

July 26, 2010

SEC Issues Concept Release Seeking Comment on U.S. Proxy System

On July 14, 2010, the Securities and Exchange Commission voted unanimously to issue a concept release seeking public comment on a range of issues related to the U.S. proxy system.¹ It has been nearly 30 years since the SEC last conducted a comprehensive review of the proxy solicitation and voting system, and since then a number of aspects of the proxy voting infrastructure have changed, including shareholder demographics and ownership structures, technology and the growing importance of proxy distribution service providers, shareholder proxy service providers and other third party participants. SEC Chairman Mary Schapiro noted that "the proxy is often the principal means for shareholders and public companies to communicate with one another, and for shareholders to weigh in on issues of importance to the corporation." Chairman Schapiro added that for effective governance, "the transmission of this communication between investors and public companies must be — and must be perceived to be — timely, accurate, unbiased, and fair."

The concept release seeks comment on three main areas: (1) the accuracy, transparency and efficiency of the voting process; (2) communications and shareholder participation; and (3) the relationship between voting power and economic interest. The SEC requests comment on specific matters within each of these three areas.

Accuracy, Transparency and Efficiency of the Voting Process

- *Over-Voting and Under-Voting of Shares:* As a result of the way securities transactions are cleared and settled in U.S. securities markets, securities intermediaries (such as broker-dealers) may cast greater or fewer votes than the number of shares they actually hold. Some intermediaries have developed methods to reconcile their records and allocate votes to their customers in an effort to avoid over-voting, which may result in under-voting in certain cases. The SEC seeks comment on whether over-voting or under-voting is a problem, and if so, whether intermediaries should be required to disclose their reconciliation methods, or whether the SEC should require the use of a particular method of allocation.
- *Vote Confirmation:* Market participants are currently unable to confirm whether an investor's shares have been voted according to the investor's voting instructions. The SEC seeks comment on whether vote tabulators, securities intermediaries and proxy service providers should be required to provide each other with vote data, thereby allowing investors and issuers to confirm that votes have been received and tallied in accordance with investors' voting instructions.
- *Proxy Voting by Institutional Securities Lenders:* Currently institutional shareholders that lend their securities to third parties must recall those shares in order to vote them. Lenders may not be able to

¹ A copy of the release is available on the SEC's website at www.sec.gov/rules/concept/2010/34-62495.pdf.

recall their shares in time to vote on certain matters of interest if the lenders do not receive sufficient advanced notice of such matters. The SEC requests comment on whether it should require that agenda items at shareholder meetings be identified earlier in order to address this issue. In addition, the SEC seeks comment on whether it should require additional disclosure from registered management investment companies, including the number of shares voted at a particular meeting.

- *Proxy Distribution Fees*: The SEC noted that the structure and size of fees charged to issuers by broker-dealers and banks for the distribution of proxy materials to shareholders has been one of its most consistent concerns. The current fee structure of the national securities exchanges establishes the maximum fees that a member broker-dealer may charge an issuer for distribution services as reasonable reimbursement. The SEC seeks comment on whether the fee amounts should be revised or eliminated in favor of allowing market forces, rather than the self-regulatory organizations, determine reasonable rates of reimbursement.

Communications and Shareholder Participation

- *Issuer Communications with Shareholders*: In its concept release, the SEC noted that some issuers have expressed concerns regarding their limited ability to communicate directly with their shareholders due to the practice of shareholders holding their shares in street name and the rules allowing beneficial owners to object to having their identities disclosed to issuers (known as objecting beneficial owners or OBOs). Issuers are seeking more direct communications with their shareholders due to, among other things, recent changes in corporate governance such as the adoption of majority voting of directors, the elimination of broker discretionary voting in uncontested director elections and a potential drop in retail voting percentages. The SEC requests comment on whether it should preserve, eliminate, limit or discourage the use of OBO status. In addition, the SEC seeks input on ways issuers can communicate directly with beneficial owners.
- *Means to Facilitate Retail Investor Voting Participation*: The SEC noted a significant lack of participation by retail investors in proxy voting, which is a source of concern even in companies in which retail share ownership represents a relatively small portion of total voting power. The SEC concept release presents several ideas to potentially improve retail investor voting participation. The SEC seeks comment on the following initiatives: improving current investor education efforts; enhancing brokers' or issuers' internet platforms; enhancing investor-to-investor communications; and improving the use of the internet for distribution of proxy materials.
- *Data Tagging Proxy-Related Materials*: Currently the proxy statement and voting information is neither required nor permitted to be provided to the SEC in interactive data format which would enable shareholders and other participants to use automatic tools to retrieve, search or analyze proxy statement information. As a result, the SEC requests comment on whether it would be beneficial to investors to permit or require issuers, including funds, to provide proxy statement and voting information in interactive data format in addition to the traditional format. The SEC also seeks comment on whether there are any other types of information for which it should permit or require tagging in order to improve the efficiency and quality of proxy voting.

Relationship between Voting Power and Economic Interest

- *Proxy Advisory Firms*: Institutional investors, including pension plans and employee benefit plans, typically own shares in a large number of issuers. At shareholders' meetings, these institutional investors must decide how to vote their shares on a significant number of matters. These investors often seek the assistance of proxy advisory firms, raising a number of issues, including potential conflicts of interest and the possibility of the proxy advisory firm basing vote recommendations on erroneous or incomplete facts. The SEC seeks comment on whether it should clarify existing regulations or propose additional regulations to address concerns about the existence and disclosure of conflicts of interest. In addition, the SEC seeks comment on enhancing its regulatory oversight of proxy advisory firms, including the firms' issuance of voting recommendations and whether the SEC should require public disclosure by proxy advisory firms of their voting recommendations.
- *Dual Record Dates*: Under state corporation law, issuers set a record date in advance of a shareholder meeting to determine who is entitled to notice of and to vote at the upcoming meeting. If a shareholder sells his or her shares between the record date and the meeting, this shareholder is entitled to vote despite no longer owning the shares. Due to recent changes in state corporate law, "dual record" dates are now allowed in some states — one for determining who receives notice of the upcoming meeting and the other for determining who is entitled to vote. The SEC seeks comment on whether its rules should accommodate dual record dates.
- *"Empty Voting" and Related "Decoupling" Issues*: "Empty voting" occurs when a shareholder's voting rights substantially exceed the shareholder's economic interest in an issuer. This "decoupling" of economic interest and voting rights occurs when the shareholder uses certain strategies, such as buying a put option to sell the shares. "Decoupling" also occurs as a result of share lending practices and if a shareholder sells his or her shares between the record date and the shareholder meeting where the shareholder is entitled to vote. The SEC seeks comment on whether it should require disclosure of decoupling activities through the proxy rules, the periodic reporting system rules adopted pursuant to statutory provisions such as Sections 13(d), 13(f) and 13(g) of the Exchange Act or through the development of a new disclosure system.

Comments on the concept release may be submitted to the SEC no later than October 20, 2010. Information on submitting comments to the SEC can be found on the SEC's website at www.sec.gov/rules/submitcomments.htm.

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