Council of Institutional Investors
The Voice of Corporate Governance

The OBO/NOBO Distinction in Beneficial Ownership:

Implications for Shareowner Communications and Voting

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Executive Summary

Recent developments increase the likelihood of more meaningful, and contested, shareowner votes and the importance of shareowner communications. Shareowner voting and communications depend on both state and federal law. State law focuses on record ownership (i.e., the holder, whether or not the ultimate shareowner, shown on a company's books), whereas federal law reflects the interests of beneficial owners (i.e., the ultimate shareowners) in voting and receiving disclosure.

Under Securities and Exchange Commission (SEC) rules, companies mainly communicate with beneficial owners through broker or bank intermediaries. Intermediaries are prohibited from disclosing to a company the identity of beneficial owners who object to that disclosure (objecting beneficial owners or OBOs), and the company cannot contact OBOs directly. The company may contact directly shareowners who do not object (non-objecting beneficial owners or NOBOs), but SEC rules nonetheless require that proxy materials be forwarded to them by the intermediaries. The OBO/NOBO distinction impedes company communications with beneficial owners and communications among shareowners. Some market participants have proposed changes to this framework. The interests of the key players vary:

- Companies tend to favor the elimination of the OBO/NOBO distinction. They argue that, if shareowners can participate more directly in board elections through proxy access or other means, companies should be able to contact them directly. They also argue that a direct communication framework would increase shareowner participation and reduce costs.
- Shareowners are often said to have a privacy interest that is served by the current framework, but a 2006 survey casts doubt on this assertion. It is also unclear which information shareowners wish to keep private and from whom. Some may wish to keep their holdings or trading strategies confidential, while others seek to avoid unwanted solicitations. Shareowners seek to have unimpeded ability to communicate among the shareowner community. Shareowners also seek a level playing field with companies — to have equal access to lists of shareowners and to have their solicitation costs reimbursed as are those of management.
- Brokers and banks have several interests — maintaining the confidentiality of customer lists, preserving fee income derived from forwarding proxy materials, and preserving stock loan revenues, which could be at risk in a direct communications framework that allows greater transparency to customers about stock loan practices.
- Broadridge Financial Solutions is essentially the sole agent for intermediaries and companies and has an interest in preserving the fee income and cost reimbursements it receives under the current framework.

The SEC is likely to be cautious in seeking to change the current framework in significant ways, at least in the near term. Defining the objective is critical to developing a proposal. If the goal is to increase the ability of shareowners and companies to communicate directly, a number of incremental steps may be taken to address the OBO/NOBO distinction and facilitate direct distribution of proxy materials, without discarding the current distribution platform. Such an approach could lead to meaningful improvements, without seriously affecting the interests of many of the participants in the current framework, and we believe it has a greater chance of widespread support than more radical alternatives.

A more ambitious goal to ensure more reliable voting seems difficult to achieve without a direct communications framework with cascading executed proxies. This approach would, however, almost certainly be more contentious, since it would implicate complex strategic, cost, logistical and other considerations of critical importance to key players. Its practical benefits are also uncertain because they are likely to be limited to a minority of contested elections in which an end-to-end audit of the vote is critical to a reliable outcome. We also believe that this approach requires more detailed analysis by the various affected constituencies to obtain a clearer picture of the logistical changes, costs and potential disruptions it could entail.

On balance, we believe that the immediate interest of shareowners and companies in better communications would be better and more effectively served with an incremental approach that promotes less reliance on — or eliminates altogether — the OBO/NOBO distinction and otherwise increases the potential for direct communications.

Introduction

A shareowner's right to vote on matters as allowed under state or federal law, stock exchange rules or otherwise is a key right. Shareowner voting has also become an increasingly important element in the consideration of public company corporate governance. Recent developments have spotlighted the nature and quality of the communication process and its impact on shareowner voting and governance. These developments include adoption by a number of public companies, especially larger companies, of majority voting in uncontested director elections, the amendment of New York Stock Exchange (NYSE) Rule 452 to prohibit broker discretionary voting in uncontested director elections and the increased influence of activist shareowners and proxy advisory firms. The confluence of these developments has heightened the likelihood of more meaningful, and contested, shareowner votes and elevated the importance of shareowner communications in the context of voting and governance.

Issues of shareowner voting and communications depend on both state and federal law. State law focuses on record ownership (i.e., the holder shown on a company's books, whether or not the ultimate shareowner) because of administrative ease and certainty. Federal law, on the other hand, emphasizes regulation of communications by public companies for shareowner meetings and other matters, as federal regulators are more concerned with the interests of beneficial owners (i.e., the ultimate owners) in voting and receiving related disclosure. The record owner may also be the beneficial owner of the shares, but for shares held with financial institutions, the link between record and beneficial owners is not simple. A complex chain of intermediaries often separates the record owner from the beneficial owner. Companies typically do not know the identities of all beneficial owners of their shares, nor do beneficial owners know the identities of other beneficial owners generally. The information resides largely with the intermediaries. This information disconnect limits the ability of companies to communicate with their beneficial owners and of beneficial owners to communicate directly with each other.

While state law governs the rights of record owners, the SEC has focused on rules related to communications between companies and their owners, and among owners themselves. To address the gap between record and beneficial ownership, the SEC has created a framework in which companies primarily communicate with beneficial owners through broker or bank intermediaries. The framework requires brokers and banks to disclose to a company the identity of only those beneficial owners who do not object to such disclosure. Those who object are known as "objecting beneficial owners" (OBOs) under the SEC's rules. The company cannot contact OBOs directly. The company may, however, have direct contact with shareowners who have designated themselves "non-objecting beneficial owners" (NOBOs), owners who do not object to having their identity known to the issuing company. However, while companies may communicate directly with NOBOs, SEC rules require that proxies and proxy materials nonetheless be forwarded by broker and bank intermediaries, not by companies.

This paper provides a brief introduction to the OBO/NOBO system, its history, the consequences of its operation and possible alternative approaches or reforms. It is organized as follows:

- Section II describes the system of custodial stock ownership, the current communication framework and the practical application of the OBO/NOBO distinction;
- Section III provides a brief history of shareowner communications reforms, including the enactment of OBO/NOBO rules;
- Section IV highlights the consequences of the current framework;
- Section V describes the interests investors have in the current framework;
- Section VI discusses the interests that various other stakeholders have in the current framework;
- Section VII describes potential alternative approaches and reforms; and
- Section VIII offers recommendations with respect to reforms.

Custodial Ownership and the Current Communication Framework

Custodial Ownership: The Source of the OBO/NOBO Distinction

In the United States, few ultimate beneficial owners are holders of record. Instead, a chain of custodial ownership, which can be complex and operates through multiple levels, separates the record and beneficial owners. Under custodial ownership, a broker or bank intermediary holds legal title to shares on behalf of the beneficial owner, who retains full economic ownership. Often the beneficial owner will establish a custodial relationship through a nominee account, under which a nominee, often a partnership, holds legal title to the shares.[1] "Street name" refers to the form of nominee name brokers use to hold shares on behalf of the ultimate beneficial owners.[2] An estimated 70-80 percent of publicly-traded shares are held in street or nominee name according to the most recent data from 1997.[3] The custodians, in turn, hold the shares in accounts with The Depository Trust Company (DTC), the only central depository institution in the United States. DTC (or its nominee, Cede & Co.) is registered in a company's books and records as the record holder. DTC is thus the holder of record of a substantial majority of publicly-traded shares in the United States.[4]

The current shareowner communication framework applicable to proxy solicitations addresses the difference between record and beneficial owners principally by requiring a company to forward proxy materials to the broker or bank intermediaries, which must in turn forward them to beneficial owners, whether they are OBOs or NOBOs.

The framework does permit some direct communications between a company and its beneficial owners. For example, companies may mail their annual reports directly to NOBOs,[5] although in practice this does not occur since the annual report must accompany or precede the proxy statement (which as noted above must be sent by the intermediary).[6] A company also might choose to confirm with NOBOs that the relevant intermediary had in fact forwarded proxy materials as required or encourage NOBOs to vote.[7] To enable direct communication, brokers and banks must provide companies with a list of NOBOs upon request at any time.[8] Most brokers and banks delegate this responsibility to an agent, in almost all cases Broadridge Financial Solutions Inc. (Broadridge), the leading provider of U.S. outsourcing services regarding communications, document management and processing in connection with the proxy procedure.[9] Broadridge provides a single list of all NOBOs to the company in a standardized format. The NOBO list includes the name, address and securities position for each NOBO.[10] Because Broadridge does not disclose the identity of a NOBO's broker or bank intermediary, relying on Broadridge to provide the NOBO list allows brokers and banks to preserve the confidentiality of their customer lists from each other and from the company.

The company cannot communicate directly with OBOs,[11] so all communications with OBOs must be made through the relevant intermediary. Over 75 percent of customers holding shares in street name are OBOs,[12] and 52-60 percent of the shares of publicly-held companies in the United States are therefore held by OBOs.[13] In effect, the identity of the ultimate beneficial owner of more than half of all shares of publicly traded companies is behind a curtain.

How Shareowner Communications and Proxy Voting Work

The OBO/NOBO rules are only one component of the shareowner communication framework, which we summarize below. Additional details are provided in Annex A, which highlights the differences in the framework as it applies to brokers, on the one hand, and banks, on the other.

The distribution of proxy materials to a beneficial owner is a two-stage process as described below.

- In the first stage, the company gathers information about the number of beneficial owners in what is itself a multi-step process. This stage is illustrated in the attached Figure 1 (for brokers) and Figure 2 (for banks) in Annex B. The process by which a company obtains a NOBO list is illustrated in Figure 3 in Annex B.
  - The company requests from DTC a list of its participants (i.e., financial and other institutions with accounts at DTC) that hold company shares, to which DTC must respond "promptly."[14]
  - Upon receipt of the list, the company sends a "search card" to those institutions — the broker and bank intermediaries — at least 20 business days prior to the record date (i.e., the date as of which one must be a shareowner of record on the company's books to vote at a shareowner meeting), requesting the quantity of proxy materials and annual reports each requires for further distribution to beneficial owners.[15]
    - Brokers (or Broadridge as their agent) must respond to the company's inquiry no later than seven business days after receipt of the search card.[16]
    - Banks must respond to a search card inquiry in two ways. Because there are often several layers of "respondent banks" (i.e., smaller bank custodians which deposit shares on behalf of beneficial owners with larger bank intermediaries) between a DTC bank participant and the beneficial owner, banks must tell the company, within one business day, the names of respondent banks holding shares of the company through them.[17] The company then sends a search card to the identified respondent banks within one business day.[18] Those respondent banks must respond in turn within one business day with the names of their respondent banks holding shares of the company through them, and this respondent bank process continues through however many layers of respondent banks exist that hold shares of the company. All banks, including both the initial banks to whom the search card inquiry was sent and all respondent banks, must also respond no later than seven business days after their receipt of the search card regarding the quantity of proxy materials needed for distribution to beneficial owners.[19]
  - If a company wishes to communicate directly with NOBOs, it needs the NOBO list, which includes the name, address and securities positions of each NOBO. A company may request a NOBO list from broker or bank intermediaries at any time. The company requests a list of all NOBO holders as of a date it specifies. Often this date is the record date, but it can be any date the company specifies. The intermediaries must be given at least five business days to compile such lists.[20]
  - Broker and bank intermediaries must compile the NOBO lists as of the date requested by the company,[21] and must transmit to the company the NOBO list no later than five days after the date specified by the company.[22] Intermediaries generally respond through their agent Broadridge, which delivers a single standardized list of NOBOs to the company.

- In the second stage, the company forwards its proxy materials to the broker and bank intermediaries for further distribution.[23]
  - In the case of proxy materials, the broker or bank (or, more typically, Broadridge) *must* forward the materials.[24] The broker or bank (or Broadridge) must also forward the annual report, although it is excused from sending it to NOBOs if the company has indicated that it will do so directly.[25]

One important difference between distribution of proxy materials and voting rights is that, under state law, only the holder of record has the right to vote.[26] As a result, the company cannot send a proxy card and proxy materials directly to each beneficial owner, but must provide the proxy card to the record holder. To delegate voting authority under state law to the beneficial owner, first, as the record holder of shares held in street name, DTC executes an "omnibus" proxy in favor of all brokers and banks who hold the company's shares through DTC's facilities,[27] thereby authorizing each broker or bank to act as DTC's proxy and to vote the shares to the extent of the broker or bank's position in the company's securities held with DTC.[28] The executed omnibus proxy is sent to the company accompanied by a list that shows the number of shares each broker or bank holding through DTC may vote pursuant to the omnibus proxy.[29]

In turn, after being vested with voting authority, the brokers and banks have two options to facilitate voting by the ultimate owners of shares. The first, rarely used option is for a bank or broker (or Broadridge) to send an executed proxy to the beneficial owner, leaving the voting provisions of the proxy card blank and fully delegating voting authority to the beneficial owner. The beneficial owner then completes the proxy card and mails it to the company directly. The second option, which is used in the vast majority of cases, is for the intermediary to request voting instructions from the beneficial owner.[30] In the typical case, Broadridge sends the requests for voting instructions on behalf of the broker and bank intermediaries. The beneficial owners return instructions as to how the proxies should be voted to Broadridge, which then tabulates the voting instructions received and fills out a proxy for each intermediary broker or bank for which it acts as agent, aggregating the voting instructions received from beneficial owners holding through that intermediary.[31] Broadridge's process for aggregating and verifying voting instructions is not one that a company itself may verify.[32]

Finally, the bank or broker (or Broadridge) sends the proxies to the tabulator (i.e., the entity retained by the company to count votes), which is often the transfer agent (i.e., the agent the company hires to transfer its securities, as well as maintain a list of the shareowners of record), for final verification and tabulation. The tabulator verifies that the number of shares voted equals (or is less than) the number held by each DTC participant. The proxy voting process is illustrated in Figure 4 and Figure 5 in Annex B.

