with potentially serious implications.

Activist shareholders may know better than the funds themselves just how difficult it is to get a majority vote of a closed-end fund's shareholders without the help of broker non-votes, especially those who have issued dissident proxies themselves. The following excerpt is from a letter from Phillip Goldstein, a veteran of many closed-end fund proxy battles, to **Seligman Quality Municipal Fund (SQF)** last November. The letter was attached to a Schedule 13D filing, and was in response to the Goldstein's group's request to include a shareholder proposal to recommend open-ending the fund:

"More troubling is that the board has reacted to our request by adopting new bylaws whose primary purpose appears to be to make it more difficult for shareholders to elect directors of their choice. For example, whereas before we sent our September 19th letter, a plurality of votes cast at a meeting was

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required to approve the election of a nominee, now 'each director shall be elected by the affirmative vote of the holders of a majority of the votes entitled to be cast thereon.' The Fund's counsel knows that it is virtually impossible for any nominee to obtain that vote in a contested election. Moreover, under Maryland law, if no directors are elected for two consecutive years, any shareholder can sue to have the Fund involuntarily dissolved."

Incidentally, Maryland is a very popular state to incorporate closed-end funds. So while it is true that under Maryland law if not enough votes are cast to elect directors, the incumbents stay in office until their successors are elected, if it happens for two years, a fund may run into trouble if it has even a single disgruntled shareholder! Dissidents will no doubt be watching next year's board elections in Maryland-incorporated **Tri-Continental Corp.** (TY), since this year the required majority vote of outstanding shares for directors was not met.

The *Journal* story indicates that although the change in treatment of broker non-votes has not yet been adopted, it is imminent. For funds, this means now may be the time to review voting requirements. By the way, to find out what the voting requirement is for any fund, just look at the fine print in the proxy statement, copies of which are filed on the SEC's EDGAR system, www.sec.gov; a proxy statement is indicated as a DEF 14A. Links to all SEC filings are appear on our website, www.herzfeld.com under Links to Funds.

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