

Standing Voting Instructions: Empowering the Excluded Retail Investor

Law Working Paper N° 360/2017

July 2017

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Abstract

Despite the increasing importance of shareholder voting, regulators have paid little attention to the rights of retail investors who own approximately 30% of publicly traded companies but who vote less than 30% of their shares. A substantial factor contributing to this low turnout is the antiquated mechanism by which retail investors vote. The federal proxy voting rules place primary responsibility for facilitating retail voting in the hands of custodial brokers who have limited incentives to develop workable procedures, and current regulatory restrictions impede market-based innovation that incorporate technological innovations.

One of the most promising such innovations is standing voting instructions (SVI). SVI allows investors to designate their voting preferences in advance of shareholders' meetings and have their shares voted in accordance with those preferences. Although SVI is readily available to institutional investors, the federal proxy rules prevent its use by retail investors, and proposals seeking modifications of these rules have languished before the Securities & Exchange Commission (SEC) for years. The SEC's primary rationale for failing to act is the concern that SVI will lead to uninformed voting.

This Article addresses and rejects the claim that the risk of uninformed voting justifies the SEC's failure to remove the regulatory obstacles to SVI. Current technology is consistent with the creation of voting platforms that allow retail investors meaningful participation in the voting process while retaining appropriate safeguards to minimize the potential for adverse effects. Ironically, implementation of voting platforms allowing SVI has the potential to make retail investor voting both more efficient and better informed and to increase the legitimacy of corporate democracy.

Keywords: Corporate governance, directors, boards, shareholders, shareholder rights, shareholder voting, corporate elections, corporate ballot, proxy fights, proxy contests, retail investors, broker voting, innovation, technological innovations in voting, standing voting instructions, SVI

JEL Classifications: G30, K22

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*Jill E. Fisch**

(forthcoming Minnesota Law Review 2017)

Abstract

Despite the increasing importance of shareholder voting, regulators have paid little attention to the rights of retail investors who own approximately 30% of publicly traded companies but who vote less than 30% of their shares. A substantial factor contributing to this low turnout is the antiquated mechanism by which retail investors vote. The federal proxy voting rules place primary responsibility for facilitating retail voting in the hands of custodial brokers who have limited incentives to develop workable procedures, and current regulatory restrictions impede market-based innovation that incorporate technological innovations.

One of the most promising such innovations is standing voting instructions (SVI). SVI allows investors to designate their voting preferences in advance of shareholders' meetings and have their shares voted in accordance with those preferences. Although SVI is readily available to institutional investors, the federal proxy rules prevent its use by retail investors, and proposals seeking modifications of these rules have languished before the Securities & Exchange Commission (SEC) for years. The SEC's primary rationale for failing to act is the concern that SVI will lead to uninformed voting.

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This Article addresses and rejects the claim that the risk of uninformed voting justifies the SEC's failure to remove the regulatory obstacles to SVI. Current technology is consistent with the creation of voting platforms that allow retail investors meaningful participation in the voting process while retaining appropriate safeguards to minimize the potential for adverse effects. Ironically, implementation of voting platforms allowing SVI has the potential to make retail investor voting both more efficient and better informed and to increase the legitimacy of corporate democracy.

Introduction

Institutional investor voting is a hot topic. Academics debate the efficacy of institutional activism.¹ Issuers malign the voting behavior of institutions who blindly follow the recommendations of proxy advisors such as ISS and Glass Lewis.² The SEC and the Department of Labor caution institutional investors that voting the shares of their portfolio companies is a fiduciary responsibility.³

In contrast, no one cares very much about the retail investor vote.⁴ With institutional investors holding a growing percentage of publicly-

¹ See, e.g., Leo E. Strine, Jr., Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law, 114 Colum. L. Rev. 449 (2014) (questioning the hypothesis that empowering activist shareholders will increase long term shareholder value); Lucian A. Bebchuk, Alon Brav & Wei Jiang, The Long-Term Effects of Hedge Fund Activism, 115 Colum. L. Rev. 1085-1156 (2015). (offering empirical evidence about the effects of shareholder activism on long term firm value).

² See, e.g., Written testimony of Darla C. Stuckey, SVP, Policy & Advocacy Society of Corporate Secretaries and Governance Professionals, before Subcommittee on Capital Markets and Government Sponsored Enterprises Committee on Financial Services, United States House of Representatives at 5 <http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-dstuckey-20130605.pdf> (describing reports from issuers that their investors follow proxy advisor recommendations without questioning them).

³ See notes __ through __ infra and accompanying text (discussing Department of Labor Avon letter and SEC rulemaking).

⁴ See Frank G. Zarb Jr., Restoring Balance in Proxy Voting: The Case For “Client Directed Voting,” Harv. L. Schl. Forum on Corp. Gov. & Fin. Reg., Feb. 14, 2010. <http://corpgov.law.harvard.edu/2010/02/14/restoring-balance-in-proxy-voting-the-case-for-client-directed-voting/> (observing that “the absence of retail investor participation [in corporate proxy voting] is mostly ignored”), but see Daniel Gallagher, Opening Statement at the Proxy Voting Roundtable, Feb. 19, 2015,

traded shares,⁵ the limited propensity of retail investors to vote their shares⁶ and the economic cost of reaching out to individual investors to solicit their proxies, the retail vote has been all but forgotten.⁷

The ability of retail investors, if engaged, to have a meaningful effect on the outcome of a shareholder vote is one reason to reconsider this approach.⁸ The 2015 proxy contest at DuPont offers an example. In a closely-contested election contest in which hedge fund activist Trian nominated four candidates for the DuPont board, DuPont emerged victorious.⁹ Although many large institutional investors, as well as the major proxy advisory firms, supported some or all of the Trian slate, none of Trian's nominees was elected.¹⁰ According to both Nelson Peltz and DuPont CEO Ellen Kullman, DuPont's victory was due, in part, to the support of its retail investors.¹¹

<https://www.sec.gov/news/statement/opening-statement-proxy-voting-roundtable-gallagher.html> (expressing particular interest in hearing “if there are ways in which the Commission can improve retail shareholder participation in the proxy process”).

⁵ Institutional investors own 70% of the share of US companies. John Endean, *The Untapped Power of Individual Investors*, Wall St. J., Oct. 5, 2014

<http://www.wsj.com/articles/john-endean-the-untapped-power-of-individual-investors-1412543380>

⁶ According to one report, retail investors vote only 29% of their shares, while institutional investors vote 90%. *Id.*, quoting Broadridge 2015 Proxy Season Preview at 6, <http://media.broadridge.com/documents/Broadridge-PwC-ProxyPulse-1st-Edition-2015.pdf>.

⁷ In the 1940s and 50s, retail shareholders attended some annual meetings in substantial numbers. James McRitchie, *Retail Shareholder Proxy Participation: Part 2 – CDV*, Corporate Governance, Feb. 17, 2015, <https://www.sec.gov/comments/4-681/4681-4.pdf>.

⁸ See, e.g., Broadridge, *Proxy Pulse 2016 Proxy Season Preview*, at 3, <http://media.broadridge.com/documents/ProxyPulse-First-Edition-2016.pdf> (“Data continues to show that engagement of the retail investor base can play an instrumental role in the outcome of a shareholder meeting.”).

⁹ Jacob Bunge & David Benoit, *DuPont Defeats Peltz, Trian in Board Fight*, Wall St. J., May 13, 2015.

¹⁰ *Id.*

¹¹ Jeff Mordoch, *Retail shareholders cited as key to DuPont's victory*, Delawareonline, May 13, 2015, <http://www.delawareonline.com/story/money/business/2015/05/13/trian-rebuffed-dupont-slate-wins-seats/27226613/>. See also Ronald Orol, *Why DuPont Beat Nelson Peltz in the Biggest Proxy Fight in Years*, The Street.com, May 20, 2015, <https://www.thestreet.com/story/13158047/3/why-dupont-beat-nelson-peltz-in-the-biggest-proxy-fight-in-years.html> (quoting Bruce Goldfarb, CEO of proxy solicitor Okapi Partners as stating that the vote by retail investors was “possibly a real factor in the decision.”).

A second reason to reconsider the importance of retail investor voting is the virtual elimination of discretionary broker voting.¹² Prior to 2010, NYSE Rule 452 permitted brokers to cast votes on most issues with respect to shares that they held as custodians if they did not receive voting instructions from the beneficial owner.¹³ The NYSE gradually narrowed the scope of this discretionary voting authority.¹⁴ By January, 2012, brokers were barred from exercising discretionary voting authority with respect to uncontested director elections, say-on-pay and charter and bylaw amendments.¹⁵ Now, with respect to all of these issues, if shareholders do not provide their brokers with voting instructions, their shares will not be voted at all.¹⁶

A final and perhaps most important reason is to preserve the legitimacy of shareholder voting in reducing managerial agency costs and

¹² See notes __ - __ infra and accompanying text (describing process by which NYSE reduced the scope of discretionary broker voting).

¹³ NYSE Rule 452. The rule authorized discretionary broker voting for so-called “routine” issues. Thus brokers were not allowed to vote uninstructed shares with respect to matters such as proxy contests or mergers. See Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Sec. Exch. Act Rel. No. 34-60216, July 1, 2009, at 2 n. 7, www.sec.gov/rules/sro/nyse/2009/34-60215.pdf (explaining scope of Rule 452 prior to the 2009 amendments); at 5 n. 14 (listing non-routine matters under the rule).

¹⁴ See notes __ through __, infra and accompanying text. Previously in 2003, the NYSE amended Rule 452 to ban discretionary voting with respect to approval of equity compensation plans. Self-Regulatory Organizations; New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc.; Order Approving NYSE and Nasdaq Proposed Rule Changes and Nasdaq Amendment No. 1 and Notice of Filing and Order Granting Accelerated Approval to NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3 Thereto Relating to Equity Compensation Plans, Sec. Exch. Act Rel. No. 48108, June 30, 2003, www.sec.gov/rules/sro/34-48108.htm.

¹⁵ NYSE Regulation Inc., Information Memo Number 12-4, Jan. 25, 2012, <https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-interpretations/2012/12-4.pdf> (explaining that these subjects will be treated as “Broker may not vote” matters under NYSE Rule 452).

¹⁶ Shares for which a broker has not received voting instructions are typically called broker “non-votes.” As long as there is at least one routine matter being voted on at the shareholders meeting, such as the ratification of the auditing firm, broker non-votes may be counted toward a quorum. Latham & Watkins, Recommended Proxy Disclosure for Director Elections and Other Proposals, Client Alert, March 3, 2016, <https://www.lw.com/thoughtLeadership/LW-recommended-proxy-disclosure>.

maintaining director accountability.¹⁷ Recent regulatory changes and the rise of shareholder activism have made shareholder voting power increasingly important.¹⁸ Shareholders today vote on a growing range of issues such as executive compensation¹⁹ and shareholder-nominated director candidates.²⁰ Recent developments in Delaware corporate law provide that director decisions that have been approved by an informed shareholder vote are largely insulated from judicial oversight.²¹ Yet current voting outcomes do not reflect the preferences of all shareholders. Currently, 90% of institutional shares are voted, but voting turnout by retail investors averages less than 30%.²²

Low retail turnout allows institutional investors to dominate election results,²³ but there are reasons to believe that retail investor voting preferences differ systemically from those of institutional investors. According to at least some commentators,²⁴ retail investors are more likely

¹⁷ See *Blasius, Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) (“The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”).

¹⁸ See, e.g., Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 *Colum. L. Rev.* 862, 897 (2013) (explaining how activist shareholders are able to leverage their power by attracting the voting support of more passive institutional investors).

¹⁹ See *Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, Sec. Act Rel. No. 9178, Apr. 4, 2011, www.sec.gov/rules/final/2011/33-9178.pdf (adopting rule providing for shareholder approval of executive compensation).

²⁰ See Skadden, *Proxy Access: Highlights of the 2016 Proxy Season*, June 28, 2016, https://www.skadden.com/sites/default/files/publications/Proxy_Access_Highlights_of_the_2016_Proxy_Season.pdf (describing the increasing adoption of proxy access provisions that enable shareholders to nominate director candidates on the issuer’s proxy statement).

²¹ See, e.g., *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 305-6 (Del. Sup. 2015) (rejecting a challenge to a merger where the merger had been approved by a fully informed shareholder vote).

²² Broadridge, *supra* note ____.

²³ See Mark Egan, *Just 27% of investors bother to vote*, CNN Money, June 12, 2014, <http://buzz.money.cnn.com/2014/06/12/shareholders-dont-vote/> (poor turnout by retail investors means “their voices are being drowned out by large institutions on hot-button issues”); See Dominic Jones, *Did e-proxy figure in Apple’s surprise say-on-pay loss?*, March 5, 2008, www.irwebreport.com/daily/2008/03/05/did-e-proxy-figure-in-apples-surprise-say-on-pay-loss. (stating that “Low retail turnout has the effect of amplifying the votes of institutional activist investors”).

²⁴ But see Brunswick Group, *A look at Retail Investors’ Views of Shareholder Activism and Why it Matters* (July 2015), available at <https://www.brunswickgroup.com/media/597919/Brunswick-> (reporting, based on

to support management²⁵ and to vote in favor of executive compensation plans.²⁶ These differences matter. Although institutional investors hold the majority of voting stock of publicly-traded companies, retail shareholders own enough shares to make a difference; in many cases, a voting threshold of 20-30% can have a critical effect on the issuer.²⁷

Although there are many plausible reasons for the low voting rate among retail investors,²⁸ the mechanics of the voting process are likely a substantial factor. Institutional investors can vote their stock easily and inexpensively – Institutional Shareholder Services (ISS) and other third party services provide voting platforms that enable institutions to authorize the voting of their shares in advance, either in accordance with customized voting guidelines or in accordance with a proxy advisor or management recommendation and to, in essence, automate the voting

results from survey of 801 retail investors, that the majority of these retail investors believe activists add long-term value, and may thus be more likely to support activists than generally thought).

²⁵ See, e.g., Neil Stewart, Retail shareholders: looking out for the little guy, IR Magazine, May 15, 2012, <https://www.irmagazine.com/articles/shareholder-targeting-id/18761/retail-shareholders-looking-out-little-guy/> (reporting that retail investors are more likely to support management than institutions); Mary Ann Cloyd, How Well Do You Know Your Shareholders?, Harvard Law School Forum on Corporate Governance and Financial Regulation Blog, June 18, 2013, available at <https://corpgov.law.harvard.edu/2013/06/18/how-well-do-you-know-your-shareholders/> (stating that “retail shareholders support management’s voting recommendations at high rates”).

