REPORT AND RECOMMENDATIONS OF THE PROXY WORKING GROUP TO THE NEW YORK STOCK EXCHANGE

June 5, 2006

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I. INTRODUCTION AND OVERVIEW

In response to the request of the New York Stock Exchange ("NYSE"), the Proxy Working Group hereby submits its recommendations relating to NYSE Rules 452 and 465.

A. The NYSE's Request And Role Of The Proxy Working Group

The Proxy Working Group was created by the NYSE in April 2005 to review the NYSE rules regulating the proxy voting process, and more specifically to review and make recommendations with respect to NYSE Rules 450-460 (with a particular focus on Rule 452) and 465. Rule 452, titled "*Giving Proxies by Member Organizations*," allows brokers to vote on certain "routine" proposals if the beneficial owner of the stock has not provided specific voting instructions to the broker at least 10 days before a scheduled meeting. The NYSE has amended Rule 452 a number of times since its adoption in 1937, and currently identifies 18 items which are not considered "routine." Among the matters still considered "routine," and thus eligible for broker-voting, are the uncontested election of directors, the ratification of auditors and an increase in authorized common stock of an issuer if there are no specific plans for the increased shares. As a general matter, the goal of the NYSE has been to not allow the broker to vote on any proposal that substantially affects the rights and privileges of stockholders, and the amendments to Rule 452 since its original adoption have been taken to keep the Rule consistent with this goal.

Rule 465 governs the fees paid by listed companies to member firms for the firms' distribution of proxy materials and other communications to the shareholder. As described in more detail below, most shares today are not registered in companies' records in the names of the actual, beneficial owners of the stock. Rather, an estimated 70-80% of all public companies' shares are held in "street name," meaning that the "record owner" is a broker, bank or other depository. This system has provided tremendous benefits to all market participants and the broader economy, making it much easier to buy, sell and transfer securities. Rules promulgated by the Securities and Exchange Commission ("SEC") require that public companies, brokers and banks take specific steps to ensure that proxy materials are distributed to beneficial owners. Under current NYSE Rules, companies must pay member firms for the dissemination of proxy materials and other required communications and related activities according to a fee schedule adopted following a process of negotiations between members and issuers, and thereafter codified by the NYSE and approved by the SEC. Virtually all brokers and banks have contracted out the administrative process of distributing proxy materials, tabulating votes and responding to requests for shareholder lists to a third party, the Investor Communications Services Division of Automatic Data Processing, Inc. ("ADP"). The contracts between ADP and the member firms typically appoint ADP as the collection agent for issuers' reimbursements to member firms, and authorize ADP to deduct its service fee from the reimbursement amount and remit to the member firm any positive difference between amounts collected and fees owed (or bill the firm for any amount owed).

The NYSE's request to the Working Group was to review these rules and make recommendations to the NYSE with respect to the rules and, if appropriate, more broadly with respect to the proxy voting process. The NYSE put no restrictions on the Working Group's review process or on the issues considered by the Working Group. In beginning this process, the NYSE and the Working Group were aware of a number of questions arising in recent years concerning these rules, as well as technological developments that have significantly impacted the proxy voting process. The Working Group is fully aware that its consideration of these issues takes place during a time of fundamental changes in technology and evolving understandings of "best practices" of corporate governance, both of which may have broad impact on the proxy process. For example, during the Working Group's consideration of its recommendations, the SEC proposed for public comment rules that would allow companies and other persons to use the Internet to satisfy proxy material delivery requirements. If adopted as proposed, the new rules could significantly impact both the ease and cost of the proxy voting process.

The Working Group's overarching purpose as it considered these issues was to develop recommendations which were in the interests of all investors. It was in the context of the NYSE's historic leadership in corporate governance and shareholder rights that the Working Group was formed, and the single objective of the Working Group was to develop recommendations which would create a more effective and efficient voting system for investors. As part of this objective the Working Group was encouraged to consider the NYSE's rules and role within the broader framework of the proxy voting system, and make such recommendations as it deems appropriate, even where those recommendations went beyond the specific regulatory authority of the NYSE. The Working Group was also cognizant of the fact that these rules apply to all member firms, and therefore shareholders of companies listed on other exchanges such as NASDAQ, as well as NYSE listed companies, would be affected by any changes in these rules.

B. The Composition Of The Proxy Working Group And A Summary Of Its Activity

In creating the Working Group, the NYSE sought to obtain a wide diversity of views as well as a broad range of expertise. As a result, the Working Group contains representatives from a number of different constituencies, all of whom have significant experience with the proxy voting process. The NYSE named Larry W. Sonsini, who chairs the NYSE's Legal Advisory Committee, is chairman of the law firm Wilson Sonsini Goodrich & Rosati and is a well recognized expert in corporate governance and corporate law, as chair of the Working Group. Other members of the Working Group included representatives from issuers, NYSE member organizations, the legal community, institutional investors and individual investors. The members of the Working Group are as follows:

--Larry W. Sonsini, Chairman, Wilson Sonsini Goodrich & Rosati (Committee Chairman)
--Rosemary Berkery, Executive Vice President and General Counsel, Merrill Lynch & Co., Inc., represented by Kevin Moynihan of Merrill Lynch & Co.
--Glenn Booraem, Principal and Assistant Fund Controller, Vanguard Group
--Peter Clapman, Senior Vice President and Chief Counsel for Corporate Governance, TIAA-CREF[1]
--Margaret Foran, Vice President – Corporate Governance & Corporate Secretary, Pfizer, Inc.
--Gary Glynn, President, U.S. Steel Pension Fund
--Amy Goodman, Partner, Gibson, Dunn & Crutcher LLP

[1] Mr. Clapman retired from his position with TIAA-CREF after the Working Group was formed.

--Richard H. Koppes, Of Counsel, Jones Day
--Jeffrey L. McWaters, Chairman and Chief Executive Officer, Amerigroup Corporation
--Stephen P. Norman, Corporate Secretary, American Express Company
--James E. Parsons, Corporate and Securities Counsel, Exxon Mobil Corporation
--Judith Smith, Managing Director, Morgan Stanley & Co.
--Esta Stecher, Executive Vice President and General Counsel, Goldman Sachs & Co., represented by Beverly O'Toole of Goldman Sachs & Co.
--Kurt Stocker, Professor, Northwestern University, Medill School of Journalism

In addition, staff of the SEC and the NASD attended various Working Group meetings, as did staff of the NYSE. David J. Berger, a partner at Wilson Sonsini Goodrich & Rosati, was counsel to the Working Group.

The Working Group began its deliberations in April 2005. The Working Group received presentations from fifteen groups, including representatives of the Council of Institutional Investors, the Securities Industry Association, ADP, the AFL-CIO, the Business Roundtable, the Society of Corporate Secretaries & Governance Professionals (formerly the ASCS), the Securities Transfer Association and Computershare. In addition, reports for the Working Group were prepared by these and other organizations. A complete list of the groups that the Working Group and/or its counsel met with is attached at Exhibit A hereto. In addition, a research report conducted on behalf of the Working Group concerning shareholder attitudes and understanding of the existing proxy system is attached at Exhibit B hereto.

C. Summary Of The Proxy Working Group's Conclusions And Recommendations

While the Working Group's focus was on the NYSE's role in the proxy process, the Group was continually struck by the integrated nature of the process, and how changing one part of this process impacts many other parts. For example, potential changes to broker discretionary voting immediately raised questions about the ability of an issuer to educate and to communicate with its shareholders about the importance of voting in the election of directors. This need increases dramatically with the movement towards majority voting for directors. Similarly, with respect to Rule 465, there was recognition that any attempt to modify the historical role of the NYSE as fee arbiter impacted the current proxy voting process which is generally perceived to work very successfully.

After an extensive review of these and other issues, the Working Group's conclusions and recommendations are as follows:

1. ***<u>The NYSE Should Amend Rule 452 to Make the Election of Directors a "Non-Routine" Matter.</u>*** The Working Group believes that the election of directors can no longer be considered a "routine" event in the life of a corporation. Directors have authority over the most fundamental issues of corporate governance today, while investors, regulators, courts and others have all recognized the critical role directors play in the life of a corporation.

Because shareholder voting for directors is a critical component of good corporate governance, the Working Group considered recommending the elimination of Rule 452 in its entirety. However, as described in more detail below, the Working Group concluded that Rule 452 continues to have an important role in the proxy process today, particularly with respect to allowing issuers to achieve a quorum for regular meetings. Accordingly, the Working Group recommends that even where an election of directors is not contested, Rule 452 should be amended so that the election of directors should not be considered "routine" and brokers should no longer be permitted to vote the shares of beneficial owners who do not give specific voting instructions.

2. ***The NYSE Should Take a Leading Role in Efforts to Further Educate Investors About the Proxy Voting System.*** The Working Group recognizes that amending Rule 452 to make the uncontested election of directors a "non-routine" event is likely to have significant consequences for issuers. Based upon research obtained by the NYSE at the request of the Working Group, as well as other information provided to the Working Group, the Working Group believes that there appears to be a general lack of understanding in the investor community with respect to the proxy voting process. The Working Group believes that any plan to amend Rule 452 to make the election of directors a "non-routine" matter must include as a critical component a large scale education effort to inform shareholders about the mechanics of the proxy voting process. Accordingly, the Working Group recommends that the NYSE work with the SEC, the listed company community and other appropriate groups to develop a significant investor education effort, to inform investors about the proxy voting process and the importance of voting.

3. ***The NYSE Should Support Efforts to Improve the Ability of Issuers to Communicate with Beneficial Owners.*** Given the potential impact that eliminating broker voting of uninstructed shares in director elections would have on issuers, particularly as a result of the trend towards "majority voting" for directors, the Working Group believes that there is a significant need for more effective communications between issuers and shareholders. The Working Group recognizes that various groups have urged the SEC to review its existing shareholder communication rules to make it easier for issuers to communicate with beneficial owners, and believes that the NYSE should support a review by the SEC of these rules. The Working Group further believes that the NYSE should convene another committee, which would include representatives of all of the groups involved in the shareholder communication process, to consider how to improve communications between issuers and beneficial owners. At the same time, members of the Working Group noted that research conducted on its behalf indicated that most investors would choose to allow issuers access to their contact information by classifying themselves as non-objecting beneficial owners ("NOBOs") if they were provided detailed information about the

differences and that further education for investors about the NOBO/OBO distinction is appropriate.

