Remarks Of

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Shareholder Voting Rights and Transparency

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*/ The views expressed herein are those of Commissioner Roberts and do not necessarily represent those of the Commission, other Commissioners or the staff.

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Shareholder Voting Rights and Transparency
NYSE Legal Advisory Speech

I. INTRODUCTION

Thank you for inviting me here today. I would like to spend a few minutes discussing two issues of mutual concern to the NYSE and the Commission. Specifically, I will focus on the NYSE's voting rights concept release and certain transparency problems that exist in the equity securities area.

II. SHAREHOLDER VOTING RIGHTS

A. Development of Voting Rights Listing Standards

Variations on voting rights for common stock are not new. Restrictions on voting rights appeared as early as 1898 when International Silver Company issued common stock that had no voting rights until some future date.[1] The issue of a voting rights standard for common stockholders is also not new. It was first brought to the attention of investors when Harvard University Professor of Political Economy, William L. Ripley, addressed the Academy of Political Science at its annual meeting in New York City on October 28, 1925.[2] His address ignited a storm of public protest concerning the proposed listing by the NYSE of Dodge Brothers, Inc. which had issued non-voting common stock. This public protest triggered the

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1 See Stevens, Stockholders' Voting Rights and the Centralization of Voting Control, 40 Q.J. ECON. 353, 355 (1926).

2 Ripley, Two Changes in the Nature and Conduct of Corporations, 11 Prod. Acad. Pol. Sci. 695 (1925), reprinted in 67 Cong. Rec. 7719 (1926).

first NYSE refusal to list an issue of non-voting common stock. For sixty years thereafter, the NYSE refused to authorize the listing of non-voting stock, however designated, which by its terms is in effect a common stock. The NYSE policy became known as one share, one vote.

In the 1980s, listed companies began to request a change in the standard and threatened to move to a market that had no similarly restrictive listing standard. For competitive reasons, the NYSE appointed a subcommittee to prepare recommendations on shareholder voting rights. The subcommittee ultimately recommended that common stocks with disparate voting rights should be eligible for NYSE listing if approved by two thirds of all shares and by a majority of independent directors, or if the board was composed of less than a majority of independent directors, by all of the independent directors. As a result of this subcommittee recommendation, the NYSE, in 1986, submitted a rule proposal that would allow disparate voting rights if approved by a majority of public shareholders.

The NYSE, Amex and NASD subsequently explored development of a uniform voting rights standard, but could not reach a consensus. In July 1988, the Commission adopted Rule 19c-4, which prohibited disenfranchisement of a company's existing common stockholders. Rule 19c-4 listed presumptively permitted and prohibited transactions,

but did not have any provisions for shareholder approval of disparate voting rights. Thus, the shareholder voting rights standard moved from a one share, one vote standard to a shareholder disenfranchisement standard.

As you know, Rule 19c-4 was subsequently struck down by a federal appellate court.[3] Nevertheless, both the NYSE and the NASD, for NASDAQ-NMS stocks,[4] have adopted a standard based on Rule 19c-4. However, it is my understanding that the NYSE is not currently enforcing its 19c-4 standard while the debate on the most appropriate shareholder voting rights policy continues. Although the American Stock Exchange filed a proposal not to long ago to change its standards for listed companies with disparate voting rights, after Commission opposition to the proposal was expressed, it has continued to use the so-called Wang formula that has been used for a number of years.[5]

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3 Business Roundtable v. SEC, 905 F.2d 406 (June 12, 1990).

4 NASDAQ (non-NMS) stocks have no voting rights standard.

5 The Wang formula has voting requirements for the two classes of stock and permits issuers to provide a dividend preference for the lower shares. The Amex's latest proposal, however, is similar to the NYSE's in that it is based on the concept of shareholder approval of the issuance of disparate voting rights shares. No action has been taken to date on the Amex's proposal.