²⁶ Proxy Pulse, 2016 Proxy Season Preview at 2 (reporting that “Among companies that failed to surpass the 70% support threshold for say on pay, retail investors cast 66% of their votes in favor — while institutions cast 65% of their votes against.”); David Bogoslaw, Retail investors seen as key to firms struggling on say on pay, says ProxyPulse, Corporate Secretary, Oct. 4, 2103, <http://www.corporatesecretary.com/articles/proxy-voting-shareholder-actions/12552/retail-investors-seen-key-firms-struggling-say-pay-says-proxypulse/> (highlighting importance of retail vote for say on pay).

²⁷ See Comments of Allen Beller at SEC Proxy Voting Roundtable, Feb. 19, 2015, Unofficial transcript, <https://www.sec.gov/spotlight/proxy-voting-roundtable/proxy-voting-roundtable-transcript.txt> (retail is more important now because shareholder voting isn’t just important in election contests it is withhold vote campaigns and say on pay and directors who get less than 70% can wind up leaving.); Comments by Reena Aggarwal, id., (“twenty to thirty percent dissent votes can make a big difference”).

²⁸ See Yaron Nili & Kobi Kastiel, In Search of 'Absent' Shareholders: A New Solution to Retail Investors' Apathy, __ Del. J. Corp. L. __ (November 16, 2016), <https://ssrn.com/abstract=2870590> (attributing low voting rates by retail investors to rational apathy).

process.²⁹ Retail investors have no such option and must submit separate voting instructions in connection with each shareholder meeting through a process that is cumbersome, in many cases is not directly linked to an investor's brokerage account and that provides no mechanism for creating across-the-board instructions or voting policies. It is little wonder that the level of retail voting is low and continues to fall.³⁰

In addition to disenfranchising retail shareholders, the fact that, on average, 20% of shares are unvoted may disserve issuers. As Scott Hirst has observed, low turnout may prevent issuers from making governance changes that are, in fact, supported by both boards and shareholders, due to their inability to obtain the necessary vote threshold.³¹ The problem arises because many voting issues require support by a majority or supermajority of outstanding shares.³² Unvoted shares count as votes against the proposal.³³ The problem of so-called "frozen charters" is particularly acute in that issuers frequently include provisions in their IPO charters that restrict the rights of public shareholders, such as classified boards or dual class voting structures.³⁴ Low voter turnout may prevent issuers from removing these provisions when they are no longer valuable.

One possible way of increasing the level of retail investor voting is to permit retail investors the opportunity to submit standing voting instructions (SVI), also known as client-directed voting.³⁵ Because most

²⁹ See notes __ through __ infra and accompanying text.

³⁰ Egan, supra note __ ("A paltry 27% of retail investor shares were voted during the fall 2013 proxy election season. That's even worse than the turnout in U.S. political elections -- 57.5% of eligible U.S. citizens participated in the 2012 presidential election.").

³¹ See Scott Hirst, Frozen Charters, __ Yale J. Reg. __ (forthcoming 2016).

³² Charters of 88% of IPO companies in 2015 contained supermajority provisions.

Wilmer Hale, 2016 M&A Report at 5,

https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/Documents/2016-WilmerHale-MA-Report.pdf

³³ Hirst, supra note __ at __.

³⁴ See, e.g., Joseph A. Hall, The Impact of ISS' New Policy on IPO Company Director Elections, Harv. L. Sch. Forum on Corp. Gov. & Fin. Reg., Aug. 10, 2016, <https://corpgov.law.harvard.edu/2016/08/10/the-impact-of-iss-new-policy-on-ipo-company-director-elections/> (reporting results of survey finding that "IPO companies continue to adopt charter provisions such as a classified board or dual class stock that can be viewed as having an anti-takeover impact, without any noticeable impact on valuation or marketing.").

³⁵ The term "client-directed voting" was coined by Steve Norman, former corporate governance officer and corporate secretary at American Express. Anna Snider, Getting Out the Vote, Corporate Secretary, Dec. 1, 2009,

modern shareholders hold their stock in street name, their votes are cast by intermediaries on the basis of their voting instructions.³⁶ Current SEC rules prohibit intermediaries from soliciting SVI from their customers, however.³⁷ Because of these rules, although most institutional investors have access to an internet-based voting platform that permits them to designate their voting instructions in advance, retail shareholders are unable to do so.

As early as 2007, the SEC's Proxy Working Group considered rule changes to facilitate SVI.³⁸ To date, however, the SEC has failed to change its rules to allow retail investors to designate their voting instructions to a broker or voting platform in advance in the same manner as institutional investors. Rather, SVI has been characterized as highly controversial.³⁹ Commentators have raised concerns about its implementation⁴⁰ and, more fundamentally, about its potential for contributing to uninformed shareholder voting.⁴¹

<https://www.corporatesecretary.com/articles/proxy-voting-shareholder-actions/11137/getting-out-vote/>. Commentators have also used the term “advance voting instructions” or “AVI.” See, e.g., Aguilar, *supra* note ___. This paper will use the term SVI to refer to all such proposals.

³⁶ See J. 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, 704 (1988) (describing this procedure).

³⁷ See *infra*.

³⁸ See August 27, 2007 Addendum to the Report and Recommendations of the Proxy Working Group to the New York Stock Exchange Dated June 5, 2006, at 4-5, http://www.shareholdercoalition.com/sites/default/files/NYSE%20PWG%20Report%20Addendum%208-27-2007_0.pdf (describing the Working Group's consideration of Steve Norman proposal for client-directed voting).

³⁹ See, e.g., Kimberly K. Rubel & Bree F. Archambault, *Proxy plumbing concept release – a move toward proxy process reform?*, Sept. 30, 2010, <http://www.lexology.com/library/detail.aspx?g=b9c859e9-3a72-4ac3-bf48-8376f4b3ae3e> (describing SVI as “The most controversial proposal to increase retail participation discussed in the [SEC's 2010] Concept Release”).

⁴⁰ See Council of Institutional Investors, *Client Directed Voting: Selected Issues and Design Perspectives*, prepared by Alan L. Beller, Janet L. Fisher, and Rebecca M. Tabb of Cleary Gottlieb Steen & Hamilton LLP (Aug. 2010), available at http://www.cii.org/files/publications/white_papers/08_31_10_client_directed_voting_white_paper.pdf.

⁴¹ See Luis A. Aguilar, *Ensuring the Proxy Process Works for Shareholders*, Comments of SEC Commissioner, Feb. 19, 2015, <https://www.sec.gov/news/statement/021915-psclaa.html> (describing uninformed voting as “one of the fundamental concerns that have been previously raised about so-called ‘standing voting instructions’”); Rubel &

This Article considers these concerns. First, the Article explores and rejects the claim that argument that the risk of uninformed voting justifies the SEC's failure to remove the regulatory obstacles to SVI. Second, the Article reflects on the appropriate safeguards for the implementation of SVI that would minimize the potential for adverse effects on the voting process. Ironically, implementation of SVI offers the potential to introduce reforms that could make retail investor voting both more efficient and better informed.

Existing technology – technology that is already available to institutional shareholders -- offers straightforward tools to implement SVI. Rather than continuing to defer the issue as unduly complex,⁴² the Commission should adopt regulatory reforms not just to remove existing impediments but to facilitate the implementation of SVI as part of the process by which brokers solicit voting instructions. Such regulation would not just reinforce the growing importance of shareholder voting, it would encourage greater retail investor engagement in corporate governance, engagement that may serve as a useful counterpoint to the increasing empowerment of institutional investors.⁴³

This Article proceeds as follows. In Part I, the Article briefly surveys the background of shareholder voting and the developments that have led to the current devaluation of the retail investor. Part II describes the SVI model and evaluates the concerns that have been raised about SVI. Part III critically examines the regulatory objective of informed shareholder voting and the role of that objective in the regulatory debate over SVI. Part IV identifies appropriate safeguards for the implementation of SVI.

Archambault, *supra* note __ (explaining that SVI “creates a tension with the policy objective of obtaining informed investor votes”).

⁴² Cf. Beller, et al. *supra* note __ at 2 (stating that “The complexity of CDV and the policy and regulatory issues it entails suggest to us that a robust CDV model is likely to have a long gestation period.”).

⁴³ This Article takes as a given the existing role of shareholder voting in corporate governance and does not address the normative question of whether the existing level shareholder power reflected in the voting process is optimal. For differing viewpoints on that issue see Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 *Harv. L. Rev.* 833, 840, 850 (2005) (arguing that shareholders who have greater power to make corporate decisions); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 *U. Pa. L. Rev.* 653, 660 (2010) (arguing against increased shareholder power).

I. The Background of Shareholder Voting

A. Legal and Market Developments in Shareholder Voting

In the 1932, Berle and Means published the classic *The Modern Corporation and Private Property*, in which they identified the central challenge posed by the corporate form as the separation of ownership and control.⁴⁴ The corporation to which Berle and Means referred was owned by dispersed public shareholders with small stakes. Indeed, Berle and Means argued that these small stakes prevented shareholders from holding management accountable.⁴⁵ The dispersed model of corporate ownership persisted – as recently as the early 1950s, institutional investors owned less than “10% of the stock of the 1000 largest companies.”⁴⁶

Today, the situation has changed. Institutional investors own a substantial majority of the shares of public companies.⁴⁷ At the largest issuers, institutional ownership exceeds 70%.⁴⁸ As a result, of their substantial voting power, institutional investors have become increasingly important. Issuers engage frequently with institutional investors,⁴⁹ and

⁴⁴ ADOLF BERLE AND GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

⁴⁵ *Id.* at 47-65.

⁴⁶ The Conference Board, *What Is the Optimal Balance in the Relative Roles of Management, Directors, and Investors in the Governance of Public Corporations?*, 2014, White Paper at 9, http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=9&cad=rja&uact=8&ved=0ahUKEwjJwfHf0tXMAhUj8IMKHjAe4QFghJMAg&url=http%3A%2F%2Fwww.shareholderforum.com%2Faccess%2FLibrary%2F20140306_ConferenceBoard-Paper.pdf&usq=AFQjCNGGk1hARYW-8cYSfW5xWEBuNDPMfQ&sig2=fyj21fqZFC2WP_vYo7Fe7w

⁴⁷ See, e.g., Broadridge, *Proxy Pulse*, First Edition 2016, at 1 (reporting that “During the 2015 mini-season [July 1-Dec. 31, 2015], institutional investors owned 62% of the street shares of U.S. companies, compared to 38% for retail investors”).

⁴⁸ Broadridge, *2015 Proxy Season Wrap-up*. *Proxy Pulse Third Edition 2015*, at 3 (noting that institutional ownership varies by issuer size and that, as of 2015, institutions owned 72% of large issuers).

⁴⁹ See Marc Goldstein, *Defining Engagement: An Update on the Evolving Relationship Between Shareholders, Directors and Executives*, Apr. 10, 2014, <https://irrinstitute.org/wp-content/uploads/2015/09/engagement-between-corporations-and-investors-at-all-time-high1.pdf> (describing trends in level and type of engagement between issuers and investors).

this engagement has an effect on firm decisions.⁵⁰ Some commentators have argued that, in fact, the re-concentration of ownership in the hands of institutional investors has transformed corporate governance away from the Berle and Means focus on managerial agency costs to a new system of agency capitalism in which the agency costs of institutional intermediaries have become more important than the managerial agency costs upon which Berle and Means focused their attention.⁵¹

A variety of regulatory developments contributed to increased institutional investor engagement in the voting process. In 1988, the Department of Labor issued the so-called “Avon letter”, the first of a series of statements advising the managers of pension funds that proxy voting was an important component of their fiduciary responsibilities under ERISA.⁵² The DOL followed up with several interpretive guidelines reinforcing this position.⁵³ Subsequently, in 2003, the SEC adopted rules requiring mutual funds to develop policies and procedures with respect to voting shares in their portfolio companies and to disclose their votes on an annual basis.⁵⁴ As a result of these regulations, a substantial percentage of institutional investors began to take proxy voting more seriously.⁵⁵ Many institutional investors with substantial equity interests allocated specialized resources to analyzing governance issues and making voting

⁵⁰ Craig Doidge, et al., Can Institutional Investors Improve Corporate Governance Through Collective Action? (Sept. 21, 2015). <http://ssrn.com/abstract=2635662> or <http://dx.doi.org/10.2139/ssrn.2635662> (reporting findings that institutional investor “private engagements influenced firms’ adoption of majority voting and say-on-pay advisory votes, improved compensation structure and disclosure, and influenced CEO incentive intensity.”),

⁵¹ Gilson & Gordon, *supra* note __ .

⁵² See Letter from Alan D. Lebowitz, Deputy Assistant Sec’y, Dep’t of Labor, to Helmuth Fandl, Chairman of the Ret. Bd., Avon Prods., Inc. (Feb. 23, 1988), in 15 Pens. Rep. (BNA) 371, 391 (Feb. 29, 1988) (explaining that “the decision[s] as to how proxies should be voted ... are fiduciary acts of plan asset management.”).

⁵³ In 1994 (and again in 2008), the Department of Labor issued clear guidelines that stated, “The fiduciary act of managing plan assets that are shares of corporate stock includes the management of voting rights appurtenant to those shares of stock.”

⁵⁴ 17 C.F.R. § 275.206(4)-6 (2003); § 270.30bl-4.

⁵⁵ See generally Independent Directors Council & Investment Company Institute, Oversight of Fund Proxy Voting, July 2008 (explaining requirements for mutual fund directors to oversee proxy voting by their funds and practices used by directors to engage in that oversight).

decisions.⁵⁶ Because institutional investors control a substantial number of votes, their policy concerns generate considerable public attention.⁵⁷

Market providers responded to increased institutional investor involvement in voting by providing them with new tools to facilitate the proxy voting process.⁵⁸ ISS developed into the most important intermediary, on a global basis, providing institutional investors with a variety of services to assist them in exercising their voting power. ISS is perhaps best known for its advisory services; it provides its investor-subscribers with information about issues on which they are being asked to vote as well as recommendations as to how to vote. ISS Voting Analytics collects and analyzes data about institutional voting policies, voting results and patterns.⁵⁹ In recent years, a second major proxy advisory firm, Glass Lewis has gained prominence for the information and recommendations that it provides to subscribers.⁶⁰

Market intermediaries also offer institutional investors tools to simplify the mechanics of the voting process.⁶¹ ISS offers its subscribers

⁵⁶ See, e.g., Kirsten Grind & Joann Lublin, Vanguard and BlackRock Plan to Get More Assertive With Their Investments, Wall St. J., Mar. 4, 2015, <http://www.wsj.com/articles/vanguard-and-blackrock-plan-to-get-more-assertive-with-their-investments-1425445200> (describing governance engagement by BlackRock, Vanguard and State Street and noting that large mutual fund companies own sufficient stakes to be taken seriously by their portfolio companies).