4. ***The NYSE Should Continue to Evaluate the Effectiveness and Necessity of Broker Discretionary Voting Following the Amendment of Rule 452 to Make the Election of Directors a "Non-Routine" Matter.*** As described above the Working Group believes the election of directors can no longer be considered a "routine" matter and for this reason brokers should not be allowed to vote uninstructed shares with respect to such elections. The Working Group also recommends that, in light of continuing technological and governance developments, including developments which make it easier to communicate with shareholders, possible regulatory and/or statutory changes impacting shareholder elections, and educational efforts, the NYSE should continue to evaluate the future need for broker discretionary voting under Rule 452. As part of this effort, the Working Group believes it is important to consider the critical role broker voting has played in allowing issuers to achieve a quorum for shareholder meetings, and to address this issue as part of any change to Rule 452.

5. ***The NYSE Should Engage an Independent Third Party to Analyze and Make Recommendations Regarding the Structure and Amount of Fees Paid Pursuant to Rule 465.*** The Working Group was told by a number of different groups that the existing proxy system, in which ADP essentially provides mail delivery and other services to virtually all banks and member firms but who must be paid for by issuers, may be expensive to issuers but generally results in shareholders receiving and being able to vote proxies in a timely manner. This is an important benefit of the current system. At the same time, the Working Group believes that acting as an intermediary or participant in the negotiations between all of the various parties in helping to determine the fees paid by issuers pursuant to Rule 465 also places the NYSE in an oversight role with respect to ADP. This is because virtually all banks and brokers contract out the administrative process for mailings to ADP. While this system may change over time, until such change occurs the NYSE remains the entity best able to review the appropriateness of the costs in the system and to oversee ADP's performance. Accordingly, the Working Group recommends that the NYSE engage an independent third party to analyze and make recommendations regarding the structure and amount of fees paid under Rule 465. In addition to the costs, this third party analysis should include a study of ADP's performance and the business process by which the distribution of proxies occurs, and should be done under the supervision of a subset of the Working Group. Following completion of this review, the NYSE should consider revising the existing fee schedule and related issues as appropriate.

6. ***The NYSE Should Request that the SEC Study the Role of Groups Making Voting Decisions Over Shares in which They Do Not Own or Have An Economic Interest.*** As the Working Group has reviewed the role of brokers

in voting shares in which they do not have any economic interest, the Working Group has also considered the role of other groups, including various institutional advisory services and proxy voting groups, making voting recommendations and/or decisions over shares in which they do not own or have an economic interest. While the Working Group recognizes that some of these groups have played an important role in the proxy process in recent years, the Working Group also believes that there is the potential for possible conflicts and/or other issues given the multiple roles such groups may have in the proxy system. Accordingly, the Working Group recommends that the NYSE request the SEC to study the role these groups play in the proxy voting process.

The specific findings and recommendations of the Working Group are set forth below.

II. THE PROXY WORKING GROUP'S FINDINGS AND CONCLUSIONS

The Working Group's mission was to review NYSE Rules 450-460, and in particular Rule 452, as well as Rule 465 and to recommend such changes as the Group considered appropriate to the NYSE. In reviewing these Rules, the Working Group was confronted by ongoing changes in technology, regulation and definitions of best practices in corporate governance. Thus, choices which were reasonable or practical when the NYSE last considered these issues may no longer be appropriate. Further, given the pace of change, the recommendations of the Working Group may also need to be reexamined in the not too distant future.

For example, with respect to Rule 452 the NYSE's determination that an uncontested election of directors was a "routine" matter historically had not been particularly controversial. However in recent years a confluence of events, including the increasing use of the internet to communicate with shareholders which makes proxy contests easier to run and harder to define, the growth of the concept of boards comprised almost entirely of independent directors as well as the development of new types of proxy campaigns such as "just vote no" campaigns, and an increasing recognition of the critical role of directors, has led many to conclude that the election of directors should not, and cannot, be viewed as a "routine" event in the life of the corporation. Similarly, the method and cost of distributing proxy materials may shortly undergo substantial changes as a result of a number of factors, including the internet. For example, the SEC has recently announced a proposed rule allowing for the distribution of proxy materials over the internet.[2]

The Working Group was also given a broader mandate by the NYSE, to consider other proxy related issues and make recommendations as appropriate. The NYSE requested that the Working Group consider possible changes within the framework of the NYSE's mission to protect and serve the investing public, and consistent with the NYSE's historical leadership role in governance. The NYSE has reviewed these or similar issues a number of times over the years, and specifically amended Rule 452 as recently as June 2003, to eliminate broker voting on equity compensation plans. The NYSE also has reviewed Rule 465 a number of times in recent years, including changing the rates paid by issuers in 2002. Yet notwithstanding this recent review, the NYSE believed that numerous factors, including increased shareholder activism, technological

[2] *See* Internet Availability of Proxy Materials, Rel. No. 34-52926 (Dec. 8, 2005) 70 Fed. Reg. 74598

changes, and potential regulatory changes made a wide-ranging review of these issues both timely and necessary.

III. THE PROXY WORKING GROUP'S ANALYSIS AND RECOMMENDATION WITH RESPECT TO RULE 452 AND BROKER DISCRETIONARY VOTING

A. A Brief History of Rule 452 and Broker Discretionary Voting

The NYSE adopted its first proxy-related rule in 1927, in order to safeguard the rights of shareholders against the voting of proxies by member firms on stock which had passed out of their possession. In the late 1920's, commentators believed that corporate reliance on the rights of "floating stock" was an unfair corporate practice that was disenfranchising shareholders.[3] To address this issue, the NYSE implemented the 1927 Rule, which prohibited member firms from voting proxies unless the stock was actually in their possession.

The 1927 Rule proved to be impractical. After the rule was implemented, the number of proxies voted by members declined significantly. Moreover, following the stock market crash of 1929, corporations faced severe financial problems and many ceased paying dividends. Combined with the decreased numbers of proxies being voted, this led to an increasing inability of corporations to secure a quorum and to conduct corporate business. By 1936, it was clear that it was necessary to amend the 1927 Proxy Rule. Thus, the NYSE commissioned a special subcommittee on proxies. Headed by noted corporate lawyers John M. Hancock and Adolf A. Berle, Jr., the subcommittee worked for more than a year and issued its final report in the fall of 1937, which recommended a wholesale revision of the proxy rules.[4]

New proxy rules were adopted later that same year, the most notable of which was the original iteration of Rule 452, colloquially referred to as the Ten Day Rule.[5] The Ten Day Rule implemented in 1937 was substantially similar to current Rule 452 – it gave permission to members to vote stock registered in their name, whether or not the stock was in their possession or control, provided that voting instructions by the beneficial owners were not given ten days prior to the shareholders' meeting, and did not apply to authorizations for a merger, consolidation or dissolution, or for the reclassification of any outstanding security.[6]

The NYSE proxy rules have been amended and expanded numerous times since 1937, but the basic tenets of the Ten Day Rule have remained largely unchanged. An amendment in 1941 adjusted the deadline for receiving beneficial owners' instructions to 15 days if proxy soliciting materials were transmitted to customers more than 25 days preceding the meeting date. In 1967, a change was made to the rules that required proxy materials to be sent to customers at least 15 days prior to the stockholders' meeting to qualify for the 10 day deadline.

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[3] William Z. Ripley, *From Main Street to Wall Street*, Atlantic Monthly (January 1926), at 103. Ripley defined "floating stock" as "stock which is passing so rapidly from hand to hand that, for convenience' sake, it remains often for many years registered in the name of banking or brokerage houses. And in the case of non-dividend-paying corporations, the proportion of such floating stock may be so great as, in and of itself, to carry control."

[4] From Historical Origins of the NYSE Ten Day Proxy Rule, at 8 (citing Sub-Committee on Proxies to the Members of the Committee on Stock List, September 7, 1937, *Subject Files*, New York Stock Exchange).

[5] *Id.* (citing Governing Committee, *Minutes*, vol. 12, December 22, 1937, New York Stock Exchange Archives).

[6] Letter from Charles R. Gay to the Members of the New York Stock Exchange, December 22, 1937, *Press Releases*, New York Stock Exchange Archives.

During much of the past half century, the focus on Rule 452 has been on which matters members should be allowed to vote on in the absence of instructions from the beneficial owner. In recent years the trend has been to restrict the matters which members may vote on in the absence of any instructions by the beneficial owners. Perhaps the most notable recent example of this trend occurred in 2003, when Rule 452 was amended to eliminate broker discretionary voting on equity compensation plans.

At the time of the 2003 amendment, there was significant concern that issuers would find it significantly more difficult to conduct normal business related to their compensation plans. However, it appears that these concerns have largely not been realized.

B. Current Status of Broker Discretionary Voting

Under the current NYSE and SEC proxy rules, brokers must deliver proxy materials to beneficial owners and request voting instructions in return. If voting instructions have not been received by the tenth day preceding the meeting date, brokers may vote on certain matters deemed "routine" by the NYSE.[7] One of the most important results of broker votes of uninstructed shares is their use in establishing a quorum at shareholder meetings.[8]

Among the other matters which the current NYSE Rule 452 defines as routine is an "uncontested" election for a company's board of directors.[9] Such elections remain the general practice in corporate America today, with contested elections occurring relatively infrequently. According to ADP, there were only thirty-four officially contested elections in calendar year 2004.

However in recent years the definition of a "contested election" has been questioned by a number of parties and interest groups.[10] This is because of the rise of a number of new types of

[7] Rule 452 states, "Voting procedure without instructions: A member organization which has transmitted proxy soliciting material to the beneficial owner of stock or to an investment adviser, registered either under the Investment Advisers Act of 1940 or under the laws of a state, who exercises investment discretion pursuant to an advisory contract for the beneficial owner and has been designated in writing by the beneficial owner of such stock (hereinafter "designated investment adviser") to receive soliciting material in lieu of the beneficial owner and solicited voting instructions in accordance with the provisions of Rule 451, and which has not received instructions from the beneficial owner or from the beneficial owner's designated investment adviser by the date specified in the statement accompanying such material, may give or authorize the giving of a proxy to vote such stock, provided the person in the member organization giving or authorizing the giving of the proxy has no knowledge of any contest as to the action to be taken at the meeting and provided such action is adequately disclosed to stockholders and does not include authorization for a merger, consolidation or any other matter which may affect substantially the rights or privileges of such stock."

