February 13, 2006

Mr. Jonathan G. Katz, Secretary
Security and Exchange Commission
Station Place, 100 F Street, NE
Washington, DC 20594-9303

Via email: rule-comments@sec.gov

Re: Proposed Rule for Internet Availability of Proxy Materials (Release No. 34-52926; File No. S7-10-05; 70 FR 74598, 12/15/05)

Dear Mr. Katz:

The proposed rule published in Commission Release No. 34-52926, "Internet Availability of Proxy Materials" (the "Proposed Rule") is an admirable attempt to escape the labyrinthine channels that issuers and shareholders are now forced to use to distribute and act on proxy materials. The current system of distribution through intermediaries impedes communication by making it slow and expensive.[1] Congress has repeatedly expressed concern about these impediments to communication between issuers and shareholders,[2] and in its 2004 petition for rulemaking,[3] the Business Roundtable pointed to the injustice of forcing issuers to bear the costs of the current system. As I explain below, however, the proposed method of posting proxy

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1 As the release for the Proposed Rule states, "We [the Commission] note that it would take more time for the delivery of proxy materials to beneficial owners through intermediaries than for delivery of the materials directly by the soliciting person to record owners." Release No. 34-52926, at p. 74609.

2 "There is evidence that 'street name' registration may be making shareholders communications more difficult by imposing a layer of record ownership between the corporation and its beneficial owners. . . . This phenomenon makes the dissemination of proxy material, financial reports, and other communications to shareholders a more complex procedure and one subject to greater possibility of error and delay. It also makes it extremely difficult for a corporation or a stockholder of a corporation to identify the beneficial owners of the corporation's shares." S. REP. No. 94-75 at 237, *reprinted in* 1975 U.S.C.C.A.N. 179; *see* also The Shareholders' Communication Act of 1985, P.L. 99-222, 99 Stat. 1737 (December 28, 1985). When this concern was expressed in 1975, it was outweighed by the immediate need to stabilize the infrastructure for the settlement of securities transfers following the "paper crunch" debacle, and "immobilization" of shares in a central depository was seen as the most feasible, immediate solution. *See infra* note 19 and accompanying text.

3 *See* The Business Roundtable, Request for Rulemaking Concerning Shareholder Communications, SEC File no. 4-493 (April 12, 2004).

materials on the Internet – a means of notice publication used in Continental Europe – is in many ways incompatible with the corporate laws of the U.S. states.

The indirect, costly manner in which proxy materials are now distributed to shareholders (see Figure 1, annexed to this letter at page 6) is the result of the so-called indirect holding system for securities settlement, which was developed in the 1970's to reduce the paper work involved in transferring securities and to allow the market to keep pace with growing volumes.[4] In the "indirect holding system," shares are no longer transferred as such, but remain registered in the name of a central depository or lower tier intermediary and only entitlements to the contents of a securities account with the depository or intermediary are transferred.[5] This system simplifies the transfer of shares and lowers settlement risk, but does so by essentially eliminating the informational function of registered shares for issuers (as far as the issuer knows, it may only have one shareholder, the central securities depository). This system erects a wall of anonymity between issuers and shareholders (now called "beneficial owners").

Under American corporate law, shareholders have certain rights to govern and profit from the corporations they establish; these rights normally include the right to elect directors, vote on major transactions, receive dividends if declared, and inspect corporate books and records. Within this system of American corporate law, the "stock ledger", "shareholder register" or "stockholder list" is designed to provide the corporation with a definitive list of the persons who have such rights. According to the laws of some states, such as Delaware, the stock ledger is "the only evidence as to who are the stockholders entitled . . . to vote" or exercise the right to inspect corporate records.[6] The stockholders who are recorded on the ledger at the "record date" are those who have the right not only to vote but also to receive dividends.[7] The corporate laws of the U.S. states were designed so that corporations could directly notify shareholders of annual meetings at the address for each shareholder entered in the ledger or register. Since Congress instructed the Commission in 1975 to promote the "immobilization" of securities in order to facilitate settlement of transactions,[8] the stock ledger of listed companies has come to contain less and less information, and for some companies it may only contain one name: "Cede & Co.", the nominee of The Depository Trust & Clearing Corporation, which currently controls 99 % of the nation's securities that are eligible for central custody settlement.[9]

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4 *See*, Securities and Exchange Commission, "Final Report of the Securities and Exchange Commission on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other Than the Name of the Beneficial Owner of Such Securities," House Doc. 2743 (Dec. 3. 1976), at 9-10.

5 *See* Prefatory Note to Article 8, Uniform Commercial Code (1994).

6 *See* Del. Code Ann. tit. 8, § 219(c) (2005).

7 *See* Del. Code Ann. tit. 8, § 213 (2005).

