



**Remarks Of**

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Washington, D.C.**

**Listing Standards on Shareholder Voting Rights**

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**\*/ The views expressed herein are those of Commissioner Roberts and do not necessarily represent those of the Commission, other Commissioners or the staff.**

**U.S. Securities and Exchange Commission  
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## **I. Introduction**

**During my confirmation process, I stressed the importance of strengthening shareholder confidence in our securities markets. I did not realize at that time what a daunting challenge that task would be. Now more than ever, Congress, regulators, members of the bar and industry professionals must be concerned about the expectations and perceptions of shareholders and the general public. We also must remind investors that their participation, through investment in U.S. securities markets is important and valued.**

**Although all investors are important and should be valued, I am particularly concerned about the lack of direct individual equity investment participation. Individual investors have been leaving our securities markets for about 20 years, a trend that accelerated after the market crash in 1987. In the last six years, individual investors have decreased their direct holdings in securities by more than a third.<sup>1</sup> According to the Securities Industry Association, individual investors were net sellers of stock at a rate of an average 3.5**

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<sup>1</sup> Michael C. Jensen, "Eclipse of the Public Corporation," Harvard Business Review, September-October 1989, p. 61.

million shares per day in early 1989. Even though individuals or households still own about 50 percent of American equity securities, fewer than one in five trades are executed for individual investors.<sup>2</sup> However, I believe that there still exists a place in our securities investment structure for individual share ownership. While individual stockholders have become concerned about their ability to compete effectively on a short-term basis with professional investors and have fled to institutional participation, there are those who proclaim that the individual pursuit of a long-term securities investment strategy can continue to be successful. I also believe that it is incumbent upon the securities industry and the Commission to encourage direct individual investment participation when given an opportunity.

The unbundling of voting rights from common stock ownership removes yet another incentive for direct individual equity investment. Such unbundling decouples the accountability of

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<sup>2</sup> U.S. Congress, Office of Technology Assessment, Electronic Bulls and Bears: U.S. Securities Markets and Information Technology, OTA-CIT-469 (Washington, D.C.: U.S. Government Printing Office, September 1990).

corporate management to the shareholder. While the institutional shareholder, by virtue of the size of its capital, has to some extent the clout to wrangle concessions from corporate management to compensate for this lack of accountability, in the absence of voting rights, an individual shareholder ordinarily has no such clout.

Although the Commission lacks the control over a shareholder voting rights standard that once it was of the opinion it possessed, the securities industry continues to have an opportunity to address the issue of shareholder voting rights through its listing standards. This issue of shareholder voting rights listing standards is the subject of my remarks today. I intend to focus on the current listing standards, particularly those of the American Stock Exchange ("Amex"), and on the extent, if any, that the new proposed Amex standards, which have recently been announced, serve to protect shareholder voting rights.

## II. Development of Voting Rights Listing Standards

Variations on voting rights for common stock are not new. Restrictions on voting rights appeared as early as 1898 when the

**International Silver Company issued common stock that had no voting rights until some future date.<sup>3</sup> The issue of a voting rights standard for common stockholders is also not new. It was first brought to the attention of investors when Harvard University Professor of Political Economy, William L. Ripley, addressed the Academy of Political Science at its annual meeting in New York City on October 28, 1925.<sup>4</sup> His address ignited a storm of public protest concerning the listing by the NYSE of Dodge Brothers, Inc., which had issued non-voting common stock. This public protest triggered the first NYSE refusal to list an issue of non-voting common stock. For over 60 years, the NYSE refused to authorize the listing of non-voting stock, however designated, which by its terms is in effect a common stock. The NYSE policy became known as the one share, one vote rule.**

**As a result of an increase in the use of disparate voting rights**

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<sup>3</sup> **See Stevens, *Stockholders' Voting Rights and the Centralization of Voting Control*, 40 Q.J. ECON. 353, 355 (1926).**

<sup>4</sup> **Ripley, *Two Changes in the Nature and Conduct of Corporations*, 11 PROD. ACAD. POL. SCI. 695 (1925), reprinted in 67 CONG. REC. 7719 (1926).**

plans in response to the takeover frenzy and of the competition for listings among the markets, in September 1986, the NYSE proposed to modify its long standing one share, one vote rule. The proposal would have essentially permitted disparate voting rights stock if it was approved by a majority of the public shareholders and independent directors.

