

SENATE BILL REPORT

SHB 1041

As Reported By Senate Committee On:
Judiciary, March 23, 2007

Title: An act relating to plurality voting for directors.

Brief Description: Modifying plurality voting for directors.

Sponsors: House Committee on Judiciary (originally sponsored by Representatives Pedersen, Rodne, Haler, Moeller and Lantz).

Brief History: Passed House: 2/28/07, 97-0.

Committee Activity: Judiciary: 3/23/07 [DPA].

SENATE COMMITTEE ON JUDICIARY

Majority Report: Do pass as amended.

Signed by Senators Kline, Chair; Tom, Vice Chair; McCaslin, Ranking Minority Member; Carrell, Hargrove, Murray and Weinstein.

Staff: Lidia Mori (786-7755)

Background: The Washington Business Corporation Act (WBCA) regulates the creation and operation of business corporations. Some of the provisions of the WBCA are default rules that will apply only if a corporation chooses not to adopt some alternative. One of the default provisions of the WBCA provides for plurality voting to elect the directors of a corporation. The default plurality voting provision in the WBCA provides that, unless otherwise provided in the articles of incorporation, in any election of directors, the candidates elected are those receiving the largest numbers of votes cast by the shares entitled to vote in the election, up to the number of directors to be elected by such shares.

Also by default, shareholders may cumulate votes by multiplying the number of votes they are entitled to cast by the number of directors for whom they are entitled to vote and to cast the product for a single candidate or to distribute the product among two or more candidates.

Plurality voting allows for the election of a director candidate who gets more votes than other candidates, but does not require a candidate to get a majority of votes. Plurality voting also allows election regardless of the number of votes withheld or cast against a candidate.

Many shareholder groups and others have been critical of plurality voting. Some corporations have provided for other methods of election, including some form of majority vote requirement, or some form of restriction on plurality voting. However, a corporation

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

operating under the default system can adopt majority voting only by amending its articles of incorporation, and amending the articles requires action by both the shareholders and the board of directors. Where strong disagreement exists between directors and shareholders, amending the articles of incorporation may be difficult. In addition, if a corporation does adopt a majority voting rule or tries to ameliorate the effects of plurality voting, other provisions of current law present potential problems. For instance, the WBCA provides that a director continues in office until a successor is elected. Thus, even in a corporation with majority voting, an incumbent director who fails to get a majority vote might nonetheless remain in office. Bylaw changes which might require a director to resign in such a situation are suspect because of the arguably overriding statutory provision calling for the director to remain in office.

In some instances, a director of a corporation may be elected by the vote of only a specified class or group of shareholders. In such a case, if a vacancy occurs and it is to be filled by a shareholder vote, only shareholders from that same class or group may vote. However, if such a vacancy is to be filled by the board of directors, the WBCA does not designate directors who may participate in filling the vacancy.

It is a generally accepted practice for publicly-held corporations to appoint someone to count votes and otherwise oversee elections at shareholders' meetings. However, there is no requirement in the WBCA for the appointment of such a person.

The American Bar Association issued a report in late 2005 that recommended changes to the plurality voting rule in the Model Corporations Act. In 2006, the state of Delaware adopted changes to its corporation law that are equivalent to those recommendations. The Corporate Act Revision Committee of the Washington State Bar Association has recommended changes to the WBCA similar to those recommended by the ABA and those adopted by Delaware.

Summary of Substitute Bill: Several changes are made to the WBCA with respect to the election of directors of corporations. The general default to a plurality voting rule is maintained; however, corporations are given increased ability to deviate from or modify plurality voting without having to amend their articles of incorporation.

Unless prohibited or contradicted by the articles of incorporation, the bylaws of a corporation may provide for election of directors in the following manner: (1) each vote may be cast up to the number of times equal to the number of directors to be elected; (2) each vote may be for or against a candidate, or may be withheld; and (3) votes may not be cumulated.

If the bylaws so provide, a candidate is elected if he or she receives a plurality of the votes cast, but if the candidate has also received more votes against than for, his or her term of office is the shorter of 90 days or until the filling of the position by the board or directors. A bylaw providing for this kind of election that has been adopted by the shareholders may not be amended by the board of directors unless the bylaw itself allows it. However, a bylaw adopted by the board of directors that imposes this rule may be amended by either the board or the shareholders.

Corporations are authorized to alter the provision requiring that directors remain in office until a successor is elected or appointed. Shorter terms of office may also be provided for directors who are elected by less than some specified vote. A director's resignation may be

made effective contingent upon a future date to be determined by some event. A notice of resignation contingent upon the failure to receive a specified vote may be made irrevocable. When a vacancy occurs in a director position that was held by a director elected by a specific voting group of shareholders, and the vacancy is to be filled by the board of directors, only those directors who were elected by that same voting group may participate in filling the vacancy.

Any corporation with shares listed on a national exchange or regularly traded in certain markets must appoint an inspector to oversee voting at shareholders' meetings. The person appointed may be an officer or employee of the corporation. It is the duty of the inspector to act impartially in determining the numbers and voting power of outstanding shares and shares represented at the meeting; the validity of proxies; and the results of the voting.

EFFECT OF CHANGES MADE BY RECOMMENDED AMENDMENT(S) AS PASSED COMMITTEE (Judiciary): The election standards are broadened and the board of shareholders are allowed latitude to set the standard for election in the bylaw. The standard could be a majority vote, i.e., the director candidate must receive a majority of votes cast in the election in favor of the candidate election. The standard could also be a modified plurality. The board of shareholders are enabled to prescribe the terms of the election in the bylaw. The prescriptive terms in the bill are transformed into default provisions and if an adopted bylaw does not cover the pertinent points, the default provisions will apply.

Appropriation: None.

Fiscal Note: Not requested.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony: PRO: This bill is about increasing accountability for shareholders. It brings us closer to a world in which shareholders have more say regarding bylaws and voting methods. There is a rational basis for treating public companies differently from private ones. The concern about plurality voting in Washington is the genesis for this bill. Other than a proxy fight, there is no other way for shareholders to express their dissatisfaction with the board of directors. A big part of this bill is that it would allow a bylaw to change how voting happens.

OTHER: There are two areas of concern. This bill requires shareholders to trade off certain rights in order to gain other rights. Cumulative voting is not seen as being in conflict with majority voting. The holdover default provision should be left as it is now.

Persons Testifying: PRO: Representative Pedersen, prime sponsor; Kent Carlson, Washington State Bar Association, Corporation Act Revision Committee.

OTHER: David Johnson, Washington State Building Trades; Douglas Kilgore, Worker Owners Council of Washington; Bob Abbott, Laborers District Council.