[8] According to estimates provided by ADP, if broker discretionary votes were excluded from the vote tabulation (and the impact of registered shares is also excluded) as many as 20% of NYSE listed companies may not have been able to achieve a quorum in 2004, and this figure could be higher for non-NYSE listed companies. More generally, ADP estimates that the process by which companies achieve a quorum for ordinary meetings would be considerably more expensive and time consuming if broker discretionary voting was eliminated, and that companies would not know until much later in the process whether or not they would be able to achieve a quorum.

[9] Rule 452.11(2) defines a "contest" as a matter that "is the subject of a counter-solicitation, or is part of a proposal made by a stockholder which is being opposed by management."

[10] For example, in 2002, the Council of Institutional Investors publicly criticized the NYSE's definition of "contests" as "problematic" because it fails to classify as contests "just vote no" campaigns, it fails to recognize the use of the Internet as a means of contesting management, it puts ADP in an inappropriate and conflicted role, and it is inconsistent with securities laws which recognize the validity of exempt solicitations. In a letter to the SEC dated June

proxy campaigns, including "just vote no" campaigns.[11] Because these campaigns often do not result in competing solicitations, historically these efforts have not been considered "contests" for purposes of NYSE Rule 452, and thus broker votes have been counted. This has drawn the ire of some investor groups since generally broker voting has been permitted in accordance with the incumbent board's recommendations.

The impact of broker votes on such campaigns can be significant. For example, in the Walt Disney Company's 2004 Annual Meeting, involving one of the best known and organized "just vote no" campaigns, Disney CEO Michael Eisner was re-elected to the board with 55% of the votes cast, while 45% of the shares voted were "no" votes. Had broker votes not counted in this election then Mr. Eisner would have received only 45% of the votes in favor of re-election, and a majority of the votes cast, 54%, would have been withheld from him.[12]

A second traditional issue considered "routine" by the NYSE is the ratification of the selection of auditors. Although there have not been significant "Vote No" campaigns against auditors, there are a number of governance commentators who have noted that auditor ratification should not be a "routine" matter in today's environment, particularly given the role of the auditor as "gatekeeper."

On "non-routine" matters, which generally speaking are those involving a contest or any matter which may affect substantially the rights or privileges of stockholders, NYSE rules prohibit brokers from voting without receiving instructions from the beneficial owners. At present, the NYSE Rule 452.11 lists by way of example eighteen such "non-routine" matters, including items such as stockholder proposals, and mergers or consolidations. [13]

13, 2003, Institutional Shareholders Services expressed concern that because "the NYSE classifies the election of directors as a routine voting item unless a full-blown proxy contest has erupted," the efforts of shareholders to express disapproval of board actions at companies like Sprint and Tyco in the 2003 proxy season were "watered down by broker votes." Moreover, in their presentations to the Working Group, several groups recommended that the definition of a contest be expanded or changed, including the AFL-CIO and the American Business Conference.

[11] The development of these types of alternative campaigns was proposed by former SEC Commissioner Joseph Grundfest in the early 1990s. *See* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 Stan. L. Rev. 857 (1993).

[12] Of course it must be noted that under the plurality system of director elections at Disney, the fact that Mr. Eisner would have obtained less than a majority of votes cast in favor of his nomination would not have prevented him from winning the election since there was no alternative candidate. At the same time it was widely reported that the substantial number of "No" votes received by Mr. Eisner was a significant factor in his decision, subsequently endorsed by the board, to retire as the Company's CEO. *See e.g.*, Floyd Norris, *Corporate Democracy and the Power to Embarrass*, N.Y. Times, Mar. 4, 2004, at C1; Michael McCarthy, *Disney strips chairmanship from Eisner*, USA Today, Mar. 4, 2004, at 01B.

[13] Rule 452.11 states, "When member organization may not vote without customer instructions.—In the list of meetings of stockholders appearing in the Weekly Bulletin, after proxy material has been reviewed by the Exchange, each meeting will be designated by an appropriate symbol to indicate either (a) that members may vote a proxy without instructions of beneficial owners, (b) that members may not vote specific matters on the proxy, or (c) that members may not vote the entire proxy.

Generally speaking, a member organization may not give a proxy to vote without instructions from beneficial owners when the matter to be voted upon:

(1) is not submitted to stockholders by means of a proxy statement comparable to that specified in Schedule 14-A of the Securities and Exchange Commission;

(2) is the subject of a counter-solicitation, or is part of a proposal made by a stockholder which is being opposed by management (i.e., a contest);

C. Issues Related To The Proxy Working Group's Consideration Of Changes To Broker Discretionary Voting

In connection with its consideration of the legal, policy and practical considerations of broker discretionary voting, the Working Group also considered a variety of other factors in assessing the scope of any possible changes or modifications to Rule 452. In particular, the Working Group has considered the following related matters:

1. Direct Communication with Beneficial Owners

The majority of publicly traded shares are not registered in companies' records in the names of the beneficial owners. Instead, an estimated 70 to 80 percent of all public companies' shares are held in "street name," meaning that they are held of record by brokers, banks or their depositories. The lists of beneficial owners who hold in street name are maintained by brokers and

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(3) relates to a merger or consolidation (except when the company's proposal is to merge with its own wholly owned subsidiary, provided its shareholders dissenting thereto do not have rights of appraisal);
(4) involves right of appraisal;
(5) authorizes mortgaging of property;
(6) authorizes or creates indebtedness or increases the authorized amount of indebtedness;
(7) authorizes or creates a preferred stock or increases the authorized amount of an existing preferred stock;
(8) alters the terms or conditions of existing stock or indebtedness;
(9) involves waiver or modification of preemptive rights (except when the company's proposal is to waive such rights with respect to shares being offered pursuant to stock option or purchase plans involving the additional issuance of not more than 5% of the company's outstanding common shares (see Item 12));
(10) changes existing quorum requirements with respect to stockholder meetings;
(11) alters voting provisions or the proportionate voting power of a stock, or the number of its votes per share (except where cumulative voting provisions govern the number of votes per share for election of directors and the company's proposal involves a change in the number of its directors by not more than 10% or not more than one);
(12) authorizes the implementation of any equity compensation plan, or any material revision to the terms of any existing equity compensation plan (whether or not stockholder approval of such plan is required by subsection 8 of Section 303A of the Exchange's Listed Company Manual);
(13) authorizes
a. a new profit-sharing or special remuneration plan, or a new retirement plan, the annual cost of which will amount to more than 10% of average annual income before taxes for the preceding five years, or
b. the amendment of an existing plan which would bring its cost above 10% of such average annual income before taxes.
Exceptions may be made in cases of
a. retirement plans based on agreement or negotiations with labor unions (or which have been or are to be approved by such unions); and
b. any related retirement plan for benefit of non-union employees having terms substantially equivalent to the terms of such union-negotiated plan, which is submitted for action of stockholders concurrently with such union-negotiated plan;
(14) changes the purposes or powers of a company to an extent which would permit it to change to a materially different line of business and it is the company's stated intention to make such a change;
(15) authorizes the acquisition of property, assets, or a company, where the consideration to be given has a fair value approximating 20% or more of the market value of the previously outstanding shares;
(16) authorizes the sale or other disposition of assets or earning power approximating 20% or more of those existing prior to the transaction.
(17) authorizes a transaction not in the ordinary course of business in which an officer, director or substantial security holder has a direct or indirect interest;
(18) reduces earned surplus by 51% or more, or reduces earned surplus to an amount less than the aggregate of three years' common stock dividends computed at the current dividend rate."

banks and not by the issuers themselves. The SEC requires banks and brokers to provide requesting issuers with the names of stockholders who do not object to having their names and addresses supplied to issuers ("non-objecting beneficial owners" or "NOBOs"). NYSE rules establish a "per name" fee that issuers must pay to banks and brokers for the NOBO list. Those stockholders who object to having their names and identity disclosed are known as "objecting beneficial owners" or "OBOs" and they represent approximately 75 percent of shares held in street name. [14]

Although issuers have access to NOBO lists, they do not generally mail required proxy materials directly to NOBOs because the SEC rules require issuers to forward proxy materials through brokers and banks regardless of whether they are also mailed directly and as a practical matter, only the banks and brokers are legally entitled to vote the shares held in street name. Virtually all brokers and banks have contracted out the administrative processes of distributing proxy materials, tabulating votes, and responding to requests for NOBO lists to ADP.

The obstacles that issuers face in communicating with OBOs and directly soliciting votes from both OBOs and NOBOs are extremely relevant in considering the impact of Rule 452. For example, if the NYSE were to completely eliminate broker discretionary voting, the need for easier (and cheaper) access to shareholders becomes paramount to most issuers, especially small to mid-size issuers who would presumably have the most difficulty convincing shareholders of the need to vote in director elections. This is discussed in detail below in the section entitled "Alternatives to the Current Rules Governing Broker Discretionary Voting Considered by the Proxy Working Group – Abolishing Broker Discretionary Voting." These issuers would need a greater ability to solicit shareholder votes in order to have shareholders vote on a matter that had long been considered "routine." The current system based on communication through ADP would mean that the costs to issuers from this additional solicitation activity could be significant, and would also potentially be difficult given that issuers would not have direct access to shareholders.

Even under a modified scenario whereby broker discretionary voting is eliminated except for the purpose of establishing a quorum[15] issuers seeking approval of certain matters requiring the majority of outstanding shares to vote (and not just votes cast)[16] may need to be significantly more proactive to solicit shareholder votes.

Even without any changes to Rule 452, certain groups, including the Business Roundtable, an association of chief executive officers of leading U.S. corporations with a combined workforce of more than 10 million employees, have petitioned the SEC to allow issuers to communicate directly with their beneficial owners using recent technological advances. The Business Roundtable petition urges the SEC to "require brokers and banks to provide companies

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[14]However, in a survey commissioned by the Working Group and performed by Opinion Research Corporation, 41% of investors surveyed believed that the stock they buy is always registered in the name of the investor, and another 23% admit that they are not sure under whose name the stock is registered. Additionally, given detailed information about the differences between OBO and NOBO status, investors opt for NOBO status by a wide margin (64%-36%), and this margin increases dramatically if there is even a relatively small fee attached to being an OBO. At the same time the Working Group understands the importance of respecting and protecting the privacy of investors, and does not mean to suggest that investors should have to pay to protect their privacy.