⁵⁷ Id. See also JoAnn Lublin, BlackRock Toughens Stance on Boards, Wall St. J., Mar. 3, 2015, <http://www.wsj.com/articles/blackrock-to-take-tougher-stance-on-u-s-corporate-directors-1425414807> (reporting BlackRock's announcement that "it may oppose board members' re-election over such issues as excessive tenure, insufficient diversity, poor short-term attendance and corporate bylaw changes that ignore investor rights."). BlackRock manages \$4.65 trillion in assets. Id.

⁵⁸ See, e.g., Stephen Choi, Jill Fisch & Marcel Kahan, The Role of Proxy Advisors, 82 S. Cal. L. Rev. 649 (2009) (describing developments at proxy advisory firms and the history and growth of ISS).

⁵⁹ ISS Voting Analytics, <https://www.issgovernance.com/governance-solutions/investment-tools-data/voting-analytics/> (last visited Feb. 27, 2017).

⁶⁰ See Ed Batts, Proxy Advisory Firms In Legislative Crosshairs, Law360, July 8, 2016, <http://www.law360.com/articles/815410/proxy-advisory-firms-in-legislative-crosshairs> (observing that the market for proxy advisory services is "dominated" by two firms: ISS and Glass Lewis). A number of additional firms provide advisory services that focus outside of the US markets. See Elizabeth Judd, A guide to proxy advisers, IR Magazine, Sept. 3, 2014, <https://www.irmagazine.com/articles/proxy-voting-annual-meetings/20359/guide-proxy-advisers/> (identifying and describing a number of non-US proxy advisory firms).

⁶¹ Proxy advisors have been subject to criticism both for the quality of the advisory services that they provide and for potential conflicts of interest. See, e.g., Stephen J.

Proxy Exchange, a service that enables institutions to outsource the mechanics of the voting process including executing ballots and maintaining voting records. Glass Lewis provides its clients with Viewpoint, a web-based voting platform.⁶² Broadridge offers Proxy Edge, an internet-based system that allows institutional investors “to manage, track, reconcile and report [their] proxy voting through electronic delivery of ballots, online voting, and integrated reporting and record keeping” in order to meet the regulatory requirements of the SEC and the DOL.⁶³

Importantly, these institution-directed services allow their subscribers to provide voting guidelines or policies in advance of any specific shareholder meeting, also known as standing voting instructions. The intermediary then applies these instructions to each shareholder meeting, and casts the client’s vote in accordance with those instructions, unless directed otherwise by its client.⁶⁴ Investors’ ability to coordinate votes for all the securities in their portfolios on a single platform and to provide standing instructions are critical components of an efficient voting process for institutional investors that may hold positions in thousands of portfolio companies.⁶⁵ As of 2014, for example, more than half of institutional users of Proxy Edge used some form of standing voting instructions.⁶⁶

Choi, Jill E. Fisch & Marcel Kahan, Director Elections and the Role of Proxy Advisors, 82 S. Cal. L. Rev. 649, 657-58 (2009) (describing accounts of advisor conflicts of interest). In response, the SEC staff released guidance to institutional investors with respect to their reliance on proxy advisors. See SEC Staff Legal Bulletin No. 20 (IM/CF), “Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms” (June 30, 2014).

⁶² Glass Lewis, Proxy Voting – Viewpoint, <http://www.glasslewis.com/proxy-voting/> (describing Viewpoint).

⁶³ Broadridge, Institutional Proxy Voting, Total Proxy Management from Voting through Disclosure <http://www.broadridge.com/bank-brokerage-investor-communication/proxy-regulatory-communications/proxy-voting-tabulation-reporting/institutional-proxy-voting> (describing ProxyEdge).

⁶⁴ See Glass Lewis letter to Mary Schapiro, SEC, dated Oct. 18, 2010 at 7 (describing process of voting subscribers’ shares according to subscribers’ custom voting policies).

⁶⁵ See Proxy Edge, <http://www.broadridge.com/mutual-fund-retirement-solutions/proxy-regulatory/institutional-voting/proxyedge> (explaining that “Our quick vote tool allows you to vote the same way across all proposals with one click”)

⁶⁶ Broadridge, Presentation, Status Update on Initiatives to Increase Retail Voting Participation, Aug. 8, 2014 (on file with author), at 12.

The market has not produced an analogous mechanism by which retail investors can vote their shares. The vast majority of retail investors⁶⁷ hold their securities in street name, meaning that the investor, known as a beneficial owner, holds his or her securities through an intermediary – typically a bank or broker, known as a nominee or record holder. Street name ownership means that the beneficial owner is not listed on the issuer’s share registry as the holder of record. To protect the voting rights of beneficial owners, SEC rules require that the nominee holder forward proxy materials to the beneficial owner and obtain instructions from the beneficial owner as to how to vote the shares.⁶⁸

Retail investors must submit separate voting instructions for every shareholder meeting at each company in which they own stock. Platforms that consolidate the voting procedure, such as those offered to institutional investors, are not open to or cost-effective for retail investors. Although retail investors can use the internet to submit their voting instructions, the mechanism for doing so, proxyvote.com, has been described “inefficient and clunky.”⁶⁹ Until recently retail investors were required to access proxyvote.com separately for each meeting by manually keying in a control number.⁷⁰ Although Broadridge has improved the proxyvote.com, incorporating some information from an investor’s past votes and, in some cases, allowing direct links from e-delivery, the functionality is far more limited than that available to institutional investors.

⁶⁷ Many institutional investors hold their securities in street name as well. As of 2007, approximately 85% of exchange-traded securities were held through nominees. Securities & Exchange Commission, Roundtable on Proxy Voting Mechanics, May 23, 2007, <https://www.sec.gov/spotlight/proxyprocess/proxyvotingbrief.htm>.

⁶⁸ See Keir D. Gumbs, Todd Hamblet & Kristin Stortini, Debunking the Myths Behind Voting Instruction Forms and Vote Reporting, 21 Corp. Gov. Adv. 1 (2013), <https://www.cov.com/files/Publication/87c02cb1-d867-42d4-ad05-121f1ba7c86b/Presentation/PublicationAttachment/b51c699e-b1a6-4126-91d6-1a882cd4e985/> (describing the SEC and NYSE rules protecting the voting rights of beneficial owners).. The regulations require the soliciting party to bear the costs of transmitting proxy materials under Regulation 14B. The NYSE sets the maximum fee that brokers can charge an issuer for the transmission of proxy materials. See Order Granting Approval to Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, Oct. 18, 2013 (adopting changes to NYSE proxy fee structure).

⁶⁹ Request for rulemaking by Moxy Vote dated Aug. 17, 2012, at 6, www.sec.gov/rules/petitions/2012/petn4-651.pdf

⁷⁰ Id.

Perhaps the most important difference is the inability of retail investors to submit SVI. Unlike institutions, retail investors cannot designate a set of voting preferences in advance, save their prior voting preferences, or designate a set of guidelines that will be applied automatically. As a result, investors must enter their voting instructions separately for each issuer, each issue and each annual meeting. In addition, proxyvote.com is purely a voting platform; it does not provide investors with information about the issues on which they are voting. Indeed, proxyvote.com is not fully integrated even with the federally mandated disclosure; access to that information via the proxyvote.com website requires a series of cumbersome click-throughs to material stored on other websites.

The SEC has not ignored developments in internet technology. Indeed, in 2007, the SEC embraced by the internet by revising the proxy solicitation rules to eliminate the requirement that issuers provide investors with a full copy of the mandated disclosures⁷¹ This rule change, known as e-proxy, substituted notice and access for full distribution, enabling issuers to satisfy the disclosure requirements by posting proxy materials on their website and to providing investors with a notice of the posting.⁷² E-proxy enhances efficiency in that it allows issuers to avoid the high cost of printing and mailing proxy materials to all their shareholders.⁷³ At the same time, however, electronic delivery may

⁷¹ Internet Availability of Proxy Material, Release No. 34-55146 (Jan. 22, 2007) [72 FR 4148] (“Internet Availability of Proxy Material Adopting Release”) and Shareholder Choice Regarding Proxy Materials, Release No. 34-56135 (July 26, 2007) [72 FR 42221]; Amendments to Rules Requiring Internet Availability of Proxy Materials, Feb. 22, 2010, <https://www.sec.gov/rules/final/2010/33-9108.pdf>

⁷² Shareholder Choice Regarding Proxy Materials, Sec. Exch. Act Rel. No. 56135, July 26, 2007, <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0ahUKEwit0drV6tfMAhXJbj4KHZAADBL4QFggjMAE&url=https%3A%2F%2Fwww.sec.gov%2Frules%2Ffinal%2F2007%2F34-56135.pdf&usq=AFQjCNEdEuEqYeWAKstbuuwSfnlC7kSg7A&sig2=7I9XOB-XLKYJy4DR1TZCyA&bvm=bv.122129774,d.cWw> Investors are entitled to receive a paper copy of the full proxy material, at no cost, on request. *Id.*

⁷³ See, e.g., Jeffrey Gordon, Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy, 61 *Vand. L. Rev.* 475 (2008) (arguing that e-proxy offers a cheaper and more efficient alternative to the traditional proxy contest).

reduce the visibility of voting issues.⁷⁴ Some statistics suggest that e-proxy has contributed to lower retail voter turnout.⁷⁵

No regulation requires retail investors to vote their stock,⁷⁶ and multi-step aspect of e-proxy coupled with the rational apathy of small investors traditionally led relatively few retail investor to submit voting instructions.⁷⁷ For many years, the effect of low retail voter turnout was masked, however, by discretionary broker voting.⁷⁸ NYSE rules in effect since 1937, and NYSE Rule 452 in particular, granted brokers discretionary voting authority with respect to routine matters.⁷⁹

⁷⁴ See Sarah N. Lynch, SEC official calls for review of electronic proxy delivery rules, Reuters, Feb. 19, 2015, <http://www.reuters.com/article/us-sec-proxy-idUSKBN0LN24D20150219> (stating that such rules likely have depressed retail investor participation in elections).

⁷⁵ See, e.g. Statement by Commissioner Aguilar, <https://www.sec.gov/news/statement/021915-psclaa.html> (observing that “that retail response rates have declined each year since the introduction of the notice and access model”); Dominic Jones, Did e-proxy figure in Apple’s surprise say-on-pay loss?, March 5, 2008, www.irwebreport.com/daily/2008/03/05/did-e-proxy-figure-in-apples-surprise-say-on-pay-loss. (arguing that e-proxy may have contributed to the turnout of only 4% of Apple’s retail shareholders at the 2008 annual meeting) Lynch, *supra* note __ (quoting statement by Robert Schifellite, an executive with Broadridge Financial Solutions that “retail investors vote 41 percent of the shares when they receive the full mailed packet, versus 23 percent when notified by e-mail, and a mere 18 percent when notified about voting by mail”); Fabio Saccone, “E-Proxy Reform, Activism, and the Decline in Retail Shareholder Voting,” The Conference Board: Director Notes, December 2010, pp. 1–4. (reporting retail vote of 16.4% for issuers that did not deliver paper proxy materials).

⁷⁶ Noam Noked, The Promise of the Enhanced Broker Internet Platform, Harv. L. Sch. Forum on Corp. Gov. & Fin. Reg., Sept. 22, 2013, <https://corpgov.law.harvard.edu/2013/09/22/the-promise-of-the-enhanced-broker-internet-platform/>

⁷⁷ See Jeffrey T. Hartlin, The SEC Approves the Elimination of Broker Discretionary Voting in All Director Elections, Paul Hastings Stay Current, Aug. 2009, www.paulhastings.com/docs/default-source/PDFs/1385.pdf (reporting that, in 2009, voting instructions were submitted for only 32% of retail shares). Data from the 2005 proxy season indicates that the voting rights relating to 56% of accounts with shares held in street name were not exercised by their beneficial owners. Presumably, many of these shares were nonetheless voted by brokers. William K. Sjostrom, Jr., The Case Against Mandatory Annual Director Elections and Shareholders’ Meetings, 74 Tenn. L. Rev. 199, 220 (2007)

⁷⁸ Broker votes of uninstructed shares typically represent five to ten percent of votes cast at an annual shareholders’ meeting. Sjostrom, *supra* note __ at 220.

⁷⁹ See SEC Publishes for Comment Proposed Amendment to NYSE Rule to Eliminate Broker Discretionary Voting in Uncontested Director Elections, Gibson Dunn Client

Discretionary voting authority, known as the ten-day rule, provided that if the beneficial owner did not provide voting instructions at least ten days before the shareholders meeting, the broker was free to vote those uninstructed shares as he or she saw fit.⁸⁰

In 2004, the Business Roundtable submitted a petition requesting the SEC to revise its proxy rules.⁸¹ The Business Roundtable observed that various aspects of the proxy rules had become outdated and that technological innovations warranted the implementation of a better system of communicating with shareholders. Among the proposals was a request that the SEC eliminate the circuitous process that required beneficial owners to use their broker as an intermediary in the voting process. Instead, the Business Roundtable suggested replacing the existing voting process with one that would enable beneficial owners to vote their shares directly.⁸² The petition also noted that various developments were leading to the erosion of the ten-day rule and that a number of commentators had proposed that the rule be eliminated as obsolete.⁸³ The Business

Alert, Mar. 13, 2009,

<http://www.gibsondunn.com/publications/pages/SECProposedAmendmentToNYSERuletoEliminateBrokerDiscretionaryVoting.aspx> (recounting history of Rule 452).

⁸⁰ See Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company, Sec. Exch. Act. Rel. No. 60215, July 1, 2009, <http://www.sec.gov/rules/sro/nyse/2009/34-59464.pdf>. With respect to routine matters, including uncontested elections, if a beneficial owner does not provide instructions at least ten days before the meeting, the broker is free to, and typically does, vote these "uninstructed shares" as it chooses. Sjoström, *supra* note __, at 220.

