

Business Roundtable
Petition for Rulemaking Regarding Shareholder Communications

I. Introduction

The time has come for the U.S. Securities and Exchange Commission (the "Commission" or "SEC") to re-examine the shareholder communications system. Although communicating with shareholders is becoming increasingly important, companies remain hampered by a communications process developed in the mid-1980s that is cumbersome, circuitous and overly expensive.¹ Companies' lack of ability to communicate with beneficial owners of their stock is primarily a result of the increased prevalence of shares held in the names of brokers and banks (so-called "street name" holdings). As discussed below, the current communications system provides companies only a limited ability to communicate directly with their beneficial owners whose shares are held in street name.

Technological advances since the 1980s have made direct communications with beneficial shareowners far more feasible. Moreover, as a result of recent regulatory developments, such as the erosion of the availability of broker voting and proposed SEC rules regarding the director election process, and industry trends, such as increased street name holdings and increased shareholder activism, companies have a heightened need to easily communicate with all their shareholders. Unfortunately, under current SEC rules proxy materials must be mailed to street name holders through their brokers and banks, or their agents, which adds unnecessary delays and costs. In addition, current SEC rules prohibit companies from communicating directly with beneficial owners who object to providing their name and address to companies (so-called "OBOs"). This is particularly significant given that OBOs beneficially own the majority of most public companies' shares.²

The street name system of share ownership was developed to enable securities transactions to be cleared more efficiently, but it should not stand in the way of efficient shareholder communications, especially given recent technological advances.³ Enhanced

¹ See letter from American Society of Corporate Secretaries to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, Attachment A, at para. K.3 (Dec. 22, 2003), SEC File No. S7-19-03 [hereinafter "ASCS Letter"]; letter from Henry A. McKinnell, Ph.D., Chairman, Business Roundtable, to Jonathan A. Katz, Secretary, U.S. Securities and Exchange Commission (Dec. 22, 2003), SEC File No. S7-19-03 [hereinafter "Roundtable Letter"]; Robert Brown, Jr., *The Shareholder Communication Rules and the Securities and Exchange Commission: An Exercise in Regulatory Utility or Futility?*, 13 J. Corp. L. 683, 687 (Spring 1988) ("The [shareholder communication] rules . . . preserve the inefficient, time-consuming, and expensive system of communicating through brokers and banks.").

² Approximately 70-80 percent of all public stock is held in street name. See *infra* note 5. Of that stock, approximately 75 percent is held by OBOs. See *infra* note 18. Therefore, roughly 52-60 percent of all shares of public companies are held by OBOs.

³ See DIVISION OF CORPORATE FINANCE, SECURITIES AND EXCHANGE COMMISSION, REPORT TO SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 96TH CONG., STAFF REPORT ON CORPORATE ACCOUNTABILITY

communication among directors, management and shareholders is an important part of enhancing corporate governance. Therefore, we urge the Commission to conduct a thorough review of the current shareholder communications system.⁴ In particular, we recommend that the Commission require brokers and banks to provide companies with contact information for *all* beneficial owners and permit the direct mailing of *all* communications (including proxy materials) to beneficial owners. We also encourage the Commission to require brokers and banks to execute omnibus proxies on behalf of beneficial owners, thereby allowing them to vote their shares directly.

II. Background

A. "Street Name" Share Ownership

The majority of publicly traded shares are not registered in companies' records in the names of the beneficial owners. Instead, an estimated 70-80 percent of all public companies' shares are held in "street name," meaning that they are held of record by brokers, banks or their depositories.⁵ Most street name shares are registered in the name "Cede & Co.," the name used by The Depository Trust Company ("DTC"),⁶ which holds shares on behalf of its participant brokers and banks. These participant brokers and banks in turn hold the shares on behalf of their clients, the individual beneficial owners. Under this "daisy chain" system, state law deems DTC to be the "legal" owner of the shares, and DTC therefore possesses all of the rights incident to share ownership, including the right to vote.⁷

[Footnote continued from previous page]

328 (Comm. Print 1980) [hereinafter "STAFF REPORT"] ("The efficiency and practicality of street and other nominee registration is beyond dispute. Indeed, formation of a national market system is premised on such processing efficiency").

⁴ The United Kingdom's Shareholder Voting Working Group has recently conducted an independent review of the U.K.'s shareholder communications system. See Paul Myners, *Report by Paul Myners to the Shareholder Voting Working Group: Review of the impediments to voting UK Shares* (Jan. 2004), available at <http://www.manifest.co.uk/myners/myners.htm> (last visited Mar. 22, 2004).

⁵ See Release No. 34-38406 (Mar. 14, 1997), at n.5.

