



**Remarks Of**

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Washington, D.C.**

**Proxy Reform and Shareholder Voting Rights**

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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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## **I. Introduction**

**During my confirmation process, I stressed the importance of strengthening investor confidence in our securities markets. In my judgment, increased investment is the key to a full recovery from our current national economic woes. Now more than ever, Congress, regulators, issuers, members of the bar and industry professionals must be concerned about the expectations and perceptions of shareholders and the general public. We also must remind investors that their participation, through investment in U.S. securities markets, is important and valued.**

**Although all investors are important and should be valued, I have been particularly concerned about the lack of direct individual equity investment participation. Individual investors have been leaving our securities markets for about 20 years, a trend that may now be reversing. I believe that there still exists a place in our securities investment structure for individual share ownership. Even though individual stockholders have become concerned about their ability to compete effectively on a short-term basis with professional investors and have fled to institutional participation,**

there are those who proclaim that the individual pursuit of a long-term securities investment strategy can continue to be successful. I also believe that it is incumbent upon the Commission to encourage direct individual investment participation when presented with an opportunity. With respect to the issues of proxy voting and minimum shareholder voting standards, the Commission may have such an opportunity.

II. Proxy Voting Reform

In recent months the Commission has undertaken a review of the effectiveness of the federal proxy rules in light of the dramatic growth in institutional equity ownership and increasing shareholder activism in matters relating to the governance of public companies. This review of the proxy and voting processes includes, but is not limited to, numerous proposals for proxy reform that either have been submitted to the Commission by corporate, individual or institutional shareholders, and other participants in the proxy process, or are the subject of debate in Congress and the academic and legal communities. As such, the review encompasses all

aspects of the proxy process, including contested and uncontested solicitations, the shareholder proposal system, and shareholder communications mechanisms.

In addition to covering disclosure issues, the review will focus on actions taken by the states, self-regulatory organizations, or public issuers to disenfranchise voters. In this regard, the Commission has been apprised that potentially significant restraints may be placed on the exercise of voting rights by individual limited partnership reorganizations, commonly referred to as roll-up transactions. The Commission also will consider investor concerns that its proxy rules erect unnecessary impediments to discussions among investors on the merits of these transactions.

It goes without saying that the issue of proxy voting reform unearths a host of controversial matters which prove difficult to resolve on a consensus basis. While I personally am inclined to favor increased communications between shareholders, a reduction in proxy voting costs, independent voter tabulation, confidential shareholder voting, and shareholder approval of extraordinary

business decisions such as golden parachutes and poison pills, I recognize that many in the Issuer community are not so inclined. Further, some of these items may be either inappropriate for consideration by the Commission under the umbrella of a proxy voting reform study or outside the Commission's legal authority. In any event, it does not appear that the staff of the Commission will conclude its study until the end of the year. I say this of course, although my predictive ability concerning Commission time schedules is not particularly acute.

### III. Shareholder Voting Rights

Without minimum shareholder voting standards, proxy voting reform will be meaningless. The unbundling of voting rights from common stock ownership removes yet another incentive for direct individual equity investment. Such unbundling decouples the accountability of corporate management to the shareholder. While the institutional shareholder, by virtue of the size of its capital, has to some extent the clout to wrangle concessions from corporate management to compensate for this lack of accountability, in the

absence of voting rights, an individual shareholder ordinarily has no such clout.

**A. History of Voting Rights Listing Standards**

As many of you are aware, at a July 7, 1988 public meeting, the Commission adopted a rule under the Exchange Act, known as Rule 19c-4, which amended the rules of national stock exchanges and the NASD to prohibit publicly traded companies from issuing securities or taking other corporate action that would have the effect of nullifying, restricting or disparately reducing the voting rights of existing shareholders of the company. Rule 19c-4 generally prohibited the listing of a company's securities if the company issued securities that restricted the voting rights of common shareholders. It was prospective in nature only, generally grandfathering in existing multiple voting capitalization structures. The Rule also contained a list of presumptively permitted transactions that were deemed not to have a disenfranchising effect on the voting rights of existing shareholders, such as the issuance of low vote stock in an initial public offering. The Commission was

of the opinion that Rule 19c-4 avoided burdening issuers and allowed companies flexibility in devising their capital structure, yet at the same time closed the window of opportunity for companies to disenfranchise shareholders.