B. NYSE Policy

The NYSE's concept proposal, as it was presented for comment in May of this year, provides that a listed company wishing to issue shares of common stock with disparate voting rights (or to change the voting rights of outstanding shares) must take the following actions and structure its capitalization as follows:

1) all shares of common stock must be freely transferable;

2) the decision to issue shares with disparate voting rights must be approved by a majority of a committee of independent members;

3) if, following implementation of the decision, management or a control group would have the majority of the voting power, then a majority of the board shall be independent directors; and

4) the decision must be approved by a vote of a majority of outstanding shares entitled to vote on the matter and of any class which would be adversely affected by the decision, without counting the vote of any interested shareholder.

Several comments on the NYSE concept release have been brought to my attention. For example, Fidelity Investments stressed that a listed company should be prohibited from offering any special

dividend or other type of one-time economic incentive to its shareholders in the event a majority approves the issuance or creation of high-vote shares because there is a payment for votes and undermines the integrity of the shareholder approval process.[6] Further, Fidelity believes that if a listed company is proposing to provide a higher dividend or economic advantage to the low-vote stock on a permanent basis, the proposal should be required to be approved by two thirds of the disinterested shareholders entitled to vote on the matter and two thirds of any class adversely affected by such a proposal.

The Council of Institutional Investors ("Council") expressed concern over the NYSE concept proposal, apparently believing that its implementation would harm the interests of all shareholders and the capital markets.[7] The Council's concerns included the fear that many so-called "independent" directors, who would be required to vote for a disparate voting rights plan, are not free of financial, familial or occupational ties to the listed company. There has been question for some time about the independence of so-called "independent" directors. Likewise, the Council believes that the term "interested"

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6 Letter from Robert C. Pozen, General Counsel and Managing Director, Fidelity Investments, to Sarah A.B. Teslik, Executive Director, Council of Institutional Investors, dated July 28, 1992.

7 Letter from Sarah A.B. Teslik, Executive Director, Council of Institutional Investors, to James E. Buck, Secretary, NYSE dated June 29, 1992.

shareholders should not include many types of shareholders who really are interested. The Council further believes that a simple majority vote by the Board is inappropriate for this "permanent altering of the single most important corporate governance mechanism."

The United Shareholders Association ("USA") strongly opposed the concept proposal, but indicated a willingness to sign off on a shareholder approval approach if the requirements were made more stringent.[8] For example, USA suggested approval of a multiple class proposal by 85% of the "disinterested" shares, a requirement that the board of directors be composed of a majority of independent directors, a requirement that at least 25% of the board of multiple-class companies be elected directly by the low vote shares, and a prohibition on listing multiple-class companies with a voting rights disparity of more than 10 to 1.

Members of the American Bar Association's ("ABA") Task Force on Listing Standards of Self-Regulatory Organizations responded favorably to the proposal. They recommended, however, that any final proposal "clearly define those disparate voting arrangements which would in whole or in part invoke the protective provisions" described in the draft. The ABA members also suggested

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[8] Letter from Ralph Whitworth, President, USA, to William H. Donaldson, Chairman and Chief Executive Officer, NYSE, dated June 15, 1992.

modification of the three-step procedure in the NYSE's draft proposal to permit certain disparate voting rights plans.

C. Chairman Breeden's letter to Chairman Donaldson

There has been some reaction by the Commission to the proposal, Chairman Breeden, in a letter to the NYSE last July, expressed disappointment with the concept proposal.[9] The Chairman emphasized his preference for the approach codified in Rule 19c-4. He also stated that a "race to the bottom" by the exchanges could mean that legislative changes may be necessary to prevent undue impairment of shareholder voting rights. There has been continuing interest on this subject on Capitol Hill. It is interesting to note that Congressman Ed Markey, the Chairman of the Subcommittee on Telecommunications and Finance of the House Energy and Commerce Committee, in a recent press release applauding the Commission's executive pay and shareholder communication rules, stated "I will be especially interested in seeing what steps the Commission intends to take to establish finally that all shareholders are entitled to equal voting rights . . ."[10]

I strongly agree with the views of Chairman Breeden as expressed in his letter. The NYSE concept proposal is similar to the standard proposed

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9 Letter from Richard C. Breeden, Chairman, SEC, to William H. Donaldson, Chairman and Chief Executive Officer, NYSE, dated July 23, 1992.