8 *See* § 17A(e) Securities Exchange Act, where Congress oddly legislates into the technical details of the settlement system to impose immobilization: "The Commission shall use its authority under this title to end the physical movement of securities certificates in connection with the settlement among brokers and dealers of transactions in securities . . . ." 15 U.S.C.A. § 78q-1(e) (2000).

9 *See* remarks of Richard B. Nesson, Managing Director and General Counsel of The Depository Trust and Clearing Corporation, SEC Historical Society, Fireside Chat: "Business Recovery Requirements for Clearance and Settlement in Light of September 11th" (Nov. 11, 2004), available at http://www.sechistorical.org/museum/programs/index.php.

The "immobilizing" of the nation's equity market under the name of a single company has created enormous efficiency in securities settlement (by essentially eliminating transfer in the classical sense), but it has also crippled the highly effective system of direct communication between issuers and shareholders foreseen by American corporate law. Shareholders have become essentially anonymous, as if they held bearer shares. In this context, it is reasonable for the Commission to borrow a technique of publication notice from countries like France and Germany, where bearer shares make it impossible for companies to contact their shareholders directly.[10] In these countries, notices to shareholders were originally published in "official gazettes" or designated business newspapers, and with the advent of new technologies paper is being replaced with Internet posting.[11] Problems arise in the Commission's proposal, however, because a U.S. stock corporation – unlike a French *société anonyme* – issues registered shares, not bearer shares.

One problem regards proof of legitimacy. It is true that the posting of proxy materials on the Internet would allow "beneficial owners" of shares to read such materials without the delays caused by distribution through layers of intermediaries. However, the "beneficial owners" are not in the "stock ledger" and are thus not legally shareholders of the issuer.[12] Because only shareholders can vote shares, it is of little use for a "beneficial owner" to download the proxy materials off the Internet and read them, for she can't vote "her" shares. Of course, Cede & Co., the legal stockholder, can issue its participant bank a proxy, and the latter can then issue its correspondent bank a proxy, and the latter can then issue the retail broker a proxy, and the broker can then issue the "beneficial owner" a proxy, and then she can vote her shares, but this is no simple process and is in no way alleviated by the posting of materials on the Internet.[13]

Another problem is that the Proposed Rule must accommodate the state corporate law requirement that issuers provide shareholders with direct notice of general meetings. Therefore,

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[10] Indeed, the Commission's Proposed Rule looks so much like the old French system that, in his January 3, 2006 comment, M. Pierre-Henri Leroy, President of Proxinvest sarl, Paris, France, gives the Commission some advice on how to avoid the problems that arise in connection with a system of publication notice for holders of bearer shares (such as blocking shares before a meeting to prove the right to attend and vote).

[11] In Germany, where stock corporations traditionally issue bearer shares, § 124(1) of the German Stock Corporation Act requires the call to annual meeting to be published in designated business newspapers, and pursuant to § 25 of this Act, the requirement is satisfied by posting the notice on the electronic version of the *Official Gazette*, which is a designated, internet bulletin board at https://www.ebundesanzeiger.de/research/banzservlet. It should be noted that § 125(2) of the Act requires the corporation to *directly* notify *registered* shareholders (i.e., owners of registered shares who are entered in the shareholders' register).

[12] *See* e.g., in the area of corporate law, Del. Code Ann. tit. 8, § 219(c), and, in the area of commercial law, U.C.C. § 8-207 (1994). "Beneficial owners" also need intermediaries' help to exercise a shareholder's right to inspect the books and records of a company because beneficial owners are not shareholders. *See* the comment of The Committee of Concerned Shareholders on the Proposed Rule, dated December 8, 2005.

[13] Advocates of the Proposed Rule may answer this objection with the suggestion that the United States simply move toward France and Germany by having the 50 states adopt systems of bearer shares. However, it should be noted that Germany is, for reasons of investor relations and the superiority of direct communications (which modern settlement technology allows), moving toward a system of registered shares. Many of Germany's largest corporations, such as Deutsche Bank and DaimlerChrysler, have switched to registered shares.

the Proposed Rule would require issuers to *directly mail* a "Notice of Internet Availability of Proxy Materials" to shareholders.[14] The distribution of this "Notice" would require the same labyrinthine procedure now used for the distribution of proxy materials. Thus, there would be no acceleration of the distribution of such materials, but only a potential savings in the bulk of what must actually be distributed,[15] and hopefully a savings in printing costs.