⁶ DTC states that it is the registered owner of 83 percent of all shares listed on the NYSE, 72 percent of the shares listed on NASDAQ, and 91 percent of the principal outstanding corporate debt listed on the NYSE. See DTC's 1999 Annual Report.

⁷ See, e.g., *In Re Giant Portland Cement Co.*, 21 A.2d 697 (Del. Ch. 1941) ("The right to vote shares of corporate stock having voting powers has always been incident to legal ownership"); *Enstar Corp. v. Senouf*, 535 A.2d 1351, 1353-55 (Del. 1987), citing *American Hardware Corp. v. Savage Arms Corp.*, 136 A.2d 690, 692 (Del. 1957) ("If an owner of stock chooses to register his shares in the name of a nominee, he takes the risks attendant upon such an arrangement, including the risk that he may not receive notice of corporate proceedings, or be able to obtain proxy from his nominee. The corporation, except in special cases, is entitled to recognize the exclusive right of the registered owner to vote.").

Because DTC's role is only that of custodian, a number of mechanisms have been developed in order to pass its legal rights down the chain to the beneficial owners. The first step in passing voting rights down the chain is the "omnibus proxy," which DTC executes to transfer its voting rights to its participant brokers and banks.⁸ What happens next depends on whether a DTC participant is a broker or a bank.

Where the DTC participant is a broker, New York Stock Exchange ("NYSE") rules govern the voting of proxies.⁹ Under SEC and NYSE rules, brokers must deliver proxy materials to beneficial owners and request voting instructions.¹⁰ Where voting instructions have not been received by the broker by the tenth day preceding the meeting date, the so-called "ten-day rule" permits brokers to vote on certain matters deemed "routine" by the NYSE.¹¹ On "non-routine" matters, NYSE rules prohibit brokers from casting uninstructed votes for shares they do not beneficially own without receiving instructions from the beneficial owners.¹² It is important to note that the voting rights received by brokers are not passed on via proxy to their customers; instead, brokers retain the right to vote the shares, but may only do so with instructions, or as otherwise permitted by ten-day rule.

Although these NYSE rules are not applicable to banks, they are often prohibited from voting the securities held in their customers' accounts by express agreements with their customers.¹³ Where banks hold securities as nominees for smaller, regional "respondent" banks, federal proxy rules require those banks to execute omnibus proxies in favor of the respondent banks, and deliver the omnibus proxies to the company.¹⁴ Where a bank holds securities on behalf of a customer who is the beneficial owner, the bank must either (1) forward the proxy to the beneficial owner, executed in blank to be filled in by the beneficial owner, or (2) request voting instructions from the beneficial owners and afterward complete and return the proxies to

⁸ See Brown, *supra* note 1, at 753 ("As a practical matter . . . depositories execute omnibus proxies in favor of participants shortly after the issuer's record date. In this way, participants obtain the power to vote shares and can vote them as instructed by beneficial owners."); John C. Wilcox & John J. Purcell III, *"Street Name" Registration & The Proxy Process*, A Practical Guide to SEC Proxy and Compensation Rules § 12.3, at 12-7 (Amy L. Goodman and John F. Olson eds., Aspen Law and Business, 3rd ed. Supp. 2004) [hereinafter "Wilcox"].

⁹ See, e.g., NYSE Rules 450 and 452.

¹⁰ 17 C.F.R. § 240.14b-2(b)(2); NYSE Rule 451(b).

¹¹ NYSE Rules 452.

¹² NYSE Rule 450.

¹³ See Wilcox, *supra* note 8, § 12.3[1][b], at 12-9.

¹⁴ 17 C.F.R. § 240.14b-2(b)(2).

the company based on those instructions.¹⁵ Absent some independent arrangement with their customers, banks have no discretionary voting authority analogous to the ten-day rule.¹⁶

B. The NOBO/OBO System

The names of the ultimate beneficial owners of street name shares – i.e., the customers of the brokers and banks who have deposited the shares with DTC – are maintained by the brokers and banks, not by companies themselves. Recognizing that this system left companies without direct contact with a large proportion of their beneficial owners, the Commission adopted rules in 1983, which went into effect in 1986, requiring brokers and banks to provide companies with lists of "non-objecting beneficial owners" (or "NOBOs") who did not object to having their names and addresses supplied to companies.¹⁷ Objecting beneficial owners (or "OBOs"), which constitute an estimated 75 percent of shares held in street name,¹⁸ still may be contacted directly only by the broker or bank, or its agent. Although companies may mail proxy materials directly to NOBOs, as a practical matter they never do so, because current SEC rules require companies to forward proxy materials through brokers and banks regardless of whether they are also mailed directly.¹⁹ Therefore, companies only use NOBO lists to mail out supplemental materials, annual reports and quarterly reports, which do not have to be mailed through brokers and banks.²⁰ Furthermore, because only the brokers and banks are legally entitled to vote shares held in street name, companies cannot use NOBO lists to enable beneficial owners to vote directly with the company.

