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August 17, 2009

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

VIA ELECTRONIC MAIL

Subject: Facilitating Shareholder Director Nominations, File No. S7-10-09

Dear Ms. Murphy:

The Shareholder Communications Coalition ("Coalition")[1] appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission ("Commission") to facilitate shareholder director nominations.

The Coalition will not be presenting a formal position on the proposed rule amendments regarding director nominations by shareholders. Instead, this comment letter will respond to the Commission's request for comments regarding "additional or different changes; or [o]ther matters that may have an effect on the proposals contained in this release."[2]

The Need for a Comprehensive Review of the Proxy System

The Coalition strongly supports the Chairman's statement on July 1, 2009, announcing that the Commission will commence a comprehensive review of the proxy voting and shareholder communications system this year. The commencement of this review was also re-affirmed in: (1) recent Congressional testimony by Meredith Cross, Director of the Division of Corporation Finance, on July 29, 2009; and (2) recent correspondence sent by the Chairman to the Coalition, on August 11, 2009.[3]

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[1] The Shareholder Communications Coalition ("Coalition") comprises five associations: the Business Roundtable, the National Association of Corporate Directors, the National Investor Relations Institute, the Securities Transfer Association, and the Society of Corporate Secretaries & Governance Professionals. Information about the Coalition and its activities is located on the Internet at www.shareholdercoalition.com.

[2] Facilitating Shareholder Director Nominations, Release Nos. 33-9046; 34-60089, 74 Fed. Reg. 29,024, at 29,062 (June 18, 2009) (hereinafter "Proposing Release").

[3] Meredith B. Cross, Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance, U.S. Senate Subcommittee on Securities, Insurance, and Investment (July 29, 2009), available at http://www.sec.gov/news/testimony/2009/ts072909mbc.htm; and Letter from Mary L. Schapiro,

The Coalition has been an advocate for this type of comprehensive review by the Commission since the Coalition was established in 2005. Coalition members also have been strong supporters of the Business Roundtable's Petition for Rulemaking Regarding Shareholder Communications, filed with the Commission in April 2004.[4]

The current proxy system was developed many years ago and--as many participants who use the process will certainly agree--it has evolved into a system that has not kept up with the needs of today's investors and issuers:

- The street name system now dominates the trading and clearing of public company shares, with more than 75% of shares currently held through third-party financial intermediaries, in street or nominee name;

- The practice by financial intermediaries of holding corporate shares in fungible bulk has created a broker-controlled system that presents obstacles to appropriate transparency in short selling, derivative transactions, and proxy voting;

- The Internet and other electronic-based communications technologies are rapidly replacing paper-based methods of communication, yet these technologies are not adequately reflected in current Commission proxy rules;

- Federal statutory and regulatory changes have transformed the governance and management of public companies, increasing both transparency and the need to communicate frequently with shareholders;

- Majority voting has replaced plurality voting in director elections for the majority of large public companies, ensuring a more competitive environment in the market for corporate control;[5] and

- General investor activism is on the rise, with more shareholder proposals being advanced, causing a need for greater engagement on the part of both investors and issuers.

Chairman, Securities and Exchange Commission, to Niels Holch, Executive Director, Shareholder Communications Coalition (Aug. 11, 2009), available at http://www.shareholdercoalition.com/LetterfromMarySchapiro.pdf.

[4] See Petition for Rulemaking Regarding Shareholder Communications, Business Roundtable, SEC File No. 4-493 (Apr. 12, 2004), available at http://www.shareholdercoalition.com/BRTPetition41604.pdf.

[5] More than 70 percent of companies in the S&P 500 Index and more than 60 percent of Fortune 500 companies have adopted some form of majority voting. Melissa Klein Aguilar, Shareholder Voices Getting Louder, Stronger, Compliance Week, Oct. 21, 2008, available at http://www.complianceweek.com/article/5113/shareholder-voices-getting-louder-stronger.

For the reasons set forth in this letter, the Coalition does not believe that the Commission should move forward with any additional proxy proposals, including its proposal to facilitate director nominations by shareholders, until the Commission: (1) completes its intended examination of the proxy system; and (2) promulgates new regulations to modernize and reform this cumbersome and expensive system.

Close Votes in Election Contests Are a Significant Regulatory Issue

For many years, the substantial majority of corporate elections were resolved by a large vote margin. Over the last decade--primarily as a result of increased shareholder activism, new regulatory requirements, and strengthened corporate governance standards --the environment that a public company operates in has changed substantially. Unfortunately, as corporate elections have become more competitive (and important decisions are resolved by closer vote margins), a number of significant flaws in the proxy system are now being identified. Before further corporate governance improvements can be achieved, the Commission needs to address these flaws, many of which are the result of outdated federal proxy rules.

In its Proposing Release, the Commission re-affirmed its long-standing goal of ensuring that the federal proxy rules serve shareholder interests:

> The SEC's mission is investor protection, and we believe that investors are best protected when they can exercise the rights they have as shareholders, without unnecessary obstacles imposed by the federal proxy rules.[6]

Documented evidence by academic researchers and the news media indicate that a large number of close proxy votes have occurred over the past decade. And a confluence of several different factors that are impacting the proxy system--including short selling, the use of derivative products, and the inability of share tabulators to be able to ensure an auditable and verifiable vote count--are only going to become more significant problems if the Commission adopts new regulatory proposals that will further burden the current proxy process.

In an examination of 97 contested proxy contests between 2000 and 2006, Yale Law Professor Yair Listokin found that more than half of the contests were decided by "close votes," defined as a margin of under 20 percentage points.[7] In an earlier study of shareholder proposals between 1997 and 2004, Professor Listokin found 605 close votes,

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[6] Proposing Release at 29,027.