Some pension funds and other institutional investors rely on proxy advisory firms to respond to requests for voting instructions (or proxies), adding another layer of complexity. RiskMetrics Group, one of the leading proxy advisory firms, advertises a range of voting services: "We receive your proxy ballots, work with your custodian banks, execute votes on your behalf, maintain vote records…"[33] Although institutional investors typically retain ultimate voting authority in their arrangements with proxy advisory firms, some institutional investors may delegate their voting authority as well.[34]

The company pays broker intermediaries and Broadridge for the services they provide (including preparing NOBO and OBO lists, providing lists to Broadridge (and in the case of NOBOs to the company), costs of mailing and other actual costs) at levels fixed by the NYSE.[35] This fee schedule is also typically followed for services rendered by bank intermediaries.[36] For example, the company pays fees for NOBO lists (e.g., a broker may charge $ 0.065 per NOBO name).

History of the Shareowner Communication Framework

The shareowner communication framework, including the OBO/NOBO distinction, was developed in the mid-1980s. The framework represented a compromise purportedly designed to address two goals: (i) improved corporate governance through increased communication between companies and their ultimate owners, as management would be more accountable if beneficial owners were given more of a say in corporate voting,[37] and (ii) a Congressional mandate to immobilize stock certificates (i.e., to eliminate transfers of physical stock certificates), and create centralized clearing for securities transactions.[38] While the SEC wanted to improve communication between companies and their shareowners, it regarded the reliability of proxy distribution and securities clearing as paramount. The result was a layered approach to communications that impedes direct communications. This section highlights key changes in the evolution of the current framework. Further details are provided in Annex C.

The Decision to Immobilize Stock Certificates

One key development leading to the prevalence of street name ownership that set the stage for the OBO/NOBO distinction was the paperwork crisis during the bear market of the late 1960s. Stock exchanges experienced unprecedented trading volume in that period, and brokers and banks were unable to process the transaction volume on a timely basis.[39] The need to handle and deliver paper security certificates for many transactions and the lack of a centralized clearance and settlement system significantly exacerbated the problem. Citing the absence of nationwide clearance and settlement as the cause of the problem, Congress amended the Securities Exchange Act of 1934 (Exchange Act) to add Section 17A, which requires clearing agencies to register with the SEC[40] and directed the SEC to implement rules to immobilize share certificates.[41]

Congress also directed the SEC to study "street name" registration,[42] a practice some institutional investors had engaged in since at least the 1930s. While approximately 10 percent of the shares of public companies was held in street name accounts in 1937, that percentage had increased to 30 percent by the mid-1970s.[43] The purpose of the study was to determine whether street name registration was consistent with a system of "prompt and accurate" clearance of securities transactions, as well as whether steps could be taken to facilitate company and shareowner communications while simultaneously maintaining effective clearing systems.[44]

The SEC's review of beneficial ownership resulted in the 1976 "Street Name Study,"[45] which found that street name holding facilitated clearance and settlement of securities transactions and noted its importance to the operation of securities depositories.[46] Increased use of securities depositories was thus an essential predicate to immobilization of share certificates. By affirming street name registration as essential for effective securities transaction clearance and settlement, the study paved the way for increased use of the practice. The Street Name Study also recommended against changes to the existing shareowner communication framework, finding that it "functioned reasonably well," as shareowners generally received communications in a timely manner whether holding shares directly with the company or through an intermediary.[47]

History of the 1980's Communication Rules

The SEC soon revisited the communications framework. The stated objective of the Congressional and SEC actions of the late-1970s and 1980s was to better integrate beneficial owners into the communication framework, thereby potentially promoting more informed votes about corporate matters. As noted in the House Report for the Shareholder Communications Act of 1985:

> Informed shareholders are critical to the effective functioning of U.S. companies and to the confidence in the capital market as a whole. When an investor purchases common stock in a corporation, that individual also obtains the ability to participate in making certain major decisions affecting that corporation. Fundamental to this concept is the ability of the corporation to communicate with its shareholders.[48]

While the reforms of the 1980s were an improvement as compared with the prior system of shareowner communications, the framework instituted was circuitous and complex.

In 1977, the SEC initiated a "corporate governance proceeding," a review of corporate governance generally, including shareowner communications and shareowner participation in corporate elections.[49] The review lasted three years and resulted in the 1980 "Staff Report."[50] The impetus for the renewed review of corporate governance, including shareowner communications, was a variety of events in the mid-to late-1970s that cast doubt on the adequacy of processes to ensure corporate accountability.[51] The Staff Report noted that shareowners elect a board of directors to direct or oversee a company's management on their behalf.[52] In principle, the periodic election of directors holds the board accountable for pursuing the best interests of shareowners. However, the foreign bribery scandals of the mid-1970s, which ultimately led to the adoption of the Foreign Corrupt Practices Act, in which hundreds of companies disclosed illegal or questionable payments to foreign officials,[53] as well as disclosures regarding the collapse of several major companies and corporate non-compliance with environmental and other laws,[54] called into question the efficacy of the election process to promote the goal of corporate accountability.

The focus of the Staff Report differed from that of the Street Name Study. While the Street Name Study focused on whether street name ownership facilitated securities trading without the need for transfer of physical stock certificates,[55] the Staff Report addressed the impact of beneficial ownership and the prevailing shareowner communications regime on corporate governance.

A key recommendation in the Staff Report was that the SEC create an advisory committee to develop a system for companies to identify beneficial owners and establish a uniform proxy material distribution system.[56] In 1981, the SEC convened the Advisory Committee on Shareholder Communications to study the then-existing framework.[57] After an extensive review, the Advisory Committee recommended several changes, many of which are a part of the current framework.[58]

The Advisory Committee recommended limited direct communications between companies and their shareowners. The framework recommended by the Advisory Committee authorized direct communications for annual reports, but not for proxies, and introduced the concept of NOBO lists. In 1983, the SEC adopted rules reflecting the Advisory Committee's recommendations.[59] Direct communications by companies with beneficial owners were therefore not permitted for the delivery of proxy cards or materials. Since then, companies have not been able to send proxy materials or cards directly to beneficial owners, even NOBOs.

It is noteworthy that the Advisory Committee also considered a more comprehensive direct communication framework that would have allowed companies to send proxy materials directly to NOBOs,[60] but ultimately rejected this approach.[61] One concern was that companies would receive non-standardized NOBO lists and would be unable to process the lists to send out proxy materials in a timely manner.[62] More fundamentally, the Advisory Committee concluded — and the SEC agreed — that any additional benefits from direct communication were outweighed by the uncertainty of both the costs and effectiveness of any alternative system.[63] Instead, the Advisory Committee and the SEC concluded that problems with the communication framework could be sufficiently remedied through the incremental reforms that were adopted. As reflected in the summary of the rules in Annex C, a clear albeit unarticulated consequence of the system that was adopted was to preclude the possibility of direct communication with OBOs, who were of course not even identified to companies.

The SEC's rules implementing the Advisory Committee's proposals became effective in January 1986.[64] Implementation was delayed so brokers and companies could work out who would bear the costs of implementation and what costs companies would reimburse going forward.[65] Prior to effectiveness, the SEC approved a provision allowing brokers to delegate to an agent their obligations to respond to company requests for information about shareowners.[66]

The Advisory Committee also recommended legislation giving the SEC regulatory authority over bank nominees, which were then and still are intermediaries for the majority of the shares held by beneficial owners.[67] After receiving a legislative proposal from the SEC,[68] in 1985 Congress passed the Shareholder Communications Act, which amended Exchange Act Section 14(b) to give the SEC authority to regulate bank intermediaries with respect to shareowner communications.[69] The SEC adopted Rule 14b-2 almost immediately thereafter, which imposed obligations on banks comparable to those applicable to brokers.[70]

Consequences of the OBO/NOBO Distinction

The most important consequences of the OBO/NOBO distinction are that it further impedes a company's direct communications with shareowners and direct communications among shareowners. Either the company must forward solicitation materials through intermediaries for a fee, as is true for OBOs, or rely on lists compiled by intermediaries and incur "per name" fees, in the case of NOBOs. This expensive and time-consuming process may deter companies from communicating with shareowners more than the minimum required by law. Similar impediments exist with respect to communications among shareowners, including in connection with contested matters that also involve the use of the current framework.

Shareowner communications are particularly critical in the solicitation of proxies. The solicitation process is aimed not only at informing shareowners about matters subject to a vote, but also at encouraging them to vote, and generally to vote a particular way. Companies have a clear interest in persuading shareowners to vote and to vote in the manner they recommend, including where applicable for the slate of directors they recommend. Companies also have a further interest in at least some cases in participation by shareowners. For example, the company must obtain a quorum to conduct business at a meeting.[71] Even where a quorum exists, the voting standard may be rigorous (e.g., supermajority provisions or provisions requiring the affirmative vote of a majority of the outstanding shares) and necessitate frequent communications to assure a favorable vote. Shareowners who are engaged in soliciting proxies or otherwise encouraging voting have an equally strong interest in effective communications to gain support for their objectives, whether promoting their own director nominees, promoting or opposing others' director nominees, or supporting or opposing shareowner or other proposals.

Recent developments in corporate governance will place more pressure on voting outcomes and increase the need for both companies and shareowners to have an effective and reliable framework for communications. These developments include the following:

- increase in proxy contests, including short slate proxy contests;
- rise of "vote no" campaigns;
- amended NYSE Rule 452; starting January 1, 2010, it prohibits brokers from using their discretion to vote uninstructed customer shares in uncontested director elections;
- adoption, mostly by big companies, of majority voting in uncontested director elections;
- widespread use of shareowner proposals to effect governance and other changes;
- Delaware General Corporation Law and Model Business Corporation Act amendments to clarify the permissibility of bylaw changes to effect proxy access or reimbursement of shareowner proxy costs; and
- the SEC's proposals to implement "proxy access" rules to permit shareowner access to the company's proxy statement.

Interests of Investors in the OBO/NOBO System and Modifications

Investors are a diverse group that includes individuals, company, union and public sector pension funds, mutual funds, hedge funds and insurance companies, among many others. While on any given matter their interests may diverge, in the context of the shareowner communications framework, they generally share two core interests — privacy and a level playing field with companies regarding communications with other shareowners in connection with proxy solicitations and other matters.

Privacy

Privacy is an interest often cited as important to investors. Indeed, the OBO/NOBO distinction was driven in significant part by this interest, and a policy decision on the part of the SEC that investors wishing to preserve anonymity should be allowed to do so.[72] Recent data casts doubt, however, on the importance of privacy as a motivation for retaining the current framework. A survey undertaken in 2006 on behalf of the NYSE Proxy Working Group revealed that only 36 percent of retail customers would choose to be OBOs if they understood the consequences, with the percentage declining to 14 percent if a $25 annual fee were charged to maintain OBO status, and to 5 percent if the annual fee were $50.[73]

Within the overall context of a privacy interest, it is also unclear which information investors may wish to keep private and from whom. Smaller retail investors simply might not want their information disclosed to avoid being bombarded with mailings, phone calls and possibly electronic communications in connection with proxy solicitations.

Some investors may also want to keep their investments private from other investors. Any shareowner can request a NOBO list. Under Delaware corporate law, a shareowner may request a stock list at any time, and the company must deliver it so long as the shareowner can show it intends to use the information for a "proper purpose."[74] The stock list includes the NOBO list if the company has obtained such a list.[75] A company need not provide a NOBO list if it has not requested one for its own use, however.[76] An investor may be concerned that activist shareowners with access to other investor names may use the information either to expose the investor's investment in a controversial company as a tactic to promote an agenda or to inundate shareowners with unwanted communications. While the "use" limitation provides some protection against these concerns,[77] the potential for abuse may be sufficient to drive this rationale for maintaining anonymity.

Investors may favor anonymity to keep their holdings or trading strategies confidential from companies, other investors, markets generally, regulators and others, a goal that may be of particular actual or perceived competitive importance to investors such as hedge funds. While the federal securities laws require disclosure when an investor acquires beneficial ownership of over 5 percent of a class of voting equity securities,[78] investors may still desire to maintain privacy or to control any public or private disclosure with respect to smaller positions. Some have raised the concern that companies might "track trading" if the companies could have access to a list of all beneficial owners at any time.[79] Some investors may have an interest in maintaining privacy to shield potentially controversial trading practices or ownership strategies from scrutiny.[80]

Access to NOBO Lists and the Ease of Shareowner Communications

One concern for investors is the ease of communicating with other shareowners. Both the cost and speed of such communications are important. Under the current SEC proxy rules, if a shareowner wants to communicate with other shareowners in connection with a proxy solicitation, the company must either (i) provide the requesting shareowner the list of record and beneficial owners, or (ii) mail the shareowner's communications, at the shareowner's cost.[81] The company may delegate such responsibilities to an agent, typically Broadridge. Many shareowners have found that relying on Broadridge to mail communications with respect to proxy solicitations to be cost effective and sufficiently fast to suit their purposes. Even if a company decides to send a requesting shareowner the list of record and beneficial owners, the shareowner can still contract with Broadridge to distribute such communications, and hence can still take advantage of any cost savings or efficiencies Broadridge provides.

Even if a company opts to mail a shareowner's communications, a shareowner may still likely gain access to NOBO and shareowner lists through state law means. Under Delaware law, for example, a company must deliver a shareowner list, including the NOBO list if the company has requested it, to a shareowner (including the beneficial owner) so long as the latter can show that it intends to use the information for a "proper purpose."[82] It is clear that "proper purposes" include communication with other shareowners about the company, whether or not in connection with a proxy solicitation.[83] If the company refuses to provide the list or fails to respond within five business days after the demand is made, the shareowner may seek an order to compel delivery from the Delaware Court of Chancery.[84] In such a case, after the shareowner has established its status and shown that it has made a proper demand, the company bears the burden of establishing that the request was for an improper purpose.[85] Given the weight of precedent, which favors shareowners seeking to communicate with each other as noted above, anecdotal evidence suggests that companies rarely challenge demands for shareowner lists.

Competing with the Company — The "Battle of the Coffer"

The current general restriction on a shareowner's access to corporate funds to finance its solicitation and other communications efforts may affect some investors' views of changing the OBO/NOBO system to foster direct communications by companies and shareowners with beneficial owners. One consequence of the elimination of OBO/NOBO status would be the potential for more frequent communications between a company and its shareowners. The recent evolution of governance practices and related rules would be likely to drive this trend. Shareowners have a similar interest, but while they should have the same access to the shareowner lists as the company,[86] they must pay for communications (and other solicitation costs) while incumbent managers have access to corporate funds to conduct solicitations.