⁸¹ See Business Roundtable Petition for Rulemaking Regarding Shareholder Communications ("Rulemaking Petition"), http://www.shareholdercoalition.com/sites/default/files/BRT%20Petition%204-16-08_0.pdf.

⁸² John Wilcox submitted a comment letter earlier, in 2003, making a similar recommendation. 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, <https://www.sec.gov/rules/proposed/s71903/georgeson121203.htm>

⁸³ Rulemaking Petition, *supra* note __ at __.

Roundtable argued that this provided additional reason to facilitate direct investor voting.

The Business Roundtable's predictions regarding the ten-day rule were accurate. Over the course of the next several years, the NYSE gradually began to cut back on the scope of the ten-day rule. The regulatory changes limited the scope of discretionary voting authority by classifying an increasing number of voting issues as non-routine.⁸⁴ As the Business Roundtable's petition had noted, the NYSE had already in 2003 classified shareholder approval of equity compensation plans as a non-routine matter for which discretionary broker voting was not permitted.⁸⁵

Similarly, in 2009, the SEC approved the NYSE's request to amend Rule 452 to eliminate discretionary voting in uncontested director elections.⁸⁶ Subsequently, the NYSE extended the ban in connection with the shareholder vote mandated by Dodd-Frank in connection with the executive compensation. On January 25, 2012, the NYSE amended the rules to prohibit discretionary voting on corporate governance issues such as charter and bylaw amendments.⁸⁷

⁸⁴ In 2005, the NYSE created its Proxy Working Group for the purpose of reviewing the NYSE's rules concerning proxy voting with a particular focus on Rule 452. See Report and Recommendations of the Proxy Working Group to the New York Stock Exchange dated June 5, 2006 at 1, <http://www.shareholdercoalition.com/sites/default/files/NYSE%20Proxy%20Working%20Grp%20Rpt%206-5-2006.pdf>. At that time, NYSE Rule 452 classified 18 items as non-routine, but including, uncontested director elections, among other items, as routine. *Id.* The working group recommended that the rule be changed to classify uncontested director elections as non-routine. *Id.* at 4. The NYSE subsequently sought SEC approval to amend Rule 452. Self-Regulatory Organizations, *supra* note __ at 1.

⁸⁵ SEC Release No. 34-48108 (June 30, 2003).

⁸⁶ See Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company, Sec. Exch. Act. Rel. No. 60215, July 1, 2009, *supra* note __. Notably, the rule change retained the broker-vote at open-end investment companies (mutual funds) because mutual funds are largely retail held, and because retail investors are less likely to vote, it is costly for funds to solicit votes.

⁸⁷ NYSE Information Memorandum 12-4, "Application of Rule 452 to Certain Types of Corporate Governance Proxy Proposals" (January 25, 2012).

Today, brokers are prohibited from exercising discretionary voting authority with respect to most issues on which shareholders are asked to vote.⁸⁸ Instead, nominee holders such as banks and brokers are supposed to obtain voting instructions from the beneficial owners of the securities and to vote the shares in accordance with those instructions.⁸⁹ Rule 14b-1(d) requires brokers to solicit voting instructions, but it does not specify the form that the broker's request must take. Unlike Rule 14a-4 which contains explicit specifications for the required form of proxy,⁹⁰ there is no similar requirement for the voter information form (VIF) or a mandate that it contain identical language to that on the formal proxy.⁹¹ Instead, the regulations leave the procedure for obtaining voting instructions to the discretion of the record holder.⁹²

In addition, although the existing rules require brokers to establish a website at which investors can access the request for voting instructions, the existing rules do not require the website even to provide investors with access to the proxy statement and other soliciting materials.⁹³ In addition, the rule only obligates a broker to solicit voting instructions once it has received proxy materials from a soliciting party.

In practice, most nominee holders outsource the transmission of proxy materials and the solicitation of voting instructions to a private

⁸⁸ The primary issue that remains classified as "routine" is the ratification of the firms' auditors. See Leigh P. Ryan, Michael L. Zuppone & Rebecca A. Brophy, NYSE Implements New Restrictions on Broker Discretionary Voting, Paul Hastings Client Alert (March 2012) ("The NYSE has specifically noted that the ratification of independent auditors continues to be a routine or "Broker May Vote" matter").

⁸⁹ Regulation 14B, 17 CFR 240.14b-1, et seq. regulates the process of disclosing proxy materials to beneficial owners and soliciting voting instructions. See Concept Release on the U.S. Proxy System, SEC Release No. 34-62495, 2010 SEC LEXIS 2407 (July 22, 2010) ("Proxy Plumbing Release"). at 19-20 (describing this process).

⁹⁰ Gumbs, et al., supra note __.

⁹¹ See James McRitchie, SEC's IAC Seeks Input for Agenda, The Shareholder Activist, <http://theshareholderactivist.com/shareholder-policies-investor-regulations/secs-iac-seeks-input-for-agenda/> (describing differences in the language of a shareholder proposal and the language that appeared on Broadridge's VIF).

⁹² Gumbs, et al., supra note __ at n 22. See also Amendments to Rules Requiring Internet Availability of Proxy Materials, Feb. 22, 2010, <https://www.sec.gov/rules/final/2010/33-9108.pdf> at 11 (observing that the notice required under e-proxy does not have to conform to Rule 14a-4 or "directly mirror the proxy card").

⁹³ See Rule 14b-1(d)(2) (noting that the provision of such access is "at the broker or dealer's option").

service provider - Broadridge.⁹⁴ Broadridge provides investor communications technology supporting the proxy voting process for more than 90% of public companies in North America.⁹⁵ Issuers, rather than nominees or record holders, bear the cost of compliance with Regulation 14B and are required to reimburse brokers for the costs of compliance under a fee schedule set by the NYSE.⁹⁶

B. Initiatives to Facilitate Retail Investor Voting

From the time that the NYSE Proxy Working Group first began to consider limiting the scope of discretionary broker voting, commentators recognized that the contemplated regulatory changes would dramatically reduce the percentage of retail shares voted because very few retail shareholders submit voting instructions.⁹⁷ At that time, the Working Group made several recommendations aimed at increasing retail voting, including increasing efforts to educate investors about the proxy voting system and supporting issuer efforts to communicate with beneficial owners.⁹⁸ In its subsequent addendum which focused on the difficulty for issuers of obtaining a quorum in the absence of broker voting, the Working Group identified proportional voting and client-directed voting as possible solutions.⁹⁹

SVI was suggested by Steve Norman who was a member of the Working Group and Corporate Secretary of American Express.¹⁰⁰ Norman suggested that investors be permitted to submit a “good until

⁹⁴ See Roundtable on Proxy Mechanics, *supra* note __ (“Most broker-dealers outsource proxy processing functions, including forwarding proxy materials to beneficial owners and collecting voting information from beneficial owners for forwarding to the issuer”); Recommendations of the Investor Advisory Committee:

Impartiality in the Disclosure of Preliminary Voting Results (October 9, 2014) at 2 (“brokers almost universally contract out the tasks to a single intermediary, Broadridge.”).

⁹⁵ Broadridge, A Leader in Investor Communication Solutions, <http://www.broadridge.com/company-information/about/overview>.

⁹⁶ Broadridge bills issuers directly for this service pursuant to a fee schedule established by the NYSE and Nasdaq See Proxy Plumbing Release at 56.

⁹⁷ Proxy Working Group Report at __.

⁹⁸ Proxy Working Group Report at 4-5.

⁹⁹ Addendum at 3-5. Proportional voting would have given brokers the discretion to vote shares for which they did not receive voting instructions in the same proportion as instructed shares. *Id.* at 3.

¹⁰⁰ Addendum at 4.

cancelled” instruction as part of their brokerage agreement which would allow the designation of one of four voting positions for all securities held in the investor’s account – 1) follow the board’s recommendation, 2) vote against the board’s recommendation, 3) abstain, 4) vote proportionally with the retail votes for which the broker has received voting instructions.¹⁰¹ Norman contemplated that the instructions would operate as a default in the event that the investor did not submit specific voting instructions for a particular shareholder meeting. The proposal contemplated that these instructions could always be revoked by the investor either generally or with respect to a specific meeting.¹⁰²

The Working Group debated the merits of Norman’s proposal but did not reach a conclusion. Although members of the group identified various advantages to the proposal, they identified a number of concerns. Arguably the most serious was the risk of uninformed voting. As the addendum explained, “it was noted that the CDV proposal could make it easy for investors (particularly retail investors) to disengage from the proxy process and essentially make important voting decisions in advance without full information about the matters to be voted upon.”¹⁰³

In 2007, the SEC held a roundtable on broker voting in connection with the first of the NYSE’s rule changes to reduce the scope of broker discretionary voting.¹⁰⁴ In its public statement concerning the roundtable, the SEC noted the Proxy Working Group’s identification of CDV as a possible alternative. The SEC noted that “Client-directed voting may raise concerns because the client (beneficial owner) is being asked to make a voting decision prior to receiving any proxy materials.”¹⁰⁵

Commentators on the SEC’s 2009 rulemaking notice proposing to approve the NYSE rule change to eliminate discretionary broker voting authority in uncontested elections also suggested that the SEC make the necessary rule changes to permit client-directed voting or SVI.¹⁰⁶ The

¹⁰¹ *Id.* at 5.

¹⁰² *Id.* at 5.

¹⁰³ *Id.*

¹⁰⁴ Roundtable on Proxy Voting Mechanics, *supra* note ____.

¹⁰⁵ *Id.*

¹⁰⁶ See Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment

SEC declined to do so, observing in its subsequent release approving the NYSE rule change that “With respect to client directed voting, the Commission notes that it raises a variety of questions and concerns, such as requiring shareholders to make a voting determination in advance of receiving a proxy statement with the disclosures mandated under the federal securities laws and without consideration of the issues to be voted upon.”¹⁰⁷

The question of whether to adopt changes to the proxy rules to permit SVI has continued to be a subject of SEC consideration and debate. In July 2010, the SEC issued the “Proxy Plumbing release.”¹⁰⁸ The release did not contain any specific proposed rules; instead it various developments in the process of shareholder voting, identified a substantial number of concerns about the existing proxy voting process and sought public input about possible improvements.¹⁰⁹

Among the topics addressed by the Proxy Plumbing release was SVI.¹¹⁰ The SEC acknowledged that the low level of voting by retail investors was “a source of concern,”¹¹¹ and that commentators had proposed SVI as a tool to increase retail investor participation in voting. The SEC observed, however, that SVI raised “a variety of questions and concerns.”¹¹² It noted that an SVI system would require “investors to make a voting decision in advance of receiving a proxy statement containing the disclosures mandated under the federal securities laws and possibly without consideration of the specific issues to be voted upon.”¹¹³ It also warned that the availability of SVI might serve as a disincentive for investors to read the proxy statement.¹¹⁴

Company, Release No. 34-60215 (July 1, 2009) [74 FR 33293] (Commission approval of amendments to NYSE Rule 452), at 34.

¹⁰⁷ Id. at ____.

¹⁰⁸ Proxy Plumbing Release, *supra* note ____.

¹⁰⁹ See *id.* at 10 (“we remain interested in ways to improve our proxy disclosure, solicitation, and distribution rules.”)

¹¹⁰ Id. at 81-86. The SEC noted the existing proxy rules would not permit brokers to solicit SVI from their customers. See Proxy Plumbing Release at 84 (“There is currently no applicable exemption for securities intermediaries to solicit standing voting instructions from their customers”).

¹¹¹ Id. at 79.

¹¹² Proxy Plumbing Release at 83.

¹¹³ Id.

¹¹⁴ See Proxy Plumbing Release at 83.

As part of the Proxy Plumbing Release, the SEC solicited comments on whether it should adopt regulatory changes to permit retail investors to submit SVI.¹¹⁵ The SEC also solicited comments on a related proposal – the development of an enhanced broker internet platform (EBIP), which would enable investors to receive proxy information and submit voting instructions through their brokerage account website.¹¹⁶ As with SVI, an EBIP would provide retail investors with functionality currently available to institutional investors. It would also create a mechanism for investors to submit or modify their SVI through their brokerage accounts.

The Proxy Plumbing Release did not lead the SEC to adopt reforms to the proxy voting process. The SEC revisited the possible need for reforms in its 2015 Proxy Voting Roundtable. Again, the subject of SVI was raised. Several roundtable participants noted that commentators had proposed various forms of SVI for a number of years. At the Roundtable, discussion of the potential disadvantages of SVI crystalized into a single essential concern – that permitting SVI would increase the potential for uninformed voting. As commentators noted, by definition, investors who submit SVI would be making their voting decisions in advance of, and without access to, the federally-mandated disclosures contained in the proxy statement. Therefore, the argument was made that SVI was inconsistent with the disclosure-based approach investor protection that animates federal securities regulation. Put more strongly, federally-mandated disclosure would arguably be irrelevant to shareholders who are not using that information to decide how to vote.

Despite the absence of regulatory changes, private market providers have attempted to respond to the concerns identified in the Proxy Plumbing Release and the 2015 Roundtable by developing mechanisms to facilitate retail investor voting. These experiments have had limited success, due in part to regulatory impediments.¹¹⁷ Perhaps the best known effort was Moxy Vote, an internet-based platform created by a private

¹¹⁵ The SEC specifically observed that such reforms would enable retail investors access to a service that is presently available to institutional investors Id. at 84.

¹¹⁶ Proxy Plumbing Release at ___.

