

## GETTING WIRED AT THE SEC: REFORMING THE PROXY PROCESS TO ACCOUNT FOR NEW TECHNOLOGIES

### I. INTRODUCTION

A March 2004 study by Nielsen//NetRatings showed that almost 75% of Americans have access to the Internet in their homes.<sup>1</sup> This represented a 9% increase in the amount of Americans accessing the Internet from their homes from 2003 to 2004.<sup>2</sup> Another study by the same company found that Americans spend an average of almost fourteen hours online each month.<sup>3</sup> This amount of usage, coupled with minimal growth in usage rates, signifies that the United States is now a “mature” Internet market.<sup>4</sup> In other words, the Internet has become commonplace in the American home, and most Americans have become familiar with its usage. In the realm of securities regulation, the Internet already plays a significant role. For example, most public companies currently file their reports electronically on the Securities and Exchange Commission’s (SEC) Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system.<sup>5</sup> The public’s familiarity with the Internet and other technological developments provides the SEC with opportunities to revamp old securities regulation rules to accommodate this advanced technology.

One such instance of the SEC attempting to revamp the old rules and further incorporate the Internet in securities regulation is the proposed amendments to its rules regarding proxy materials.<sup>6</sup> Proxy materials are provided to shareholders as part of the corporate voting process; they play a large role in voting on major corporate proposals and are critical to Ameri-

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1. Press Release, NetRatings, Inc., Three Out of Four Americans Have Access to the Internet, According to Nielsen//NetRatings (Mar. 18, 2004), [http://www.nielsen-netratings.com/pr/pr\\_040318.pdf](http://www.nielsen-netratings.com/pr/pr_040318.pdf).

2. *Id.*

3. Press Release, NetRatings, Inc., U.S. Internet Usage Shows Mature Growth, Forcing Innovation of New Web Offerings, According to Nielsen//NetRatings (Mar. 18, 2005), [http://www.nielsen-netratings.com/pr/pr\\_050318.pdf](http://www.nielsen-netratings.com/pr/pr_050318.pdf).

4. *Id.*

5. 1 CHARLOTTE ROEDERER, REGULATION OF SECURITIES ON THE INTERNET § 1.01[A][1], at 1-5 (Supp. 2002).

6. *See* Internet Availability of Proxy Materials, Exchange Act Release No. 52,926, Investment Company Act Release No. 27,182, 70 Fed. Reg. 74,598 (proposed Dec. 15, 2005) [hereinafter Proposed Amendments] (to be codified at 17 C.F.R. pts. 240, 249, and 274). These amendments related to delivery method follow in the wake of other efforts by the SEC in recent years to update, more generally, its proxy rules. *See, e.g.*, Security Holder Director Nominations, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,206, 68 Fed. Reg. 60,784 (Oct. 23, 2003) (codified at 17 C.F.R. pts. 240, 249, and 274).

can corporate governance.<sup>7</sup> These amendments would provide an issuer of securities and other people soliciting proxies with an alternative method to the current rules.<sup>8</sup> Under the amendments, the issuer or other proxy solicitors would be able to post the proxy materials on a Web site and provide the shareholders with notice of their presence and location.<sup>9</sup> These new rules are the SEC's attempt to "tak[e] advantage of technological developments and the growth of the Internet and electronic communications."<sup>10</sup> This is the SEC's first attempt to amend the proxy rules directly to incorporate the Internet. Previously, the SEC had issued interpretive releases pertaining to electronic delivery of materials that encompassed proxy materials as well as other areas of securities regulation.<sup>11</sup> The result of these interpretations was the allowance of some delivery of materials through electronic means but not nearly in as extensive a fashion as the current Proposed Amendments to the proxy rules would allow.<sup>12</sup>

The SEC's proposal constitutes an important change, but not one without some controversy. To understand why change nonetheless would be beneficial, this Comment will discuss the Proposed Amendments to the current rules regulating the dissemination of proxy materials to shareholders and their possible effects, benefits, and shortcomings. The Comment begins with a summary of the current rules, their purpose, and their function. It then will detail the SEC's stance on the delivery of materials electronically prior to the Proposed Amendments. This will entail a discussion of the SEC Interpretive Releases from 1995, 1996, and 2000 that dealt with the electronic delivery under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940.<sup>13</sup> This Comment will then provide a discussion of the Proposed Amendments, which will summarize the alternative to the current rules and how this new process will operate. This part will also include the benefits of the Proposed Amend-

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7. See SEC General Rules and Regulations, Securities Exchange Act of 1934, 17 C.F.R. § 240.14a-1 to .14c-101 (2006). Proxies are important because they provide shareholders with the necessary information to vote on important matters as well as allow the shareholders to vote their shares without actually having to attend the related shareholder meeting, which could be quite cumbersome. See ROEDERER, *supra* note 5, § 1.02[D][5], at 1-24.

8. Proposed Amendments, *supra* note 6.

9. *Id.*

10. *Id.*

11. See Use of Electronic Media, Securities Act Release No. 7,856, Exchange Act Release No. 42,728, Investment Company Act Release No. 24,426, 65 Fed. Reg. 25,843 (May 4, 2000) [hereinafter 2000 Interpretive Release] (codified at 17 C.F.R. pts. 231, 241, and 271); Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Securities Act Release No. 7,288, Exchange Act Release No. 37,182, Investment Company Act Release No. 21,945, Investment Advisers Act Release No. 1,562, 61 Fed. Reg. 24,644 (May 15, 1996) [hereinafter 1996 Interpretive Release] (codified at 17 C.F.R. pts. 231, 241, 271, and 276); Use of Electronic Media for Delivery Purposes, Securities Act Release No. 7233, Exchange Act Release No. 36,345, Investment Company Act Release No. 21,399, 60 Fed. Reg. 53,458 (Oct. 13, 1995) [hereinafter 1995 Interpretive Release] (codified at 17 C.F.R. pts. 231, 241, 271, and 276).

12. See 2000 Interpretive Release, *supra* note 11; 1996 Interpretive Release, *supra* note 11; 1995 Interpretive Release, *supra* note 11.

13. See 2000 Interpretive Release, *supra* note 11; 1996 Interpretive Release, *supra* note 11; 1995 Interpretive Release, *supra* note 11.

ments, followed by some criticisms and analysis. The author will then conclude with his take on why the benefits of the Proposed Amendments to issuers, other proxy solicitors, and shareholders will outweigh any negatives that may arise.

## II. CURRENT RULES ON THE DELIVERY OF PROXY MATERIALS

Section 14(a) of the Securities Exchange Act of 1934 (Exchange Act) states that:

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section [12] of this title.<sup>14</sup>

This section governs the solicitation of proxies and requires issuers of securities registered under section 12 of the Exchange Act to disclose to shareholders the information for which the proxies are sought.<sup>15</sup> The rules pertaining to proxy solicitation can be found in Regulation 14A, supplemented by Schedule 14A, and were promulgated under the authority of section 14(a).<sup>16</sup> The rules are a result of a conscious decision by Congress following the stock market crash of 1929 to allow the SEC to regulate proxy solicitation through Section 14.<sup>17</sup> The basic philosophy underlying the rules is one of disclosure, but the rules are not completely limited to that end.<sup>18</sup> Because the proxy can be a “tremendous force”<sup>19</sup> in corporate governance, the SEC crafted the rules “to make the proxy device the closest practicable substitute for attendance at the meeting,” meaning it should make the shareholder privy to the information he would have acquired had he attended the meeting.<sup>20</sup> The SEC’s proxy rules are perhaps the most effective disclosure device that the Commission has promulgated because they ensure that the proxy materials are provided to investors in time to prepare for the vote.<sup>21</sup>

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14. Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (2000).

