

Proposed Amendment to NYSE Rule 452 May Hinder Investment Advisory Contract Approvals

Introduction

On September 2, 2005, the New York Stock Exchange (the "Exchange") proposed an amendment to its classification of "routine" and "non-routine" matters under Exchange Rule 452 (Giving Proxies by Member Organization). Under the proposed amendment, any proposal to obtain shareholder approval of an investment advisory contract between a registered investment company and a new investment adviser is a "non-routine" matter for which an Exchange member with stock registered in its name must obtain voting instructions from the beneficial owner of the shares.¹

For purposes of the amended rule, a "new" investment adviser will include the investment adviser counterparty to a new investment advisory contract following the assignment and termination of an advisory contract. As detailed in this update, the proposed amendment may hinder investment advisory contract approvals.

Discussion

Exchange Rule 452 provides that an Exchange member can give a proxy to vote shares registered in its name, even where the beneficial owner of the shares fails to instruct the firm on how to vote, as long as the giving of the proxy does not authorize an action that "may affect substantially the rights or privileges of such stock." The Exchange provides guidance

on 18 "non-routine" actions that, in its view, may substantially affect shareholders. Member organizations cannot vote uninstructed shares in these instances.² However, "routine" matters such as approval of a one-year extension of the term of an existing advisory contract, or a non-material amendment to the contract, do not require the instruction of beneficial owners.

The proposed amendment classifies the approval of an investment advisory contract with a new investment adviser as "non-routine." For example, an Exchange member would be required to obtain client instruction when there will be an assignment of an advisory contract caused by a change in control of the investment adviser that is a party to the contract. Prior interpretations of Rule 452 allowed member organizations to vote uninstructed shares on the approval of new investment advisory contracts where a change in the identity of the investment adviser was the only change being made to the substantive terms of the contract.³

Preventing Exchange members from voting uninstructed shares may make it more difficult for new investment advisory contracts to be approved. Under Section 15(a) of the

² Supplementary Material 11 to Rule 452. These include situations involving appraisal rights, the mortgaging of property, and the creation of preferred stock, among others.

³ SR-NYSE-2005-61, Amendment No. 1.

¹ SR-NYSE-2005-61, Amendment No. 1.

Investment Company Act of 1940, investment advisory contracts must be approved by a “majority of the outstanding voting securities” of the fund, which is defined as the lesser of (1) more than 50% of the outstanding shares of the fund, or (2) 67% of the shares present at a meeting at which at least 50% of the outstanding shares are present or represented by proxy. Funds often rely on the latter method to determine whether approval has been obtained.

Under the amended interpretation of Rule 452, an Exchange member’s submission of a proxy indicating that the member cannot vote its clients’ shares due to a lack of instruction will increase the number of shares present, which will in turn increase the number of votes necessary to meet the 67% approval requirement. Since Exchange members cannot vote on the new advisory contract without client instruction, they effectively will cast a negative vote against the contract by their mere presence. In that event, the fund may be unable to obtain the approval required by Section 15(a), in which case it must adjourn a shareholder meeting to permit the further solicitation of proxies on that item, which will entail increased cost and may prevent approval of the advisory contract if Exchange members do not obtain client instruction or revoke the proxy.⁴

⁴ The Exchange identified and acknowledged this problem in 1992, when it amended its interpretation of Rule 452 to

The comment period for the proposed amendment expires 21 days after its publication in the *Federal Register*.



This legal update was authored by Keith T. Robinson (+1.202.261.3386; keith.robinson@dechert.com) and Alan Rosenblat (+1.202.261.3332; alan.rosenblat@dechert.com), with research assistance by Lisa R. Price (+1.212.649.8795; lisa.price@dechert.com).

reclassify the approval of initial investment advisory contracts as “routine,” enabling Exchange members to vote uninstructed shares. In the order approving the proposal, the Exchange noted that “with regard to the initial approval of an investment advisory contract for which member organizations cannot vote shares on which no instructions have been received, it can be difficult to obtain the vote necessary.” In classifying the authorization of initial advisory contracts as “routine,” the Exchange reasoned that because such contracts are described in the prospectus that an investor receives when deciding to invest in a fund, the investor implicitly approves the contract through his or her choice to invest, thereby eliminating the need for client instruction. Exchange Act Release No. 30697 (May 13, 1992) (SR-NYSE-92-05).

Additional practice group contacts

For further information, contact the authors, one of the attorneys listed, or any Dechert LLP attorney with whom you are in regular contact. Visit us at www.dechert.com/financialservices.

Sander M. Bieber
Washington
+1.202.261.3308
sander.bieber@dechert.com

Robert W. Helm
Washington
+1.202.261.3356
robert.helm@dechert.com

Jon S. Rand
New York
+1.212.698.3634
jon.rand@dechert.com

Douglas P. Dick
Newport Beach
+1.949.442.6060
douglas.dick@dechert.com

Jane A. Kanter
Washington
+1.202.261.3302
jane.kanter@dechert.com

Keith T. Robinson
Washington
+1.202.261.3386
keith.robinson@dechert.com

Ruth S. Epstein
Washington
+1.202.261.3322
ruth.epstein@dechert.com

Stuart J. Kaswell
Washington
+1.202.261.3314
stuart.kaswell@dechert.com

Alan Rosenblat
Washington
+1.202.261.3332
alan.rosenblat@dechert.com

Susan C. Ervin

Washington
+1.202.261.3325
susan.ervin@dechert.com

Joseph R. Fleming

Boston
+1.617.728.7161
joseph.fleming@dechert.com

Brendan C. Fox

Washington
+1.202.261.3381
brendan.fox@dechert.com

David J. Harris

Washington
+1.202.261.3385
david.harris@dechert.com

George J. Mazin

New York
+1.212.698.3570
george.mazin@dechert.com

Jack W. Murphy

Washington
+1.202.261.3303
jack.murphy@dechert.com

John V. O'Hanlon

Boston
+1.617.728.7111
john.ohanlon@dechert.com

Jeffrey S. Poretz

Washington
+1.202.261.3358
jeffrey.poretz@dechert.com

Frederick H. Sherley

Charlotte
+1.704.339.3100
frederick.sherley@dechert.com

Patrick W. D. Turley

Washington
+1.202.261.3364
patrick.turley@dechert.com

Brian S. Vargo

Philadelphia
+1.215.994.2880
brian.vargo@dechert.com

David A. Vaughan

Washington
+1.202.261.3355
david.vaughan@dechert.com

Dechert^{LLP}
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