

Election of Directors May No Longer Be “Routine”

The NYSE is currently contemplating a further change to Rule 452. The uncontested election of directors has always been considered a “routine” item, and therefore one for which “broker non-votes” would be permitted, and this treatment often helps funds obtain a quorum for their annual meetings. A proposed change to re-classify such votes as “non-routine” is being considered and may not only have costly implications for closed-end funds, but may actually make them more vulnerable to dissidents.

We asked Ken Altman, President of The Altman Group, a proxy solicitation firm with many closed-end fund clients, how these issues could affect corporate voting and in particular, closed-end fund director elections. Mr. Altman's expert opinion on the proposed change, as well as his firm's suggestions appear in the box on page 5.

The rule change could not only affect the election of directors, but also the ability of some funds to obtain a quorum for their meeting. If, for instance, the only item to be voted on is the election of directors, then broker non-votes cannot be used to obtain a quorum, potentially requiring the fund to hire a proxy solicitor. However, if another “routine” item is on the agenda, such as approval of the auditors, then the broker non-votes could be counted towards obtaining a quorum.

Majority vs. Plurality

When it comes to how closed-end funds tabulate votes in board seat elections, there are two methods that can be used: a majority or a plurality of the votes. In the survey that begins on page 9 we have identified how each fund counted its board election votes in its latest proxy (and, incidentally, we have seen the funds switch from majority to plurality and vice versa in a few instances). In a board election, a majority is usually defined as “the affirmative vote of a majority of the votes cast at a meeting at which a quorum is present,” and very few funds use this measure. Plurality is by far the most popular method used by closed-end funds—not surprisingly, it is a threshold much easier to obtain than a majority. In an uncontested election plurality just means that more votes were cast “for” a candidate 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 by the large number of broker non-votes.

A plurality count could work *against* the incumbents in a contested election, one in which a dissident group issues its own nominees for director posts. In such a situation, broker non-votes are not permitted even under current rules—if the election is contested, it is certainly not “routine”. For funds that measure results by a plurality of the votes, the candidate(s) receiving more votes would be the winners, and in most cases, the dissidents would be more inclined to vote than the typically apathetic closed-end fund shareholders. Indeed, shareholders who might otherwise not vote, may be persuaded to do so by the promises of future action, usually to address discounts, that dissidents usually include in their proxy materials.

We asked Warren Antler, also of The Altman Group, to give us some background on the issue and to elaborate on the differences; in particular: Why do closed-end funds favor a plurality voting measure to elect incumbent directors?

“Corporate issuers have been involved in a battle to reform the director voting process to ensure that directors are accountable to shareholders. Majority voting has emerged as the meaningful reform for those advocating accountability of directors in uncontested elections. For instance, about 52% of the S&P companies have adopted a majority voting standard with a director policy attached, compared to about 20% that had a majority voting standard for director elections in 2005.

One of the reasons closed-end funds have gone to a plurality voting standard for directors might be the ‘just vote no’ campaigns by activists over the past two years or so. These campaigns have been tying up the election of incumbent directors in funds with a majority voting standard as not enough votes are cast in favor of the incumbents. For uncontested board elections in funds with a plural-

ity voting standards, the 'just vote no' campaigns generally have no effect on the election of incumbent directors who are running unopposed.

Closed-end fund activists will tell you that a majority voting standard makes it virtually impossible for any nominee to obtain the requisite vote in a contested election—incumbent or dissident candidate.

Unlike the corporate activists who support majority voting for corporate issues, if a closed-end fund tried to switch back to the majority standard for election of directors, the closed-end fund activist will assert that the fund and its counsel are impeding shareholder democracy and the fund's counsel is guilty of malpractice and has taken on a partisan role on behalf of incumbent directors faced with a potential proxy challenge."