[7] Yair Listokin, Corporate Voting vs. Market Price Setting, Yale Law & Economics Research Paper No. 362, July 3, 2008, available at http://ssrn.com/abstract=1112671; See also Yair Listokin, Does Shareholder Voting Maximize Stock Market Value?, Unpublished Paper, Apr. 3, 2008, available at http://www.law.stanford.edu/display/images/dynamic/events_media/Yair%20Listokin%20Paper.pdf. The Coalition takes no position regarding Professor Listokin's recommendations for reforming the proxy voting rules in his academic articles, including any recommendation on the issue of shareholder access to the corporate ballot.

defined as having votes of support between 40 and 60 percent.[8] If one combines the data from both studies, it averages to 82.6 close votes per year, from 1997 to 2006.[9]

The news media and other sources have also documented a number of high profile election contests, where the outcome was determined by a close vote. Several of these contests were the subject of active short selling of shares or complex derivative transactions, either of which may have been undertaken to influence the outcome of the vote. For example:

- In 2002, the merger between Compaq Computer and Hewlett Packard was approved by only 51.4 percent of the voting shares.[10]

- In 2003, incumbent directors at El Paso Corporation were re-elected by a margin of less than 3% (17.2 million shares), at a time when more than four times as many shares (76 million) were loaned out for short selling.[11]

- In 2004, the merger between AXA Financial and The MONY Group was approved by only 53.8 percent of the shares outstanding and entitled to vote.[12] The approval margin was only 1.7 million shares at a time when more than three times that amount of share holdings (6.2 million shares) were loaned out for short selling.[13]

- In 2005, the merger between Transkaryotic Therapies and Shire Pharmaceuticals was approved by a 2.6% margin, representing 929,813 shares out of 35.6 million shares outstanding and entitled to vote.[14]

- In 2005, a bylaw amendment to approve a "poison pill" plan at the Alaska Air Group's annual meeting fell 2.4 million votes short of the required 75 percent approval, at a time when 4 million shares had been sold short.[15]

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[8] Yair Listokin, Management Always Wins the Close Ones, Yale Law & Economics Research Paper No. 348, Apr. 20, 2007, available at http://ssrn.com/abstract=980695.

[9] Professor Listokin's research found more than 49 close votes in proxy contests over a 7 year period (2000-2006) and 605 close votes in shareholder proposals over an 8 year period (1997-2004). This averages to 82.6 close votes per year, once the data is combined.

[10] Karen Kaplan and David Colker, HP Says Compaq Merger Approved by 51.4%, Los Angeles Times, Apr. 18, 2002.

[11] Bob Drummond, Corporate Voting Charade, Bloomberg Markets, April 2006.

[12] Floyd Norris, Holders of MONY Approve $1.5 Billion Sale to AXA, The New York Times, May 19, 2004.

[13] Bob Drummond, Corporate Voting Charade, Bloomberg Markets, April 2006; See also, Bob Drummond, One Share, One Vote: Short Selling Short-circuits the System, International Herald Tribune, Mar. 1, 2006.

[14] In Re Transkaryotic Therapies, Inc., 954 A. 2d 346 (Del. Ch. 2008). This case is moving to trial, in part, on allegations of "over-voting" by one custodian in an amount that exceeded the approval margin ("In sum, I find that plaintiffs have raised a genuine issue of material fact with respect to as many as 1,897, 484 votes in favor of a merger that was approved by 929,813 votes."). Id. at 377.

[15] Bob Drummond, Corporate Voting Charade, Bloomberg Markets, April 2006.

- In a 2006 proxy contest, activist Nelson Peltz succeeded in electing two of 5 candidates to the Heinz board with a margin of victory of only 3.2 percent (8 million out of 250 million shares voted).[16]

Close votes in shareholder elections are going to increase significantly if the Commission moves forward with its proposal on director nominations by shareholders. The Commission's own projections support this assertion:

- The Commission estimates that 4,163 reporting companies are likely to have at least one shareholder who meets the eligibility criteria established in the Proposing Release.[17]

- The Commission estimates that 5% of these companies (208 public companies and 61 registered investment companies) will receive director nominations from shareholders for inclusion in their proxy materials on an annual basis.[18]

- The Commission estimates that 90% of this group of companies (187 public companies and 55 registered investment companies) will be required to include one or more nominee in its proxy materials on an annual basis.[19]

- The Commission estimates that a total of 115 bylaw proposals regarding shareholder nomination procedures (97 public companies and 18 registered investment companies) will be submitted on an annual basis.[20]

If one assumes that 90% of the nomination proposals and 100% of the bylaw proposals end up on a corporate ballot, the Commission is estimating a total of 242 director nomination measures and 115 bylaw proposals on an annual basis, for a total of 357 proposals.[21] If one further assumes that each one of these proposals is competitive, the Commission's shareholder nomination amendments will potentially raise the average number of "close votes" expected each year from Professor Listokin's average of 82.6 to 357, an increase of more than 330%.[22]

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[16] See Marcel Kahan & Edward B. Rock, The Hanging Chads of Corporate Voting, 96 Geo. L. J. 1227, footnotes 5 and 6 (2008), available at http://www.georgetownlawjournal.com/issues/pdf/96-4/Kahan-Rock.PDF.

[17] Proposing Release at 29,063.

[18] Id. at 29,064.

[19] Id. at 29,064.

[20] Id. at 29,066-29,067.

[21] The Commission estimates that 187 public companies and 55 registered investment companies will be required to include one or more nominee in its proxy materials on an annual basis. The Commission also estimates that 115 bylaw proposals regarding shareholder nomination procedures will be submitted on an annual basis. If one assumes that these bylaw proposals are not successfully excluded under an amended Rule 14a-8(i)(8), then the Commission estimates a total of 357 shareholder nomination measures and bylaw proposals on an annual basis, if its rule amendments are adopted.