15. 2 FEDERAL SECURITIES EXCHANGE ACT OF 1934 § 7.01, at 7-7 (A.A. Sommer Jr. ed., Supp. 2006).

16. *Id.*

17. *Id.* § 7.01[2], at 7-8 to -9.

18. 4 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1931-32 (3d ed. 2000).

19. *Id.* at 1916.

20. *Id.* at 1932-33.

21. *Id.* at 1933.

Regulation 14A contains thirteen proxy solicitation rules setting forth the requirements for the proxy statement: the annual report (which must be distributed to shareholders no later than the time the proxy materials are distributed), the form of the proxy, and the materials that must be filed with the SEC.<sup>22</sup> These rules cover “every solicitation of a proxy with respect to securities registered pursuant to section 12 of the [Exchange] Act.”<sup>23</sup> What the term “solicitation” exactly entails is unclear, but its definition includes:

- (i) Any request for a proxy whether or not accompanied by or included in a form of proxy; (ii) Any request to execute or not to execute, or to revoke, a proxy; or (iii) The furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.<sup>24</sup>

Because of a concern that the definition of “solicitation” was too broad, the SEC amended the definition to exclude certain communications it did not feel warranted regulation under the proxy solicitation rules.<sup>25</sup>

When a proxy is solicited, it must be accompanied or preceded by “a publicly-filed preliminary or definitive written proxy statement containing the information specified in Schedule 14A.”<sup>26</sup> Schedule 14A designates, in detail, what information the proxy statement must contain.<sup>27</sup> This information is broken up into three categories: “(i) information required regardless of the nature of the action to be taken at the shareholders’ meeting; (ii) information required in connection with an annual meeting at which directors are to be elected; and (iii) information required only if specified proposals are to be voted upon by shareholders.”<sup>28</sup>

The proxy rules also require that a form of proxy, also known as a proxy card or proxy statement, be filed and sent to shareholders.<sup>29</sup> The proxy card “shall indicate in bold-face type whether or not the proxy is solicited on behalf of the registrant’s board of directors;” if it is not provided by a majority of the board, then the form of proxy must indicate in bold-face type the name of the party that is making the solicitation.<sup>30</sup> Rules 14a-4(a)(3) and (b)(1) together require that the proxy card identify each matter to be acted upon at the meeting and provide for a separate space for each

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22. 2 FEDERAL SECURITIES EXCHANGE ACT OF 1934, *supra* note 15, § 7.01[4][a].

23. SEC General Rules and Regulations, Securities Exchange Act of 1934, 17 C.F.R. § 240.14a-2 (2006).

24. *Id.* § 240.14a-1(l)(1).

25. *See* LOSS & SELIGMAN, *supra* note 18, at 1946-47; *see also* 17 C.F.R. § 240.14a-1(l)(2) (incorporating the amendments).

26. 17 C.F.R. § 240.14a-3(a).

27. *See id.* § 240.14a-101.

28. 2 FEDERAL SECURITIES EXCHANGE ACT OF 1934, *supra* note 15, § 7.04, at 7-52.

29. 17 C.F.R. § 240.14a-3(a).

30. *Id.* § 240.14a-4(a)(1).

matter to be voted upon.<sup>31</sup> A registrant must file the proxy statement and proxy card with the SEC a minimum of ten days before copies are sent to the shareholders unless the only matter to be acted upon is the election of directors.<sup>32</sup>

If the solicitation is made on behalf of the issuer and is made for the annual meeting that involves the election of directors, the proxy statement must also be “accompanied or preceded by an annual report to security holders.”<sup>33</sup> The annual report must include financial information, such as audited balance sheets from the previous two fiscal years and audited statements of income and cash flows for the previous three fiscal years,<sup>34</sup> as well as other financial information as required by Regulation S-K.<sup>35</sup> It must also provide “a brief description of the business done by the registrant . . . during the most recent fiscal year”<sup>36</sup>; “information relating to the registrant’s industry segments, classes of similar products or services, foreign and domestic operations and exports sales”<sup>37</sup>; the identity and principal occupation or employment of “each of the registrant’s directors and executive officers”<sup>38</sup>; and “the market price of and dividends on the registrant’s common equity and related security holder matters.”<sup>39</sup>

In what seems to be an effort to reduce costs of delivery of the proxy statement and annual reports, the SEC adopted amendments to Rule 14a-3 to allow an issuer or broker to send one annual report and proxy statement to security holders who share an address.<sup>40</sup> This privilege, which the SEC refers to as “householding,” is subject to the receipt of express or implied consent from the security holders as well as four other conditions enumerated in Rule 14a-3(e).<sup>41</sup> If registrants household, they also have to include in the proxy statement that only one copy is being delivered, a phone number and address of someone the security holders can contact to cancel the householding, details on how to choose to household, and an attempt to provide another copy of the materials to any security holder who did not receive them but would like to do so.<sup>42</sup> Also, each security holder should be provided with his or her own proxy card regardless of how many copies of the other materials the registrant is allowed to send.<sup>43</sup>

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31. *Id.* § 240.14a-4(a)(3), -4(b)(1); *see also* 2 FEDERAL SECURITIES EXCHANGE ACT OF 1934, *supra* note 15, § 7.05, at 7-92.5 to -92.6.

32. 17 C.F.R. § 240.14a-6(a) (other exceptions apply).

33. *Id.* § 240.14a-3(b).

34. *Id.* § 240.14a-3(b)(1).

35. *See* 2 FEDERAL SECURITIES EXCHANGE ACT OF 1934, *supra* note 15, § 7.03, at 7-46.

36. 17 C.F.R. § 240.14a-3(b)(6).

37. *Id.* § 240.14a-3(b)(7).

38. *Id.* § 240.14a-3(b)(8).

39. *Id.* § 240.14a-3(b)(9).

40. 2 FEDERAL SECURITIES EXCHANGE ACT OF 1934, *supra* note 15, § 7.03, at 7-51. The amendments are located at Rule 14a-3(e).

41. *Id.*

42. *Id.*

43. *Id.*

Equalization of the rights of security holders who oppose the registrant with those of the registrant in proxy solicitation is one problem the SEC has attempted to tackle through the rules.<sup>44</sup> It did this with three approaches.<sup>45</sup> The first approach gives a security holder intending to make a solicitation the ability to contact other shareholders.<sup>46</sup> This is done through Rule 14a-7, which gives the registrant a choice between either providing a shareholder list to the soliciting security holder or mailing the proxy materials for the soliciting security holder at the security holder's expense.<sup>47</sup> Under this rule, the security holder has no actual right to the list as it is the registrant's choice whether to furnish the list or mail the materials themselves.<sup>48</sup> Generally, the registrant will prefer to mail out the materials itself to see the security holder's material and reply to it as soon as possible.<sup>49</sup>

The second approach toward equalizing the proxy process deals with proxy contests, specifically election contests, which are "subject to special requirements involving reporting and disclosure of the identity of any 'participant' in the contest and of the interest of each participant in the matters to be acted upon."<sup>50</sup> An election contest begins after one party, most likely the registrant's board of directors, sends out a solicitation (the "Primary Solicitation") regarding the election or removal of directors, and another party, most likely dissident security holders, offers a solicitation opposing the Primary Solicitation (the "Opposing Solicitation").<sup>51</sup> Rule 14a-12<sup>52</sup> allows for a solicitation to be made without furnishing security holders with a proxy statement if the solicitation includes "[t]he identity of the participants in the solicitation . . . and a description of their direct or indirect interests"<sup>53</sup> as well as "[a] prominent legend in clear, plain language advising security holders to read the proxy statement when it is available."<sup>54</sup> The form of proxy must not be sent prior to the proxy statement.<sup>55</sup> Materials that are sent prior to the proxy statement under 14a-12(a) must be filed with the SEC no later than when they are sent to the security holders.<sup>56</sup> In the case of these early types of solicitations regarding the election or removal of directors at a

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44. LOSS & SELIGMAN, *supra* note 18, at 1980.

