

SEC Seeks Comments on U.S. Proxy System

On July 14, 2010, the Securities and Exchange Commission approved the issuance of a long-anticipated concept release concerning the U.S. proxy system.¹ The SEC seeks comment on a broad range of issues that affect the voting infrastructure applicable to U.S. public companies, including communications with beneficial holders, the role of proxy advisory firms and the “empty voting” of shares.

The last time that the SEC conducted a comprehensive review of proxy fundamentals was almost 30 years ago. During the SEC’s recent rulemakings on discreet proxy-related topics, commentators have provided feedback on a number of issues pertaining to “proxy plumbing,” a generic reference to the many technical aspects of the proxy system that can significantly affect vote outcomes. The Concept Release is an effort by the SEC to gather information from interested parties, and is likely the first step toward a new set of rule proposals.

Comments on the Concept Release must be received by the SEC on or before October 20, 2010. Due to the length of time needed for the SEC to analyze comment letters and follow its normal rulemaking process, it is unlikely that any significant changes regarding these topics will be effective for the 2011 proxy season.

Request for Comments

The SEC is soliciting responses to over 350 specific questions in the Concept Release. In many instances, the SEC has not yet determined whether additional regulation is needed and appears to be interested primarily in receiving empirical data about the nature and significance of a perceived problem. Set forth below is a list of the broad subject matter categories addressed in the Concept Release.

A. Issuers’ ability to communicate with beneficial owners of securities

Based on data presented in an NYSE Proxy Working Group report, the majority of all shares of public issuers are held by “objecting beneficial owners,” or “OBOs.”² OBOs may be contacted only by the applicable securities intermediary (for example, the broker holding the shares in “street” name) and have not given permission for their names and addresses to be shared with the issuer. Issuers are often frustrated by their inability to communicate directly with beneficial holders. This is particularly true in light of recent regulatory changes and trends, such as the elimination of broker discretionary voting for uncontested director elections, the movement toward majority voting for directors and the increasing number of contested proxy issues. The SEC would like interested parties to comment on the regulatory framework for OBO status and possible reforms allowing more interaction between companies and the beneficial owners of their securities.

¹ Securities Exchange Act Release No. 34-62495 (July 14, 2010), 75 Fed. Reg. 42982 (July 22, 2010) (the “Concept Release”).

² Report and Recommendations of the Proxy Working Group to the New York Stock Exchange, dated June 5, 2006, available at http://www.nyse.com/pdfs/REVISED_NYSE_Report_6_5_06.pdf.

B. Role of proxy advisory firms

The SEC observes in the Concept Release that the use of proxy advisory firms by institutional investors has substantially increased in recent years and that proxy advisory firms may be highly influential in determining the outcome of shareholder votes. The Business Roundtable suggested to the SEC in a 2009 comment letter that proxy advisory firms “exert a strong influence on proxy voting decisions of institutional investors” and that some institutional investors are “unwilling to deviate from the suggestions of such firms, even in light of a company’s individual circumstances.”³ The SEC believes that the use of proxy advisory firms raises a number of potential issues. Conflicts of interest may exist between the proxy advisory firm and the institutional investors being advised, as well as the issuer, and such conflicts may not be appropriately disclosed and managed. Also, the dissemination of proxy recommendations without sufficient oversight or accountability may impair informed shareholder voting.

In the Concept Release, the SEC requests comments about the control or influence that proxy advisory firms have in the shareholder voting process. The SEC describes the possible oversight of proxy advisory firms through the Advisers Act, Exchange Act proxy solicitation rules, and/or a regulatory framework similar to that governing credit rating agencies.

C. “Empty voting”

“Empty voting” refers to circumstances in which a shareholder has voting rights with respect to certain securities but little or no economic interest in such securities as a result of hedging strategies, securities lending activities, a single record date for both meeting notice and voting, or other reasons. The SEC believes that empty voting presents a potentially serious problem in that a core assumption of the corporate franchise is that voting shareholders have an economic stake in the matters on which they are voting.

