

## U.S. Securities and Exchange Commission's Proxy Plumbing Concept Release

On July 14, 2010, the Securities Exchange Commission issued its long-awaited "Concept Release on the U.S. Proxy System," Release Nos. 34-62495; IA-3052; IC-29340, available at <http://www.sec.gov/rules/concept/2010/34-62495.pdf>. This concept release addresses infrastructure and related technical issues affecting the solicitation, tabulation and voting of proxies in the United States. The SEC has been examining, and is looking for further input on, these "proxy plumbing" concerns.

The issuance of this concept release does not portend any imminent transformation of the proxy solicitation system. In fact, it is highly unlikely that it will result in any modifications in time for the 2011 proxy season, especially given the many rulemaking projects mandated for the SEC by the Dodd-Frank Wall Street Reform and Consumer Protection Act. But the concept release does signal that the SEC understands that issues about the proxy process have been raised and that changes may be in the future.

The SEC has identified three categories of issues in the proxy system:

- Accuracy, Transparency and Efficiency of the Voting Process
- Communications and Shareholder Participation
- Relationship between Voting Power and Economic Interest

By examining the concept release and the comments received by the SEC, it is possible to

glean a preview of where the SEC may look to revise the proxy system in the coming years. By providing comments, it may be possible to influence the shape of the proxy system in the future. Comments on the concerns and questions raised in this concept release are due by October 20, 2010.

### Accuracy, Transparency and Efficiency of the Voting Process

**Over-Voting and Under-Voting.** Over-voting occurs when the vote tabulator receives votes from a securities intermediary that exceed the number of shares that the securities intermediary is entitled to vote. For example, because of the way securities lending transactions are tracked, if all of a broker-dealer's customers owning a particular issuer's securities actually provide voting instructions to the broker-dealer, the broker-dealer may receive voting instructions for, and may vote, more securities than it is entitled to vote. Also, because shares are held in fungible bulk, it may be unclear which investor has the right to vote. Sometimes, both the lending and borrowing broker-dealers submit voting instruction forms (VIF) for the same shares even though it is clear that only one is entitled to vote. Voting imbalances can also occur because of "fails to deliver" in the stock clearance and settlement system.

Currently, there are different methods by which over-voting and under-voting are reconciled. The SEC is interested in receiving views on whether it

would be helpful to investors for broker-dealers to publicly disclose the voting allocation and reconciliation method used by the firm during each proxy season in an attempt to avoid over-voting or under-voting, as well as the likely effect of that method on whether the customer's instructions would actually be reflected in the broker-dealer's proxy that is sent to the vote tabulator. Alternatively, the SEC is seeking input on whether broker-dealers should be required to use a particular reconciliation method.

**Vote Confirmation.** The concept release discusses the inability under the current proxy system to confirm that votes have been properly submitted in accordance with an investor's instructions. The problem is that no single participant in the proxy process holds all of the information necessary to provide this vote confirmation. A possible regulatory response suggested by the SEC is requiring that the issuer or transfer agent be granted access to certain voting record information for the limited purpose of enabling a shareholder or securities intermediary to confirm how a particular shareholder's shares were voted. In that regard, the SEC has solicited comments on whether confidentiality could be maintained. The SEC has also asked whether issuers should have to confirm to registered or beneficial owners that their votes were received and properly tabulated and whether investors should have access to voting records for a vote audit.

**Proxy voting by Institutional Securities Lenders.** Institutional investors sometimes lend out their portfolios with voting rights; they must terminate the loan and receive the loaned securities back before the record date if they want to vote. Since the agenda appears in the proxy statement, mailed after the record date, it is difficult for institutional securities lenders to obtain timely information about what will be voted upon. A possible regulatory solution suggested by the SEC is to expand upon the New York Stock Exchange's 10-day notice of record

date requirement so that such notice also specifies agenda items and to make such notice available to the public and have other exchanges adopt a similar rule. Alternatively, agenda items could be disclosed in advance on a Form 8-K, in a press release or via a website posting. The SEC has also solicited comments on requiring management investment companies registered under the Investment Company Act to disclose the actual number of votes they cast.

