

Big Business Goes to Bat for Small Shareholders

Agenda article published on November 24, 2008

An Information Service of Money-Media, a Financial Times Company

By Tony Chapelle

A powerful combination of corporate trade groups is calling upon the SEC to fix practices that hinder small stockholders from voting their shares in proxy elections.

One of the biggest changes would allow more shareholders to vote in elections for directors. It would also apply to ratifying auditors.

“We would make sure that retail investors’ votes count,” says **Niels Holch**, the executive director of the organization, called the **Shareholder Communications Coalition**¹, which is spearheading the campaign. The group comprises the **Business Roundtable**, the **National Association of Corporate Directors**, **National Investor Relations Institute**, the **Securities Transfer Association** and the **Society of Corporate Secretaries and Governance Professionals**.

Yet while the changes could empower small investors, they also could create more insulation for boards by reducing the voting power of activist investors.

“I do not think that [thwarting] shareholder activism is driving the initiative,” says **Larry Sonsini**, a director at **Echelon** and chairman of Silicon Valley law firm **Wilson Sonsini**. “However, [this] initiative will give issuers more transparency to shareholders, and this is helpful when dealing with activism.”

Currently, SEC and exchange rules on shareholder communications create barriers between public companies and their individual investors. Often companies are restricted from knowing who holds their shares.

The proponents of the reforms are seeking five changes (please see chart below). Number one on the list is to require that stock be held in a shareholder’s actual name instead of a “street name” account at a brokerage. By improving disclosure, retail investors would be notified and could vote on proxies at companies in which they hold shares rather than having a brokerage intermediary vote on their behalf. Usually, brokers vote according to the dictates of the management in proxy elections.

Meanwhile, hedge funds and other activist investors can control a disproportionate number of votes by timing short sales to occur before and after a company establishes its record date. They can also use a complicated derivative known as a cash-settled equity swap to avoid SEC disclosure and hide large equity positions.

“With activists out there engaged in hostile tender offers, proxy contests and putting pressure on managements, you don’t know what their economic interests and voting interests are in the corporation,” says **Cary Klafter**, the corporate secretary at **Intel**² and a committee chair at the Society of Corporate Secretaries and Governance Professionals.

If boards knew, they could better understand the motives of investors who take on the corporation.

But activists assign a market benefit to what they do. Activism aligns the interests of shareholders, boards and managements, says **Dennis Johnson**, managing director of the **Shamrock Activist Value Fund**.

Johnson says he’s watching how the coalition’s campaign develops. “If the SEC should pursue this evaluation, Shamrock looks forward to providing input,” says Johnson, who is the former senior portfolio manager of corporate governance for **Calpers**.

The debate could end up on Capitol Hill. “I expect Congress to get very involved in regulatory issues next year because of the financial crisis,” says Holch. “We’re going to be talking to all members of the key committees.”

The coalition has sought these reforms since 2004, when it petitioned the SEC for a review. The SEC held roundtables on the subject, according to an agency spokesman, but hasn’t set a date to address the issues.

Broker voting plays a key role in helping public companies achieve quorums. Two years ago, a panel commissioned by the New York Stock Exchange recommended educating shareholders about NYSE Rule 452. The rule grants brokers the right to vote on “routine” proxy proposals on behalf of beneficial owners who object to having their names and addresses provided to the issuing companies. Routine proposals include uncontested director elections.

The collective broker vote needs to be eliminated, says **Richard Koppes**, a director at **Valeant Pharmaceuticals International**³ and the former general counsel of Calpers. “It’s best known as ballot stuffing,” Koppes says, likening it to a non-vote because brokers almost always vote with management.

Members of the coalition are asking directors to support the cause of proxy voting reforms with their own communication: letters to the SEC.

Recommendations for Reform

- 1. *Direct Communications with Individual Investors.*** The SEC should eliminate NOBO/OBO distinction.
 - 2. *Voting by Retail Investors.*** The SEC should (a) pass voting rights directly to beneficial owners, and (b) allocate uninstructed share votes in the same proportion as instructed shares.
 - 3. *Competition Among Proxy Service Providers.*** Issuers should be able to choose the company that distributes their communications.
 - 4. *Proxy Voting Integrity.*** The SEC should ensure that the proxy voting is transparent and verifiable.
 - 5. *Proxy Advisory Services.*** The SEC should review proxy advisory services and how they generate recommendations.
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