[15] *See infra* section III.D.4.a.

[16] For example, under Delaware corporate law, the following matters require approval by a majority of outstanding shares: mergers or consolidations; the sale, lease or exchange of assets; and dissolution of the corporate entity.

with contact information for *all* beneficial owners and permit the direct mailing of *all* communications (including proxy materials) to beneficial owners." The petition also encourages "the Commission to require brokers and banks to execute omnibus proxies on behalf of beneficial owners, thereby allowing them to vote their shares directly." Under this proposal, the NOBO/OBO distinction would be eliminated, although investors who chose to remain anonymous could appoint a nominee. While the Business Roundtable petition has the support of various groups, some shareholder activist organizations have opposed the petition on a variety of grounds, including that the petition would give issuers too much control over voting. The SEC has not taken any action on the petition.[17]

2. The Role of Broker Discretionary Voting With Respect to an Issuer's Ability to Achieve a Quorum

Under the current proxy rules, brokers must deliver proxy materials to beneficial owners and request voting instructions in return. If voting instructions have not been received by the tenth day preceding the meeting date, brokers may vote on certain matters deemed "routine" by the NYSE. One of the most important results of broker votes of uninstructed shares is their use in establishing a quorum at shareholder meetings.[18] ADP estimates that it would have been materially more difficult and expensive for companies to meet their quorum requirements in 2004 without the use of broker discretionary voting, and that many companies would not even know until very close to the meeting date whether or not they would be able to achieve a quorum.

Under state law, corporations must have a quorum of shares present at shareholder meetings in order to conduct business. Most states, including Delaware, set the statutory default for a quorum at 50% of an issuer's outstanding shares.[19] Perhaps the primary benefit of allowing broker discretionary voting is that broker votes count for purposes of achieving a quorum even with respect to non-discretionary actions on which they are not entitled to vote. Prohibiting brokers from voting uninstructed shares must take into account the effect on the ability of issuers to achieve a quorum. While it is unclear exactly how many issuers in 2004 would have not been able to achieve a quorum in the absence of broker discretionary voting, information provided by ADP indicates that it would be materially more difficult (and probably more expensive) for many issuers, particularly smaller issuers, to achieve a quorum without using broker discretionary voting.

3. The Director Election Process

Under most state corporate laws, including Delaware, a plurality vote is the default standard in the election of the board of directors. While these laws typically provide that a different threshold may be set in a company's certificate of incorporation or bylaws, only a handful of companies have a majority (of the shares cast or outstanding) as the vote requirement in director

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[17] Organizations that have indicated their support of the Business Roundtable petition by submitting favorable comment letters to the SEC include Georgeson Shareholder Communications Inc. and the American Society of Corporate Secretaries. Groups that have indicated concerns regarding the Business Roundtable petition in comment letters to the SEC include the AFL-CIO, Securities Industry Association and the American Business Conference.

[18] A "quorum" is the number of shares that must be present, in person or by proxy, in order for business to be transacted at the meeting.

[19] *See* Del. Code tit. 8, §216 (2005). However Delaware (as well as certain other jurisdictions) provides that the quorum can be lowered (or increased) for certain decisions provided that such a quorum figure is in the company's charter or bylaws.

elections. Under the current plurality system, a director nominee in an uncontested election needs to receive only a single affirmative vote to win the election. Even if holders of a substantial majority of the shares vote to "withhold," the director nominee is elected.

Recently a number of large institutional investors and other governance advocates have sought to change this system, in favor of a system which would require that directors receive majority approval by shareholders rather than be elected by a plurality. Among the institutions and/or governance services promoting various types of "majority voting" proposals are ISS, the Council of Institutional Investors and the California Public Employees' Retirement System ("CalPERS") as well as a number of labor unions. The State of Delaware and the ABA are also studying this issue. In response to this movement a number of corporations, including Pfizer, Best Buy, Intel, Motorola, Hercules, Potlatch and U.S. Bancorp have voluntarily adopted some form of majority voting of directors. Overall, according to the Council of Institutional Investors more than 120 companies have some form of majority voting in place (predominantly director resignation policies), with 73 of them adopting some type of majority voting procedure over the past 14 months in response to this campaign.[20]

As discussed above, Rule 452 allows broker discretionary voting on "routine" matters. The election of directors, if uncontested, is considered a "routine" matter for which broker discretionary voting is allowed. In the Working Group's recommendations regarding the possible elimination or modification of broker discretionary voting the Working Group has carefully considered the campaign for a majority voting standard for the election of directors. If broker discretionary voting were eliminated or revised to prohibit the voting of uninstructed shares in the uncontested election of directors, or if election of directors were to be considered "non-routine" and directors required a majority vote to get elected, the impact on issuers would be significant. According to statistics provided to the Committee by ADP, during the 2004 proxy season, eliminating broker discretionary voting would have caused at least 32 NYSE-listed companies to have individual directors receive a majority of "withhold" votes. Further, if broker discretionary voting is modified and/or eliminated as described above, and some type of majority voting requirement is adopted, the Working Group believes that there will be a critical need to educate investors about the importance of voting for directors in uncontested elections. Similarly, issuers and others will need to have ability to communicate more effectively and efficiently on matters which have traditionally been considered routine.

4. Recent Technological Advances

Increasing use of the internet and other technological advances are changing the way issuers communicate with shareholders. For example, on December 8, 2005, the SEC announced a proposal to permit the electronic delivery of proxy materials by issuers and by other persons soliciting proxies through a notice and access model. Under the SEC's proposal, issuers would be able to satisfy their obligation to furnish proxy materials by posting proxy materials on a website and sending a "Notice of Electronic Proxy Materials" at least 30 days prior to the meeting containing: the date, time and place of the meeting; matters to be acted upon (including the

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[20] *See generally*, Dennis Berman, *Boardroom Defensetration—As Proxy Season Heats Up, Companies Consider Rules to Boot Unwanted Directors,"* Wall Street Journal, Mar. 16, 2006, at B1. In addition, labor unions are targeting another 120 companies during this year's proxy season, according to a list prepared by the carpenter's union. *Id*.

company's recommendation); web site address of the proxy materials (proxy statement, proxy card and annual report to shareholders); and a phone number and e-mail where shareholders could request hard copies.[21] The various SEC interpretive releases require that an issuer obtain affirmative written consent from a shareholder in order to use electronic delivery for proxy materials.[22]

Under the SEC's proposal, for shareholders holding their shares through brokers, banks, or other intermediaries, the Notice and voting instruction form would be delivered through the intermediary. Those shareholders could request copies through either the company or the intermediary. In addition, this method of soliciting proxies would not be limited to management. Others would be able to rely on the proposed "notice and access" model in substantially the same manner as the company, with appropriate changes in the information required in the Notice.

Given this proposed rule and the SEC embrace of technological advancements in the area of shareholder communications, the Working Group is also considering the impact of this rule on various items including the definition of "contest" as described below and the NYSE fee schedule for shareholder communications under Rule 465.

D. Alternatives to the Current Rules Governing Broker Discretionary Voting Considered By the Proxy Working Group

1. Abolish Broker Discretionary Voting So That a Broker May Not Vote Shares Absent Specific Instructions from the Beneficial Owner of the Shares

Allowing brokers to vote uninstructed shares under Rule 452 is controversial for several reasons. On the most basic level, the problem with broker voting is that it allows someone (i.e. the broker) who does not have an economic interest in the corporation the opportunity to vote on the corporation's business. A second problem is that historically brokers have generally cast uninstructed shares overwhelmingly in support of the board's recommendations, which provides a significant advantage to the incumbent board in director elections and other matters. However, it should be noted that given the lengthy history of Rule 452 it is entirely possible that the beneficial holder assumes (and even expects) that their decision not to vote on a "routine" matter will result in a vote in accordance with the board's recommendations. In other words, given that some form of Rule 452 has been in effect for approximately 70 years, a not unreasonable assumption may well be that shareholders who choose not to vote on "routine" matters recognize that their shares are likely to be voted in accordance with the board's recommendation with respect to such matters. More generally, some believe that shareholders generally understand that absent extraordinary circumstances directors are likely to get elected in accordance with the board's recommendations.

[21] *See* Internet Availability of Proxy Materials, 70 Fed. Reg. 74598 (proposed Dec. 8, 2005) (to be codified at 17 C.F.R. pts. 240, 249 and 274).
[22] *See* Rel. No. 33-7233 (Oct. 6, 1995); Rel. No. 33-7288 (May 9, 1996); Rel. No. 33-7856 (Apr. 28, 2000).

The Working Group attempted to obtain some empirical data concerning investor awareness and views on the broker discretionary voting process as part of its effort to understand these issues. Specifically, the Working Group commissioned a survey by Opinion Research Corporation of individuals who owned and traded stocks outside of an employer sponsored retirement savings program (a copy of which is attached at Exhibit B, hereto). The results of this survey show significant confusion about the proxy voting process. Only 27% of those participating in the survey indicated awareness of the fact that if they do not vote their proxy on routine matters their shares may be voted by their brokerage firm in accordance with the recommendations of the company's board of directors.[23]

One indisputable (and very significant) benefit of allowing brokers to vote uninstructed shares is that the broker vote makes it easier to obtain the necessary quorum to conduct shareholder business. This was true at the time the original 10 Day Rule was adopted, and remains true today.

The Working Group also noted that, according to ADP, eliminating the broker vote would likely have a relatively minor impact on the outcome of the election of directors for NYSE listed companies, assuming continued plurality voting. Analyzing 2004 results under a majority voting scenario (meaning that votes either "for" or "withhold" were greater than 50% of all instructed votes), ADP found that thirty-two issuers would have had an individual director receive a majority of "withhold" votes.