Incumbent directors and managers typically may be reimbursed for expenses related to proxy contests, regardless of the outcome, so long as the expenses are reasonable and related to deciding a matter of principle or policy.[87] Shareowners involved in a proxy contest, on the other hand, must pay their own expenses, including the cost of communications. A board may authorize reimbursement of such expenses but, as a practical matter, reimbursement is only likely where the shareowner has been successful in electing a majority of the board or in reaching an agreement with the company.

A recent Delaware case illustrated the board's ultimate authority over a decision to reimburse and the limits shareowners may place on the board's ability to fulfill its fiduciary duties in that regard. In *CA, Inc. v. AFSCME Employees Pension Plan,*[88] the Delaware Supreme Court held that a proposed shareowner bylaw that would require the board to reimburse a shareowner's reasonable expenses when that shareowner sought to elect less than 50 percent of the board (i.e., a short slate) and succeeded in electing at least one director was invalid on its face because it could require reimbursement of a shareowner's expenses in circumstances that would force the board to violate its fiduciary duties. In response to *CA, Inc.,* in April 2009, the Delaware General Assembly adopted Delaware General Corporation Law Section 113 to clarify that a bylaw to allow reimbursement of shareowners' expenses is permissible.[89] In the absence of a bylaw or if a challenging shareowner failed to meet the conditions of the bylaw, the *CA, Inc.* result would continue to apply in maintaining the discretion of the board with respect to reimbursing shareowner expenses. (The extent to which a bylaw could limit the ability of a board to exercise its fiduciary duties is unclear.)

Interests of Various Other Stakeholders

Companies

Companies tend to favor more comprehensive shareowner communications reform proposals. In April 2004, the Business Roundtable (BRT) filed a Request for Rulemaking with the SEC urging revision of the shareowner communications rules and proposing a direct communications framework.[90] In response to SEC proposals regarding proxy access, the BRT filed comment letters in both 2003 and 2009, again urging revision of the current framework to allow direct communications.[91] Other industry groups reflecting company, management and director interests, such as the Shareowner Communications Coalition,[92] have supported the BRT's reform proposals, and it is a fair assumption that the BRT's position reflects the public company perspective (or at least the perspective of large public companies) more generally.

In advancing a direct communications framework, companies have two key objectives:

- **Direct Communications.** Companies have asserted their strong interest in direct communications as a matter of symmetry — if shareowners are able to participate more directly in board elections through proxy access or other means, companies should be able to contact them directly as well. The practical arguments are two-fold. First, given the rise in the number of meaningful and contested voting matters, companies have a more urgent need to communicate with shareowners. Second, as the BRT has argued, if proxy access is adopted and opposition candidates appear on the company's proxy card, the board would have a fiduciary duty to take actions it considered necessary or appropriate to promote the nominees best suited for the job, including additional communications with beneficial owners.[93] In those cases, companies may have an interest in communications with shareowners beyond what are today the customary proxy materials, for example to promote the company slate or to "get out the vote."
- **Costs of Communications.** Companies (or, more precisely, their shareowners) bear the costs of forwarding proxies at levels set by the NYSE,[94] and the potential for direct communications could reduce those costs. Companies have complained that under the current system, the other participants (including Broadridge as agent, banks and brokers) have no incentive to reduce costs, since their expenses are fully reimbursed.[95]

Broker-Dealers and Bank Intermediaries

Broker and bank intermediaries tend to favor the status quo with respect to shareowner communications. When the BRT proposed reforms in 2004, the Securities Industry Association (a broker-dealer trade association that since merged with the Bond Market Association to form the Securities Industry and Financial Markets Association, or SIFMA), strongly opposed the proposal.[96] The stated reason for opposition was that the current framework had proven to be reliable and did not warrant comprehensive overhaul.

In taking this position, the interests of brokers and banks appear to include the following:

- **Competitive Interest in Confidentiality of Customer Lists.** Because Broadridge does not disclose the identity of a NOBO's broker or bank intermediary in the NOBO list under the current framework, delegating authority to Broadridge to compile NOBO lists allows brokers and banks to maintain the confidentiality of their customer lists.[97]
- **Preservation of Fee Income From Forwarding Communications.** The prospect of eliminating or reducing the role of intermediaries would reduce the fee income they earn both for forwarding proxy materials and for providing NOBO lists.[98]
- **Preservation of Stock Loan Revenues.** Direct communications could affect the securities lending market. A customer with a margin account agrees that the broker may lend the customer's shares, but at least retail customers (and potentially some institutional customers) are typically not entitled to any fees the broker earns from stock loan transactions[99] and are almost always unaware that their shares are on loan. The current practice is for brokers to lend securities from an unidentified pool of shares, not specifying which particular customer's shares are on loan.[100] With a direct communications framework, however, if the broker were also required to execute a proxy in favor of the specific holder entitled to vote each share, the broker would need to identify which particular customer's shares were on loan (and to whom). As a result, there might be pressure from retail and institutional customers on brokers to curtail lending activity, identify it or share stock loan fees.[101]

While brokers and banks have their own interests to advance, their interests may also to some degree reflect those of the beneficial owners who are their customers. Beneficial owners are not a homogenous group, however, and they may have diverging interests with respect to the current system and reform. The distribution of investor types across intermediaries is not random. Brokers tend to have hedge funds and retail investors as customers,[102] while banks act more typically as custodians for mutual funds, pension funds, insurance companies, endowments and trusts.[103] As the interests of these groups diverge, so may the expressed interests of their respective intermediaries.

Broadridge

Broadridge has a strong interest in preserving the current framework, since it is essentially the sole central agent providing "investor communications, document management and proxy processing services" in the United States.[104] Indeed, its current business model is driven by the current framework under which it both earns agency fees and is reimbursed for its other costs.

Possible Reform of the OBO/NOBO Regime

Approaches to reform of the current OBO/NOBO framework range from minor incremental changes to a comprehensive overhaul. Any reform must advance the goal of operational reliability — or at least not appear to further impair the reliability of the current framework. One important question of course is the degree of reliability of the current framework, which is the subject of some debate.[105] There is no systematically gathered information regarding reliability. Broadridge and intermediaries express the view that reliability is high. There is some anecdotal evidence of breakdowns in reliability, including NYSE examination results and the 2008 under-reporting by Broadridge of withheld votes for certain directors of Yahoo.

Customer preferences

Customers do not express an overwhelming preference to be OBOs. In the NYSE Proxy Working Group survey, 64 percent of retail customers responded they would prefer to be NOBOs, when advised of the consequences of the OBO/NOBO distinction, with the percentage preferring NOBO status increasing on the imposition of fees to maintain OBO status.[106] Based on this data, NOBO status would seem to be the preferred default preference among customers, and one incremental reform could require intermediaries to set NOBO as the default in customer account documentation and even mandate a system of more informed and affirmative election of OBO status. If the data from the Proxy Working Group is an accurate reflection of investors generally, the percentage of shares held by OBOs likely would be reduced significantly.[107] This reform would not, however, address a company's ability to send proxies directly to beneficial owners, nor the costs associated with the current framework.

Such an approach would be in line with the SEC's original intentions in implementing the OBO/NOBO distinction. The rules require brokers and banks to disclose the information of all beneficial owners "who have not objected to disclosure of such information."[108] This language suggests that the SEC explicitly intended the standard to be one of non-objection, not one of affirmative permission to release information.[109]

Cost of Maintaining OBO Status

Under the current framework, companies must pay brokers or banks and their agents for distributing proxies and NOBO lists. A company must not only pay the actual distribution costs, but also is charged an additional fee for these services, costs that are ultimately borne by shareowners.[110] If a shareowner's OBO status makes a company's communications more expensive, other shareowners in fact subsidize that cost.

An alternative would be to impose the cost of OBO status more directly on OBOs themselves. This approach could be implemented in a variety of ways. One option would be to charge a fee to any customer who wanted to be an OBO, similar to the fee payable for an unlisted landline telephone number. Another option, which addresses the cost question but leaves open the other issues that could be addressed by more far-reaching reform, would be to abolish the OBO/NOBO distinction and require any customer seeking privacy to open a nominee account to maintain confidentiality.[111] Opening and maintaining a nominee account has fees beyond those charged for a typical brokerage account. Under either option, a shareowner's privacy interest is respected, but at the shareowner's expense.

Direct Communications

A more comprehensive approach to reform would entail a movement to a direct communication framework. This approach would combine the elimination of the OBO/NOBO distinction with the elimination of all mandatory communications through broker and bank intermediaries and Broadridge. These intermediaries and Broadridge could still play a role, albeit a different one. The BRT presented one such approach in its 2004 request for rulemaking.[112] This reform approach is illustrated in Figure 6 in Annex B. Another direct communication reform approach, proposed by the Altman Group, is discussed in endnote 112, *infra*.

The BRT proposal relies on two key changes — the elimination of the OBO/NOBO distinction and SEC rulemaking to authorize companies to mail all proxy materials directly to beneficial owners. Under this approach, a cascading series of executed proxies would form the basis of the shareowner vote. First, DTC would execute an omnibus proxy in favor of its participant broker and bank intermediaries, thereby entitling the participants to vote the number of shares on deposit as of the record date, as it does now. Next, in contrast to the current framework, intermediaries would execute an omnibus proxy entitling those customers holding shares through the intermediaries to vote, and so forth down the chain of ownership until the proxies reached beneficial owners. As the end result of this series of omnibus proxies, each beneficial owner would receive a proxy card that it had full authority to vote, which it would complete and return directly to the company.

Under the BRT proposal, brokers and banks would still maintain a list of the names, addresses and securities positions of beneficial owners,[113] and Broadridge might still be engaged to create a standardized, integrated list that compiled this information for *all* beneficial owners. Broadridge's involvement could thus continue to make it possible for bank and broker intermediaries to maintain the confidentiality of their separate customer lists. This list would provide the company with information as to who was entitled to vote its shares for verification purposes and would be available to both the company and shareowners (presumably for a fee payable by the requesting party).[114] Beneficial owners would return their proxies directly to the company (or the tabulator acting on the company's behalf), instead of forwarding voting instructions to the intermediaries or Broadridge. Importantly, both companies and shareowners could also communicate directly with shareowners to solicit proxies, seek support for their positions and "get out the vote."

The BRT proposal would likely increase the degree of transparency of beneficial ownership to companies and shareowners, while preserving the flexibility of beneficial owners to shield their identities through the use of nominee accounts. Given the costs associated with nominee accounts and shareowners' stated preference not to pay an annual fee to maintain their privacy, the likely result of a direct communication framework is that only a minority of shareowners would use nominee accounts and thereby shield their identities from companies. The proposal creates uncertainty with respect to costs and also raises a concern that the system will not operate as effectively as the current framework, which essentially relies on the centralization of information distribution through Broadridge. The BRT proposal also raises the concerns described above that, because of the expense to shareowners unless there is company reimbursement, the greater advantages of direct communication on contested matters accrue to companies.

The potential costs associated with implementing a new framework could be a significant obstacle to reform. In the case of the 1982 reforms, huge disparities in cost estimates, as well as uncertainty about ongoing cost-savings, were an important reason the Advisory Committee did not recommend direct communications.[115] Even implementing the current framework required a one-year delay to allow brokers and companies to allocate start-up costs and resolve fee and expense reimbursement issues.[116]

Today, brokers and banks have in place procedures that could facilitate direct communications, particularly Broadridge's standardized beneficial owner list. However, any changes to the framework would doubtless entail start-up costs, the level of which is somewhat uncertain given the availability of electronic delivery and voting options.

The reliability of a direct communications framework is also not likely to be accepted as incontrovertible fact, notably by intermediaries. When the BRT proposed direct communications in 2004, the Securities Industry Association (now SIFMA) opposed the proposal, noting the efficiency, reliability and accuracy of the existing framework and the years of development and investment required to achieve those standards.[117] Similar arguments persuaded the SEC not to adopt direct communications in 1982. The switch to a new delivery system would entail some degree of execution risk as companies assumed the responsibility of delivering proxy materials. Given the SEC's longstanding concern about fairness towards retail investors,[118] a particular concern would be whether companies could assure timely delivery to that segment of investors. Any proposal for direct communications would have to address this concern with specificity. The fact that the infrastructure that supposedly ensures reliable communications is in place and could be adapted to a direct communications system, coupled with huge advances in technology since the 1980s, suggests that reliability concerns may be addressed in an objective manner.

The following table summarizes the reform proposals discussed above.

NOBO Status	Fee to Maintain OBO Status	Business Roundtable Proposal	Altman Group Proposal
▪ Keep OBO/NOBO distinction ▪ Require NOBO to be set as "default" in broker customer account documentation ▪ Investors may retain privacy if they choose at no cost to them ▪ Direct communication only to NOBOs ▪ Proxy materials still must be distributed through intermediaries ▪ No change to costs of distributing communications and proxy materials	▪ Keep OBO/NOBO distinction ▪ Investor must pay a fee to be an OBO ▪ Investors may retain privacy if they choose, but for a fee ▪ Direct communication only to NOBOs ▪ Proxy materials still must be distributed through intermediaries ▪ No change to costs of distributing communications and proxy materials	▪ Eliminate OBO/NOBO distinction ▪ Access to list of beneficial owners at any time ▪ Investor may still use nominee account to maintain privacy ▪ Direct communication to all beneficial owners ▪ Proxy materials sent directly to beneficial owners, returned directly to company (or tabulator) ▪ Costs of distributing communications and proxy materials potentially lower	▪ Replace OBO/NOBO distinction with "ABO" status ▪ Access to "ABO" list permitted only for annual and special meetings, limited number of other circumstances ▪ Mandatory disclosure of all beneficial owners, including of those shares held in nominee accounts ▪ Direct communication to all beneficial owners ▪ Does not take position on whether proxy materials should be sent directly to beneficial owners ▪ Costs of distributing communications and proxy materials potentially lower

Recommendations

The compelling and competing interests we describe above are likely to make the SEC cautious in seeking to change the communications framework in significant ways, at least in the near term. These interests will also likely present issues that would probably constrain, or at least delay, the SEC's ability to achieve significant change if it decides to try. Further, the caution that we would expect from the SEC will be particularly marked on the subject of proposed changes that could face strong opposition from the perspective of cost or reliability. That said, some change is all but inevitable given the emerging consensus that the limitations of the current framework are increasingly unworkable in an era of rising investor activism and more meaningful shareowner voting.