¹¹⁷ See Robin Miller, Shareholder Advocacy in Corporate Elections: Case Studies in Proxy Voting Websites for Retail Investors, International Development, Community and Environment Paper 52, 2016, working paper at 5 (reporting that “Of the several websites that were created in the United States [to facilitate retail investor voting] including Moxy Vote, Sharegate.com, Shareowners.org, United States Proxy Exchange and ProxyDemocracy.org, all but one site have effectively ceased operations”)

investment firm that was designed to allow retail investors both to cast their votes and to view information from institutional investors, such as hedge funds.¹¹⁸ The site simplified the mechanics of the voting process by allowing shareholders to mirror other shareholders' votes or to cast their votes in accordance with particular advocacy positions or predetermined voting policies.¹¹⁹ For shareholders to use Moxy Vote, however, their brokers had to forward voting authority to Moxy Vote, and at least some brokers were unwilling to do so.¹²⁰

Moxy Vote ceased operations in 2012 due to a combination of regulatory hurdles and the reluctance of custodial brokers to allow their customers to vote through the site.¹²¹ At that time, Moxy Vote petitioned the SEC for a rulemaking to permit a "neutral Internet voting platform" that would enable retail investors to designate a neutral internet site for delivery of proxy information, storing voting preferences and executing shareholder votes.¹²² To date, the SEC has not enacted such a rule.¹²³

¹¹⁸ Joseph N. DiStefano, West Chester's Moxy Vote boosts rebel shareholders , Phil Inq. Nov 20, 2009, http://www.philly.com/philly/blogs/inq-phillydeals/West_Chesters_MoxyVote_boosts_rebel_shareholder_voices_.html Moxy Vote was started as a for-profit market intermediary with seed funding from the investment partnership, and at the time of its creation, it was unclear whether the site could be funded through advertising subscriptions or fees. Id.

¹¹⁹ See Letter dated Oct. 20, 2010 from Lary Eiben to Elizabeth Murphy, Secretary, SEC (describing Moxy Vote).

¹²⁰ McRitchie, Retail Shareholder Proxy Participation: Part 2, supra note __ ("Some brokers were refusing to deliver to the now defunct Moxy Vote CDV system").

¹²¹ Richard Finger, Shareholders, Shake Off Your Apathy And Vote To Stop Tom Ward And Michael Dell, Forbes, Feb. 21, 2013,

<http://www.forbes.com/sites/richardfinger/2013/02/21/shareholders-shake-off-your-apathy-and-vote-to-stop-tom-ward-and-michael-dell-from-screwing-you/#599544968093>. See also Jeff Blumenthal, Done in by regulatory stumbling blocks, Moxy Vote says. Phil. Bus. J., July 20, 2012, <http://www.bizjournals.com/philadelphia/print-edition/2012/07/20/done-in-by-regulatory-stumbling.html> (observing that "Individual shareholders have no legal grounds to compel their brokers to deliver ballots electronically to internet voting platforms. And, unfortunately, many brokerage firms have stated clearly to us that they will send them only when required to do so by regulators.").

¹²² Moxy Vote Request for rulemaking re Neutral Internet Voting Platform dated Aug. 17, 2012.

¹²³ James McRitchie advanced a similar but broader proposal for an "open CDV" that would allow anyone to create a voting feed and enable retail shareholders to choose a feed as the basis for their proxy votes). See James McRitchie, The False Promise of the Enhanced Broker Internet Platform. CorpGov.net, Sept. 25 ,2013,

Although Moxy Vote’s effort to combine internet proxy voting with information relevant to the voting decision was not successful, other market participants continued to innovate with respect to some of its intended functions. ProxyDemocracy.org, for example, provides retail investors, in a searchable format, with information on pending voting issues and on how major mutual funds and other institutional investors are voting on those issues.¹²⁴ Although this information is useful, it is not linked with a voting platform for retail shareholders; accordingly, investors using proxy vote must shift to ProxyDemocracy for each shareholder meeting at which they want to vote.¹²⁵ In addition, Proxy Democracy does not offer a mechanism by which shareholders can automatically cast their votes in the same way that a designated institutional shareholder is voting.

Broadridge has also continued to develop and expand technological tools for retail investor voting. Broadridge’s innovations offered retail investors the first modern alternatives to submitting their voting instructions by mail – initially enabling telephonic submission and then electronic submissions through proxyvote.com. Of the retail shares that are currently voted, been quite successful – of the retail shares that are voted, more than 2/3 are voted through proxyvote.com.¹²⁶

Recognizing the cumbersome nature of the process for retail investors, Broadridge has repeatedly sought to innovate. For example, Broadridge developed a “one-click button” to allow investors to vote in accordance with the board’s recommendations on all issues rather than providing instructions separately for each issue on the proxy card.¹²⁷ When critics objected to the button because Broadridge did not offer a similar mechanism for investors to vote against all the board

<http://www.corpgov.net/2013/09/the-false-promise-of-the-enhanced-broker-internet-platform/>

¹²⁴ ProxyDemocracy Home Page, <http://proxydemocracy.org/> (last visited Feb. 17, 2017).

¹²⁵ In addition, ProxyDemocracy currently includes information from only ten institutions, representing a limited perspective on voting issues. See ProxyDemocracy, Advance Disclosers, http://proxydemocracy.org/about/vote_sources (describing identities of advance disclosers).

¹²⁶ Broadridge Presentation, *supra* note __ at 2.

¹²⁷ Ross Kerber, Proxy Site Dump One-Click Vote Button on SEC Concerns, Reuters, Mar. 20, 2013, <http://www.reuters.com/article/proxy-voting-website-idUSL1N0C5D3M20130320>

recommendations, creating an uneven playing field,¹²⁸ Broadridge removed the button.¹²⁹

Although Broadridge has continued to develop proxyvote.com to simplify the mechanics of the voting process,¹³⁰ the challenge is that brokers are not currently required to connect the platform to retail investors' brokerage accounts. As a result, many investors have to go to proxyvote.com to submit voting instructions to their brokers.¹³¹ Retail investors could engage in internet voting more efficiently if they had access to a single platform to manage their account – a platform that would include securities positions, notice of upcoming shareholder meetings, access to proxy information and the ability to cast the investor's vote. In addition, Proxyvote.com does not offer investors the ability to submit SVI and does not include additional information that might assist shareholders in making their decisions such as the recommendations of proxy advisors or information on how other large investors are voting.

The system by which the costs of investor voting are paid has impeded innovation in this area by limiting the incentive for brokers – who currently control retail voting – to provide their customers with more efficient voting procedures. Regulation 14B requires issuers to compensate nominee holders for the costs of forwarding proxy material and collecting voting instructions. The NYSE oversees this system by setting the rules concerning the fees that issuers must pay to broker-dealers for this process.¹³² In 2010, the NYSE created the Proxy Fee Advisory

¹²⁸ See, e.g., James McRitchie, ProxyVote.com Encourages Zombie Voting, The Shareholder Activist.com, <http://theshareholderactivist.com/shareholder-policies-investor-regulations/proxyvote-com-encourages-zombie-voting/> (arguing that “The vote with management button results in zombie voting”)

¹²⁹ See id; Gumbs, supra note __ at n. 23. Technically the button might have seemed to be in tension with Rule 14a-4, which requires that shareholders be given the opportunity to vote individually on each matter under consideration, although shareholders would obviously not have been required to use the button if they wanted to vote separately on each matter.

¹³⁰ See, e.g., Broadridge, Broadridge Introduces the First Mobile ProxyVote Platform Shareholders Can Now Vote on Smartphones and other Mobile Devices, Dec. 2, 2010, <http://www.broadridge.com/news-events/press-releases/Broadridge-Introduces-the-First-Mobile-ProxyVote-Platform.html> (describing Broadridge's expansion of proxyvote.com to mobile devices).

¹³¹ Proxy Plumbing release, supra note __ at 80.

¹³² See Recommendations of the Proxy Fee Advisory Committee to the New York Stock Exchange dated May 16, 2016, <http://www.shareholdercoalition.com/sites/default/files/NYSE%20PFAC%20Report%2>

Committee (PFAC) to review the existing fee structure and make recommendations. Among the PFAC's objectives was to "encourage and facilitate active participation by retail street name investors."¹³³

In response to the SEC's Proxy Plumbing release, Broadridge suggested to the PFAC that it could further this objective through the use of EBIPs, also known as investor mailboxes.¹³⁴ Like Moxy Vote, EBIPs centralize the mechanics of proxy voting for retail shareholders by allowing them to vote their proxies on their broker's website as well as providing them with consolidated access to proxy materials and other information. Although Broadridge was not successful in persuading the SEC to adopt EBIPs through rulemaking,¹³⁵ it argued to the PFAC that brokers could be encouraged to cooperate with Broadridge to implement EBIPs if they were compensated through an incentive fee.¹³⁶

The NYSE agreed and, in 2013, amended its rules to establish an incentive fee program designed to encourage brokers to develop and encourage the use of EBIPs.¹³⁷ Since 2013, Broadridge has developed an investor mailbox that can be directly integrated into the broker's website, and that allows the broker's customers to submit voting instructions directly through that website.¹³⁸ The incentive fee has increased broker use of EBIPs, but progress has been limited, in large part because broker participation remains voluntary.¹³⁹ As of Sept. 2016, brokers that provide

[05-16-2012.pdf](#) at 2. In 2012, issuer paid approximately "\$200 million in aggregate on fees for proxy distribution to street name shareholders during a year" *Id.* at 3.

¹³³ *Id.* at 9, 22.

¹³⁴ Order Granting Approval to Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, Oct. 18, 2013.

¹³⁵ *Noked*, *supra* note __.

¹³⁶ Recommendations of the Proxy Fee Advisory Committee, *supra* note __ at 23. The rules permit brokers to charge issuers a one-time .99 fee per account for establishing an EBIP through which it provides investors with notice of upcoming meetings and a mechanism for submitting voting instructions through the broker's website. The .99 incentive fee is in effect for a test period that ends Dec. 31, 2018. *Id.*

¹³⁷ Rulemaking Order at 55.

¹³⁸ See Broadridge, Product Insights, Mailbox for Investors Product Demo <http://www.broadridge.com/product-insight/Mailbox-Product-Demo.html> (last visited Feb. 27, 2017) (providing an investor mailbox demo).

¹³⁹ The SEC has been criticized for failing to mandate broker cooperation in the development of EBIPs. See <https://corpgov.law.harvard.edu/2013/09/22/the-promise-of-the-enhanced-broker-internet-platform/> ("Unfortunately, EBIPs are currently the caboose on a stalled train: a rulemaking to change the structure of proxy fees which has been years in the making and is now languishing at the Commission."). See also Letter

their customers with access to EBIPs handle 58% of all street positions.¹⁴⁰ In addition, the functionality of EBIPs is limited by existing proxy solicitation rules, as will be discussed in the next Part.

Retail investor voting can be increased in other ways. One possibility is to reward investors for voting their shares. In 2010, Prudential created an innovative vote incentive program. The program offered investors who voted their shares the choice of having a tree planted or receiving an eco-friendly tote bag.¹⁴¹ Prudential's program appears to have been successful in increasing voting by shareholders who had not previously voted, and the other companies might increase retail voting by adopting similar programs.¹⁴² Prudential is somewhat unique, however, in that it did not have to rely as heavily as most companies on the cooperation of broker intermediaries because it has a substantial number of retail shareholders who are holders of record.¹⁴³ Most companies in which retail shareholders hold through intermediaries would find implementing a voting incentive program to be more costly.¹⁴⁴

In a recent paper Kobi Kastiel and Yaron Nili propose a somewhat different approach to increasing retail voting – a nudge.¹⁴⁵ Structured after Richard Thaler and Cass Sunstein's well known book,¹⁴⁶ the proposal would offer investors “highly visible default arrangements that would allow (or force) them to choose between several available voting short-

of Senator Charles Schumer to Mary Jo White, Chairman, Securities and Exchange Commission, May 23, 2013. <http://www.sec.gov/comments/sr-nyse-2013-07/nyse201307-32.pdf>

¹⁴⁰ Email from Chuck Callan, Broadridge to Jill Fisch dated Oct. 5, 2016.

¹⁴¹ See Prudential, Our Approach to Shareholder Engagement, Shareholder Vote Incentive Program, <http://corporate.prudential.com/view/page/corp/31846> (last visited 8/19/16).

¹⁴² See William L. Tolbert, Jr., Elaine Wolff and Adam R. Kreis, Incentivizing Shareholders to Vote – Tote Bag Anyone?, Jenner & Block Corporate Update, 1,3 (2012), https://jenner.com/system/assets/publications/9013/original/Incentivizing_Shareholders_to_Vote_%E2%80%93_Tote_Bag_Anyone.pdf?1364833031 (reporting the effect of Prudential's program but reporting that, as of March 2012, “why no company has yet followed Prudential's example and adopted such a program”).

¹⁴³ *Id.* at 3.

¹⁴⁴ *Id.* at 3.

¹⁴⁵ Kobi Kastiel & Yaron Nili, Just a Little “Nudge” Curing Investors' Rational Apathy, working paper, Comments on Proxy Voting Roundtable, Feb. 17, 2015, www.sec.gov/comments/4-681/4681-2.pdf

¹⁴⁶ Richard H. Thaler & Cass R. Sunstein, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2008).

cuts.”¹⁴⁷ The idea behind the nudge is to enable investors to use short-cuts to streamline the voting process by allowing shareholders to set up and opt into default voting arrangements or preferences rather than being forced to specify votes on each individual issue at each issuer. The proposal strongly resembles the types of voting arrangements that are currently available to institutional investors.

The nascent market developments and proposals demonstrate that greatest promise for increasing retail participation involves harnessing technology to make retail voting more efficient. The model for doing so can be found in the voting platform that market forces currently provide to institutional investors. Although the progress with EBIPs has substantially improved the efficiency of the retail process, the functionality of EBIPs is limited so long as they cannot be used to submit SVI. Broadridge has documented retail investor interest in the SVI mechanism. In 2011 and 2014, Broadridge conducted two separate on-line surveys.¹⁴⁸ In response, investors overwhelmingly reported that they viewed SVI as making it easier to vote their shares and that they would be more likely to vote if this service were available to them.

II. SVI and Existing Regulatory Constraints

As the preceding Part explains, institutional investors have access to a variety of services that simplify the mechanics of proxy voting: 1) a centralized, web-placed platform on which they can access information relating to voting matters for their entire portfolio; 2) the ability to cast votes through this platform; and 3) the ability to designate voting policies or preferences rather than casting votes on an individual firm-by-firm basis. The institutional experience demonstrates that the technological challenges to providing these services are minimal. Nonetheless EBIPs, the closest retail analogue, provide only a subset of these services and are available only to a fraction of the retail investor population. Specifically, EBIPs do not offer retail investors the opportunity to designate their voting preferences in advance or to submit voting guidelines that would apply across their entire portfolio. SVI provides this functionality. Nonetheless, market participants are precluded from offering SVI to retail investors

¹⁴⁷ Kastiel & Nili, *supra* note ___, working paper at 5.

¹⁴⁸ See Broadridge Research Report, *Evaluate the redesign of Proxyvote.com* SECTION ON ADVANCED VOTING INSTRUCTIONS, Jan. 2015.

because of existing provisions in the SEC's rules regulating the solicitation of proxies.

