Bank and Corporate Governance Law Reporter

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SEC Issues Wide-Ranging Concept Release on Proxy System

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The SEC yesterday[3] issued a wide-ranging concept release on the U.S. proxy system (http://www.sec.gov/rules/concept/2010/34-62495.pdf). The release solicits comments on a number of specific issues, grouped within three general areas: (1) the accuracy, transparency and efficiency of the voting process; (2) shareholder communications and shareholder participation in the proxy process; and (3) the alignment of voting power and economic interest. The release also welcomes comments on any other aspect of the proxy process.

Accuracy, transparency and efficiency. The release notes the use of securities intermediaries for the ownership of stock, and the mechanical issues this structure raises in the distribution of proxy materials, the solicitation of voting instructions, and the voting and tabulation process. The issues include broker overvoting that may result from securities lending or fails to deliver, the ability to confirm that voting instructions have been accurately recorded, the ability to call back shares that are on loan in advance of a record date in order to be able to vote those shares, and the fees for broker distribution of proxy materials.

Shareholder communications and participation. This area focuses on communications between issuers and beneficial owners who hold stock in street name, communications among shareholders with respect to matters presented to shareholders for a vote, the relatively low level of proxy participation by retail holders, and the possibility of interactive data formats in proxy statements. The release notes the NYSE's elimination of broker discretionary voting in director elections as a reason for focusing on the ability of issuers to identify and communicate with beneficial owners, and for the importance of increasing participation to limit the number of shares that cannot be voted.

Alignment of voting power and economic interest. The third area of focus is the separation of voting power and economic interest that arises from a variety of sources, including hedging, securities lending, the use of derivative securities, and the gap between record dates and meeting dates. The release also discusses the role of proxy advisory firms that may influence or control a significant percentage of the vote in any company despite having no direct economic interest, potential conflicts these firms may have in formulating their voting recommendations, and concerns about factual inaccuracies in the reports issued by these firms. The release suggests possible responses, including enhanced disclosure, dual record dates (one for notice of the meeting and a second for voting that is closer in time to the meeting), expanded regulation of proxy advisory firms, and/or new regulations designed to align more closely voting rights and economic interest.

We have previously urged the SEC to undertake regulatory reform to address the distorting effects and lack of transparency caused by non-traditional structured and derivative arrangements that separate voting and economic interests, and we have also expressed concerns about the significant and growing role played by proxy advisory firms in the voting process. We hope this release will spur much needed reform in these areas as well as other aspects of the proxy process, and we encourage other interested parties to make their views known to the SEC in response to the release.

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3 This memo was originally issued July 15, 2010.