[22] Professor Listokin's research found more than 49 close votes over a 7 year period (2000-2006) and 605 close votes over an 8 year period (1997-2004). This averages to 82.6 close votes per year. The

The Problems with the Current Proxy System

It goes without saying that beneficial and registered owners of corporate shares expect that their votes will be counted properly and accurately at a shareholder meeting. It is also a reasonable expectation that the tabulator of the votes will be in possession of both a list of eligible voters and adequate documentation for how each share owner voted. Finally, in an election involving a close vote, it is a normal expectation that the actual vote tabulation process will be subject to an audit and verification by an independent third-party.

The current proxy voting system cannot meet these standards in its present form. And there are also additional problems with the system--involving the methods by which voting shares are acquired and processed--that will need to be resolved before the proxy system has the level of integrity necessary for investor and issuer confidence. Specifically, these problems include:

1. **Empty Voting**. This practice occurs when an investor acquires voting rights to corporate shares, but may have little or no economic interest in those same shares.[23] This typically is accomplished through share lending. One example of empty voting can occur when an investor borrows shares just before a corporate record date and then returns these shares to the long position investor shortly after the record date.[24]

Under current rules and contracts, the short seller in possession of the shares on the record date is entitled to vote the shares at the shareholder meeting, even though he or she may have little or no economic interest in the company or, more importantly, may have an interest that is adverse to the long-term shareholders of the company.

Recent examples of the empty voting problem include:

- In 2002, an activist investor increased his holdings of Australian company Coles Myer to support his proxy campaign, while hedging his economic ownership using option contracts.[25]

- In 2002, an activist hedge fund seeking to control British Land, a U.K. real estate company, boosted its share holdings to 9 percent by borrowing more

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Commission estimates that 357 public companies and registered investment companies will be required to place at least one shareholder nominee or a director nomination bylaw proposal in its proxy materials on an annual basis. The rate of increase from 82.6 to 357 is 332.2%.

[23] The term is meant to describe a situation where voting power has been "emptied" of a corresponding economic interest.

[24] This example is called "record date recapture."

[25] Malcolm Maiden, Lew Confirms Hedging Coles Myer, ABIX – Australasian Business Intelligence – The Age, Oct. 24, 2002.

than 40 million shares before the record date, in order to increase its influence at the shareholder meeting.[26]

- In 2004, the Perry Corporation, a New York hedge fund, increased its equity ownership of King Pharmaceuticals to 9.9%, during an attempted takeover by Mylan Laboratories of the company.[27] At the same time, Perry hedged its entire long position, leaving it with a significant voting interest, but no economic interest in the shares.[28]

- In 2006, a privatization plan proposed by Henderson Investments, a Hong Kong company, failed by a margin of 2.7 percent, amid substantial allegations of short selling designed to influence the vote on this plan and to profit from a subsequent drop in share price when the plan was defeated.[29]

2. **Hidden Ownership**. Another problem in the share voting process involves efforts by certain institutional investors to hide their ownership of a company's shares through the use of a financial derivative called a cash-settled equity swap.[30]

The following are several examples of this problem:

- In 2001, the Perry Corporation, a hedge fund, reduced its equity holdings in Rubicon, Ltd., a New Zealand public company, to below the 5% required for public disclosure purposes. A year later, Perry disclosed a 16% stake in Rubicon, created without public disclosure through the use of equity swap transactions.[31]

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[26] Kara Scannell, How Borrowed Shares Swing Company Votes, The Wall Street Journal, Jan. 26, 2007; See also Florian Gimbel, Uneasy Bedfellows with Money in Mind, Financial Times, Apr. 18, 2004.

[27] Andrew Sorkin, Nothing Ventured, Everything Gained, The New York Times, Dec. 2, 2004; Jesse Eisinger, Icahn Cries Foul at Perry's No-Risk Play in Takeover Fight, The Wall Street Journal, Dec. 15, 2004.

[28] Id.

[29] Patricia Cheng, Hedge Funds Find Loophole in H.K., International Herald Tribune, Feb.16, 2006; Kara Scannell, How Borrowed Shares Swing Company Votes, The Wall Street Journal, Jan. 26, 2007.

[30] Under an equity swap of this type, two parties enter into an agreement that seeks to replicate the positions of a long and short investor in a particular stock. The long investor receives all of the benefits of an increase in the stock price, along with cash flows that replicate any dividends paid. The short investor receives the benefits of any decline in the stock's price. Any differences are settled in cash, although the counterparty to the short side of the transaction often holds the underlying securities as a hedge against its position. If the swap is unwound, the long investor is usually able to immediately purchase the underlying securities, significantly increasing its ownership position overnight.

[31] See Henry T.C. Hu & Bernard Black, The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership, 79 S. Cal. L. Rev. 811, 836 (2006), available at http://ssrn.com/abstract=904004 (hereinafter "Hu and Black"). A number of other empty voting and hidden ownership examples are discussed in this excellent law review article, as well as in two other similar articles by the same authors: (1) Henry T.C. Hu & Bernard Black, Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms, 61 Bus. Law. 1011 (2006), available at http://ssrn.com/abstract=887183; and (2) Henry T. C. Hu & Bernard Black, Hedge Funds, Insiders, and Empty Voting: DeCoupling of Economic and Voting Ownership in Public Companies, 13 J. Corp. Fin. 343 (2007), available at http://ssrn.com/abstract=874098.