C. The Role of ADP

The overwhelming majority of brokers and banks have contracted out the administrative processes of distributing proxy materials, tabulating votes, and responding to requests for NOBO lists, to the Investor Communications Services Division of Automatic Data Processing, Inc.

¹⁵ 17 C.F.R. § 240.14b-2(b)(3).

¹⁶ See Wilcox, *supra* note 8, § 12.3[1][b], at 12-9.

¹⁷ See Release No. 34-20021 (July 28, 1983).

¹⁸ Based on information provided by ADP representatives at meetings of the Proxy Voting Review Committee, held on August 29, 2001 and October 17, 2001.

¹⁹ 17 C.F.R. § 240.14a-13(b)(4) (permitting companies to use NOBO lists for any "corporate communications"). See Brown, *supra* note 1, at 760.

²⁰ See Brown, *supra* note 1, at 758.

("ADP").²¹ Brokers and banks accomplish this by transferring the proxy authority they receive from DTC (via omnibus proxy) to ADP via powers of attorney.²² ADP then mails the proxy statements and voting instruction forms (known as "VIFs") to beneficial owners. It does not mail "proxies" to beneficial owners; instead, it requests voting instructions from beneficial owners via the VIFs, and thereby retains the legal right to vote the shares.²³ ADP, as the agent of the brokers and banks, also has the responsibility of creating NOBO lists upon request by companies.²⁴ As discussed below, companies must reimburse ADP for its dissemination of proxy materials and other communications, and creation of NOBO lists according to a fee structure established by the NYSE and approved by the SEC.²⁵

III. Reasons for Re-Examining Shareholder Communications System

A. Increased Focus on Shareholder Communications

1. Shareholder Activism

Increased shareholder activism in recent years has heightened the need for companies to be able to communicate with beneficial owners. For example, the number of shareholder proposals submitted in connection with annual meetings has risen from 221 in 1999 to 1,081 in 2003.²⁶ Moreover, as shareholder activism increases, it becomes increasingly important for companies to be able to communicate with beneficial owners regarding those proposals.

2. SEC and NYSE Rules Regarding Shareholder/Director Communications

Regulatory developments in recent years have also contributed to the rising importance of communications between companies and their shareholders. For example, as a part of its efforts to enhance corporate governance, the Commission recently adopted rule amendments requiring,

²¹ See, e.g. Thomas M. Ball, *A Box Full of Proxies*, 2 THE M & A LAWYER No. 7 (Nov. 1998) ("ADP is a service bureau that provides mailing and tabulation services to virtually all major U.S. banks and brokers, making ADP the conduit for over 90 percent of holders in street name.").

²² See Wilcox, *supra* note 8, § 12.3[1][c], at 12-10.

²³ *Id.*

²⁴ See Harold S. Bloomenthal and Samuel Wolff, *Going Public and the Public Corporation*, § 11.10[3] (discussing the important role played by the Independent Election Corporation of America, which was subsequently purchased by ADP, in assembling NOBO lists).

²⁵ NYSE Rules 451 and 465; NYSE Listed Company Manual, Para. 402.10(A); Release No. 34-45644 (Mar. 25, 2002) (approving the NYSE fee structure).

²⁶ Investor Responsibility Research Center, www.ircrc.org (last visited Feb. 20, 2004).

among other things, disclosure of whether a company has a process in place by which security holders can communicate with the board of directors, and if not, why not.²⁷ Companies that have such a process must disclose the details of that process in the company's proxy statement.²⁸ In addition, the NYSE's recently enhanced corporate governance listing standards address the issue of greater access to the board.²⁹ These developments underscore the importance of opening lines of communication between directors and beneficial owners. In addition to enabling shareholders to more easily communicate with companies, the Commission should also work to ease the difficulties companies face in communicating with shareholders. Enhancing companies' access to their beneficial owners would also inure to the benefit of other shareholders, who are entitled to receive shareholders lists in the possession of the company.³⁰

3. SEC's Proposed Election Contest Rules

Companies' need to communicate with their shareholders will be further exacerbated if the Commission adopts final rules to enable shareholders to directly nominate candidates for the board of directors (the "Election Contest Rules").³¹ Under the Election Contest Rules, shareholder nominations for the board of directors would have to be included in company proxy materials if one of two triggers is met: (1) more than 35 percent of shares voted are "withhold" votes for a director, or (2) a proposal made by a more than 1 percent shareholder to activate shareholder nomination procedures receives a majority vote.³² If one of these triggers is reached, any group comprised of the holders of more than 5 percent of the company's stock would be able to place up to three director nominees (depending on the size of the board) in the company's proxy statement and on the company's proxy card for two years.³³

Once the Election Contest procedure is triggered and shareholder nominees are included in company proxy materials, the board will have a resultant fiduciary duty to support the

²⁷ See Release No. 34-48825 (Apr. 11, 2003); See Schedule 14A, Item 7(h)(1).