If a company fails to achieve a quorum, the shareholder meeting can be adjourned to solicit additional votes. Soliciting additional votes under the current system of shareholder communications is likely to be a time consuming and expensive process.[24] While it is generally the rule that when a quorum is not achieved and new directors are unable to be elected, the old directors continue in place until new directors could be elected,[25] this result is obviously not ideal. The Working Group did not want to create a situation where issuers are unable to achieve a quorum or conduct such fundamental business as electing directors.

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[23] This is despite the fact that a number of issuers and institutional investors (as well as articles in the financial press and elsewhere) have made it clear to shareholders that their failure to vote on a particular routine matter may result in their shares being voted in accordance with the recommendation of the company's board. For example, American Express' 2006 Proxy Statement explicitly informs investors about the likely impact of the broker vote. American Express' proxy reads as follows: "Broker Vote. If you hold your shares in a bank or brokerage account you should be aware that if you fail to instruct your bank or broker how to vote within 10 days of the shareholders meeting, the bank or broker is permitted to vote your shares in its discretion on your behalf on routine items. *Banks and brokers generally cast their votes on routine items in support of management in the absence of instructions from their clients.* Thus if you wish to vote against management's recommendations on Items 1 and 2, the two routine matters in this proxy statement, you should complete and return your voting instruction form before April 14, 2006." American Express Company Proxy Statement, dated Mar. 17, 2006, at 3 (emphasis added). It should also be noted that an additional 10% of those participating in the survey indicated awareness that if they do not vote their proxy on routine matters their shares may be voted by their brokerage firms in their discretion. Thus, 37% of those surveyed appear to have some knowledge about broker discretionary voting.

[24] If the SEC proposed rule regarding electronic delivery of shareholder communications were adopted, the costs of additional mailings may decrease. Please see Section IV.B of this report for additional information regarding the SEC proposal.

[25] *See, e.g.*, Del. Code tit. 8 §141(b) (2005). ("Each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal.")

2. Proportional Voting

Another alternative considered by the Working Group as an alternative to existing Rule 452 was the adoption of a proportional voting system, also referred to as "mirror" or "echo" voting. Under this approach, rather than giving brokers discretion to vote uninstructed shares, uninstructed shares would be voted in the same proportion as instructed shares. Proportional voting is presently used by publicly traded member firms on routine issues for shares held beneficially by these firms in their proprietary accounts. Specifically, the current practice among NYSE member organizations voting shares of their publicly traded parent corporations is to vote those shares in the same proportion as all other shares voted. This means shares held in the name of a member firm's subsidiary for a customer can be voted in the same "yea" or "nay" proportion as that represented by votes received from all other record owners of stock.[26]

At least one brokerage firm recently adopted this approach. Specifically, in December 2005 Charles Schwab announced that rather than use its discretion to vote in accordance with the board of director's recommendation, it would adopt a proportional voting system. Under this system, on all routine matters sent to beneficial owners for which Schwab acts as nominee, Schwab will vote in proportion to that of all instructed shares held by Schwab. The proportional vote would be provided by ADP to the issuer 48 hours prior to the meeting date, and would be updated by ADP as necessary to reflect additional instructed shares.

A proportional voting system would allow uninstructed shares to be voted on every proposal, including those proposals now considered non-routine. [27] As a result, non-routine items which require approval of a certain percentage of the outstanding stock would presumably have an easier time obtaining approval than under the current system, since under the current system _all_ uninstructed shares effectively have the same impact as "no" votes for such proposals, while under a proportional voting system the number of uninstructed shares being counted as "no" votes would depend on the number of instructed shares which were voted "no." In other words, under the current system, non-routine matters requiring the affirmative approval of a majority (or more) of the outstanding shares, 100% of the uninstructed shares are effectively considered "no" votes, while under a proportional voting system the percentage of the uninstructed shares voted "yes" and "no" would mirror the vote of the instructed shares.[28]

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[26] There is no specific NYSE rule relating to proportional voting. While the practice has been in place since the early 1970's, prior to the enactment of the Securities Acts Amendments of 1975, it has never been codified, nor is it embodied in any of Exchange's rules or rule interpretations. Member firms regularly disclose this practice to shareholders in their proxy statements.

[27] For example, the current definition of "routine" limits the definition of "contests" to those situations when shareholders solicit against management by mailing separate proxy cards to other shareholders. This definition of contest has been controversial because it fails to classify many types of campaigns where shareholders do not mail separate proxy cards as contests. Perhaps the most common of these types of campaigns are the so-called "just vote no" campaigns—when shareholders urge others to just withhold votes from directors—but the Working Group believes that these and other non-traditional campaigns are likely to increase in frequency in the future.

[28] The Working Group also considered establishing proportional voting under the current proxy voting system. In such a system, broker discretionary voting would only be counted proportionally for routine matters. As under the current system, broker discretionary voting would not be allowed for non-routine matters. However, this type of system would continue to require that the NYSE make distinctions between routine and non-routine proposals.

The Working Group recognized that there are a number of difficult details involved in considering any type of proportional voting system. First, in terms of the actual voting process, proportional voting could be tabulated in at least two different ways. One way would be to have the uninstructed shares voted in proportion to all votes cast at a meeting; alternatively, one could have the shares tied only to street name holders who give instructions. The Working Group has considered whether registered holders of stock are likely have different voting patterns than street name holders and which group is most similar to shareholders who fail to instruct the brokers on how to vote are those shareholders who returned voting instruction forms.

A second issue in any proportional voting system is deciding whether to tie the proposed proportional voting rule to voting that occurs on the individual broker level (which is referred to as "broker by broker proportional voting" or the "broker by broker system") or to the aggregate voting of all street name holders (which is referred to as "aggregate proportional voting" or the "aggregate system"). Under the broker by broker system, each individual broker or nominee would vote its uninstructed shares in same proportion to those shares for which the broker or nominee received voting instructions. For example, if clients of a brokerage firm who choose to return their proxies voted 50/50 for and against a given proposal, the uninstructed shares would be voted in the same proportion even if the overall vote on the proposal was different. Under the aggregate system, all uninstructed shares across all brokers and nominees would be voted in the same proportion as those shares for which all brokers or nominees received voting instructions. For example, if all street name holders voted 60/40 for and against a given proposal, all uninstructed shares across at all brokers and nominees would be voted 60/40 for and against the proposal.

There are advantages and disadvantages associated with each of these proportional voting systems. Most significantly, the Working Group was concerned that with broker by broker proportional voting the results can be skewed if one particular broker has a large number of uninstructed shares and an unusual vote by the instructed shares. In short, there was concern that the votes could be manipulated. On the other hand, the Working Group was aware that the broker by broker system is easy to implement. As the Schwab announcement demonstrates, few if any logistical problems are likely to result from a switch to a system of broker by broker proportional voting. While ADP would have to make changes to its current system, ADP indicates that its systems can be easily modified in several weeks to handle broker by broker proportional voting.

Although the aggregate system would more accurately reflect the vote by the instructed shares, implementing the aggregate system is more complicated in several ways than the broker by broker system. First, brokers, as the recipient of the omnibus proxy from DTC, are entitled to vote the uninstructed shares. In the aggregate system, some entity would have to aggregate all of the instructed shares and either (1) instruct the broker as to proportion of the instructed vote so the broker could then vote the uninstructed shares or (2) vote the uninstructed shares on behalf of each broker. There are several entities that could be responsible for tabulating the instructed vote, including ADP or the issuer's transfer agent.

Proportional voting does not have the same disadvantages as discretionary voting under Rule 452 with respect to brokers voting uninstructed shares in favor of the board's recommendations and would eliminate the need for the NYSE to determine which matters are "routine." Yet in many ways proportional voting creates its own set of problems. First, on a fundamental level proportional voting continues to assign votes to shares that have not been voted by the beneficial owners. Second, proportional voting may result in an increase in the influence of shareholders who do choose to vote, since they will obtain additional votes from shareholders who have not voted. Third, some institutional investors have expressed concern that it would make it easier for companies to achieve approval for matters which are currently not considered routine, since under a proportional voting system some percentage of the votes that are now considered "no" votes because they are not voted would be voted in favor of the proposal. Finally, as described above the Working Group believes there is a possibility that a proportional voting system may be subject to abuse depending upon how it is implemented. For all of these reasons, the Working Group concluded that while a proportional voting system was somewhat attractive, it is not the optimum result.

3. Election of Directors as a "Non-Routine" Matter

Another option for fixing the most immediate problem with the current Rule 452 is to further amend Rule 452 by altering the items currently classified as "routine" and "non-routine." As described above, the uncontested election of directors is currently considered a "routine" matter. Many argue that the election of directors is the "most important action that shareholders can take"[29] Therefore, the NYSE could classify the election of directors as a "non-routine" proposal in all situations. As described above, such a change would mean that brokers would no longer be permitted to vote for the board of directors where they do not receive specific voting instructions from shareholders.,

Such an amendment to Rule 452 would be easy to implement and could potentially be the fastest solution to what is often cited as the main problem with Rule 452. At the same time, amending Rule 452 to add yet another category of "non-routine" fails to deal with the broader issue of whether or not the NYSE should continue to be in the business of making decisions about what is, and is not, a routine corporate matter subject to stockholder approval. The Working Group discussed at some length whether the NYSE should be in the business of making such decisions because they have a substantive impact on the way corporations are governed. While there was no consensus on this issue, it was noted that this has become an increasingly complex and controversial issue.

4. Other Alternatives

a. Broker Discretionary Voting for Quorum Purposes Only

As discussed above, without allowing brokers to vote uninstructed shares some issuers (especially small and mid-cap issuers) may have difficulty achieving quorums at stockholders meetings. One alternative to address the competing needs at issue is to grant brokers the limited authority as record owners to represent unreturned or uninstructed proxies at shareholder meetings for the sole purpose of establishing a quorum. Under this proposal, broker discretionary voting would be eliminated completely, with the NYSE granting brokers the limited

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[29] *Harrah's Entertainment, Inc. v. JCC Holding Co*., 802 A.2d 294, 311 (Del. Ch. 2002) (citing *PL Capital, LLC v. Bonaventura*, Del. Ch., C.A. No. 19068, tr. at 27, Noble, V.C. (Sept. 28, 2001); s*ee also Durkin v. Nat'l Bank of Olyphant*, 772 F.2d 55, 59 (3d Cir. 1985).

authority as record owners to represent unreturned or uninstructed proxies at shareholder meetings for the sole purpose of establishing a quorum.