- In 2005, the family controlling Fiat entered into equity swaps for Fiat shares, in order to avoid public disclosure rules in Italy.[32]

- In 2006, a company seeking to block a takeover bid for Austral Coal in Australia used a combination of shares and equity swaps, with the swaps being used by the company to avoid public disclosure rules.[33]

- In 2007, activist hedge fund Pershing Square was able to assemble an economic interest in Target of 12.6%, through equity swaps and other transactions, while allegedly only being required to make disclosures to the Commission of a 9.6% stake in the company.[34]

- In 2008, a group of hedge funds used equity swaps to avoid Commission beneficial owner disclosure rules in a proxy contest involving the CSX Corporation.[35]

Commission rules that require public disclosure of certain beneficial ownership thresholds do not explicitly include derivative products. A cash-settled equity swap permits investors to create synthetic ownership positions that can evade public disclosure. Regulators in other countries have addressed this problem by requiring disclosure of these derivative positions, but the Commission has not taken formal steps to address the issue in the United States.[36]

3. **Over-Voting**. A third problem in proxy voting involves over-voting. Over-voting occurs when a broker casts more votes than it is entitled to cast. This problem is typically caused by share lending.[37]

Brokers generally hold all their shares in fungible bulk, i.e., without any allocation of shares into separate investor accounts. As a result, they do not routinely

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This research was updated by the authors in 2008. See Henry T. C. Hu & Bernard Black, Equity and Debt Decoupling and Empty Voting II: Importance and Extensions, 156 U. Pa. L. Rev. 625 (2008), available at http://www.pennumbra.com/issues/pdfs/156-3/Hu.pdf.

[32] Hu and Black at 839.

[33] Id. at 840.

[34] Kaja Whitehouse, Setting His Target – Ackman's Fund Takes Dead Aim at Board Seats, The New York Post, Mar. 17, 2009; Jim Jelter, Target Warns Same Store Sales May Decline, MarketWatch, Dec. 24, 2007.

[35] The hedge funds in this dispute purchased equity securities and cash-settled equity swaps, in an attempt to elect five new members to the CSX Board of Directors. More information on this dispute can be found on the Coalition's website at http://www.shareholdercoalition.com/votinginfluence.html.

[36] The Financial Services Authority, the securities regulator in the United Kingdom, announced in July 2008 that it will require the disclosure of certain derivative contracts, including cash-settled equity swaps, which reach a 3% level, when aggregated with ownership of common stock.

[37] Over-voting can also occur because of a failure to deliver securities by a different broker on the settlement date.

match loaned shares to specific customer accounts. The inability to match long and short positions means that brokers are often unable to accurately calculate the number of equity shares their customers are entitled to vote when a corporate record date is established.[38] When shares are lent out by brokers, both long and short investors of the same security may receive an instruction form for proxy voting.

In 2005, one of the Coalition's member associations--The Securities Transfer Association--reviewed 341 shareholder votes in corporate contests for that year.[39] The STA found evidence of over-voting in all 341 shareholder votes.[40]

An excellent description of this problem can be found in a 2006 administrative decision by the Board of Directors of the New York Stock Exchange ("NYSE Board"). In this decision, the NYSE Board sanctioned one of its broker-dealer members for failing to reconcile its beneficial ownership positions in a timely manner for proxy voting purposes.[41] The NYSE Board explained the over-voting problem as follows:

> For each proxy solicitation, the Tabulator compares the proxy votes submitted on behalf of the member organization and/or its customers with the number of shares reflected on the records of the Depository Trust and Clearing Corporation ('DTCC') for the member organization on the applicable record date. The number of shares showing on the records of DTCC for the member organization, with certain adjustments, is the maximum number of shares (votes) that will be tallied by the Tabulator in determining the outcome of the proxy vote. If a member organization submits to the Tabulator more shares than are shown for the member organization on the records of DTCC, then an 'over-vote' results.[42]

In its decision, the NYSE Board went on to explain the importance of having a timely reconciliation of long and short positions, to avoid sending out requests for proxy voting instructions to investors who are not entitled to vote:

> Member organizations use timely reconciliation of their records to provide accurate proxy instructions to their proxy service providers. Failure to timely reconcile stock records on beneficial ownership may result in inaccurate instructions being given to the proxy service provider. If there is no reconciliation of stock records of beneficial ownership, customer votes may be allocated inaccurately, because customers with both long

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[38] See SEC Staff Briefing Paper: Roundtable on Proxy Voting Mechanics, May 2007, available at http://www.sec.gov/spotlight/proxyprocess/proxyvotingbrief.htm.
[39] Bob Drummond, Corporate Voting Charade, Bloomberg Markets, April 2006.
[40] Id.
[41] In the Matter of Deutsche Bank Securities, Inc., New York Stock Exchange, Inc. Decision 05-45, Feb. 2, 2006, available at www.nyse.com/pdfs/05-045.pdf.
[42] Id. at 3.

and short positions will receive requests for proxy voting instructions for too many shares.[43]

In the course of a two year examination (2002-2003) of this broker-dealer's proxy operations by the Division of Member Firm Regulation of the New York Stock Exchange ("NYSE"), 23 instances of over-voting were uncovered, out of 27 instances tested.[44] The over-votes ranged from 31 shares to 2,152,721 shares.[45] Given that this examination involved only one broker-dealer, the potential magnitude of this problem within the brokerage industry appears to be very significant for any close vote in a shareholder proposal or a director election.

A similar examination was conducted by the NYSE on the proxy operations of three other broker-dealers in 2006, with similar results.[46]

After these NYSE examinations were conducted, the securities industry adopted guidelines to address this reconciliation problem.[47] However, these industry guidelines do not require the broker-dealer to reconcile long and short positions before a proxy mailing takes place, in order to ensure an accurate list of eligible voters before proxy instruction forms are mailed out.[48]

The proxy voting process should be fully transparent and verifiable, starting with the compilation of a reconciled list of beneficial owners eligible to vote and ending with the final tabulation of votes cast at a shareholder meeting. Brokers and other financial intermediaries should be required to reconcile their share positions as of the record date for each shareholder meeting, in order to avoid distributing proxies to ineligible shareholders and to avoid discrepancies in tabulating final vote counts. Additionally, vote counts should be auditable and capable of third party verification--an important level of checks and balances that cannot be achieved under the current system--so that a validation of the final tabulation of votes of both registered and beneficial owners can occur.