²⁸ See Schedule 14A, Item 7(h)(2).

²⁹ See Release No. 34-48745 (Nov. 4, 2003); Commentary to Paragraph 303A(3) of the NYSE Listed Company Manual ("In order that interested parties may be able to make their concerns known to the non-management directors, a company must disclose a method for such parties to communicate directly with the presiding director or with the non-management directors as a group.").

³⁰ 17 C.F.R. § 240.14a-7(a)(2)(ii).

³¹ See Release No. 34-48626 (Oct. 14, 2003).

³² *Id.*

³³ *Id.*

nominees it believes would best serve the interests of the company and *all* of its shareholders. In this regard, when a board of directors nominates a slate of director candidates, it must act in a manner it believes to be in the best interests of the company and all of its shareholders. Accordingly, a board that receives a shareholder nominee through the Election Contest procedure would be required to consider whether the board's own nominees would better manage the company and better satisfy applicable independence standards (*e.g.*, the NYSE and NASDAQ independence requirements). If so, the board's fiduciary duties would require it to act to counter the shareholder nominee. This would result in additional communication between the company and its shareholders, in order to solicit support for board-nominated candidates. In this regard, there generally are at least five times more communications to shareholders in a proxy contest than during a routine annual meeting solicitation. Even before the Election Contest procedure is triggered, companies will need to communicate with the beneficial owners of their shares in connection with triggering events. Companies will need to provide shareholders with information regarding Election Contest shareholder proposals, and will need to support board-nominated candidates in order to avoid tripping the "withhold" votes trigger.

Because the Election Contest Rules would require increased shareholder communications, it is important that the Commission conduct a thorough review of the shareholder communications system (and complete any resulting revisions) before the effectiveness of any Election Contest rules.³⁴

4. Erosion of Broker Voting: NYSE Ten-Day Rule

As noted above, the NYSE's "ten-day rule," embodied in NYSE Rule 452, gives brokers discretionary authority to vote proxies on "routine" matters for beneficial owners who have not given voting instructions by the tenth day before the meeting at which the votes are to be cast. The ten-day rule is an important tool for enabling companies to achieve quorum at meetings of stockholders. The applicability of the ten-day rule has been limited recently, however, as a result of the NYSE's new listing standards requiring shareholder approval of equity compensation plans. The amended listing standards deem shareholder approval of equity compensation plans to be a "non-routine" matter on which broker votes are prohibited. As a result, companies now have an increased need to communicate with shareholders in order to support the board's recommendations regarding equity compensation plans.

The Election Contest Rules could, if adopted, further limit the effectiveness of the ten-day rule. Because brokers' discretionary voting authority under the ten-day rule is limited to voting on routine matters, the NYSE may deny brokers the authority to vote in a contested

³⁴ See Letter from Cary Klafter, Vice President, Legal and Government Affairs and Corporate Secretary, Intel Corporation, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission (Dec. 22, 2003), SEC File No. S7-19-03 [hereinafter "Intel Letter"] ("Dealing with the [Election Contest Rules] in seeming isolation from the rest of the system runs the risk of unanticipated material expense, breakdown and frustration of the state and national policies which support and encourage voting by shareholders").

director election or on a shareholder proposal to activate the Election Contest procedure.³⁵ If brokers were unable to vote on behalf of non-responding shareholders on Election Contest shareholder proposals, companies would have an even greater need to communicate with their shareholders to solicit votes in support of board-nominated candidates or against Election Contest shareholder proposals.

Moreover, if the ten-day rule is abolished, as some commenters have recommended,³⁶ the overall number of votes cast would decrease considerably because votes would not be cast on behalf of beneficial owners of shares held in street name who do not give voting instructions to their brokers. Therefore, because the Election Contest Rules include a "withhold" votes triggering event based on the number of votes cast (as opposed to the number of shares outstanding), eliminating the ten-day rule would make the threshold for withhold votes much easier to trigger. Accordingly, elimination of the ten-day rule would increase companies' need to communicate with shareholders in the event of a withhold votes campaign against a board-nominated candidate. Elimination of the ten-day rule would also increase the importance of shareholder communications in that companies would need to encourage beneficial owners to return voting instructions even on routine matters, or risk granting institutional investors (who tend to return their proxies more frequently) a disproportionate amount of the voting power. Furthermore, since beneficial owners assume that their brokers or will cast votes on their behalf, they will be disenfranchised without an extensive educational campaigns to make them understand that they need to return voting instructions.³⁷