Under Section 14(a) of the Securities Exchange Act of 1934, the SEC has the authority to regulate the proxy solicitation process. The SEC has defined the scope of its regulatory authority as all communications to shareholders that are "reasonably calculated to result in the procurement, withholding or revocation of a proxy" constitute proxy solicitations.¹⁴⁹ The SEC rules provide that, unless an exemption applies, all proxy soliciting material must be filed with the SEC.¹⁵⁰ In addition, most proxy solicitations require that the speaker file a proxy statement and provide that statement to shareholders.¹⁵¹

When a broker requests voting instructions from beneficial owners, because that request is a communication reasonably calculated to result in the procurement of a proxy, it, falls within the SEC's definition of a proxy solicitation. However, SEC has created a regulatory exemption for certain communications from a broker to its customers. Under Rule 14a-2(a)(1), brokers can transmit third party proxy solicitation material to their customers and request voting instructions so long as the broker 1) receives no compensation other than reimbursement of his or her costs; 2) promptly furnishes all proxy soliciting material and 3) impartially requests a proxy or voting instructions.¹⁵² The exemption only applies if the broker refrains from providing its own information or analysis of the matters upon which the shareholders are being asked to vote. The exemption has the effect of treating the broker's function as ministerial rather than a proxy solicitation. Rule 14a-2(a)(1) limits a broker's ability to obtain standing voting instructions because, for the exemption to apply, the broker must "furnish promptly" proxy materials to the person solicited.¹⁵³ By definition, the submission of SVI takes place prior to the filing of proxy materials, making it impossible for the broker to satisfy this requirement.

¹⁴⁹ 17 CFR § 240.14a-1(1)(iii) (defining "solicitation").

¹⁵⁰ See 17 C.F.R. § 240.14a-2 (providing exemptions from the filing and proxy statement requirements); § 240.14a-6 (describing filing requirements).

¹⁵¹ 17 C.F.R. § 240.14a-3 (describing information that must be furnished to shareholders).

¹⁵² 17 C.F.R. § 240.14a-2(a)(1).

¹⁵³ The broker must "Furnishe[] promptly to the person solicited (or such person's household in accordance with § 240.14a-3(e)(1)) a copy of all soliciting material with respect to the same subject matter or meeting received from all persons who shall furnish copies thereof for such purpose...." Rule 14a-2(a)(1)(ii).

The exemption under rule 14a-2(a)(1) does not extend to a broker's own expert analysis, recommendations, or information on how other shareholders are voting. Brokers are permitted under a different exemption, Rule 14a-2(b)(3), to furnish not just additional information but explicit proxy voting advice to their clients.¹⁵⁴ The exemption for proxy voting advice applies as long as the broker provides financial advice in the ordinary course of business, does not receive special compensation for the advice, discloses any conflicts or relationships, and is not soliciting on behalf of any participant in the proxy contest. Unlike the exemption under Rule 14a-2(a)(1),¹⁵⁵ however, this provision only exempts the broker from the filing requirements and the obligation to furnish a proxy statement.¹⁵⁶ As a result, a broker who provides advice pursuant to this exemption faces some regulatory risk; the broker could be liable under Rule 14a-9 for proxy fraud.¹⁵⁷

Rule 14a-4(d) also limits, a broker's ability to ask his or her client for SVI.¹⁵⁸ Rule 14a-4(d) does not permit a proxy to confer voting authority "with respect to more than one meeting" or for "any annual meeting other than the next annual meeting . . . to be held after the date on which the proxy statement and form of proxy are first sent or given to security holders."¹⁵⁹ An SVI platform would require a change in the rule to allow the submission of voting instructions prior to the distribution of the proxy statement and that would be applicable to multiple shareholders' meetings.

Only very modest changes to these provisions would be required to permit brokers to solicit SVI from their customers. The SEC would have to broaden the exemption under Rule 14a-2 to permit brokers to solicit SVI, to enable them to do so in advance of the distribution of the proxy statement, and to provide information in addition to the materials that are distributed by the issuer and any other soliciting party. An additional regulatory change, however, is necessarily to facilitate efficient

¹⁵⁴ The rule limits the exemption to those with whom the broker has a business relationship. 14a-2(b)(3).

¹⁵⁵ Rule 14a-2(a)(1) provides that "Sections 240.14a-3 to 240.14a-15" do not apply to solicitations exempt under its provisions.

¹⁵⁶ See Rule 14a-2(b) (providing that "Sections 240.14a-3 to 240.14a-6 (other than paragraphs 14a-6(g) and 14a-6(p)), § 240.14a-8, § 240.14a-10, and §§ 240.14a-12 to 240.14a-15 do not apply [to solicitations exempt under this provision]").

¹⁵⁷ 17 C.F.R. § 240.14a-9.

¹⁵⁸ 17 C.F.R. § 240.14a-4(d).

¹⁵⁹ *Id.*

retail investor voting – the SEC needs to amend Regulation 14B to require custodial brokers to provide investors with access to a voting platform that includes comparable functionality to that available to institutional investors, including the ability to submit voting instructions through the broker’s website and the ability to provide standing voting instructions or SVI.¹⁶⁰

Amending Regulation 14B to require an effective internet-based system for retail voting would have several advantages over the current system. First, it would overcome existing broker reluctance to establishing EBIPs and provide all investors with access to voting platforms. Second, requiring that brokers permit SVI would alleviate potential concerns that brokers may currently face about their liability exposure if they deviate from existing practices.¹⁶¹ Third, by addressing these issues explicitly, the regulation could include appropriate safeguards to protect investors. This Article will consider those safeguards in Part IV.

Despite these advantages, and despite the fact that SVI proposals have been before the SEC for more than ten years, the SEC has failed to make the necessary changes even to permit SVI much less to encourage it. The SEC’s failure to act appears to be based on several concerns. As noted earlier, in 2009, the SEC identified the concern that SVI would enable investors to make their voting decisions before receiving the federally-mandated proxy disclosures.¹⁶² This, in turn, might lead

¹⁶⁰ Alternatively, the SEC could eliminate the pass-through nature of existing Regulation 14B by requiring intermediaries to execute proxies giving beneficial owners the right to vote their shares directly. This would enable beneficial owners to cast their votes directly or by use of an internet-based intermediary like Moxy Vote. See 2003 Request for Rulemaking at 14 (“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”). By obligating brokers to execute such proxies, this regulatory change would enable market participants to compete over the development of voting platforms in the same way that market competition has produced multiple options for institutional investors.

¹⁶¹ Recall that the SEC stated, in its proxy plumbing release in 2010, that the proxy rules do not contain an exemption permitting SVI. Proxy Plumbing Release, *supra* note at 84.

¹⁶² Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two

shareholders to make their voting decisions in a generic fashion without reference to the firm-specific context in which those instructions are being applied. This is likely to lead at least some investors to rely on rules of thumb or heuristics. Investors using SVI might also rely to a substantial degree on third party voting recommendations or policies, especially policies formulated by governance intermediaries such as proxy advisory firms.

These concerns reflect a common theme – the prospect that SVI will promote uniformed voting by shareholders. At the 2015 SEC Roundtable, Allan Beller succinctly identified uninformed voting as the key obstacle to the implementation of SVI: “there is a tension between providing a system that encourages retail investors to vote and the promotion of informed voting.”¹⁶³ In the next Part, this Article challenges the claim that the risk of uninformed voting is an appropriate basis for failing to implement SVI for retail investors. In Part IV, the Article offers some preliminary suggestions about the appropriate safeguards for such implementation.

III. SVI and Uninformed Shareholder Voting

This Article argues that the SEC should not continue to deny retail investor access to a functional voting platform that includes the capacity for SVI because of the risk of uninformed voting for four reasons. First, uninformed voting by retail investors is unlikely. Second, existing regulations are inconsistent with the voting rights conferred on investors by state law. Third, SVI is not in tension with the mandatory disclosure regime provided by federal law. Finally, institutional investors currently have access to AVI, and the differences between retail and institutional investors do not warrant different treatment.

A. Retail Investors are Unlikely to Engage in Uninformed Voting

Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company, Release No. 34-60215 (July 1, 2009) [74 FR 33293] (Commission approval of amendments to NYSE Rule 452), at 34

¹⁶³ 2015 Roundtable unofficial transcript at ___.

Uninformed voting is, assuredly, undesirable. If shareholders lack adequate information about the issues on which they vote, they may make mistakes and be vulnerable to exploitation. The economic rationale for shareholder voting rights is based on the theory that, as residual claimants, shareholders have the incentive to make discretionary decisions in a way that will maximize firm value.¹⁶⁴ If shareholders do not vote in an informed manner, they may not maximize firm value through their voting decisions. This behavior has the potential to impose costs not only on shareholders, but also on other stakeholders and society at large.

Berle and Means famously recognized that dispersed public shareholders faced collective action costs that limit their ability to use their voting rights effectively.¹⁶⁵ For small investors it is rational to be apathetic about voting – the typical retail investor may lack a sufficient stake to warrant the investment of time necessary to make a fully informed decision. Rational apathy is, of course, not a by-product of SVI. Nonetheless, because SVI gives shareholders the opportunity to designate their voting preferences in advance and across all their holdings, its availability could reduce the incentive for shareholders to research a particular vote at a specific issuer.

There is, nonetheless, a substantial gap between theory and practice. Simply put, the risk that retail investors will engage in uninformed voting is overstated. There are several reasons for this. First, and most importantly, retail investors have skin in the game. As owners, retail shareholders have a meaningful economic stake in the companies in which they invest. It is far more likely that shareholders who do not believe themselves to be sufficiently informed will fail to vote than will cast a vote on an informed basis that might risk damaging that economic stake. In contrast, most institutional votes are cast by agents or intermediaries, introducing the potential for conflicts of interest or other agency costs.¹⁶⁶

Not only do retail investors have a meaningful economic interest, they acquired that economic interest by making an affirmative decision to purchase their shares. Even if a retail investor's stake in a voting outcome is relatively small, the underlying investment is likely to be economically meaningful to that shareholder. In addition, information acquired by the

¹⁶⁴ Easterbrook & Fischel, *The Economic Structure of Corporate Law*, 68.

¹⁶⁵ Berle & Means, *supra* note ____.

¹⁶⁶ See Gilson & Gordon, *supra* note ____ at 865 (identify the dual set of agency relationships presented by institutional investor involvement in corporate governance).

investor in connection with the trading decision also has the capacity to inform that investor's voting decisions. Indeed, although retail investor trading decisions may be less sophisticated, they are likely to be more information-based than a substantial proportion of institutional decisions that are made on the basis of index composition, benchmarks or trading algorithms.¹⁶⁷

Second, the use of SVI is not inconsistent with investor use of and reliance on federally-mandated disclosures. As discussed in Part IV below, this article's proposal for SVI would retain the requirement that brokers send a full set of proxy material to their SVI clients for each meeting at the same time they distribute those proxy materials to their other clients. It would also require that brokers provide clients with the opportunity to override the standing instructions at any time and to notify clients of their right to do so in connection with every shareholder meeting. Accordingly, customers would retain the ability to use the federally-mandated disclosure to change or reaffirm any voting instructions that they had previously submitted.

Third, the proxy statement is not the only relevant source of information with respect to voting decisions. Shareholders today have access to substantial and timely information about issuers and voting issues. As noted above, shareholders have access to information in connection with their trading decisions and have some level of familiarity of the issuers at which they are being asked to cast votes by virtue of having voluntarily invested in those companies. Issuer information is available on the internet and mediated through an increasing number of analysts, websites and service providers. Retail investors can access the voting guidelines of mutual funds and the voting policies of many other institutional investors and use that information to formulate their own voting policies.¹⁶⁸ The business and financial media provide extensive

¹⁶⁷ See Dan Li & Geng Li, Are Household Investors Noise Traders: Evidence from Belief Dispersion and Stock Trading Volume, Fed. Res. Working Paper, 19 (2014) (presenting data that trading by household investors is belief and information-based and contributes to market efficiency).

¹⁶⁸ SEC rules require mutual funds to disclose their votes and voting policies publicly. DOL Regulations impose similar requirements on public pension funds. See, e.g. Vanguard's Proxy Voting Guidelines, <https://about.vanguard.com/vanguard-proxy-voting/voting-guidelines/> (last visited Aug. 17, 2016) (describing Vanguard's voting policies); California Public Employees' Retirement System Statement of Investment Policy for Global Governance, March 16, 2015,

coverage of shareholder voting issues, and recent economic studies demonstrate the influence of media coverage on voting outcomes.¹⁶⁹

Finally, increased levels of retail participation in the voting process will create an incentive for participants in an election to reach out and communicate with retail investors. Proxy solicitation firms have a variety of tools available to enable issuers and challenges to communicate their views to a retail investor base, and the use of such tools is far more likely to generate an informed vote than the existing system of notifying an investor of the on-line availability of a complex proxy statement.¹⁷⁰ Today, because of the low levels of retail voting, participants in the proxy solicitation process have little reason to provide information to retail investors beyond filing the federally-mandated proxy statement, a document which, after the adoption of e-proxy is generally not even provided to shareholders directly.¹⁷¹

B. State law voting rights are not conditioned on informed voting

Although federal law regulates the mechanics of shareholder voting, state corporate law is the primary source of shareholders' substantive voting rights.¹⁷² Indeed, the original rationale for federal

<https://www.calpers.ca.gov/docs/policy-global-governance.pdf> (describing CalPERS voting policy).

¹⁶⁹ See, e.g., Reggy Hooghiemstra, Yu Flora Kuang & Bo Qin, Say-on-Pay Votes: The Role of the Media, 24 *European Accounting Review* 753 (2015) (reporting that negative media coverage of CEO pay is associated with say-on-pay voting dissent in the UK); Reena Aggarwal, Isil Erel & and Laura T. Starks, Influence of Public Opinion on Investor Voting and Proxy Advisors (July 1, 2015).

<http://ssrn.com/abstract=2447012> (finding that public opinion as reflected in media coverage, influences both proxy advisor recommendations and voting outcomes).

¹⁷⁰ See Broadridge, A Short-List Of Incentives That Might Get More Folks To Vote Their Proxies..., *The Shareholder Service Optimizer*, 2011, <http://www.optimizeronline.com/article/101670/a-short-list-of-incentives-that-might-get-more-folks-to-vote-their-proxies> (discussing how mailing a full package of proxy materials is more likely to get retail investors to vote).