Defining the objective is critical to developing a proposal. If the goal is to increase the ability of shareowners and companies to communicate directly, a number of incremental steps may be taken individually or together, without discarding the current platform. Such an approach could enhance communications without seriously affecting the interests of many of the participants in the current framework.

A more ambitious goal to ensure not only improved communications, but also more reliable voting seems difficult to achieve without a more radical solution that is (or approaches) a pure direct communications framework with cascading executed proxies. Implementing such an approach would, however, almost certainly be more contentious, since it would implicate complex strategic, cost, logistical and other considerations of critical importance to key players. In addition, while the SEC is likely to pursue investor education initiatives in light of the continuing large retail shareowner base, the elimination of uninstructed broker voting and falling retail investor participation, the SEC might well conclude that such efforts would have to be more substantial, and changes take longer, if it pursued a more radical change in proxy mechanics. Moreover, the SEC could conclude that facilitating direct communication is more in line with its disclosure mandate than improving the reliability of voting and facilitating end-to-end audit trails for shareowner votes. On balance, we believe that an incremental approach that promotes greater transparency around shareowner lists and more opportunity for direct communications by shareowners and companies alike has a greater chance of widespread support than more radical alternatives.

A first step could be to address the OBO/NOBO distinction, preferably by eliminating it. This discrete change would likely increase the number of shareowners with whom other shareowners and companies could communicate directly in some ways, while preserving the logistical apparatus now used to compile shareowner lists and distribute communications. This step could itself, if desired, have a phased implementation starting with a mandate to make NOBO the default status for customer accounts, with full disclosure about the consequences of selecting OBO status. Election of OBO status could be coupled with a charge to defray the costs of maintaining a platform to support OBO status. Eventually, the OBO/NOBO distinction could be eliminated, with customers able to preserve their anonymity through nominee accounts at their own expense.[119] We do not believe that proposals that eliminate the possibility of anonymity altogether are workable, at least in the near term, since they do not accommodate the strong privacy interest of many retail and institutional investors.[120]

A second step could be to relax restrictions on the ability of companies and shareowners to distribute proxy materials and solicit proxies directly and to streamline the process for both companies and shareowners to obtain shareowner lists. We would not recommend that this step be achieved through eliminating the intermediary-agent platform altogether, since to do so could raise concerns about the reliability of communications[121] and would likely face significant opposition from some players whose business model depends at least in part on aspects of the current framework. Instead, this step could be achieved in a less intrusive way through regulatory changes that would permit direct distribution and solicitation, but maintain the intermediary-agency platform as an alternative. Even in a world where direct communications are fully permissible, we believe that companies will continue to use agents for purposes of compiling shareowner lists and particularly document distribution given the advantages of large scale fulfillment in terms of cost and reliability. Similarly, we believe shareowners will continue to use the agent platform for document distribution in at least some circumstances, even as the ability to communicate directly will provide advantages in other circumstances. Preserving the role of intermediaries in this approach would continue to accommodate customer and intermediary preferences for anonymity. Likewise, preserving a “neutral” agent as the centralized repository of shareowner lists may also provide comfort to shareowners who, we understand, find the current system for requesting shareowner lists from Broadridge (or another agent) to be relatively easy and inexpensive.

A full direct communications framework in which companies control the shareowner lists, but all parties have easy access to the list and may communicate directly with each other, could also ultimately be workable.[122] The desirability of this approach would depend on whether it would protect shareowners from the risk that companies prevent or limit access to the shareowner list. If shareowners in fact have ready access to shareowner lists under existing state law, the utility of this additional step is uncertain. Even in the case of a direct communications framework, we would recommend that the framework continue to permit reliance on fulfillment services provided by Broadridge and other agents. We would note that, although not central to our analysis, taking steps to permit and facilitate direct communications by shareowners and companies alike could lead to a more competitive environment around intermediaries’ and agents’ services, including increasing pressures for competitively negotiated (and possibly lower) fees.

Other reforms would be needed to achieve reliable end-to-end audit trails, such as the cascading series of executed proxies from DTC to the beneficial owner resulting in the beneficial owner having exclusive authority to vote. The proxies returned would bear the names of the beneficial owners, allowing the tabulator to compare the votes with the list of all beneficial owners on file with the company. Without this reform, Broadridge would still verify and tabulate the majority of votes, as most beneficial owners would still return their voting instructions to Broadridge. Companies would have to rely on Broadridge to ensure that only those shareowners entitled to vote do so, as is the case under the current system. Without access to Broadridge’s procedures and results in aggregating votes, companies cannot effectively audit Broadridge’s verification process, and could not do so even if they knew who all of their beneficial owners were.[123]

Whether the practical benefits of coupling a direct communications framework with cascading executed proxies would outweigh the costs is uncertain. The benefits are likely to be limited to a minority of contested elections in which an end-to-end audit of the vote is critical to a reliable outcome. It may be worthwhile to have more data, particularly about director elections in the wake of the elimination of uninstructed broker voting in uncontested director elections and other recent developments and the practice that emerges if the SEC adopts a proxy access regime, before moving to this more comprehensive type of solution. We also believe that this approach requires more detailed analysis by the various affected constituencies to obtain a clearer picture of the logistical changes, costs and potential disruptions it could entail.

Given the time required for that exercise, we believe that the immediate interest of shareowners and companies in better communications would be better and more effectively served with the incremental approach that promotes less reliance on — or eliminates altogether — the OBO/NOBO distinction and otherwise increases the potential for direct communications.

The SEC has indicated that it will address the OBO/NOBO issue and ask whether the distinction is needed in a concept release to be drafted in the coming months.[124] Each of the potential reform proposals raises issues for particular groups of stakeholders. The interplay of these stakeholder interests will influence the direction of any reforms. Moreover, in considering any reform proposal with respect to shareowner communications, it is important to keep in mind the emphasis the SEC has placed historically on reliability of proxy delivery.[125] Even where the SEC agrees with the conceptual underpinnings of a particular proposal, the details of implementation will receive significant scrutiny involving both practical and political issues.

Operation of the OBO/NOBO Rules

The following summarizes the operation of the shareowner communication rules for broker and bank intermediaries. While the process is similar for these intermediaries, differences remain, largely attributable to the more limited scope of the SEC's authority over banks.

In both cases, communicating with beneficial owners requires that the company determine how many beneficial owners hold its securities and details of NOBOs and distribute proxy materials. While all proxy cards and proxy statements must be distributed through the broker or bank intermediaries, annual reports and other communications may be sent to NOBOs directly. All communications with OBOs occur through the intermediaries.

Broker Intermediaries

Company contacts broker for information regarding beneficial owners. After a company receives information from DTC about participants that hold its shares held in street name,[1] it sends a "search card" to the broker nominee holders in which it seeks information relevant to the proxy distribution process, including the number of proxy cards, proxy solicitation materials, annual reports or other materials it must print.[2] A company must send such a search card when soliciting proxies, seeking consents in lieu of a meeting[3] or mailing information statements.[4] In the search card, the company must indicate whether it intends to distribute the annual report directly to beneficial owners, as it is permitted to do under Rule 14a-13(c).[5] The initial search card inquiry must be made at least 20 business days prior to the record date[6] (or, if impracticable, a shorter period as far in advance of the record date as practicable).[7]

Broker responds to company's request for information. Brokers must respond to the company's inquiry within seven business days of receipt of the search card.[8] The broker must indicate: (i) the approximate number of its customers who are the beneficial owners; (ii) the number of OBOs;[9] and (iii) the identity of any agent designated to fulfill the broker's Rule 14b-1(b)(3) obligations.[10] Almost all broker custodians delegate their Rule 14b-1(b)(3) obligations to Broadridge Financial Solutions (Broadridge).[11]

Broker provides company with NOBO list. If requested, the broker (or its agent) must provide the company with the names, addresses and securities positions of NOBOs.[12] The list need not identify the broker with which each NOBO holds its shares. Indeed, one benefit of delegating responsibility for the NOBO list to Broadridge is the broker's ability to keep such data private. The NOBO list must be transmitted to the company no later than five business days after the record date.[13]

Company sends proxies and other information materials to broker for distribution. The company must provide each broker intermediary with enough proxy materials to enable the broker to comply with its distribution obligations.[14] The company must send proxy cards and proxy solicitation materials through the broker or its agent, but it may send the annual report or other information materials directly to NOBOs.[15] Effective in 2007, the broker must send a "Notice of Internet Availability of Proxy Materials" to beneficial owners if the company is relying on the e-proxy rules.[16]

Broker forwards proxy and other information materials to beneficial owners. The broker must forward proxy and other information materials to beneficial owners no later than five business days after receiving them (other than the annual report in the case of NOBOs, if the company has indicated its intention to send that document directly).[17] Brokers may delegate the forwarding of proxy materials to an agent, and almost all use Broadridge for this purpose. The company must reimburse Broadridge's distribution expenses,[18] and the NYSE and the Financial Industry Regulatory Authority (FINRA) have established applicable fee schedules.[19] Because voting depends on record ownership, the broker (as the holder of record for voting purposes) must either (i) provide the beneficial owner with an executed proxy card or (ii) a request of voting instructions.[20] Generally, brokers choose the latter option.

Proxies are forwarded to the company. If a broker requests voting instructions from beneficial owners, it typically delegates the task of collecting and forwarding completed proxies to its agent, Broadridge. If a broker forwards an executed proxy to a beneficial owner, that beneficial owner could return a completed proxy to the company directly.

Bank Intermediaries

Company seeks information regarding beneficial owners from bank intermediary. After receiving information about bank custodians holding shares at the DTC, the company sends a search card to bank nominee holders seeking information from the bank.[21]

Bank intermediary identifies respondent banks. By contrast to the broker framework, the information-gathering process is more complex in the case of banks because many smaller bank custodians hold shares for beneficial owners through custodial accounts at larger banks (e.g., such as Bank of NY Mellon, JP Morgan, State Street or Citigroup). The larger banks only have records of the holdings by the smaller "respondent banks," not of the ultimate beneficial owners.[22] Sometimes there can be three or four tiers of respondent banks. A bank intermediary must identify all its respondent banks holding the company's shares within one business day of receipt of the company's search card.[23]

Company sends search card to respondent banks. Within one business day of receipt of information identifying respondent banks, the company must send the same search-card inquiry to the respondent banks.[24] The respondent banks have the same response obligations as the original bank intermediaries.

Bank responds more generally to company's request for information. Like brokers, a bank has seven business days to indicate: (i) the approximate number of beneficial owners who hold shares directly with the bank;[25] (ii) the number of NOBOs;[26] and (iii) the identity of any agent acting on behalf of the bank in providing NOBO lists. A bank intermediary may delegate its responsibility to respond to an agent, which is typically Broadridge.

Bank provides company with NOBO list. Upon request, banks (or their agent) must provide NOBO details no later than five business days after the date specified by the company,[27] but this obligation only applies to accounts opened after Dec. 28, 1986.[28] For accounts opened on or before Dec. 28, 1986, the disclosure is only required if a customer affirmatively consents.[29] Banks are required to make a good faith effort to obtain consent.[30]

Company sends proxy materials to bank intermediaries. The company has the same responsibility to forward proxy and other information materials to bank intermediaries as it has for broker intermediaries.[31]

Bank forwards proxies to beneficial owners. As in the case of brokers, banks either forward an executed proxy to the beneficial owners or request voting instructions.[32] (As with brokers, most banks use voting instructions.) Proxy materials must be forwarded no later than five business days after receipt,[33] and banks may use agents to distribute voting materials and collect votes. Banks (or their agents) may be reimbursed for their expenses and typically follow the rates set by the NYSE.[34] For respondent bank holders, banks execute an omnibus proxy in favor of the respondent banks within five business days after the record date.[35] Respondent banks in turn execute the omnibus proxy in favor of the next layer of respondent banks, and so forth. The final layer of respondent banks follows the same procedure for acquiring the proxies of the beneficial owners (generally using voting instructions) as set out above.