Indeed what Mr. Antler points out is exactly the scenario we saw last year in **Seligman Quality Municipal Fund** (SQF). A shareholder group led by activist Phillip Goldstein that had a declared stake in SQF complained after the fund switched to majority voting for directors from plurality stating that "the primary purpose appears to be to make it more difficult for shareholders to elect directors of their choice....The fund's counsel knows that it is virtually impossible for any nominee to obtain that vote in a contested election."

By the way, under Maryland law, if no candidate receives the requisite vote to be elected, the incumbents stay in office until their successors are elected—an interpretation that favors the incumbent candidates.*

Although the change in Rule 452 is scheduled to go through beginning in 2008, industry groups have been lobbying the SEC for an exemption for closed-end funds. For instance, the Investment Company Institute (ICI), which represents both open-end and closed-end funds, has argued that disallowing broker non-votes in director elections has no benefit to funds, while the cost implications could be enormous. These costs would ultimately be passed along to shareholders. We'll keep you informed on any progress related to this issue.

Rule 452: A Proxy Solicitor's Opinion
contributed by Ken Altman, President, The Altman Group

The Altman Group is a leading proxy solicitation and corporate governance consulting firm in the United States and winner of the last two TOPS Awards as the highest rated proxy solicitation firm.

There has been much discussion since the NYSE put forward its plan in June 2006 to change the NYSE rule (Rule 452) governing the routine vote by brokers for the election of directors. This article presents our view as a proxy solicitor of steps that should be taken by the NYSE, the SEC and the brokerage community (including ADP) to try and mitigate the tremendous problems that will be created for most closed-end funds by the change to Rule 452.

Currently, Rule 452 is scheduled to change on January 2, 2008 so that routine director votes by brokers, i.e., those reflecting both the returned and unreturned votes of beneficial owners, would no longer be permitted. Starting in 2008 brokers will only be permitted to vote the proxies actually received from beneficial owners and not be able to cast votes on directors for clients who did not return a proxy.

To address potential concerns with the rule change, there have been some statements from the NYSE to the effect that the SEC may decide to exempt closed-end funds from the rule change, and there have been other comments with regard to a move by some major brokerage firms to adopt proportional voting (creating a process in which firms would cast votes for non-returning clients in the same proportion as for clients who return proxies). Hedge funds who vote would apparently not be factored in to the proportional calculation.

Nonetheless, it is our view that the NYSE has made a serious mistake in promulgating the proposed rule change. The change will affect different companies in very different ways, and those effects cannot be rectified by the remedies referenced in the NYSE's comments on the rule. Particularly worth noting is that the change will have little impact on companies primarily held by

institutional owners, given that institutions which hold shares through banks are already required to return a proxy if their shares are to be represented at an annual meeting.

In contrast, the rule change will have a disproportionately negative impact on many Nasdaq-listed companies and NYSE companies that have a large retail shareholder base, including many closed-end funds. In fact, we believe that some closed-end funds will not even be able to get a majority of their outstanding shares voting for the election of directors unless they engage in expensive follow-up mailings and calls to beneficial owners.

It is also our belief that many closed-end funds will be significantly more vulnerable to hostile attacks, particularly those that struggle to get a majority of outstanding shares to vote as well as those that choose to not spend significant extra dollars on a proxy solicitation firm to get a decent vote return for directors. In our view and experience, a low vote total will be seen as a signal to an aggressive investor or group of investors that there is a better chance to oust the board or succeed with a vote to open-end a closed-end fund. Surely this should have been considered by the NYSE committee that made these recommendations. It appears such concerns were either not addressed or ignored by a committee made up mostly of large companies or their advisors.

We believe an appropriate solution at this point would be for the NYSE to delay its implementation until it establishes a real and effective education program that targets the millions of street name holders who do not routinely return proxies. The program's goal would be to help beneficial owners understand the new consequences of not voting, that their vote truly is important and that a failure to return their proxy means their vote will not be cast. Most street holders believe that if they do not return a proxy the broker will vote for their shares. That said, while an education program would be helpful to some extent, we also recognize that this is a problem that defies an easy solution.