¹⁷¹ Sarah Lynch, SEC official calls for review of electronic proxy delivery rules, Reuters, Feb. 19, 2015, <http://www.reuters.com/article/us-sec-proxy-idUSKBN0LN24D20150219>.

¹⁷² Federal law has, to some extent, supplemented shareholders' state law voting rights. The most obvious example is the federally-mandated advisory vote on executive compensation. See Jill E. Fisch, Leave it to Delaware: Why Congress should stay out

proxy regulation was to restore to shareholders the ability to exercise their state-conferred voting rights when shareholder dispersion threatened their ability to do so effectively.¹⁷³

State law does not, however, require that shareholders cast an informed vote. Indeed, state law imposes few restrictions on the motive or intent underlying the exercise of shareholder voting power. Delaware courts, for example, have explicitly recognized the shareholder's right to act selfishly in exercising its voting power.¹⁷⁴ Similarly the courts have explained that shareholders may validly determine how to vote their shares "by whim or caprice."¹⁷⁵

Shareholder voting power is not conditioned upon shareholder-specific characteristics such as a shareholder's independence, intent, or good faith.¹⁷⁶ Shareholders do not act as fiduciaries when they exercise their voting rights,¹⁷⁷ and they are under no obligation to vote their shares

of Corporate Governance, 37 Del. J. Corp. L. 731, 752 (2013) (discussing "say on pay").

¹⁷³ See, e.g., Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 Emory L.J. 435, 453 (2012) (explaining that "the federal proxy rules were designed to replicate, as nearly as possible, an in-person shareholder meeting").

¹⁷⁴ See *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 442 (Del. 1996) (citing DEL. CODE ANN. tit. 8, § 271 (1996) to affirm controlling shareholder's right to vote based on own self-interest in a transaction requiring shareholder approval to sell substantially all of the corporation's assets).

¹⁷⁵ *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling*, 53 A.2d 441, 447 (Del. 1947) ("Generally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders."); accord *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 845 (Del. 1987).

¹⁷⁶ See Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 Emory L.J. 435, 455 (2012) ("State law does not condition the exercise of voting power on shareholder-specific characteristics").

¹⁷⁷ See, e.g., *Tanzer v. International General Industries, Inc.*, 379 A.2d 1121, 1124 (Del. 1977) quoting *Fletcher Cyclopedia, Corporations* (Perm.Ed.) § 2031 ("At a stockholders' meeting, each stockholder represents himself and his own interests solely and in no sense acts as a trustee or representative of others...."). See also *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 845 (Del. 1987) ("Stockholders in Delaware corporations have a right to control and vote their shares in their own interest").

in the best interests of the corporation.¹⁷⁸ Delaware corporate law even allows to sell shareholders to sell their voting rights to someone else.¹⁷⁹

Although shareholders have occasionally faced challenges for acting selfishly with respect to the exercise of their voting rights, those cases typically involve controlling shareholders in which the shareholder is not acting purely in its capacity as shareholder acting on behalf of the corporation.¹⁸⁰ Even in those cases, courts have recognized that, while a controlling shareholder may not use the corporate machinery to gain an advantage at the expenses of the minority, even controlling shareholders may nonetheless act out of self interest in both voting and selling their stock.¹⁸¹

C. Uninformed shareholder action is not in tension with the Objectives of the Federal Securities Laws

In contrast to state corporate law, the disclosure orientation of the federal securities laws prioritizes the goal of informed shareholder action. The very rationale of a mandatory disclosure system is to protect investors by giving them sufficient information relevant to their trading and voting decisions.¹⁸² Federal law requires the disclosure of specified information

¹⁷⁸ Concededly state law recognizes that Court of Chancery recognized that "[w]hat legitimizes the stockholder vote as a decision-making mechanism is the premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization." *In re IXC Commc's, Inc. S'holders Litig.*, 1999 Del. Ch. LEXIS 210, 1999 WL 1009174, at *8 (Del. Ch. Oct. 27, 1999); *Crown Emak Partners, LLC v. Kurz*, 992 A.2d 377, 388 (Del. 2010)

¹⁷⁹ Shareholders are free to do whatever they want with their votes, including selling them to the highest bidder. *Hewlett v. Hewlett-Packard Co.*, 2002 Del. Ch. LEXIS 44, *11 (Del. Ch. Apr. 8, 2002).

¹⁸⁰ See, e.g., *Iman Anabtawi & Lynn Stout, Fiduciary Duties for Activist Shareholders*, 60 *Stan. L. Rev.* 1255, 1269 (2008) (observing that the circumstances in which courts have imposed fiduciary duties on shareholders have been limited both to controlling shareholders and to cases involving "freeze-outs" and closely held corporations").

¹⁸¹ *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121, 1124 (Del. 1977) (even a controlling "stockholder in a Delaware corporation has a right to vote his shares in his own interest"); *Williams v. Geier*, 671 A.2d 1368, 1380-81 (Del. 1996) ("Stockholders (even a controlling stockholder bloc) may properly vote in their own economic interest.").

¹⁸² See, e.g., *Troy Paredes, Blinded By the Light: Information Overload and its Consequences for Securities Regulation*, 81 *Wash. U. L. Q.* 417, 431 (2003)

in a variety of circumstances. Issuers are required to file a registration statement and prospectus prior to selling securities to the public.¹⁸³ After going public, issuers are required to make periodic disclosures to keep investors informed, including an annual report.¹⁸⁴ In addition, anyone who solicits proxies from shareholders is required to comply with the proxy solicitation requirements of Regulation 14A which include the preparation of a proxy statement.¹⁸⁵

One objective of this disclosure is to facilitate informed shareholder action,¹⁸⁶ Federal law does not actually require, however that shareholders be informed. Rather, the obligation is on issuers to disclose, not on investors to use that disclosure.¹⁸⁷ The principle behind the federal disclosure system is to require that the mandated disclosure be sent to each investor, not that each investor read it, acknowledge that they have read it, or demonstrate his or her familiarity with its contents prior to investing or voting.

Moreover, as a practical matter, modern investors are unlikely to read the federally-mandated disclosure documents. The length and complexity of the proxy statement and supporting documents continues to increase. For example, Jeff Gordon observed that the average length of an annual report increased from approximately sixteen pages in 1950 to 165 in 2004.¹⁸⁸ A similar increase has occurred in the length of proxy statements.¹⁸⁹ Not only has the documentation increased in length, but shareholders are asked to vote on an increasing number of issues.¹⁹⁰

(“Disclosure is merely the chosen means to the end of informed investor decision making”).

¹⁸³ 15 U.S.C. § 77e.

¹⁸⁴ Exchange Act, §§12(b)(1), 12(g)(1), 13, 15(d), 15 U.S.C. §§78(b)(1), 78(g)(1), 78m, 78o(d).

¹⁸⁵ Exchange Act of 1934, §§14(a), 15 U.S.C. §§78n(a),

¹⁸⁶ See, e.g., Paredes, *supra* note __ at 462 (“informed investor decision making [is] a key goal of the federal securities laws, probably the main goal today”).

¹⁸⁷ Cf. Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 *Calif. L. Rev.* 279, 280 (2000) (proposing instead the elimination of issuer-based regulatory requirements in favor of investor regulation).

¹⁸⁸ Jeffrey Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 *Stan. L. Rev.* 1465, 1547 (2007).

¹⁸⁹ See, e.g., Kastiel & Nili, *supra* note __, working paper at 20 (citing the example of the Apple Proxy Statement, which grew from eighteen pages in 1994 to 90 in 2004).

¹⁹⁰ *Id.* at 19.

As a result, although many investors never read the federally-mandated disclosures.¹⁹¹ As Troy Paredes explains, the existing disclosure regime is too extensive and complex, and, as a result, “few people expect the ‘average’ individual investor to focus in any detail on the information that companies disclose.”¹⁹² Similarly a 2006 survey by the ICI reported that only one-third of mutual fund investors consulted the mutual fund prospectus before purchasing their shares and that most investors do not use the SEC-mandated disclosure documents to monitor their investments.¹⁹³ In addition, the SEC appears to be comfortable permitting voting mechanisms that create a substantial risk that shareholders will not read the proxy materials such as voting on mobile devices, a process that does not appear conducive to an investor reading a lengthy proxy statement.¹⁹⁴

This is not to say that the federally-mandated disclosure system is a failure. The system works because the disclosures are made to the market and some market participants incorporate that information into trading prices by relying on that information. This enables the rest of the investing public to free-ride – relying on the market price set by better-informed investors.¹⁹⁵ In addition, issuer disclosures are largely “filtered” through experts - various securities professionals and financial intermediaries - who research and process the information and whose trades and recommendations ultimately set securities prices”¹⁹⁶ Developments in technology have dramatically increased the market’s ability to process and disseminate information, meaning that the average

¹⁹¹ Cf. Stephen Choi, Behavioral Economics and the Regulation of Public Offerings, 10 Lewis & Clark L. Rev. 85, 118 (2006) (observing that “most individual investors are likely not to read the prospectus even if delivered to them”).

¹⁹² Paredes, supra note __ at 431-32.

¹⁹³ See Investment Company Institute, Understanding Investor Preferences for Mutual Fund Information, at 22 (2006), https://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf.

¹⁹⁴ See, e.g., Wells Fargo Proxy Statement dated Mar. 16, 2016 at 1, <https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/annual-reports/2016-proxy-statement.pdf> (advising shareholders that they can vote their shares using their mobile devices).

¹⁹⁵ As the Court explained in *Halliburton*, “it is reasonable to presume that most investors—knowing that they have little hope of outperforming the market in the long run based solely on their analysis of publicly available information—will rely on the security’s market price as an unbiased assessment of the security’s value in light of all public information.”, *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2411 (2014), quoting *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184 (2013).

¹⁹⁶ Paredes, supra note __ at 431-32.

investor reaps the benefit of issuer disclosures today through an ever-growing number of internet and social media sources.

That federal law expressly vests investors with discretion to choose which and how much information to use is reflected in the SEC's 2005 Public Offering Reforms.¹⁹⁷ In the reforms, the SEC shifted the disclosure requirement in the Registration process from that of providing investors with disclosure to instead providing investors with access – that is, making the disclosure available.¹⁹⁸ The access equals delivery system treats issuers as having delivered the mandated disclosures to investors once those disclosures are made publicly available.¹⁹⁹ The result of the system, however, is that investors are left with the choice of whether to access the applicable disclosure documents and need not affirm that they have read them before purchasing securities.

D. Allowing SVI for Institutional but not Retail Investors is not Warranted

Finally, it is important to recognize that the SEC's current regulations have the practical effect of enabling institutional but not retail investors to utilize SVI. The risk of uninformed voting is not unique to retail investors, however. The same concern might be raised about institutional investor voting.

The regulatory changes adopted by the DOL and the SEC to mandate institutional voting impose a duty on institutional investors to vote, but institutions do not necessarily cast that vote in an informed manner. Indeed, commentators frequently criticize institutional investors for “blindly” relying on proxy advisors,²⁰⁰ and policymakers have sought to impose greater regulatory restrictions on advisors with the objective of

¹⁹⁷ Securities Offering Reform, Securities Act Release No. 8591, Exchange Act Release No. 52,056, Investment Company Act Release No. 26,993, 70 Fed. Reg. 44,722, 44,731-32 (Aug. 3, 2005).

¹⁹⁸ See Choi, *supra* note __ (evaluating the effect of shifting from delivery to access).

¹⁹⁹ See Rules 153, 172, 173, 174, 17 C.F.R. §§230.153, 230.172, 230.173, 230.174.

²⁰⁰ See, e.g., Daniel Gallagher,

<https://www.sec.gov/News/Speech/Detail/Speech/1370539700301> (“The last thing we should want is for investment advisers to adopt a mindset that leads to them blindly casting their votes in line with a proxy advisor’s recommendations, especially given the fact that such recommendations are often not tailored to a fund’s unique strategy or investment goals.”).

compelling a more informed institutional vote.²⁰¹ The mechanism for doing so is unclear, however. Many institutions lack the sophistication and resources to vote in an informed manner. Investment advisors may be expert in designing investment strategies but lack competence in evaluating governance issues. Some institutions such as index funds compete by minimizing their operating expenses, and devoting substantial resources to governance research may be in tension with that business model. In addition, institutional investors are subject to agency costs – those who are making voting decisions do not, as a general rule, have an economic interest in the securities that they are voting.

Commentators have suggested that institutional investors are better positioned to research and develop voting policies than retail investors, and it is certainly true that some institutional investors such as Blackrock and Vanguard devote substantial resources to voting research.²⁰² Both institutional and retail investors vary tremendously, however, and it is likely that a substantial percentage of retail investors who invest directly in common stock are at least as sophisticated as the advisors to many smaller pension and mutual funds. In short, the difference between retail and institutional investors, with respect to both their ability and their willingness to make informed voting decisions is overstated.

Even the claim that retail investors are less sophisticated than institutions is likely overstated. Wealthy, better-educated and more sophisticated households are most likely to invest in the stock market in general,²⁰³ and, within the overall population of retail investors are more likely to own stock directly, as opposed to mutual fund shares.²⁰⁴ This

²⁰¹ See, e.g., Bonnie Barsamian & Marc Leaf, Proxy Advisory Firms In The Regulatory Spotlight, Law360, Dec. 8, 2016, <https://www.law360.com/articles/869646/proxy-advisory-firms-in-the-regulatory-spotlight> (discussing proposed regulation of proxy advisory firms).

²⁰² See, e.g., Madison Marriage, BlackRock, Vanguard and State Street bulk up governance staff, Fin. Times, Jan. 28, 2017, <https://www.ft.com/content/657b243c-e492-11e6-9645-c9357a75844a> (describing expansions in the size of corporate governance teams at Blackrock, Vanguard and State Street).