Rather than simply approve or reject this proposal, the Commission issued a release soliciting comment, held hearings on the issue in December 1986 and encouraged the major securities markets, comprised of the NYSE, Amex and NASD, to negotiate an agreement on a uniform rule to protect shareholder voting rights. In December 1986, the Amex filed a rule proposing to eliminate entirely its partial restrictions on the issuance of dual class common. In March 1987, the NASD submitted a letter to the Commission apparently supporting the concept of a minimum voting rights rule with certain exceptions. However, ultimately, the three self-regulatory organizations ("SROs") failed to reach agreement on a uniform rule. Confronted with the negotiation

impasse and still uninterested in either accepting or rejecting the NYSE proposal, at a June 22, 1987 meeting, the Commission announced the commencement of a proceeding to consider whether to adopt a rule which would have the effect of amending the rules of national stock exchanges and the NASD to prohibit publicly traded companies from issuing securities or taking other corporate action that would have the effect of nullifying, restricting or disparately reducing the voting rights of existing shareholders of the company. On July 22, 1987, a public hearing was held on proposed Commission Rule 19c-4. At its July 7, 1988 meeting, the Commission approved the Rule.

Rule 19c-4, as adopted, amended the rules of the national securities exchanges and national securities associations to prohibit the listing or quotation by a securities exchange or association, "if the issuer of such security issues any class of security or takes other corporate action, with the effect of nullifying, restricting or disparately reducing the per share voting rights of holders of an outstanding class or classes of common stock of such issuer

registered pursuant to Section 12 of the Exchange Act.”<sup>5</sup> The rule generally prohibited the listing of a company’s securities if the company issued securities that restricted the voting rights of common shareholders. Rule 19c-4 was prospective in nature only, generally grandfathering in existing multiple voting capitalization structures. The rule also contained a list of presumptively permitted transactions that were deemed not to have a disenfranchising effect on the voting rights of existing shareholders, such as the issuance of low vote stock in a public offering. The Commission was of the opinion that Rule 19c-4 avoided burdening issuers and allowed companies flexibility in devising their capital structure, yet at the same time closed the window of opportunity for companies to rush to disenfranchise shareholders.

Rule 19c-4 was short lived, however. Last June, in Business Roundtable v. SEC,<sup>6</sup> a federal circuit court invalidated the Commission’s shareholder disenfranchisement rule. The United

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<sup>5</sup> Exchange Act Release No. 25891 (July 7, 1988).

<sup>6</sup> The Business Roundtable v. SEC, No.88-1651 (U.S.C.A.) (June 12, 1990).

**States Court of Appeals for the District of Columbia Circuit held that the Commission did not have the authority to adopt corporate governance rules under its Section 19(c) powers and that Rule 19c-4 to some extent encroached upon state corporate governance standards. The Commission ultimately decided not to appeal the case.**

**During the two years that Rule 19c-4 was in effect for the major securities markets, it is my view that it worked well and that it served its purpose of prohibiting shareholder disenfranchising transactions while permitting companies flexibility in devising their capital formation. Moreover, through interpretations published by the SROs, companies were becoming more familiar and comfortable with the rule. More importantly, the historical right of common stock holders to vote their shares was to some extent preserved.**

**III. Current Voting Rights Listing Requirements After Rule 19c-4**

**While the challenge to Rule 19c-4 was pending, the Commission approved a rule filing submitted by the NYSE under Section 19(b) of the Exchange Act that adopted the exact text of**