Below are some of the steps I recommended that the NYSE consider at a seminar we hosted on March 2, 2007 at the American Stock Exchange. Both the NYSE and ADP were co-panelists at this seminar.

While we are not counting on the NYSE to adopt all of the following suggestions, it seems only fair that they seriously consider the impact the proposed change will have and that they accept responsibility for helping companies to adapt to a radical change in the rules that feels to many as if it has come out of left field and is of no discernible benefit to thousands of publicly listed corporations.

Recommended Steps for NYSE

- Establish an education fund
- Create and introduce education plan to corporations
- Initiate proactive PR and advertising programs to inform/educate investors
- Require Brokers/Agents to participate in education efforts
 - Establish minimum level of cooperation
- Lobby SEC to convert true default on brokerage accounts to Non-Objecting Beneficial Owner (NOBO)¹ status
 - Many brokers today check off Objecting Beneficial Owner (OBO) status on new account forms they send to new customers

¹ A brief explanation: When beneficial owners open an account with a bank or brokerage firm, they fill out a form that includes a box asking whether they object to their information being made available upon request of the issuer. Those that do not object to their information being made available are referred to as Non-Objecting Beneficial Owners (NOBOs). Those that object are Objecting Beneficial Owners (OBOs). The significance from a solicitation perspective is that an issuer can obtain a list of all NOBOs in order to try to contact those holders. On the other hand, there is no way of identifying OBOs and therefore no way of contacting them.

- Mandate that Brokers initiate a charge for OBO status for retail owners. The charge could be \$50/year, \$100/year or whatever the NYSE determines to be reasonable and consistent with research completed by the NYSE.
 - The likely result would be that many retail owners would opt for NOBO status over OBO status rather than pay the charge.
- Consider using funds generated by OBO status to fund education effort
- Consider charging each institution that files for OBO status a yearly fee which will help fund NYSE education programs
 - Why are these charges reasonable?
 - ⊙ Because NOBO/OBO distinction was created at a time when the standard was that a vote on Directors was considered routine.
 - ⊙ Elimination of the routine vote will create substantial additional costs year after year for the corporation. Therefore, it makes sense that the NYSE should find a way to fund efforts to help reduce such costs.
- Lobby SEC to permit and enable companies to communicate directly with OBOs in order to try to persuade OBOs to convert to NOBO status.
 - Requires support from NYSE and Brokers/ADP
- Lobby SEC to permit and enable companies to obtain names of all shareholders for record dates in connection with annual or special meetings.
 - Other countries often require full disclosure of identity. Therefore, ironically, the same owners who do not identify themselves in the U.S. do already identify themselves when required by legislation.

Recommended Steps for Other Relevant Parties

- **ADP**
 - Work with brokerage community to permit and enable all mailings to owners to be easily segregated by NOBO and OBO status. (Must include cooperation from brokerage firms.)
 - Commit to including educational materials in mailings to OBOs.
 - Provide service of dissemination of educational materials at no or extremely low cost in a defined number of mailings each year.
- **Corporation**
 - Develop explanatory materials to accompany proxy materials.
 - Lobby for changes to NOBO/OBO legislation, either individually or through industry organizations.
 - Seek a legal solution, either individually or through industry organizations, requiring full disclosure of ownership at record dates in connection with annual or special meetings.
- **Brokers**
 - Agree to include educational materials with monthly/periodic statements.
 - Agree to support SEC action to encourage move to full disclosure of owner identity for record dates for annual or special meetings.
 - Agree to NOT oppose efforts to encourage NOBO account status over OBO account status.

For more information about The Altman Group, visit their website at www.altmangroup.com.

**Excerpt from *THE INVESTOR'S GUIDE TO CLOSED-END FUNDS* Monthly Research Report, Published by THOMAS J. HERZFELD ADVISORS, INC. (MIAMI)
www.herzfeldresearch.com - (305) 271-1900**