One effect of this type of change is to eliminate the current problem of the broker votes generally being voted in accordance with the Board's recommendation on routine matters. While this may cause some disruption in the existing system as well as increase costs to obtain approval for what is currently a "routine" matter, issuers would still reap the benefits of the efficient establishment of quorums. Further, this plan would eliminate the NYSE from policy making by removing its role in determining "routine" versus "non-routine" matters.

Perhaps the most significant issue with counting broker votes for quorum purposes only is that there is some question as to how such an approach would be treated under state law. The Delaware Supreme Court has held that a limited proxy can be counted for the purpose of establishing a quorum, even when it is neutral in other respects. Specifically, in *Berlin v. Emerald Partners*, [30] the court held that while broker non-votes should not be counted with respect to non-discretionary actions on which they are not entitled to vote, they may be counted for the purposes of establishing a quorum. However, it is unclear if *Berlin*'s logic would be extended to a situation where the broker's authority is limited to being present for quorum purposes and where they have no authority to vote on any other shareholder proposal, and the law outside of Delaware is even less developed.

b. Broaden the Definition of "Contest" for Broker Discretionary Voting

Currently, Rule 452 prohibits brokers from voting uninstructed shares on any election of directors or agenda item that "is the subject of a counter-solicitation, or is part of a proposal made by a stockholder who is being opposed by management (i.e., a contest)." The NYSE does not define "contest" in the listing rules, but in practice, the NYSE currently limits "contests" to those situations when shareowners solicit against management using a separate proxy card and mail the materials to other shareowners. The Working Group considered the appropriateness of the existing NYSE definition of a contest which requires physical delivery of proxies to be the definition of a valid "contest." This definition has been criticized as unduly narrow insofar as it fails to classify "just vote no" campaigns and other exempt solicitations as "contests." [31]

As discussed above with respect to election of directors, an option for correcting some of the perceived problems with the current Rule 452 is to further amend Rule 452

[30] 552 A.2d 482 (Del. 1989).

[31] As described above, a "just vote no" campaign is a targeted effort by shareholder who urge other shareholders to withhold votes from certain directors. Given the reality of plurality director voting and the inability of withhold votes to remove directors, these withhold vote campaigns are designed to "send a message" to management and directors. While some have argued that a substantial showing of withhold votes can generate enough negative publicity to induce incumbent directors to resign (*see* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 Stan. L. Rev. 857 (1993)) other studies show no association between board membership improvements and "just vote no" campaigns. In fact, one recent study finds that even relatively successful "just vote no" campaigns do not increase the likelihood of an issuer taking shareholder requested action. *See* Diane Del Guercio, Laura Wallis & Tracey Woidtke, *Do Board Members Pay Attention When Institutional Investors 'Just Say No'?*, (June 2005) (unpublished manuscript, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=575242).

by altering the items currently classified as "routine" and "non-routine." For example, the definition of "contest" under Rule 452 could be expanded to include "just vote no" campaigns, although defining such a "campaign" may have some significant practical difficulties.[32] However, the NYSE would continue to have to make policy decisions about what is, and is not, a routine corporate matter. In addition, the SEC's recent proposal concerning electronic delivery of proxies must be considered, because it would make a "contest" easier to wage.

The Council of Institutional Investors recommends that the NYSE change its definition of "contest" to classify as "contested" any situations in which investors file definitive proxy materials with the Securities and Exchange Commission or which qualify as "exempt solicitations" under Rule 14a-2(b)(1) of the Securities Exchange Act of 1934. Shareowners should then be required to provide evidence of their exempt or non-exempt efforts to the NYSE, ADP and any other parties involved in determining whether an item qualifies for broker voting. Once the required evidence is forwarded to the appropriate parties, the proxy item should no longer be deemed "routine" and eligible for broker votes. However, this proposal by the Council of Institutional Investors would essentially qualify as a "contest" a shareholder solicitation of less than 10 other shareholders in certain circumstances. The practical effect of such a broad definition of "contest" would mean that broker discretionary voting would likely never be allowed for the approval of any disputed matter.

E. Proxy Working Group's Recommendations With Respect To Broker Discretionary Voting

One of the critical regulatory functions of the NYSE has been to govern the relationships between member brokers as record owners of shares held in street name and the beneficial owners of those shares. As an extension of this function, it also regulates the proxy voting process. Since 1937, the NYSE has permitted brokers to vote shares held by beneficial owners on a variety of routine matters. Traditionally, this policy has provided substantial benefits to corporations and their shareholders by allowing the corporation to obtain a quorum and take routine action without creating undue costs or borders. However, in recent years this practice has been harshly criticized because it allows persons without an economic interest in the corporation to vote on corporate issues and because brokers have traditionally cast their votes in favor of the board of directors' recommendation. Moreover, technological advances offer the prospect for improvements in the shareholder communications process.

For most of its lengthy history, the NYSE has been a strong leader in the advancement of corporate governance policies. It was from this position of leadership that the NYSE formed the Corporate Accountability and Listing Standard Committee in 2002, which recommended a number of governance changes subsequently adopted by the NYSE's board. Moreover, during the nearly 70 years since the implementation of the proxy rules, the NYSE has consistently amended and updated the rules to ensure their continued efficacy and to stay current with technology.

Given these concerns and the significant impact that the NYSE's proxy rules have on corporate governance through shareholder voting, the Working Group was formed to review the

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[32] Some of the practical difficulties involved include defining what a "campaign" is (*i.e.* does a single website constitute a "campaign") or whether there are any limitations or other minimal requirements for a contest.

NYSE's rules relating to the proxy solicitation process. The Working Group's mandate was to review all NYSE proxy rules, with a particular focus on Rules 452 and 465. These rules govern the transmission of proxy materials, voting by investment advisers and other brokers, and the fees paid by listed firms for proxy services provided by member firms.

Following extensive deliberation, the Working Group has agreed on the following recommendations to the NYSE:

1. ***The NYSE Should Move to Amend Rule 452 to Make the Election of Directors a "Non-Routine" Matter.***

The Proxy Working Group believes that the election of directors can no longer be perceived as a "routine" matter in the life of a corporation. As is well established under law, "the business and affairs of every corporation . . . shall be managed by or under the direction of" the board of directors.[33] Investors, courts, regulators and others expect directors to be accountable for the corporate decision-making process, and the primary way that accountability is expressed is through the director election process. In light of this reality, the Working Group believes that the election of directors should no longer be viewed as routine under Rule 452 and thus that brokers should no longer be permitted to cast uninstructed shares for the election of directors.

The Working Group understands that this proposed change could significantly impact the director election process. For example, it is likely to increase the costs of uncontested elections, as issuers will have to spend more money and effort to reach shareholders who previously did not vote. These costs may increase substantially with the rise of majority voting for directors, as issuers have to obtain the votes from shareholders who may not realize the impact from their failure to vote. Such a change may also increase the influence of special interest groups or others with a particular agenda to challenge an incumbent board, at the expense of smaller shareholders. These consequences could fall most dramatically on smaller issuers, who have a smaller proportion of institutional investors and/or have greater difficulty in contacting shareholders and convincing them to vote in uncontested elections.

The benefit to amending Rule 452 to eliminate discretionary voting in director elections is clear: it will end the voting for directors by a group (brokers) who do not have an economic interest in the corporation. At the same time, the Working Group recognizes that other issues in the proxy systems, such as shareholders who either do not vote or delegate or otherwise give away their voting decisions to others, will continue to be potential problems. Amending Rule 452 to eliminate discretionary voting does not deal with these broader issues.

Despite these potential difficulties, the Working Group believes that it is important to recognize that the election of a director, even where the election is uncontested, is not a routine event in the life of a corporation. Directors are simply too important to the corporation for their election to ever be considered routine. While this is likely to result in some greater costs and difficulties for issuers, it is a cost required to be paid for better corporate governance and transparency of the election process.

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[33] *See* Del. Code tit. 8, §141(b) (2005).

2. ***<u>The NYSE Should Take a Leading Role in Efforts to Further Educate Investors About the Proxy Voting System.</u>***

The Working Group recognizes that amending Rule 452 to make the uncontested election of directors a "non-routine" event is likely to have significant consequences for issuers. As described above, according to research performed by Opinion Research Corporation at the request of the Working Group, there appears to be "widespread ignorance" of the proxy process. For example, the research provided to the Working Group indicated that only about one in four persons are aware that if they do not vote their proxy on routine matters that their shares are voted by their brokerage firm at the discretion of the firm. More broadly, many investors appear to not understand how their shares are held, the "street name" process or other critical aspects of the proxy voting procedure. In sum, there appears to be an apparent lack of understanding in the investment community about the proxy process. Accordingly, the Working Group recommends that the NYSE work with the SEC and the listed company community to develop a significant investor education effort, to inform investors about the proxy process and the importance of voting.

The Working Group notes that issuers and others already go to great efforts to inform investors. For example, American Express specifically discloses in its proxy the Broker Voting process, and the impact of a decision by an investor to not vote on routine matters. Further, there was significant coverage in the financial and popular press concerning the impact of the broker vote on a number of recent elections. While these efforts are all to be commended, the Working Group believes they are not sufficient. Indeed, the Working Group believes it is a critical and integral part of its proposal to amend Rule 452 to make the election of directors a non-routine matter that the NYSE take a leading role in a large scale investor education effort to inform investors about the proxy voting process.

3. ***<u>The NYSE Should Support Efforts to Improve the Ability of Issuers to Communicate with Beneficial Owners</u>*****.**

Given the potential impact that eliminating broker voting of uninstructed shares in director elections would have on issuers, particularly given the trend towards "majority voting" for directors, the Working Group believes that there is a significant need for more effective communications between issuers and shareholders. The Working Group recognizes that various groups have urged the SEC to review its existing shareholder communication rules to make it easier for issuers to communicate with beneficial owners, and believes that the NYSE should support a review by the SEC of these rules. The Working Group further believes it is appropriate for the NYSE to convene another committee, which would include representatives from the groups involved in the shareholder communication process, to consider how to improve communications between issuers and beneficial owners. At the same time, members of the Working Group noted that the research conducted by Opinion Research Corporation on behalf of the Working Group showed that an overwhelming majority of investors would choose to be "NOBOs" if they were provided with full information about the differences between being a "NOBO" and an "OBO."

