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**Bill Number:** Senate Bill 1207 (Alarcon) – As amended 05/16/06

**SUMMARY:**

SB 1207 establishes as a default the use of majority (rather than plurality) voting to elect a member of the board of directors of a publicly-traded, California corporation, in an uncontested election. Allows corporations to amend their bylaws to continue using the plurality default voting method.

**PURPOSE OF THE BILL:**

The purpose of this bill is to ensure the independence of corporate directors and make corporate boards more representative and accountable to shareholders.

**BOARD POSITION:**

Co-Sponsor. The Teachers' Retirement Board (Board) and other responsible shareholders question the value and propriety of the current plurality voting rule as a default standard, and believes that majority voting is the fairest and most representative method to elect corporate directors.

**LEGISLATIVE HISTORY:**

AB 2752 (Chu--2004) would have required publicly traded companies incorporated in California to revise their procedures for election to the board of directors and to make a copy of their corporate election procedures available to shareowners upon written request and post them on the corporation's website. AB 2752 was vetoed by Governor Schwarzenegger, who indicated that it placed new, unnecessary filing requirements on California businesses.

Resolution Chapter 92, Statutes of 2004 (AJR 79--Chu) urges the federal Securities and Exchange Commission (SEC) to implement proposed rules regarding corporate board of director nominations to require companies to include in their proxy materials information regarding security holder nominees for election as director.

**BACKGROUND:**

In the United States, corporate directors are generally nominated by a company's Board of Directors and "elected" or "confirmed" by shareholders by a plurality of proxy votes. Plurality vote allows corporate directors to be elected by the vote of a single share, unless they are opposed by a shareowner nominee that receives more votes. Existing state law requires publicly-traded companies incorporated in California to conduct their uncontested board elections in this manner. Majority voting is not permitted.

Although each state has its own corporation law, a substantial majority of the states follow the Model Business Corporation Act (Model Act), either by adoption of the Model Act in its entirety or by adoption of substantial parts of it. The Model Act was originally developed by the American Bar Association (ABA) in the 1980's to encourage uniformity within the corporation laws of each US state. The Model Act is not binding law, but instead serves as a guide for other states, and its

revisions have significantly influenced the development and uniformity of state's corporation law, including in this instance. California law is not consistent with the Model Act with respect to uncontested corporate board elections, because of making the plurality vote requirement the default standard, it actually precludes corporations from adopting the majority vote requirements.

Plurality voting, by minimizing the role of shareholders in the election of directors, does not properly acknowledge shareholders' fundamental right to select the directors they desire to serve as their fiduciaries. Although nominees are selected by current board members, who are fiduciaries of the shareholders, plurality voting doesn't necessarily produce the best result for shareholders of public companies since they do not have a significant voice in the election.

It has been the Board's policy to vote for shareholders and management proposals that establish a true majority vote standard. The Board delegates to CalSTRS staff the authority to vote proxies of companies in which it holds securities according to its Financial Responsibility Criteria for Corporate Investment. During 2004-05, CalSTRS cast 7,882 votes on a variety of proxy issues including financial, corporate governance and social issues affecting 2,959 companies whose shares were held in the Teachers' Retirement Fund.

CalSTRS, as a major corporate shareholder, actively votes its proxies to elect corporate board members who share the interests and philosophy of CalSTRS. CalSTRS generally votes in favor of a director unless the proxy statement shows circumstances contrary to policy including a potential conflict of interest due to other directorships, employment, providing legal or investment banking advice, and poor board meeting attendance. During 2004-05, CalSTRS cast proxy votes to seat all board nominees 26 percent of the time; none 20 percent of the time, and split the remaining 54 percent.

According to the Investor Responsibility Research Center (IRRC) in 2004, 12 majority voting shareholder proposals were included on company ballots and were supported by between 8 percent and 18 percent of the votes cast for and against. In contrast, in 2005 more than 80 majority voting shareholder proposals were submitted for inclusion in the company proxy materials, and supporting votes tracked by IRRC on these proposals averaged 43 percent of the votes cast for and against, a huge increase from 12 percent support in 2004.

In addition, majority voting for directors already is standard practice in the United Kingdom, France, Germany and other European nations. Many major U.S. corporations – Abbott Laboratories, Best Buy, Circuit City, Dell, Disney, Emerson Electric, FirstBancorp, Hasbro, Hercules, Intel, Lockheed Martin, Pfizer, Potlatch, Texas Instruments, Wells Fargo and 3M – have all modified their corporate governance principles in some fashion to include a majority vote standard.

## **ANALYSIS:**

Senate Bill 1207 establishes a default procedure for the uncontested election of directors of a publicly traded corporation incorporated in California. Specifically, the bill:

- Requires that uncontested candidates for positions on the board of directors be elected by majority vote rather than plurality vote;

- Requires that shares voted against or withheld from a candidate be considered shares represented and voting;
- Requires that shares that do not indicate a vote (i.e., abstain) not be considered represented and voting;
- Prohibits cumulative voting unless the corporation amends its bylaws or articles of incorporation to provide for cumulative voting;
- Requires uncontested incumbents who fail to receive majority approval of the shareholders to resign within 90 days of the date of the election. Prohibits the board of directors from appointing a candidate who failed an election to any vacant position on the board of directors;
- Allows a corporation to use the existing procedures for all elections, provided the corporation amends its articles of incorporation.

This bill does not change existing requirements for contested elections, which require a plurality of votes to elect a director.

Existing law generally assigns each shareholder of a corporation a number of votes equal to the number of shares he/she holds in the corporation, except where otherwise established. According to the Senate Judiciary Committee, shares may be “cumulated” (all voted for one candidate or spread over several candidates, as the shareholder sees fit), but no shareholder may cumulate votes unless the shareholder has given prior notice that he/she intends to cumulate his or her votes. Under this bill, cumulative voting would not be allowed in an uncontested election unless the corporation amends its articles or bylaws to provide for cumulative voting.

CalSTRS and a number of concerned institutional and individual investors believe that shareholders have little voice in the election of directors because the pervasive practice of plurality voting allows a nominee to be seated on the board with only one affirmative vote. Although under the current system shareholders hold the symbolic power of the “withhold” vote, which may impact on a board’s decision-making, in the end “withhold” votes are at most, advisory, with no legal significance or effect on the outcome of the election.

CalSTRS believes that the majority default rule approach, in conjunction with a modified holdover rule provides the best characteristics of an effective voting system and would be the best approach for a new default voting system for publicly-traded California corporations.

#### **FISCAL IMPACT:**

**Benefit Program Cost – None.**

**Administrative Costs/Savings – None.**

#### **SUPPORT/OPPOSITION**

##### **Support:**

Teachers’ Retirement Board;  
CalPERS Board of Administration, (Co-Sponsor);  
AFSCME;  
SEIU

**Opposition:**

American Electronics Association;  
Business Law Section of the State Bar;  
California Business Roundtable;  
California Chamber of Commerce

**ARGUMENTS****Pro:**

- Majority voting holds directors accountable for their performance on the Board.
- Ending plurality voting and the ability of incumbent directors to be held over until they are removed will make entrenched board of directors more responsive.
- Provisions of SB 1207 are permissive. A corporation may amend its bylaws to provide for a plurality voting standard in uncontested elections as well as contested elections.
- SB 1207 puts the power over the election in the hands of shareowners, and helps California corporations set the standard of best practices in corporate governance.

**Con:**

- Majority voting subjects companies to the risk of “failed elections” which may result in disruptions of board operations or the loss of otherwise qualified directors.