**Proxy Distribution Fees.** The concept release raises an issue that has been a source of concern and frustration to issuers—the fees they are charged for the dissemination of their proxy materials. Pursuant to SEC Rules 14b-1 and 14b-2, broker-dealers and banks must distribute proxy materials that they receive from an issuer to their customers who are beneficial owners of that issuer's securities, but this obligation is conditioned upon the issuer providing assurance that it will reimburse the broker-dealers and banks for reasonable expenses incurred in distributing that material to their customers. The NYSE has set a fee schedule for reimbursement of such expenses that is applicable for NYSE members, and other exchanges have rules similar rules. Concerns have been raised as to whether the fees in the NYSE schedule currently reflect reasonable reimbursement.

Issuers pay the fees for their proxy materials to be distributed, but they have no control over the process by which the proxy service provider is selected, the contract terms for mailing proxy materials or the fees incurred through the proxy distribution process. The SEC has noted that under the current proxy system, there is an absence of competition in determining what constitutes a reasonable mailing fee for proxy materials. The SEC has noted that Broadridge, which is the service provider for most U.S. broker-dealers, often charges issuers, on behalf of its broker-dealer clients, the maximum fee allowed by the NYSE, while Broadridge charges its large broker-dealer clients a lesser amount. This results in Broadridge remitting

funds it so receives from issuers to some of its broker-dealer clients.

The SEC has suggested, as a potential regulatory response, that self-regulatory organizations should review existing fee structures to see whether they are reasonably related to the actual costs of proxy solicitation. Another potential alternative would be the use of a central data aggregator that would collect beneficial ownership information from all securities intermediaries and provide such information to any agent that the issuer chooses. This would allow service providers to compete to provide services to forward proxy materials, with the issuer that pays the cost of mailing choosing the service provider, rather than the securities intermediary, which has no incentive to reduce costs. The SEC has also solicited comments on whether self-regulatory organizations should set reimbursement rates for notice and access, for which there are not currently any maximum fees. The SEC has also asked whether changes in the objecting beneficial owner (OBO)/non-objecting beneficial owner (NOBO) mechanism would encourage competition in the proxy distribution sector and, if so, how that would affect costs or accountability.

## Communications and Shareholder Participation

### Issuer Communications with Shareholders.

The concept release addresses concerns about the ability of issuers to communicate directly with their shareholders. The SEC suggested several potential responses. One is a system that would identify all beneficial owners, except those that elect to remain anonymous by registering shares in a nominee account, and allow beneficial owners the right to vote directly. Another would provide issuers with a list of all beneficial owners (as opposed to only the NOBO list), but only as of the record date for a particular meeting. The SEC also discussed educating investors about OBO and NOBO status and eliminating OBO status as the default on broker-dealer forms. The SEC is

soliciting comments on whether investors have legitimate privacy interests with respect to share ownership, whether issuers need to be able to identify shareholders or just be able to communicate with them, and whether periodic reaffirmations of OBO or NOBO status should be required.

### Means to Facilitate Retail Investor

**Participation.** The concept release focuses on a number of methods that might increase retail participation in the proxy voting process and solicited comments with respect to each of the areas identified. The first method the SEC noted is investor education, with more proxy-related educational materials being posted on issuer and broker-dealer websites. The concept release also considers whether the account opening process could be used as a means of educating investors about proxy voting.

Another potential means to promote retail voting identified by the concept release is enhancing broker-dealers' Internet platforms so that investors can access proxy materials and VIFs through the investors account page on the broker-dealer website. The concept release considers whether improvements are needed in investor-to-investor communications, such as additional forums for shareholder-to-shareholder communication. It also asks whether improvements are needed in the use of the Internet for proxy distribution, including whether it would be helpful to allow a proxy card or VIF to accompany the notice of Internet availability when the notice and access model of proxy material delivery is used.