**Rule 19c-4 as the basis for the NYSE's voting rights listing policy. The NYSE standard, like former Rule 19c-4, prohibits issuances, or corporate action, that has the effect of nullifying, restricting or disparately reducing the voting rights of common stock shareholders of the company. This standard continues to apply to NYSE listed companies today.**

**The NASD also submitted, and the Commission approved in October 1990, a proposal that adopts a voting rights standard for NASDAQ/NMS issuers that is identical to the Rule 19c-4 standard and the NYSE's standard. Unlike Rule 19c-4 which applied to all NASDAQ issuers, the NASD rule applies the substance of Rule 19c-4 only to NASDAQ/NMS issuers. There is currently no voting rights listing standards for non-NMS/NASDAQ quoted stocks.**

**Pending the adoption of a new voting rights rule, the Amex voting rights standard remains unchanged from the Amex standard in effect prior to the adoption of Rule 19c-4. That standard prohibits the listing of non-voting common stock but permits the listing of stock with super or inferior voting rights if certain**

requirements are met (this is known as the Wang Formula). The most important requirements were that the voting ratio between each class could not exceed 10 to 1 and the lower class had the right to elect at least 25% of the governing board.

In response to the invalidation of Rule 19c-4 in September, 1990, the Amex formed a special committee on Shareholder Voting Rights ("Committee") to study shareholder voting rights and to make recommendations on an appropriate Amex standard. The Committee issued its recommendations to the Amex Board two weeks ago on February 14. These recommendations will shortly be published in a report expected to be voted on by the Amex Board no later than its April Board meeting.

The Committee has apparently recommended that the Amex adopt a new voting rights policy that would permit listed companies to recapitalize into a multiple stock class structure if they obtained shareholder approval. The recommendation also covered two-class companies issuing additional shares that carry a higher voting power. The required shareholder approval would be either two-

**thirds of the total outstanding shares or a majority of the shares not affiliated with management or other controlling shareholders.**

**Additionally, the Committee recommended that the Amex require all multiple class listed companies to have "independent directors" constituting at least one-third of the board of directors or, alternately, to afford the holders of the lesser voting class of stock the exclusive right to elect at least twenty-five percent of the board. The listing of no vote stock would also be permitted.**

**The Commission has been advised that there would be a number of exceptions from the shareholder vote requirements for approving multiple classes. It is my understanding that these exceptions are as follows:**

- 1. foreign issuers,**
- 2. financial emergencies (as reviewed and designated by audit committee and exchange staff),**
- 3. de minimis issuances defined as no more than 10% over a 5 year period, with not more than 5% in any one year, and**
- 4. possible issuances and transactions fairly described in proxy**

**materials, to recapitalize from a one share, one vote company to a dual class structure, so long as the transaction or issuance is completed within 24 months of its original authorization.**

#### **IV. Concerns with the Amex Committee Recommendation**

**I have major concerns with what I understand to be the Amex Committee recommendations. The Rule 19c-4 standard prohibited disenfranchisement of common stock shareholders. That standard itself represented a partial retreat from the historical one share, one vote standard. The Committee recommendations would, however, permit disenfranchising actions only subject to approval of a majority of the non-affiliated shareholders or 2/3rds of all shareholders including the insider control group. Similar shareholder approval requirements (without any exceptions) were considered previously by the Commission in the context of a NYSE proposal, as I mentioned, some four years ago. The Commission specifically rejected this approach in favor of the Rule 19c-4**

**standard.**

**As detailed in the release adopting Rule 19c-4, shareholder approval allows the minority voting against a multiple class to be unwillingly disenfranchised. In addition, the release discusses the coercive aspects involved in defeating a dual class recapitalization plan by shareholder vote which makes shareholder approval requirements inadequate in protecting shareholders from disenfranchising actions. Generally, collective action problems may make defeating an issuer recapitalization proposal extremely difficult by preventing shareholders from acting in their collective best interest. As stated in the release:**