45. *Id.*

46. *See id.*

47. 17 C.F.R. § 240.14a-7; LOSS & SELIGMAN, *supra* note 18, at 1980.

48. LOSS & SELIGMAN, *supra* note 18, at 1984-85.

49. *See id.* at 1983-84.

50. 2 FEDERAL SECURITIES EXCHANGE ACT OF 1934, *supra* note 15, § 7.08, at 7-132.3.

51. *Id.* § 7.08[1][a], at 7-132.3 to -133.

52. 17 C.F.R. § 240.14a-12. This rule was expanded and Rule 14a-11 was rescinded by the SEC in Regulation of Takeovers and Security Holder Communications, Securities Act Release No. 7,760, Exchange Act Release No. 42,055, Investment Company Release No. 24,107, 64 Fed. Reg. 61,408 (Nov. 10, 1999) (codified in 17 C.F.R. pts. 200, 229, 230, 232, 239, and 240). Rule 14a-12 now allows for any solicitation to be made prior to furnishing a proxy statement as long as its conditions are met. 17 C.F.R. § 240.14a-12.

53. 17 C.F.R. § 240.14a-12(a)(1)(i).

54. *Id.* § 240.14a-12(a)(1)(ii).

55. *See id.* § 240.14a-12(a)(2).

56. *Id.* § 240.14a-12(b).

meeting of security holders, Rule 14a-12(c) also applies.<sup>57</sup> The proxy statements of solicitations subject to Rule 14a-12(c) must contain extra information regarding the “Persons Making the Solicitation,”<sup>58</sup> the “Interest of certain Persons in Matters To Be Acted Upon,”<sup>59</sup> and “Directors and executive officers,”<sup>60</sup> which is detailed in Schedule 14A.

The third and final approach to equalizing the proxy process is through shareholder proposals in the proxy materials via Rule 14a-8.<sup>61</sup> This approach allows a shareholder who wants to submit a proposal at a shareholders’ meeting to have the company include the shareholder’s proposal in its proxy materials.<sup>62</sup> The rule, posed in question and answer format, defines a “shareholder proposal” as a shareholder’s “recommendation or requirement that the company and/or its board of directors take action, which [the shareholder] intend[s] to present at a meeting of the company’s shareholders.”<sup>63</sup> It also maintains that “[the shareholder’s] proposal should state as clearly as possible the course of action that [the shareholder] believe[s] the company should follow.”<sup>64</sup>

To have a proposal included in the company’s proxy materials, a shareholder must meet four procedural requirements.<sup>65</sup> The first is that the shareholder must be eligible, meaning that the shareholder “must be a record or beneficial owner of at least 1% or \$2,000 in market value of the securities entitled to be voted at the meeting, *and* have held these securities for at least one year, *and* continue to own the securities through the date when the meeting is held.”<sup>66</sup> The second requirement is notice of the proposal and attendance at the shareholder meeting.<sup>67</sup> Section (h), or Question 8, under Rule 14a-8 states that, “Either [the shareholder], or [the shareholder’s] representative . . . , must attend the meeting to present the proposal.”<sup>68</sup> The rule provides that, “If [the shareholder] or [the shareholder’s] qualified representative fail to appear and present . . . without good cause, the company will be permitted to exclude all of [the shareholder’s] proposals from its proxy materials” for two years.<sup>69</sup> The third requirement is timeliness.<sup>70</sup> The proposal is required to be “received at the company’s principal executive offices not less than 120 calendar days before the date of the company’s proxy statement released to shareholders in connection with the previous year’s

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57. *Id.* § 240.14a-12(c).

58. *Id.* § 240.14a-101 item 4.

59. *Id.* § 240.14a-101 item 5.

60. *Id.* § 240.14a-101 item 7.

61. *See id.* § 240.14a-8.

62. 2 FEDERAL SECURITIES EXCHANGE ACT OF 1934, *supra* note 15, § 7.07, at 7-108.

63. 17 C.F.R. § 240.14a-8(a).

64. *Id.*

65. LOSS & SELIGMAN, *supra* note 18, at 1994.

66. *Id.*

67. *Id.* at 1996-97.

68. 17 C.F.R. § 240.14a-8(h)(1).

69. *Id.* § 240.14a-8(h)(3).

70. LOSS & SELIGMAN, *supra* note 18, at 1997-99.

annual meeting.”<sup>71</sup> In situations where the company held no annual meeting the previous year, the date of the current year’s annual meeting is changed by more than thirty days from the previous year, or the proposal is to be presented at a special meeting, then the company has to receive the proposal within a “reasonable time” prior to when it starts printing its proxy materials.<sup>72</sup> The last requirement is a limitation on the number of proposals.<sup>73</sup> Under the rule, no shareholder may submit more than one proposal to the company for each shareholder’s meeting.<sup>74</sup> Further, a “proposal, including any accompanying supporting statement, may not exceed 500 words.”<sup>75</sup>

Even if the shareholder completely complies with the procedural requirements and shows up at the meeting to present a proposal, the company can rely on other bases to exclude the proposal.<sup>76</sup> These bases are listed under Question 9 of 14a-8(i).<sup>77</sup> In attempting to exclude an otherwise procedurally valid shareholder proposal, the company also must follow certain procedures that are detailed under Question 10 of Rule 14a-8(j).<sup>78</sup>

The proxy rules also contain a general fraud provision located in Rule 14a-9.<sup>79</sup> This rule does not allow statements in conjunction with proxy materials that are “false or misleading with respect to any material fact [or omission].”<sup>80</sup> The two basic questions that tend to arise when dealing with this rule are whether the statement or omission at issue was false and misleading and whether it was material.<sup>81</sup>

The proxy rules also require the company to distribute information to security holders prior to taking action even when the company is not soliciting proxies in connection with a shareholder action.<sup>82</sup> These rules fall under Regulation C, and the information that is required to be provided in one of these instances is “substantially equivalent” to that information required in Regulation 14A.<sup>83</sup>

### III. PRIOR SEC GUIDANCE ON ELECTRONIC DELIVERY

In 1995, the SEC published its views on the use of electronic media as a means for delivering information required under the Securities Act of 1933, the Exchange Act, and the Investment Company Act of 1940.<sup>84</sup> The federal

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71. 17 C.F.R. § 240.14a-8(e)(2).

72. *Id.* § 240.14a-8(e)(2)-(3); LOSS & SELIGMAN, *supra* note 18, at 1997.

73. LOSS & SELIGMAN, *supra* note 18, at 1999.

74. 17 C.F.R. § 240.14a-8(c).

75. *Id.* § 240.14a-8(d).

76. *Id.* § 240.14a-8(i).

77. *Id.* Some of these bases can get quite complicated. For an informative overview, see LOSS & SELIGMAN, *supra* note 18, at 2001-60.

78. 17 C.F.R. § 240.14a-8(j).

79. *Id.* § 240.14a-9.

80. *Id.* § 240.14a-9(a).

81. LOSS & SELIGMAN, *supra* note 18, at 2061.

82. 2 FEDERAL SECURITIES EXCHANGE ACT OF 1934, *supra* note 15, § 7.01[4][c], at 7-11.