Diagrams of Shareowner Communications and Proxy Voting

Figure 1. Shareowner Communications: Broker Intermediary

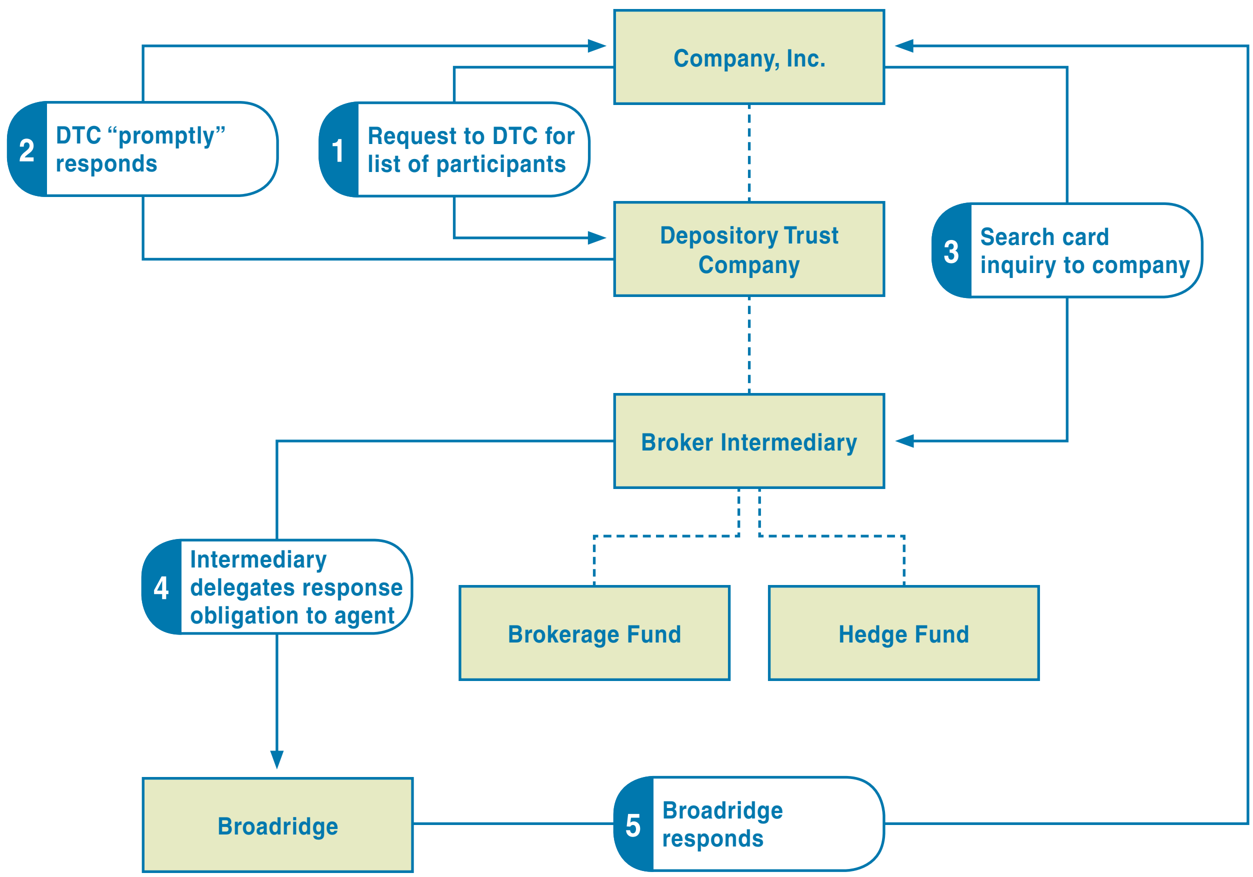


Figure 2. Shareowner Communications: Bank Intermediary

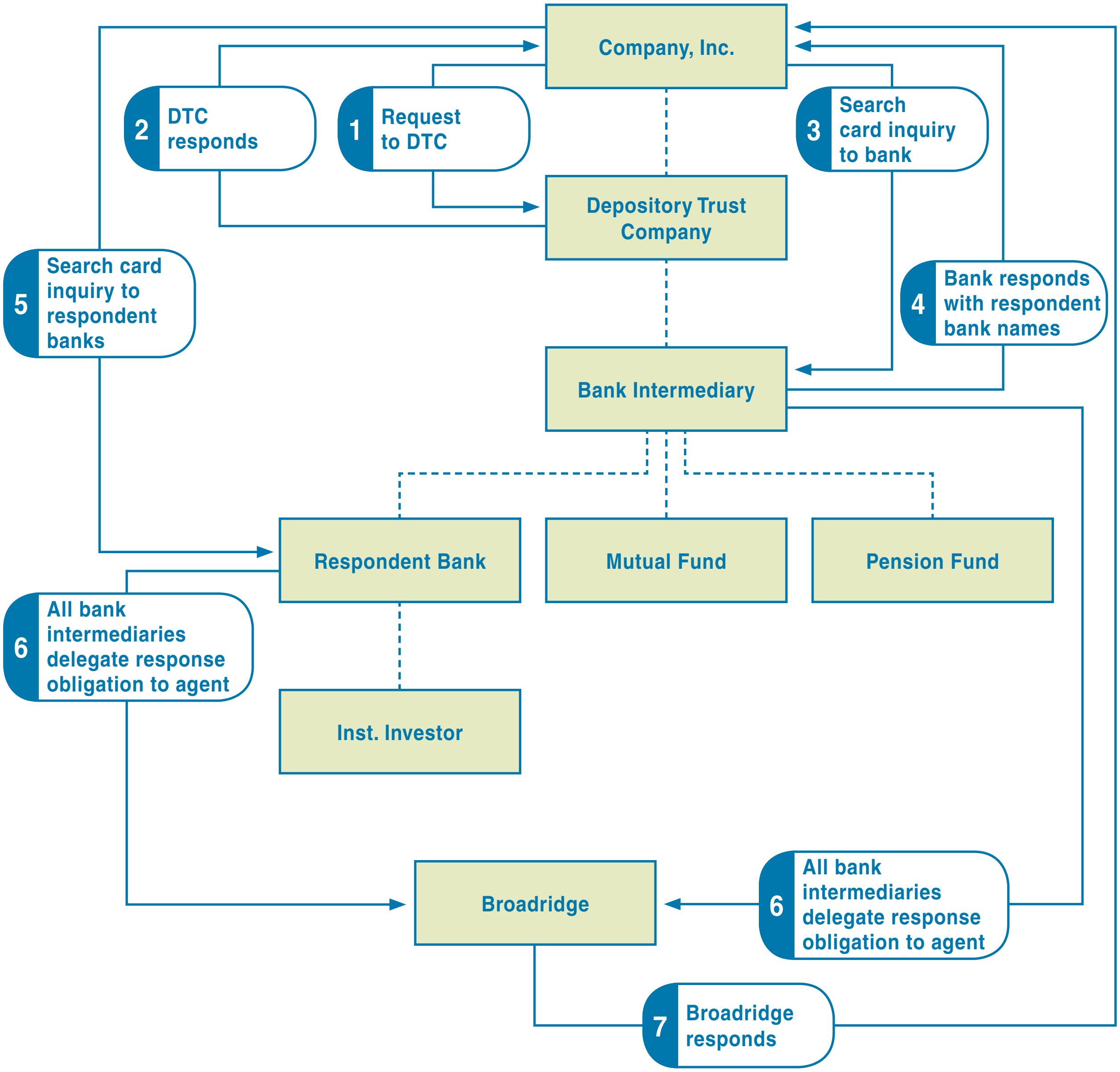


Figure 3. Shareowner Communications: NOBO Lists

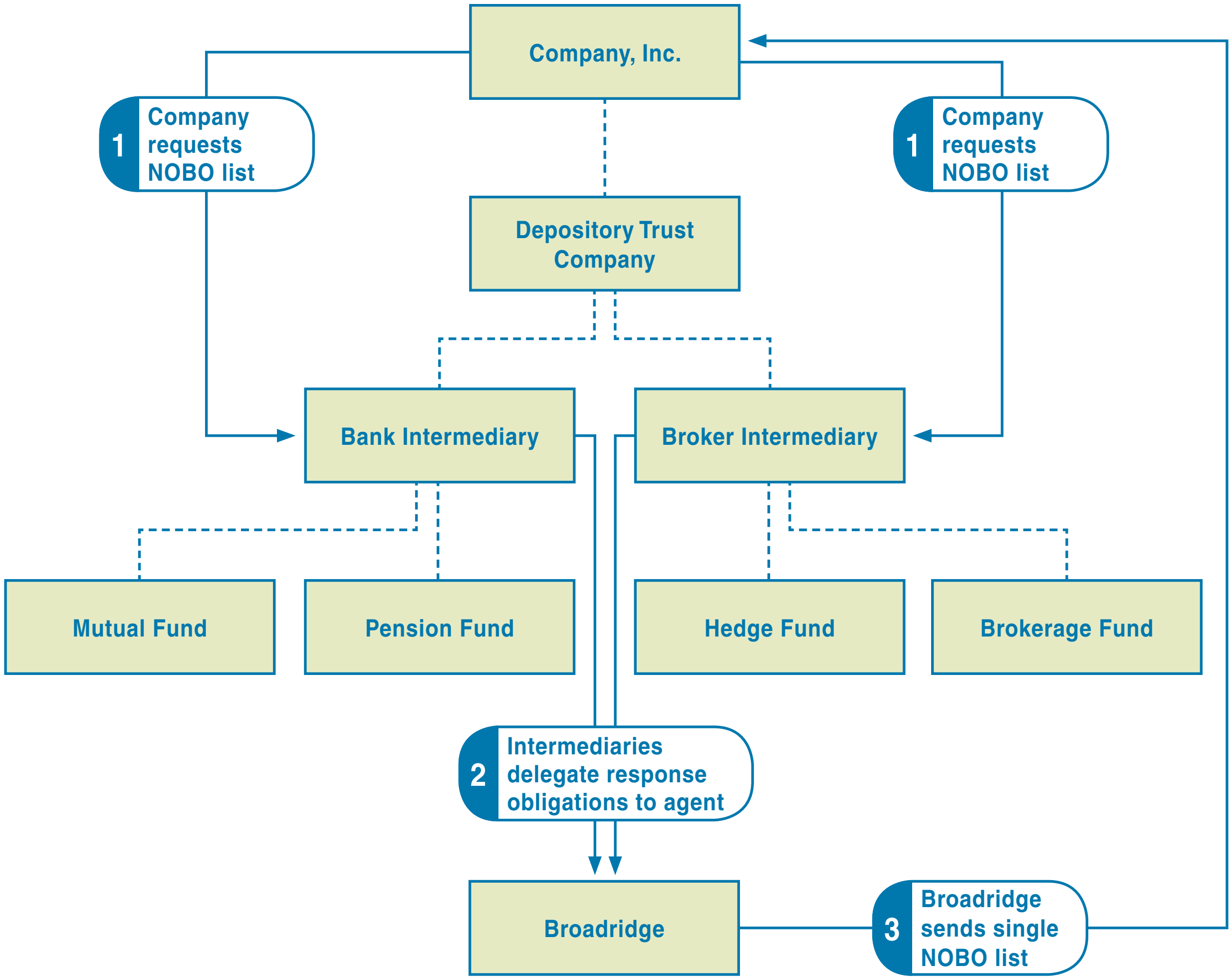


Figure 4. Proxy Voting: Part One

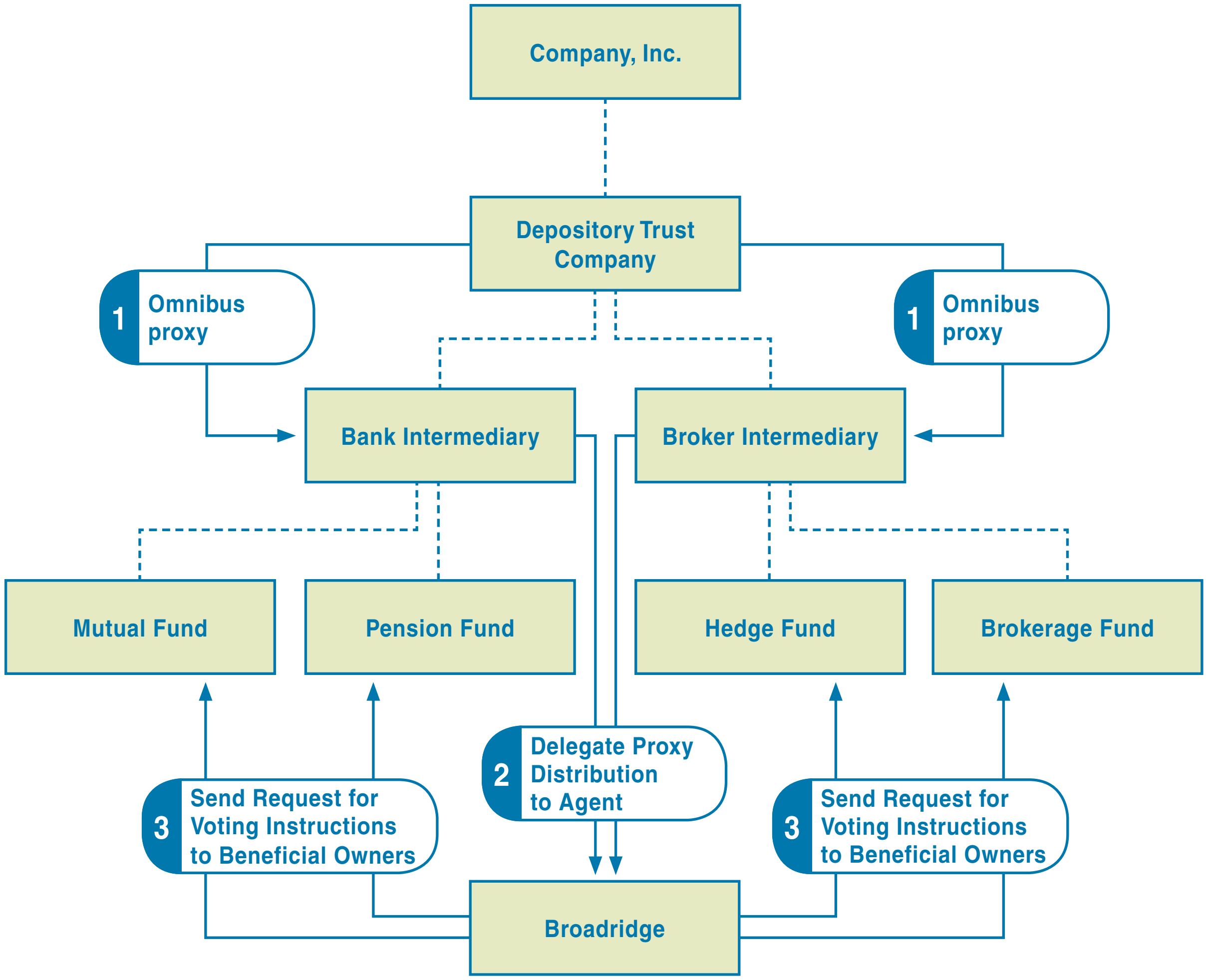


Figure 5. Proxy Voting: Part Two

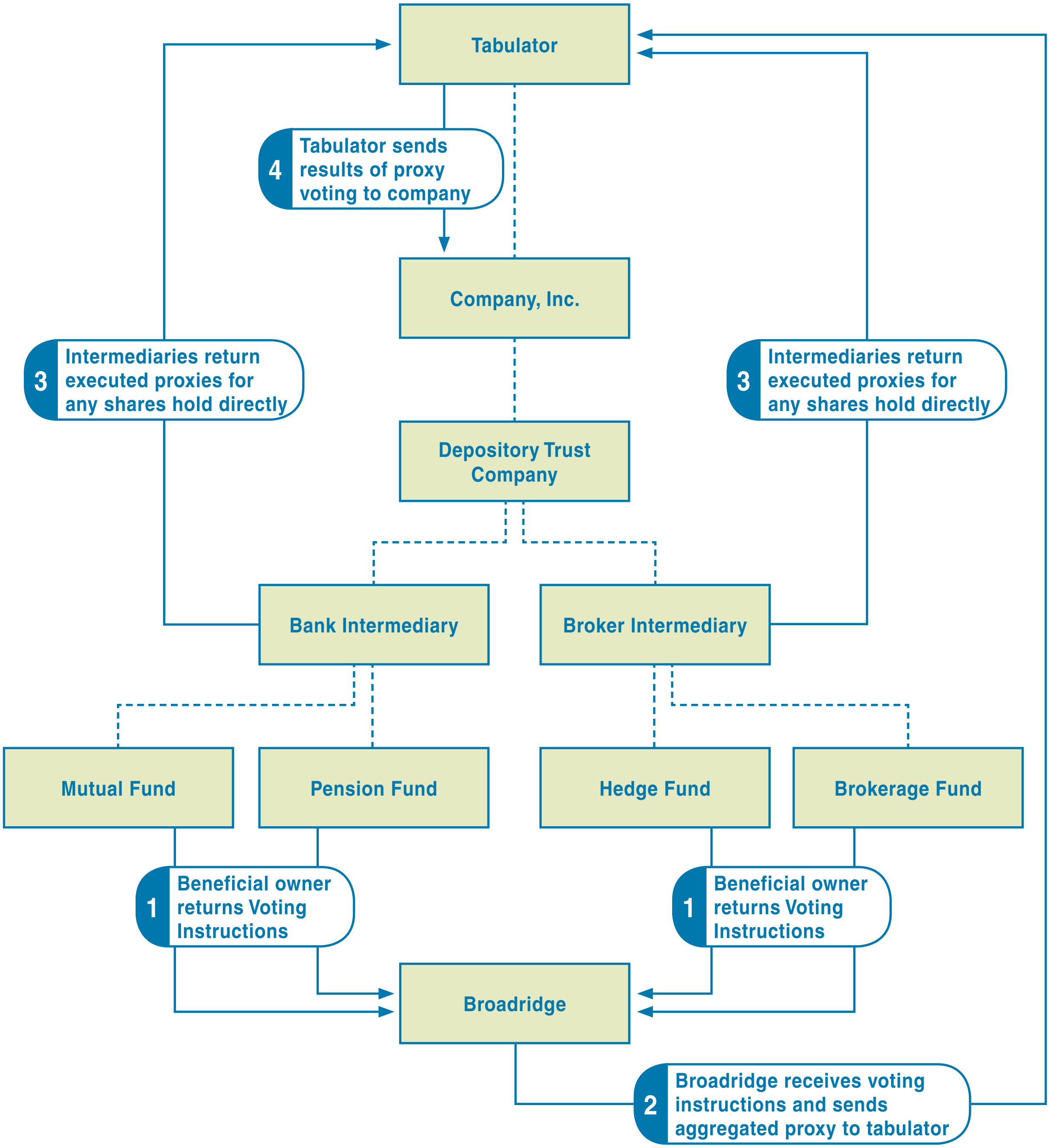
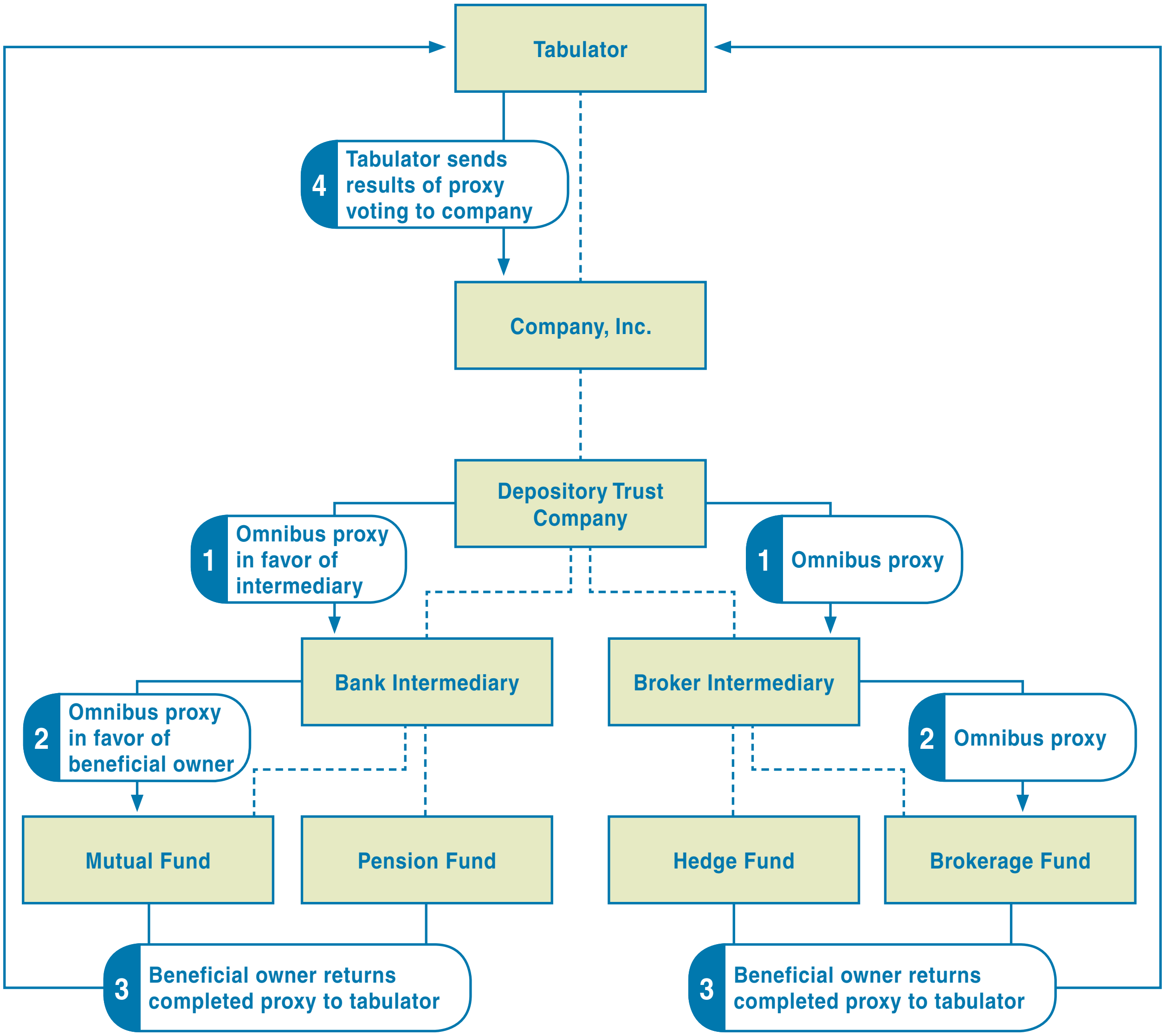


Figure 6. Proxy Voting: BRT Proposal



Shareowner Communication Framework

Exchange Act Section 14(b)[1]

Section 14(b) makes it unlawful for a broker-dealer or bank intermediary to give or refrain from giving a proxy or other information statement in a manner that violates SEC rules and grants the SEC regulatory authority with respect to communications involving the company, broker and bank intermediaries and beneficial owners.

Section 14(b) was enacted as part of the passage of the Exchange Act in 1934,[2] with the aim of addressing the concern that brokers were voting customer shares without first consulting them. The SEC did not use its rulemaking authority under this section due to questions about the scope of its authority, particularly whether it could force broker-dealers to distribute proxies.[3] Congress amended Section 14(b) in 1964 to clarify that the SEC could regulate brokers in this regard and require them to distribute proxy materials.[4]

The Shareholder Communications Act of 1985 extended the SEC's rulemaking authority with respect to proxy distribution to cover bank intermediaries.[5] Bank regulatory authorities had authority, but refused to implement rules with respect to shareowner communications, despite SEC requests to do so.[6] The 1985 amendments distinguished between the SEC's authority to require banks to produce lists of beneficial owners depending on whether a customer's account with the bank was (i) opened on or before Dec. 28, 1985 or (ii) opened after Dec. 28, 1985. For the latter, the SEC had the same authority as it had for brokers (i.e., it could require disclosure of a NOBO list). For the former, it could only require disclosure of the beneficial owners for customers who affirmatively consented to such disclosure. This was a compromise to address banks' concern about existing customers' expectation of privacy.[7]

In 1990, Section 14(b) was amended to extend the proxy forwarding requirements to securities issued by investment companies covered by the Investment Company Act of 1940.[8]

Exchange Act Rule 14a-13[9]

Rule 14a-13 outlines a company's obligations with respect to shareowner communications, particularly proxy solicitations, including its responsibilities to gather information from broker and bank intermediaries[10] and to forward sufficient quantities of proxy materials to permit distribution by intermediaries to beneficial owners.[11] The rule permits direct communication between the company and NOBOs in the limited form of the annual report.[12]

Rule 14a-13 was adopted in January 1986[13] and consolidated prior regulatory provisions. Concurrently with the adoption of Rule 14b-2, Rule 14a-13 was amended to reflect the incorporation of banks into the communications system as regulated by the SEC.[14] In 1992, Rule 14a-13 was amended to cover investment company securities.[15]

Exchange Act Rule 14b-1[16]

Rule 14b-1 outlines broker obligations to respond to information requests from companies about shares held in street name and requires brokers to forward proxy materials to beneficial owners.[17] Rule 14b-1(b)(3) requires brokers to provide NOBO lists.

Rule 14b-1 was adopted in 1977, but did not take its current form until the 1983 amendments.[18] The SEC proposed amended Rule 14b-1 in December 1982,[19] with a view to facilitating communications between companies and beneficial owners, allowing direct communication in some cases. In part to retain the existing framework, which it found workable and facilitated the immobilization of share certificates,[20] the SEC adopted a system that incorporated direct communications with NOBOs into a general system of communication with beneficial owners through intermediaries. The proposed rules were scheduled to become effective on Jan.1, 1985,[21] but effectiveness was deferred for one year to Jan.1, 1986[22] to address broker concerns, particularly about cost. During the deferral, the SEC approved a provision allowing brokers to delegate their forwarding obligations to an agent and set time periods for brokers to respond to companies' information requests.[23] In 1992, the SEC amended Rule 14b-1 to impose on brokers comparable information and proxy-forwarding requirements with respect to registered investment companies.[24] In 2007, the SEC added subsections (d) and (e) to address distribution requirements for companies using the e-proxy rules.[25]