Rule 19c-4 was short lived, however. Last June, in Business Roundtable v. SEC,<sup>1</sup> a federal circuit court invalidated the Commission's shareholder disenfranchisement rule. The United States Court of Appeals for the District of Columbia Circuit held that the Commission did not have the authority to adopt corporate governance rules under its Section 19(c) powers and that Rule 19c-4 to some extent encroached upon state corporate governance standards. The Commission ultimately decided not to appeal the case. I do not view Business Roundtable as either a particularly sound decision or as necessarily the final word on the Commission's authority in this area.

During the two years that Rule 19c-4 was in effect for the major securities markets, it is my view that it worked well and that

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<sup>1</sup> The Business Roundtable v. SEC, No.88-1651 (U.S.C.A.) (June 12, 1990).

it served its purpose of prohibiting shareholder disenfranchising transactions while permitting companies flexibility in devising their capital formation. Moreover, through interpretations published by the SROs, companies were becoming more familiar and comfortable with the rule. More importantly, the historical right of common stock holders to vote their shares was to some extent preserved.

**B. Current Voting Rights Listing Requirements After Rule 19c-4**

While the challenge to Rule 19c-4 was pending, the Commission approved a rule filing submitted by the NYSE under Section 19(b) of the Exchange Act that adopted the exact text of Rule 19c-4 as the basis for the NYSE's voting rights listing policy. The NYSE standard, like former Rule 19c-4, prohibits issuances, or corporate action, that has the effect of nullifying, restricting or disparately reducing the voting rights of common stock shareholders of the company. This standard continues to apply to NYSE listed companies today.

The NASD also submitted, and the Commission approved in October 1990, a proposal that adopts a voting rights standard for



**NASDAQ/NMS issuers that is identical to the Rule 19c-4 standard and the NYSE's standard. Unlike Rule 19c-4 which applied to all NASDAQ issuers, the NASD rule applies the substance of Rule 19c-4 only to NASDAQ/NMS issuers. There is currently no voting rights listing standards for non-NMS/NASDAQ quoted stocks.**

**Pending the adoption of a new voting rights rule, the Amex voting rights standard remains unchanged from the Amex standard in effect prior to the adoption of Rule 19c-4. That standard prohibits the listing of non-voting common stock but permits the listing of stock with super or inferior voting rights if certain requirements are met (this is known as the Wang Formula). The most important requirements are that the voting ratio between each class could not exceed 10 to 1 and the lower class had the right to elect at least 25% of the governing board.**

**In response to the invalidation of Rule 19c-4 in September, 1990, the Amex formed a special committee on Shareholder Voting Rights ("Committee") to study shareholder voting rights and to make recommendations on an appropriate Amex standard. The**

**Committee issued its recommendations to the Amex Board on February 14 ("Committee Report"). On April 11, 1991 the Amex's Board of Governors voted to adopt the recommendations made by the Committee with certain modifications.**

**Generally, the new Amex Board approved voting rights policy would permit listed companies to recapitalize into a multiple stock class structure if they obtained shareholder approval. The recommendation also covered two-class companies issuing additional shares that carry a higher voting power. The required shareholder approval would be either two-thirds of the total outstanding shares or a majority of the shares not affiliated with management or other controlling shareholders.**

**C. Concerns with the Amex Proposal**

**The Amex proposal is troublesome to me in several respects:**

- 1. Reliance on institutional holders to protect individual shareholders: The Committee Report stresses the fact that Institutional shareholders have become more active in corporate governance, so that a**

shareholder vote requirement is an effective protective measure. Yet, the Report states many Amex companies have institutional holdings below 20%. How can this low percentage class of shareholder, for most Amex listed companies, help prevent a dual class recapitalization that may not be in the best interests of shareholders? The reliance on institutional investors as de facto representatives of individual shareholders does not appear to be well founded.

2. Shareholder approval as a solution to collective action problems: The Committee Report does not address coercive aspects of the vote itself. The coercive theory of collective action is that the vote process is unable to protect individual shareholders from actions that may be disenfranchising and that individually they would oppose, but as a group are forced to accept.

