HOUSE BILL REPORT
SHB 1041

As Amended by the Senate

Title: An act relating to plurality voting for directors.

Brief Description: Modifying plurality voting for directors.

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

Brief History:
Committee Activity:
Judiciary: 1/12/07, 1/17/07 [DPS].
Floor Activity:
Passed House: 2/28/07, 97-0.
Senate Amended.
Passed Senate: 4/12/07, 42-0.

Brief Summary of Substitute Bill

- Allows a corporation to adopt a modified version of the statutory default plurality voting method for electing corporate directors.
- Allows directors' resignations to be made contingent upon the happening of some future event such as an election at which the director receives less than a specified vote.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 10 members: Representatives Lantz, Chair; Goodman, Vice Chair; Rodne, Ranking Minority Member; Warnick, Assistant Ranking Minority Member; Ahern, Kirby, Moeller, Pedersen, Ross and Williams.

Staff: Bill Perry (786-7123).

Background:

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.

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:

> 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 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 (ABA) 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 as follows:

- each vote may be cast up to the number of times equal to the number of directors to be elected;
- each vote may be for or against a candidate, or may be withheld; and
- 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.

Other changes are made to correct a citation and to provide for terminology consistent with other provisions of the WBCA and the model act.

EFFECT OF SENATE AMENDMENT(S):

The amendment expands the options that a corporation is given if it chooses in its bylaws to adopt director election procedures that depart from the statutory default plurality voting procedures.

Instead of allowing bylaws to provide for modified plurality voting, as the House Substitute does, the Senate amendment allows the bylaws to specify the "number, percentage, or level of votes" required for election.

Instead of providing that a nominee who is elected by a plurality but who receives more votes against than in favor will serve for the lesser of 90 days or until a director is selected by the board, the amendment provides that an incumbent director who does not receive the number, percentage, or level of votes required in the bylaws will serve for the lesser of a period of up to 90 days as specified in the bylaws, or until a director is selected by the board.

The amendment explicitly allows the bylaws to provide for the counting of votes cast against or withheld in determining whether a candidate has received the specified number, percentage or level of votes. Unless the bylaws provide otherwise, abstentions will not count as votes cast.

The amendment provides that in the case of an election where there are more candidates than positions, and at least one candidate is proposed by shareholders, election procedures created in the bylaws apply only if so specified in the bylaws.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony:

(In support) The bill is an important part of efforts to insure that shareholders are allowed to hold boards of directors accountable. This state has a strong tradition of staying on the leading edge in improving corporate governance and maintaining investor confidence in Washington corporations. The bill will provide an alternative to an expensive proxy battle when shareholders wish to express their dissatisfaction with a board of directors. The bill also allows corporations to modify the current law's holdover rule and thereby allow valid director resignation agreements.

(Opposed) None.

Persons Testifying: Kent Carlson, Washington State Bar Association, Corporate Act Revision Committee.

Persons Signed In To Testify But Not Testifying: None.