

SEC Concept Release Solicits Comment on Proxy Voting System

The Securities and Exchange Commission (the "SEC") on July 14, 2010 published a concept release (the "Release") to solicit comments on the proxy voting system.¹ The SEC last performed a comprehensive review of the proxy system nearly 30 years ago and in the past few years has adopted rules to address specific concerns in proxy statement content and distribution. The SEC's use of a concept release, which solicits comments and input before rules are drafted, reflects an intention to conduct a complete review of the system now.

It is unclear, however, what the SEC's timing will be regarding this Release since Section 971 of the newly-enacted Dodd-Frank Wall Street Reform and Consumer Protection Act allows the SEC to issue rules permitting shareholders to use an issuer's proxy materials to nominate directors and the SEC has already proposed, but not yet finalized, rules regarding this topic of proxy access.² The SEC may choose to work on these two mandates simultaneously or one may take precedent over the other.

The Release asks "whether the U.S. proxy system as a whole operates with the accuracy, reliability,

transparency, accountability, and integrity that shareholders and issuers should rightfully expect" and focuses on three general areas: (1) the voting process; (2) communications and shareholder participation; and (3) the relationship between voting power and economic interest. The topics addressed are over-voting and under-voting of shares, vote confirmation, proxy voting by institutional securities lenders, proxy distribution fees, issuers' ability to communicate with beneficial owners of securities, possible ways to improve retail investor voting participation, tagging proxy-related data, the role of proxy advisory firms, dual record dates and "empty voting" when a shareholder's voting rights substantially exceed its economic interest in the issuer.

The public has until October 20, 2010 to comment on the Release. The use of a concept release indicates that even if the SEC decides to focus on this Release and the pending proxy access rules simultaneously, new rules will not be adopted until next year. Notwithstanding that, the following are some issues to consider now.

¹ The release can be found at <http://www.sec.gov/rules/concept/2010/34-62495.pdf>.

² See Facilitating Shareholder Director Nominations, Release Nos. 33-9046, 34-60089 (June 10, 2009), which can be found at <http://www.sec.gov/rules/proposed/2009/33-9046.pdf>.

Accuracy, Transparency, and Efficiency of the Voting Process

Over-Voting and Under-Voting

The Release raises concerns about securities intermediaries voting more shares than they are entitled to vote, often due to securities lending transactions or a broker-dealer's failure to timely deliver a security.

Loaned Securities and Advance Notice of Meeting Agenda

Many institutional investors lend out their portfolio securities to earn additional income. Because voting rights generally transfer with the securities to the borrower, the lender must terminate these loans and recall the loaned securities before the record date for a shareholder meeting in order to be able to vote the securities. Currently many securities lenders learn of upcoming votes too late to recall their securities loans and regain their voting rights. The SEC is soliciting comment as to whether issuers should be required to publicly disclose their upcoming meeting agenda sufficiently in advance of the meeting's record date to enable securities lenders to decide if they wish to terminate their outstanding securities loans so that they may vote at the upcoming meeting. Such a change may require issuers to prepare their meeting agendas earlier and it is unclear if published agendas may later be changed.

Proxy Distribution Fees

Banks and broker-dealers must distribute certain issuer materials to their customers who are beneficial owners of that issuer's securities. In turn, issuers must reimburse the reasonable expenses of the bank or broker. Currently, self-regulatory organization ("SRO") rules set the maximum amount of reimbursement that can be received for such distributions, however no maximum fees have been established regarding the delivery of proxy materials using the notice and access method.³ The SEC is soliciting comment on whether it would be better for the marketplace, and not SRO rules,

³ Since 2007, issuers may opt to use the notice and access model to send shareholders a Notice of Internet Availability of Proxy Materials instead of full paper copies of the proxy statement, annual report and proxy card.

to set reasonable reimbursement rates for the distribution of proxy materials. Such a process might give issuers more control over the selection of, and payment to, a proxy service provider, but it is unknown if such a market-based system would increase or decrease issuers' costs.