B. Current Inefficiencies

The current system of shareholder communications is circuitous and unnecessarily time-consuming. As noted earlier, companies may communicate directly only with NOBOs, and only for the purpose of mailing annual and quarterly reports and supplementary materials. Proxy mailings and vote tabulations for beneficial owners of shares held in street name must all be

³⁵ See Supplementary Material .11(2) to NYSE Rule 452 (providing that brokers may not use the "ten-day rule" to give a proxy where the matter to be voted upon "is the subject of a counter-solicitation, or is part of a proposal made by a stockholder which is being opposed by management (*i.e.*, a contest).").

³⁶ See, e.g., Letter from Sarah A.B. Teslik, Executive Director, Council of Institutional Investors, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission (May 10, 2003), SEC File No. S7-10-03; Letter from James E. Heard, Chief Executive Officer, Institutional Shareholder Services, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission (June 13, 2003), SEC File No. S7-10-03; See also John C. Wilcox, *What Next for the 10-Day Rule?*, THE CORPORATE GOVERNANCE ADVISOR, Sept./Oct. 2003, at 12 ("There is no question that there will be pressure for the SEC and the NYSE to prohibit discretionary broker voting altogether.").

³⁷ See Letter from John C. Wilcox, Vice Chairman, Georgeson Shareholder Communications, Inc., to U.S. Securities and Exchange Commission (Dec. 12, 2003), SEC File No. S7-19-03 ("If the practice [of broker voting] were disallowed, a comprehensive effort by regulators to educate investors about the changes and their additional responsibilities would be necessary.").

conducted by the broker, bank or ADP. OBOs may be contacted directly by only the broker, bank or ADP, regardless of the purpose of the communication. Going through a broker, bank or ADP to forward proxy materials and other communications to beneficial owners inserts an unnecessary time delay in delivering those materials to beneficial owners.

A description of the process of forwarding proxy materials in connection with a company's annual meeting will help illustrate this point. Under SEC rules, the process must begin with a search card.³⁸ At least 20 business days (*i.e.*, approximately one calendar month) prior to the record date for the annual meeting, companies must send a search card to any "broker, dealer, voting trustee, bank, association, or other entity that exercises fiduciary powers in nominee name" that the company "knows" is holding shares for beneficial owners.³⁹ The search card must request: (1) the number of proxies and other solicitation materials needed for forwarding to beneficial owners; (2) the number of annual reports needed for forwarding; and (3) the name and address of any agent appointed by the bank or broker to process a request for a list of beneficial owners.⁴⁰ Practically speaking, however, the process begins even before the search card is mailed. Since most brokers and banks deposit their shares with DTC, which is therefore the record holder, companies must first request from DTC a list of its participant brokers and banks holding the company's shares.⁴¹ DTC must promptly respond to the company with the number of shares in each participant's account, and may charge a fee for this service.⁴² Shortly before the record date, DTC executes omnibus proxies in favor of its participants in order to grant them the power to vote.⁴³

Once the identities of participants (banks and brokers) are ascertained, the company then sends them the search cards described above. Upon receipt, brokers and banks (or, more commonly their agent, ADP) respond with the requested information. In the case of brokers, a response must be sent to the company within seven business days of receipt.⁴⁴ The response must include the approximate number of beneficial owners, and, if the company will be mailing

³⁸ See Brown, *supra* note 1 at 746.

³⁹ 17 C.F.R. § 240.14a-13(a).

⁴⁰ 17 C.F.R. § 240.14a-13(a)(1)(i).

⁴¹ 17 C.F.R. § 240.14a-13(a) n.1 ("If the registrant's list of security holders indicates that some of its securities are registered in the name of a clearing agency registered pursuant to Section 17A of the Act (*e.g.*, "Cede & Co.," nominee for Depository Trust Company), the registrant shall make appropriate inquiry of the clearing agency and thereafter of the participants in such clearing agency. . .").

⁴² See 17 C.F.R. § 240.17Ad-8(b) ("A registered clearing agency may charge issuers requesting securities position listings a fee designed to recover the reasonable costs of providing the securities position listing to the issuer.").

⁴³ See *supra* note 8.