83. *Id.*

84. 1995 Interpretive Release, *supra* note 11, at 53,458.



securities laws, originally passed in the 1930s and 1940s, do not designate a particular delivery medium to be used, leaving the door open for electronic delivery.<sup>85</sup> The SEC stated that “[a]dvances in computers and electronic media technology are enabling companies to disseminate information to more people at a faster and more cost-effective rate,” and “[t]he Commission believes that, given the numerous benefits of electronic distribution of information and the fact that in many respects it may be more useful to investors than paper, its use should not be disfavored.”<sup>86</sup> The SEC defined “electronic” as referring to “audiotapes, videotapes, facsimiles, CD-ROM, electronic mail, bulletin boards, Internet Web sites and computer networks.”<sup>87</sup> According to the SEC, electronic media has numerous benefits and its use “should be at least an equal alternative to the use of paper-based media.”<sup>88</sup> Therefore, the SEC reasoned that any information that could be delivered in a paper format under the federal securities laws also could be delivered in an electronic format.<sup>89</sup> The SEC also noted, though, that it expected issuers and others would still make paper delivery of such information available until electronic media became more universally accepted.<sup>90</sup>

In stressing that it is the disclosure of information that is important rather than the medium, the SEC noted that “[a]n electronic medium would not provide an adequate means for the delivery of required disclosure, and thus not serve the statutory purposes, if the medium does not permit effective communication to investors or is practically unavailable.”<sup>91</sup> According to the SEC, for electronic delivery to satisfy the delivery requirements of federal securities laws, the distribution of information must result “in the delivery to the intended recipients of substantially equivalent information as these recipients would have had if the information were delivered to them in paper form,” and “there should be an opportunity to retain a permanent record of the information.”<sup>92</sup>

The SEC determined that several non-exclusive factors play an important role in determining whether electronic delivery is adequate under federal securities laws.<sup>93</sup> The first was whether the security holder, or investor, had notice that the new information existed.<sup>94</sup> Thus, a party providing information through electronic means would have to assure that “the electronic communication provides timely and adequate notice to investors that information for them is available and, if necessary, consider supplementing the electronic communication with another communication that would pro-

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85. See ROEDERER, *supra* note 5, § 1.03[B][3], at 1-38.

86. 1995 Interpretive Release, *supra* note 11, at 53,458.

87. *Id.* at 54,458 n.9.

88. *Id.* at 53,459.

89. *Id.*

90. *Id.*

91. *Id.* at 53,460.

92. *Id.* (citation omitted).

93. *Id.* at 53,460-61.

94. *Id.* at 53,460.

vide notice similar to that provided by delivery in paper.”<sup>95</sup> In an assertion that relates to the current proposed rules, the SEC opined that, “If the document is provided on an Internet Web site, . . . separate notice would be necessary to satisfy the delivery requirements unless the issuer can otherwise evidence that delivery to the investor has been satisfied.”<sup>96</sup>

The second factor used in determining whether electronic delivery is adequate was the investors’ access to the required disclosure.<sup>97</sup> The SEC felt that investors who were provided with disclosure information via electronic means should have comparable access to an investor who received the same information through the postal mail.<sup>98</sup> Basically, the use of “a particular [electronic delivery] medium should not be so burdensome that intended recipients cannot effectively access the information provided.”<sup>99</sup> An investor, according to the SEC, also should be able to retain the provided information, or have personal access to it, which is “equivalent to personal retention.”<sup>100</sup> For instance, “If disclosure is made available by posting it on the Internet, making it available through on-line services, or making it available by similar means, the document should be accessible for as long as the delivery requirement applies.”<sup>101</sup> And because of possible failures and incompatibilities, the SEC deemed it a necessary precaution that issuers make available paper copies of the documents they attempted to deliver electronically.<sup>102</sup>

The SEC also felt it was important that issuers of securities and others who use electronic delivery have procedures to ensure there is evidence that the delivery requirements have been satisfied.<sup>103</sup> One way to do this, the SEC determined, would be to gather informed consent from a security holder to receive the disclosure information through a particular electronic medium coupled with assuring appropriate notice and access.<sup>104</sup> “[G]eneral consent to receive *all* documents electronically” could be given, but an investor also could choose to give consent only to receive certain proxy materials electronically and receive others through the mail.<sup>105</sup> Other ways to provide evidence that the delivery requirements have been satisfied include obtaining actual evidence that the investor received the materials, use of “certain facsimile methods,” hyperlinking to a required document, and using forms that are available only by accessing the information.<sup>106</sup>

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95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at 53,461.

103. *See id.*

104. *Id.*

105. *Id.* at 53,461 n.29.

106. *Id.* at 53,461. For a summary of each of these methods, see ROEDERER, *supra* note 5, § 1.03[C][3], at 1-43.

The 1995 Interpretive Release also included examples of how the rules would apply in various situations with the new interpretations.<sup>107</sup> Example 23 provides a scenario similar to one that would be permissible under the Proposed Amendments.<sup>108</sup> In that example, a company puts its annual report and proxy materials on a Web site.<sup>109</sup> It then sends a notice to all security holders alerting them to the presence of the annual report and proxy materials on the Web site, and giving a telephone number that the security holders can call to request a paper copy.<sup>110</sup> According to the SEC, under the current proxy rules, this would not be adequate because:

[A] company should not presume that all record holders have the ability to access the annual report and proxy soliciting materials via an Internet Web site. Therefore, absent other factors such as a consent from, or actual access by, a Company shareholder, posting of the [materials] via the Company's Internet Web site would be insufficient to constitute delivery to all record holders.<sup>111</sup>

Under the Proposed Amendments, this method of notice and access would be available to issuers and other proxy solicitors without the need for consent or any of the other factors required under this interpretation of the current rules.<sup>112</sup>

In May 1996, the SEC put out a second interpretive release dealing with the electronic delivery of proxy materials.<sup>113</sup> This release, a complement to the 1995 release, provided guidance on how broker-dealers, transfer agents, and investment advisers could satisfy their delivery requirements under federal securities laws through electronic means.<sup>114</sup> According to the SEC, broker-dealers, transfer agents, and investment advisors "should apply the same considerations in using electronic media to satisfy their delivery obligations."<sup>115</sup>

The SEC's third interpretive release regarding the use of electronic media occurred in May 2000.<sup>116</sup> The relevant point addressed was the use of electronic media for delivery purposes under federal securities laws.<sup>117</sup> The SEC again recognized that "[o]ne of the key benefits of electronic media is that information can be disseminated to investors and the financial markets rapidly and in a cost-effective and widespread manner."<sup>118</sup> The first relevant

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107. 1995 Interpretive Release, *supra* note 11, at 53,461-67.

108. *Id.* at 53,464 example 23.

109. *Id.*

110. *Id.*

111. *Id.*

112. *See* Proposed Amendments, *supra* note 6, at 74,598.

113. 1996 Interpretive Release, *supra* note 11.

114. *Id.* at 24,644.

115. *Id.* at 24,646.

116. 2000 Interpretive Release, *supra* note 11.

117. *Id.* at 25,844.