4. **Proxy Administrative Services**. Another area of concern is the fact that brokers and banks all use the same service provider to provide proxy processing services to public companies and investors. Under current Commission rules, public companies pay

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[43] Id.
[44] Id. at 6.
[45] Id.
[46] Kara Scannell, How Borrowed Shares Swing Company Votes, The Wall Street Journal, Jan. 26, 2007 ("In June [2006], UBS Securities, Goldman Sachs Group Inc. and Credit Suisse Securities agreed to pay a total of $1.35 million, without admitting or denying wrongdoing, to settle similar NYSE charges.").
[47] Suggested Practice Guidelines for Proxy Processing, Securities Industry Association, Sept. 2006, available at http://www.shareholdercoalition.com/SIASuggestedPracticesforProxyProcessing906.pdf.
[48] Id. at footnote 11 ("Participants must decide if they are going to reconcile their customer's votable positions before or after (Pre or Post) the ballot mailing. Both methods are suitable as long as there is correct supervision, and impartial allocation methods that are fair and equitable among all clients in the event that the amount of shares the holder is entitled to vote needs to be adjusted.").

for the proxy processing services provided by this service provider and its broker-dealer clients. Public companies have no choice in selecting the service provider, exert little or no control over the services that are actually provided, and have no direct ability to negotiate the fee structure.[49] As a result, there is little accountability or economic incentive to change the system.

In a 2006 report, the NYSE Proxy Working Group recommended that the NYSE consider commissioning a study to review: (1) the entire shareholder communications and proxy voting system, for the purpose of recommending a plan to change the current system into a free market model, with service provider competition and unregulated fees; and (2) the effect of amending current NYSE Rules to allow individual issuers to negotiate reimbursement fees with banks and brokers for delivery of shareholder communications to beneficial owners.[50]

5. **Proxy Advisory Firms**. Another unaddressed problem is the role of proxy advisory firms. Many institutional investors use these firms to help them vote their proxies in corporate elections. These firms offer vote recommendations on proposed corporate directors, as well as company and shareholder proposals. They wield enormous influence on these matters.

Unfortunately, proxy advisory firms are not subject to any required disclosures or oversight regarding their ability to control or influence the outcome of a vote. As a result, the Coalition concurs with the recommendation of the NYSE Proxy Working Group that the Commission should examine the role of proxy advisory firms because these firms make voting recommendations and decisions over corporate shares which they do not own, or have an economic interest in.[51]

The Coalition believes that the Commission should consider developing a regulatory regime for proxy advisory firms, with appropriate disclosures and regulation. And, given the enhanced influence of proxy advisory firms now that the proposed amendment to NYSE Rule 452 has been approved by the Commission, any Commission review of the proxy advisory system needs to take place before January 1, 2010, the effective date of amended Rule 452.[52]

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[49] Under the current system, a single service provider operates through contracts with brokers and banks and has its fees for proxy processing services approved by the NYSE and the Commission. Each issuer then pays these fees.

[50] Report and Recommendations of the Proxy Working Group to the New York Stock Exchange, June 5, 2006, at 29, available at http://www.nyse.com/pdfs/PWG_REPORT.pdf.

[51] Id. at 6 ("While the Working Group recognizes that some of these groups have played an important role in the proxy process in recent years, the Working Group also believes that there is the potential for possible conflicts and/or other issues given the multiple roles such groups may have in the proxy system. Accordingly, the Working Group recommends that the NYSE request the SEC to study the role these groups play in the proxy voting process.").

[52] On July 1, 2009, the Commission approved a proposed amendment to NYSE Rule 452. Under the amendment, an uncontested election of corporate directors will no longer be considered a "routine" matter, thereby prohibiting brokers from voting shares without receiving instructions from beneficial owners.

As a part of this review, the Coalition recommends the Commission consider a recently released study on the proxy advisory industry by the Millstein Center for Corporate Governance and Performance.[53] In this study, the Millstein Center concluded the following:

> [T]his briefing finds that the proxy voting system in the US and other markets is chronically subject to criticism that it is short on integrity sufficient to ensure trust. Parties involved are institutional investors, agents such as proxy advisory services, and intermediaries charged with transmitting ballots. Threats include conflicts of interest, opacity, technical faults in the chain by which ballots are transmitted, and a shortage of resources devoted to informed decision-making.[54]

The Millstein study goes on to recommend the following remedies for the proxy advisory system:

- Proxy advisory firms should endorse and comply with an industry-wide code of professional ethics, including a general ban on a vote advisor performing consulting work for any company on which it provides voting recommendations or ratings;[55]

- Institutional investors should endorse and follow guidelines on their own governance produced by the International Corporate Governance Network; and

- Institutional investors should report to clients or beneficiaries at least annually on their voting policies and voting records. Institutional investors also should: (1) regularly review voting policies to ensure they are fit for purpose; (2) identify, manage and disclose real or potential conflicts of interest on a regular basis; and (3) determine the level and quality of resources necessary and appropriate to deliver vote recommendations and decisions that are in line with their voting policies.

The Millstein study also commented on the overall problems with the current proxy voting and shareholder communications system:

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[53] Meagan Thompson-Mann, Policy Briefing No. 3--Voting Integrity: Practices for Investors and the Global Proxy Advisory Industry, The Millstein Center for Corporate Governance and Performance, Mar. 2, 2009, available at http://millstein.som.yale.edu/Voting%20Integrity%20Policy%20Briefing%2002%2027%2009.pdf.

[54] Id. at 3.

[55] Id. A proposed code of ethics for the proxy advisory industry is attached as Appendix A to Millstein Policy Briefing No. 3.