**Frequently, a disparate voting rights plan is presented to shareholders in a form, such as an offer to exchange higher vote stock for lower vote stock with a dividend sweetener, that provides shareholders with an incentive to accept less than full voting rights stock rather than oppose the recapitalization, although, acting collectively, shareholders as a group might prefer to retain their voting rights and reject the sweetener**

**offered by management. The coercive nature of some disparate voting rights plans may also be exacerbated by management's ability to set the proxy agenda and use corporate funds to lobby shareholders in favor of its proposal.<sup>7</sup>**

**Aside from the problems with shareholder approval, the Committee recommendations contain several notable exceptions to the shareholder approval requirements that also cause me a great deal of concern. These are the exceptions noted above that permit certain issuances without the need to obtain shareholder approval. These exceptions would permit substantial increases in voting control by management without any significant restrictions or oversight by shareholders. In addition, these exceptions would allow companies to force their shareholders, in some instances, to vote to authorize "blank check" high vote stock without any knowledge of the specific planned transactions.**

**In particular, I believe that high vote stock issuances of 5%**

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<sup>7</sup> **See note 6, supra.**

per year with no more than 10% within 5 years can result in a significant incremental increase in control by management. Unlike the Rule 19c-4 standard which focuses on the disenfranchising effect of such issuances, the Committee recommendations would permit such issuances even when they clearly disenfranchise existing shareholders and solidify control in management.

I still believe, as the Commission apparently did in 1987 when it rejected the NYSE's proposal, that shareholder approval requirements are inadequate to protect shareholders from disenfranchising transactions. Indeed, except for corporate management, the NYSE proposal was overwhelmingly rejected by individual shareholders and institutional investors in favor of a Rule 19c-4 standard. To the extent shareholder approval provides some oversight, the exceptions to the proposed Amex shareholder approval requirements would make this check on management meaningless.

If the Amex decided to adopt the Committee recommendations, my fear is that there would be a renewed "race

to the bottom" in voting rights listing standards among the major securities markets. The NYSE has been waiting to see what action the Amex would take and indications have been that the NYSE would continue to uphold a 19c-4 standard only if the Amex continued to do so. The NASD, in adopting the Rule 19c-4 standard for NASDAQ/NMS stocks, also indicated that it would consider changes depending on what the other major markets did. Accordingly, the Amex's actions clearly have the ability to unravel any steps that have been made to protect shareholders from disenfranchising actions.

V. Conclusion

Finally, I believe that common stock shareholder voting rights, which are arguably the strongest basis for management accountability in our corporate system, should not be dispensed with simply because of the competition for listings among the markets. Hopefully, the Amex Board in reviewing the Committee recommendations will consider the implications its actions may have for investors in all our securities markets and make the right

**decision. I consider it ironic that Amex, which has represented itself as the only major securities market that is still predominantly used by individuals, may implement a listing standard that, in a relative manner, discourages corporate accountability to the individual shareholder. I also note with considerable irony that as a historical matter, I can recall when the Amex enthusiastically, in a legislative context, supported the potential adoption by the Senate of a shareholder voting rights listing standard remarkably similar to Rule 19c-4.**

**While the Committee recommendations represent an improvement over the existing Wang Formula, they represent a substantial backward step from the standard enunciated in Rule 19c-4. I remain convinced that if the accountability alternatives available to individual shareholders are only "grin and bear it" or "take the Wall Street Walk," then they will elect to either own common stock institutionally or not at all. Under either result, corporate management, when under fire, will be forced to confront and negotiate with institutional shareholders at an increasing pace**

**thereby rendering meaningless, as a general proposition, any value to corporate management of a dual class capitalization. Under a no investment result, our securities markets will become less liquid and thereby less efficient, which will substantially impair our capital formation process.**

**In conclusion, I would urge the Amex Board, after its review, to reject its Committee recommendations and adopt instead a Rule 19c-4 like standard.**