- 3. Disenfranchised minority: The Committee Report does not address the concerns of the disenfranchised minority. The alternative requirement of a 2/3rds vote including insiders or a majority of shares held by outsiders allow companies with large inside holdings to force a dual class recapitalization on the outside minority shareholders. This is inherently unfair to minority shareholders, particularly because these holders bought, and the company sold, stock with the full understanding that the shares carried a vote. Under the Amex proposal, these minority shareholders could be unwillingly disenfranchised.**
- 4. Committee's view that its recommendations provide more shareholder protection than Rule 19c-4 in some respects:**

**The Committee Report claims the Committee recommendations are more protective than Rule 19c-4 because it will let shareholders vote on the ability to disenfranchise themselves. This is clearly not true for**

**the disenfranchised minority, and probably not even true for all shareholders due to the collective action problem.**

**The Rule 19c-4 standard prohibited disenfranchisement of common stock shareholders. That standard itself represented a partial retreat from the historical one share, one vote standard. The Amex proposal would permit disenfranchising actions only subject to approval of a majority of the non-affiliated shareholders or 2/3rds of all shareholders including the insider control group.**

**I still believe, as the Commission apparently did when it promulgated Rule 19c-4, that shareholder approval requirements are inadequate to protect shareholders from disenfranchising transactions.**

**Because the Amex Board decided to adopt the Committee recommendations, I fear that there may be a renewed "race to the bottom" in voting rights listing standards among the major securities markets. The NYSE has been waiting to see what action the Amex would take and indications have been that the NYSE would continue to uphold a 19c-4 standard only if the Amex**

continued to do so. The NASD, in adopting the Rule 19c-4 standard for NASDAQ/NMS stocks, also indicated that it would consider changes depending on what the other major markets did. Accordingly, the Amex's actions clearly have the ability to unravel any steps that have been made to protect shareholders from disenfranchising actions.

As I previously mentioned, any change in listing standards generally requires that Amex submit a rule proposal to the Commission for its rejection or approval as a new exchange rule. It is my understanding that to date, the Amex has not submitted to the Commission a rule request for a new listing standard consistent with its Board action. It would be my recommendation that the Amex Board reconsider its decision and instead adopt a Rule 19c-4 like standard.

A recent news article indicated that California is currently considering whether to revoke the blue sky exemption for Amex listed companies in the event Amex adopts the new voting rights policy recently approved by the Amex Board. While I do not have

any additional information to date, I do believe that such an action by California would provide significant pressure on the Amex to rethink its shareholder approval approach for dual classes. Along those same lines, I have personally recommended to several representatives of the North American Securities Administrators Association ("NASAA"), the national organization for state securities administrators, that NASAA consider approving a resolution recommending that their state legislators revoke the blue sky exemption for Amex listed companies in the event Amex adopts the new voting rights policy recently approved by the Amex Board.

**D. Legislation**

With respect to potential federal legislative action on this issue, Chairman Breeden issued a recent statement to the Subcommittee on Telecommunications and Finance of the House Energy and Commerce Committee in connection with testimony on limited partnership "roll-ups" concerning the possibility of a legislative solution to the shareholder voting rights problem. The Chairman stated that "... if Congress wants to exercise its power to"

even the scales "between investors and insiders, it should consider identifying certain minimum federal protections for voting rights in any publicly traded corporation or partnership." I am confident that bills clarifying the authority of the Commission in this area will soon be introduced in both the House and the Senate.

#### IV. Conclusion

In conclusion, I believe that common stock shareholder voting rights are arguably the strongest basis for management accountability in our corporate system and should not be dispensed with simply because of the competition for listings among the markets.

The Amex Board action represents, in my judgment, a substantial backward step from the standard enunciated in Rule 19c-4. I remain convinced that if the accountability alternatives available to individual shareholders are only "grin and bear it" or "take the Wall Street Walk," then they will elect to either own common stock institutionally or not at all. Under either result, corporate management, when under duress, will be forced to confront



**and negotiate with institutional shareholders at an increasing pace thereby rendering meaningless, as a general proposition, any value to corporate management of a dual class capitalization. Under a no investment result, our securities markets will become less liquid and thereby less efficient, which will substantially impair our capital formation process.**