Exchange Act Rule 14b-2[26]

Rule 14b-2 extends the communication obligations of broker intermediaries to banks and generally imposes the same requirements. Differences exist that reflect the more limited scope of the SEC's regulatory authority. See Annex A for the differences in the two approaches.

Rule 14b-2 was adopted in November 1986 and became effective July 1, 1987.[27] As in the case of Rule 14b-1, the SEC amended Rule 14b-2 in 1992 to impose on banks comparable information and proxy forwarding requirements with respect to registered investment companies[28] and, in 2007, to reflect adoption of the e-proxy rules.[29]

Exchange Act Section 14(c)[30]

Section 14(c) requires a company that is not seeking proxies, consents or other authorizations from its shareowners to forward to all record holders information statements containing "information substantially equivalent to the information which would be required to be transmitted if a solicitation were made."[31] Companies must comply with SEC rules in distributing information.

Congress adopted Section 14(c) as part of the 1964 amendments to the Exchange Act with a view to allowing the SEC to regulate the distribution of information statements. The SEC was concerned that some companies were avoiding the proxy disclosure rules by choosing not to solicit proxies.[32]

Exchange Act Rule 14c-7[33]

Rule 14c-7 regulates a company's obligations with respect to shareowner communications and generally mirrors Rule 14a-13, but relates to materials that are "substantially similar" to those distributed with a proxy card, but that a company might distribute when not soliciting proxies.

Rule 14c-7 was first adopted in January 1986, consolidating all of a company's obligations with respect to the distribution of information statements into one rule.[34] Rule 14c-7 was amended concurrently with the adoption of Rule 14b-2 to reflect the integration of bank intermediaries into the shareowner communications system.[35]

Exchange Act Rule 17a-3(a)(9)[36]

Rule 17a-3(a)(9) facilitates the shareowner communication system by requiring members of national securities exchanges and registered broker-dealers to keep records of the names and addresses of customers who hold cash or margin accounts. The intermediary must also record OBO/NOBO status. The rule only applies to broker intermediaries, as the SEC does not have authority with respect to the books and records of banks.

Exchange Act Rule 17Ad-8[37]

Enacted in 1979, Rule 17Ad-8 also facilitates the shareowner communication system by requiring registered clearing agencies to furnish a company with a position listing on request.[38] The Depository Trust Company (DTC) is the sole U.S. depository institution and the holder of record for shares immobilized with it, including shares held in street name through its participants. In particular, the rule allows a company to determine which broker and bank intermediaries that are DTC participants hold shares in street or nominee name.

Endnotes

Sections I – VIII

[1] *See* J. Robert Brown, Jr. *Shareholder Communication Rules and the SEC: An Exercise in Regulatory Utility or Futility?,* 13 J. Corp. L. 683, 687-88 (1988). Banks most typically use nominee partnerships to hold shares on behalf of their customers. See Louis Loss et al., Securities Regulation 664 (4th ed. 2006).

[2] *See* Loss et al., *supra* note 1, at 664.

[3] *See* Order Granting Approval to Proposed Rule Change Relating to a One-Year Pilot Program for Transmission of Proxy and Other Shareholder Communication, SEC Release No. 34-38406 (Mar. 14, 1997), at n.5.

[4] *See* Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Governance*, 96 Geo.L.J. 1227, 1237 (2008).

[5] *See* 17 C.F.R. § 240.14a-13(c) (2009).

[6] *Id.* § 240.14a-3(a). Brokers typically forward the proxies using first class mail. *See* Brown, *supra* note 1, at 761-62. A company choosing to forward the annual report directly also would have to use first class mail to ensure it met the requirement of preceding the proxy. As a result, the company likely would not realize cost savings if it choose to forward the annual report directly.

[7] *See* SEC, Report of the Advisory Committee on Shareholder Communications, Improving Communications Between Issuers and Beneficial Owners of Nominee Held Securities 70 (1982) (Advisory Committee Report).

[8] *See* 17 C.F.R. § 240.14b-1(b)(3)(i) (brokers); *Id.* § 240.14b-2(b)(4)(ii)(B) (banks).

[9] Because Broadridge is the agent for essentially all intermediaries in the proxy process described herein, we refer to the intermediaries' agent as Broadridge in this memorandum.

[10] *See* 17 C.F.R. § 240.14b-1(b)(3)(i) (brokers); *Id.* § 240.14b-2(b)(4)(ii) (banks).

