

**SEC ISSUES CONCEPT RELEASE ON PROXY MECHANICS**

On July 14, 2010, the SEC issued a “concept release” on the U.S. proxy system,<sup>1</sup> following a comprehensive review of the proxy voting infrastructure commenced by the SEC staff last year.<sup>2</sup> This review, the first by the SEC in nearly three decades, examines the dramatic changes affecting the proxy system over that period, including technological innovations, changes in the nature of stock ownership, consolidation of proxy distribution service providers, growth in other types of proxy service providers and the introduction of new financial products.

The release seeks public comment on concerns raised by investors and industry participants in three general areas:

- the accuracy, transparency and efficiency of the voting process;
- communications and shareholder participation; and
- the relationship between voting power and economic interest.

Comments are due within 90 days following publication of the release in the Federal Register.

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

***Over-voting and under-voting of shares:*** At times, a broker-dealer or other securities intermediary may cast more or fewer votes than the number of shares it actually holds, due to the way securities transactions are cleared and settled. Some securities intermediaries have developed methods of reconciling their records and allocating votes to their customers in order to avoid “over-voting,” but one of those methods may result in “under-voting.” The concept release seeks comment on whether over-voting or under-voting is a significant problem, and if so, whether the method used by a broker-dealer to allocate votes should be disclosed and whether the SEC should require the use of a particular method.

***Vote confirmation:*** The release discusses concerns about the inability to confirm whether shareholder votes have been properly counted and suggests the possibility of requiring vote tabulators, securities intermediaries and proxy service providers to provide each other with access to vote data so stockholders and issuers can confirm that votes have been tabulated according to shareholders’ voting instructions.

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<sup>1</sup> See SEC Release No. 34-62495, available at <http://www.sec.gov/rules/concept/2010/34-62495.pdf>.

<sup>2</sup> In June 2009, the SEC proposed rules that would require a company, under certain circumstances, to include in its proxy materials a shareholder’s nominees for director. See Facilitating Shareholder Director Nominations, Release Nos. 33-9046, 34-60089, IC -28765. In recent statements, Chairman Mary Schapiro said that she expects to consider final adoption of such a proxy access rule that would take effect in time for the 2011 proxy season. Proxy access is not specifically addressed in the concept release.

***Proxy voting by institutional securities lenders:*** The concept release explores the common practice of institutional shareholders lending their securities. Shares on loan generally cannot be voted by the lender unless the lender recalls its shares, and without sufficient advance notice, a lender may not be able to do so in time to vote. The release asks whether the SEC should require agendas for upcoming shareholder meetings to be made public prior to the record date for the applicable meeting, so that lenders can decide whether to recall their shares to be able to vote. In addition, the release explores whether mutual and closed-end funds should be required to disclose the *number* of shares that they vote at a particular meeting, in addition to *how* they vote.

***Proxy distribution fees:*** Stock exchange rules, last revised in 2002, establish the maximum fees that a member broker-dealer may charge an issuer as “reasonable reimbursement” for forwarding proxy materials to beneficial owners. In response to concerns about whether this fee structure is excessive, the release discusses several potential alternatives, including having the stock exchanges revise the fee schedule or eliminate it in favor of allowing market forces to determine appropriate fees.

### **Communications and Shareholder Participation**

***Issuers’ ability to communicate with beneficial owners of securities:*** Some issuers have expressed concerns that they are limited in their ability to communicate directly with their shareholders due to the “street name” system of stock ownership and the rules allowing beneficial owners to object to having their identities disclosed to issuers. The concept release seeks comments on various options to preserve, eliminate, limit or discourage the use of this “objecting beneficial owner” status.

***Potential means of facilitating retail investor voting participation:*** To increase the relatively low levels of retail investor voting participation, the release makes several suggestions, including improving investor education, enhancing brokers’ Internet platforms, permitting advance voting instructions for retail investors, enhancing investor-to-investor communications and improving the use of the Internet for the distribution of proxy materials.

***Data-tagging proxy-related materials:*** To improve shareholders’ ability to analyze proxy disclosure, the concept release asks whether the SEC should require the data-tagging of certain proxy-related data, such as information relating to executive compensation and director qualifications, similar to the data-tagging currently required for the financial statements of many companies.

### **Relationship Between Voting Power and Economic Interest**

***Role of proxy advisory firms:*** Particularly in light of the increased influence that proxy advisory firms have on the voting process, the release cites concerns that these firms may be subject to conflicts of interest or may fail to conduct adequate research and base their recommendations on incorrect or incomplete facts. To address these concerns, the release seeks comment on improving disclosure of potential conflicts of interest, enhancing regulatory oversight over proxy advisory firms’ procedures for formulating voting recommendations and requiring public disclosure by proxy advisory firms of their voting recommendations in SEC filings.

**Empty voting:** The concept release requests comment on whether “empty voting” is being used to inappropriately influence voting results. Empty voting occurs when a shareholder’s voting rights are “decoupled” from his economic interest, such as when a shareholder buys a put option on his shares but retains voting rights on the shares. Among other possible regulatory solutions, the release suggests that there is a “strong argument” for requiring disclosure of decoupling activities to enable issuers and other investors to better respond to such activities.

**Dual record dates:** Empty voting can also occur if a shareholder sells his shares after the record date for voting at a shareholder meeting, but before the meeting. As in the above example, the shareholder retains the right to vote his shares, even though he no longer has an economic interest in the shares. The concept release requests comment on whether the SEC’s rules should be revised to accommodate recent changes to state law that permit “dual record dates,” one for determining who is entitled to receive notice of the meeting and a later one for determining who can vote at the meeting.

**Next Steps:**

- While this “concept release” contains no actual rule proposals, it is likely that proposed rules will follow. The release suggests “potential regulatory responses” for each of the topics it explores, and many of the more than 150 questions posed seek comments on specific regulatory approaches. We would be pleased to discuss with you how the issues being explored by the SEC may affect your business or to assist you in preparing comments for the SEC on any of the topics covered by the release.

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If you would like to comment on the concept release or if you have any questions, please contact David K. Boston (212-728-8625, [dboston@willkie.com](mailto:dboston@willkie.com)), Jeffrey S. Hochman (212-728-8592, [jhochman@willkie.com](mailto:jhochman@willkie.com)), Michael A. Schwartz (212-728-8267, [mschwartz@willkie.com](mailto:mschwartz@willkie.com)), Adam M. Turteltaub (212-728-8129, [aturteltaub@willkie.com](mailto:aturteltaub@willkie.com)) or the Willkie attorney with whom you regularly work.

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July 16, 2010

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