> Further complicating the process, depending on the market, there can be a dizzying array of intermediaries, standing between the beneficial owner and the issuer, including custodian and sub-custodian banks, brokers, tabulators and registrars. Any break in this lengthy chain could lead to a discrepancy between the shareowner's stated voting intention and the outcome. There is no real incentive to remove or streamline these layers, as each link stands to benefit economically from being a part of the voting process. As one [study] participant stated, 'In fact, there's probably reason to resist change, because once you create standards that make it easier for issuers and investors, potentially, to communicate, then what happens to the guy in the middle, right?'[56]

In its conclusion, the Millstein study called on the Commission to "empanel a high-level independent review aimed at modernizing the US proxy system." [57]

The Coalition's Recommendations for Reforming the Proxy System

To help facilitate Commission and NYSE review of the proxy voting and shareholder communications system, the Coalition has prepared a Discussion Draft on Public Company Proxy Voting. This Discussion Draft outlines the Coalition's initial recommendations for how to reform the proxy system. A copy of the Coalition's Discussion Draft was sent to the Commission on August 4, 2009, and another copy is attached to this comment letter.

Conclusion

The Commission should consider delaying adoption of its shareholder director nominations proposal until the proxy voting and shareholder communications rules can be evaluated, modernized, and reformed. The Commission's approval of NYSE Rule 452 has had the effect of increasing the influence of institutional investors over individual investors; and the proposal to allow these same institutional investors--including pension and mutual funds--to nominate directors in a company's proxy materials will only add to this imbalance.

A shareholder nomination process that operates in a proxy voting system that cannot produce an accurate and verifiable vote count will do little to improve the overall corporate governance system. The Commission's proposed nomination process also will have to operate in a system where certain institutional investors are able to exploit regulatory gaps in current federal rules, in order to influence or manipulate the outcome of a board election. And, finally, a proxy access proposal that does not provide issuers with an efficient and effective means for communicating with their beneficial owners will

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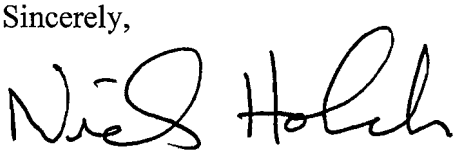
[56] Id. at 11.
[57] Id. at 3.

only exacerbate investor confusion about the circuitous and very expensive system--with multiple layers of intermediaries--that represents the proxy system in the U.S. today.

For all of the foregoing reasons, the Commission should reverse the order of its regulatory agenda on proxy reform and begin to tackle proxy infrastructure and processing issues before it renders any judgments on broader policy issues that impact shareholder voting.

Thank you for your consideration of these views. The Coalition is happy to provide additional information on any of the issues raised in this letter, or answer any questions the Commission may have on these matters.

Sincerely,



Niels Holch
Executive Director
Shareholder Communications Coalition

Attachment: Coalition Discussion Draft on
Public Company Proxy Voting (Aug. 4, 2009)

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
Kayla Gillan
Meredith Cross
Brian Breheny

ATTACHMENT:
Discussion Draft on Public Company Proxy Voting
Shareholder Communications Coalition
August 4, 2009
www.shareholdercoalition.com

SHAREHOLDER COMMUNICATIONS COALITION
DISCUSSION DRAFT
8/4/09

Public Company Proxy Voting: Empowering Individual Investors and Encouraging Open Shareholder Communications

The U.S. proxy voting and communications system is in desperate need of modernization. In this position paper, the Shareholder Communications Coalition ("Coalition")[1] describes the current system and its problems. The Coalition also offers recommendations for revising the current proxy rules to bring them into the 21st century and encouraging communications between shareholders and the companies in which they invest.

The U.S. Proxy Voting and Communications System

- The New York Stock Exchange ("NYSE") estimates that 70-80% of all public company shares in the United States are held in "street" or nominee name, meaning that the underlying beneficial owners of the shares are not the shareholders of record. Under the street name system, legal title and ownership of individual shares reside with a depository institution, such as the Depository Trust Company ("DTC").[2]

- State corporation law, which regulates most corporate governance matters, provides that only the shareholder of record has the right to vote on corporate matters, as the "legal" owner of the shares.

- When a public company seeks to hold a shareholder meeting, a record date is established to identify the current registered and beneficial owners who are eligible to vote at such shareholder meeting. The company notifies DTC, as the record holder for most of the corporate shares held in street name. DTC then provides a list of the brokers, banks, and other institutions holding a company's shares in street name and issues an "omnibus proxy" to these institutions, granting them the authority to vote proxies at the upcoming meeting. Companies are then required to request information from these intermediaries regarding the number of proxy packets that need to be provided to them for distribution to beneficial owners.

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[1] The Shareholder Communications Coalition currently comprises the following organizations: the Business Roundtable, the National Association of Corporate Directors, the National Investor Relations Institute, the Securities Transfer Association, and the Society of Corporate Secretaries & Governance Professionals. The Coalition's website is located at www.shareholdercoalition.com.

[2] The street name system was established to improve the efficiency of securities trading by eliminating the need to transfer paper stock certificates. Under this system, stock certificates are immobilized and stored in a central depository created for this purpose. Stock transfers are then handled through an electronic book-entry process, which records transfers among financial intermediaries.

- Under Securities and Exchange Commission ("SEC") and NYSE rules, brokers, banks and other financial intermediaries are responsible for handling proxy processing activities among their customers, including the delivery of proxy materials with information about the matters to be voted on at a shareholder meeting.

- Pursuant to these SEC and NYSE rules, public companies pay for the proxy processing services provided by these financial intermediaries. Reimbursement rates for the "reasonable expenses" of proxy services are established by the NYSE, subject to approval by the SEC. Companies have no choice in selecting a proxy service provider, exert little to no control over the services that are actually provided, and have no ability to negotiate fees with the service provider.

- The overwhelming majority of brokers and banks have contracted out their proxy processing responsibilities to a single service provider. Pursuant to written agreements, brokers and banks provide this service provider with contact information and share positions for their beneficial owners, along with a power of attorney to act as their agent in voting the shares for which they have been granted proxy authority. The service provider then distributes proxy materials through the mail or electronically to the beneficial owners of all company shares.