The concept release discusses a possible amendment to the proxy rules to enable broker-dealers to obtain advance voting instructions from their customers on particular topics that could be used unless the customers changed those instructions. For example, beneficial owners could instruct their broker-dealers to vote as the board of directors recommends, to vote against the board's recommendations, to vote on particular types of proposals consistently with

specified special interest groups or proxy advisory firms, to abstain from voting, to vote proportionally with all instructed votes that the brokerage firm receives from its customers or to vote proportionally with all instructed votes from institutional or retail customers of the brokerage firm only.

**Data-Tagging Proxy-Related Materials.** The concept release asks whether there should be an interactive format for proxy and voting information. This could be in the form of permitting or requiring data tagging for the entire proxy statement, for a portion of the proxy statement such as executive compensation information, director experience and other directorships, transactions with related persons or corporate governance or for specific components of executive compensation. The SEC has requested comments on whether data tagging would result in more informed voting decisions. The concept release also asks whether it would be useful to have officer and director identities be tagged and linked to their unique Central Index Key identifier to enable investors to more easily determine if they have relationships with other filers.

## Relationship between Voting Power and Economic Interest

**Proxy Advisory Firms.** The concept release observes that institutional investors have substantially increased their use of proxy advisory firms and reflects on how the proxy solicitation rules and Investment Advisers Act should apply to proxy advisory firms. Among the concerns that the SEC identified in this area are conflicts of interest arising from proxy advisory firms providing proxy voting recommendations to institutional investors, and consulting services to corporations or proponents on the same matters. Conflicts also arise when proxy advisory firms provide governance ratings to institutional clients while also offering consulting services to corporate clients on how to improve such ratings.

Possible regulatory actions include addressing conflicts with additional disclosure through revisions of, or interpretive guidance under, the proxy rules and/or the Investment Advisers Act. The SEC is also considering whether additional regulations, similar to those addressing conflicts on the part of ratings organizations, should be developed for proxy advisory firms.

The concept release also expresses a concern about lack of accuracy and transparency by proxy advisory firms in formulating voting recommendations, noting that there is not always a process to correct mistakes in voting recommendations and that even after corrections are made, some votes may be cast based upon prior recommendations. A possible response would be to require proxy advisory firms to increase disclosure regarding the extent of research and the effectiveness of controls ensuring accuracy of data. Proxy advisory firms might be required to disclose their policies and procedures for interacting with issuers, informing issuers of recommendations and handling appeals of recommendations. Another approach posed by the concept release would be to require proxy advisory firms to file voting recommendations as soliciting material.

**Dual Record Dates.** The concept release explores issues arising from recent changes to state corporate law, such as in Delaware, to permit dual record dates. The concept release identifies two general models that could be used to facilitate issuers' use of separate record dates for notice and voting. The first requires issuers to provide proxy materials to investors on the notice record date. The concept release questions whether issuers should also have to send materials to investors who become investors by the voting record date (as opposed to relying on Internet availability of the proxy materials). The second approach is to require issuers to provide the disclosure document to investors as of the voting record date.

An open issue in this context is whether and how issuers should be obligated to make the proxy

materials public at some point before the voting record date. Under either model, investors may submit a proxy card or VIF prior to the voting record date and then buy or sell additional shares so that the number of shares held at the time of the proxy card or VIF submission is different from the number of shares such investor ultimately owns on the voting record date. One possible solution would be to specify that if an investor submits a proxy or VIF prior to the voting record date, all shares held on that date would be voted in accordance with such proxy card or VIF in absence of specific contrary instructions. Alternatively, regulations could provide that the proxy card or VIF could only be used to vote shares owned at the time the proxy card or VIF is submitted, so that shares acquired after the notice record date would not be voted unless a separate proxy card or VIF is submitted. In addition to seeking comments on whether issuers wish to use dual record dates and why, the SEC has asked whether it should wait to see how popular dual record dates become before providing a regulatory response.