It should also be noted, however, that because of the nature of financial printing, savings in connection with printing materials would not be as significant as one might hope.[16] Unlike many other types of printers, financial printing companies must typeset text very rapidly and precisely to meet the time constraints of their clients. This means that for each document, regardless of the number of copies actually printed, the typesetting and layout of the document make up a disproportionately high percentage of the overall printing costs. Thus, for example, the second 50,000 copies in a printing of 100,000 proxy statements will represent much less than 50% of the total printing cost to the issuer. Moreover, because under the Proposed Rule, shareholders may always request hard copies,[17] and because such requests could exceed the number that an issuer holds in reserve, a company could be forced to print a second batch – which would require incurring the substantial cost of setting up the presses again. Therefore, even if the Proposed Rule were adopted, it would be economically rational for issuers to continue printing a high volume of copies to hedge against the risk of high shareholder demand. In this case, Internet posting would not significantly lower printing costs.

As a result, although it is very reasonable for the Commission to propose a European technique to match the "European" system of de facto bearer shares we have created with our "indirect holding system," the proposal runs up against the problem that we still have American stock corporations with American registered shares, and the rights of stockholders often hinge on being enrolled in the shareholders' register. Of course, we could instead import a transplant from a tradition a little closer to home. Under the English Companies Act of 1985, an issuer can simply demand that a registered shareholder reveal the identity of any beneficial owner, and if the holder fails to comply the company can ask the court to suspend the voting, dividend and transfer rights of the shares.[18] However, such coercion would rarely be necessary if shareholders were directly listed on the stock ledger.

Therefore, the Commission should hesitate to adopt the Proposed Rule in its current form. Although it appears to alleviate burdens caused by the circuitous method of distributing proxy

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14 *See* § 240.14a-3(g)(1), as proposed to be amended, in Release No. 34-52926, p. 74617.

15 The mailing of individual proxy material packets on an as-requested basis, as no. 3 of the proposed Legend on the "Notice of Internet Availability of Proxy Materials" provides, could be quite expensive. Postal rates for mass mailings are significantly lower than individual mailing rates, and even if the issuer and the various intermediaries were to centrally outsource the dispatch of mailed copies to a single entity like Automatic Data Processing (ADP), the batches mailed would likely be smaller and more numerous, and would necessitate higher handling costs and postage rates than a single mass mailing.

16 This information is based on my conversation with the general manager of the Frankfurt office of Bowne Financial Printers, which is currently the world's largest printer of securities prospectuses and proxy statements.

17 *See* § 240.14a-3(g)(2)(i), Legend for Notice, no. 3, as proposed to be amended, in Release No. 34-52926, p. 74616.

18 *See* Companies Act of 1985, §§ 212-216 (Eng.).

materials through intermediaries, it fails to account for the fact that direct distribution of a notice to beneficial owners will still be slow and costly, and that beneficial owners can do little with the information posted on the Internet unless they have the right to vote as shareholders. In addition, the magnitude of savings on printing and postage costs are debatable.

A real solution to the problem of circuitous communication with unknown shareholders is *direct registration.* The Commission first discussed direct registration as an optimal solution in 1971,[19] and then launched it as a practical reality in the 1990's with the Direct Registration System (DRS).[20] DRS, combined with the possibility of direct electronic delivery of proxy materials, would allow issuers to distribute materials cheaply and quickly to shareholders, and allow shareholders to respond just as quickly with a request for paper delivery or perhaps by voting electronically. This would reduce not only costs, but also shareholder apathy, and guarantee that not just the largest shareholders are known to and have the possibility of contacting management. The DRS system is now fully operational,[21] and – as no major securities exchange or state still requires the issue of paper stock certificates – is no longer a "utopian" option,[22] but one within grasp. The Commission should encourage and facilitate its use to eliminate the impediment to communication which is the "indirect holding system" rather than introducing a system of "publication notice" designed for bearer shares.

Thank you for giving me an opportunity to express my views on this proposed rule. I hope you find them useful. If you have any questions, please contact me at the email address listed below.

Respectfully submitted,

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19 The Commission may remember that, in the aftermath of the 1960's "paper crunch," which nearly crippled the market, dematerialization of shares and the introduction of a system like DRS was considered the most desirable solution, but was thought to be "utopian". "Immobilization" was considered an intermediate step to this ultimate goal. *See* Securities and Exchange Commission, "Study of Unsafe and Unsound Practices of Brokers and Dealers," House Doc. 92-231 (1971), p. 191.

20 *See* Securities and Exchange Commission, Concept Release, "Transfer Agents Operating Direct Registration System," Release No. 34-35038, File No. S7-34-94 (Dec. 8, 1994).

21 *See* Securities Industry Association, "Securities Industry Immobilization & Dematerialization Implementation Guide – *The Phase Out of Stock Certificates*" (2004), available at www.sai.com.

22 In 1971, the Commission noted that one reason it backed the central depository solution over direct registration was the opinion, expressed by the Rand Corporation among others, that "the proposed utopian solution of abolishing the stock certificate would require very extensive legal work and lead time to implement." SEC, *supra* note 19, at 194. That legal work is now all but complete and the lead-time has disappeared.

Figure 1

Indirect Distribution of Proxy Materials in the Indirect Holding System