Communications and Shareholder Participation

Issuer Communications with Shareholders

To facilitate the processing of a large number of securities transactions, the practice developed in the United States to insert securities intermediaries between issuers and the beneficial owners of the securities. Many beneficial owners object to disclosure of their names and addresses to the issuer and these "objecting beneficial owners" or "OBOs" can only be directly contacted by the intermediary with whom such beneficial owner has a relationship.⁴ Such a system restricts an issuer's ability to have direct communication with its shareholders. The SEC is seeking comment on possible revisions to standard practices to enable issuers to communicate directly with their shareholders. One concern is whether beneficial owners are entitled to privacy with respect to their ownership positions. Some shareholders, particularly certain institutional investors, wish to keep their ownership positions private, whether to minimize the queries they receive regarding their investments or to protect their investment strategies for competitive reasons.

Relationship Between Voting Power and Economic Interest

Proxy Advisory Firms

The Release raises concerns about the role of proxy advisory firms, particularly regarding potential conflicts of interest and the lack of accuracy and transparency in how the proxy advisory firms develop their voting

⁴ Conversely, banks and brokers are required to provide issuers, at their request, with the names and addresses of NOBOs, or non-objecting beneficial owners.

recommendations. As the SEC seeks comment on the possible need for additional regulations to address these concerns, issuers should re-examine their relationships with proxy advisory firms for potential conflicts of interest. For instance, a conflict of interest exists when a proxy advisory firm offers consulting services to an issuer regarding a particular matter and also provides voting recommendations on that same matter. Companies should keep these concerns in mind when retaining proxy advisory firms.

Many of the issues raised by the Release are complex and will attract a large number of comments, all of which will be posted on the SEC's website.



This update was authored by Christopher G. Karras (+1 215 994 2412; christopher.karras@dechert.com) and Sara R. Bucholtz (+1 609 955 3273; sara.bucholtz@dechert.com).

Practice group contacts

For more information, please contact one of the lawyers listed, the Dechert attorney with whom you regularly work. Visit us at www.dechert.com/corporateandsecurities.

If you would like to receive any of our other *DechertOnPoints*, please [click here](#).

Stéphan Alamowitch

Paris
+33 1 57 57 80 90
stephan.alamowitch@dechert.com

Abbi L. Cohen

Philadelphia
+1 215 994 2352
abbi.cohen@dechert.com

Graham Defries

London
+44 20 7184 7661
graham.defries@dechert.com

Jay R. Alicandri

New York
+1 212 698 3800
jay.alicandri@dechert.com

James Croock

London
Hong Kong: +852 2273 5832
London: +44 20 7184 7660
james.croock@dechert.com

Eric Deltour

Brussels
+32 2 535 5418
eric.deltour@dechert.com

Jonathan Angell

London
+44 20 7184 7586
jonathan.angell@dechert.com

Carl A. de Brito

New York
+1 212 698 3543
carl.debrito@dechert.com

David S. Denious

Philadelphia
+1 215 994 2177
david.denious@dechert.com

Bonnie A. Barsamian

New York
+1 212 698 3520
bonnie.barsamian@dechert.com

Ella De Trizio

Princeton
+1 609 955 3211
ella.detrizio@dechert.com

Adam M. Fox

New York
+1 212 649 8732
adam.fox@dechert.com

Laura M. Brank

London, Moscow
London: +44 20 7184 7870
Moscow: +7 499 922 1110
laura.branks@dechert.com

Shane R. DeBeer

London, Moscow
London: +44 20 7184 7871
Moscow: +7 499 922 1133
shane.debeer@dechert.com

Thomas J. Friedmann

Washington, D.C.
+1 202 261 3313
thomas.friedmann@dechert.com

Kristopher D. Brown

New York
+1 212 698 3679
kristopher.brown@dechert.com

Alain Decombe

Paris
+33 1 57 57 82 82
alain.decombe@dechert.com

Sarah B. Gelb

Philadelphia
+1 215 994 2763
sarah.gelb@dechert.com

Sean Geraghty

London
+44 20 7184 7540
sean.geraghty@dechert.com

Douglas L. Getter

London
+44 20 7184 7425
douglas.getter@dechert.com

Craig L. Godshall

Hong Kong, Philadelphia
Hong Kong: +852 3518 4700
Philadelphia: +1 215 994 2491
craig.godshall@dechert.com