**“Empty Voting” and Related “Decoupling” Issues.** Empty voting occurs where there has been a “decoupling” of the voting and the economic rights inherent in a share of stock, with a shareholder’s voting rights exceeding its economic interest. Empty voting can be accomplished using either hedging transactions or non-hedging strategies, such as active trading after a record date or a trustee voting unallocated ESOP shares. Sometimes an empty voter has a negative economic interest, which may make it prefer that the company’s share price falls. On the other hand, it is possible that empty voting would not always be contrary to the interests of shareholders. At least one commentator has argued that informed investors could potentially improve electoral outcomes through empty voting by taking long economic positions, acquiring disproportionate voting power from less informed shareholders and casting votes that

are more informed, thereby more likely to contribute to shareholder value.

Possible regulatory responses for the empty voting issue discussed in the concept release include requiring fuller disclosure of empty voting and/or requiring voters to certify when voting that they hold full economic interest in the shares being voted. Another possibility is to require issuers to disclose agendas in sufficient time for investors to recall loaned securities so that they could vote them. The SEC also raised the possibility of permitting only persons who possess long positions to vote by proxy and prohibiting empty voting, especially in situations where there is a negative economic interest.

## Practical Considerations

- The concept release provides a window into potential upcoming rule changes affecting future proxy seasons. Even though such rule changes are not imminent, the concept release and the related comments will provide public companies and other interested parties with an overview of the many proxy issues that may be addressed in the future. This gives public companies the opportunity to reflect upon how such changes may impact them.
- Public companies should consider whether any of the issues raised by the concept release merit, either individually or as part of a group, submitting a comment letter to the SEC. The concept release addresses a wide variety of issues relating to the proxy process. Particular concerns to public companies may include voting mechanics that may affect outcomes of proxy proposals, fees payable to intermediaries in connection with the dissemination of proxy materials and issues relating to proxy advisor recommendations.
- The concept of dual record dates for shareholder meetings is a relatively recent development in the United States. Companies contemplating using this new statutory procedure may find it particularly worthwhile to participate in the SEC’s initial regulatory

reaction by making their views and concerns known in a comment letter.

- In addition to posing many questions regarding potential improvements to the proxy system, the concept release summarizes the existing mechanics of proxy solicitation and tabulation. This makes the concept release a good resource for people who are involved in other aspects of proxy solicitation, such as drafting the proxy statement. In that regard, Section II of the concept release entitled “The Current Proxy Distribution and Voting Process” is very helpful to understanding what happens between the time the issuer releases its proxy materials and the time of the annual meeting.

---

*If you have any questions regarding the SEC’s concept release on “proxy plumbing,” please contact the author of this Legal Update, Laura D. Richman, at +1 312 701 7304, or any of the lawyers listed below or any other member of our Corporate & Securities group.*