The Working Group believes that given its recommendation to amend Rule 452, and in light of the apparent lack of understanding among individual investors about, for example, broker voting and the "NOBO/OBO" distinction, the NYSE should support efforts to improve the ability of issuers to communicate with their shareholders. These efforts should include a reexamination by the SEC of its rules regarding shareholder communication, as well as a further examination of the practical issues impacting shareholder communications under the sponsorship of the NYSE, which could include representatives of all the various constituencies.

4. ***The NYSE Should Continue to Evaluate the Effectiveness and Necessity of Broker Discretionary Voting Following the Amendment of Rule 452 to Make the Election of Directors a "Non-Routine" Matter.***

As described above the Working Group believes the election of directors can no longer be considered a "routine" matter and for this reason brokers should not be allowed to vote uninstructed shares with respect to such elections. The Working Group also recommends that the NYSE take a leading role in a substantial education campaign on the proxy voting process, and work to support regulatory changes to make it easier for issuers to communicate with investors. Consistent with these proposals, the Working Group believes that the NYSE should continue to consider and evaluate the future need for Rule 452. As part of this effort, the Working Group believes it is important to consider the critical role broker voting has played in allowing issuers to achieve a quorum for shareholder meetings, and to address this issue as part of any change to Rule 452. In this regard, the NYSE should consult with state law experts to determine if changes in state corporation law might be appropriate.

IV. PROXY WORKING GROUP'S ANALYSIS AND RECOMMENDATIONS WITH RESPECT TO RULE 465

A. History Of Rule 465

The NYSE has required companies to reimburse member firms for the costs of transmitting proxy materials to owners since 1937. Initially, reimbursement rates were not set forth in formalized rules. Rather, they were applied as NYSE policy. In 1938, the rates were set at $0.15 per set of proxy materials for the first 25 sets, $0.10 per set for the second 25 sets and $0.05 per set for each additional set in excess of 50 sets. In 1952, the proxy rates were codified as part of the NYSE proxy rules. At that time, issuers were required to reimburse brokers at a rate of $0.30 per set of proxy materials mailed, with a minimum of $2.00 for all sets mailed. The rates have been revised every 5-10 years or so for the last 50 years.[34] Rule 465 fees were reduced in 1999, and prior to 1998 were as high as $0.70 per set of proxy materials.

Responding to concern about the reimbursement schedule, an NYSE-sponsored audit examined member firm reimbursement rates for the 1998 proxy season and determined that the level had been too high in recent years. Accordingly, in 1999, the NYSE worked with all of the interested parties, and this process led to a proposal to amend Rule 465 to lower the fees.[35] Eventually, in 2002, initial mailing rates were lowered from $0.50 per set of proxy materials to $0.40 per set. Additionally in 2002, incentive "suppression" fees were introduced to encourage the elimination of multiple mailings to the same address (referred to as "householding") and the use of electronic delivery and to eliminate paper mailings.

[34] NYSE History of Proxy Fees.

[35] Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Relating to the Reimbursement of Member Organizations for Costs Incurred in the Transmission of Proxy and Other Shareholder Communication Material, 64 Fed. Reg. 35229 (June 23, 1999).

B. Current Status Of Rule 465

Rule 465 continues to regulate the fees that issuers must pay to "reimburse" brokers for their "reasonable" expenses associated with communicating with beneficial owners of shares held in street name. Currently, ADP acts as a billing and collection service for the member firms, billing issuers for the mailing costs pursuant to Rule 465, and giving back to member firms any difference between ADP's collection and the member firm's billings. In addition to out-of-pocket costs, companies also pay the following basic fees: (a) $0.40 per beneficial owner for each set of proxy materials mailed; (b) $1.00 per set of proxy materials for annual meetings where an opposition proxy statement has been furnished; (c) $0.40 for each set of supplementary proxy material mailed; and (d) $0.15 for each copy, plus postage, for annual reports mailed separately from the proxy statement, interim reports, post meeting reports, and other material. Moreover, companies also pay "nominee-coordination" fees to intermediaries that coordinate mailings to multiple brokers, as well as the "incentive" and "suppression" fees mentioned above.

Although the fee structure was updated as recently as 2002, the underlying framework for distinguishing between NOBOs and OBOs, and for gathering and using their contact information, was developed in the early 1980's. Since then, there have been tremendous advances in technology which could, in theory, improve the efficiency and possibly the effectiveness of communications by companies with their shareholders.

On December 8, 2005, the SEC proposed amendments to the proxy rules under the Securities Exchange Act of 1934 which would permit the electronic delivery of proxy materials by issuers and others soliciting proxies.[36] The proposed rules use a "Notice and Access" model, meaning that issuers would mail notice (meeting certain requirements) to shareholders informing them that proxy materials were electronically available, at least 30 days prior to the meeting. The proxy materials would then be posted on an internet website available to shareholders. Current SEC rules require that issuers obtain affirmative written consent from a shareholder in order to use electronic delivery for proxy materials. Thus, the proposed amendments would represent a substantial departure from the current system. According to the SEC, the proposed rules could result in "a substantial decrease in the expense incurred to comply with the proxy rules."[37]

The SEC's proposed rules call the future of Rule 465 into question, particularly with regard to the incentive structure. Specifically, if all proxy materials are eligible for electronic delivery, the operation of the incentives in the current fee structure aimed at encouraging electronic delivery will be fundamentally altered. Moreover, widespread electronic delivery of proxy materials would appear to render the mailing fees largely obsolete.

[36] Internet Availability of Proxy Materials, 70 Fed. Reg. 74598 (proposed Dec. 8, 2005) (to be codified at 17 C.F.R. pts. 240, 249 and 274).
[37] U.S. Securities and Exchange Commission, Press Release 05-166, SEC Votes to Propose Rule to Provide Investors with Internet Availability of Proxy Materials (2005).

C. Issues Related To The Proxy Working Group's Consideration Of Changes To Rule 465

1. Current System

As discussed above, NYSE rules regulate the fees that issuers must reimburse brokers and banks for expenses incurred in forwarding shareholder communications to beneficial owners. The Working Group recognizes that a benefit of this system is that ADP, as the agent for almost all banks and brokerage houses, has generally proven its ability to distribute proxy materials in an organized and timely fashion, which is critical to the functioning of the corporate governance system for American publicly traded companies. According to many parties, including large institutional investors and the Securities Industry Association, the current proxy communication system is generally efficient and accurate. A number of institutional investor representatives who appeared before the Working Group expressed support for the existing system, noting that while perceived as expensive, the present proxy process, as administered by ADP, is viewed by the institutional community as impartial, reliable and efficiently administered. The Working Group was also aware of the fact that one previous group who studied the proxy voting process (and included some of the members of the Working Group) concluded that the U.S. system was "finest proxy system in the world," and that the "integrity, efficiency, fairness, audit ability [sic] and reliability of the U.S. proxy system must be maintained."[38]

At the same time, the Working Group heard from others who expressed significant concern about the costs of the existing system and suggested that a better system might be available. In this regard, the Working Group reviewed the Business Roundtable's Petition to the SEC, which asserts that the "current system of shareholder communications is circuitous and unnecessarily time-consuming." The Business Roundtable further asserts that "it is very difficult and expensive for companies to communicate with their beneficial owners."[39]

The Working Group also heard from groups claiming that the fees charged under the existing system are both unnecessarily high and act as a disincentive for companies to communicate with beneficial owners beyond the required proxy and annual reports. This issue increases in importance in light of our other recommendations, since issuers will have a much greater need to communicate with shareholders on routine matters just to "get out the vote" on such matters as a quorum and an uncontested director election.

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[38] Letter and Report from Richard H. Koppes, Facilitator & Secretary, Proxy Voting Review Committee to Sharon Lawson, Senior Special Counsel, Office of Market Supervision, SEC Division of Market Regulation, at 11 (Feb. 28, 2002).

[39] *See* letter from Steve Odland, Chairman, Corporate Governance Task Force, Business Roundtable to Jonathan G. Katz, Secretary, U.S. Securities & Exchange Commission (Apr. 12, 2004).

2. Committee's Consideration Of Alternatives To Rule 465

a. Eliminate Rule 465 or Re-Evaluate the Current Fee Structure

Some groups appearing before the Working Group emphasized that the proxy mailing and shareholder communication fees appear to be expensive and therefore act as a disincentive for issuers to communicate with beneficial owners beyond the required proxy and annual reports. The NYSE has continually endeavored to work with the various parties and interest groups to create a fee structure at a level that keeps costs to a minimum for issuers, while providing proper incentives to the service providers to perform the required processes efficiently and accurately. The NYSE's role places it at the center of the often-conflicting interests of issuers, shareholders, broker-dealers and banks. Some believe that the current role that the NYSE plays in setting fees is inefficient and unnecessary.

Other groups who provided information to the Working Group, including the Securities Industry Association and the brokers it represents, believe that the NYSE performs an invaluable function under Rule 465 which benefits "issuers, shareholders, banks and broker-dealers by facilitating a proxy voting process for street name shareholders that is fair, accurate, objective, timely and efficient by every metric that has been carefully applied."[40] The SIA believes that "the NYSE has done a remarkable job over the years of balancing the specific and sometimes contending interests of each of the many participants in the process." [41] The SIA has claimed that eliminating Rule 465 and removing the NYSE from its fee setting role would "risk higher costs and inconsistent performance for all participants in the proxy process."[42]

If the NYSE were to abandon its role pursuant to Rule 465 to help establish fees for the shareholder communication process, a mechanism for allowing the market to set fees would need to be established. Issuers would still need to reimburse banks and brokers for their expenses associated with forwarding shareholder communications to beneficial owners. Issuers would have to individually negotiate reimbursement rates with banks and brokers or with their agent, ADP. Given the current data available, the Working Group is unable to predict whether the market fees that would come to pass would decrease overall costs for issuers. There is evidence indicating that the per shareholder cost of communicating with registered shareholders is higher than the per shareholder cost of communicating with beneficial owners through ADP.[43] While the costs associated with mailing to registered holders is not entirely predictive of the costs associated with mailing to beneficial owners, it does give some insight into the effect of eliminating Rule 465. Without more extensive economic study of the proxy voting system, the Working Group is unable to predict whether a "market" rate would be to the economic benefit of issuers and shareholders.