118. *Id.*

issue of electronic delivery was obtaining telephonic consent from investors to receive documents electronically.<sup>119</sup> The SEC determined “that an issuer or market intermediary may obtain an informed consent telephonically, as long as a record of that consent is retained.”<sup>120</sup> The reasoning behind this was that the telephone was a common way to communicate significant matters in the market, and it had been proved that “business can be transacted as effectively over the telephone today as it can in paper.”<sup>121</sup>

The second relevant issue of electronic delivery that the 2000 Interpretive Release addressed was global consent.<sup>122</sup> The SEC decided that “an investor may give a global consent to electronic delivery—relating to all documents of any issuer—so long as the consent is informed.”<sup>123</sup> But this global consent would not be considered obtained if, as a condition of opening a brokerage account, consent to electronic delivery was required since the consent may not have been informed.<sup>124</sup> However, an intermediary such as a broker-dealer could obtain global consent to electronic delivery via an account-opening agreement if the agreement “contains a separate section with a separate electronic delivery authorization, or through a separate document altogether.”<sup>125</sup> Global consent agreements such as these would allow issuers to consent to electronic delivery of documents pertaining to all securities held with a particular broker-dealer.<sup>126</sup>

The third relevant issue regarding electronic delivery addressed by the 2000 Interpretive Release dealt with Portable Document Format (PDF) documents.<sup>127</sup> Because the 1995 Interpretive Release stated that a particular medium should not be too burdensome, the rules were often read to preclude delivery via PDF as such documents cannot be read without special software.<sup>128</sup> The SEC determined that issuers and intermediaries may now use PDF files for electronic delivery.<sup>129</sup> To do this, issuers must ensure that use of the PDF is not too burdensome by informing the investors of the requirements to download the files and providing the software to do so at no cost.<sup>130</sup>

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119. *Id.* at 25,845.

120. *Id.* at 25,845-46.

121. *Id.* at 25,845.

122. *Id.* at 25,846.

123. *Id.*

124. *Id.*

125. *Id.*

126. *See id.*

127. *Id.*

128. *Id.* (citing 1995 Interpretive Release, *supra* note 11, at 53,460 n.24 and accompanying text).

129. *Id.*

130. *Id.*

## IV. THE PROPOSED AMENDMENTS

## A. Summary

The interpretive releases gave the SEC's guidance on the electronic delivery of documents under the federal securities laws that were current at the time.<sup>131</sup> The securities rules involving the solicitation of proxy materials are basically the same now as they were then.<sup>132</sup> But the Proposed Amendments differ from previous SEC action in this area because they attempt to add an alternative solicitation method to the proxy solicitation rules rather than merely interpret them.<sup>133</sup>

The SEC proposed the new amendments to provide issuers and other solicitors with an alternative to the current rules that would reduce both printing and mailing costs associated with sending paper copies of proxy materials to the shareholders.<sup>134</sup> This alternative method of furnishing the proxy materials would be carried out through what the SEC refers to as a "notice and access" model, which would allow issuers of securities to satisfy requirements of the "[SEC]'s proxy rules by posting [their] proxy materials on a specified, publicly-accessible Internet Web site . . . and providing shareholders with a notice informing them that the materials are available and explaining how to access those materials."<sup>135</sup> These new amendments would serve only as an alternative method of disseminating proxy materials and would not affect the current, traditional methods.<sup>136</sup> Issuers or others relying on the notice and access method for disseminating proxy materials would be required to provide shareholders with paper copies of the proxy materials if so requested.<sup>137</sup> However, solicitors other than the issuer could elect not to provide a paper copy of their proxy materials if they are running proxy solicitation subject to an "electronic only" condition.<sup>138</sup> If soliciting under this new, alternative model, a solicitor would need to send a notice to the shareholders no later than thirty days prior to the meeting in question indicating the location of the solicitor's proxy materials on the Internet.<sup>139</sup> This notification also should include an explanation of the procedure for requesting paper copies of the materials, if the shareholder so desires.<sup>140</sup> The SEC also noted that the proxy solicitor would not have to use the notice and

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131. See 2000 Interpretive Release, *supra* note 11; 1996 Interpretive Release, *supra* note 11; 1995 Interpretive Release, *supra* note 11.

132. See SEC General Rules and Regulations, Securities Exchange Act of 1934, 17 C.F.R. § 240.14a-1 to .14c-101 (2006).

133. See Proposed Amendments, *supra* note 6, at 74,598-99.

134. *Id.* at 74,598.

135. *Id.*

136. *Id.* at 74,599.

137. *Id.*

138. *Id.*

139. *Id.* at 74,601.

140. *Id.*

access model for all proxy materials.<sup>141</sup> The amendments would allow a solicitor to use the new alternative method with respect to some proxy documents, while using other, more traditional methods—such as paper copies—with respect to the other proxy documents.<sup>142</sup>

### *B. Reasoning Behind the Proposed Amendments*

The SEC explained that it proposed this new, alternative notice and access model to “promote use of the Internet as a reliable and cost-efficient means of making proxy materials available to shareholders.”<sup>143</sup> Further, the new model would give soliciting shareholders and others “an alternative method to furnish proxy materials that may have the effect of reducing the cost of engaging in a proxy contest.”<sup>144</sup> The new model also may address the difficulties that stem from the previous guidance on electronic delivery through the current rules.<sup>145</sup> Problems in implementing the guidance provided through the previous interpretive releases have arisen because of “shareholders’ inattention to requests for consent to electronic delivery.”<sup>146</sup> For instance, when Intel attempted to mail consent requests to 120,000 registered security holders in 1997, only 11,000, approximately 9%, of them responded and agreed to receive proxy materials online.<sup>147</sup> In fact, the cost of mailing out the consent forms actually outweighed the printing and mailing cost savings from those who consented to participate in the electronic delivery.<sup>148</sup> Another such attempt by American Express to obtain consent in 2000 showed worse results.<sup>149</sup> In that case, of the 82,000 consent forms mailed out, fewer than 2% were even returned.<sup>150</sup>

With the passage of five years between the 2000 Interpretive Release and the Proposed Amendments, the SEC determined that it was time to consider enacting an alternative to the current proxy rules.<sup>151</sup> This decision was due to the “increased use of the Internet as a means to quickly, reliably, and inexpensively disseminate information.”<sup>152</sup> The SEC cited statistics that more than 10.7 million shareholders have now given consent to electronic delivery, and around 85% of those shareholders voted either electronically or by telephone during the 2005 proxy season.<sup>153</sup> The SEC also cited the

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141. *Id.* at 74,599.

142. *Id.*

143. *Id.* at 74,599.

144. *Id.*

145. *Id.*

146. *Id.*

147. HOWARD M. FRIEDMAN, SECURITIES REGULATION IN CYBERSPACE § 11.01, at 11-2 (3d ed. Supp. 2004).

148. *Id.*

149. *Id.*

150. *Id.*

151. See Proposed Amendments, *supra* note 6, at 74,599.

152. *Id.*

153. *Id.* (citing Automatic Data Processing, Inc., Investor Communication Services, 2005 Proxy Season Statistics, Letter from Rich Daly, President, ADP, to Industry Participant, <http://www.ics>).

Nielsen//NetRatings data, referred to in the introduction of this Comment, that almost 75% of Americans now have Internet access at home.<sup>154</sup>

### *C. Operation of the Proposed Amendments*

The Proposed Amendments would affect many of the proxy rules in an effort to create this alternative notice and access model.<sup>155</sup> The proxy materials that a solicitor will be able to provide electronically include: “Notices of shareholder meetings; Schedule 14A proxy statements and consent solicitation statements; Proxy cards; Schedule 14C information statements; Annual reports to security holders; Additional soliciting materials; and Any amendments to such materials that are required to be furnished to shareholders.”<sup>156</sup> The proxy solicitor who relies on the notice and access model would be required to send a Notice of Internet Availability of Proxy Materials (Notice) to shareholders at least thirty days prior to a shareholders meeting to give the shareholders enough time to receive the Notice, request paper copies, and review the materials before voting.<sup>157</sup> The Notice could be combined with a state law notice of a shareholder meeting if permitted by state law, but it may not be combined with any other document.<sup>158</sup> This restriction is due to the SEC’s desire to bring the Notice to the shareholder’s attention.<sup>159</sup> The Notice also should include “[a] prominent legend in bold-face type”; “[t]he date, time, and location of the meeting”; a list of every matter to be acted upon, including the issuer’s recommendations in regard to each matter; a list of materials available on the specified Web site; and a toll-free phone number and email address “where the shareholder can request a copy of the proxy materials.”<sup>160</sup>

Under the Proposed Amendments to Rule 14a-3(e), proxy solicitors would be allowed to household the Notice, meaning they could send only one copy of the Notice to shareholders residing at the same address.<sup>161</sup> The solicitor would not need to re-solicit consent to household the Notice if the shareholders have previously consented to householding proxy materials.<sup>162</sup> The Proposed Amendments would further allow an issuer to send the proxy card with the Notice; this option would not be required, but “the proxy card would have to either be: [1] [f]urnished together with, and through the same

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adp.com/release11/public\_site/about/stats.html) (last visited Oct. 24, 2006).