**David S. Bakst**  
+1 212 506 2551  
[dbakst@mayerbrown.com](mailto:dbakst@mayerbrown.com)

**John P. Berkery**  
+1 212 506 2552  
[jberkery@mayerbrown.com](mailto:jberkery@mayerbrown.com)

**Paul C. de Bernier**  
+44 20 3130 3232  
[pdebernier@mayerbrown.com](mailto:pdebernier@mayerbrown.com)

**Edward S. Best**  
+1 312 701 7100  
[ebest@mayerbrown.com](mailto:ebest@mayerbrown.com)

**Michael T. Blair**  
+1 312 701 7832  
[mblair@mayerbrown.com](mailto:mblair@mayerbrown.com)

**Robert E. Curley**  
+1 312 701 7306  
[rcurley@mayerbrown.com](mailto:rcurley@mayerbrown.com)

**Eric J. Finseth**  
+1 650 331 2066  
[efinseth@mayerbrown.com](mailto:efinseth@mayerbrown.com)

**Dan A. Fleckman**  
+1 713 238 2718  
[dfleckman@mayerbrown.com](mailto:dfleckman@mayerbrown.com)

**Marc H. Folladori**  
+1 713 238 2696  
[mfolladori@mayerbrown.com](mailto:mfolladori@mayerbrown.com)

**Robert F. Gray**  
+1 713 238 2600  
[rgray@mayerbrown.com](mailto:rgray@mayerbrown.com)

**Lawrence R. Hamilton**  
+1 312 701 7055  
[lhhamilton@mayerbrown.com](mailto:lhhamilton@mayerbrown.com)

**Michael L. Hermsen**  
+1 312 701 7960  
[mhermsen@mayerbrown.com](mailto:mhermsen@mayerbrown.com)

**Philip J. Niehoff**  
+1 312 701 7843  
[pniehoff@mayerbrown.com](mailto:pniehoff@mayerbrown.com)

**Elizabeth A. Raymond**  
+1 312 701 7322  
[eraymond@mayerbrown.com](mailto:eraymond@mayerbrown.com)

**Laura D. Richman**  
+1 312 701 7304  
[lrichman@mayerbrown.com](mailto:lrichman@mayerbrown.com)

**Diego A. Rotsztain**  
+1 212 506 2587  
[drotsztain@mayerbrown.com](mailto:drotsztain@mayerbrown.com)

**David A. Schuette**  
+1 312 701 7363  
[dschuette@mayerbrown.com](mailto:dschuette@mayerbrown.com)

**Jodi A. Simala**  
+1 312 701 7920  
[jsimala@mayerbrown.com](mailto:jsimala@mayerbrown.com)

**Frederick B. Thomas**  
+1 312 701 7035  
[fthomas@mayerbrown.com](mailto:fthomas@mayerbrown.com)

---

Mayer Brown is a leading global law firm serving many of the world's largest companies, including a significant portion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest investment banks. We provide legal services in areas such as Supreme Court and appellate; litigation; corporate and securities; finance; real estate; tax; intellectual property; government and global trade; restructuring, bankruptcy and insolvency; and environmental.

**OFFICE LOCATIONS** Americas: Charlotte, Chicago, Houston, Los Angeles, New York, Palo Alto, São Paulo, Washington DC  
Asia: Bangkok, Beijing, Guangzhou, Hanoi, Ho Chi Minh City, Hong Kong, Shanghai  
Europe: Berlin, Brussels, Cologne, Frankfurt, London, Paris

**ALLIANCE LAW FIRMS** Spain (Ramón & Cajal); Italy and Eastern Europe (Tonucci & Partners)

Please visit our web site for comprehensive contact information for all Mayer Brown offices. [www.mayerbrown.com](http://www.mayerbrown.com)

This Mayer Brown publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek specific legal advice before taking any action with respect to the matters discussed herein.

IRS Circular 230 Notice. Any advice expressed herein as to tax matters was neither written nor intended by Mayer Brown LLP to be used and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed under US tax law. If any person uses or refers to any such tax advice in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to any taxpayer, then (i) the advice was written to support the promotion or marketing (by a person other than Mayer Brown LLP) of that transaction or matter, and (ii) such taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

© 2010. Mayer Brown LLP, Mayer Brown International LLP, Mayer Brown JSM and/or Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated. All rights reserved. Mayer Brown is a global legal services organization comprising legal practices that are separate entities (the Mayer Brown Practices). The Mayer Brown Practices are: Mayer Brown LLP, a limited liability partnership established in the United States; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales; Mayer Brown JSM, a Hong Kong partnership, and its associated entities in Asia; and Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated. "Mayer Brown" and the Mayer Brown logo are the trademarks of the Mayer Brown Practices in their respective jurisdictions.