Alternatively, the NYSE can re-evaluate the current fee structure rather than eliminating in its entirety the regulated fee system under Rule 465. Issuers and shareholders deserve periodic confirmation that the system is performing as cost-effectively, efficiently and accurately as possible, with the proper level of responsibility and accountability in the system. The

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[40] *See* letter from Donald Kittell, Securities Industry Association to NYSE Proxy Working Group (Oct. 19, 2005).
[41] *Id.*
[42] *Id.*
[43] The Proxy Voting Review Committee found, in its report to the SEC, that "fees for registered processing are as much as 400% higher than the beneficial side considering the size of the company."

NYSE can continue to work with the participants in the shareholder communications and proxy voting system and conduct cost studies, commission audits and surveys of various constituencies involved.

In addition, an obvious problem with the existing system is that the entity that pays the costs for the system—the issuer—has no choice in the service provider and no direct ability to negotiate fees with the service provider. Rather, the service provider (ADP through its contracts with the member firms) has a contract with the broker or bank, and has its fees set by the NYSE and paid for by the issuer. As a result, there is limited accountability in the current system. If an issuer has a problem in delivery of information to shareholders or in vote tallies, there is a limited economic incentive on the part of ADP to be responsive.

b. Consideration of the Canadian System

Historically the shareholder communication and proxy voting system in Canada was substantially similar to the U.S. system. However, effective September 30, 2004, National Instrument 54-101 enabled issuers in Canada to mail proxy communications to NOBOs through an agent of their choice. Prior to this new rule, brokers and banks in Canada (as in the United Sates) were required to provide issuers with lists of NOBOs. However, the Canadian rules also required companies to forward proxy materials through brokers and banks regardless of whether they are mailed directly by issuers. The new rule change no longer requires that issuers forward proxy materials through brokers and banks to NOBOs regardless of whether they are also mailed directly. Therefore, instead of issuers using NOBO lists to mail out supplemental materials, annual reports and quarterly reports, issuers in Canada can mail proxy materials directly to NOBOs.

In the first complete proxy season since the new rules were implemented in Canada, it is estimated by the Securities Transfer Association that 10% of issuers have chosen to mail proxy materials directly to NOBOs.[44] At least with respect to the NOBO mailing, there is now competition in the Canadian proxy voting system. Issuers now have the option to use their transfer agents to mail to NOBOs as well as their registered holders. In the United States, OBOs represent 75% of the shares held in street name. Therefore, although increasing competition on some level, this type of system still effectively leaves ADP as the only option with respect to communications with OBOs.

There is a keen debate about how well these changes have served Canadian issuers and investors. Information provided to the Working Group by ADP indicates that fewer than 2% of issuers with greater than 5000 shareholders have requested a NOBO list for distribution purposes, and that fees have not been reduced. Other information provided to the Working Group

[44] There is some dispute as to the cost effectiveness of directly mailing to NOBOs (using transfer agents) under the new Canadian system versus consolidated mailings to NOBOs and OBOs through ADP. The Securities Transfer Association has provided the Working Group with the projected costs of the issuer choice model. For issuers with large number of shareholders (e.g. more than 1 million), the STA has projected a savings of $0.14 per beneficial owner (or about 25%). Savings are considerably greater for smaller issuers (e.g. fewer than 1200 shareholder) at $2.18 per beneficial shareholder (or about 74%). On the other hand, ADP has countered this data and has concluded that despite the number of shareholders, issuers will always pay more to use their transfer agents for NOBO mailings compared to OBO mailings with ADP. In fact, ADP statistics provide that for smaller issuers (e.g. under 1000 shareholders), ADP would be significantly cheaper than using a transfer agent for mailing.

indicates that at least on some level the Canadian experience has been beneficial for issuers and investors. Given that the Canadian system is still quite new, as well as the differences between Canadian and U.S. corporate governance laws and market, it is unclear whether the Canadian model is a realistic alternative to the current U.S. system.

D. PROXY WORKING GROUP'S RECOMMENDATIONS WITH RESPECT TO RULE 465

1. ***The NYSE Should Engage an Independent Third Party to Analyze and Make Recommendations Regarding the Structure and Amount of Fees Paid Pursuant to Rule 465.***

The existing proxy system, where ADP essentially provides mail delivery and other services to virtually all brokerage houses but must be used and paid for by issuers, has resulted in a system which generally provides shareholders with their proxies, and issuers with the votes from those proxies, in a timely manner and on an accurate and trustworthy basis. This is an important benefit which must not be lost. At the same time, the Working Group recognizes that the NYSE's role as an intermediary or participant in the negotiations between all of the various parties in helping to determine the fees paid by issuers pursuant to Rule 465 places the NYSE in a unique oversight role with respect to ADP. This is because virtually all banks and brokerage houses contract out the administrative process for proxy mailings and related activities to ADP. The Proxy Working Group therefore recommends that the NYSE should periodically re-evaluate the fees structure to ensure that no entity is unduly profiting off the current system. Issuers and shareholders deserve periodic confirmation that the system is performing as cost-effectively, efficiently and accurately as possible, with the proper level of responsibility and accountability in the system.

To achieve these objectives, the Proxy Working Group recommends that the NYSE engage an independent third party to analyze what is a "reasonable" amount for issuers to be charged pursuant to Rule 465 and to conduct cost studies of the current services provided by ADP and commission an audit of ADP costs and revenues for proxy mailing. These studies and audit should include a detailed review of ADP's actual and anticipated future costs, especially in light of the new electronic delivery proposal by the SEC. The NYSE should disclose the findings of these regular reviews to a Sub-Committee of the Working Group before instituting any changes to the current fees.

The Working Group also recommends that the NYSE review ADP's contract arrangements with brokers. It is understood that these contracts are designed to cover the brokers' costs of providing information about beneficial owners to ADP, but since this reimbursement is tied to the fees regulated by the NYSE, they should be carefully reviewed to make sure that these agreements are not covering other costs unrelated to beneficial owner information.

In addition, the NYSE should periodically conduct satisfaction surveys of the various constituents in the proxy voting process (issuers, shareholders and brokers) to ensure the efficiency and accuracy of the system. Consideration also should be given to creating a more formal role for issuers in the fee setting process.

2. ***<u>The NYSE Should Consider Commissioning an Economic Study of the Existing Payment and Mailing System to Determine Its Utility Given Changes in Technology.</u>***

The Working Group believes that while the current regulated system is generally effective, the NYSE should continue to explore alternative systems, along with the SEC, such that a competitive system, with fees set by the free market, could eventually succeed the current system.

Therefore, the Proxy Working Group recommends that the NYSE consider commissioning a study to review (i) the entire shareholder communications and proxy voting system and recommend a plan to evolve the current system into a free market model with competitors to ADP and unregulated fees and (ii) the effect of eliminating Rule 465 under the current system and allowing individual issuers to negotiate reimbursement fees with banks and brokers for delivery of shareholder communications to beneficial owners.

V. OTHER ISSUES

A. The NYSE Should Request that the SEC Engage in a Study into the Role of Groups Making Voting Decisions Over Shares They Do Not Own or in which They Do Not Have An Economic Interest

As part of its analysis of the proxy system, the Working Group heard a great deal of concern expressed about the increasing role and influence of shareholder voting advisory services in the proxy system. These services often have multiple roles in the proxy process, including advising issuers on various governance issues, making recommendations to institutions and other shareholders on how to vote and actually voting the shares of numerous institutions that choose to outsource their voting decisions. In light of these concerns, the Working Group recommends that the NYSE request the SEC to study the role these groups play in the proxy voting process.

VI. CONCLUSION

As described above, the last several years have witnessed tremendous changes in corporate governance, which have impacted the proxy voting system. Moreover, technology has provided the opportunity for easier and less expensive for communication between issuers and shareholders, and this trend is likely to increase.

As the Working Group reviewed the NYSE Rules, it could not ignore these changes. To the contrary, the Working Group spent a considerable amount of time trying to determine where these changes were going to lead in the next few years and how they would impact the proxy voting process. In addition, the Working Group considered issues beyond the direct scope of the NYSE's authority, such as the NOBO/OBO question and direct access to shareholders by issuers. The Working Group believes that these issues were important to its analysis because, fundamentally the proxy voting process is an integrated system and the rules established by the SEC, as well as the various states, all have a substantial impact on the NYSE's Rules.

As the Working Group reviewed these issues, it was also impossible not to recognize the tremendous success of the existing system. This country has more than 15,000 public companies, and shareholders of all of these companies generally receive their proxy voting materials on a timely basis, and have the ability to vote their shares following full disclosure of all material information. This does not mean that the system is perfect or could not be improved. What it does mean is that the improvements must be done in such a way that the strengths of the system are not lost and in particular that shareholders are not disenfranchised and issuers not constrained in their ability to conduct ordinary business. Also, the Working Group noted that while that high profile proxy contests or other issues of corporate control may dominate the news, the fact remains that most corporate meetings do not involve particularly controversial issues.

In considering all of these issues, the Working Group's recommendations are made in an effort to improve the proxy voting system without causing a significant disruption to the existing system. The Working Group was very conscious of the NYSE's role as a watchdog for the investor, and the Working Group believes that its recommendations are consistent with the NYSE's historic role. The Working Group also anticipates that these issues are likely to be the subject of further changes in years to come, as technology and notions of "best governance practices" continue to change and develop. The Working Group views this as a strength of the U.S. proxy system, and believes the flexibility and ability to adapt to these changes is one of the key attributes that makes the U.S. proxy system the strongest in the world.

Exhibit A

The Proxy Working Group met with representatives of the following groups:

- Georgeson Shareholder Communications
- Computershare Limited
- Council of Institutional Investors
- AFL-CIO
- Securities Industry Association
- Automated Data Processing
- Investment Company Institute
- Society of Corporate Secretaries & Governance Professionals
- Business Roundtable
- CalSTERS
- Securities Transfer Association
- Swingvote
- American Business Conference
- Morgan Lewis & Bockius
- Borders Law Group