154. *Id.*

155. *See id.* at 74,598 for a list of the rules that would be affected.

156. *Id.* at 74,600 (citations and bullet points omitted).

157. *Id.* at 74,601. If there is not a meeting pending, then the Notice must be sent thirty days prior to when the “votes, consents, or authorizations may be used to effect the corporate actions to be voted on.”  
*Id.*

158. *Id.* To see what the Notice of Internet Availability of Proxy Materials would have to include, see *id.*

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

medium as, the Notice . . . ; or [2] [f]urnished together with, and through the same medium as, the proxy statement.”<sup>163</sup>

Under the Proposed Amendments, the materials provided through the notice and access model must be posted on the Web site when the solicitor sends the Notice to the shareholders and must remain on the Internet until the related shareholder meeting occurs.<sup>164</sup> The Web site address must be clearly identified and must “lead shareholders directly to the proxy materials.”<sup>165</sup> The Web site also must be publicly accessible and cannot be the SEC’s EDGAR Web site.<sup>166</sup>

An issuer’s decision to use the notice and access model would extend only to the particular meeting for which it sends the Notice.<sup>167</sup> Therefore, reliance on the notice and access model for one meeting “would not affect its determination of whether to rely on the model for subsequent meetings.”<sup>168</sup> The same is true for the shareholders who choose not to request a paper copy of the proxy materials.<sup>169</sup> The SEC also made a point to note that the proposed rules should not affect any state law requirements regarding delivery of proxy materials.<sup>170</sup> As for any additional proxy soliciting materials, the Proposed Amendments would require the issuer to post them on the same Web site no later than when “additional soliciting materials are first sent to [the] shareholders or made public.”<sup>171</sup>

If a shareholder wants to receive a paper copy of the proxy materials when an issuer has chosen to use the notice and access model, he or she can ask the issuer to send one under proposed Rule 14a-3(g)(7).<sup>172</sup> After receiving such a request, the issuer must send the requested copy within two business days.<sup>173</sup> This applies even if the request is made after the shareholder meeting in question has occurred.<sup>174</sup> The time requirements under the rules “are designed to provide approximately two weeks for a shareholder to request a copy, receive it, and still have approximately two weeks to review the proxy materials and make an informed voting decision,” but “it is incumbent on the shareholder to request a copy in sufficient time.”<sup>175</sup>

When dealing with distributing proxy materials to beneficial owners,<sup>176</sup> the rules can get “more complicated.”<sup>177</sup> Because in most states only the

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163. *Id.* at 74,602 (bullet points omitted).

164. *Id.* at 74,603.

165. *Id.*

166. *Id.*

167. *Id.* at 74,604.

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.* at 74,605.

173. *Id.*

174. *Id.*

175. *Id.*

176. According to the Proposed Amendment, “beneficial owners’ refers to beneficial owners whose names and addresses do not appear directly in issuers’ stock registers because they hold their stock through a broker, bank, trustee, or similar intermediary.” *Id.* at 74,605 n.70.



record owner of a security can vote, intermediaries generally forward the proxy materials to a beneficial owner with a request for instructions on how to vote.<sup>178</sup> The Proposed Amendments would require these intermediaries “to furnish proxy materials . . . to beneficial owners of the issuer’s securities based on the ‘notice and access’ model.”<sup>179</sup> The issuer would have to provide the intermediary with a sufficient number of Notices a minimum of five days before the deadline for sending out the Notices.<sup>180</sup> After that, the process of forwarding the Notices to the beneficial owners “would be similar to the current process by which intermediaries forward proxy materials to beneficial owners.”<sup>181</sup>

For those other than the issuer soliciting proxies, such as a shareholder engaging in a proxy contest, the notice and access model also would be available.<sup>182</sup> The SEC predicts that the alternative model can “significantly decrease the cost of a proxy solicitation, given the potential decrease in printing and mailing costs.”<sup>183</sup> These solicitors can follow the same process as the issuer, such as furnishing a Notice and posting a proxy statement on a Web site.<sup>184</sup> Further, unlike issuers, they may decline to provide paper copies as long as the Notice states that they are soliciting only those who will access the proxy materials via the Internet.<sup>185</sup> A solicitor other than the issuer may also post the proxy materials, proxy card included, on a Web site without providing a Notice.<sup>186</sup> The shareholders could be alerted to the presence of the materials by means permissible under Rule 14a-12, which was previously discussed.<sup>187</sup> If a solicitor other than the issuer chooses to utilize an electronic-only solicitation as discussed above, he or she does not have to follow the thirty-day timeframe for sending the Notice.<sup>188</sup> This is because the solicitor does not have to furnish paper copies to the shareholder in that instance, and therefore, that thirty-day timeframe is unnecessary for those purposes.<sup>189</sup> For a solicitor other than the issuer who is not conducting an electronic-only solicitation, the thirty-day time frame also would not be applied because many times those solicitations are in response to the issuer’s solicitation.<sup>190</sup> Instead, the SEC deemed it to be more equitable to require that the Notice be sent out “prior to the later of (1) 30 days prior to

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177. *Id.* at 74,605.

178. *Id.* at 74,606.

179. *Id.*

180. *Id.*

181. *Id.* For a summary of the responsibilities that the Proposed Amendments would put on intermediaries, see *id.*

182. *Id.* at 74,607.

183. *Id.*

184. *Id.* at 74,608.

185. *Id.*

186. *Id.*

187. *Id.* For a summary of the various options that a solicitor other than the issuer has, see *id.*

188. *Id.* at 74,609.

189. *Id.*

190. *Id.*

the meeting; or (2) ten days after the issuer first sends out its proxy solicitation.”<sup>191</sup>

Under the Proposed Amendments, Rule 14a-7’s requirement that issuers either provide a shareholder list or send a requesting shareholder’s proxy materials does not change much.<sup>192</sup> One minor change regarding providing shareholder lists is that:

[T]he issuer would be required to include any electronic delivery information that it already has obtained from shareholders, including information about shareholders that have affirmatively consented to electronic delivery as well as shareholders that have requested copies of the issuer’s proxy materials if the issuer is relying on the notice and access model.<sup>193</sup>

If, on the other hand, the issuer elects to send the solicitor’s proxy materials, then the issuer would be required “to share the benefit of any affirmative consent to electronic delivery of proxy statements that it has obtained from shareholders.”<sup>194</sup> The solicitor could request the issuer to follow the notice and access model but would have to provide the issuer with a copy of the Notice and, if he or she chooses to send the proxy card in paper, copies of the proxy card.<sup>195</sup>

#### *D. Benefits of the Proposed Amendments*

The SEC’s best reason for enacting the Proposed Amendments is the cost savings they would bring because of reduced printing and mailing costs.<sup>196</sup> As the SEC has stated, the company’s shareholders ultimately bear these costs.<sup>197</sup> The proposed notice and access model would also increase the efficiency of the proxy solicitation process because issuers would be able to take advantage of technological advancements, such as the Internet, that have been underutilized thus far in the proxy solicitation process.<sup>198</sup>

The SEC conceived of at least three distinct benefits of the proposed model.<sup>199</sup> First, the notice and access model would allow for “[m]ore rapid dissemination of proxy information to shareholders over the Internet.”<sup>200</sup> This seems like a rational assumption, as the Internet allows for immediate posting of the materials on a Web site and would reduce the time that it would take to print, package, and send the proxy materials via mail. It

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191. *Id.*

192. *Id.* at 74,609-10.