- As noted above, the service provider does not transmit actual "proxies" to beneficial owners; instead, it requests voting instructions from beneficial owners. Thus, in their proxy materials, beneficial owners do not receive proxy cards, but instead receive a voting instruction form ("VIF") that is to be used by them to indicate their voting preferences. Beneficial owners then return this VIF for processing by the service provider. The use of a VIF form is necessary because brokers and banks retain the authority to cast the actual votes and do not transfer their proxy authority to the beneficial owner level.[3]

- If a beneficial owner has not provided specific voting instructions at least 10 days before a shareholder meeting, NYSE Rule 452 permits brokers to vote the shares of such owner if the proposal before the shareholder meeting is considered a "routine" matter. Under an amendment to Rule 452 recently approved by the SEC, an uncontested election of corporate directors would not be considered a "routine" matter, thereby prohibiting brokers from voting shares without receiving instructions from beneficial owners.

- Under rules adopted in the mid-1980's, brokers and banks are required to classify beneficial owners as either Non-Objecting Beneficial Owners ("NOBOs") or Objecting Beneficial Owners ("OBOs"), generally based on indications by beneficial

[3] Since a broker or a bank retains the legal authority to vote at a shareholder meeting, a beneficial owner who attends such a meeting is not able to vote his or her shares using a VIF. Instead, the current rules require a beneficial owner to make special arrangements before the meeting to obtain a legal proxy to vote his or her shares. The use of a VIF at a shareholder meeting does not entitle a beneficial owner to vote in person at the meeting without a legal proxy.

owners at the time they open an individual account. Recent studies and surveys indicate a lack of uniformity among brokers regarding how beneficial owners are actually classified as NOBOs or OBOs. There are no standards or regulatory requirements for how a broker reviews this classification with its customers at account opening, or on a periodic basis to update this classification.

- The names of NOBOs may be disclosed to a public company by brokers and banks for a general communications purpose, although a list of NOBOs may not be used by a company for the distribution of its proxy materials. The names of OBOs may not be disclosed to a company for any purpose whatsoever.

- A further complication in the proxy system is the share lending programs of brokers and other intermediaries. Share lending enables a "short" investor to borrow shares from a "long" investor, with an agreement to return these borrowed shares at a later date. Share lending agreements generally assign voting rights to the borrower of the shares on a record date, causing the need for each intermediary to reconcile its long and short positions in order to accurately calculate the number of shares each investor is entitled to vote.

Problems with the Current Proxy System

- Research on the views and preferences of individual investors indicate a significant lack of knowledge about the proxy voting process and how it functions. This education gap is all the more critical due to current problems with the system, as detailed below.

- The NOBO/OBO classification system prevents public companies from knowing who many of their shareholders are and engaging in any meaningful communications with them. Research findings suggest that sometimes brokers use OBO as their default, meaning that some owners are classified as "OBOs" without their knowledge.

- At a time when changes in corporate governance are providing shareholders with more involvement and additional transparency, there is a critical need to ensure that public companies can communicate with their shareholders through a proxy system that is accurate and flawless. Under the current system, companies seeking to encourage more voting participation by beneficial owners cannot do so without using a circuitous and expensive process that is controlled primarily by one service provider acting as an agent for brokers and banks, yet funded by the public companies themselves. The continued reliance on this single provider for proxy administrative services has resulted in a system in which fees are established by regulatory fiat rather than by a free market that would take shareholder interests into account.

- The use of share lending schemes and certain derivative strategies by hedge funds and other institutional investors have permitted a decoupling of voting rights from the economic ownership of corporate shares. This decoupling of rights offers the

potential for, and there have been actual cases of, these investors manipulating the proxy voting process for the purpose of gaining a strategic market advantage.

- Furthermore, the increased use of share lending by brokers can cause a broker to cast more votes than it is entitled to cast in a corporate election. More than a majority of brokers hold their shares in fungible bulk, and do not reconcile their long and short positions to determine which investors are eligible to vote before a proxy mailing is sent. This lack of pre-mailing reconciliation by brokers when a record date is established makes it impossible for a vote tabulation to be completely accurate, a goal that is especially important in a close vote on a director election or a shareholder proposal.

- Reports in the news media of voting miscounts and delays in determining election results by proxy service providers have raised questions about the integrity of the proxy voting process. Additionally, there does not appear to be any ability for an independent third-party to audit and verify the results of a close election. These problems need to be addressed, as increasing investor activism and proposed regulatory changes are expected to cause many more close votes on shareholder proposals and director elections.

Proxy Practices in Other Countries

Unlike the U.S., other countries have avoided the creation of artificial barriers between public companies and their shareholders, choosing instead to have beneficial ownership transparency and permitting companies to have direct communications with their investors.

- In the United Kingdom, a public company has the right to learn the identity of individuals and institutions with voting rights and/or beneficial owner interests in its shares.[4] This information is acquired through a written notice process that permits a public company the power to investigate the ownership of its shares. The law imposes both civil and criminal penalties for a failure to provide the requested information within a required time period.[5]

- In Australia, a public company is required to keep a register with the name and address of all its shareholders, including beneficial owners.[6] The disclosure of identity and address information on matters unrelated to the interests or rights of shareholders in the affairs of the company is not allowed.[7]

- In Canada, a public company is permitted to have direct communications with its beneficial owners.[8] However, Canada has maintained the NOBO/OBO classification and it is still expensive for public companies to communicate with all their

[4] Section 793 of the Companies Act 2006.
[5] Sections 794 and 795 of the Companies Act 2006.
[6] Section 169 of the Corporations Act 2001. In the Corporations Act, shareholders are referred to as "members."
[7] Section 177 of the Corporations Act 2001.

shareholders in Canada because of the complex chain of intermediaries involved in the proxy process.