⁴⁴ 17 C.F.R. § 240.14b-1(b)(1).

annual reports directly, the response must also identify any agent (such as ADP) appointed by the broker to process a request for a NOBO list.⁴⁵

For banks, the process is even more circuitous. Because of the problem of "layering," it is frequently the case that the participant bank will own shares not on behalf of the beneficial owner, but instead on behalf of another respondent bank, which may in turn be holding on behalf of another respondent bank, and so on.⁴⁶ Therefore, SEC rules require banks to respond within one business day with the identities of all respondent banks, and must respond within seven days with the number of beneficial owners on whose behalf it owns shares directly.⁴⁷ The company must then send a search card to all respondent banks, and the process is repeated until eventually, the company knows the total number of sets of proxy materials needed in order to reach all beneficial owners. SEC rules require banks to execute omnibus proxies on behalf of respondent banks, thereby passing the right to vote down the chain of ownership (notably, this process stops short of passing the right to vote shares directly to the beneficial owner).⁴⁸

Once the search card process is complete, the company will then know the approximate number of beneficial owners. The company must then provide the brokers, banks or their agents with enough copies of the proxy card, solicitation materials, and annual reports for forwarding to the beneficial owners. The broker, dealer, or its agent must then forward these materials to beneficial owners no later than five business days after receiving such materials.⁴⁹

Where the beneficial owner is an institutional investor, the right to provide voting instructions often lies with Institutional Shareholder Services, Inc. ("ISS") or Investor Responsibility Research Center ("IRRC"). Many institutional investors outsource the voting process to ISS and IRRC, who provide voting instructions on their behalf to ADP through ADP's proprietary ProxyEdge system. ADP then tabulates and communicates these instructions to the broker or bank, or to the company itself by executing the proxies on behalf of the broker or bank.

This process could be greatly simplified if companies were able to communicate directly with the beneficial owners of their securities. While it would still be necessary to coordinate between companies and record holders (brokers and banks) for the purpose of compiling lists of beneficial owners, the time delay involved in physically delivering materials to brokers, banks or ADP, and then to beneficial owners, could be avoided and communications between companies and their beneficial owners would be facilitated.

⁴⁵ *Id.*

⁴⁶ See Brown, *supra* note 1, at 741 (discussing the "piggybacking" of shares held through a chain of banks).

⁴⁷ 17 C.F.R. § 240.14b-2(b)(1).

⁴⁸ 17 C.F.R. § 240.14b-2(b)(2).

⁴⁹ 17 C.F.R. § 240.14b-1(b)(2); 17 C.F.R. § 240.14b-2(b)(3).

C. Costs

In addition to being time-consuming and circuitous, the process of communicating with the beneficial owners of shares held in street name is very costly to companies and their shareholders. NYSE rules regulate the fees that must be paid to brokers and banks (or their agents, such as ADP) for forwarding communications to beneficial owners.⁵⁰ Companies must reimburse brokers, banks and/or ADP for expenses incurred in forwarding communications to beneficial owners, including: (1) actual postage costs; (2) the actual cost of envelopes; and (3) any actual communication expenses (excluding overhead) incurred in receiving voting returns either telephonically or electronically.⁵¹ In addition to these out-of-pocket costs, companies must also pay the following basic fees for mailing communications to beneficial owners: (1) \$0.40 per beneficial owner for each set of proxy material mailed; (2) \$1.00 per set of proxy material for annual meetings where an opposition proxy statement has been furnished; (3) \$0.40 for each set of supplementary proxy material mailed; and (4) 15¢ for each copy, plus postage, for annual reports mailed separately from the proxy statement, interim reports, post meeting reports, and other material.⁵² In addition, companies must pay "nominee-coordination" fees to intermediaries that coordinate mailings to multiple brokers and/or banks,⁵³ and "incentive" fees meant to incentivize the elimination of multiple mailings to the same address ("householding") and the use of electronic delivery to eliminate mailings.⁵⁴

In addition to fees for forwarding materials to beneficial owners, the NYSE fee structure includes fees for the creation of NOBO lists. Currently, the fee paid by public companies *per NOBO* consists of a \$0.065 fee paid to nominees (the broker or bank), and an additional fee paid to agents of nominees (typically ADP).⁵⁵ ADP's fee is based on a sliding scale, where the per-NOBO fee depends on the size of the NOBO list (the per-NOBO fees are: \$.10 for 1 to 10,000

⁵⁰ Supplementary Material to NYSE Rules 451 and 465; NYSE Listed Company Manual, Para. 402.10(A).

⁵¹ *Id.*

⁵² *Id.*

⁵³ When an intermediary, such as ADP, coordinates multiple nominees (i.e., brokers and banks), ADP is entitled to charge \$20 per nominee, plus \$0.10 or \$0.05 per set of proxy material (depending on the number of nominee accounts) in addition to the per-mailing fees described above. *Id.*

⁵⁴ ADP is entitled to charge an "incentive fee" for each mailing eliminated in the amount of \$0.25 per set of proxy material (where shares are held in at least 200,000 nominee accounts), \$0.50 per set of proxy material (where shares are held in fewer than 200,000 nominee accounts), or \$0.10 per interim report. *Id.*

⁵⁵ See Supplementary Material .92 to NYSE Rule 451.