[11] As noted, the standard for disclosure under the OBO/NOBO regime is that one must affirmatively object to disclosure for the broker to withhold a beneficial owner's information from the company. See Facilitating Shareowner Communications, SEC Release No. 34-19291, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,282 at 10 (Dec. 10, 1982) (SEC 1982 Release). However, in the case of bank intermediaries, the standard of consent differs between customer accounts opened on or before December 28, 1986 (the effective date on which the standard of consent in respect of accounts held at bank intermediaries was modified), and those opened after. For the former, the customer must affirmatively consent to such disclosure, as opposed to simply not objecting. 17 C.F.R. § 240.14b-2(b)(4)(ii)(A). Please refer to Annex A for more details.

[12] *See* Report and Recommendations of the Proxy Working Group to the New York Stock Exchange 11 (2006), *available at* http://www.nyse.com/pdfs/PWG_REPORT.pdf (PWG Report).

[13] Bus. Roundtable, Request for Rulemaking Concerning Shareholder Communications, Petition 4-493, Apr. 12, 2004, at n.2, http://www.sec.gov/rules/petitions/petn4-493.htm (BRT Proposal).

[14] *See* 17 C.F.R. § 240.17Ad-8(b).

[15] *See Id.* § 240.14a-13(a)(1), *id.* § 240.14a-13(a)(3). If the 20 days proves impracticable, the company must act as many days before the record date as is practicable. *Id.* § 240.14a-13(a)(3). Note that in Delaware, the record date must be not more than 60 days but not less than 10 days prior to the meeting date. Del. Code Ann, tit. 8, § 213 (2009).

[16] *See* 17 C.F.R. § 240.14b-1(b)(1).

17 *Id.* § 240.14b-2(b)(1)(i). Under SEC Rules, "respondent bank" is defined as "any bank, association or other entity that exercises fiduciary powers which holds securities on behalf of beneficial owners and deposits such securities for safekeeping with another bank, association or other entity that exercises fiduciary powers." *Id.* § 240.14a-1(k).

18 *Id.* § 240.14a-13(a)(2).

19 *Id.* § 240.14b-2(b)(1)(ii).

20 *Id.* § 240.14a-13(b)(2).

21 *Id.* § 240.14b-1(b)(3)(i) (brokers); *Id.* § 240.14b-2(b)(4)(ii) (banks).

22 *Id.* § 240.14b-1(b)(3)(ii) (brokers) ("no later than five business days after the record date or other date specified by the registrant"); *Id.* § 240.14b-2(b)(4)(iii) (banks) ("no later than five business days after the date specified by the registrant").

23 *Id.* § 240.14a-13(a)(4).

24 *See Id.* § 240.14b-1(b)(2) (rule requiring brokers to forward a company's communications); *Id.* § 240.14-2(b)(3) (rule requiring bank intermediaries to forward a company's communications).

25 *See Id.* § 14a-13(c) (companies may forward annual report directly to NOBOS); *Id.* § 240.14b-1(c)(2)(ii) (brokers need not forward annual report to NOBOs if company indicates its intention to do so); *Id.* § 240.14b-2(c)(2)(ii) (banks need not forward annual report to NOBOs if company indicates its intention to do so).

26 *See, e.g,* Del. Code Ann, tit. 8, §212 (2009).

27 *See* Kahan & Rock, *supra* note 4, at 1247.

28 *See* SEC, 94th Con., 2d Sess., Final Report of the Securities and Exchange Commission on the Practice of Recording the Ownership of Securities in the Records of the Issuer in other than the Name of the Beneficial Owner of Such Securities 15, House Comm. on Interstate and Foreign Com. (Comm. Print 1976) (Street Name Study).

29 *See* R. Franklin Balotti et al., Meetings of Stockholders § 10.7 (3d. ed. 1996 & Supp. 2002).

30 17 C.F.R. § 240.14b-1(b)(2) (for brokers); *id.* § 240.14b-2(b)(3) (for banks).

31 *See* Balotti et al., *supra* note 29, at § 10.7. See Kahan & Rock, *supra* note 4, at 1247.

32 Concerns have been raised about whether Broadridge always properly accounts for revoked votes and how it adjusts internally for overvoting. *See Id.* at 1253-54. It appears that the inability to audit Broadridge's verification process may be a function of state law. Under Delaware law, for example, election inspectors are limited in what they may examine to determine the validity of proxies, and in particular may only go beyond the proxy card in the limited circumstance of overvoting in cases of nominee holders. Del. Code Ann, tit. 8, § 231(d) (2009) ("In determining the validity and counting of proxies and ballots, *the inspectors shall be limited to an* examination of the proxies, any envelopes submitted with those proxies, any information provided in accordance with § 211(e) or § 212(c)(2) of this title, or any information provided pursuant to § 211(a)(2)(B)(i) or (iii) of this title, ballots and the regular books and records of the corporation, except that the inspectors may consider other reliable information for the limited purpose of reconciling proxies and ballots submitted by or on behalf of banks, brokers, their nominees or similar persons which represent more votes than the holder of a proxy is authorized by the record owner to cast or more votes than the stockholder holds of record (emphasis added).") .

33 *See* RiskMetrics Group, Proxy Voting Services for Institutional Investors, at 2, *available at* http://www.riskmetrics.com/sites/default/files/GS2-Proxy%20Voting%20Services.pdf (last visited Nov. 30, 2009).

34 *See, e.g.,* Egan-Jones Proxy Services, About Our Services, http://www.ejproxy.com/services.aspx ("Egan-Jones offers automated voting services for a small additional fee to eliminate the hassle and expense of handling this increasingly important aspect of the investment process. Plus, clients retain the ability to over-ride Egan-Jones's recommendations if desired."). Egan-Jones is another prominent proxy adviser in the U.S. market.

[35] *See* NYSE Inc., Rule 465 Supplementary Material; FINRA Inc., Rule 2260 Interpretive Material. NYSE Rule 465 specifies reasonable reimbursement rates members may charge companies, both listed and unlisted, for forwarding communications. Given that all broker intermediaries are members of NYSE, as is Broadridge, the NYSE fee schedule is the applicable one in almost all cases.

[36] Reimbursement of an amount no greater than that brokers are permitted to charge for reimbursement is deemed a reasonable amount. *See* NYSE Inc., Rule 465 Supplementary Material; FINRA Inc., Rule 2260 Interpretive Material for approved fee schedules.

[37] *See* Brown, *supra* note 1, at 715.

[38] *Id.* Under the old system of trading, shareowners held physical stock certificates registered with the issuer. To execute a trade, these certificates would be delivered to the transfer agent after sale and endorsed to the buyer of the stock. *See* Kahan & Rock, *supra* note 4, at 1237.

[39] *See* Brown, *supra* note 1, at 720.

[40] 15 U.S.C. §78q-1 (2009).

[41] *Id.* § 78q-1(e).

[42] Of course, in most cases today, the record holder is DTC. *See supra* note 4 and accompanying text.

[43] *See* Brown, *supra* note 1, at 693.

[44] *See Id.* at 721.

[45] *See* Street Name Study, *supra* note 28.

[46] *Id.* at 3.

[47] *Id.* at 42. The SEC found that 11 days prior to meetings, similar numbers of record and street name holders received proxies. *Id.* at 17. The SEC also found that companies with the highest percentage of street name ownership had the highest percentage of voting participation. *Id.* at 21.

[48] H.R. Rep. No. 181, 99th Cong., 1st Sess. 2-3 (1985) (emphasis added).

[49] *See* SEC Staff Report on Corporate Accountability, Division of Corporate Finance 7 (1980) (Staff Report).

[50] *Id.*

[51] *See Id.*

[52] *See, e.g., Id.* at 544. State corporate law in most, if not all, states provides that the board of directors manages the affairs of the corporation on the shareowner's behalf. *See, e.g.,* Del. Code Ann., tit. 8, § 141(a) (2009).

[53] *See* Brown, *supra* note 1, at 715 – 16.

[54] *See* Staff Report, *supra* note 49, at 29.

[55] *See* Street Name Study, *supra* note 28, at 2.

[56] *See* Staff Report, *supra* note 49, at 374-75.

[57] *See* Brown, *supra* note 1, at 735.

[58] *See* Advisory Committee Report, *supra* note 7, at 25-29.

[59] *See* Facilitating Shareholder Communications Provisions, Exchange Act Release No. 34-20021 (Aug. 3, 1983) (SEC 1983 Release).

[60] *See* Advisory Committee Report, *supra* note 7, at 55, 58-60.

[61] *See Id.* at 69.

[62] *See Id.* at 62-63. The issue of non-standardized lists is of course soluble; for example, Broadridge currently provides a standardized NOBO list to companies.

[63] *See Id*. at 69.

[64] *See* Facilitating Shareholder Communications, SEC Release No. 34-22533, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,930 (Oct. 15, 1985) (SEC 1985 Release).

[65] *See Id.*

[66] *See Id.*

[67] *See* Advisory Committee Report, *supra* note 7, at 29-31.

[68] *See* Brown, supra note 1, at 743.

[69] *See* Pub. L. No. 99-222, §2, 99 Stat. 1737 (1985).

[70] *See* Shareholder Communication Facilitation, SEC Release No. 34-23847 (Nov. 25, 1986). These rules became effective in 1987.

[71] In Delaware, quorum is a majority as a default, but can be set as low as one-third in the charter. Del. Code Ann., tit. 8, § 216 (2001).

[72] *See* Advisory Committee Report, *supra* note 7, at 68; SEC 1982 Release, *supra* note 11, at 10.

[73] *See* PWG Report, *supra* note 12, at ex. B at 3, 21.

[74] *See* Del. Code Ann., tit. 8, § 220 (2009). *See also* Model Bus. Corp. Act § 1602 (2005). The Model Business Corporation Act also requires shareowner lists to be available to all shareowners two days after notice of a meeting is given. *See* Model Bus. Corp. Act § 720.

[75] *See Shamrock Associates v. Texas American Energy Corp.,* 517 A.2d 658, 661 (Del. Ch. 1986).

[76] *See R.B. Associates of New Jersey v. Gillette Co.,* 1998 Del. Ch. LEXIS 40, *21 (Del. Ch. 1988).

[77] *See* 17 C.F.R. §240.14a-13(b)(4) (requiring companies to only use the list for "corporate communications"); *Shamrock Associates v. Texas American Energy Corp.,* 517 A.2d 658 (Del. Ch. 1986) (applying restrictions on companies with respect to use of NOBO lists to dissident shareowners using the same lists).

[78] *See* 17 C.F.R. § 240.13d-1.

[79] *See* The Altman Group, Practical Solutions to Improve the Proxy Voting System, Oct. 21, 2009, at 10, available at http://www.altmangroup.com/pdf/PracticalSolutionTAG.pdf.

[80] *See* Brown, *supra* note 1, at 766-67.

[81] *See* 17 C.F.R. § 240.14a-7 (2009).

[82] *See* Del. Code Ann., tit. 8, § 220 (2009). *See also* Model Bus. Corp. Act § 1602 (2005). The shareowner's request is a written demand made under oath that also provides evidence of beneficial ownership if the shareowner is not the record owner.

[83] *See Marathon Partners L.P. v. M&F Worldwide Corp.,* 2004 Del. Ch. LEXIS 101, *30, *37 (Del. Ch. 2004) (communication with other stockholders "to effectuate a change in management policies" held to be a proper purpose); *Conservative Caucus Research, Analysis & Educ. Foundation, Inc. v. Chevron Corp.,* 525 A.2d 569, 571 (Del. Ch. 1987) (communication with other stockholders regarding the economic risks of a company's business activity in Angola and a resolution that was proposed to be submitted in connection with an annual meeting held to be a proper purpose); *Weiss v. Anderson, Clayton & Co.,* C.A. No. 8488 (Del. Ch. May 22, 1986) (communication with other stockholders to encourage them to dissent from a merger and seek appraisal held to be a proper purpose). Under Delaware law, a "proper purpose" is defined as "a purpose reasonably related to such person's interest as a stockholder." *See* Del. Code Ann., tit. 8, § 220(b).

[84] *See Id.* § 220(c). *See also* Model Bus. Corp. Act § 1604 (2005). There is no reliable data on which to estimate the costs of litigating the propriety of a demand in these circumstances, but depending on the circumstances, the cost could be meaningful in amount.

[85] *See Id.*

[86] *See Shamrock Associates,* 517 A.2d 658.

[87] *See, e.g., Hibbert v. Hollywood Park, Inc.,* 457 A.2d 339, 345 (Del. 1983) (court held reimbursement acceptable for "reasonable expenses" in a proxy contest actually involving "substantive differences about corporation policy"); *Rosenfeld v. Fairchild Engine & Airplane Corp.,* 128 N.E.2d 291 (N.Y. 1955).

[88] 953 A.2d 227 (Del. 2008).

[89] Del. Code Ann., tit. 8, § 113 (2009). *See* 145th Delaware General Assembly, "An Act To Amend Title 8 of The Delaware Code Relating To The General Corporation Law," *available at* http://delcode.delaware.gov/sessionlaws/ga145/chp014.shtml. Any bylaw a company adopted likely would have to ensure the board had sufficient discretion over reimbursement such that it could satisfy its fiduciary duties, as Section 113 does not seem to trump the holding in *CA, Inc.,* and merely clarifies that propriety of a bylaw allowing reimbursement under Delaware law. The Committee on Corporate Laws of the Section of Business Law of the American Bar Association has proposed a similar amendment to the Model Business Corporation Act.

[90] *See* BRT Proposal, *supra* note 13.

[91] *See* Letter from Alexander M. Cutler, Chairman and Chief Executive Officer of Eaton Corporation and Chair, Corporate Leadership Initiative, Business Roundtable, to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n (Aug. 17, 2009), *available at* http://www.sec.gov/comments/s7-10-09/s71009-267.pdf; Letter from Henry A. McKinnell, Chairman, Business Roundtable, to Jonathan G. Katz, Sec'y, Sec. & Exch. Comm'n (Dec. 22, 2003), *available at* http://www.sec.gov/rules/proposed/s71903/s71903-381.pdf.

[92] *See* Letter from Niels Holch, Shareholder Communications Coalition Executive Director, to Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n (Aug. 8, 2009), *available at* http://shareholdercoalition.com/SCCLettertoSECChairmanMarySchapiroAug2009.pdf (SCC Letter). The Shareholder Communications Coalition consists of the Business Roundtable, the National Association of Corporate Directors, the National Investor Relations Institute, the Securities Transfer Association, and the Society of Corporate Secretaries and Governance Professionals.