193. *Id.* at 74,610.

194. *Id.*

195. *Id.*

196. *Id.* at 74,612.

197. *Id.*

198. *See id.*

199. *Id.*

200. *Id.*

would still likely take some time to send the required Notice through the mail and to program the materials onto the Web site, although one would assume that this would take less time than printing out thousands upon thousands of pages of materials and packaging them to be sent. Thus, it seems that posting the materials on the Internet, at least to a layman, would be quite a bit more efficient and rapid than printing and packaging them.

The second benefit that the SEC conceived was “reduced printing and mailing costs for issuers and their shareholders.”<sup>201</sup> In the 2005 proxy season, the SEC estimates that both issuers and other solicitors spent \$535.5 million in printing and mailing fees.<sup>202</sup> The benefit of Internet posting seems rather obvious, as an issuer would avoid these exorbitant printing and mailing costs. The SEC anticipates that the printing and mailing savings could initially be reduced because issuers would have to project the number of requests for paper copies and prepare that many for mailing because they are required to send the materials to requesting shareholders within two business days.<sup>203</sup> This is a very valid concern that could reduce a fair amount of cost savings from printing and mailing, but the SEC argues that the amount of savings lost would likely decline as issuers learn to make better projections and shareholders get more accustomed to receiving proxy materials via the Internet.<sup>204</sup> It is likely that as solicitors use the alternative model provided by the Proposed Amendments, they will become more comfortable with it and will be able to reap more of the benefits that the proposed model intends to impart. This, of course, can lead to large cost savings either to the soliciting shareholder or the issuing company, which then would benefit the shareholder.<sup>205</sup>

The SEC also argues that beneficial owners who choose not to vote also probably would not request copies of the proxy materials, thus saving in the neighborhood of \$500 million in printing and mailing costs.<sup>206</sup> This is a very plausible argument, as some investors and beneficial owners choose to take the apathetic approach and throw away their proxy materials without reading them, thus refraining from corporate governance altogether.<sup>207</sup>

The third benefit that the SEC conceived was “reduced costs for other soliciting parties engaging in proxy contests.”<sup>208</sup> Because the other parties relying on the notice and access model are not required to deliver a Notice and are able to limit their solicitation to those willing to receive the materi-

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201. *Id.*

202. *Id.*

203. *Id.* at 74,613.

204. *Id.*

205. To quote John J. Castellani, president of Business Roundtable: “This proposal is a positive step forward for companies and shareholders alike. It will modernize the antiquated proxy voting process, saving companies billions of dollars each year—which is ultimately a savings for shareholders.” *SEC Proposes to Modernize Rules Governing Proxy Solicitations*, 37 Sec. Reg. & L. Rep. (BNA) No. 47, at 1958 (Dec. 5, 2005) [hereinafter *SEC Proposes to Modernize Rules*].

206. Proposed Amendments, *supra* note 6, at 74,613.

207. This author is one of these apathetic investors.

208. *Id.* at 74,612.

als electronically, this process can reduce the costs of proxy contests.<sup>209</sup> Therefore, proxy contests may increase in effectiveness and efficiency,<sup>210</sup> which could result in an increased number of proxy contests waged by shareholders. In fact, the rules can reduce the cost of communicating with other shareholders significantly, thus allowing solicitors other than the issuer to “have a less costly, highly effective, and virtually instant means of waging a proxy contest.”<sup>211</sup> This reduction in cost can “help level the playing field between management and dissenting shareholders.”<sup>212</sup> Some concern has arisen regarding the potential for frivolous proxy contests due to the low barrier to entry under the Proposed Amendments.<sup>213</sup> This is a legitimate concern of those weary of changes to the proxy rules, but other significant costs involved in engaging in a proxy contest still can serve as a barrier to entry.<sup>214</sup>

Other fringe benefits that the SEC envisioned were environmental in nature.<sup>215</sup> For instance, a reduction in the amount of printing could have benefits for the environment due to the adverse effects of paper production and consumption.<sup>216</sup> Another environmental benefit that the SEC failed to mention could come from the reduction in paper disposal.

The SEC also detailed potential costs that the Proposed Amendments are likely to impose on the involved parties.<sup>217</sup> For instance, issuers and other solicitors still would have to pay postage when sending the Notices to shareholders under the notice and access model.<sup>218</sup> This would reduce the savings gained from not mailing the proxy materials.<sup>219</sup> Shareholders also would incur the cost of paying for a computer and Internet access,<sup>220</sup> but most shareholders already have Internet access at home so they will already have sunk these costs.<sup>221</sup> There is also the possibility that printing costs will be shifted to the shareholders who choose to print the materials off the Web site on their own.<sup>222</sup> Of course, this would be the shareholders’ own choice, as they have the option to request paper copies from the issuer.

The SEC also anticipates costs to intermediaries, such as forwarding the Notice to beneficial owners, but these are likely a wash as the Notice can be

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209. *Id.* at 74,613. The SEC stated: “We expect that the flexibility afforded to persons other than the issuer under the proposed amendments would substantially reduce what has traditionally been viewed as the high cost of engaging in proxy contests, thereby increasing the effectiveness and efficiency of proxy contests as a corporate control mechanism.” *Id.*

210. *Id.*

211. *SEC Proposes to Modernize Rules*, *supra* note 205, at 1958 (quoting SEC Chairman Christopher Cox).

212. *Id.* (quoting SEC Commissioner Annette Nazareth).

213. *See id.* at 1959.

214. *Id.*

215. Proposed Amendments, *supra* note 6, at 74,613.

216. *Id.*

217. *Id.* at 74,613-14.

218. *Id.* at 74,613.

219. *Id.*

220. *Id.*

221. *See supra* text accompanying notes 1-4.

222. Proposed Amendments, *supra* note 6, at 74,613.

sent along with the request for voting instructions that the intermediaries already have to send.<sup>223</sup> The real costs to intermediaries that the SEC is worried about are the costs of posting proxy materials and requests for voting instructions on their own Web sites, when that is required, and “[t]he costs to an intermediary of collecting and processing requests [of a copy of the proxy materials] from beneficial owners.”<sup>224</sup> While these are legitimate and potentially significant costs, the SEC expects them—like the projected printing costs for requested copies of proxy materials—to diminish after the first few years under the new system.<sup>225</sup> The SEC is probably correct in this expectation, as an adaptation to the new model likely would result in intermediaries who are better adapted to handling these costs. As the SEC stated, these costs “will subsequently decline as intermediaries develop the necessary systems and procedures and as beneficial owners increasingly become comfortable with accessing proxy materials online.”<sup>226</sup>

A legitimate concern the SEC does not address in the commentary provided with the Proposed Amendments is the scenario where the proxy card is mailed with the Notice and therefore apart from the proxy statement and annual report.<sup>227</sup> There is some fear that if the proxy card is received without the other materials, the shareholder will fill out the proxy card without first reading the materials.<sup>228</sup> The Director of the SEC’s Division of Corporate Finance’s response to this concern was that today, many shareholders already fill out the proxy card without reviewing the accompanying proxy materials.<sup>229</sup> Since the Proposed Amendments are intended to provide an alternative akin to the current rules, this concern seems moot, as it is the investor’s decision to read the materials; all the system can do is make sure they are disclosed.<sup>230</sup>

### *E. Criticisms of the Proposed Amendments*

Some parties have criticized the Proposed Amendments because they feel the SEC did not go far enough.<sup>231</sup> The Business Roundtable criticized the SEC for not tackling the issue of communication between a company and its beneficial owners.<sup>232</sup> It asserts that “[l]imiting the benefits of the ‘notice and access’ method to record holders is not a viable alternative.”<sup>233</sup>

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223. *Id.*

224. *Id.*

225. *Id.* at 74,613-14.