NOBOs; \$.05 for 10,001 to 100,000 NOBOs; or \$.04 for 100,001 or more NOBOs).⁵⁶ Finally, as mentioned earlier, depositories often charge companies a fee for providing a list of respondent brokers and banks.⁵⁷

These fees add up rather quickly, and can act as a disincentive for companies to communicate with beneficial owners beyond the required proxy and annual reports. Furthermore, they are borne by the company, and therefore all shareholders, whereas they benefit only a subset of shareholders – those who choose to remain anonymous. The fees for forwarding materials to beneficial owners could be avoided if companies were permitted to communicate directly with beneficial owners.

D. Technological Advances

As noted above, the current framework for distinguishing between NOBOs and OBOs and permitting companies to obtain contact information only for NOBOs was developed in the early 1980s. In addition to the continuing increase in street name share ownership over the ensuing two decades,⁵⁸ thereby further restricting companies' ability to communicate with beneficial owners of their shares, tremendous technological advance have also taken place. The current system does not take advantage of these technological improvements. For example, many companies now are providing Internet voting for their registered shareholders, a technology that was unavailable in the 1980s. If nominees were able to issue omnibus proxies delegating voting power to their customers (*i.e.*, beneficial owners), beneficial owners of shares held in street name would be able to use the same Internet voting system as registered beneficial owners. In addition to Internet voting, companies now have the ability to deliver communications electronically to beneficial owners, a technology that was not available in the 1980s.⁵⁹ This means that many companies and shareholders are technologically equipped to avoid the largely paper-based system of delivering hard copies of proxy materials. These are only a few examples, and a broad review of the shareholder communications process is likely to illuminate other technological advancements that could be used to provide companies with "real time" access to databases of beneficial ownership information.

⁵⁶ See ADP Fee Schedule (Mar. 2003).

⁵⁷ *Supra* note 42.

⁵⁸ See Release No. 34-38406 (Mar. 14, 1997) (noting that "stockholdings continue to migrate from registered to street or nominee ownership.").

⁵⁹ See Release No. 34-36345 (Oct. 6, 1995) (issuing guidance on the use of electronic media to deliver communications to shareholders, noting that "[a]dvances in computers and electronic media technology are enabling companies to disseminate information to more people at a faster and more cost-effective rate than traditional distribution methods, which have been largely paper-based.").

E. Privacy Interests

At the time the Commission adopted the NOBO/OBO distinction, the primary reason given for the distinction was to respect some investors' wishes that their identities remain private and confidential.⁶⁰ However, this privacy interest is not a sufficient reason to maintain the current cumbersome system, which makes it difficult and extremely expensive for companies to communicate with all their beneficial owners. Furthermore, those who value their privacy should bear the cost of maintaining their anonymity, rather than passing the cost on to all shareholders.

The primary privacy rationale is in respecting small investors' wishes to prevent their names and addresses from being disclosed to companies. Little is known about whether investors truly value this anonymity, especially in light of the full implications of becoming an OBO (i.e., that proxy mailings and other important communications must come through an intermediary). In this regard, it is noteworthy that studies conducted during the development of the NOBO/OBO system indicated that only between 8 and 12 percent of street name holders raised an objection to disclosure of their names to companies, contrasted with the fact that ADP currently estimates that OBOs represent approximately 75 percent of all shares held in street name.⁶¹ Accordingly, there is likely confusion among investors as to the effect of OBO status, or an inherent bias in the way the NOBO/OBO election is elicited. Given that the privacy interest appears low, and investors are able to maintain their anonymity through other means (for example, by setting up nominee accounts), the distinction between NOBOs and OBOs should be abolished. Those investors who truly care about their anonymity should bear the costs of remaining anonymous by setting up nominee accounts in the name of a partnership or other entity, which would then be the beneficial owner of the shares.⁶² This would be far more

⁶⁰ See ADVISORY COMMITTEE ON SHAREHOLDER COMMUNICATIONS, SECURITIES AND EXCHANGE COMMISSION, IMPROVING COMMUNICATIONS BETWEEN ISSUERS AND BENEFICIAL OWNERS OF NOMINEE HELD SECURITIES 68 (1982) [hereinafter "ADVISORY COMMITTEE REPORT"], 68 and 71 (noting privacy concerns, and recommending that the Commission adopt the NOBO/OBO distinction).