[93] *See* BRT Proposal, *supra* note 13, at 6.

[94] *See* NYSE Inc., Rule 465 Supplementary Material.

[95] Small companies might not realize these cost-savings, however, because any scale effect of lower costs per distribution might not outweigh the fixed costs of implementing such a system.

[96] Letter from Donald D. Kittell, Executive Vice President, Sec. Indus. Ass'n, to Jonathan G. Katz, Sec'y, Sec. & Exch. Comm'n (June 24, 2004), *available at* http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/30454888.pdf (SIA Letter).

[97] *Cf.* Brown, *supra* note 1, at 725.

[98] *See* NYSE Inc., Rule 465 Supplementary Material for fee schedules.

[99] *See* Kahan & Rock, *supra* note 4, at 1240. Although retail customers holding shares in margin accounts and some institutional investors do not share securities lending fees, many institutional investors already share in such fees. *See Id.* at 1239. The amounts institutional investors may earn from securities lending fees can be substantial. For example, for the year ending in March 31, 2006, one institutional investor made $129.4 million from securities lending. *See Id.*

[100] *See Id.* at 1240.

[101] *See Id.* at 1273.

[102] *See Id.* at 1240.

[103] *See Id.* at 1238.

[104] *See* Broadridge, http://www.broadridge.com/about.asp (last visited Nov. 7, 2009).

[105] *See* Balotti, et al., *supra* note 29, at § 13.15.4; Kahan & Rock, *supra* note 4, at 1254.

[106] *See* PWG Report, *supra* note 12, at ex. B at 3.

[107] Currently, between 70-80 percent of street name holders are OBOs. *See supra* note 3 and accompanying text. If customers acted in line with their stated preferences in the PWG survey and investors generally shared similar preferences to retail investors, that would mean that only 36 percent of customers would be OBOs, or half the current number.

[108] 17 C.F.R. § 240.14b-1(b)(3)(i) (brokers); *Id.* § 240.14b-2(b)(4)(ii)(B) (banks). This standard is applicable only to customer accounts at banks opened after Dec. 28, 1986. Affirmative consent is required for customer accounts at banks opened on or before Dec. 28, 1986. *Id.* § 240.14b-2(b)(4)(ii)(A).

[109] *See* SEC 1983 Release, *supra* note 59, at 8.

[110] *See* NYSE Inc., Rule 465 Supplementary Material (list of fees that brokers and their agents may charge for provision of various services related to the proxy and communication distribution process). Banks typically follow the NYSE rules when determining the fees to charge.

[111] Given the retail customer response to an annual fee for privacy as noted previously, see *supra* note 73 and accompanying text, it seems unlikely that many retail holders would choose to invest via nominee accounts under such a system.

[112] *See* BRT Proposal, *supra* note 13. See Kahan & Rock, *supra* note 4, at 1271-72 for a summary. The BRT proposal is just one approach to a system of direct communications. Alternatives have been presented, many of which differ in minor respects from BRT's proposal. *See, e.g.,* SCC Letter, *supra* note 92. As one example, the Altman Group has proposed a system under which companies have access to the information of all beneficial owners (ABOs), but may only request the "ABO" list a limited number of times a year. This proposal contemplates a variety of alterations to the system of distributing proxy materials. *See* The Altman Group, *supra* note 79, at 12-13.

[113] *See,* e.g., 17 C.F.R. § 240.17a-3(a)(9) (requiring brokers to maintain records regarding information about the beneficial owners of an company's shares).

[114] The BRT proposal does not specify who would pay what fees under their communications framework and also does not state the specific requirements a shareowner must meet to be able to get the list for the purpose of soliciting support for its proxy proposal. However, in the latter case, likely the standard would be similar as that under state law currently. *See supra* notes 74-77 and accompanying text.

[115] *See* Advisory Committee Report, *supra* note 7, at 66.

[116] *See* SEC 1985 Release, *supra* note 64, at 2-3.

[117] *See* SIA Letter, *supra* note 96.

[118] *See*, e.g., *supra* note 48 and accompanying quote. Retail investor participation is a current issue of concern to the SEC. See Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n, Address to the Practicing Law Institute's 41st Annual Institute on Securities Regulation 7 (Nov. 4, 2009), *available at* http://www.sec.gov/news/speech/2009/spch110409mls.htm (Schapiro Speech).

[119] In the absence of legislation, the option to elect OBO status would presumably be retained for customer accounts maintained by banks and opened on or before Dec. 28, 1985. *See infra* Annex C, note 7 and accompanying text.

[120] While not directly germane to the communications framework, we note that the current large shareholder reporting threshold under Exchange Act Section 13 (beneficial ownership individually or as a part of a group of 5 percent or more of a company's voting securities) is probably too high. Both companies and other shareowners have a legitimate interest in knowing the identities of large investors, and for many companies that threshold is probably 3 percent or even 1 percent. It is noteworthy that the SEC incorporated lower ownership thresholds (1percent for large accelerated filers and 3 percent for accelerated filers) among the conditions for shareowner nominations of directors in its most recent proxy access proposal. Facilitating Shareholder Director Nominations, SEC Release Nos. 33-9046; 34-60089, IC-28765 (June 10, 2009).

[121] *See supra* note 62 and accompanying text.

[122] A single list is also an important step towards end-to-end audits of shareowner votes. Otherwise, votes from record holders who are also beneficial owners can be directly audited, but the number of votes of shares held in street name may only be compared against the number of shares held by record holders. *See* Kahan & Rock, supra note 4, at 1253.

[123] *See Id.* at 1253-55.

[124] *See* Schapiro Speech, *supra* note 118, at 7.

[125] Reliability of the proxy distribution system continues to be an emphasis of the SEC. *See Id.*

ANNEX A

[1] *See* 17 C.F.R. § 240.17Ad-8 (2009).

[2] *Id.* § 240.14a-13(a)(1)(i).

[3] *See Id.*

[4] *See Id.* § 240.14c-7(a)(1).

[5] *See Id.* § 240.14a-13(a)(1)(ii)(A). For distribution of an information statement not in connection with a proxy, *see Id.* § 240.14c-7(a)(1)(ii)(A).

[6] *Id.* § 240.14a-13(a)(3).

[7] *Id.* § 240.14a-13(a)(3)(i). A company also may be allowed a shorter period if a securities exchanges allows. *Id.* § 240.14a-13(a)(3)(iii).

[8] *Id.* § 240.14b-1(b)(1).

[9] This requirement is only applicable if the company has indicated under *Id.* § 240.14a-13(a)(1)(ii)(A) or *Id.* § 240.14c-7(a)(1)(ii)(A) that it will distribute the annual report to NOBOs.

[10] *Id.* § 240.14b-1(b)(1). A broker may inform a company in advance to forward such communications to its appointed agent.

[11] Broadridge used to be ADP Brokerage Services Group before it was spun off by ADP in 2007.

[12] 17 C.F.R. § 240.14b-1(b)(3)(i).

[13] *Id.* § 240.14b-1(b)(3)(ii). The company may also specify a date other than the record date. *See Id.*

[14] *Id.* § 240.14a-13(a)(4).

[15] *Id.* § 240.14a-13(c); *Id.* § 14c-7(c).

[16] *Id.* § 240.14b-1(d).

[17] *Id.* § 240.14b-1(b)(2).

[18] *Id.* § 240.14a-13(a)(5).

[19] *See* NYSE Inc., Rule 465 Supplementary Material and FINRA Inc., Rule 2260 Interpretive Material for approved fee schedules.

[20] 17 C.F.R. § 240.14b-1(b)(2).

[21] *Id.* § 240.14a-13(a)(1)(i). *See also Id.* § 240.14c-7(a)(1)(i) (forwarding information statements when not soliciting proxies).

[22] "Respondent bank" is defined at *Id.* § 240.14a-1(k).

[23] *Id.* § 240.14b-2(b)(1)(i).

[24] *Id.* § 240.14a-13(a)(2).

[25] *Id.* § 240.14b-1(b)(1)(ii)(A).

[26] *Id.* § 240.14b-2(b)(1)(ii)(B). This requirement is only applicable if the company has indicated under *Id.* § 240.14a-13(a)(1)(ii)(A) or *Id.* § 240.14c-7(a)(1)(ii)(A) that it will distribute the annual report to beneficial owners who do not object. Note that the relevant standard for consent depends on whether a customer account was opened on or before or after Dec. 28, 1986. For accounts opened on or before Dec. 28, 1986, the bank should indicate how many beneficial owners have affirmatively consented to disclosure of their names, addresses and securities positions. *Id.* § 240.14b-2(b)(1)(ii)(B)(1). For those accounts opened after Dec. 28, 1986, the relevant standard is customers who have not objected to disclosure of their information. *Id.* § 240.14b-2(b)(1)(ii)(B)(2).

[27] *Id.* § 240.14b-2(b)(4)(iii).

[28] *Id.* § 240.14b-2(b)(4)(ii)(B).

[29] *Id.* § 240.14b-2(b)(4)(ii)(A).

[30] *Id.* § 240.14b-2(b)(5).

[31] *Id.* § 240.14a-13(a)(4).

[32] *Id.* § 240.14b-2(b)(3).

[33] *Id.*

[34] *See Id.* § 240.14b-2(c)(3).

[35] *Id.* § 240.14b-2(b)(2)(i).

ANNEX C

[1] 15 U.S.C. § 78n(b) (2009).

[2] H.R. Rep. No. 1838, 73d Cong., 2d Sess. 16 (1934).

[3] *See* J. Robert Brown, Jr., *Shareholder Communication Rules and the SEC: An Exercise in Regulatory Utility or Futility?,* 13 J. Corp. L. 683, 700 (1988).

[4] *See Id.* at 711.

[5] *See* Pub. L. No. 99-222, §2, 99 Stat. 1737 (1985).

[6] Section 12(i) of the Exchange Act did require bank regulatory agencies to issue "substantially similar regulations to regulations and rules" that the SEC issued with respect to some provisions of the Exchange Act. See 15 U.S.C. § 78l(i) (1982). Section 14(b) was not one of the covered sections, however.

[7] *See* Brown, *supra* note 3, at 744.

[8] *See* Pub.L. No. 101-550, Title III § 302(b), 104 Stat. 2721(1990).

[9] 17 C.F.R. § 240.14a-13 (2009).

[10] *Id.* § 240.14a-13(a)(1).

[11] *Id.* § 240.14a-13(a)(4).

[12] *Id.* § 240.14a-13(c).

[13] *See* Facilitating Shareholder Communications, SEC Release No. 34-22533, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,930 (Oct. 15, 1985) (SEC 1985 Release).

[14] *See* Shareholder Communication Facilitation, SEC Release No. 34-23847 (Nov. 25, 1986) (SEC 1986 Release).

[15] *See* Shareholder Communication Rules, SEC Release No. 34-30147 (Jan. 10, 1992).

[16] 17 C.F.R. § 240.14b-1 (2009).

[17] *Id.*

[18] *See* Facilitating Shareholder Communications Provisions, Exchange Act Release No. 34-20021 (Aug. 3, 1983) (SEC 1983 Release).

[19] *See* Facilitating Shareholder Communications, SEC Release No. 34-19291, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,282 (Dec. 10, 1982).

[20] *See* Brown, *supra* note 3, at 735-36.

[21] *See* SEC 1983 Release, *supra* note 18.

[22] *See* SEC Release No. 34-21339 (Sept. 21, 1984).

[23] *See* SEC 1985 Release, *supra* note 13.

[24] *See* Shareholder Communication Rules, *supra* note 15.

[25] *See* Internet Availability of Proxy Materials, SEC Release No. 34–55146 (Mar. 30, 2007).

[26] 17 C.F.R. § 240.14b-2 (2009).

[27] *See* SEC 1986 Release, *supra* note 14.

[28] *See* Shareholder Communication Rules, *supra* note 15.

[29] *See* Internet Availability of Proxy Materials, *supra* note 25.

[30] 15 U.S.C. § 78n(c) (2009).

[31] *Id.*

[32] *See* Brown, *supra* note 3, at 712.

[33] 17 C.F.R. § 240.14c-7 (2009).

[34] *See* SEC 1985 Release, *supra* note 13.

[35] *See* SEC 1986 Release, *supra* note 14.

[36] 17 C.F.R. § 240.17a-3(a)(9) (2009).

[37] *Id.* § 240.17Ad-8.

[38] *Id.* § 240.17Ad-8(b).

Selected Resources

1. Securities Exchange Act of 1934
    a. 15 U.S.C. § 78n(b) (2009) (Section 14(b))
    b. 15 U.S.C. § 78n(c) (Section 14(c))
2. Rules under the Securities Exchange Act of 1934
    a. 17 C.F.R. § 240.14a-1 (2009)
    b. 17 C.F.R. § 240.14a-13
    c. 17 C.F.R. § 240.14b-1
    d. 17 C.F.R. § 240.14b-2
    e. 17 C.F.R. § 240.14c-1
    f. 17 C.F.R. § 240.14c-7
    g. 17 C.F.R. § 240.17a-3(a)(9)
    h. 17 C.F.R. § 240.17Ad-8
3. Marcel Kahan & Edward Rock, The Hanging Chads of Corporate Governance, 96 Geo. L.J. 1227 (2008)
4. J. Robert Brown, Jr., Shareholder Communication Rules and the SEC: An Exercise in Regulatory Utility or Futility?, 13 J. Corp. L. 683 (1988)
5. Report and Recommendations of the Proxy Working Group to the New York Stock Exchange (2006), available at http://www.nyse.com/pdfs/PWG_REPORT.pdf
6. Bus. Roundtable, Request for Rulemaking Concerning Shareholder Communications, Petition 4-493, Apr. 12, 2004, http://www.sec.gov/rules/petitions/petn4-493.htm
7. Letter from Niels Holch, Shareholder Communications Coalition Executive Director, to Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n (Aug. 8, 2009), available at http://shareownercoalition.com/SCCLettertoSECChairmanMarySchapiroAug2009.pdf
8. The Altman Group, Practical Solutions to Improve the Proxy Voting System, Oct. 21, 2009, http://www.altmangroup.com/pdf/PracticalSolutionTAG.pdf

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