Richard A. Goldberg

New York
+1 212 649 8740
richard.goldberg@dechert.com

René H. Gonne

Brussels
+32 2 535 5421
rene.gonne@dechert.com

Gary L. Green

Philadelphia
+1 215 994 2656
gary.green@dechert.com

Ian A. Hartman

Philadelphia
+1 215 994 2277
ian.hartman@dechert.com

François Hellot

Paris
+33 1 57 57 80 85
francois.hellot@dechert.com

Berthold Hummel

Munich
+49 89 21 21 63 12
berthold.hummel@dechert.com

Basil H. Hwang

Hong Kong
+852 3518 4788
basil.hwang@dechert.com

Ronald R. Jewell

New York
+1 212 698 3589
ronald.jewell@dechert.com

Christopher G. Karras

London, Philadelphia
London: +44 20 7184 7412
Philadelphia: +1 215 994 2412
christopher.karras@dechert.com

Jeffrey M. Katz

New York
+1 212 698 3665
jeffrey.katz@dechert.com

Howard Kleinman

New York
+1 212 698 3567
howard.kleinman@dechert.com

John D. LaRocca

Philadelphia
+1 215 994 2778
john.larocca@dechert.com

William G. Lawlor

Philadelphia
+1 215 994 2823
william.lawlor@dechert.com

James A. Lebovitz

Philadelphia
+1 215 994 2510
james.lebovitz@dechert.com

R. Jeffrey Legath

Philadelphia
+1 215 994 2365
jeffrey.legath@dechert.com

Stephen M. Leitzell

Philadelphia
+1 215 994 2621
stephen.leitzell@dechert.com

Adam Levin

London
+44 20 7184 7564
adam.levin@dechert.com

James J. Marino

Princeton
+1 609 955 3230
james.marino@dechert.com

Dr. Michael H. Meissner, LL.M.

Munich
+49 89 21 21 63 14
michael.meissner@dechert.com

Harold I.G. Minjauw

Brussels
+32 2 535 5423
harold.minjauw@dechert.com

Corinna Mitchell

London
+44 20 7184 7890
corinna.mitchell@dechert.com

Fabrice Mourlon Beernaert

Brussels
+32 2 535 5422
fabrice.mourlonbeernaert@dechert.com

Henry N. Nassau

Philadelphia
+1 215 994 2138
henry.nassau@dechert.com

Martin Nussbaum

New York
+1 212 698 3596
martin.nussbaum@dechert.com

Daniel O'Donnell

Philadelphia
+1 215 994 2762
daniel.odonnell@dechert.com

Federico G. Pappalardo

Munich
+49 89 21 21 63 11
federico.pappalardo@dechert.com

Sean H. Porter

New York
+1 212 698 3579
sean.porter@dechert.com

Wayne Rapozo

London
+44 20 7184 7671
wayne.rapozo@dechert.com

Carmen J. Romano

Philadelphia
+1 215 994 2971
carmen.romano@dechert.com

David S. Rosenthal

New York
+1 212 698 3616
david.rosenthal@dechert.com

David E. Schulman
London, Washington, D.C.
+1 202 261 3440
david.schulman@dechert.com

Jonathan A. Schur
Paris
+33 1 57 57 80 53
jonathan.schur@dechert.com

Eric S. Siegel
Philadelphia
+1 215 994 2757
eric.siegel@dechert.com

Geraldine A. Sinatra
Philadelphia
+1 215 994 2824
geraldine.sinatra@dechert.com

R. Craig Smith
Philadelphia
+1 215 994 2769
craig.smith@dechert.com

Richard J. Temko
Brussels
+32 2 535 5430
richard.temko@dechert.com

Mark E. Thierfelder
New York
+1 212 698 3804
mark.thierfelder@dechert.com

James Waddington
London
+44 20 7184 7746
james.waddington@dechert.com

Geoffrey Walters
London
+44 20 7184 7426
geoffrey.walters@dechert.com

Henry Wang
Beijing
+8610 5829 1318
henry.wang@dechert.com

Charles I. Weissman
New York
+1 212 698 3847
charles.weissman@dechert.com

Barton J. Winokur
New York, Philadelphia
New York: +1 212 698 3575
Philadelphia: +1 215 994 2505
barton.winokur@dechert.com

Derek M. Winokur
New York
+1 212 698 3860
derek.winokur@dechert.com

Scott M. Zimmerman
New York
+1 212 698 3613
scott.zimmerman@dechert.com