The SEC would like to receive comments about mechanisms through which voting rights may be “decoupled” from economic interests. The SEC is considering new or enhanced disclosure requirements that would provide transparency for decoupling activities. The SEC also appears open to more stringent prohibitions of empty voting under certain circumstances, depending on its findings during the Concept Release process.

D. Dual record dates

Recent changes to the corporate codes in Delaware and other states permit, but do not require, corporations to establish two

record dates with respect to a scheduled meeting. Different records dates may be used to establish the shareholders entitled to receive notice of the meeting and the shareholders entitled to vote at the meeting. These changes in Delaware law allow the voting record date to be established very close to the meeting date, thus increasing the probability that the shareholders casting votes continue to own the securities they are voting.

In the Concept Release, the SEC would like to explore possible revisions to the proxy rules to accommodate companies that would like to use dual record dates. One obvious challenge is ensuring that the shareholder group on the voting record date has an opportunity to review proxy disclosure prior to making voting decisions.

E. Potential means to facilitate retail investor voting participation

Retail investors have historically demonstrated low participation rates in the proxy process. The Concept Release introduces a number of concepts that the SEC hopes might stimulate retail voting. In particular, the SEC would like to receive comments on investor education initiatives, potential uses of broker Internet platforms, the mechanics of standing voting instructions that could be provided by beneficial owners to securities intermediaries, steps to encourage investor-to-investor communications, and possible revisions to the “notice and access” proxy delivery model.

F. Proxy voting by institutional securities lenders

It is relatively common for some institutional holders to enter securities lending transactions that provide the lender with additional income and enable the borrower to cover a short position or accomplish other objectives. The holder may not vote shares loaned to others unless it re-acquires title to the loaned securities. However, under current rules the lender may not learn of the subject matter of the meeting in time to re-acquire and vote the loaned shares. The SEC is considering, among other things, requirements for issuers to provide notice of the matters expected to be voted on at shareholder meetings (through, for example, a Form 8-K, press release or Web site posting) in advance of the record date.

G. Over-voting and under-voting of shares

For a variety of reasons, a mismatch may occur between the number of shares that a broker-dealer purports to vote on behalf of beneficial holders and the actual number of shares for which the broker-dealer is apparently entitled to vote. When the issuer or vote tabulator identifies a discrepancy, the broker-dealer must reconcile the discrepancy with the voting instructions received

³ Comment letter of The Business Roundtable Group to SEC Release No. 33-9046, dated August 11, 2009, at 21.

from customer accounts. The method by which the broker-dealer performs this reconciliation may lead to “over-voting” or “under-voting” of beneficial shares. In other words, the actual votes cast by the broker-dealer may not precisely match the sets of instructions provided to the broker-dealer.

The SEC would like to determine whether there is an over-voting or under-voting problem, and if so, the extent of it. The SEC requested comments on, among other things, the size and impact of over-voting and under-voting, possible disclosure requirements, and the allocation and reconciliation methods used by broker-dealers.

H. Vote confirmation

A beneficial holder of shares does not generally receive confirmation that votes on those shares were actually cast by the securities intermediary and recorded by the vote tabulator in accordance with the holder’s instructions. In an effort to increase transparency, certainty, and accuracy in the voting process, the SEC requested comments about the possible implementation of vote confirmation procedures. One of several complexities involved in this issue is that many investors would like to preserve anonymity in the voting process.

I. Proxy distribution fees

Companies have frequently raised concerns with the fees used by broker-dealers for distributing proxy materials to beneficial holders. The Concept Release presents a number of questions with respect to proxy distribution fees, the maximum amounts of which were last revised in 2002.

J. Data-tagging proxy-related materials

Issuers are not currently permitted or required to provide proxy disclosure, such as executive compensation data or corporate governance descriptions, in XBRL or other interactive data formats. The SEC believes that doing so may help investors find and compare highly material information. The Concept Release seeks comment on whether the SEC’s recent data-tagging initiatives should be extended to proxy statements and voting information.

If you have any questions regarding the Concept Release, or if you need advice or assistance in preparing comments in response or otherwise determining how the Concept Release may affect you, please contact your usual Winston & Strawn contact or any of the Winston & Strawn attorneys listed below:

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