²⁰³ Robert Frank, The stock gap: American stock holdings at 18-year low, CNBC Sept. 8, 2014, <http://www.cnbc.com/2014/09/08/the-stock-gap-american-stock-holdings-at-18-year-low.html> (reporting that, in “2010, the latest period available, the top 10 percent of Americans by net worth held 81 percent of all directly held or indirectly held stocks”)

²⁰⁴ See id. at 24 (“prime-age, more educated, white, and higher-income investors

pattern has increased recently, as unsophisticated households have reduced their investment in equity.²⁰⁵

It is possible, of course, that the opportunity to submit SVI will encourage retail investors to be lazy. It is also possible that institutional investors have structures and internal controls that enable them better to oversee the mechanics of the SVI process and identify situations in which it is in their interests to override their standing instructions. Even institutions, however, can make stupid mistakes in casting their votes. Recently, for example, T. Rowe Price failed manually to override its computerized voting system and mistakenly voted its shares in favor of the 2013 Dell merger even though the funds' advisors believed the merger price was too low.²⁰⁶ By voting in favor, the funds were disqualified from exercising their appraisal rights, an error that cost them \$194 million.²⁰⁷

IV. Implementation of SVI

Implementation of SVI raises a variety of practical considerations. There is the question of the manner in which brokers should solicit SVI. Should brokers be required to ask every customer for standing voting instructions or is it sufficient if brokers give their customers the opportunity to do so? Should third party providers be permitted to offer retail investors the opportunity to sign onto sites that enable them to submit SVI? Should brokers be required to cooperate with third party providers?

A second question concerns the types of instructions that customers should be permitted to submit. A voting platform could

are more likely to hold stocks.”); Daniel Barth, *The Costs and Beliefs Implied by Direct Stock Ownership*, European Central Bank working paper at 9 (March 2014) (analyzing data from the Survey of Consumer Finances and Household Wealth and finding that wealthy households are relatively more likely to own individual stocks, hold an increased number of individual stocks and allocate more of their household wealth to equity).

²⁰⁵ See, e.g., Marcin Kacperczyk, Jaromir Nosal & Luminita Stevens, *Investor Sophistication and Capital Income Inequality*, working paper at 4 (2015) (“Over time, unsophisticated households increase their share of liquid, money-like instruments and shift away from direct stock ownership and ownership of intermediated products, such as actively managed equity mutual funds”)

²⁰⁶ Sarah Krouse, *T. Rowe Price Pays Up for Botched Vote*, Wall St. J., June 6, 2016, http://www.wsj.com/articles/t-rowe-price-to-reimburse-clients-194-million-for-dell-deal-flub-1465244254?mod=itp&mod=djemITP_h

²⁰⁷ *Id.*

provide investors with a limited number of choices, such as the four choices proposed by Moxy Vote -- voting with the board recommendation, voting against the board recommendation, voting proportionately with other shareholders or abstaining. This range of choices would be very simple to implement, as evidenced by Broadridge's one-click button.²⁰⁸

A platform could also provide investors with a broader set of options such as, for example, allowing investors to cast their votes in the same way that another designated investor, such as a mutual fund or public pension fund, votes its shares. An investor might, for example, choose to vote their shares in the same way that Vanguard's S&P 500 index fund votes. This option is similar to the manner in which institutional investors currently have the ability to direct their votes to be cast in accordance with the recommendations of a proxy advisor such as ISS or Glass Lewis.

Because this approach would result in the investor essentially delegating voting authority to a third party, it raises questions about the extent to which such delegations are appropriate. Institutional investors have been highly criticized for delegating their voting decisions to proxy advisory firms.²⁰⁹ Delegating voting authority, however, raise fewer concerns in the context of retail investors. First, retail investors who may lack the interest or expertise to analyze voting decisions carefully may rationally view institutions as more knowledgeable. Second, a retail investor's decision to delegate voting authority to a large institutional investor with skin in the game is very different from an institution's decision to delegate to a proxy advisor who is not subject to the disciplinary forces of an underlying economic interest.²¹⁰ Third retail investors who delegate voting authority are acting as principals rather than fiduciaries with respect to their voting decision.

More complex SVI options would allow investors to designate issue-specific voting policies or guidelines such as voting against

²⁰⁸ See infra notes __ through __ and accompanying text (discussing one-click button).

²⁰⁹ See Gallagher, supra note __; David Larcker & Allan McCall, Outsourcing Shareholder Voting to Proxy Advisory Firms, 58 J. Law & Econ. 173, 203 (2015) (reporting that "the outsourcing of voting to proxy advisory firms appears to have the unintended economic consequence that boards of directors are induced to make choices that decrease shareholder value").

²¹⁰ See Leo E. Strine, Jr., The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (And Europe) Face, 30 DEL. J. CORP. L. 673, 688 (2005) (criticizing the influence of proxy advisors that have no "skin in the game").

classified boards, in favor of separating the chair and CEO or against overboarded directors. The mechanism by which investors designate such preferences would, of necessity, be more complex. Nonetheless, the systems available to institutional investors allow these types of designations. An even more complex menu might enable investors to set up screens such as voting in accordance with management recommendations unless the screens flag an issuer for problems like underperformance or poor corporate governance.

A third question concerns the type of information that should be available on a voting platform. This Article argues that, at a minimum, a retail voting platform should enable an investor to designate SVI for all the investor's security holdings and to access the proxy statement, proxy card and annual report, as well as any other soliciting material, when those documents become available.²¹¹ Platform providers may find, however, that investors want to obtain additional information. Providers could collect and include, as ProxyDemocracy does, the pre-announced votes of institutional investors.²¹² Providers could include the published voting guidelines of major institutional investors or of the proxy advisory firms. Providers could include links to research concerning corporate governance issues or media reports concerning specific issuers or voting issues. The broader the scope of this information, the more the voting platform can serve as a single source for informing investors.

Resolving questions about the best way to implement SVI is complex. This Article argues, however, that it is neither necessary nor desirable for the SEC to address these questions or to determine the ideal structure for a retail voting platform.²¹³ Instead, the Article suggests that

²¹¹ In an ideal world, the voting platform would populate the voting options with the precise language contained in the proxy, when that language becomes available.

²¹² CalPERS publishes its voting decisions in advance of the shareholders' meeting in an explicit attempt to encourage other shareholders to vote the same way. See CalPERS, Key Decisions, <https://www.calpers.ca.gov/page/investments/governance/proxy-voting/key-decisions> (last visited Aug. 17, 2016) ("We publish our proxy voting decisions to encourage shareowners to vote in accordance with CalPERS. These votes are for informational purposes only and not intended as investment advice").

²¹³ Because voting platforms can be implemented in conjunction with brokers' existing web sites, as Broadridge has done with EBPs, it is unnecessary to impose a separate registration requirement on the voting platform itself. To the extent that non-brokers seek to establish stand-alone voting platforms, the SEC may consider whether to require them to register as broker-dealers or investment advisers. It is worth noting that, under current law, proxy advisory firms do not have to register with the SEC,

existing market forces will enable service providers to experiment with voting platforms based on investor demand for these options and the cost of providing them. Rather than concern itself with identifying an ideal protocol, in adopting its regulations, the SEC should limit itself to removing the existing regulatory impediments and implementing minimal safeguards to prevent abuse. These safeguards should be implemented through regulation of broker-dealers who permit customers to establish SVI and through regulation of intermediaries who provide a proxy voting platform.²¹⁴

With respect to the manner of implementing SVI, SEC regulations should mandate that any communication to shareholder clearly disclose that the SVI instructions can be revoked at any time prior to the shareholder meeting, that the SEC has mandated specific disclosures in connection with a shareholder vote, and that shareholders should read those disclosures before deciding whether to adhere to their pre-designated instructions. Investors who have established SVI should continue to receive notice of all proxy communications in the same manner as other shareholders. Indeed, the SEC should require proxy voting platforms to post or link all SEC-mandated disclosures to the voting page once they are available, to facilitate that investors have easy access to the information at the time they are making or reconsidering

although legislation has been proposed to require such registration. See, e.g., Ed Batts, *Yet Another Congressional Proposed Corporate Reform: Proxy Advisory Firms in the Crosshairs*, Harv. L. Sch. Forum on Corp. Gov. & Fin. Reg., July 20, 2016, <https://corpgov.law.harvard.edu/2016/07/20/yet-another-congressional-proposed-corporate-reform-proxy-advisory-firms-in-the-crosshairs/> (describing the “the Proxy Advisory Reform Act of 2016”).

²¹⁴ This structure is analogous to the regulatory structure established by Title II of the Jumpstart Our Business Startups Act of 2012 (the JOBS Act) with respect to crowdfunding. Pub. L. No. 112-106, 126 Stat 306, 315-23 (2012) (codified as amended in scattered sections of 15 U.S.C.). Specifically, the JOBS Act allows crowd-funded securities to be sold either by a registered broker-dealer or through a registered crowdfunding funding portal. Lori Smith, Bridget Henwood & Michael Psathas, *Regulating the Gatekeepers: The Regulatory Scheme for Funding Portals in Crowdfunding Offerings*, White and Williams LLP News & Resources, Nov. 15, 2013, <http://www.whiteandwilliams.com/resources-alerts-Regulating-the-Gatekeepers-The-Regulatory-Scheme-for-Funding-Portals-in-Crowdfunding-Offerings.html>. See also Shekhar Darke, Note, *To Be or Not to Be a Funding Portal: Why Crowdfunding Platforms Will Become Broker-Dealers*, 10 *Hastings Bus. L.J.* 183 (2014) (arguing that providers will prefer to register as broker-dealers). SEC rules implement a variety of safeguards applicable to crowdfunding platforms. Smith, et al., *supra*.

their voting decisions.²¹⁵ In addition, investors should receive a communication from their proxy voting platform, in advance of the annual meeting of each issuer in which they own stock. The communication should alert investors about the upcoming shareholder vote, advise them how their shares will be voted based on their existing instructions, explain how they can change that vote if they so desire and inform investors of the final deadline for submitting or changing voting instructions with respect to this meeting.

With respect to the SVI options, the SEC's primary focus should be to require that they be even-handed and transparent. Thus, if a platform contains a "vote with management" button, it should also offer investors the option to "vote against management." If the platform allows investors to vote in accordance with the votes or guidelines of other investors, it should provide investors with those guidelines and/or the investors' past voting record. In addition, the site should not contain any language that suggests or endorses a particular vote or voting policy.²¹⁶

The SEC's policy with respect to permitting platforms to provide additional information is perhaps the most difficult because the SEC has long taken the view that someone who provides information to investors has endorsed the information provided and may be liable if that information is inaccurate or incomplete.²¹⁷ In addition, the SEC may be wary of encouraging platforms to provide links to information that is one-sided, unverified, or has the potential to mislead investors. Here, however, the SEC's regulatory approach may need to reflect the reality that investors already have access to this information through the

²¹⁵ Currently this is a substantial deficiency in the Proxyvote.com. Although the site includes a hyperlink to the proxy statement, the web page itself lacks complete information on the issues for which voting instructions are sought and investors who access the proxy statement through the hyperlink risk timing out on the voting platform.

²¹⁶ Issuers and institutional investors will have ample incentives for monitor platforms and to report instances of potential distortion or bias to the SEC, which will obviously have the ability to regulate such conduct under Rule 14a-9. Notably, Rule 14a-9 applies to prohibit proxy fraud even with respect to proxy solicitations that are otherwise exempt from the proxy statement and filing requirements of Regulation 14A.

²¹⁷ Indeed, the SEC failed to exempt crowdfunding intermediaries from liability for issuer fraud. See Alan Bickerstaff, Jeff C. Dodd & Ted Gilman, SEC Adopts Rules to Allow Crowdfunding Beginning May 16, 2016, Andrews Kurth Insights, Dec. 2, 2015, <https://www.andrewskurth.com/insights-1284.html> ("The SEC specifically declined to exempt funding portals (or any intermediaries) from the statutory liability provision of Securities Act Section 4A(c).").

internet, and that the collection or aggregation of publicly-sourced information should not expose a platform to liability unless that information is modified or skewed. With respect to issues of distortion or bias, the SEC's approach should focus on the incentives for such distortion rather than the provision of information.

Toward that end, perhaps the most significant safeguard that the SEC can impose is a requirement that voting platforms be free of conflicts of interest. The fundamental principles underlying this requirement are already contained in the proxy rules, which distinguish those with an interest in the outcome of a shareholder vote or a relationship with the participants from others. The SEC rules should prohibit a voting platform, or anyone that maintains a voting platform from having a financial interest in an issuer, the subject of a shareholder vote, or a relationship to participants in an election contest. The regulations should designate that voting platforms can only be funded by 1) issuers through the NYSE schedule under Regulation 14B or a substantially similar fee structure; 2) brokers that are providing the platform for the benefit of their customers; or 3) customers themselves through direct fees. The regulations should explicitly prohibit platforms from receiving any form of compensation from individuals or organizations who might have a direct or indirect interest in the subject of a shareholder vote, including, proxy contest participants, advocacy groups, institutional investors such as hedge funds, and proxy advisory firms.

Finally, the SEC might decide that some issues are inherently case-specific and inappropriate for SVI. Accordingly, the SEC rules might provide that, for issues such as a merger or a contested election, the broker may not utilize standing instructions and, instead, has the obligation, at the time the proxy statement is released, to provide notice to the customer and to solicit voting instructions. In such cases, the rules should require that the broker or platform explicitly notify SVI investors that their standing instructions do not apply and that their shares will not be voted unless they take action.

The foregoing discussion offers a preliminary blueprint for the introduction of voting platforms and SVI. The market responses to this proposal cannot be predicted with certainty, and the SEC will need to continue to monitor voting platforms in the same way that it monitors the overall proxy solicitation process, and to police against bias, conflicts of interest and potential fraud. The difficulty of this task is likely to be

minimal however. A variety of interested participants in the shareholder voting process, including institutional investors, issuers, and investor advocates, are likely to detect and reveal potential problems.

Conclusion

Despite the increasing importance of shareholder voting, retail investors have been largely excluded. Few retail investors vote their stock, and the mechanics of the voting process rarely make it rational for them to do so. This Article advocates a solution to the problem – providing retail investors with access to a voting platform analogous to those used by institutional investors. A voting platform that allows investors to obtain information and cast votes with respect to all their security positions, submit standing voting instructions and obtain information relevant to the voting decision would reduce the cost and improve the efficiency of the voting process.

The biggest obstacle to regulatory changes implementing voting platforms and SVI is the concern that SVI would increase uninformed voting. As this Article has demonstrated, however, this risk is not specific to retail investors nor likely to be exacerbated by SVI. Instead, this Article offers specific suggestions as to the regulatory changes required to implement SVI and the appropriate safeguards to protect investors. By creating the opportunity for market providers to meet the needs of retail investors, SVI offers the potential to bring greater legitimacy to shareholder voting.

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The European Corporate Governance Institute has been established to improve *corporate governance through fostering independent scientific research and related activities*.

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