⁶¹ See STAFF REPORT, *supra* note 3, at D46, n. 114 (indicating that 8.2 percent of brokerage customers object); ADVISORY COMMITTEE REPORT, *supra* note 60, at 68 (indicating that 12 percent of securities held through banks or brokers object); *supra* note 18 (indicating that OBOs represent 75 percent of all shares held in street name).

⁶² Other countries take a different approach to enhance the availability of beneficial owner information to companies, irrespective of beneficial owners' privacy interests. In the United Kingdom, for example, public companies are entitled to obtain details of all persons who are interested in their shares, including beneficial owners. See Companies Act 1985 § 212. In addition, public companies in the United Kingdom have greater ongoing access to the names of large beneficial owners, in that any person with an interest of at least 3% (or 10% in the case of a discretionary fund manager) of a company's stock is required to disclose the nature of that interest to the company. See Companies Act 1985, §§ 198-208. Furthermore, any information which a company obtains under §§ 198 and 212 of the Companies Act is required to be entered into a register that is available for inspection by the public. In the case of listed companies, changes to interests which are notified to the company must be announced to the market without delay. See UK Listing Authority Listing Rules, para. 9.11 and 9.12.

appropriate than spreading the costs of maintaining the privacy of a small subset of shareholders across all shareholders as a group by maintaining a circuitous, expensive communications system.⁶³

Brokers have a privacy interest in maintain the confidentiality of whom their customers are. This interest is already being protected in the context of NOBO lists. Currently, since most brokers and banks contract with ADP to create NOBO lists, those lists are provided to companies without the accompanying broker affiliations of individual beneficial owners. This mechanism of maintaining the privacy of broker affiliations would be available if OBOs were included in the list.

IV. Proposals for change

The Commission should take steps to make the system of shareholder communications more efficient. First, as mentioned earlier, the NOBO/OBO distinction should be eliminated, so as to permit companies to obtain a list of *all* beneficial owners and communicate with them directly.⁶⁴ This would permit companies to avoid sending communications through brokers, banks and ADP, and enable them to communicate with beneficial owners more quickly and more cost-effectively. Those beneficial owners who have a strong interest in maintaining their anonymity could continue to do so, but would bear the costs of such anonymity.

Second, the Commission should consider requiring brokers, banks and their agents to pass voting rights directly to beneficial owners by executing omnibus proxies in their favor. Banks are already required to execute omnibus proxies to pass voting rights to respondent banks, and DTC uses omnibus proxies to pass voting right to its participants. The Commission should similarly require brokers and banks to execute omnibus proxies in favor of their customers, thus enabling them to vote their shares directly and thereby avoid the circuitous and inefficient process of requesting "voting instructions" from beneficial owners. Providing the right to vote to the beneficial owner would simplify the voting and vote tabulation process, and would enable those companies using Internet voting systems for record holders to extend that system to all beneficial owners.⁶⁵

Third, the Commission should permit companies to bypass brokers and banks in the mailing of proxy materials. By transmitting proxy materials directly to beneficial owners, an unnecessary time delay would be avoided. The Commission last considered (and rejected) this

⁶³ See ASCS Letter, *supra* note 1 (supporting the notion that the NOBO/OBO distinction should be eliminated, and that beneficial owners valuing their privacy should bear the costs associated with such privacy); Roundtable Letter, *supra* note 1.

⁶⁴ See, e.g., Intel Letter, *supra* note 34; ASCS Letter, *supra* note 1; Roundtable Letter, *supra* note 1.

⁶⁵ See ASCS Letter, *supra* note 1 (recommending that beneficial owners of shares held in street name be permitted to vote their shares directly with the company); Roundtable Letter, *supra* note 1.

approach in 1982, when it found that technical and cost impediments would make such a system unworkable.⁶⁶ The tremendous technological advances since 1982 suggest that it would now be feasible for companies to disseminate proxy materials directly to their beneficial owners.

A thorough review of the shareholder communication system is likely to reveal other ways to improve shareholder communications that technological advances since the 1980s have made possible.

V. Conclusion

It is time for the Commission to initiate a thorough review of the shareholder communications process. The Commission could begin this process by issuing a concept release that would solicit public comment on the possibility of: (1) eliminating the NOBO/OBO distinction; (2) requiring brokers, banks and their agents to execute omnibus proxies on behalf of beneficial owners; and (3) removing the requirement to mail proxy materials to beneficial owners through brokers and banks.⁶⁷

70271462_8.DOC

⁶⁶ See ADVISORY COMMITTEE REPORT, *supra* note 60, at 69.

⁶⁷ Consistent with the Commission's existing communications rules, we would anticipate that any means of direct communication available to companies also would be available to nominating shareholders.