10 Statement of Edward J. Markey, Chairman, House Subcommittee on Telecommunications & Finance on the SEC's Executive Pay and Shareholder Communication Rules (October 15, 1992).

recently by the Amex. With respect to the Amex's proposed shareholder voting rights standard, Commissioner Schapiro and I, in a letter to Chairman Jones, expressed great concern with that proposal.[11] For your information and enlightenment, I will read to you some of the text of this letter.

"We are troubled by the Committee's conclusion that the shareholder voting process is a 'cure all' for the problems of collective action. In our view, voting rights are fundamental rights, and no majority of current shareholders should be permitted to diminish or eliminate the voting rights of an opposed minority. We similarly are disturbed by the provisions of the Committee Report that would freely permit potentially disenfranchising issuances of high vote stock.

We are concerned that, should the Board adopt the Committee's recommendations as currently formulated, other exchanges will find themselves forced by competitive pressures to adopt similar voting rights policies. We had hoped that, rather than adopt a standard which affords shareholders less protection, the exchanges would agree collectively on a standard that embraced the principles of Rule 19c-4. We firmly believe that in the long run, if companies are allowed to undermine the rights of shareholders presently entitled to representation equal to their equity

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11 Letter from Mary L. Schapiro and Richard Y. Roberts to James R. Jones, Chairman, American Stock Exchange, dated April 9, 1991.

interest, we will discourage investment in U.S. equity securities, to the detriment of our domestic markets, companies, and economy."[12]

Those same comments apply equally as well to the proposal now advocated by the NYSE. The NYSE's shareholder voting rights standard has already dropped from an absolute one share, one vote requirement to a shareholder disenfranchisement rule that permits disparate voting rights plans that are not disenfranchising. It should not drop any further in my judgment.

The NYSE has long been the leader in the shareholder voting rights area. It is odd that the NYSE would be attempting to relinquish this leadership role when the Commission has just attempted, through a lengthy rulemaking proceeding, to increase information to shareholders, to make it easier for shareholders to communicate with each other and with corporate management, and to make alternatives available for shareholders when electing corporate directors. The Commission's proxy and executive compensation disclosure amendments are much less meaningful if the voting rights of shareholders are subsequently diminished by the NYSE. It is a mystery to me why the NYSE would be interested in rendering hollow the Commission's recent victory for shareholders.

Common stock shareholder voting rights should not be reduced

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12 Id.

simply because of the competition for listings among the markets. Hopefully, the NYSE will consider the implications its actions may have for investors in the securities markets and make the "right" decision. I do not believe that the NYSE concept proposal, if implemented, would enhance investor confidence in our securities markets. In fact, a decrease in such confidence would probably result.

I urge the members of this audience to encourage the NYSE to drop its most recent shareholder voting rights concept proposal and instead to retain and enforce its current 19c-4 standard.

III. TRANSPARENCY

A. General

I now wish to move to my second topic, transparency in equity securities, which, similar to the issue of shareholder voting rights, has investor protection implications.

Transparency has become the hallmark of efficient equity securities markets in this country. However, the development of new trading systems does pose a new set of transparency problems. The Commission has struggled over the past decade with this problem. The Commission has increasingly been forced to balance the need for innovation against the concern that the creation of these new markets may result in excessive market fragmentation and impair price transparency.

Obviously this is one area that the Commission's Division of Market

Regulation will focus on in its Market 2000 study.

B. Off-Shore and After Hours Trading

In addition to issues raised by new trading systems, attacks on the integrity of our markets also arise when firms send trades off-shore to be executed by their London affiliates in order to circumvent exchange regulations or to avoid reporting transactions to the U.S. market. While dealers have well-founded reasons about protecting proprietary information that would benefit their competitors, the need for trade information, which has been the strength of our markets, should not be ignored.