The Shareholder Communications Coalition Proxy Process Reform Plan

In light of the overwhelming problems with the current proxy voting and communications system, the Shareholder Communications Coalition offers the following recommendations as a starting point for discussions about reforming the system:

1. **Investor Education**. As a new proxy voting and communications system is implemented, a national investor education campaign should be launched to explain the proxy voting process and to encourage individual investors to vote their proxies at shareholder meetings. Survey research indicates that the substantial majority of individual investors do not understand the workings of the proxy system.

2. **NOBO and OBO Classification**. Public companies should have access to contact information for all of their beneficial owners and should be permitted to communicate with them directly. The NOBO and OBO classification for beneficial owners should be eliminated.

   Those beneficial owners wishing to remain anonymous should be permitted to register their shares in a nominee account with their broker, bank, or other third-party intermediary. Beneficial owners should not bear the cost of this registration, either directly or indirectly. Those who are currently classified as OBOs should have adequate notice of the elimination of their OBO status, to permit them to decide whether to establish a nominee account.

   Communications with beneficial owners should only be for purposes involving the corporate or business affairs of a company. Federal privacy regulations should apply to the use of beneficial owner information received from a broker or bank.[9]

3. **Competition among Proxy Service Providers**. The current functions of (a) beneficial owner data aggregation, and (b) proxy communications distribution should be separated, providing a public company with the opportunity to select a proxy distribution provider of its own choosing. The proxy distributor should be responsible for transmitting the proxy statement and proxy forms to all shareholders, once the beneficial owner list is obtained from an entity serving as the data aggregator. The prices for proxy distribution and

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[8] National Instrument 54-101.

[9] SEC regulations permit the disclosure of information: (a) "necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes"; or (b) "as permitted by law." See 17 C.F.R. § 248.14(a), 17 C.F.R. § 248.14(b)(2), and 17 C.F.R. § 248.15(a)(7)(i). Similar privacy provisions apply to banks.

communications services should be established by open competition among service providers handling these functions, based on value to end users, and not through a fee schedule established by regulators.

4. **Beneficial Owner List Compilation**. The lists of beneficial owners used for shareholder meetings and other communications purposes should be maintained by a data aggregator selected by a special committee of the NYSE established for this purpose. The compilation of the beneficial owner lists for shareholder meetings should become a non-profit function, and a fee schedule should be established for access to the beneficial owner lists by the NYSE.

   The data aggregator would obtain beneficial owner contact information from all brokers, banks, and other intermediaries, but no information about any intermediary relationship with a customer would be provided. In other words, as is the case today, the names of brokers and other intermediaries with whom the beneficial owners maintained their accounts would not be disclosed.

   Beneficial owner positions should be fully reconciled as of a specified record date for a shareholder meeting. This share position reconciliation should include shares on loan and any "failure to deliver" shares. All intermediaries would be required to reconcile beneficial owner and other positions back to their total holding position at DTC or another depository institution.

   Access to beneficial owner lists should be non-discriminatory. Both a company and its shareholders seeking to communicate with beneficial owners should have equal access to the beneficial owner list, upon payment of the NYSE-approved fee for this list.[10] As noted above, beneficial owner lists should only be used for communications involving the corporate or business affairs of a company.

   The special NYSE committee should use a competitive bidding process to select and retain the data aggregator. The committee should enter into a contractual agreement with the data aggregator for a recommended term of five (5) years.

   The special NYSE committee should also be responsible for the ongoing oversight of the data aggregator selected for this purpose. The committee should comprise representatives of brokers, banks, issuers, institutional investors, individual investors, and other identified stakeholders.

5. **Proxy Vote Counting and Tabulation**. Proxy votes should continue to be counted and tabulated using the current practices governed by state law, including, when necessary, the services of an independent inspector of elections.

[10] Access to the beneficial owners list will be provided at the same reimbursement fee to company shareholders wishing to communicate with other shareholders.

6. **Beneficial Owner Proxy Authority**. Proxy voting authority should be transferred to each beneficial owner, as of the record date established for a shareholder meeting, through the same omnibus proxy process that is currently employed by DTC. Beneficial owners would be free to transfer their proxy authority back to their broker or bank—through a client-directed voting agreement or similar arrangement—or to another third-party intermediary. A transfer of proxy authority to the beneficial owner level eliminates the need for broker discretionary voting under NYSE Rule 452 and also eliminates the need for brokers and banks to provide their service provider with a power of attorney for proxy voting purposes.[11]

7. **Integrity of Proxy Voting Process**. The proxy voting process should be fully transparent and verifiable, starting with the compilation of a reconciled list of beneficial owners eligible to vote and ending with the final tabulation of votes cast at a shareholder meeting.

   Brokers and other financial intermediaries engaged in share lending (or with "failure to deliver" positions) should be required to reconcile their share positions as of the record date for each shareholder meeting. This reconciliation should occur before an intermediary transmits record date beneficial owner information to the data aggregator discussed above and before proxy forms are mailed to beneficial owners and registered shareholders. All record date positions maintained by financial intermediaries should be reconciled early in the voting process, to avoid distributing proxies to ineligible shareholders and to avoid discrepancies in tabulating final vote counts.[12]

   The vote counts on matters before a shareholder meeting should be auditable and capable of third-party verification, so that a validation of the final tabulation of the votes of both registered and beneficial owners can occur.

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[11] If this recommendation is adopted, there would no longer be any broker discretionary voting pursuant to NYSE Rule 452, which currently permits brokers to vote uninstructed shares on routine matters at a shareholder meeting. The SEC recently approved an amendment to Rule 452 that would no longer permit brokers to exercise this discretionary authority in uncontested director elections.

[12] This proposed process would be facilitated by a recent amendment to the Delaware General Corporation Law permitting a board of directors to fix one record date for shareholders entitled to notice of a meeting and a separate record date for determining the shareholders entitled to vote at such a meeting. This new amendment should help a company better align the economic and voting interests of its shareholders and reduce the risk of having investors with voting rights but no share ownership as of the date of the shareholder meeting.