226. *Id.*

227. *SEC Proposes to Modernize Rules*, *supra* note 205, at 1959.

228. *Id.*

229. *Id.*

230. *Id.*

231. *Roundtable Seeks SEC Expansion of Proposal on Web Availability of Proxies*, 38 *Sec. Reg. & L. Rep.* (BNA) No. 8, at 291 (Feb. 20, 2006) [hereinafter *Roundtable Seeks SEC Expansion*].

232. Letter from Steve Odland, Chairman, Corporate Governance Task Force, Business Roundtable, to Nancy Morris, Sec’y, Sec. & Exch. Comm’n (Feb. 10, 2006), <http://www.sec.gov/rules/proposed/s71005/tjlehner6587.pdf>.

233. *Id.* at 3.

This is mainly because it is cumbersome and more costly for a company to have to communicate with a beneficial owner through an intermediary.<sup>234</sup> This is a legitimate concern and should be considered by the SEC. While the Proposed Amendments are intended to provide an alternative model akin to the current proxy rules,<sup>235</sup> there is no reason why they cannot address this problem under both the current and proposed notice and access model. The Proposed Amendments are centered around reducing costs to companies and shareholders as well as improving communications among shareholders and between shareholders and the company. This improvement suggested by the Business Roundtable would squarely fit into that theme.

In contrast, other commentators expressed concern that the Proposed Amendments are too much.<sup>236</sup> For instance, the Council of Institutional Investors (CII) "encourages the Commission to consider a slower paced, phased-in approach to introducing electronic delivery, through possible mechanisms such as test groups, an opt-in voluntary system, or by starting with investors who are already voting online."<sup>237</sup> It has concerns that first, not enough investors have adequate Internet access; second, the plan is burdensome for investors who have multiple investments and want paper copies; third, the proxy card will not be attached to the proxy materials; and fourth, the SEC's vision of cost reductions is misleading.<sup>238</sup> While they make good points, it is hard to see how the cost reductions from printing and mailing would not exist and would not outweigh the other concerns. With society becoming more and more dependent on the Internet, the CII should be applauding the SEC's attempts to reduce the printing and mailing costs for companies, from which they, as investors, will reap the benefits. Further, investors still have the default option of simply requesting the materials in print and under the rules would have plenty of time to receive and review them before voting.

A valid criticism of the Proposed Amendments, raised by SEC Chairman Roel Campos, is that shareholders with multiple holdings who want paper copies will have to request paper copies for each holding every proxy season.<sup>239</sup> This would appear to be overly burdensome, as it would require multiple phone calls every time proxies are solicited. A modification to the Proposed Amendments is being considered by the SEC to permanently retain a shareholder's decision to receive paper copies of the proxy materials until the shareholder changes his or her mind.<sup>240</sup> This would allow share-

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234. *Id.* at 2.

235. *See supra* text accompanying note 230.

236. *See, e.g., Roundtable Seeks SEC Expansion, supra* note 231.

237. Letter from Ann Yerger, Executive Dir., Council of Institutional Investors, to Nancy Morris, Sec'y, Sec. & Exch. Comm'n (Feb. 8, 2006), <http://www.sec.gov/rules/proposed/s71005/s71005-75.pdf>.

238. *Id.* at 1-2.

239. *Campos Has Concerns About SEC's Proxy Reform Proposal*, 38 *Sec. Reg. & L. Rep.* (BNA) No. 12, at 470 (Mar. 20, 2006).

240. *Id.*

holders to opt out of electronic delivery of proxy materials affirmatively but require them to do so only once.

One other interesting and quite irrelevant objection to the operation of the Proposed Amendments comes from those in the paper industry.<sup>241</sup> Their concern is with a loss of jobs that could occur because of electronic delivery of proxy materials and the effect on vendors in the paper and forestry industries.<sup>242</sup> These are legitimate concerns for their industry, but it is not the SEC's job to protect an industry from technological advancement and the use of electronic media. Industry representatives claim to be concerned with investors who do not have regular access to the Internet, those in the "digital divide," but this concern is fairly transparent.<sup>243</sup> The concern that those without Internet access (especially the "elderly") cannot take full advantage of electronic delivery is misplaced, as it neglects the fact that those investors can simply request a paper copy of the materials.<sup>244</sup> The paper industry also suggests an "Opt In" process where investors would have to choose to receive documents electronically.<sup>245</sup> The SEC has created an "Opt In" program, only in reverse of the paper industry's preferences. The Commission allows investors who do not want to receive materials electronically to "opt in" to receive a paper copy.

#### V. CONCLUSION

The SEC has taken steps to update its fairly antiquated proxy solicitation rules to allow for use of the Internet in the delivery of proxy materials. While use of electronic media was previously allowed, it was, on the whole, less than effective because of cumbersome requirements such as obtaining informed consent from the investors and proving that they actually received the materials electronically. The Proposed Amendments now assume that most investors have adequate access to the Internet and allow proxy solicitors to post their materials there rather than spend unnecessary amounts of money on printing and mailing. For those investors for whom this assumption is wrong, or those investors who just are not comfortable receiving the materials online, the SEC has provided a simple process where the investor can opt to receive paper copies of the proxy materials in time to review them and vote. This process, while adding a small extra step for investors to receive hard copies of proxy materials, has the benefit of allowing companies to save money—especially in cases where the investors throw away the proxy materials without even looking at them. The cost savings under the Proposed Amendments do not benefit only the issuer of the securities. For

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241. *See, e.g.*, Letter from Lisbeth A. Lyons, Vice President, Gov't Affairs, Printing Industries of America, Inc., to Jonathan G. Katz, Sec'y, Sec. & Exch. Comm'n (Feb. 6, 2006), <http://www.sec.gov/rules/proposed/s71005/llyons020606.pdf>.

242. *Id.* at 1.

243. *Id.*

244. *See id.*

245. *Id.*

those investors wishing to enter into a proxy contest, the Proposed Amendments lower the barrier, making it easier for them to engage in one. The cost savings from allowing a solicitor other than the issuer to enter into an electronic-only solicitation can increase the number of proxy contests and enhance shareholder communication.

In this commentator's opinion, the Proposed Amendments are long overdue. Today, the Internet has been integrated into almost every facet of American life. Consumers can shop online; post their opinions and thoughts via web logs ("blogs"); order pizza; play games; invest; get news, scores, and sports highlights; and even meet their potential mates. It was not always this way though. There were times toward the beginning of Internet usage when people were afraid to put their financial or personal information online. Today, most people have become accustomed to it. While risks are still involved, there are risks, such as mail tampering or miscommunication over the telephone, involved in any type of communication. Those who oppose the Proposed Amendments because they integrate the Internet too quickly incorrectly believe that they are living in an age where the Internet is too new and uncertain. These critics must realize that the Internet is not only the future but the present as well. Their initial fears are just fears of change that will be soothed once they are used to the new system. The benefits, such as ease of use, cost reduction, and efficiency, soon should outweigh any apprehension.

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