In May of 1991, the Commission approved the NYSE's proposal to operate a trading facility after the close of its 9:30 a.m. to 4:00 p.m. (ET) trading session ("off-hours trading facility").[13] The NYSE's off-hours trading facility consists of two sessions: Crossing Session I and Crossing Session II. The NYSE developed its off-hours trading facility as a means to attract back to the U.S. the portfolio trades that were being executed overseas. The NYSE apparently believes that the off-hours trading facility, particularly Crossing Session II, has been successful in recapturing some of this business. I hope that is the case.

Although the Commission permitted the NYSE initially to operate its crossing session for market baskets without requiring current reporting

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13 Securities Exchange Act Release No. 29237 (May 30, 1991). The system also will compete with domestic crossing systems.

transactions, this exemption from our current reporting requirements should be reexamined in the future. In addition, the Commission should reconsider whether the circumstances that justified the need for an exemption of this nature remain valid over time.

The Commission has indicated in the past that transactions in U.S. securities which are negotiated in the United States and sent abroad for execution are subject to U.S. securities laws. In a recent release, for example, the Commission stated:

> trades negotiated in the U.S. on a U.S. exchange are domestic, not foreign trades. The fact that the trade may be time-stamped in London . . . does not in our view affect the obligation . . . to maintain a complete record of such trades and report them as U.S. trades to U.S. regulatory and self-regulatory authorities and, where applicable, to U.S. reporting systems.[14]

The provisions of Section 11A and 17(a) of the Exchange Act, in my judgment, empower the Commission with the ability to compel such trade reporting. Rather than endorsing a practice that introduces the "virus of opacity" into the U.S. securities markets, the Commission could exercise this current authority to require reporting of transactions between U.S. securities institutions that are generated in the U.S. markets and only nominally "executed abroad." A securities trading policy that masks from

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14 See Securities Exchange Act Release No. 28899 (February 20, 1991).

the market important trade information, in my view, challenges the integrity of our capital markets and should not be permitted for long. This latter statement applies just as equally to new trading systems.

C. Rule 410B

There does appear to be some progress toward transparency in the overseas and off-hours market areas. Currently, transactions in NYSE listed stocks effected outside business hours or trades effected in foreign markets are not reported to the consolidated tape and, with the exception of program trading information, are not reported to the NYSE. The NYSE apparently is of the opinion that all transactions in at least NYSE-listed stocks should be reported to the Exchange, wherever or whenever they take place, and has advocated a rule requiring such reporting, at least with respect to NYSE-listed stocks. This rule comes in the form of proposed NYSE Rule 410B.

It is my understanding that the Division of Market Regulation, by delegated authority, will shortly be approving Rule 410B. The rule requires reporting of all trades in NYSE-listed securities by members and member organizations to the NYSE whenever such trades are not otherwise reported to the consolidated tape. Trades for members or member organization's own accounts or for their customer accounts are required to be reported to the NYSE under the rule. Trades by foreign affiliates of a member organization that are arranged and or executed in

the United States also are required to be reported. [15]

Rule 410B will hopefully provide both the NYSE and the Commission with a clearer picture of overseas and after-hours market transactions in NYSE-listed stocks. I view Rule 410B as a baby step in the right direction toward transparency with respect to U.S. securities transactions executed in overseas and after-hours markets, although I acknowledge there remains a great deal of distance left to cover. My preference is that these transactions should be reported to the consolidated tape.

IV. CONCLUSION

While differences do arise from time to time, continued communication often reduces the tensions surrounding these differences, and sometimes even reduces the differences. During my tenure on the Commission, a continual line of communication has always existed between me and the NYSE. I hope that this continuous dialogue is maintained throughout my term on the Commission. It is certainly my intention to preserve such a relationship. I do look forward to working with the NYSE toward confronting and resolving the securities public policy challenges that lie ahead.

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15 Rule 410B, however, does not generally apply to transactions in NYSE listed stocks that are effected outside of the U.S. for the account of a foreign affiliate of a NYSE member firm or transactions effected by such an affiliate for the account of a customer in a foreign country.